

Annual Report 2009

www.kfh.bh



Bringing Banking to Life

2009



بيت التمويل الكويتي
Kuwait Finance House
البحرين ب.س.ج. (م) (Bahrain B.S.C.(c))





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



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



His Royal Highness
Prince Salman bin Hamad
Al Khalifa
The Crown Prince, Deputy
Supreme Commander

Best Islamic Wealth Management
Islamic Business & Finance Awards '09
Priority Banking

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

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

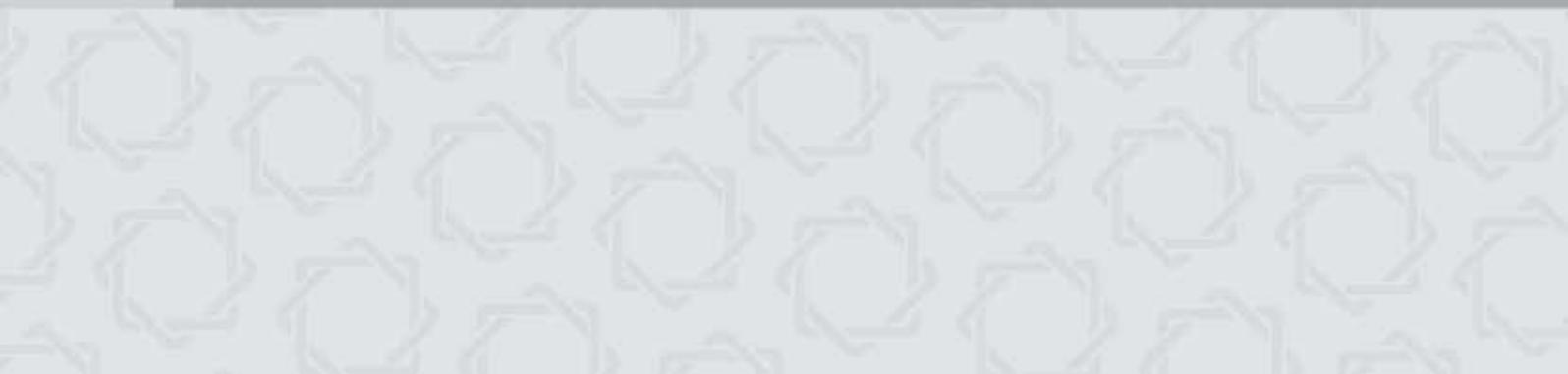
Best New Product
Islamic Business & Finance Awards '08
Priority Banking

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



Kuwait Finance House-Bahrain

Annual Report 2009



Contents

05	Vision & Mission
06	3 Year Highlights
08	Chairman's Statement
12	Managing Director & CEO's Statement
16	Board of Directors
18	Management Team
20	Investment Portfolio
24	Banking Group
28	Corporate Finance
29	Treasury & Debt Capital Markets
30	Risk Management
32	Corporate Governance
37	Corporate Social Responsibility
38	Shari'a Board Report
39	Independent Auditor's Report
40	Consolidated Financial Statements



Bringing Banking to Life

Vision

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

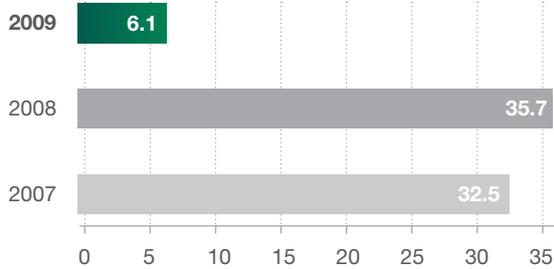
Mission

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



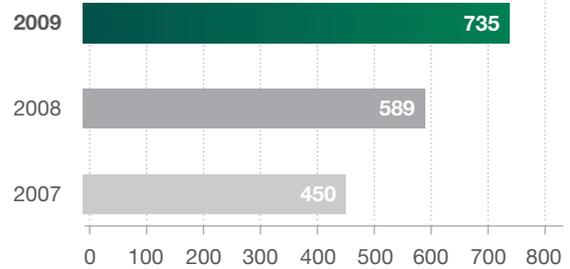
Net Income

BD Million



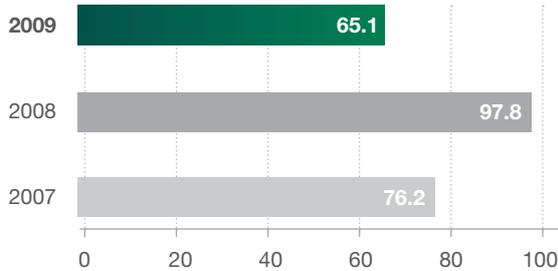
Customers Deposits

BD Million



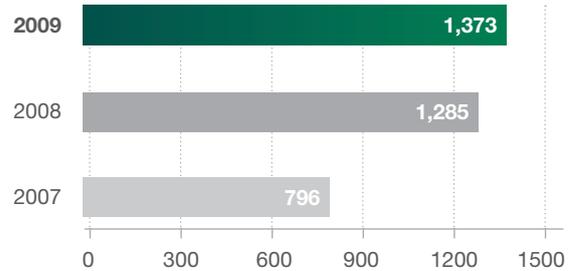
Operating Income

BD Million



Total Assets

BD Million



3 Years Highlight

Profile

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

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

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

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



Bader A. M. Al-Mukhaizeem
Chairman

Chairman's Statement

Dear stakeholders and partners,

In the name of Allah, the Beneficent, the Merciful, Prayers and Peace Be Upon the Last Prophet and Messenger Muhammed.

It is my pleasure to present the annual report of Kuwait Finance House Bahrain for the fiscal year ended on 31 December 2009. By the grace of Allah the Almighty, 2009 was another successful year for KFH-Bahrain. Against a backdrop of economic recession and uncertainty around the global banking system, KFH-Bahrain posted satisfactory financial results in 2009. This is a testament to the Bank's prudence and adherence to sound Islamic Banking practices.

Financial Results

The financial results of the fiscal year ended on 31 December 2009 showed that the total income stood at BD65.1 million and the net pre-distributed income was BD 26.2 million. The net post-distributed income reached 6.1 million, while the assets were BD1.5 billion. Despite the 2009 economic crisis, the revenues of general banking operations grew by 33%.

Focus on the customer

Throughout 2009, the Bank focused on the customer and increased its network of branches and ATMs as well as improving its products and services. We further enhanced our customer service in terms of product range, and responsiveness, through substantial technological enhancements. We have worked closely with our corporate customers, providing support to their businesses as they weathered the economic recession. The result was a 25% increase in our customer deposits to BD 735.4 million.

Operational Excellence

A good deal of credit for KFH-Bahrain's financial performance in 2009 goes to the employees in the Bank who worked hard and great efforts have been made so that the Bank operates efficiently, processing transactions in a timely fashion to meet customer's expectations and all within a framework of best practice when it comes to governance, risk management and compliance.

Despite the 2009 economic crisis, the revenues of general banking operations grew by 33%. The result was a 25% increase in our customer deposits to BD 735.4 million.

