

**KHALEEJI COMMERCIAL BANK BSC**  
**CONSOLIDATED FINANCIAL STATEMENTS**  
**31 DECEMBER 2013**

Commercial registration	:	55133 (registered with Central Bank of Bahrain as a retail Islamic bank).
Office	:	Bahrain Financial Harbour East Tower PO Box 60002, Manama, Kingdom of Bahrain
Directors	:	Dr. Fuad Abdulla Al-Omar, <i>Chairman</i> Abdulrahman Mohamed Jamsheer, <i>Vice Chairman</i> Abdulla Abdulkarim Showaiter Hisham Ahmed Al Rayes Dr. Ahmed Khalil Al Mutawa Khalid Rashid Al-Thani Mohammed Barrak Al-Mutair Mosobah Saif Al-Mutairy Tariq Qassim Fakhroo
Chief Executive Officer	:	Khalil Ismaeel Al-Meer
Company secretary	:	Mohammed Abdulla Ebrahim
Auditors	:	KPMG Fakhro, Bahrain

**KHALEEJI COMMERCIAL BANK BSC**

**CONSOLIDATED FINANCIAL STATEMENTS  
for the year ended 31 December 2013**

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# Chairman's Report - 2013

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Dear Shareholders,

In the name of Allah, the beneficent, the merciful, prayers and peace upon the last apostle and messenger, our prophet Muhammad.

On behalf of the Board of Directors, it is my pleasure to present the annual financial statements of Khaleeji Commercial Bank for the year ended 31 December 2013. This, the ninth year of operations for the Bank, has been challenging one. While regional and global economic environment has seen signs of improvement, local economic and business environment remained challenging.

The Bank continued to execute its articulated business model based on its strategic plan, which focuses on expanding its retail and commercial banking business. Key elements of the plan are increasing the retail banking business in Bahrain; enhancing the Bank's share of business in the local corporate and consumer finance markets; and expanding the Bank's commercial banking business into the regional markets. While the overall business volumes have not yet reached our expectations, I am pleased to report that we have achieved considerable progress in accomplishing key milestones including opening new branches, launching new retail banking products and expanding our consumer finance business.


## Overall Performance

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Similar to many other financial institutions, the current market environment has had an adverse impact on the Bank, both directly and indirectly. However, I am pleased to report that by adopting a combination of prudent and conservative management, the Bank was able to navigate this difficult period successfully. The Bank has focused on diversifying and expanding its business while maintaining conservative liquidity and capital positions.

Despite difficult market conditions, the Bank grew its Total Assets by 14.6% from BD 473.2 million to BD 542.2 million. Of particular satisfaction was the fact that customer deposits (including Restricted Investment Accounts and Reverse Murabaha from customers and Current Accounts) have also increased by BD 110.6 million reaching BD 391.9 million (a growth of 39.3%), which reflects the market's confidence in the Bank's products and services. Commercial Banking Assets overall increased by 7.2% over 2012, reaching BD 289.3 million; with Consumer Finance Portfolio reaching BD 52.3 million, a 66.7% growth over 2012. Total Income from Commercial Banking comprises 94.6% of total income as a result of a significant 74.5% increase in Consumer Finance activities.

As the Bank continued to execute its strategic plan, the Board and the Management conducted a comprehensive review to ensure that assets, especially those acquired prior to the new business model reflect realisable and fair value. Based on this review the Board decided to take a very conservative view and provide for all assets which were impaired or likely to be impaired in the short to medium term. Consequently, in 2013 the Bank provided an aggregate amount of BD 17.7 million in impairment provisions and marked to market losses. This resulted in a Net Loss of BD 19.2 million compared to a Profit of BD 751 thousand in 2012. The Board and the Management now believe that assets on the Bank's books reflect true and fair value. Furthermore, this will provide considerable stability for the business in the future and will pave the way forward to achieving acceptable results. Even after accounting for this large provisions, the Bank continues to maintain strong liquidity (with 27.3% of the Bank's assets being liquid) and adequate



capital (the Bank has a regulatory capital adequacy ratio of 23.8% compared to a minimum regulatory mandated 12%), both comfortably in excess of regulatory requirements.

The Bank will continue to promote and market a full suite of Consumer Finance products including Auto Finance, Personal Finance, Mortgage Finance and Visa branded credit cards and will launch new products based on customer needs. I am happy to report that products that have been launched in 2013 were well received by the Bank's customers. The enhanced Al-Waffer savings account continued to expand and attract new customers with a growth in deposits of BD 6.1 million compared to 2012. A new cycle of Al-Waffer will be launched very soon with higher prices and higher probability of winning. Continuing a line of successful liability products, the Bank launched "Loyalty" account, which helped in attracting additional customer deposits, and diversifying its customer base and managing the liquidity mismatch. The Bank's investment banking team has been actively managing the portfolio of investment products and Restricted Investment Accounts (RIA), to enhance the value of the assets held in those products and to work towards potential exits. During the year the team achieved the sale of one of the larger Investment products, namely Jawhara Greens in Doha, Qatar. Given the current market conditions, the full sale of land rather than sale of individual plots shortened the time frame to fully exit investors.

## Organisational Development

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The Board believes that to remain competitive in the long run, building organisational capacity, including human capital, is imperative. A committed and well-trained work force is a key enabler in achieving the Bank's long term objectives. In order to achieve our expansion targets the Bank hired 21 employees in 2013, mainly for the Bank's Retail Banking Business. The Bank also continued to invest in the training and development of its Human Resources through external and in-house training programmes and by enhancing the Graduate Trainees' Programme. The Board takes pride in the fact that 95% of the Bank's employees are Bahrainis. In addition, the Bank has continued to support the HRD Fund of the Kingdom of Bahrain, the Waqf Fund, and Tamkeen in addition to providing training opportunities to students from different local and international universities.

## Corporate Social Responsibility

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The Board believes that, as a growing institution, the Bank has a social responsibility to contribute towards the communities in which it operates, and in the past, the Bank has supported several initiatives that provided benefits to the local community. In 2013, a wide range of organisations involved in humanitarian, education, health and other activities received support from the Bank both in cash and in kind. The Board has a continued commitment to expand his social responsibility through the Bank's on-going programme of Corporate Social Responsibility.

## Looking Ahead

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The Board believes that the recent challenges facing the banking sector will continue in 2014 and the Bank will not be immune to these challenges. However, the Board also foresee many opportunities for growing the Bank's business, not only in the primary markets of the GCC, but also in the wider MENA region. In the last five years, the Bank has taken several steps to diversify its assets, revenue streams and widen its customer base. The launch of the Bank's suite of consumer finance products and expansion of the branch network will further support this endeavour.

The key challenge in the medium term would be to build the scale necessary for the Bank to become a leading player in the local and regional market. The Bank will continue to aggressively grow its commercial



and retail banking business while exploring other options; which includes viable acquisitions of other entities and asset portfolios as well as forming strategic alliances or merger with other financial institutions. The Board will also continue to expand the Bank's network of branches and distribution channels to reach wider and a larger number of customers.

The Board believes that the Bank has established a solid foundation from which to execute the new Strategic Plan and capitalise on opportunities currently available in the market.

## Appreciation

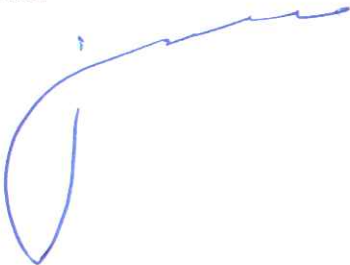
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On behalf of the Board, I would like to express my gratitude to his Majesty King Hamad Bin Isa Al Khalifa; His Royal Highness Prince Khalifa Bin Salman Al Khalifa, the Prime Minister; and His Royal Highness Prince Salman Bin Hamad Al Khalifa, the Crown Prince and Deputy Supreme Commander of Bahrain Defence Force and First Deputy Prime Minister for their encouragement of the growth of the private sector and the development of the banking and finance industry in Bahrain. I also extend my thanks to all government ministries and the Central Bank of Bahrain for their continued guidance and support.

Special appreciation is due to the Bank's shareholders, clients and business partners for their on-going confidence and loyalty; and to the Bank's management and staff for their hard work and dedication.

Allah the almighty is the purveyor of all success.

Dr. Fuad Abdulla Al-Omar  
Chairman





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**INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS  
KHALEEJI COMMERCIAL BANK BSC**  
Manama, Kingdom of Bahrain

30 January 2014

**Report on the consolidated financial statements**

We have audited the accompanying consolidated financial statements of Khaleeji Commercial Bank B.S.C. ("the Bank") and its subsidiaries (together the "Group"), which comprise the consolidated statement of financial position as at 31 December 2013, the consolidated income statement, the consolidated statement of changes in equity, the consolidated statement of cash flows, the consolidated statement of changes in restricted investment accounts and the consolidated statement of sources and uses of charity and zakah fund for the year then ended, and a summary of significant accounting policies and other explanatory notes.

*Respective responsibilities of board of directors and auditors*

These consolidated financial statements and the Group's undertaking to operate in accordance with Islamic Shari'a rules and principles are the responsibility of the board of directors of the Bank. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

*Basis of opinion*

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

*Opinion*

In our opinion, the consolidated financial statements give a true and fair view of the financial position of the Group as at 31 December 2013 and of the consolidated results of its operations, its consolidated cash flows, consolidated changes in equity, consolidated changes in restricted investment accounts and consolidated sources and uses of charity and zakah fund for the year then ended in accordance with Financial Accounting Standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions and the Shari'a rules and principles as determined by the Shari'a Supervisory Board of the Bank.

**Report on other regulatory requirements**

As required by the Bahrain Commercial Companies Law and the Central Bank of Bahrain (CBB) Rule Book (Volume 2), we report that: the Bank has maintained proper accounting records and the consolidated financial statements are in agreement therewith; the financial information contained in the chairman's report is consistent with the consolidated financial statements; we are not aware of any violations of the Bahrain Commercial Companies Law, the Central Bank of Bahrain and Financial Institutions Law, the CBB Rule Book (Volume 2, applicable provisions of Volume 6 and CBB directives), the CBB Capital Markets Regulations and associated resolutions, rules and procedures of the Bahrain Bourse or the terms of the Bank's memorandum and articles of association having occurred during the year that might have had a material adverse effect on the business of the Bank or on its financial position; and satisfactory explanations and information have been provided to us by the management in response to all our requests.

**CONSOLIDATED STATEMENT OF FINANCIAL POSITION**  
as at 31 December 2013

BD 000's

	Notes	31 December 2013	31 December 2012
<b>ASSETS</b>			
Cash and bank balances	3	38,848	23,856
Placements with financial institutions	4	82,745	57,525
Financing assets	5	253,635	245,745
Investment securities	6	90,397	100,860
Assets acquired for leasing	7	32,061	20,938
Lease rentals receivable	7	3,569	3,035
Investment in associates	8	2,681	2,887
Investment property	9	6,583	6,583
Other assets	10	23,342	2,806
Property and equipment	11	8,381	8,924
<b>Total assets</b>		<b>542,242</b>	<b>473,159</b>
<b>LIABILITIES</b>			
Placements from financial institutions		42,940	67,732
Placements from non-financial institutions and individuals	12	80,912	53,416
Customers' current accounts		18,923	11,395
Other liabilities	13	7,407	4,739
<b>Total liabilities</b>		<b>150,182</b>	<b>137,282</b>
<b>Equity of investment account holders</b>	14	<b>292,049</b>	<b>216,429</b>
<b>OWNER'S EQUITY</b>			
Share capital	15	115,416	115,416
Share premium		1,535	1,535
Statutory reserve		6,425	6,425
Treasury shares		(6,060)	(6,060)
Unvested employee incentive scheme shares		(291)	(291)
(Accumulated losses)/ retained earnings		(17,014)	2,423
<b>Total owner's equity (page 7)</b>		<b>100,011</b>	<b>119,448</b>
<b>Total liabilities, equity of investment account holders and owners' equity</b>		<b>542,242</b>	<b>473,159</b>

The consolidated financial statements, which consist of pages 5 to 62, were approved by the Board of directors on 30 January 2014 and signed on its behalf by:

  
Dr. Fuad Abdulla Al-Omar  
Chairman

  
Abdulrahman Mohamed Jamsheer  
Vice Chairman

  
Khalil Ismaeel Al-Meer  
Chief Executive Officer

The accompanying notes 1 to 35 form an integral part of these consolidated financial statements.

**CONSOLIDATED INCOME STATEMENT**  
**for the year ended 31 December 2013**

BD 000's

	Note	2013	2012
Management and other fees		1,088	111
Income from placements with financial institutions		430	244
Income from financing assets and assets acquired for leasing		18,318	18,168
(Loss) / income from investment securities	16	(624)	986
Share of loss from associate companies	8	(115)	(113)
Other income		599	421
<b>Total income before return to investment account holders</b>		<b>19,696</b>	19,817
Less: Return to investment account holders before Bank's share as Mudarib	14	(13,315)	(9,923)
Bank's share as a Mudarib	14	4,596	3,626
<b>Return to investment account holders</b>		<b>(8,719)</b>	(6,297)
Expense on placements from financial institutions, non-financial institutions and individuals		(3,968)	(2,823)
<b>Total net income</b>		<b>7,009</b>	10,697
Staff cost	17	5,692	4,580
Depreciation	11	1,169	1,153
Other expenses	19	4,112	3,310
<b>Total expenses</b>		<b>10,973</b>	9,043
<b>(Loss)/ profit for the year before impairment allowances</b>		<b>(3,964)</b>	1,654
Impairment allowances	18	(15,245)	(903)
<b>(LOSS)/ PROFIT FOR THE YEAR</b>		<b>(19,209)</b>	751
<b>Earnings per share</b>			
Basic earnings per share (fils)	24	<b>(17.11)</b>	0.67
Diluted earnings per share (fils)	24	<b>(17.11)</b>	0.67

The accompanying notes 1 to 35 form an integral part of these consolidated financial statements.

**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY**  
**for the year ended 31 December 2013**

BD 000's

2013

	<b>Share Capital</b>	<b>Share premium</b>	<b>Statutory reserve</b>	<b>Treasury shares</b>	<b>Unvested employee incentive scheme shares</b>	<b>(Accumulated losses)/ Retained earnings</b>	<b>Total</b>
At 1 January 2013	115,416	1,535	6,425	(6,060)	(291)	2,423	119,448
Loss for the year	-	-	-	-	-	(19,209)	(19,209)
<b>Total recognised income and expense for the year</b>	-	-	-	-	-	<b>(19,209)</b>	<b>(19,209)</b>
Transfer to zakah fund (2012)	-	-	-	-	-	(228)	(228)
<b>At 31 December 2013</b>	<b>115,416</b>	<b>1,535</b>	<b>6,425</b>	<b>(6,060)</b>	<b>(291)</b>	<b>(17,014)</b>	<b>100,011</b>

The accompanying notes 1 to 35 form an integral part of these consolidated financial statements.

**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY**  
**for the year ended 31 December 2013**

BD 000's

2012

	Share Capital	Share premium	Statutory reserve	Treasury shares	Unvested employee incentive scheme shares	Share grant reserve	Investments fair value reserve	Retained earnings	Total
At 1 January 2012	115,416	1,485	6,350	(6,043)	(420)	120	54	1,961	118,923
Fair value changes	-	-	-	-	-	-	41	-	41
Transfer on disposal of investments	-	-	-	-	-	-	(95)	-	(95)
Profit for the year	-	-	-	-	-	-	-	751	751
Total recognised income and expense for the year	-	-	-	-	-	-	(54)	751	697
Transfer to statutory reserve	-	-	75	-	-	-	-	(75)	-
Treasury shares acquired	-	-	-	(17)	-	-	-	-	(17)
Adjustment for vesting and issue of shares	-	50	-	-	129	(50)	-	-	129
Vesting charge for the year (note 20)	-	-	-	-	-	(70)	-	-	(70)
Transfer to zakah fund (2011)	-	-	-	-	-	-	-	(214)	(214)
At 31 December 2012	115,416	1,535	6,425	(6,060)	(291)	-	-	2,423	119,448

The accompanying notes 1 to 35 form an integral part of these consolidated financial statements.

**CONSOLIDATED STATEMENT OF CASH FLOWS**  
**for the year ended 31 December 2013**

BD 000's

	Note	2013	2012
<b>OPERATING ACTIVITIES</b>			
Disbursements of financing assets, net		(4,987)	(25,888)
Payment for asset acquired for leasing, net		(11,775)	(10,421)
Management fees received		850	111
Income from short-term placements received		430	244
Returns paid to investment account holders		(7,017)	(6,055)
Net receipts from investment account holders		75,620	21,062
Payment for expenses		(10,335)	(9,292)
Other receipts		651	421
Payment for charity		(355)	(672)
Receipts in/ (withdrawals from) customers' current accounts		7,528	(24,042)
Placements from financial institutions, net		(24,792)	22,297
Placements from non-financial institutions and individuals, net		27,496	6,769
Net payment to CBB reserve account		(4,790)	(1,130)
<b>Net cash generated from/ (used in) operating activities</b>		<b>48,524</b>	<b>(26,596)</b>
<b>INVESTING ACTIVITIES</b>			
Purchase of investment securities, net		(25,305)	(11,710)
Proceeds from sale/redemption of investment securities		15,572	22,031
Distribution of investment in associate		91	-
Dividend/ income from investment securities received		930	608
Purchase of equipment and capital advances made		(422)	(671)
<b>Net cash (used in) / generated from investing activities</b>		<b>(9,134)</b>	<b>10,258</b>
<b>FINANCING ACTIVITIES</b>			
Purchase of treasury shares, net		-	(17)
Expense paid on placements		(3,968)	(2,823)
<b>Net cash used in financing activities</b>		<b>(3,968)</b>	<b>(2,840)</b>
<b>Net increase/ (decrease) in cash and cash equivalents</b>		<b>35,422</b>	<b>(19,178)</b>
Cash and cash equivalents at 1 January		71,086	90,264
<b>Cash and cash equivalents at 31 December</b>		<b>106,508</b>	<b>71,086</b>
<b>Cash and cash equivalent comprise:</b>			
Cash and bank balances (excluding CBB reserve)	3	23,763	13,561
Placements with financial institutions	4	82,745	57,525
		<b>106,508</b>	<b>71,086</b>

The accompanying notes 1 to 35 form an integral part of these consolidated financial statements.

**CONSOLIDATED STATEMENT OF CHANGES IN RESTRICTED INVESTMENT ACCOUNTS**  
for the year ended 31 December 2013

BD 000's

2013	Balance at 1 January 2013			Movements during the year					Balance at 31 December 2013			
	No of units (000's)	Average value per share BD	Total BD 000's	Investment (withdrawals) BD 000's	Revalua- tion BD 000's	Gross income/ (loss) BD 000's	Dividends paid BD 000's	Bank's fees as an agent BD 000's	Adminstra- tion expenses BD 000's	No of units (000's)	Average value per share BD	Total BD 000's
Al Hareth French Property Fund	17.05	497.81	8,487	-	381 <sup>1</sup>	-	-	-	-	17.05	520.12	8,868
Safana Investment WLL (RIA 1)	8,323	1.00	8,323	-	-	-	-	-	-	8,323	1.00	8,323
Janayen Holding Limited (RIA 4)	48,082	0.12	5,532	-	(386)	254	-	-	(136)	48,082	0.11	5,264
Shaden Real Estate Investment WLL (RIA 5)	8,100	1.00	8,100	-	-	-	-	-	-	8,100	1.00	8,100
Locata Corporation Pty Ltd (RIA 6)	3,427	0.38	1,292	(181)	(110)	-	-	-	-	2,948	0.34	1,001
			<b>31,734</b>	<b>(181)</b>	<b>(115)</b>	<b>254</b>	<b>-</b>	<b>-</b>	<b>(136)</b>			<b>31,556</b>

<sup>1</sup> Includes gain or loss on revaluation of foreign currency balances as at the year end.

The accompanying notes 1 to 35 form an integral part of these consolidated financial statements.

**CONSOLIDATED STATEMENT OF CHANGES IN RESTRICTED INVESTMENT ACCOUNTS**  
**for the year ended 31 December 2013 (continued)**

BD 000's

2012	Balance at 1 January 2012			Movements during the year						Balance at 31 December 2012		
	No of units (000's)	Average value per share BD	Total BD 000's	Investment (withdrawals) BD 000's	Revalua- tion BD 000's	Gross income/ (loss) BD 000's	Dividends paid BD 000's	Bank's fees as an agent BD 000's	Adminstra- tion expenses BD 000's	No of units (000's)	Average value per share BD	Total BD 000's
Al Hareth French Property Fund	17.05	487.45	8,311	-	176 <sup>1</sup>	-	-	-	-	17.05	497.81	8,487
Safana Investment WLL (RIA 1)	8,323	1.00	8,323	-	-	-	-	-	-	8,323	1.00	8,323
Janayen Holding Limited (RIA 4)	52,685	0.18	9,370	(484)	(1,519)	(1,232)	-	-	(603)	48,082	0.12	5,532
Shaden Real Estate Investment WLL (RIA 5)	8,100	1.00	8,100	-	-	-	-	-	-	8,100	1.00	8,100
Locata Corporation Pty Ltd (RIA 6)	3,427	0.38	1,292	-	-	-	-	-	-	3,427	0.38	1,292
			35,396	(484)	(1,343)	(1,232)	-	-	(603)			31,734

<sup>1</sup> Includes gain or loss on revaluation of foreign currency balances as at the year end.

<sup>2</sup> Please refer note 22.

The accompanying notes 1 to 35 form an integral part of these consolidated financial statements.

**CONSOLIDATED STATEMENT OF SOURCES AND USES OF CHARITY AND ZAKAH FUND**

for the year ended 31 December 2013

BD 000's

	<b>2013</b>	2012
<b>Sources of charity and zakah fund</b>		
At 1 January	910	1,362
Contributions by the Bank	228	214
Non-Islamic income	52	6
<b>Total sources</b>	<b>1,190</b>	1,582
<b>Uses of charity and zakah fund</b>		
Contributions to charitable organisations	355	672
<b>Total uses</b>	<b>355</b>	672
<b>Undistributed charity and zakah fund at 31 December</b> (note 13)	<b>835</b>	910

The accompanying notes 1 to 35 form an integral part of these consolidated financial statements.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**for the year ended 31 December 2013**

**1 INCORPORATION AND PRINCIPAL ACTIVITY**

Khaleeji Commercial Bank BSC (“the Bank”), a public shareholding company, was incorporated on 24 November 2004 in the Kingdom of Bahrain under Commercial Registration No. 55133. The Bank operates under an Islamic retail banking license granted by the Central Bank of Bahrain (“CBB”) on 20 October 2003. The Bank’s shares are listed on the Bahrain Bourse.

The Bank’s activities are regulated by the Central Bank of Bahrain (CBB) and supervised by a Religious Supervisory Board to ensure adherence to Shari’a rules and principles in its transactions and activities.

The principal activities of the Bank include providing banking and investment products and services to retail customers, high net worth individuals, corporate entities, and financial institutions. These include retail and corporate banking, consumer finance, wealth management, structured investment products and project financing facilities which comply with Islamic Shari’a rules and principles as determined by the Bank’s Shari’a Supervisory Board.

The consolidated financial statements include the financial statements of the Bank and its subsidiaries (together “the Group”). The significant subsidiaries are as follows:

<b>Name</b>	<b>Country of incorporation</b>	<b>% holding</b>	<b>Nature of business</b>
Hawafiz Khaleeji Management Company BSC (c)	Bahrain	100%	To hold shares for the beneficial interest of the employee incentive scheme. (refer note 20)
Binaa Investment 1	Cayman Islands	100%	To hold investments for the beneficial interest of the Bank.
Harbour Tower West 2 Real Estate SPC	Bahrain	100%	To hold property for the beneficial interest of the Bank.
Harbour Tower West 4 Real Estate SPC	Bahrain	100%	To hold property for the beneficial interest of the Bank.

**2 SIGNIFICANT ACCOUNTING POLICIES**

The significant accounting policies applied in the preparation of these consolidated financial statements are set out below. These accounting policies have been consistently applied by the Group and are consistent with those used in the previous year, except for those changes arising from revised/new AAOIFI financial accounting standards.

**New standards effective from 1 January 2013:**

**FAS 26 - “Investment in real estate”**

The entity has adopted Financial Accounting Standard 26 (“FAS 26”) “Investment in real estate” issued by AAOIFI during 2012, which is effective from 1 January 2013. The new standard replaces the requirements of FAS 17 which was applied for investments in real estate. The significant requirement of the standard is that for investment in real estate held-for-use, the entity shall choose either fair value model or cost model as its accounting policy. Where the entity adopts fair value model, then fair value changes should be directly recognised in equity under ‘property fair value reserve’. The adoption of the new standard did not have any material impact on the Group.

**New standard issued but not effective**

There are no AAOIFI accounting standards or interpretations that are effective for the first time for the financial year beginning on or after 1 January 2014 that would be expected to have a material impact on the Group.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**for the year ended 31 December 2013**

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2 *SIGNIFICANT ACCOUNTING POLICIES (continued)***(a) Statement of compliance**

The financial statements have been prepared in accordance with Financial Accounting Standards ('FAS') issued by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI). In line with the requirement of AAOIFI and the CBB Rule Book, for matters that are not covered by AAOIFI standards, the Group uses guidance from the relevant International Financial Reporting Standards.

**(b) Basis of preparation**

The consolidated financial statements are presented in Bahraini Dinars, being the principal currency of the Bank's operations. They are prepared on the historical cost basis except for the measurement at fair value of certain investments carried at fair value.

The Group classifies its expenses in the income statement by the nature of expense method.

The preparation of consolidated financial statements requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. Estimates and underlying assumptions are reviewed on an on-going basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected. Management believes that the underlying assumptions are appropriate and the Group's consolidated financial statements therefore present the financial position and results fairly. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in note 21.

**(c) Basis of consolidation****(i) Subsidiaries**

The consolidated financial statements of the Group comprise the financial statements of the Bank and its subsidiaries. Subsidiaries are those enterprises (including special purpose entities) controlled by the Bank. Control exists when the Group has the power, directly or indirectly, to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities. Subsidiaries are consolidated from the date on which control is transferred to the Group and de-consolidated from the date that control ceases.

Special purpose entities (SPEs) are entities that are created to accomplish a narrow and well-defined objective such as the securitisation of particular assets, or the execution of a specific borrowing or investment transaction. An SPE is consolidated if, based on an evaluation of the substance of its relationship with the Group and the risks and rewards transferred by the SPE, the Group concludes that it controls the SPE. The assessment of whether the Group has control over an SPE is carried out at inception and normally no further reassessment of control is carried out in the absence of changes in the structure or terms of the SPE, or additional transactions between the Group and the SPE. Where the Group's voluntary actions, such as lending amounts in excess of existing liquidity facilities or extending terms beyond those established originally, change the relationship between the Group and an SPE, the Group performs a reassessment of control over the SPE. The Group in its fiduciary capacity manages and administers assets held in trust and other investment vehicles on behalf of investors.

The financial statements of these entities are not included in these consolidated financial statements except when the Group controls the entity. Information about the Group's fiduciary assets under management is set out in note 22.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**for the year ended 31 December 2013**

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2 *SIGNIFICANT ACCOUNTING POLICIES (continued)**(c) Basis of consolidation (continued)***(ii) Associates**

Associates are those enterprises in which the Group holds, directly or indirectly, more than 20% of the voting power and exercises significant influence, but not control, over the financial and operating policies.

Investments in associates are initially recognised at cost and the carrying amount is increased or decreased to recognise the investor's share of the profit or loss of the investee after the date of acquisition. Distributions received from an investee reduce the carrying amount of the investment. Adjustments to the carrying amount may also be necessary for changes in the investor's proportionate interest in the investee arising from changes in the investee's equity. When the Group's share of losses exceeds its interest in an associate, the Group's carrying amount is reduced to nil and recognition of further losses is discontinued, except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associate.

**(iii) Transactions eliminated on consolidation**

Intra-group balances and transactions, and any unrealised gains arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Intra-group gains on transactions between the Group and its equity accounted associates are eliminated to the extent of the Group's interest in the investees. Unrealised losses are also eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment. Accounting policies of the subsidiaries and associates have been changed where necessary to ensure consistency with the policies adopted by the Group.

**(d) Foreign currency transactions**

Items included in the consolidated financial statements of the Group are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The consolidated financial statements are presented in Bahraini Dinars, which is the Bank's functional and presentation currency.

Foreign currency transactions are translated using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement. Translation differences on non-monetary items carried at their fair value, such as certain equity securities measured at fair value through equity, are included in investments fair value reserve.

The other Group companies functional currencies are either denominated in Bahraini dinars or US dollars which is effectively pegged to the Bahraini dinar. Hence, the translation of financial statements of the group entities that have a functional currency different from the presentation currency do not result in exchange differences.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
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2 *SIGNIFICANT ACCOUNTING POLICIES (continued)***(e) Investment securities**

Investment securities comprise equity investments and investments in sukuk (Islamic bonds). Investment securities exclude investments in subsidiaries and equity accounted associate companies (refer note 2(c)).

**(i) Classification**

The Group segregates its investment securities into debt-type instruments and equity-type instruments. Debt-type instruments are investments that have terms that provide fixed or determinable payments of profits and capital. Equity-type instruments are investments that do not exhibit features of debt-type instruments and include instruments that evidence a residual interest in the assets of an entity after deducting all its liabilities.

*Debt-type Instruments:*

Investments in debt-type instruments are classified in the following categories: 1) at amortised cost or 2) at fair value through income statement (FVTIS).

A debt-type investment is classified and measured at amortised cost only if the instrument is managed on a contractual yield basis or the instrument is not held for trading and has not been designated at FVTIS. Debt-type investments at amortised cost include investments in medium to long-term sukuk.