In 2009, KFH-Bahrain continued to be recognised for its strong performance by receiving a prestigious award at the Islamic Business and Finance Awards 2009 organised by CPI Financial for 'Best Islamic Wealth Management'.

Permanent Adherence to Islamic Shari'a

KFH-Bahrain is synonymous with adherence to Islamic Shari'a. We have a dedicated Shari'a Compliance Board comprising of elite scholars with high experience in the Islamic Banking sector including Shaikh Ajeel Jasem Al-Nashmi (Chairman), Shaikh Dr. Khalid Mathkour Al-Mathkour (Member) and Shaikh Dr. Mohammed Abdul Razaq Al-Tabtabaee (Member). This team of qualified scholars oversee the activities of the Bank's Shari'a department which in turn, ensures Shari'a compliance in each and every Bank activity.

Community Service

The Bank also supported a range of initiatives and activities, contributing towards the further development of Islamic banking and finance in both the business and economic sectors of the Kingdom in addition to several social initiatives.

Recognition

In 2009, KFH-Bahrain continued to be recognised for its strong performance by receiving a prestigious award at the Islamic Business and Finance Awards 2009 organised by CPI Financial for 'Best Islamic Wealth Management'. Earlier in the year, the Bank was also honoured by CPI Financial with the 'Best New Product 2008' award for its Priority Banking service.

Thanks

On behalf of the Bank's Board of Directors and executive management, I would like to thank His Majesty King Hamad Bin Isa Al Khalifa, His Royal Highness Prince Khalifa Bin Salman Al Khalifa, the Prime Minister, and His Royal Highness Prince Salman Bin Hamad Al Khalifa, the Crown Prince and Deputy Supreme Commander. I would also like to extend our sincere appreciation to the Government of Bahrain and the Central Bank of Bahrain for their valuable direction during these testing economic times.

In conclusion, I would like to thank our esteemed stakeholders for their support and confidence, our clients and business partners for their trust and loyalty, and the management and staff for their dedication and high professional standards.

Bader Abdul Muhsen Al-Mukhaizeem
Chairman

A portrait of Abdulhakeem Yacoob Alkhayat, a man with a beard and glasses, wearing a traditional white thobe and ghutra with a black agal. He is looking directly at the camera with a slight smile.

Abdulhakeem Yacoob Alkhayat
Managing Director & CEO

Managing Director and CEO's Statement

Dear Stakeholders,

In the name of Allah, the Beneficent, the Merciful, Prayers and Peace Be Upon the Last Prophet and Messenger Muhammed.

It is my privilege to report to you, by the grace of Allah the Almighty, KFH-Bahrain's performance for 2009. Whilst 2009 will probably be remembered as the most challenging year for the banking sector in living memory, for KFH-Bahrain, 2009 will be remembered as the year in which we worked hardest in terms of our product offering, our services and our internal policies and procedures. Thanks to Allah the Almighty and the support of the Chairman and Board members and the continuous efforts of management and staff we posted positive financial results and have maintained with the grace of Allah our overall long term strategy of growth.

Retail and Corporate Banking

I am particularly pleased by the way in which we strengthened our partnership with the Bank's customers. We have significantly grown our deposit base and continue to enhance our services.

Our branch and ATM network continues to increase with 9 branches and 20 ATMs to date. We have upgraded our core banking applications and have reduced transaction processing time so that we carry out our customers' requests on a timely basis. Our ATM cards have been updated with more secure "chipped" cards, as required by Central Bank of Bahrain. 2009 also saw the launch of the Baytik Ijara Card that offers our customers the lowest and most flexible finance on durable products.

Investment Banking & Debt Capital Markets

2009 was a challenging year for investment banking and the debt capital markets, however, I am pleased to report that our Investment and Debt Capital Market departments worked to preserve, protect and enhance the Bank's assets. By the grace of Allah the Almighty, we continued to progress our flagship real estate investments such as Durrat Al Bahrain and Diyar Al Muharraq, which represent long term strategic investments for the Bank. On the Debt Capital Market side the Bank is focusing on relatively low risk investment opportunities.

Whilst 2009 will probably be remembered as the most challenging year for the banking sector in living memory, for KFH-Bahrain, 2009 will be remembered as the year in which we worked hardest in terms of our product offering, our services and our internal policies and procedures.

2010 is expected to provide greater investment opportunities in the global market. With the anticipation of the freeing up of the capital markets, we can be assured that the Bank is well prepared for the coming year.

Risk, Governance and Compliance

Extra efforts have been deployed to ensure that the Bank continues to follow best practice in terms of its risk management, corporate governance and compliance. The Bank fully adheres to the Central Bank of Bahrain's requirements and I am pleased to report our full implementation of and adherence to Basel II which will ensure we continue to follow best practice when it comes to managing our capital.

New Shari'a Board

I would like to take this opportunity to thank the newly appointed Shari'a Board who have provided valuable direction and guidance on Shari'a issues to ensure that we maintain the Bank's identity and its genuineness.

Information Technology

Throughout the year our I.T. department have worked consistently hard to upgrade our capability in terms of internal processing, which in turn improves our responsiveness to customers' needs and our ability to monitor and manage the Bank's risk management. A key milestone will be met in the beginning of 2010 after the extensive work that was undertaken in 2009 to introduce a new eBanking service to our customers, providing an even wider range of services to offer greater conveniences online.

Outlook

2010 is expected to provide greater investment opportunities in the global market. With the anticipation of the easing of the capital markets, we can be assured that the Bank is well prepared for the coming year.

Appreciation

In conclusion, I would like to express my sincere thanks and gratitude to the Chairman and members of the Board for their continued guidance and support during this challenging year. I would also like to thank each of our loyal customers for their trust and confidence in the Bank and look forward to providing them with an enhanced banking experience in 2010. I would also like to thank the Bank's staff for their dedication and hard work throughout 2009.

Abdulhakeem Yaqoub Alkhayyat
Managing Director & Chief Executive Officer



Board of Directors



**Bader Abdul Muhsen
Al-Mukhaizeem**
Chairman



**Mohammed AlShaikh
Ishaq**
Vice Chairman



**Mohammed Sulaiman
Al Omar**
Board Member



**Abdulhakeem Yaqoub
Alkhayat**
Managing Director & CEO



**Yaqoob Yousef
Majed**
Board Member



**Adel Ahmed Al
Banwan**
Board Member

EXECUTIVE
MANAGEMENT



Abdul Razak Jawahery
Executive Manager



Ahmad Saeed
Executive Manager



Khalid Al Maarafi
Executive Manager

DEPARTMENT
SENIOR MANAGERS



Hisham Al-Moayyed
Senior Manager - Real Estate



Lilian Le Falher
Executive Manager



Paul Mercer
Executive Manager



Sattam Algozaibi
Executive Manager



Yousif Al-Hammadi
Senior Manager - Financial Control
& Administration



Isa Al Duwaishan
Shari'a Advisor



Investment Portfolio

While the world's financial and economic crisis continued into the year 2009 affecting the entire financial services industry across the globe, the Bank has managed to mitigate these risks and challenges by a “well-managed strategic approach”.