Debt-type investment classified and measured at FVTIS include investments held for trading or designated at FVTIS. At inception, a debt-type investment managed on a contractual yield basis, can only be designated at FVTIS if it eliminates an accounting mismatch that would otherwise arise on measuring the assets or liabilities or recognising the gains or losses on them on different bases. Debt-type instruments at FVTIS include investments in medium to long-term (quoted) sukuk

*Equity-type investments:*

Investments in equity type instruments are classified in the following categories: 1) at fair value through income statement (FVTIS) or 2) at fair value through equity (FVTE), consistent with its investment strategy.

Equity-type investments classified and measured at FVTIS include investments held for trading or designated at FVTIS.

An investment is classified as held for trading if acquired or originated principally for the purpose of generating a profit from short-term fluctuations in price or dealer's margin. Any investments that form part of a portfolio where there is an actual pattern of short-term profit taking are also classified as 'held for trading'. The Group has currently classified certain long-term listed equity sukuk and a private equity investment under this category.

Equity-type investments designated at FVTIS include investments which are managed and evaluated internally for performance on a fair value basis. This category currently includes an investment in private equity.

On initial recognition, the Bank makes an irrevocable election to designate certain equity instruments that are not designated at FVTIS to be classified as investments at fair value through equity. These include investments in certain quoted and unquoted equity securities.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
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2 *SIGNIFICANT ACCOUNTING POLICIES (continued)*(e) *Investment securities (continued)***(ii) Recognition and de-recognition**

Investment securities are recognised at the trade date i.e. the date that the Group contracts to purchase or sell the asset, at which date the Group becomes party to the contractual provisions of the instrument.

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

**(iii) Measurement**

Investment securities are measured initially at fair value, which is the value of the consideration given. For FVTIS investments, transaction costs are expensed in the income statement. For other investment securities, transaction costs are included as a part of the initial recognition.

Subsequent to initial recognition, investments carried at FVTIS and FVTE are re-measured to fair value. Gains and losses arising from a change in the fair value of investments carried at FVTIS are recognised in the income statement in the period in which they arise. Gains and losses arising from a change in the fair value of investments carried at FVTE are recognised in the consolidated statement of changes in equity and presented in a separate fair value reserve within equity. The fair value gains / losses are recognised taking into consideration the split between portions related to owners' equity and equity of investment account holders. When the investments carried at FVTE are sold, impaired, collected or otherwise disposed of, the cumulative gain or loss previously recognised in the statement of changes in equity is transferred to the income statement.

Investments at FVTE where the entity is unable to determine a reliable measure of fair value on a continuing basis, such as investments that do not have a quoted market price or other appropriate methods from which to derive reliable fair values, are stated at cost less impairment allowances.

Subsequent to initial recognition, debt type investments, other than those carried at FVTIS, are measured at amortised cost using the effective profit method less any impairment allowances.

**(iv) Measurement principles***Amortised cost measurement*

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus capital repayments, plus or minus the cumulative amortisation using the effective profit method of any difference between the initial amount recognised and the maturity amount, minus any reduction (directly or through use of an allowance account) for impairment or uncollectability. The calculation of the effective profit rate includes all fees and points paid or received that are an integral part of the effective profit rate.

*Fair value measurement*

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 on the measurement date. The Group measures the fair value of quoted investments using the market bid-prices in an active market for that instrument.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
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2 *SIGNIFICANT ACCOUNTING POLICIES (continued)**(e) Investment securities (continued)**(iv) Measurement principles (continued)*

For certain unquoted investments, the Group uses proprietary models, which usually are developed from recognised valuation models for fair valuation. Some or all of the inputs into these models may not be market observable, but are estimated based on assumptions. Inputs to valuation techniques reasonably represent market expectations and measures of the risk-return factors inherent in the financial instrument.

Valuation adjustments are recorded to allow for bid-ask spreads, liquidity risks, as well as other factors. Management believes that these valuation adjustments are necessary and appropriate to fairly state the values of these investments.

**(f) Financing assets**

Financing assets comprise Shari'a compliant financing contracts with fixed or determinable payments. These include financing provided through Murabaha, Musharaka, Istisna and Wakala contracts. Financing assets are recognised on the date at which they are originated and are carried at their amortised cost less impairment allowances, if any.

**(g) Placements with and from financial institutions, non-financial institutions and individuals**

These comprise inter-bank and over the counter customer placements made/received using Shari'a compliant contracts. Placements are usually for short-term and are stated at their amortised cost.

**(h) Cash and cash equivalents**

For the purpose of the statement of cash flows, cash and cash equivalents comprise cash and bank balances (excluding CBB reserve account), and placement with financial institutions with maturities of three months or less when acquired which are subject to insignificant risk of changes in fair value and are used by the Group in the management of its short-term commitments.

**(i) Assets acquired for leasing**

Assets acquired for leasing (Ijarah Muntahia Bittamleek) are stated at cost less accumulated depreciation and any impairment in value. Under the terms of lease, the legal title of the asset passes to the lessee at the end of the lease term, provided that all lease instalments are settled. Depreciation is calculated on a straight line basis at rates that systematically reduce the cost of the leased assets over the period of the lease. The Group assesses at each reporting date whether there is objective evidence that the assets acquired for leasing are impaired. Impairment losses are measured as the difference between the carrying amount of the asset (including lease rental receivables) and the estimated recoverable amount. Impairment losses, if any, are recognised in the income statement.

**(j) Investment property**

Properties held for rental, or for capital appreciation purposes, or both, are classified as investment property. Investment property are carried at cost less impairment allowances, if any. Cost includes expenditure that is directly attributable to the acquisition of the investment property. Investment property of the Group includes a plot of land held for capital appreciation purposes.

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2 *SIGNIFICANT ACCOUNTING POLICIES (continued)***(k) Property and equipment**

Property and equipment is stated at cost, net of accumulated depreciation and impairment allowances, if any. Property includes land which is not depreciated and buildings which are depreciated over 25 years. Other equipment is depreciated using the straight-line method to write-off the cost of the assets over their estimated useful lives ranging from 3 to 5 years. The assets residual values and useful lives are reviewed, and adjusted if appropriate, at each reporting date.

**(l) Impairment of assets**

The Group assesses at each reporting date whether there is objective evidence that an asset is impaired. Objective evidence that financial assets (including equity securities) are impaired can include default or delinquency by a borrower, restructuring of financing facility or advance by the Group on terms that the Group would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group. In addition, for an investment in an equity security, a significant or prolonged decline in its fair value below its cost is objective evidence of impairment.

*Financial assets carried at amortised cost*

These include debt-type instruments, financing assets and receivables. For financial assets carried at amortised cost impairment is measured as the difference between the carrying amount of the financial assets and the present value of estimated cash flows discounted at the assets' original effective profit rate. Losses are recognised in income statement and reflected in an allowance account. When a subsequent event causes the amount of impairment loss to decrease, the impairment loss is reversed through the income statement. The Group considers evidence of impairment for financial assets carried at amortised cost at both a specific asset and collective level.

All individually significant financial assets are assessed for specific impairment. All individually significant financial assets found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Financial assets that are not individually significant are collectively assessed for impairment by grouping together assets with similar risk characteristics.

*Equity investments carried at fair value through equity (FVTE)*

In the case of investments in equity securities classified as FVTE and measured at fair value, a significant or prolonged decline in the fair value of the security below its cost is an objective evidence of impairment. If any such evidence exists, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognised in income statement – is removed from equity and recognised in the income statement. Impairment losses recognised in the income statement on equity instruments are subsequently reversed through equity.

For FVTE investments carried at cost less impairment due to the absence of reliable fair value, the Group makes an assessment of whether there is an objective evidence of impairment for each investment by assessment of financial and other operating and economic indicators. Impairment is recognised if the estimated recoverable amount is assessed to be below the cost of the investment.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
for the year ended 31 December 2013**

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2 *SIGNIFICANT ACCOUNTING POLICIES (continued)**(l) Impairment of assets (continued)**Other non-financial assets*

The carrying amount of the Group's assets (other than for financial assets covered above), are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. The recoverable amount of an asset is the greater of its value in use or fair value less costs to sell. An impairment loss is recognised whenever the carrying amount of an asset exceeds its estimated recoverable amount. Impairment losses are recognised in the income statement. Impairment losses are reversed only if there is an indication that the impairment loss may no longer exist and there has been a change in the estimates used to determine the 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. An impairment loss is recognised whenever the carrying amount of an asset or its cash generating unit exceeds its estimated recoverable amount. Impairment losses are recognised in the income statement. Impairment losses are reversed only if there is an indication that the impairment loss may no longer exist and there has been a change in the estimates used to determine the recoverable amount. Separately recognised goodwill is not amortised and is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on separately recognised goodwill are not reversed.

**(m) Customers' current accounts**

Balances in current (non-investment) accounts are recognised when received by the Bank. The transaction are measured at the cash equivalent amount received by the Bank at the time of contracting. At the end of the accounting period, the accounts are measured at their book value.

**(n) Equity of investment account holders**

Equity of investment account holders are funds held by the Bank in unrestricted investment accounts, which it can invest at its own discretion. The investment account holder authorises the Bank to invest the account holders' funds in a manner which the Bank deems appropriate without laying down any restrictions as to where, how and for what purpose the funds should be invested.

The Bank charges management fee (Mudarib fees) to investment account holders. Of the total income from investment accounts, the income attributable to customers is allocated to investment accounts after setting aside provisions, reserves (Profit equalisation reserve and Investment risk reserve) and deducting the Bank's share of income as a Mudarib. The allocation of income is determined by the management of the Bank within the allowed profit sharing limits as per the terms and conditions of the investment accounts. Administrative expenses incurred in connection with the management of the funds are borne directly by the Bank and are not charged separately to investment accounts.

Investment accounts are carried at their book values and include amounts retained towards profit equalisation and investment risk reserves, if any. Profit equalisation reserve is the amount appropriated by the Bank out of the Mudaraba income, before allocating the Mudarib share, in order to maintain a certain level of return to the deposit holders on the investments. Investment risk reserve is the amount appropriated by the Bank out of the income of investment account holders, after allocating the Mudarib share, in order to cater against future losses for investment account holders. Creation of an these reserves results in an increase in the liability towards the pool of unrestricted investment accounts.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
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2 *SIGNIFICANT ACCOUNTING POLICIES (continued)*

**(o) Restricted investment accounts**

Restricted investment accounts represents assets acquired by funds provided by holders of restricted investment accounts and their equivalent and managed by the Bank as an investment manager based on either a Mudaraba contract or agency contract. The restricted investment accounts are exclusively restricted for investment in specified projects as directed by the investments account holders. Assets that are held in such capacity are not included as assets of the Bank in the consolidated financial statements.

**(p) Financial guarantees**

Financial guarantees are contracts that require the Group to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument. A financial guarantee contract is recognised from the date of its issue. The liability arising from a financial guarantee contract is recognised at the present value of any expected payment, when a payment under the guarantee has become probable.

**(q) Treasury shares**

The amount of consideration paid including all directly attributable costs incurred in connection with the acquisition of the treasury shares are recognised in equity. Consideration received on sale of treasury shares is presented in the financial statements as a change in equity. No gain or loss is recognised on the Group's income statement on the sale of treasury shares.

**(r) Statutory reserve**

The Bahrain Commercial Companies Law 2001 requires that 10 per cent of the annual net profit be appropriated to a statutory reserve which is normally distributable only on dissolution. Appropriations may cease when the reserve reaches 50 per cent of the paid up share capital.

**(s) Revenue recognition**

**Fees and commission income** that are integral to the effective profit rate on a financial asset carried at amortised cost are included in the measurement of the effective profit rate of the financial asset. Other fees and commission income, including account servicing fees, sales commission, management fees, placement and arrangement fees and syndication fees, are recognised as the related services are performed.

**Income from Murabaha and Wakala contracts** are recognised on a time-apportioned basis over the period of the contract using the effective profit method.

Profit or losses in respect of the Bank's share in **Musharaka financing** transaction that commence and end during a single financial period is recognised in the income statement at the time of liquidation (closure of the contract). Where the Musharaka financing continues for more than one financial period, profit is recognised to the extent that such profits are being distributed during that period in accordance with profit sharing ratio as stipulated in the Musharaka agreement.

**Istisna'a revenue** and the associated profit margin is recognised using the percentage of completion method.

**Income from assets acquired for leasing** (Ijarah Muntahia Bittamleek) are recognised proportionately over the lease term.

**Income from sukuk** and income / expenses on placements is recognised at its effective profit rate over the term of the instrument.

**Dividend income** is recognised when the right to receive is established.

**(t) Earnings prohibited by Shari'a**

The Bank is committed to avoid recognising any income generated from non-Islamic sources. Accordingly, all non-Islamic income is credited to a charity account where the Bank uses these funds for charitable purposes.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**for the year ended 31 December 2012**

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2 *SIGNIFICANT ACCOUNTING POLICIES (continued)***(u) Zakah**

Zakah is calculated on the Zakah base of the Group in accordance with FAS 9 *Zakah* using the net assets method. Zakah is paid by the Group based on the statutory reserve and retained earnings balances at the end of the year and the remaining Zakah is payable by individual shareholders. The Bank calculates and notifies the shareholders of their pro-rata share of the Zakah payable annually. The calculations of Zakah is approved by the Shari'a Supervisory Board. Payment of Zakah on the unrestricted investment and other accounts is the responsibility of the investment account holders.

**(v) Employee benefits****(i) Short-term benefits**

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. A provision is recognised for the amount expected to be paid under short-term cash bonus or profit-sharing plans if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

**(ii) Post-employment benefits**

Pensions and other social benefits for Bahraini employees are covered by the Social Insurance Organisation scheme, which is a "defined contribution scheme" in nature, and to which employees and employers contribute monthly on a fixed-percentage-of-salaries basis. Contributions by the Bank are recognised as an expense in income statement when they are due.

Expatriate employees on fixed contracts are entitled to leaving indemnities payable under the Bahraini Labour Law, based on length of service and final remuneration. Provision for this unfunded commitment has been made by calculating the notional liability had all employees left at the reporting date.

These benefits are in the nature of "defined benefit scheme" and any increase or decrease in the benefit obligation is recognised in the income statement.

The Bank also operates a voluntary employees saving scheme under which the Bank and the employee contribute monthly on a fixed percentage of salaries basis. The scheme is managed and administered by a board of trustees who are employees of the Bank. The scheme is in the nature of a defined contribution scheme and contributions by the Bank are recognised as an expense in the income statement when they are due.

**(iii) Share-based employee incentive scheme**

The Bank operates a share-based incentive scheme for its employees (the "Scheme") whereby eligible employees are granted the Bank's shares as compensation on achievement of certain non-market based performance conditions and additional service conditions (the 'vesting conditions').

The grant date fair value of equity instruments granted to employees is recognised as an employee expense, with a corresponding increase in equity (share grant reserve), over the period in which the employees become unconditionally entitled to the share awards. The amount recognised as an expense is adjusted to reflect the number of share awards for which the related service and non-market performance vesting conditions are expected to be met, such that the amount ultimately recognised as an expense is based on the number of share awards that do meet the related service and non-market performance conditions at the vesting date.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
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2 **SIGNIFICANT ACCOUNTING POLICIES** (continued)

(v) *Employee benefits* (continued)

(iii) *Share-based employee incentive scheme* (continued)

The total share awards have been transferred to Hawafiz Khaleeji Management Company BSC (c) a special purpose entity formed to manage the scheme until the date of vesting. The unvested and forfeited shares, if any, are treated similar to treasury shares and are shown under 'Unvested employee incentive scheme shares' in equity. On the date of vesting, a transfer is made within components of equity to reflect the issue of shares to employees.

**(w) Dividends and board remuneration**

Dividends to shareholders and board remuneration are recognised as liabilities in the period in which they are declared.

**(x) Trade date accounting**

All "regular way" purchases and sales of financial assets are recognised on the trade date, i.e. the date that the Group commits to purchase or sell the asset.

**(y) Offsetting**

Financial assets and liabilities are offset only when there is a legal or Sharia' based enforceable right to set off the recognised amounts and the Group intends to either settle on a net basis, or to realise the asset and settle the liability simultaneously.

**(z) Provisions**

A provision is recognised if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation.

3. **CASH AND BANK BALANCES**

	<b>31 December 2013</b>	31 December 2012
Cash	2,962	2,586
Balances with banks	12,751	7,294
Balances with the Central Bank:		
- Current account	8,050	3,681
- Reserve account	15,085	10,295
	<b>38,848</b>	23,856

The reserve account with the Central Bank of Bahrain is not available for day-to-day operational purposes.

4. **PLACEMENTS WITH FINANCIAL INSTITUTIONS**

	<b>31 December 2013</b>	31 December 2012
Gross Murabaha and Wakala receivable	82,755	57,534
Less: Deferred profits	(10)	(9)
	<b>82,745</b>	57,525

The average profit rate on placement with financial institutions for 2013 was 0.66% per annum (31 December 2012: 0.69% per annum).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
for the year ended 31 December 2013

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## 5. FINANCING ASSETS

	31 December 2013	31 December 2012
Murabaha	195,965	184,522
Musharaka	50,643	56,681
Wakala	22,952	20,257
Istisna	400	670
	<b>269,960</b>	262,130
Less: Impairment allowances – specific	(12,529)	(13,645)
Less: Impairment allowances – collective	(3,796)	(2,740)
	<b>253,635</b>	245,745

Murabaha financing receivables are net of deferred profits of BD 32,130 thousand (2012: BD 28,402 thousand).

Of the total financing asset portfolio, consumer financing receivables amounted to BD 21,151 thousand (2012: BD 12,772 thousand).

The movement in impairment allowances are as follows:

## 2013

	Specific	Collective	Total
At 1 January	13,645	2,740	16,385
Charge for the year	5,401	1,056	6,457
Adjusted on write-off of assets	(6,517)	-	(6,517)
<b>At 31 December</b>	<b>12,529</b>	<b>3,796</b>	<b>16,325</b>

## 2012

	Specific	Collective	Total
At 1 January	16,151	1,963	18,114
(Write back) / charge for the year	(910)	777	(133)
Adjusted on write-off of assets	(1,596)	-	(1,596)
<b>At 31 December</b>	<b>13,645</b>	<b>2,740</b>	<b>16,385</b>

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## 6. INVESTMENT SECURITIES

	31 December 2013	31 December 2012
<b>Equity type instruments:</b>		
<i>At fair value through income statement</i>		
- Unquoted equity securities (at fair value)	14,959	17,452
- Listed equity sukuk (at fair value)	4,765	3,858
<i>At fair value through equity</i>		
- Unquoted equity securities (carried at cost less impairment)	46,306	71,041
	<b>66,030</b>	92,351
<b>Debt type instruments:</b>		
Sukuk:		
- <i>At amortised cost</i>	23,351	7,493
- <i>At fair value through income statement (quoted)</i>	1,016	1,016
	<b>24,367</b>	8,509
	<b>90,397</b>	100,860

Unquoted equity securities at fair value through equity comprise investments in closed companies managed by external investment managers or represent investments in projects promoted by the Group. These investments are carried at cost less impairment in the absence of a reliable measure of fair value. The Group intends to exit these investments principally by means of private placements, strategic buy outs, sale of underlying assets or through initial public offerings.

During the year, impairment allowances of BD 7,660 thousand (31 December 2012: BD 975 thousand) was recognised on equity securities carried at cost. Impairment allowance of BD162 thousands (31 December 2012 write back of BD 45 thousand) was recognised on investments at amortised cost.

Debt type instruments are net of collective impairment allowances of Nil (2012: BD 4 thousand) and specific impairment allowances of BD 200 thousand (2012: BD 34 thousand).

## 7. ASSETS ACQUIRED FOR LEASING

	2013	2012
<b>Cost</b>		
At 1 January	26,291	15,316
Additions during the year	17,824	13,199
Settlements/adjustments during the year	(4,186)	(2,224)
<b>At 31 December</b>	<b>39,929</b>	26,291
<b>Accumulated depreciation</b>		
At 1 January	5,353	3,604
Charge for year	6,701	3,973
Settlements during the year	(4,186)	(2,224)
<b>At 31 December</b>	<b>7,868</b>	5,353
<b>Net book value at 31 December</b>	<b>32,061</b>	20,938

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7 *ASSETS ACQUIRED FOR LEASING (continued)*

At 31 December 2013, accrued lease rental receivable amounted to BD 3,569 thousand (2012: BD 3,035 thousand). Lease rental receivable is net of collective provision of BD 360 thousand (2012: BD 242 thousand). During the year an impairment allowance of BD 118 thousands (31 December 2012 BD 106 thousands) was made on the lease rental receivables.

Of the total net book value of assets acquired for leasing, consumer financing amounted to BD 31,896 thousand (2012: BD 18,469 thousand).

8. **INVESTMENT IN ASSOCIATES**

	2013	2012
At 1 January	2,887	3,000
Redemption during the year	(91)	-
Share of losses for the year	(115)	(113)
<b>At 31 December</b>	<b>2,681</b>	<b>2,887</b>

Investment in associates comprise:

Name	Country of incorporation	% holding	Nature of business
Capital Real Estate Projects Company BSC (c)	Bahrain	30.0%	Real estate holding and development
Amlak II SPV	Cayman Islands	23.1%	Purchase and sale of real estate in Bahrain

*Summarised financial information of associates that have been equity accounted not adjusted for the percentage ownership held by the Group (based on their most recent unaudited management accounts):*

	2013	2012
Total assets	11,748	12,731
Total liabilities	1,822	2,345
Total revenues	1,730	2,978
Total net losses	91	(209)

9. **INVESTMENT PROPERTY**

The Bank owns two plots of land in the Bahrain Financial Harbour project which were received in consideration for sale of an investment in 2010. Of the two plots of land received, one plot is intended for the Group's own use and has been classified under "Property and equipment" (refer note 11). The second plot of land is held for capital appreciation purposes and hence has been classified as "Investment property".

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**10. OTHER ASSETS**

	31 December 2013	31 December 2012
Receivable on sale of investment	11,326	-
Qardh Hassan receivable	5,086	-
Prepayments	638	648
Income from sukuk receivable	147	81
Other receivables	6,145	2,077
	<b>23,342</b>	<b>2,806</b>

Qardh Hassan receivable represents a conversion of a financing facility for a customer into a non-profit bearing funding, after obtaining requisite approvals. This receivable is expected to be settled from future proceeds from sale of certain investments of the customer. During the year, an impairment allowance of BD 848 thousands (31 December 2012: BD Nil) was made on the Qardh Hassan receivables.

Other receivables is net of impairment provision of BD 773 thousand (2012: BD 773 thousand).

**11. PROPERTY AND EQUIPMENT**

	Land (note 9)	Building	Furniture and fixtures	Computers	Motor vehicle and Other equipment	Work-in- progress	2013 Total	2012 Total
<b>Cost</b>								
At 1 January	6,714	-	4,017	2,885	331	401	14,348	13,678
Additions	-	203	132	115	9	167	626	671
Capitalisation	-	280	-	40	-	(320)	-	-
Disposals	-	-	-	-	-	-	-	(1)
<b>At 31 December</b>	<b>6,714</b>	<b>483</b>	<b>4,149</b>	<b>3,040</b>	<b>340</b>	<b>248</b>	<b>14,974</b>	<b>14,348</b>
<b>Accumulated Depreciation</b>								
At 1 January	-	-	2,804	2,392	228	-	5,424	4,272
Charge for year	-	19	827	279	44	-	1,169	1,153
Disposals	-	-	-	-	-	-	-	(1)
<b>At 31 December</b>	<b>-</b>	<b>19</b>	<b>3,631</b>	<b>2,671</b>	<b>272</b>	<b>-</b>	<b>6,593</b>	<b>5,424</b>
<b>Net book value at 31 December 2013</b>	<b>6,714</b>	<b>464</b>	<b>518</b>	<b>369</b>	<b>68</b>	<b>248</b>	<b>8,381</b>	<b>8,924</b>
Net book value at 31 December 2012	6,714	-	1,213	493	103	401	8,924	

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**12. PLACEMENTS FROM NON-FINANCIAL INSTITUTIONS AND INDIVIDUALS**

	<b>31 December 2013</b>	31 December 2012
Non-financial institutions	36,712	25,196
Individuals	44,200	28,220
	<b>80,912</b>	<b>53,416</b>

These represent placements in the form of Murabaha and Wakala contracts.

**13. OTHER LIABILITIES**

	<b>31 December 2013</b>	31 December 2012
Mudaraba profit accrual	3,734	2,032
Employee related accruals	1,008	367
Charity and zakah payable (page 12)	835	910
Payable for Istisna'a contracts	111	128
Other payables and accrued expenses	1,719	1,302
	<b>7,407</b>	<b>4,739</b>

**14. EQUITY OF INVESTMENT ACCOUNT HOLDERS**

The funds received from investment account holders have been commingled and jointly invested with the Bank in the following asset classes as at 31 December:

	<b>31 December 2013</b>	31 December 2012
Balances with banks	12,751	7,294
CBB reserve account	15,085	10,295
Placements with financial institutions	82,745	57,525
Debt type instruments - sukuk	24,367	8,509
Equity type instrument – sukuk	4,765	3,858
Financing assets	152,336	128,948
	<b>292,049</b>	<b>216,429</b>

The investors' share of the return on jointly invested assets and distribution to investment account holders were as follows:

	<b>2013</b>	2012
Returns from jointly invested assets	13,315	9,923
Banks share as Mudarib	(4,596)	(3,626)
<b>Return / distribution to investment account holders'</b>	<b>8,719</b>	<b>6,297</b>

Approximately 3.35% (31 December 2012: 3.26%) was distributed to investors and the balance was retained by the Bank as a Mudarib fee. As at 31 December 2013, the balance of profit equalisation reserve was Nil (2012: Nil) and the balance of investment risk reserve was Nil (2012: Nil).

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## 15. SHARE CAPITAL

	31 December 2013	31 December 2012
<b>Authorised:</b>		
3,000,000,000 ordinary shares of BD 0.100 each	<b>300,000</b>	300,000
<b>Issued and fully paid up:</b>		
1,154,161,084 ordinary shares (2012: 1,154,161,084) of BD 0.100 each	<b>115,416</b>	115,416

The Bank has only one class of equity shares and the holders of these shares have equal voting rights. At 31 December 2013, the Bank holds 28,621,332 as treasury shares (2012: 28,621,332).

*Distribution schedule of equity shares, setting out the number of holders and percentage in the following categories:*

Categories*	Number of Shares	Number of Shareholders	% of total outstanding shares
Less than 1%	202,368,988	551	17.53
1% up to less than 5% **	143,696,370	7	12.45
5% up to less than 10%	103,950,000	1	9.01
10% up to less than 20%	161,700,000	1	14.01
20% and less than 50%	542,445,726	1	47.00
	<b>1,154,161,084</b>	<b>561</b>	<b>100.00</b>

\* Expressed as a percentage of total outstanding shares of the Bank.

\*\* Includes treasury shares and unvested employee incentive scheme shares.

*Names and nationalities of the major shareholders and the number of equity shares held in which they have an interest of 5% or more of outstanding shares:*

	Nationality	Number of shares	% of total outstanding shares
Gulf Finance House BSC *	Bahrain	542,445,726	47.00
Al Imtiaz Investment Company KSCC	Kuwait	161,700,000	14.01
Emirates Islamic Bank PJSC	UAE	103,950,000	9.01

\*As at 31 December 2013, these shares representing 47.00% were held by KHCB Asset Company on behalf of Gulf Finance House BSC.

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**16. (LOSS) / INCOME FROM INVESTMENT SECURITIES**

	<b>2013</b>	2012
Income from equity-type investments:		
- Dividend and other investment income	1,574	302
- Fair value (loss)/ gain on investment	(2,722)	71
	<b>(1,148)</b>	373
Income from debt-type investments:		
- Income from Sukuk	503	478
- Other gain on Sukuk	21	120
- Fair value (loss)/ gain on investments	-	15
	<b>(624)</b>	986

**17. STAFF COST**

	<b>2013</b>	2012
Salaries and short-term benefits	4,952	3,901
Social insurance expenses	557	558
Other staff expenses	183	121
	<b>5,692</b>	4,580

**18. IMPAIRMENT ALLOWANCES**

	<b>2013</b>	2012
Financing assets (note 5)	6,457	(133)
Lease rental receivable (note 7)	118	106
Investments at fair value through equity (note 6)	7,660	975
Investments at amortised cost (note 6)	162	(45)
Other assets (note 10)	848	-
	<b>15,245</b>	903

**19. OTHER EXPENSES**

	<b>2013</b>	2012
Premises cost	922	924
Advertisement and marketing expenses	723	650
Professional fees	689	396
Information technology expenses	454	463
Board expenses	352	118
Communication expenses	252	128
Distribution channel expenses	145	106
Other administrative expenses	575	525
	<b>4,112</b>	3,310

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**20. SHARE-BASED EMPLOYEE INCENTIVE SCHEME**

The Bank had an equity-settled share-based incentive scheme for its employees (the "Scheme") whereby eligible employees were granted the Bank's shares as a compensation on achievement of certain non-market performance conditions.

The Group had incorporated a special purpose vehicle, Hawafiz Khaleeji Management Company BSC (c) ('Hawafiz'), to hold the shares for the beneficial interest of the Scheme until they vest and forfeited shares. The shares granted were vested to eligible employees in a staggered manner over a 5 year vesting period ('service condition'). These shares granted were eligible to receive dividends. The vested shares were settled by physical delivery on completion of vesting conditions.

In case the employee leaves before satisfying the vesting conditions, he/ she would be entitled for a cash payment for the unvested shares in accordance with the terms of the Scheme. Such forfeited shares will be retained by Hawafiz and may be offered to other employees as per the terms of the Scheme.