The Investment team, as a top priority, carefully scrutinised its existing investment portfolio and categorised each investments as either for exit in the short to medium term as well as those for strategic long term hold. The Bank provided financing support to selected investments to ensure sustainability and maximise value for future exits. As some of the investments were not completely immune to the crisis, adequate fair value adjustments have been made in the financial statements to reflect the fall in value.

Although the Investment team continued to identify good investment opportunities during the year, it acted prudently and postponed the potential investments due to the vulnerability and instability of the current investment environment.

In 2009, the Bank continued its financial and management support for the existing large scale real estate development projects and completed major phases within the deadlines and budget. Steady progress was made towards the pre-development phase of some of the new projects and these are being monitored closely.

Several new initiatives were introduced to strengthen the post acquisition monitoring process, which led to closer scrutiny of the portfolio and enabled the Investment team to formulate tailor made strategies for individual investments to improve portfolio performance and to identify candidates for exit.



REAL ESTATE INVESTMENTS

Constantly seeking and identifying opportunities in the real estate market, both in the Kingdom of Bahrain and MENA region, continues to remain a key strength of the Bank, not only as a developer itself, but also through strategic partnerships and joint ventures with other renowned industry players. The Bank's robust portfolio includes several renowned projects such as Diyar Al Muharraq, Durrat Al Bahrain, Ishbiliya Village, as well as other projects at early stages of progress.



CORPORATE INVESTMENTS

The Bank's strategy is to pursue private equity deals with mature and cash generative underlying businesses that have committed and experienced management teams. The corporate investment plan includes companies with a clear competitive advantage or ability to create high-growth in sectors predominantly within telecommunications, technology, healthcare, utilities and oil and gas industries. However, given the economic crisis, the investment plan was put on hold during the year with significant focus shifted to managing, rebalancing the corporate investment portfolio, devising and implementing a strategy to exit investments that did not fit with the core strategy, and supporting the remaining to maximise value.





Banking Group



A unique 25 year home financing scheme is another example of KFH–Bahrain's dedication for product innovation. With an exclusive offer targeting Ishbiliya Village properties, we set another standard in consumer finance.



Bahrain World Trade Centre Branch



Manama Branch



East Riffa Branch



Automall Sitra Branch



Muharraq Branch



Adliya Branch



Automall Exhibition Branch



West Riffa Branch



Isa Town Branch - Opening Soon

The consumer banking and finance services provided by KFH–Bahrain combine a broad range of innovative products and services with exceptional customer care. Our products and financing facilities are developed with the aim of providing for the long term needs of customers in the local market, which continue to increase steadily. Thinking innovatively and ultimately striving to deliver superior products, remains at the core of all we do. Despite the current downturn in market trends we have continued to expand both our product and services portfolio as well as our delivery channels.

KFH–Bahrain provides a ‘one–stop–shop’ for our customers’ banking and financing requirements through our growing network of branches and ATMs. The number of branches has increased from six to nine, with the Bahrain World Trade Centre, Exhibition Road and Muharraq among the new locations. The Bank’s ATM network has been upgraded to provide a more secure service, while the network coverage has increased with new machines being installed in major residential, financial and shopping districts bringing the current total to 20.

New services and innovative products are constantly being introduced for the benefit of customers. These range from technology and service enhancements that provide greater access to information and funds, both locally and internationally, to the launch of our unique never before seen products. One such product is the Baytik Ijara card, the world’s first Islamic financing card that allows cardholders to acquire durable goods

on a ‘lease–to–own’ basis. This financing facility has been developed further to provide exclusive finance schemes such as Student Finance and higher credit limits for Durrat Al Bahrain villa owners.

A unique 25 year home financing scheme is another example of KFH–Bahrain’s dedication for product innovation. With an exclusive offer targeting Ishbiliya Village properties, we set another standard in consumer finance.

During 2009, KFH–Bahrain also focused on further enhancing customer service. Plans included upgrading the Telebanking service to a fully fledged Contact Centre.

The first Islamic chipped credit card, a Shari’a compliant offering with many benefits, introduced in 2007 in association with Visa, was enthusiastically received, with the initial take–up proving to be greater than expected. Customers enjoy a revolving credit facility without incurring interest costs, paying a low annual service charge instead.

KFH Automall, which was officially opened in 2007, enjoyed a successful second year of operations. As well as being the Kingdom’s largest car showroom housing the widest range of car brands, KFH Automall provides customers with a ‘one–stop–shop’ for financing and insurance. The second Automall branch was inaugurated in 2009 to better serve customers in the heart of the capital, Manama.

KFH-Bahrain's Corporate Finance Department has continued to maintain a strong performance, despite market conditions throughout 2009. The primary objective was to instill confidence in our client based on our solid track record of supporting the growth of our clients by providing effective Shari'a compliant resources and strategies.

The Corporate Finance team identifies and evaluates compelling opportunities and offers advice and financing solutions for a wide range of projects, both in the private and public sectors. Complimenting the Bank's vision and mission to support growth in local and regional markets, we continue to achieve the maximisation of the business potential of our clients.

Corporate Finance provides services across various sectors including:

- Project financing
- Real Estate financing
- Working capital financing
- Trade financing

Our experienced team of professionals provide exceptional service and advice along with a broad range of Shari'a compliant financing instruments. These include: Murabaha, Ijara and Istisna'a, as well as Commodity and Convertible Murabaha facilities. Through scrutinising market trends and conditions, we strive to ensure that clients are provided with solutions that are tailor made to meet their needs.

Corporate Finance

Treasury and Asset Management

Strong liquidity management and capital adequacy for the Bank were targeted throughout the challenging year of 2009 by the Treasury Department (internally responsible for the Assets & Liabilities Management and the interbank activities framework). While monitoring the Bank's placement policy, the department has extended its relationship with banks for the purpose of treasury lines development with a particular evolution represented by the promotion of the Wakala solution with Islamic financial institutions. In this direction of expansion, it has recently reinforced its Financial Institutions unit team.

The development of services in the fields of liquidity management, long term investment funds and asset-backed securities, intended for financial institutions as well as corporate and institutional investors are also a mission for the department. Additionally, the Treasury Department aims at introducing an FX spot trading platform in the coming year.

Debt Capital Markets (DCM) & Syndication

2009 represented the first full year of operation of the DCM unit. Given the effects of the global financial crisis and the resultant regional impact, DCM chose to take a very conservative approach to new financing. DCM took the strategic decision to focus on sovereign or quasi-sovereign transactions or project financing backed by strong sovereign offtake agreements. No new deals were concluded during Q1 '09 as the regional fallout from the global financial crisis continued

to manifest itself. During Q2, the markets began to thaw with sovereign and quasi-sovereign issuers taking the lead. During this time, DCM took advantage of attractive yields and participated in the Bahrain sovereign sukuk issue. In Q3, DCM successfully partially underwrote and solely lead the arrangement of Mumtalakat's (Bahrain's sovereign wealth fund) US\$ 140 million syndicated aircraft Ijara facility. DCM also participated in the Ras Al Khaimah sovereign sukuk.