The maximum number of shares to be issued to employees under the scheme were 30.4 million ordinary shares at an exercise price of BD 0.120 per share, to be issued over the vesting period in accordance with the terms of the Scheme. The vesting period of the scheme was completed on 31 December 2012. As at 31 December 2012, on a cumulative basis, 30.4 million share grants were awarded of which 27.97 million shares were vested up to 31 December 2012 and 2.43 million shares were forfeited due to failure to satisfy the service condition. No new grants have been made since 2009. The vesting expense for the 2012, net of reversals due to forfeitures, amounted to a reversal of BD 70 thousand.

**21. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES**

The Bank makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectation of future events that are believed to be reasonable under the circumstances.

**Judgements***Classification of investments*

In the process of applying the Group's accounting policies, management decides on acquisition of an investment whether it should be classified as debt type instruments carried at fair value through equity or amortised cost, or equity-type instruments carried at fair value through equity or fair value through income statement. The classification of each investment reflects the management's intention in relation to each investment and is subject to different accounting treatments based on such classification [refer note 2 (e)].

*Special purpose entities*

The Bank sponsors the formation of special purpose entities (SPE's) primarily for the purpose of allowing clients to hold investments. The Bank provides corporate administration, investment management and advisory services to these SPE's, which involve the Group making decisions on behalf of such entities. The Bank administers and manages these entities on behalf of its clients, who are by and large third parties and are the economic beneficiaries of the underlying investments.

The Bank does not consolidate SPE's that it does not have the power to control. In determining whether the Bank has the power to control an SPE, judgements are made about the objectives of the SPE's activities, its exposure to the risks and rewards, as well as about the Group's intention and ability to make operational decisions for the SPE and whether the Group derives benefits from such decisions.

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**for the year ended 31 December 2013**

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21 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES  
(continued)**Estimations***Impairment of equity investments*

The Group determines that equity securities carried at fair value are impaired when there is an objective evidence of impairment and there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgment.

In case of quoted equity securities, the Group considers a decline of more than 30% in the fair value below cost to be significant and considers a decline below cost which persists for more than 6 months as prolonged. Where fair values are not readily available and the investments are carried at cost, the recoverable amount of such investment is estimated to test for impairment.

For unquoted investments carried at cost, the Group makes an assessment of whether there is an objective evidence of impairment for each investment by assessment of financial and other operating and economic indicators. Impairment is recognised if the estimated recoverable amount is assessed to be below the cost of the investment.

In making this judgment, the Bank evaluates among other factors, evidence of a deterioration in the financial health of the investee, industry and sector performance, changes in technology, and operational and financing cash flows. It is reasonably possible, based on existing knowledge, that the current assessment of impairment could require a material adjustment to the carrying amount of the investments within the next financial year due to significant changes in the assumptions underlying such assessments.

*Fair value of unquoted equity securities*

The Group determines the fair value of unquoted investments by using valuation techniques. This includes using recent arm's length transactions between knowledgeable, willing parties (if available), discounted cash flow analysis or market multiples for similar instruments. Fair value estimates are made at a specific point in time, based on market conditions and information about the investee companies/funds. These estimates involve uncertainties and matters of significant judgement and therefore, cannot be determined with precision. There is no certainty about future events (such as continued operating profits and financial strengths). It is reasonably possible, based on existing knowledge, that outcomes within the next financial year that are different from assumptions could require a material adjustment to the carrying amount of the investments.

Significant judgment is required to be made by the Group and the Board of Directors in the selection of an approach that would reflect the best measure of fair value of the investments. The choice of the models used for valuation on each reporting period may have a significant impact on the fair value of investments and the amounts reported in the consolidated financial statements. The Bank has adopted the market approach for valuation of its unquoted equity security.

The potential effect of using reasonable possible alternative assumptions for valuing the investments resulting in 5% decrease / increase in the market multiple would increase / decrease the reported fair value by BD 744 thousands (31 December 2012: BD 835 thousands). The corresponding impact would be on the profit or loss reported by the Group.

*Impairment of financing assets*

Financing assets are evaluated for impairment on a basis described in accounting policy, refer to note 2 (l). Each counterparty exposure is evaluated individually for impairment and is based upon management's best estimate of the present value of the cash flows that are expected to be received. In estimating these cash flows, management makes judgements about a counterparty's financial situation and the net realisable value of any underlying assets/ collaterals. Each impaired asset is assessed on its merits, and the workout strategy and estimate of cash flows considered recoverable are independently evaluated by the Risk Management Department.

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21 *CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES*  
*(continued)*

For evaluation of the portfolio for impairment on a collective basis, management, where available, uses estimates based on historical loss experience for assets and loss experience in the industry for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio. For the purposes of a collective evaluation of impairment, financing assets are grouped on the basis of similar credit risk characteristics (that is, on the basis of the Group's grading process that considers asset type, industry, geographical location, collateral type, past-due status and other relevant factors). The methodology and assumptions used for the grading process and estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience. In view of the management, the current level of provisioning is adequate and no additional impairment allowances are required on a collective basis.

**22. ASSETS UNDER MANAGEMENT**

The Bank provides corporate administration, investment management and advisory services to its investment entities, which involve the Group making decisions on behalf of such entities. Assets that are held in such capacity are not included in these consolidated financial statements. At the reporting date, the Group had assets under management of BD 336.52 million (2012: BD 384.42 million). During the year, the Bank has charged management fees amounting to BD 1,088 thousands (31 December 2012: BD 111 thousands) for the management of these assets.

**23. RELATED PARTY TRANSACTIONS**

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions. Related parties include the significant shareholders and entities over which the Bank and the shareholders exercises significant influence, directors and executive management of the Bank.

A significant portion of the Bank's income from management fees arises from entities (assets under management) over which the Bank or its significant shareholders exercises influence. Although these entities are considered related parties, the Bank administers and manages these entities on behalf of its clients, who are by and large third parties and are the economic beneficiaries of the underlying investments.

Details of Directors' interests in the Bank's ordinary shares as at the end of the year were:

Categories*	Number of Shares	Number of Directors
Less than 1%	8,358,250	4
1% up to 10%	-	-

\* Expressed as a percentage of total outstanding shares of the Bank.

*Compensation of key management personnel*

Key management personnel of the Bank comprise of the Board of Directors and key members of management having authority and responsibility for planning, directing and controlling the activities of the Bank.

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23 *RELATED PARTY TRANSACTIONS (continued)*

The key management personnel compensation during the year is as follows:

	2013	2012
Board member fees	101	93
Board member allowances	108	120
Salaries and other short-term benefits	667	570

*Transactions with restricted investment accounts*

Transactions involving transfer/sale of assets to restricted investment accounts are generally executed based on the pre-agreed values as per the terms of the contracts for each restricted investment product. During 2013, in its normal course of business, the Bank has bought certain investments at agreed contractual values amounting to BD 181 thousands.

The related party balances and transactions (except for compensation of key managerial personnel) included in these consolidated financial statements are as follows:

**31 December 2013**

	Associates	Key management personnel	Significant shareholders / entities in which directors are interested	Assets under management (including special purpose entities)	Total
<b>Assets</b>					
Financing assets	744	-	-	9,308	10,052
Investment securities	-	-	-	24,922	24,922
Investment in associates	2,681	-	-	-	2,681
Other assets	178	-	-	15,753	15,931
<b>Liabilities</b>					
Customers' current accounts	357	3	13	636	1,009
Equity of investment account holders	387	513	8,009	13,884	22,793

**31 December 2012**

	Associates	Key management personnel	Significant shareholders / entities in which directors are interested	Assets under management (including special purpose entities)	Total
<b>Assets</b>					
Financing assets	1,041	-	-	9,754	10,795
Investment securities	-	-	-	45,606	45,606
Investment in associates	2,887	-	-	-	2,887
Other assets	298	-	-	1,198	1,496
<b>Liabilities</b>					
Customers' current accounts	424	6	18	733	1,181
Equity of investment account holders	37	6	5,681	11,734	17,458
<b>Transactions</b>					
Purchase of property	-	-	-	280	280

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## 23 RELATED PARTY TRANSACTIONS (continued)

2013	Associates	Key management personnel	Significant shareholders / entities in which directors are interested	Assets under management (including special purpose entities)	Total
<b>Income</b>					
Management and other fees	-	-	-	1,054	1,054
Income from financing assets and assets acquired for leasing	102	-	-	396	498
Income from investment securities	-	-	-	1,110	1,110
Share of losses from associates	(115)	-	-	-	(115)
<b>Expenses</b>					
Return to investment account holders	17	14	196	337	564
Other expenses	-	-	-	56	56
Impairment allowances	-	-	-	5,639	5,639

2012	Associates	Key management personnel	Significant shareholders / entities in which directors are interested	Assets under management (including special purpose entities)	Total
<b>Income</b>					
Management and other fees	-	-	-	83	83
Income from financing assets and assets acquired for leasing	83	-	-	652	735
Income from investment securities	-	-	-	225	225
Share of losses from associates	(113)	-	-	-	(113)
<b>Expenses</b>					
Return to investment account holders	1	5	92	280	378
Other expenses	-	-	-	43	43
Impairment allowances	-	-	-	859	859

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**24. EARNINGS PER SHARE**

Basic earnings per share is calculated by dividing the profit/ (loss) for the year by the weighted average number of equity shares outstanding during the year. The Bank does not have any dilutive equity instruments.

<b>Basic EPS</b>	<b>2013</b>	2012
(Loss)/ profit for the year (BD 000's)	(19,209)	751
Weighted average number of equity shares (Nos. in 000's)	1,122,668	1,122,963
Basic earnings per share (in fils)	(17.11)	0.67

**25. SHARI'A SUPERVISORY BOARD**

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

**26. ZAKAH**

Zakah is directly borne by the shareholders on distributed profits and investment account holders. The Bank currently does not collect or pay Zakah on behalf of its shareholders and investors in restricted investment accounts. Zakah payable by the shareholders is computed by the Bank on the basis of the method prescribed by the Bank's Shari'a Supervisory Board and notified to shareholders annually. During the year, the Shari'a Supervisory Board has computed Zakah payable of BD 905 thousand (2012: BD 1,903 thousand) of which Nil (2012: BD 228 thousand) represents the Zakah computed on the cumulative statutory reserve and retained earnings as at 31 December 2013, payable by the Bank (refer note 32). The remaining Zakah balance amounting to BD 905 thousand or 0.784 fils per share (2012: BD 1,675 thousand or 2.485 fils per share) is due and payable by the shareholders.

**27. SEGMENT REPORTING**

An operating segment is a component of the Group that engages in business activities from which it may earn revenues and incur expenses, whose operating results are regularly reviewed by the Group's chief operating decision maker (Board of Directors) to make decisions about resource allocation to each segment and assess its performance and for which discrete financial information is available. An operating segment is divided into business segment and geographic segments. For management purposes, the Group is organised into two major business segments:

*Commercial banking*

Providing customer services such as accepting Mudaraba deposits, savings account and current account facilities, fund transfer facilities, bill payment facilities. It also provides financing facilities (in the form of Commodity Murabaha, Musharaka, Istisna'a and Ijarah facilities) to corporate clients and High-Networth-Individuals and consumer finance products. Provides money market and treasury services in the form of short term Commodity Murabaha to banks, financial institutions and corporate, investments in sukuk and also used to manage funding of the Group.

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27 *SEGMENT REPORTING (continued)**Investment banking*

Primarily relates to conceptualising of investment deals and performing roles of an arranger, lead manager, and administrator of the funds (involves structuring of deals, raising of funds through private placement and fund administration). Also offers products like Restricted Investment Accounts (RIA) and management of funds raised through the RIA structures. Also involves carrying out strategic investments in the form of equity contribution (either in the funds created and managed by the Bank or other institutions).

Segment performance is measured based on results for each department as mentioned in the internal management reports that are reviewed by the Board of directors on a quarterly basis. Segment results is used to measure performance as management believes that such information is the most relevant in evaluating the results of certain segments relative to other entities that operate in these industries.

The Bank reports directly attributable revenue and cost relating to transactions originating from respective segments as segment revenue and segment cost respectively. Indirect costs and corporate overheads are treated as unallocated. The internal management reports are designed to reflect revenue and cost for respective segments which are measured against the budgeted figures.

The Group primarily operates from Bahrain and does not have any overseas branches/divisions. The geographic concentration of assets and liabilities is disclosed in note 29 (b) to the consolidated financial statements.

These segments are the basis on which the Group reports its primary segment information. Transactions between segments (if any) are conducted on an arm's length basis.

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## 27 SEGMENT REPORTING (continued)

31 December 2013	Investment Banking	Commercial Banking	Unallocated	Total
Cash and bank balances	-	38,848	-	<b>38,848</b>
Placements with financial institutions	545	82,200	-	<b>82,745</b>
Financing assets	-	253,635	-	<b>253,635</b>
Investment securities	61,265	29,132	-	<b>90,397</b>
Assets acquired for leasing (including lease rentals receivable)	-	35,630	-	<b>35,630</b>
Investment in associates	2,681	-	-	<b>2,681</b>
Investment property	6,583	-	-	<b>6,583</b>
Other assets	15,931	1,544	5,867	<b>23,342</b>
Property and equipment	-	-	8,381	<b>8,381</b>
<b>Total segment assets</b>	<b>87,005</b>	<b>440,989</b>	<b>14,248</b>	<b>542,242</b>
Placements from financial institutions	-	42,940	-	<b>42,940</b>
Placements from non- financial institutions and individuals	-	80,912	-	<b>80,912</b>
Customers' current accounts	545	18,378	-	<b>18,923</b>
Other liabilities	101	5,166	2,140	<b>7,407</b>
<b>Total segment liabilities</b>	<b>646</b>	<b>147,396</b>	<b>2,140</b>	<b>150,182</b>
<b>Equity of investment account holders</b>	<b>13,917</b>	<b>278,132</b>	-	<b>292,049</b>
<b>Restricted investment accounts</b>	<b>31,556</b>	-	-	<b>31,556</b>

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## 27 SEGMENT REPORTING (continued)

2013	Investment Banking	Commercial Banking	Unallocated	Total
Management and other fees	1,088	-	-	1,088
Income from placements with financial institutions	3	427	-	430
Income from financing assets and assets acquired for leasing	-	18,318	-	18,318
Income from investment securities	(1,165)	541	-	(624)
Share of loss from associate companies	(115)	-	-	(115)
Other income	293	306	-	599
<b>Total income before return to investment account holders</b>	<b>104</b>	<b>19,592</b>	<b>-</b>	<b>19,696</b>
Less: Return to investment account holders before Bank's share as Mudarib	(634)	(12,681)	-	(13,315)
Bank's share as a Mudarib	219	4,377	-	4,596
<b>Return to investment account holders</b>	<b>(415)</b>	<b>(8,304)</b>	<b>-</b>	<b>(8,719)</b>
Less: Expense on placements from financial institutions, non- financial institutions and individuals	-	(3,968)	-	(3,968)
<b>Total segment revenue</b>	<b>(311)</b>	<b>7,320</b>	<b>-</b>	<b>7,009</b>
Staff cost	569	2,277	2,846	5,692
Depreciation	-	-	1,169	1,169
Other expenses	56	401	3,655	4,112
<b>Total segment cost</b>	<b>625</b>	<b>2,678</b>	<b>7,670</b>	<b>10,973</b>
Segment results before impairment allowances	(936)	4,642	(7,670)	(3,964)
Charge of impairment allowances	(7,660)	(7,585)	-	(15,245)
<b>Segment results</b>	<b>(8,596)</b>	<b>(2,943)</b>	<b>(7,670)</b>	<b>(19,209)</b>

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27 *SEGMENT REPORTING (continued)*

31 December 2012	Investment Banking	Commercial Banking	Unallocated	Total
Cash and bank balances	-	23,856	-	23,856
Placements with financial institutions	189	57,336	-	57,525
Financing assets	-	245,745	-	245,745
Investment securities	88,493	12,367	-	100,860
Assets acquired for leasing (including lease rentals receivable)	-	23,973	-	23,973
Investment in associates	2,887	-	-	2,887
Investment property	6,583	-	-	6,583
Other assets	1,376	174	1,256	2,806
Property and equipment	-	-	8,924	8,924
<b>Total segment assets</b>	<b>99,528</b>	<b>363,451</b>	<b>10,180</b>	<b>473,159</b>
Placements from financial institutions	-	67,732	-	67,732
Placements from non- financial institutions and individuals	-	53,416	-	53,416
Customers' current accounts	189	11,206	-	11,395
Other liabilities	37	3,309	1,393	4,739
<b>Total segment liabilities</b>	<b>226</b>	<b>135,663</b>	<b>1,393</b>	<b>137,282</b>
Equity of investment account holders	11,734	204,695	-	216,429
Restricted investment accounts	31,734	-	-	31,734

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27 *SEGMENT REPORTING (continued)*

2012	Investment Banking	Commercial Banking	Unallocated	Total
Management and other fees	111	-	-	111
Income from placements with financial institutions	1	243	-	244
Income from financing assets and assets acquired for leasing	-	18,168	-	18,168
Income from investment securities	302	684	-	986
Share of losses from associate companies	(113)	-	-	(113)
Other income	192	229	-	421
Total income before return to investment account holders	493	19,324	-	19,817
Less: Return to investment account holders before Bank's share as Mudarib	(441)	(9,482)	-	(9,923)
Bank's share as a Mudarib	161	3,465	-	3,626
Return to investment account holders	(280)	(6,017)	-	(6,297)
Less: Expense on placements from financial institutions, non-financial institutions and individuals	-	(2,823)	-	(2,823)
Total segment revenue	213	10,484	-	10,697
Staff cost	458	1,832	2,290	4,580
Depreciation	-	-	1,153	1,153
Other expenses	43	387	2,880	3,310
Total segment cost	501	2,219	6,323	9,043
Segment results before impairment allowances	(288)	8,265	(6,323)	1,654
(charge) / Write-back of impairment allowances	(975)	72	-	(903)
Segment results	(1,263)	8,337	(6,323)	751

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**28. MATURITY PROFILE**

The maturity profile of placements with and from financial institutions, financing assets, assets acquired for leasing, (including lease rental receivable), investment in sukuk (non-trading), and equity of investment account holders has been presented using their contractual maturity period. For other balances, maturity profile is based on expected cash flows/ settlement profile of the respective assets and liabilities.

<b>31 December 2013</b>	<b>Up to 3 months</b>	<b>3 to 6 months</b>	<b>6 months-1 year</b>	<b>1 to 3 years</b>	<b>Over 3 years</b>	<b>Total</b>
<b>Assets</b>						
Cash and bank balances	38,848	-	-	-	-	<b>38,848</b>
Placements with financial institutions	82,745	-	-	-	-	<b>82,745</b>
Financing assets	41,884	15,450	17,934	77,891	100,476	<b>253,635</b>
Investment securities	8,335	5,825	5,786	35,696	34,755	<b>90,397</b>
Assets acquired for leasing (including lease rental receivable)	6	-	1,884	1,170	32,570	<b>35,630</b>
Investment in associates	-	-	-	2,681	-	<b>2,681</b>
Investment property	-	-	-	-	6,583	<b>6,583</b>
Other assets	1,514	13,536	-	3,206	5,086	<b>23,342</b>
Property and equipment	-	-	-	-	8,381	<b>8,381</b>
<b>Total assets</b>	<b>173,332</b>	<b>34,811</b>	<b>25,604</b>	<b>120,644</b>	<b>187,851</b>	<b>542,242</b>
<b>Liabilities</b>						
Placements from financial institutions	25,492	-	-	17,448	-	<b>42,940</b>
Placements from non-financial institutions and individuals	24,230	20,047	31,181	4,258	1,196	<b>80,912</b>
Customers' current account	18,705	218	-	-	-	<b>18,923</b>
Other liabilities	2,015	1,397	1,575	2,420	-	<b>7,407</b>
<b>Total liabilities</b>	<b>70,442</b>	<b>21,662</b>	<b>32,756</b>	<b>24,126</b>	<b>1,196</b>	<b>150,182</b>
<b>Equity of investment account holders</b>	<b>156,922</b>	<b>52,336</b>	<b>80,078</b>	<b>2,713</b>	<b>-</b>	<b>292,049</b>
<b>Restricted Investment accounts</b>	<b>5,264</b>	<b>-</b>	<b>1,001</b>	<b>25,291</b>	<b>-</b>	<b>31,556</b>
<b>Commitments</b>	<b>8,884</b>	<b>21,431</b>	<b>12,082</b>	<b>1,772</b>	<b>-</b>	<b>44,169</b>

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## 28 MATURITY PROFILE (continued)

31 December 2012	Up to 3 months	3 to 6 months	6 months-1 year	1 to 3 years	Over 3 years	Total
<b>Assets</b>						
Cash and bank balances	23,856	-	-	-	-	23,856
Placements with financial institutions	57,525	-	-	-	-	57,525
Financing assets	46,415	13,528	6,437	90,192	89,173	245,745
Investment securities	7,654	1,885	15,567	71,739	4,015	100,860
Assets acquired for leasing (including lease rental receivable)	-	-	22	3,571	20,380	23,973
Investment in associates	-	-	-	-	2,887	2,887
Investment property	-	-	-	-	6,583	6,583
Other assets	685	-	-	2,121	-	2,806
Property and equipment	-	-	-	-	8,924	8,924
<b>Total assets</b>	<b>136,135</b>	<b>15,413</b>	<b>22,026</b>	<b>167,623</b>	<b>131,962</b>	<b>473,159</b>
<b>Liabilities</b>						
Placements from financial institutions	50,216	-	-	17,516	-	67,732
Placements from non-financial institutions and individuals	12,319	7,594	27,072	5,129	1,302	53,416
Customers' current account	11,319	76	-	-	-	11,395
Other liabilities	1,347	440	579	2,373	-	4,739
<b>Total liabilities</b>	<b>75,201</b>	<b>8,110</b>	<b>27,651</b>	<b>25,018</b>	<b>1,302</b>	<b>137,282</b>
Equity of investment account holders	119,794	37,572	54,097	4,966	-	216,429
Restricted Investment accounts	5,531	-	1,292	24,911	-	31,734
Commitments	9,394	4,497	12,402	1,563	286	28,142

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29. CONCENTRATION OF ASSETS, LIABILITIES, EQUITY OF INVESTMENT ACCOUNT HOLDERS AND RESTRICTED INVESTMENT ACCOUNTS

(a) Industry sector

31 December 2013

	<b>Banks and financial institutions</b>	<b>Real estate</b>	<b>Others</b>	<b>Total</b>
<b>Assets</b>				
Cash and bank balances	38,848	-	-	<b>38,848</b>
Placements with financial institutions	82,745	-	-	<b>82,745</b>
Financing assets	38,680	59,551	155,404	<b>253,635</b>
Investments securities	26,601	35,954	27,842	<b>90,397</b>
Assets acquired for leasing (including lease rentals receivable)	1,060	33,549	1,021	<b>35,630</b>
Investment in associates	-	2,681	-	<b>2,681</b>
Investment property	-	6,583	-	<b>6,583</b>
Other assets	434	20,973	1,935	<b>23,342</b>
Property and equipment	-	7,179	1,202	<b>8,381</b>
<b>Total assets</b>	<b>188,368</b>	<b>166,470</b>	<b>187,404</b>	<b>542,242</b>
<b>Liabilities</b>				
Placements from financial institutions	42,940	-	-	<b>42,940</b>
Placements from non-financial institutions and individuals	-	-	80,912	<b>80,912</b>
Customers' current accounts	617	2,399	15,907	<b>18,923</b>
Other liabilities	-	-	7,407	<b>7,407</b>
<b>Total liabilities</b>	<b>43,557</b>	<b>2,399</b>	<b>104,226</b>	<b>150,182</b>
<b>Equity of investment account holders</b>				
Restricted investment accounts	-	30,555	1,001	<b>31,556</b>
Commitments	-	2,020	42,149	<b>44,169</b>

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29 *CONCENTRATION OF ASSETS, LIABILITIES, EQUITY OF INVESTMENT ACCOUNT HOLDERS AND RESTRICTED INVESTMENT ACCOUNTS (continued)*

(a) *Industry sector (continued)*

31 December 2012

	Banks and financial institutions	Real estate	Others	Total
<b>Assets</b>				
Cash and bank balances	23,856	-	-	23,856
Placements with financial institutions	57,525	-	-	57,525
Financing assets	47,098	81,339	117,308	245,745
Investments securities	26,026	60,622	14,212	100,860
Assets acquired for leasing (including lease rentals receivable)	1,545	21,175	1,253	23,973
Investment in associates	-	2,887	-	2,887
Investment property	-	6,583	-	6,583
Other assets	259	1,473	1,074	2,806
Property and equipment	-	6,715	2,209	8,924
<b>Total assets</b>	<b>156,309</b>	<b>180,794</b>	<b>136,056</b>	<b>473,159</b>
<b>Liabilities</b>				
Placements from financial institutions	67,732	-	-	67,732
Placements from non-financial institutions and individuals	-	2,045	51,371	53,416
Customers' current accounts	19	2,542	8,834	11,395
Other liabilities	-	-	4,739	4,739
<b>Total liabilities</b>	<b>67,751</b>	<b>4,587</b>	<b>64,944</b>	<b>137,282</b>
Equity of investment account holders	5,573	3,433	207,423	216,429
Restricted investment accounts	-	30,442	1,292	31,734
Commitments	-	8,389	19,753	28,142

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29 *CONCENTRATION OF ASSETS, LIABILITIES, EQUITY OF INVESTMENT ACCOUNT HOLDERS AND RESTRICTED INVESTMENT ACCOUNTS (continued)*

**(b) Geographic sector**

<b>31 December 2013</b>	<b>GCC countries</b>	<b>Europe</b>	<b>USA</b>	<b>Asia</b>	<b>Australia</b>	<b>Africa</b>	<b>Total</b>
<b>Assets</b>							
Cash and bank balances	32,532	485	5,796	35	-	-	<b>38,848</b>
Placements with financial institutions	78,974	3,771	-	-	-	-	<b>82,745</b>
Financing assets	242,145	11,490	-	-	-	-	<b>253,635</b>
Investment securities	64,030	-	-	22,226	4,141	-	<b>90,397</b>
Assets acquired for leasing (including lease rentals receivable)	35,630	-	-	-	-	-	<b>35,630</b>
Investment in associates	2,681	-	-	-	-	-	<b>2,681</b>
Investment property	6,583	-	-	-	-	-	<b>6,583</b>
Other assets	21,937	908	-	454	43	-	<b>23,342</b>
Property and equipment	8,381	-	-	-	-	-	<b>8,381</b>
<b>Total assets</b>	<b>492,893</b>	<b>16,654</b>	<b>5,796</b>	<b>22,715</b>	<b>4,184</b>	<b>-</b>	<b>542,242</b>
<b>Liabilities</b>							
Placements from financial institutions	42,940	-	-	-	-	-	<b>42,940</b>
Placements from non-financial institutions and individuals	80,912	-	-	-	-	-	<b>80,912</b>
Customers' current accounts	18,073	768	-	82	-	-	<b>18,923</b>
Other liabilities	7,407	-	-	-	-	-	<b>7,407</b>
<b>Total liabilities</b>	<b>149,332</b>	<b>768</b>	<b>-</b>	<b>82</b>	<b>-</b>	<b>-</b>	<b>150,182</b>
<b>Equity of investment account holders</b>	<b>280,560</b>	<b>420</b>	<b>-</b>	<b>11,069</b>	<b>-</b>	<b>-</b>	<b>292,049</b>
<b>Restricted investment accounts</b>	<b>21,687</b>	<b>8,868</b>	<b>-</b>	<b>-</b>	<b>1,001</b>	<b>-</b>	<b>31,556</b>
<b>Commitments</b>	<b>43,717</b>	<b>452</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>44,169</b>

Concentration by location for financing assets is measured based on the location of the counterparty, which has a high correlation with the location of the collateral for the exposure.

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29 *CONCENTRATION OF ASSETS, LIABILITIES, EQUITY OF INVESTMENT ACCOUNT HOLDERS AND RESTRICTED INVESTMENT ACCOUNTS (continued)*

(b) *Geographic sector (continued)*

31 December 2012	GCC countries	Europe	USA	Asia	Australia	Africa	Total
<b>Assets</b>							
Cash and bank balances	21,304	267	2,228	5	52	-	23,856
Placements with financial institutions	55,525	-	-	2,000	-	-	57,525
Financing assets	235,384	10,361	-	-	-	-	245,745
Investment securities	71,043	1,376	-	24,008	4,433	-	100,860
Assets acquired for leasing (including lease rentals receivable)	23,973	-	-	-	-	-	23,973
Investment in associates	2,887	-	-	-	-	-	2,887
Investment property	6,583	-	-	-	-	-	6,583
Other assets	2,450	-	-	313	43	-	2,806
Property and equipment	8,924	-	-	-	-	-	8,924
<b>Total assets</b>	<b>428,073</b>	<b>12,004</b>	<b>2,228</b>	<b>26,326</b>	<b>4,528</b>	<b>-</b>	<b>473,159</b>
<b>Liabilities</b>							
Placements from financial institutions	67,732	-	-	-	-	-	67,732
Placements from non-financial institutions and individuals	53,416	-	-	-	-	-	53,416
Customers' current accounts	11,027	305	-	63	-	-	11,395
Other liabilities	4,739	-	-	-	-	-	4,739
<b>Total liabilities</b>	<b>136,914</b>	<b>305</b>	<b>-</b>	<b>63</b>	<b>-</b>	<b>-</b>	<b>137,282</b>
Equity of investment account holders	207,610	361	-	8,458	-	-	216,429
Restricted investment accounts	21,954	8,488	-	-	1,292	-	31,734
Commitments	25,453	2,689	-	-	-	-	28,142

**30. FAIR VALUE**

a) *Fair value of financial instruments*

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

The fair values of quoted Sukuk carried at amortised cost of BD 7,352 thousand (31 December 2012: BD 636 thousand) amounts to BD 7,081 thousand as at 31 December 2013 (31 December 2012: BD 633 thousand).