At the beginning of Q4, DCM acted as joint lead manager and joint bookrunner for the International Finance Corporation's inaugural, US Dollar international sukuk issue. The transaction was recognised by Islamic Finance News as the Wakalah Deal of the Year and by emefinance as the Most Innovative Islamic Bond Deal of the Year for 2009 and highlighted DCM's ability to structure, lead arrange and bookrun a global sukuk issuance for an international issuer, working effectively with large international banks. The impact of the IFC mandate is already bearing fruit as DCM has received several inquiries for future sukuk mandates for international issuers.

DCM also successfully structured the first Islamic Tier 2 capital financing in Bahrain, receiving the Central Bank of Bahrain's approval in September 2009. The facility was a conversion of short term Treasury lines provided by KFH-Kuwait to fund long term KD assets in Kuwait into a facility meeting the CBB's requirements for Tier 2 subordinated debt. The financing helped increase the Bank's Tier 2 capital by nearly BD 100 million.

Treasury & Debt Capital Market

At KFH-Bahrain we believe that a robust and well implemented risk management framework is essential in protecting the interests of its stakeholders and translating our banking processes into tangible results. We aim at pursuing strategies that build long term shareholder value, whilst meeting regulatory requirements as well as economic capital standards. Our Risk Management Framework aims at proactive management of risks in the full life cycle of a financial transaction, including its operating circumstances from origination to final disposal from the books of the Bank.

In line with the Bank's strategy, KFH-Bahrain has developed a sound and comprehensive corporate governance and risk management framework in accordance with Basel II and the CBB rule book. The risk charter of the Bank mandates that the Board of Directors (BoD) and the Board level Audit, Risk, Governance and Compliance Committee (ARGCC) to develop and oversee the risk management framework in the Bank. Further, senior management implements this BoD approved framework through various senior management committees such as the Risk Management, Asset Liability, Credit, Investment and Basel II committees.

The Bank developed a well articulated risk strategy based on the Board approved business strategy. Risk policies and procedures for various risk categories such as Credit, Investment, Liquidity, Market, Operational and Profit Rate risks are developed in line with the mandate of risk charter to guide the businesses in managing the risk they take. The Bank continually monitors and controls risk through a comprehensive set of Limit structure and Credit Criteria.

Further, the Bank annually or more frequently, if required, revises risk policies, procedures, limits and risk criteria with changing economic environment and our risk appetite.

In 2009, the Bank revamped the risk management framework and processes to adequately and proactively identify, monitor and manage risks effectively across the Bank. The Bank started many initiatives and training programmes to inculcate a culture of risk management across its business and support units. It was emphasised that the different business units are the front line operators of risk management practices in the Bank and hence, are the first line of control. The support and control units including the Financial & Internal Control, Credit Administration & Review, Collections, Compliance, Operations, Legal, Shari'a and Risk Management functions are the second line of control on the risks taken by the business units. The Risk Management Group (RMG) provides the risk management tools and framework for business and support units. The Audit function is responsible to independently ensure the adequacy of controls and the adherence to the Bank's risk policies and procedures.

In achieving an optimum balance between risk and return, the Bank this year has established an Internal Capital Adequacy Assessment Program (ICAAP) which quantifies the economic capital standards for the key risks that the Bank is exposed to including credit risk, investment risk, market risk, liquidity risk, strategic risk, reputation risk, operational risk, and concentration risk. The Bank has conducted comprehensive stress tests for its various portfolios to assess the impact of

Risk Management

probable but unlikely adverse events on our capital and profitability. The Bank's stress testing framework and models allow for forward looking scenarios and take cognizance of our business growth strategies and changes in economic circumstances. These stress tests and ICAAP implementation have become a part of our day to day management of risk in the Bank.

The Bank has further reinforced its risk management culture in 2009 by implementing a comprehensive Risk and Control Self Assessment ("RCSA") framework to identify the main processes, existing controls and required controls. Business and various operating departments own the management of various risks embedded in their operations within the oversight of Risk Management Committee of the Bank. RMG also monitors a set of Key Risk Indicators (KRI) for managing the risks across its business and support processes, and provides a comprehensive set of management information reports to the Board, ARGCC and Senior Management committees.

Towards building an Enterprise Wide Risk Management Framework in 2009, the Bank took steps to develop Risk Management guidelines and monitoring frameworks for its key subsidiaries. The Bank is enforcing these guidelines through its Investment Managers.

Towards the end of 2009, the Bank completed the Central Bank of Bahrain (CBB) mandated risk review profile assessment for Basel II compliance. The Bank identified that a well implemented Business Continuity Plan (BCP) and Disaster Recovery Plan (DRP) will go far in protecting the Bank from identified and unknown disasters. The Bank is taking further steps to enhance and implement a robust and integrated BCP and DRP processes and infrastructure.

During 2009, the Bank implemented the major building blocks of a Risk Management Framework. However, we realise the best practices in the Risk Management are continuously evolving and changing and we need to further improve our Risk Management processes. Going forward, we are preparing ourselves to further enhance and implement evolving best practices in Risk Management which will be developed by the industry from time to time.

KFH-Bahrain is committed to adopting the highest international standards and global best practices in corporate governance. KFHBahrain has established a strong corporate governance framework that is designed to protect the interests of all stakeholders, ensure compliance with regulatory requirements, and enhance organisational efficiency.

KFH-Bahrain has established a robust organisational structure that clearly segregates functions and responsibilities, and reflects a division of roles and responsibilities of the Board of Directors and Management. Clear mandates exist for the Board, Chairman of the Board, Board Committees, Managing Director and Chief Executive Officer, the Management, and Senior Management Committees.

Responsibilities

The Board of Directors are accountable to the shareholders for the creation and delivery of strong sustainable financial performance and long term sustainable shareholder value by providing effective governance over the Bank's affairs. It determines the strategic objectives and policies of the Bank to deliver such long term value, providing overall strategic direction to the Bank within a framework of rewards, incentives and controls. Detailed responsibilities of the Board are provided in the Bank's Articles of Associations.

The Chairman is responsible for leading the Board, ensuring its effectiveness and monitoring the performance of the Executive Management. The Board currently has three committees: the Audit, Risk, Governance & Compliance Committee; the Executive Committee and the Nomination and Remuneration Committee. Each committee has specific terms of references that define its scope and powers. Detailed responsibilities of the Board are provided in the KFHBahrain's Corporate Governance Charter.

Information about the Board Structure, the Managerial Structure, the profession and experience of each Board Member, the qualification and experience of the Chairman, the Managing Director and Chief Executive Officer and the Executive Managers are provided in Section 4 of the Public Disclosure (enclosed to this Annual Report). Section 4 of the Public Disclosure also contains information on the Board structure, the basic organisational structure and the managerial structure of the Bank.

The remuneration/incentive structure of the Managing Director and the Chief Executive Officer, Board Members and Shari'a Members is discussed at Board level. Remuneration of the Managing Director and the Chief Executive Officer and Board Members is approved in the AGM.

Corporate Governance Charter

The Bank has developed a Corporate Governance Charter that provides the basis for promoting high standards of corporate governance in the Bank. It sets out high level guidelines and lays the foundation for the overall corporate governance system in the Bank. It outlines the key elements of an effective corporate governance framework and describes the roles and responsibilities of the Board of Directors which outlines the role of the Board in its review, approval and monitoring of the Bank's strategy and financial performance within a framework of sound corporate governance. It also contains the terms of references for all the Board and Senior Management Committees.

Code of Conduct

The Bank has developed a Code of Conduct that governs the professional and personal behaviour of the Banks' directors, management and staff.

Compliance

KFH–Bahrain is committed to conducting its business in a Shari'a compliant manner, to delivering its strategic and operational objectives with the highest professional and ethical standards and to comply fully with the spirit and letter of any applicable regulatory requirements, Kingdom of Bahrain legislation, code of best practice promoted by industry associations and internal codes of conduct.

In this context and in compliance with the Central Bank of Bahrain requirements, the Bank has appointed a Compliance Officer pursuant to the provisions

of the CBB rulebook volume 2 and established an independent Compliance/AML Department that is responsible for ensuring the appropriate implementation of the Compliance Framework, and adherence to the Compliance Policies documented in the Compliance Policy Manual approved by the Board. The Compliance Framework is based upon the premise that compliance with laid down policies is intended to help the Bank to efficiently realise its goals while complying with applicable laws, rules and regulations.

The primary purpose of the Compliance Policy Manual is to establish a strong compliance culture within the Bank by providing a framework of policies and guidelines that the Bank must adhere to ensure appropriate management of Compliance Risk and discharge of its duties relating to regulatory authorities' requirements. It aims at ensuring that the Bank adheres to all applicable regulations, violations if any, are identified on a timely basis and corrective action is taken at the earliest. The Manual provides the basis for the creation of the Bank's Compliance Function Infrastructure thus facilitating the optimisation of shareholder value, as well as meeting the emerging regulatory compliance and leading industry practice standards. It is envisaged that by implementing these guidelines the Bank would be able to monitor and control its Compliance Risk exposures more effectively.

The Board of Directors has the overall responsibility for ensuring that all activities of KFH–Bahrain are conducted in accordance and in full compliance with applicable laws and regulations.

The Board has approved the Compliance Policy. The Policy shall be reviewed as and when there is a significant change in the Bank's business model or regulatory requirements to ensure that it is in line with the Bank's current practices or any other changes introduced by the CBB and other regulatory authorities that may have an impact on the Compliance Function.

In addition to the Policy, the Bank has adopted Compliance Procedures which will allow the Bank to appropriately manage compliance risk and discharge its responsibilities relating to regulatory authorities. The objective of the procedures are to ensure that:

- All regulatory requirements are adequately complied with;
- Potential non-compliance is detected, reported and rectified in a timely manner; and
- Non-compliances are reported to the appropriate statutory body and internally to the Managing Director & Chief Executive Officer and Audit, Risk, Governance and Compliance Committee.

Disclosures

A Public Disclosure Policy has been developed as part of the Bank's commitment to adopting the highest standards of transparency and fairness in disclosing information for the benefit of all stakeholders. The Public Disclosure Policy provides the approach adopted towards managing and controlling the process of public disclosure of financial and non-financial

communication to shareholders and the customers in order to ensure that the information disseminated complies with the CBB directives and is accurate, complete and fairly presents the Bank's financial position and results of operations in all material respects within regulatory stipulated timelines. The purpose of the policy is to assist the Board, Senior Management and relevant department to understand their roles and responsibilities in the Disclosure Process. KFH-Bahrain is committed to disclosing information to the public in a manner consistent with guidelines provided by the Central Bank of Bahrain, and in line with Basel II Pillar III requirements.

Anti-money Laundering

KFH-Bahrain has adopted detailed policies and procedures in line with the Central Bank of Bahrain's directives to combat money laundering, financing of terrorism and other financial crimes. Detailed procedures are included on account opening and customer due diligence, internal and external reporting, staff training and record keeping. It aims to assist all members of management and staff to understand:

- The legal requirements and the different penalties for non-compliance;
- What the Bank requires of all members of management and staff; and
- How to recognise money laundering and the action one must take.

It is a firm policy of the Bank not to allow itself to be directly or indirectly used by any elements for unlawful activities. From the Bank's perspective, the prevention of money laundering financing of terrorism and other financial crimes has three objectives:

- **Ethical** – taking part in the fight against crime;
- **Professional** – ensuring that the Bank is not involved in recycling the proceeds of crime that could call into question its reputation, integrity and, if fraud is involved, its solvency; and
- **Legal** – complying with Bahrain legislation and regulations that impose a series of specific obligations on financial institutions and their employees.

In this context and in compliance with the Central Bank of Bahrain requirements, the Bank has appointed a Money Laundering Reporting Officer pursuant to the provisions of the CBB rulebook volume 2 and established Compliance/AML Department that is responsible for ensuring the appropriate implementation of and adherence to the AML Policies and Procedures as approved by the Board.

Corporate Communications Policy

The Bank maintains an effective communications policy that enables both the Board and Management to communicate effectively with its shareholders, stakeholders and the general public. Main communications channels include the annual staff

meeting, annual report, corporate website and corporate brochure, and regular announcements in the appropriate local press.

The Communications Policy has been approved by the Board. This Policy is set to ensure the disclosure of all relevant information to stakeholders on a timely basis in a timely manner and the provision of at least the last three years of financial data on the Bank's website.

The Bank has a Corporate Communications Department which is responsible for communicating new products information through various channels of communication which may include publications, website, direct mailers, electronic mail and local media.

The department supports the Compliance Officer of the Bank on any communication required to the investors and customers as set up by the Bank. The Corporate Communications Department has assisted, where required, with all business units of the Bank in support of their awareness programmes or marketing of new products and services for the year 2009. The department has assisted the Bank throughout the year with its various social functions and charitable contributions. These are highlighted in the Corporate Social Responsibility section of the Annual Report.

Consumer / Investor Awareness Programmes

The Bank employs a range of communication channels to reach the consumer and investor, to create awareness of the Banks products, services and investments.

Communication channels for consumers normally adopt an integrated approach, depending on the level of exposure and awareness required. This can include mass media, publishing advertisements in the press and magazine publications, billboards, lamp posts, LED display boards, direct mail, SMS messaging and emails.

The external communication programme is supported by in-branch communication including; roll-ups, banners, posters, leaflets, flyers, brochures and danglers and online media via the KFH-Bahrain website, Call Center and eBanking site.

Communication to Investors is predominantly via Private Placement Memorandums and Investor Reports. The Bank also communicates its investments via its website. All other Investment communication is directly via the Bank's Investment Placement Team as part of its investor relations programmes.

Complaints and Feedback

The procedures for lodging of and responding to complaints and addressing feedback are highlighted in the Public Disclosures section of the Annual Report as attached.