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## 30 FAIR VALUE (continued)

## a) Fair value of financial instruments (continued)

In case of financing assets and lease receivables, the average profit rate of the portfolio is in line with current market rates for similar facilities and hence after consideration of adjustment for prepayment risk and impairment charges it is expected that the current value would not be materially different to fair value of these assets. Other than equity investments carried at cost of BD 46,306 thousand (2012: BD 71,041 thousand), the estimated fair values of the Bank's other financial instruments are not significantly different from their carrying values due to their short-term nature.

## b) Fair value hierarchy

The table below analyses the financial instruments carried at fair value, by valuation method. The different levels have been defined as follows:

- Level 1: quoted prices (unadjusted) in active markets for identical assets and liabilities.
- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).
- Level 3 : inputs for the asset or liability that are not based on observable market data (unobservable inputs).

**31 December 2013**

	Level 1	Level 2	Level 3	Total
Investment securities				
Equity type instruments carried at fair value through income statement	4,765	-	14,959	19,724
Debt type instruments carried at fair value through income statement	1,016	-	-	1,016
	<b>5,781</b>	<b>-</b>	<b>14,959</b>	<b>20,740</b>

## 31 December 2012

	Level 1	Level 2	Level 3	Total
Investment securities				
Equity type instruments carried at fair value through income statement	3,858	-	17,452	21,310
Debt type instruments carried at fair value through income statement	1,016	-	-	1,016
	<b>4,874</b>	<b>-</b>	<b>17,452</b>	<b>22,326</b>

The table below shows the reconciliation of movements in value of investments measured using Level 3 inputs:

	2013	2012
At 1 January	17,452	17,452
Total gains or losses		
- In profit or loss	(2,493)	-
Purchases	-	-
<b>At 31 December</b>	<b>14,959</b>	<b>17,452</b>

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**31. RISK MANAGEMENT****Introduction and overview**

The Group has exposure to the following risks from its use of financial instruments:

- credit risk
- liquidity risk
- market risks
- operational risks

This note presents information about the Group's exposure to each of the above risks, its objectives, policies and processes for measuring and managing risk, and the Bank's management of capital.

**Risk management framework**

The Board of Directors has overall responsibility for the establishment and oversight of the Bank's risk management framework. The Board has established an Executive Risk Management Committee, which is responsible for developing and monitoring the Bank's risk management policies in the specified areas. The committee also continuously monitors consistent implementation of the Board approved policies in the Bank and reports deviations, if any, to the Board. The committee consists of heads of business and other functional units in the Bank and reports regularly to the Risk Management Committee of the Board.

The Bank's risk management policies are established to identify and analyse the risks faced by the Bank, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered. The Bank, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment, in which all employees understand their roles and obligations.

The Bank's Audit Committee is responsible for monitoring compliance with the risk management policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Bank. The Audit Committee is assisted in these functions by Internal Audit. Internal Audit undertakes both regular and ad-hoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee.

**CREDIT RISK**

Credit risk is the risk of financial loss to the Bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Bank's exposures to placements with financial institutions, financing assets, outstanding assets acquired for leasing, investment in sukuk and receivables classified under other assets. For risk management reporting purposes, the Bank considers and consolidates all elements of credit risk exposure (such as individual and group exposure risk, country and sector concentration risk, related party exposure, etc.). The Bank monitors the total exposure to assets acquired for leasing (including lease rentals receivable) on a cumulative basis for monitoring of market risk and credit risk.

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31 *RISK MANAGEMENT (continued)**CREDIT RISK (continued)*

The Board of Directors has delegated responsibility for the management of credit risk to its Executive Risk Management Committee (ERMC). A separate Risk and Credit Management Department (RMD), reporting to the ERMC is responsible for oversight of the Bank's credit risk, including:

- Formulating credit policies in consultation with business units, covering collateral requirements, credit assessment, risk grading and reporting, documentary and legal procedures, and compliance with regulatory and statutory requirements and submitting the same for approval to the Board of Directors.
- Establishing the authorisation structure for the approval and renewal of credit facilities. Authorisation limits are not at present allocated to business units. Smaller exposures are approved by the Executive Credit & Investment Committee consisting of heads of business units and the Chief Operating Officer. Larger facilities require approval by the Chief Executive Officer, Chairman, Board Investment and Credit Committee or the full Board, as the case may be.
- Reviewing and assessing credit risk. RMD assesses all credit exposures and signs off on the relevant proposals prior to approval of the facilities by the appropriate authorities. Renewal and review of facilities are subject to the same process.
- Limiting concentrations of exposure to counterparties, countries and industries in respect of financing assets, assets acquired for leasing as well as investments.
- Developing and maintaining the Bank's risk grading's in order to categorise exposures according to the degree of probable risk of financial loss to focus management on the attendant risks. The risk grading system is also used to identify specific exposures for which impairment provisions may be required. The risk grading framework for the Bank's financing portfolio consists of ten grades reflecting varying degrees of risk of default and the availability of collateral or other credit risk mitigation. Investments in equity securities are not currently being graded and are evaluated individually on a case-by-case basis. The responsibility for setting risk grades lies with the final approving executive / committee as appropriate on the recommendations of the RMD. Risk grades are subject to regular reviews by RMD.
- Reviewing compliance of business units with agreed exposure limits, including those for selected industries, country risk and product types. Regular reports are submitted to the Board on the compliance levels. RMD also provides advice, guidance and specialist skills to business units to promote best practice throughout the Bank in the management of credit risk.
- Each business unit is required to implement the Bank credit policies and procedures in respect of exposures assumed by them and are responsible for the quality and performance of its credit portfolio and for monitoring and controlling all credit risks in its portfolios, irrespective of the approving authority for the exposure. Regular audits of business units and Bank credit processes are undertaken by Internal Audit.

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## 31 RISK MANAGEMENT (continued)

## CREDIT RISK (continued)

## Exposure to credit risk

31 December 2013	Placements with financial institutions	Financing assets	Assets acquired for leasing (including lease rental receivable)	Investment securities-Sukuk	Other financial assets	Total
<b>Impaired</b>						
Grade 9:						
Impaired	-	25,827	1,884	2,001	-	29,712
Unrated	-	-	-	-	7,614	7,614
Allowance for impairment	-	(12,529)	-	(200)	(1,620)	(14,349)
<b>Carrying amount</b>	-	<b>13,298</b>	<b>1,884</b>	<b>1,801</b>	<b>5,994</b>	<b>22,977</b>
<b>Past due but not impaired</b>						
Grade 1-6						
Low-Fair Risk	-	25,671	3,622	-	-	29,293
Grade 7-8						
Watch list	-	8,372	1,339	-	-	9,711
Past due comprises:						
Up to 30 days	-	16,544	2,260	-	-	18,804
30-60 days	-	9,579	1,222	-	-	10,801
60-90 days	-	5,741	313	-	-	6,054
90-180days	-	792	784	-	-	1,576
180 days +	-	1,387	382	-	-	1,769
<b>Carrying amount</b>	-	<b>34,043</b>	<b>4,961</b>	-	-	<b>39,004</b>
<b>Neither past due nor impaired</b>						
Grade 1-6						
Low-Fair Risk	82,745	196,417	29,145	27,331	-	335,638
Grade 7,8:						
Watch list	-	13,673	-	-	-	13,673
Unrated	-	-	-	-	16,710	16,710
<b>Carrying amount</b>	<b>82,745</b>	<b>210,090</b>	<b>29,145</b>	<b>27,331</b>	<b>16,710</b>	<b>366,021</b>
Less:						
Collective impairment provisions	-	(3,796)	(360)	-	-	(4,156)
<b>Total</b>	<b>82,745</b>	<b>253,635</b>	<b>35,630</b>	<b>29,132</b>	<b>22,704</b>	<b>423,846</b>

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
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## 31 RISK MANAGEMENT (continued)

## CREDIT RISK (continued)

## Exposure to credit risk (continued)

31 December 2012	Placements with financial institutions	Financing assets	Assets acquired for leasing (including lease rental receivable)	Investment securities-Sukuk	Other financial assets	Total
<u>Impaired</u>						
Grade 9:						
Impaired	-	26,389	2,194	687	-	29,270
Unrated	-	-	-	-	773	773
Allowance for impairment	-	(13,645)	-	(34)	(773)	(14,452)
Carrying amount	-	12,744	2,194	653	-	15,591
<u>Past due but not impaired</u>						
Grade 1-6						
Low-Fair Risk	-	27,032	1,875	-	-	28,907
Grade 7-8						
Watch list	-	19,867	175	1,314	-	21,356
<u>Past due comprises:</u>						
Up to 30 days	-	13,358	1,875	-	-	15,233
30-60 days	-	6,756	-	-	-	6,756
60-90 days	-	2,547	-	-	-	2,547
90-180days	-	8,032	175	-	-	8,207
180 days +	-	16,206	-	1,314	-	17,520
Carrying amount	-	46,899	2,050	1,314	-	50,263
<u>Neither past due nor impaired</u>						
Grade 1-6						
Low-Fair Risk	57,525	184,930	19,426	10,404	-	272,285
Grade 7,8:						
Watch list	-	3,912	545	-	-	4,457
Unrated	-	-	-	-	2,158	2,158
Carrying amount	57,525	188,842	19,971	10,404	2,158	278,900
Less:						
Collective impairment provisions	-	(2,740)	(242)	(4)	-	(2,986)
Total	57,525	245,745	23,973	12,367	2,158	341,768

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
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31 *RISK MANAGEMENT (continued)**CREDIT RISK (continued)***Impaired financial assets**

Impaired financial assets are those for which the Bank determines that it is probable that it will be unable to collect all or part of the principal and profit due according to the contractual terms of the exposure. Generally these assets fall under risk grades 9 or 10, for other financial assets impairment is assessed on an individual basis for each exposure under the Bank's internal credit risk grading system.

**Past due but not impaired exposures**

The exposure pertains to financing assets where contractual profit or principal payments are past due but the Bank believes that impairment is not appropriate on the basis of subsequent collections, the level of security / collateral available and / or the stage of collection of amounts owed to the Bank.

**Renegotiated facilities**

Exposures classified as neither past due nor impaired financing facilities include facilities renegotiated during the year amounting to BD 17,509 thousand (2012: BD 54,412 thousand) that would otherwise be past due as per their original repayment terms. The renegotiated terms usually require settlement of profits accrued till date on the facility and/or part payment of the principal and/or obtaining of additional collateral coverage. The renegotiated facilities are subject to revised credit assessments and independent review by the RMD. Of the total past due facilities of BD 39,004 thousands (2012: BD 50,263 thousand) only instalments of BD 6,370 thousands (2012: BD 11,849 thousand) are past due as at 31 December 2013.

**Allowances for impairment**

The Bank makes provisions for impairment on individual assets classified under grades 9 and 10. This is done on the basis of the present value of projected future cash flows from the assets themselves and consideration of the value of the collateral securities available. On a collective basis, the Bank has provided for impairment losses based on management's judgment of the extent of losses incurred but not identified based on the current economic and credit conditions.

**Write-off policy**

The Bank writes off an asset/security balance (net of any related allowances for impairment losses) when it determines that the asset/security are uncollectible. This determination is reached after considering information such as the occurrence of significant changes in the counterparty's financial position such that he can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure. During the year, the Bank has written off financing facility amounting to BD 6,518 thousands which was fully provided.

**Collaterals**

The Bank holds collateral against financing assets and receivables from assets acquired for leasing in the form of mortgage/ pledge over property, listed/ unlisted securities, other assets and guarantees. Estimates of fair value are based on the value of collateral assessed at the time of borrowing, and updated periodically, generally at annual intervals. Collateral generally is not held against exposure to other banks and financial institutions. An estimate of the fair value of collateral and other security enhancements held against financial assets is shown below. This includes the value of financial guarantees from banks, but not corporate and personal guarantees as the values thereof are not readily quantifiable. The collateral values considered for disclosure are restricted to the extent of the outstanding exposures.

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BD 000's

## 31 RISK MANAGEMENT (continued)

## CREDIT RISK (continued)

## Collaterals (continued)

	As at 31 December 2013			As at 31 December 2012		
	Financing assets	Assets acquired for leasing (including lease rentals receivable)	Total	Financing assets	Assets acquired for leasing (including lease rentals receivable)	Total
<u>Against impaired</u>						
Property	11,729	1,329	<b>13,058</b>	6,475	1,680	8,155
Equities	-	-	-	1,339	-	1,339
Other	993	-	<b>993</b>	1,531	-	1,531
<u>Against past due but not impaired</u>						
Property	24,116	4,961	<b>29,077</b>	34,824	1,424	36,248
Equities	-	-	-	4,051	-	4,051
Other	4,561	-	<b>4,561</b>	269	-	269
<u>Against neither past due nor impaired</u>						
Property	77,501	28,463	<b>105,964</b>	77,863	20,460	98,323
Equities	11,362	-	<b>11,362</b>	277	-	277
Other	56,656	-	<b>56,656</b>	62,207	-	62,207
<b>Total</b>	<b>186,918</b>	<b>34,753</b>	<b>221,671</b>	<b>188,836</b>	<b>23,564</b>	<b>212,400</b>

The average collateral coverage ratio on secured facilities is 163.41% at 31 December 2013 (31 December 2012: 159.48%).

For analysis of concentration of total assets and liabilities refer note 29.

Further, for financing assets and assets acquired for leasing the Bank monitors concentrations of credit risk by sector and by geographic location.

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31 *RISK MANAGEMENT (continued)**CREDIT RISK (continued)*

An analysis of concentrations of credit risk at the reporting date is shown below:

Concentration by Sector	As at 31 December 2013			As at 31 December 2012		
	Financing assets	Assets acquired for leasing (including lease rentals receivable)	Total	Financing assets	Assets acquired for leasing (including lease rentals receivable)	Total
Banking and finance	38,680	1,060	<b>39,740</b>	47,098	1,545	48,643
Real estate:						
- Property	38,261	33,549	<b>71,810</b>	51,625	21,175	72,800
- Infrastructure Development	10,242	-	<b>10,242</b>	17,027	-	17,027
- Land	11,048	-	<b>11,048</b>	12,687	-	12,687
Construction	39,353	-	<b>39,353</b>	18,804	-	18,804
Trading	63,434	-	<b>63,434</b>	55,171	-	55,171
Manufacturing	13,116	-	<b>13,116</b>	4,021	-	4,021
Others	39,501	1,021	<b>40,522</b>	39,312	1,253	40,565
<b>Total carrying amount</b>	<b>253,635</b>	<b>35,630</b>	<b>289,265</b>	245,745	23,973	269,718

**Settlement risk**

The Bank's activities may give rise to risk at the time of settlement of transactions and trades. Settlement risk is the risk of loss due to the failure of a company to honour its obligations to deliver cash, securities or other assets as contractually agreed.