The Bank has appointed a Complaints Officer to manage customer complaints and ensures that all complaints are properly addressed and issues are solved in a timely manner. After receiving a complaint, the Complaints Officer internally address the complaint to the concerned department for their response. After analysing the responses of the concerned department the Complaints Officer finds a suitable solution and this will be communicated to the complainant. There are various channels in place to assist in receiving feedback/complaints from customers including the Bank's website and suggestion boxes that have been placed at each of the Bank's branches.

Other Disclosures

The information on the nature and extent of transactions with related parties is reported on pages 74 and 75 of the Bank's Financial Statements.

Page 90 of the Bank's Financial Statements provides the information on systems and controls employed by the Bank to ensure Shari'a compliance which include the information if there was any non-Shari'a compliant earnings and expenditure occur and the manner in which they were disposed of and the annual zakah contributions of the Bank.

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

Throughout 2009, KFH-Bahrain continued to implement its comprehensive corporate social responsibility (CSR) programme comprising financial and practical support for numerous charitable, educational, medical, cultural, sporting and social organisations, and deserving causes. The Bank also participated in and sponsored a number of major initiatives and events aimed at supporting Islamic banking and finance, and promoting business and economic development. Some examples of our diverse CSR activities during the year are listed below.

Developing tomorrow's Sporting Champions

- Sponsored the Crown Prince Horse Racing Cup.
- Sponsored the Manama Club Bankers' Cup.
- Sponsored the Bahrain Fencing Association's Summer Programmes.
- Sponsored the General Organization for Youth and Sports initiatives during the World Cup qualifying matches.

Supporting Islamic Banking and Finance

- Silver Sponsor of the 9th Banking Conference.
- Diamond Sponsor of the 6th Islamic Financial Services Board Summit in Singapore.
- Platinum Sponsor of the Annual Conference of the Accounting and Auditing Organisation of Islamic Financial Institutions (AAOIFI) in Bahrain.

Promoting Business and Economic Development

- Gold Sponsor of the 12th International Conference, Seminars and Exhibition in Bahrain.
- Sponsor of the Clean Technologies for Economic Development Conference.
- Sponsor of the Bahrain World Economic Crisis Lecture.

Corporate Social Responsibility

In the name of Allah, the Beneficent, the Merciful. Praise be to Allah, the Lord of the Worlds, and peace and blessing be upon our Prophet, Muhammed, and on his Companions.

To the Shareholders of KFH-Bahrain,

Assalam Alaikum Wa Rahmatullah Wa Barakatuh,
According to the letter of appointment, we submit the following report:

We have monitored the products used and the contracts relating to the transactions and applications undertaken by KFH-Bahrain during the period ended 31st December 2009. We have also conducted our required monitoring to form an opinion as to whether KFH-Bahrain has complied with Shari'a Rules and Principles and also with the specific fatwas, rulings and guidelines issued by us.

Through the Shari'a Supervision & Compliance Department we reviewed and approved the contracts and agreements forms and reviewed all the transactions of Kuwait Finance House - Bahrain, with the shareholders, investors and others, by selecting a random sample of them from all the departments according to the annual plan of Shari'a Audit, and through the Shari'a Advisor periodic reports on the reviews and field visits, and conduct of business and the proper compliance with the fatwas and decisions issued by the Shari'a Board.

We planned and performed our view so as to obtain all the information and explanations which we consider necessary in order to provide us with sufficient evidence to give reasonable assurance that KFH-Bahrain has not violated the Shari'a Rules and Principles.

In our opinion:

- a) The contracts, transactions, and dealings entered into by KFH-Bahrain during the year ended 31st December 2009 that we have reviewed are in compliance with the Shari'a Rules and Principles;
- b) The allocation of profits and losses relating to investment accounts conform to the basis that had been approved by us in accordance with Shari'a Rules and Principles;
- c) All earnings that have been realised from sources or by means prohibited by Shari'a Rules and Principles, have been disposed of to charitable causes; and
- d) The calculation of Zakat is in compliance with Shari'a Rules and Principles.

This opinion is rendered based on what has been presented to us by KFH-Bahrain's Managing Director and CEO, and its in-house Shari'a Advisor.

We would like to thank the management for its acceptance and compliance to the Shari'a principles and guidelines. We pray to Allah the Almighty to grant us success and the path of straightforwardness.

Wassalam Alaikum Wa Rahmatullah Wa Barakatuh.

Ajeel Jasem Al-Nashmi
Chairman

Khalid Mathkour Al-Mathkour
Member

Mohammed Abdul Razaq Al-Tabtabaee
Member

Shari'a Board Report

Independent Auditors' Report

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

We have audited the accompanying consolidated financial statements of Kuwait Finance House (Bahrain) B.S.C. (c) (the "Bank") and its subsidiaries (together the "Group") which comprise the consolidated statement of financial position as at 31 December 2009 and the consolidated statement of income, the consolidated statement of comprehensive income, the consolidated statement of cash flows, the consolidated statement of changes in equity and the consolidated statement of restricted investment accounts for the year then ended and a summary of significant accounting policies and other explanatory notes.

Board of Directors' Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

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

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

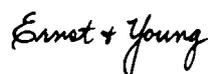
Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as of 31 December 2009 and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with Financial Accounting Standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions and the Islamic Shari'a Rules and Principles as determined by the Shari'a Supervisory Board of the Bank.

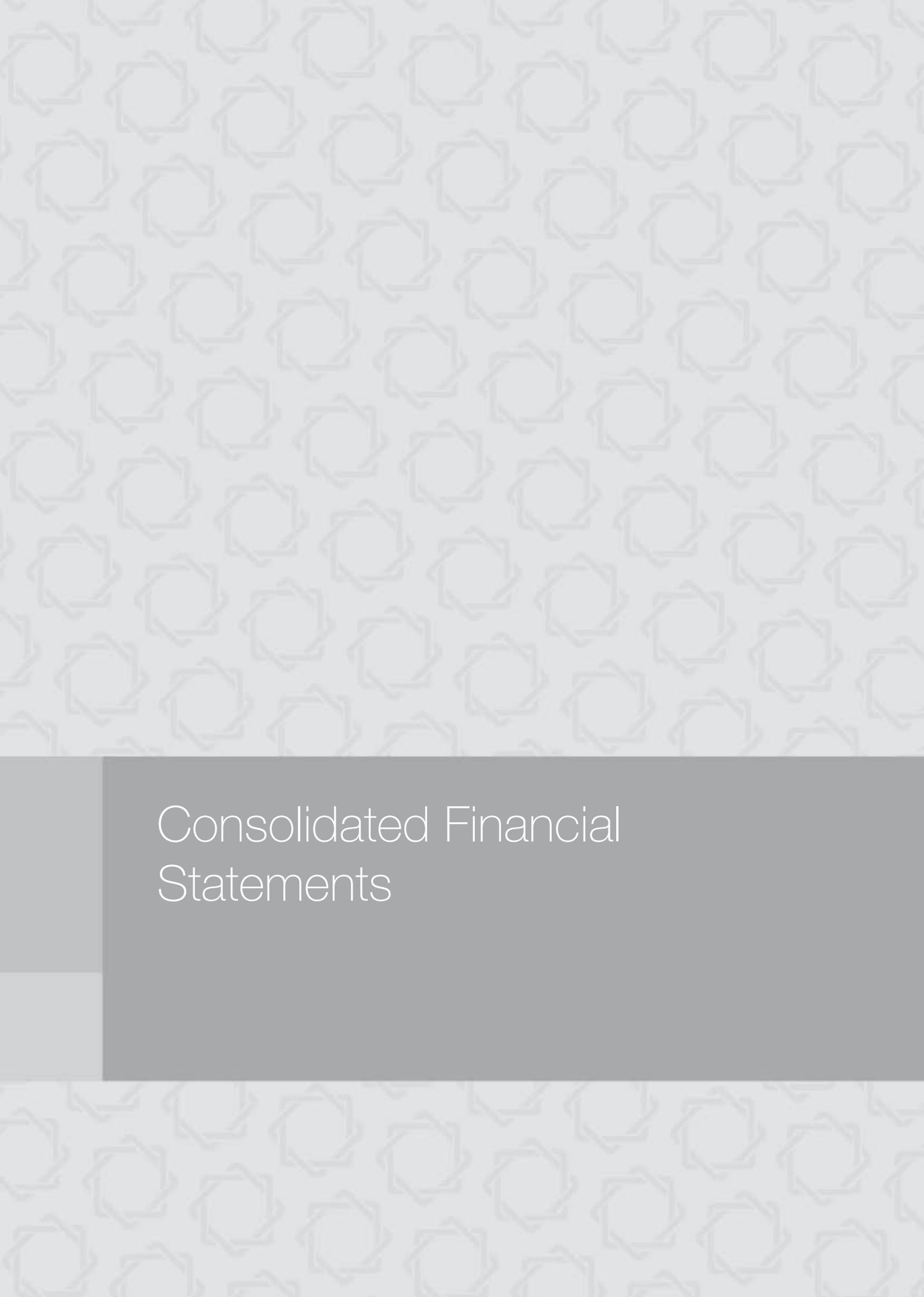
In addition, in our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as of 31 December 2009 and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards.

Other Regulatory Matters

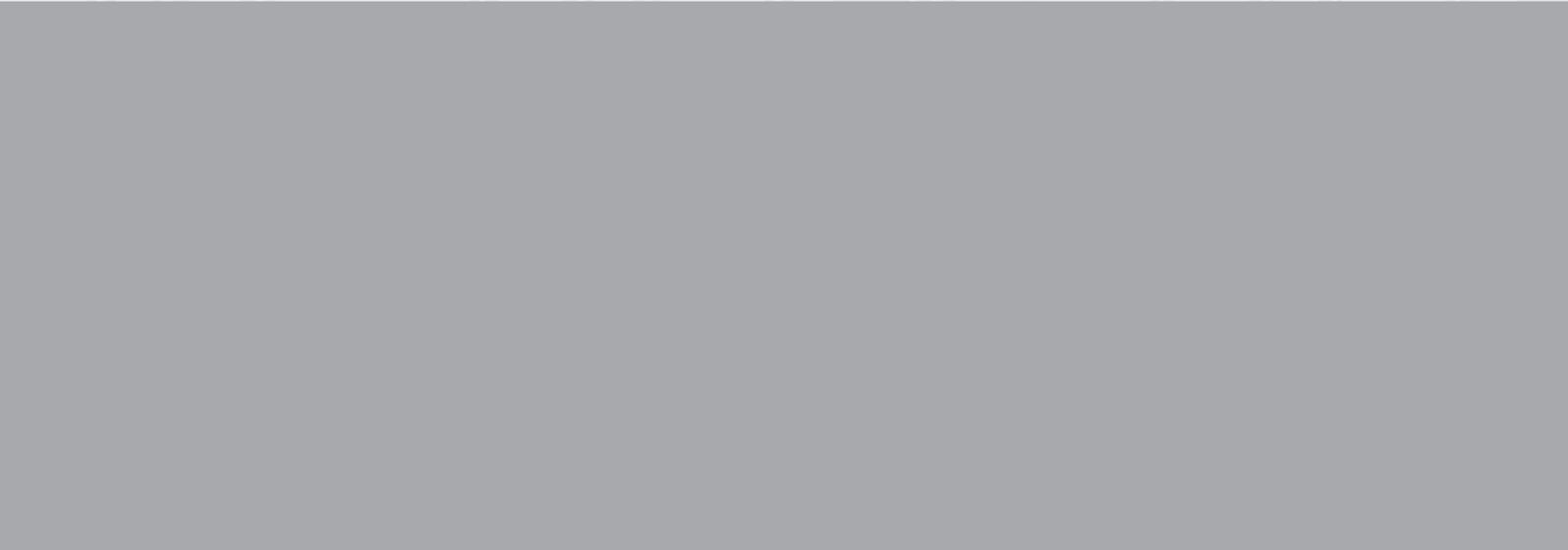
We confirm that, in our opinion, proper accounting records have been kept by the Bank and the consolidated financial statements, and the contents of the Report of the Board of Directors relating to these consolidated financial statements, are in agreement therewith. We further report, to the best of our knowledge and belief, that no violations of the Bahrain Commercial Companies Law, nor of the Central Bank of Bahrain and Financial Institutions Law, nor of the memorandum and articles of association of the Bank have occurred during the year ended 31 December 2009 that might have had a material adverse effect on the business of the Bank or on its consolidated financial position, and that the Bank has complied with the terms of its banking licence.



15 February 2010
Manama, Kingdom of Bahrain

The background of the page is a repeating pattern of overlapping, light gray octagons. Each octagon is slightly offset from the others, creating a sense of depth and movement. The pattern covers the entire page, with a dark gray horizontal band at the bottom where the title is located.