Settlement limits form part of the credit approval / limit monitoring process described earlier. Acceptance of settlement risk on free settlement trades requires transaction specific or counterparty specific approvals from RMD.

**LIQUIDITY RISK**

Liquidity risk is the risk that the Bank will encounter difficulty in meeting obligations associated with its financial liabilities that are settled by delivering cash or another financial assets.

**Management of liquidity risk**

The Bank's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Bank's reputation.

Financial Control Department (FCD) collates data from treasury and other business units regarding the liquidity profile of their financial assets and liabilities and details of other projected cash flows arising from projected future business. FCD communicates the information to the treasury who manages the Bank's portfolio of short-term liquid assets, largely made up of short-term placements with other banks and other inter-bank facilities, to ensure that sufficient liquidity is maintained within the Bank as a whole.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
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31 *RISK MANAGEMENT (continued)*

*LIQUIDITY RISK (continued)*

*Management of liquidity risk (continued)*

The daily liquidity position is monitored by FCD. The Bank has in place a Liquidity Contingency Plan, the elements of which are periodically tested. Tools for implementation of regular stress testing under various scenarios are in place. All liquidity policies and procedures are subject to review by ALCO and approval by appropriate authorities. A summary report, including any exceptions and remedial action taken, is submitted regularly to ALCO members.

**Exposure to liquidity risk**

The key measure used by the Bank for managing liquidity risk is the ratio of net liquid assets to deposits from customers. For computation of this, net liquid assets are considered as including cash and bank balances and placements with financial Institutions and certain investments in sukuks less placements from financial institution, and deposits comprise current accounts, placements from non-financial institutions and individuals, and equity of investment account holders.

Details of the reported Bank ratio of net liquid assets to deposits and customers at the reporting date and during the reporting period were as follows:

	<b>2013</b> %	2012 %
At 31 December	25.05	8.23
Average for the period	21.93	11.87
Maximum for the period	36.03	19.67
Minimum for the period	4.86	5.35

For maturity profile of assets and liabilities refer note 28.

**MARKET RISK**

Market risk is the risk that changes in market prices, such as profit rate, equity prices, foreign exchange rates and credit spreads will affect the Bank's income, future cash flows or the value of its holdings of financial instruments. Market risk comprises three types of risk: currency risk, profit rate risk and other price risk. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

**Management of market risks**

The Bank separates its exposure to market risk between trading and non-trading portfolios. The Bank has no trading positions in equity or commodities and the main source of market risk for the Bank is its foreign exchange exposure and profit rate gap.

The Bank does not do any trading in foreign exchange. The Bank does not engage in proprietary trading of foreign exchange derivatives. However, the Bank enters into Shari'a compliant foreign exchange risk management transactions to hedge economic risks to cover significant open positions under its risk management guidelines. All foreign exchange income/ losses arising out of customer transactions and revaluation of statement of financial position assets and liabilities are booked by the treasury operations. The responsibility for monitoring and managing the related risks also rests with the Treasury department.

Overall authority for market risk management is vested with ALCO. The RMD is responsible for the development of detailed risk management policies (subject to review and approval by appropriate approval authorities) and the Financial Control Department is responsible for the day-to-day review of their implementation.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
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## 31 RISK MANAGEMENT (continued)

## LIQUIDITY RISK (continued)

**Exposure to profit rate risk–non–trading portfolios**

The principal risk to which non-trading portfolios are exposed is the risk of loss from fluctuations in the future cash flows or fair values of financial instrument because of a change in market profit rates. Profit rate risk is managed principally through monitoring profit rate gaps and by having pre-approved limits for re-pricing bands. The ALCO is the monitoring body for compliance with these limits and is assisted by the Bank's Risk Management Department in its day-to-day monitoring activities.

A summary of the Bank's profit rate gap position at 31 December 2013 is as follows:

31 December 2013	Up to 3 months	3 - 6 months	6 months - 1 year	1 - 3 years	More than 3 years	Total
<b>Assets</b>						
Placements with financial institutions	82,745	-	-	-	-	<b>82,745</b>
Financing assets	41,884	15,450	17,934	77,891	100,476	<b>253,635</b>
Assets acquired for leasing (including lease rentals receivable)	6	-	1,884	1,170	32,570	<b>35,630</b>
Investments securities (sukuk)	8,335	4,286	-	2,537	13,974	<b>29,132</b>
<b>Total profit rate sensitive assets</b>	<b>132,970</b>	<b>19,736</b>	<b>19,818</b>	<b>81,598</b>	<b>147,020</b>	<b>401,142</b>
<b>Liabilities and investment accounts</b>						
Placements from financial institutions	25,492	-	-	17,448	-	<b>42,940</b>
Placements from non-financial institutions and individuals	24,230	20,047	31,181	4,258	1,196	<b>80,912</b>
Customers' current accounts	545	-	-	-	-	<b>545</b>
Equity of investments account holders	156,922	52,336	80,078	2,713	-	<b>292,049</b>
<b>Total profit rate sensitive liabilities and investment accounts</b>	<b>207,189</b>	<b>72,383</b>	<b>111,259</b>	<b>24,419</b>	<b>1,196</b>	<b>416,446</b>
<b>Profit rate gap</b>	<b>(74,219)</b>	<b>(52,647)</b>	<b>(91,441)</b>	<b>57,179</b>	<b>145,824</b>	<b>(15,304)</b>

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## 31 RISK MANAGEMENT (continued)

## LIQUIDITY RISK (continued)

31 December 2012	Up to 3 months	3 - 6 months	6 months - 1 year	1 - 3 years	More than 3 years	Total
<b>Assets</b>						
Placements with financial institutions	57,525	-	-	-	-	57,525
Financing assets	46,415	13,528	6,437	90,192	89,173	245,745
Assets acquired for leasing (including lease rentals receivable)	-	-	22	3,571	20,380	23,973
Investments securities (sukuk)	7,448	-	905	-	4,015	12,368
<b>Total profit rate sensitive assets</b>	<b>111,388</b>	<b>13,528</b>	<b>7,364</b>	<b>93,763</b>	<b>113,568</b>	<b>339,611</b>
<b>Liabilities and investment accounts</b>						
Placements from financial institutions	50,216	-	-	17,516	-	67,732
Placements from non-financial institutions and individuals	12,319	7,594	27,072	5,129	1,302	53,416
Customers' current accounts	189	-	-	-	-	189
Equity of investments account holders	119,794	37,572	54,097	4,966	-	216,429
<b>Total profit rate sensitive liabilities and investment accounts</b>	<b>182,518</b>	<b>45,166</b>	<b>81,169</b>	<b>27,611</b>	<b>1,302</b>	<b>337,766</b>
<b>Profit rate gap</b>	<b>(71,130)</b>	<b>(31,638)</b>	<b>(73,805)</b>	<b>66,152</b>	<b>112,266</b>	<b>1,845</b>

The management of profit rate risk against profit rate gap limits is supplemented by monitoring the sensitivity of the Bank's financial assets and liabilities to various standard and non-standard profit rate scenarios. Standard scenarios that are considered on a monthly basis include a 100 basis point parallel fall or rise across all yield curves and a 50 bp rise or fall of all yield curves.

An analysis of the Bank's sensitivity to an increase or decrease in market profit rates (assuming no asymmetrical movement in yield curves and a constant statement of financial position) is as follows:

	100bp parallel increase/decrease	50bp increase/decrease
At 31 December 2013	±153	± 77
At 31 December 2012	± 18	± 9

Overall non-trading profit rate risk positions are managed by Treasury department, which uses short term investment securities, placement with banks and placement from banks to manage the overall position arising from the Bank's non-trading activities.

**Exposure to foreign exchange risk**

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Group had the following significant net exposures denominated in foreign currency as of 31 December:

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31 *RISK MANAGEMENT (continued)**LIQUIDITY RISK (continued)**Exposure to foreign exchange risk (continued)*

	<b>2013 BHD Equivalent</b>	2012 BHD Equivalent
US Dollars*	107,636	106,717
Other GCC Currencies *	20,602	10,535
Euros	4,932	5,004
Australian Dollars	4,601	4,485
Kuwaiti Dinars	3,060	2,479
Sterling Pounds	1,455	1,222
Indian Rupee	35	5

(\* ) The exposure in US dollars and other GCC currencies does not create any foreign exchange risk for the Bank since Bahrain Dinars and other GCC currencies are effectively pegged to the US Dollars.

The management of foreign exchange risk against net exposure limits is supplemented by monitoring the sensitivity of the Bank's financial assets and liabilities to various foreign exchange scenarios. Standard scenarios that are considered on a monthly basis include a 5% plus/minus increase in exchange rates, for currencies other than US Dollars, other GCC currencies.

An analysis of the Bank's sensitivity to an increase or decrease in foreign exchange rates (assuming all other variables, primarily profit rates, remain constant) is as follows:

	<b>2013 BHD Equivalent</b>	2012 BHD Equivalent
Euros	±247	±250
Australian Dollars	±230	±224
Kuwaiti Dinars	±153	±124
Sterling Pounds	±73	±61
Indian Rupees	±2	±0.25

**Exposure to other price risks—non—trading portfolios**

Credit spread risk on debt securities is subject to regular monitoring by RMD, but is not currently significant in relation to the overall financial position of the Bank.

The Group's unquoted equity securities carried at cost are exposed to risk of changes in equity values. Refer to note 21 for significant estimates and judgments in relation to impairment assessment of unquoted equity investments carried at cost. The Group manages exposure to other price risks by actively monitoring the performance of the equity securities. The performance assessment is performed on a quarterly basis and is reported to the Board Investment and Credit Committee.

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31 *RISK MANAGEMENT (continued)***OPERATIONAL RISK**

Operational risk is the risk of loss arising from systems and control failures, fraud and human errors, which can result in financial and reputation loss, and legal and regulatory consequences. The Bank manages operational risk through appropriate controls, instituting segregation of duties and internal checks and balances, including internal audit and compliance. The Risk Management Department is in charge of identifying, monitoring and managing operational risk in the bank. The Bank already has an approved policy for doing this and all required organisational and physical infrastructure are in place.

The Bank has completed conducting one cycle of Risk Control Self-Assessment (RCSA) of Operational risk for majority of the departments of the Bank to identify the important Key Risk Areas, Key Risk Indicators and Key Risk Triggers: the RCSA process is a continuous process and will be conducted at regular frequencies across the Bank. A software for monitoring these triggers and recording actual and near miss losses is already in place. The medium term objective of the Bank is to generate statistically reliable data to upgrade to more sophisticated modes of Operational Risk Control both to manage the risk better and to reduce capital commitment.

**CAPITAL MANAGEMENT**

The Central Bank of Bahrain (CBB), sets and monitors capital requirements for the Bank as a whole. In implementing current capital requirements CBB requires the Bank to maintain a prescribed ratio of total capital to total risk-weighted assets. Capital adequacy regulations of CBB is based on the principles of Basel II of the IFSB guidelines.

The Bank's regulatory capital is analysed into two tiers:

- *Tier 1 capital*, includes ordinary share capital, disclosed reserves including share premium, general reserves, legal / statutory reserve as well as retained earnings after deductions for goodwill and other regulatory adjustments relating to items that are included in equity but are treated differently for capital adequacy purposes.
- *Tier 2 capital*, includes interim retained profits reviewed by the auditors and an allowed portion profit equalisation reserve (PER) and investment risk reserves (IRR). As per CBB, the PER & IRR can be up to a maximum amount equal to the capital charge pertaining to 30% of the risk weighted assets financed by unrestricted investment accounts.

Certain limits are applied to elements of the capital base in line with regulatory requirements. Tier 1 capital should represent at least half of the total eligible capital, i.e., Tier 2 capital is limited to 100% of Tier 1 capital. The limit on Tier 2 capital is based on the amount of Tier 1 capital after all deductions of investments pursuant to Prudential Consolidation and Deduction Requirements (PCD) Module of the CBB. The PCD Module sets out the regulatory rules for prudential consolidation, pro-rata consolidation or deduction where the own controlling or significant minority stakes in regulated financial entities, insurance entities and have significant exposures to investment in commercial entities. It also sets out the framework for the prudential deductions from capital for various instances including exposures to counterparties exceeding the large exposure limits as set out by CBB. As on 31 December 2013, the Bank has made deduction of BD 2,369 thousands each (2012: Nil), from its Tier 1 and Tier 2 capital respectively, in line with the requirements of the PCD Module.

Banking operations are categorised as either trading book or banking book, and risk-weighted assets are determined according to specified requirements that seek to reflect the varying levels of risk attached to assets and off-balance sheet exposures.

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31 *RISK MANAGEMENT (continued)**CAPITAL MANGEMENT (continued)*

For computation of credit risk on assets financed by equity of investment account holders, 30% of risk weight assets are considered as against 100% for assets self-financed.

The Bank's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The impact of the level of capital on shareholders' return is also recognised and the Bank recognises the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position.

The Bank has adopted the standardised approach to credit and basic indicator approach for management of operational risk under the CBB capital adequacy framework. The Bank on a conservative basis for capital management does not claim any of the benefits for permissible credit risk mitigants against credit exposure.

The Bank's regulatory capital position at 31 December was as follows:

	<b>31 December 2013</b>	31 December 2012
<b>Total risk weighted assets</b>	<b>439,219</b>	430,731
Tier 1 capital	98,331	119,448
Tier 2 capital	2,476	2,986
<b>Total regulatory capital</b>	<b>100,807</b>	122,434
<b>Total regulatory capital expressed as a percentage of total risk weighted assets</b>	<b>22.95</b>	28.42

The Bank has complied with all externally imposed capital requirements throughout the year.

**Capital allocation**

The allocation of capital between specific operations and activities is primarily driven by regulatory requirements. The Bank's capital management policy seeks to maximise return on risk adjusted while satisfying all the regulatory requirements. The Bank's policy on capital allocation is subject to regular review by the Board.

**32. PROPOSED APPROPRIATIONS**

The Board of Directors propose the appropriation for zakah of Nil in 2013 (2012: BD 228 thousands) which is subject to shareholders' approval in the ensuing Annual General Meeting.

**33. COMMITMENTS**

The commitments contracted in the normal course of business of the Bank:

	<b>2013</b>	2012
Undrawn commitments to extend finance	35,897	15,405
Financial guarantees	8,272	12,737
	<b>44,169</b>	28,142

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**33**     **COMMTMENTS** *(continued)**Performance obligations*

During the ordinary course of business, the Group may enter into performance obligations in respect of certain of its infrastructure development projects. It is the usual practice of the Group to pass these performance obligations, wherever possible, on to the companies that own the projects. In the opinion of the management, no liabilities are expected to materialise on the Group at 31 December 2013 due to the performance of any of its projects.

**34.     SOCIAL RESPONSIBILITY**

The Bank discharges its social responsibilities through donations to charitable causes and organisations.

**35.     COMPARITIVES**

Certain prior period amounts have been regrouped to conform to current year's presentation. Such regrouping did not affect previously reported profit or equity.