Consolidated Financial Statements



Consolidated Statement of Financial Position

At 31 December 2009

	Note	2009 BD 000	2008 BD 000
ASSETS			
Cash and balances with banks and Central Bank of Bahrain	7	41,111	69,791
Murabaha due from banks	8	24,612	64,421
Financing contracts with customers	9	658,748	578,482
Investments	10	227,381	204,643
Investment in associates	11	77,569	71,180
Investment properties	12	136,920	124,984
Receivables, prepayments and other assets	13	124,549	97,776
Goodwill and intangibles	14	25,172	10,599
Premises and equipment		24,358	31,409
		1,340,420	1,253,285
Assets of disposal group classified as held for sale	15	32,959	31,390
TOTAL ASSETS		1,373,379	1,284,675
LIABILITIES, UNRESTRICTED INVESTMENT ACCOUNTS AND EQUITY			
LIABILITIES			
Murabaha and due to banks		152,738	301,452
Murabaha and due to non-banks		183,948	224,880
Customers' current accounts		52,155	53,236
Other liabilities	17	35,052	26,268
Subordinated Murabaha payable	18	97,189	-
		521,082	605,836
Liabilities associated with disposal group classified as held for sale	15	1,890	19,532
Total liabilities excluding unrestricted investment accounts		522,972	625,368
Unrestricted investment accounts	19	499,293	310,474
Total liabilities including unrestricted investment accounts		1,022,265	935,842
EQUITY ATTRIBUTABLE TO SHARE HOLDERS OF THE PARENT			
Share capital	20	177,140	161,036
Share premium		71,403	71,403
Statutory reserve	21	12,420	11,807
General reserve	20	28,236	27,596
Available for sale reserve		(5,984)	(4,769)
Investment revaluation reserve		37,043	37,764
Foreign currency translation reserve		(1,688)	(1,383)
Retained earnings		6,239	16,743
		324,809	320,197
NON-CONTROLLING INTERESTS		26,305	26,997
NON-CONTROLLING INTERESTS IN DISPOSAL GROUP CLASSIFIED AS HELD FOR SALE	15	-	1,639
		351,114	348,833
TOTAL LIABILITIES, UNRESTRICTED INVESTMENT ACCOUNTS AND EQUITY		1,373,379	1,284,675
RESTRICTED INVESTMENT ACCOUNTS		74,196	93,269
COMMITMENTS AND CONTINGENT ITEMS	22	80,610	198,017

Bader Abdul Muhsen Al-Mukhaizeem

Chairman of the Board of Directors

Abdulhakeem Yaqoub Alkhayyat

Managing Director and Chief Executive Officer

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

Consolidated Statement of Income

For the year ended 31 December 2009

	Note	2009 BD 000	2008 BD 000
Income from retail and corporate banking activities	23	51,248	38,664
Income from investment activities	24	6,607	30,428
Share of income of associates	11	7,514	21,034
Other income		(289)	7,666
		65,080	97,792
Less: Profit on Murabaha due to banks, non-banks and subordinated Murabaha payable		9,194	14,870
		55,886	82,922
Staff costs		10,777	10,418
Depreciation		3,157	2,980
Provisions	26	1,007	8,453
Other operating expenses	27	14,700	11,688
		29,641	33,539
Net income before profit on unrestricted investment accounts		26,245	49,383
Less: Profit on unrestricted investment accounts		20,817	9,865
Profit for the year from continuing operations		5,428	39,518
Loss for the year from discontinued operations	15	(2,266)	(1,084)
Net income for the year		3,162	38,434
Net income attributable to non-controlling interests		2,970	(2,748)
NET INCOME ATTRIBUTABLE TO SHARE HOLDERS OF THE PARENT		6,132	35,686

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

Consolidated Statement of Comprehensive Income

For the year ended 31 December 2009

	2009 BD 000	2008 BD 000
Net income for the year	3,162	38,434
Other comprehensive income:		
Net unrealized loss on available for sale investments	(716)	(1,592)
Net movement in foreign currency translation reserve	(305)	(1,383)
Share of other comprehensive income of associate	(499)	(3,177)
Other comprehensive income for the year	(1,520)	(6,152)
Total Comprehensive Income for the Year	1,642	32,282
Attributable to non-controlling interests	2,970	(2,748)
ATTRIBUTABLE TO SHARE HOLDERS OF THE PARENT	4,612	29,534

None of the other comprehensive income for the year is attributable to the discontinued operations.

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

Consolidated Statement of Changes in Equity

For the year ended 31 December 2009

	Attributable to the shareholders of the parent											Non-controlling interests in investment held for sale	Total equity	
	Note	Share capital BD 000	Share premium BD 000	Statutory reserve BD 000	General reserve BD 000	Available for sale reserve BD 000	Investment revaluation reserve BD 000	Foreign currency translation reserve BD 000	Retained earnings BD 000	Total BD 000	Non-controlling interests BD 000			
Balance at														
1 January 2009		161,036	71,403	11,807	27,596	(4,769)	37,764	(1,383)	16,743	320,197	26,997	1,639	348,833	
Total comprehensive income for the year		-	-	-	-	(1,215)	-	(305)	6,132	4,612	(3,245)	275	1,642	
Transfer to investment revaluation reserve		-	-	-	-	-	(721)	-	721	-	-	-	-	
Transfer to general reserve	20	-	-	-	16,744	-	-	-	(16,744)	-	-	-	-	
Bonus shares issued	20	16,104	-	-	(16,104)	-	-	-	-	-	-	-	-	
Transfer to statutory reserve	21	-	-	613	-	-	-	-	(613)	-	-	-	-	
Net movement in non-controlling interests		-	-	-	-	-	-	-	-	-	2,553	(1,914)	639	
Balance at														
31 December 2009		177,140	71,403	12,420	28,236	(5,984)	37,043	(1,688)	6,239	324,809	26,305	-	351,114	
Balance at														
1 January 2008		70,016	15,040	8,238	20,173	-	22,390	-	17,925	153,782	10,479	-	164,261	
Total comprehensive income for the year		-	-	-	-	(4,769)	-	(1,383)	35,686	29,534	2,748	(618)	31,664	
Transfer to investment revaluation reserve		-	-	-	-	-	17,119	-	(17,119)	-	-	-	-	
Transfer to retained earnings on sale of investments		-	-	-	-	-	(1,745)	-	1,745	-	-	-	-	
Increase in non-controlling interests due to new subsidiaries		-	-	-	-	-	-	-	-	-	13,770	2,257	16,027	
Transfer to general reserve		-	-	-	17,925	-	-	-	(17,925)	-	-	-	-	
Bonus shares issued		10,502	-	-	(10,502)	-	-	-	-	-	-	-	-	
Issue of new shares		80,518	56,363	-	-	-	-	-	-	136,881	-	-	136,881	
Transfer to statutory reserve	21	-	-	3,569	-	-	-	-	(3,569)	-	-	-	-	
Balance at 31														
December 2008		161,036	71,403	11,807	27,596	(4,769)	37,764	(1,383)	16,743	320,197	26,997	1,639	348,833	

Note: Included in retained earnings is a non-distributable reserve amounting to BD 1,534 (2008: BD 906) thousand relating to subsidiaries of the Bank.

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

Consolidated Statement of Cash Flows

For the year ended 31 December 2009

	Note	2009 BD 000	2008 BD 000
OPERATING ACTIVITIES			
Net income for the year		3,162	38,434
Adjustments for:			
Provisions		1,007	8,453
Depreciation		3,157	2,980
Gain on sale of investment properties	24	-	(2,026)
Loss on sale of investments	24	-	302
Share of income of associates	11	(7,514)	(21,034)
Unrealised loss / (gain) on investments	24	850	(9,783)
Unrealised gain on investment properties	24	(158)	(9,220)
Other movements		2,744	597
Operating income before changes in operating assets and liabilities		3,248	8,703
Changes in operating assets and liabilities:			
Mandatory reserve with Central Bank of Bahrain		7,494	(19,909)
Financing contracts with customers		(80,028)	(305,942)
Receivables, prepayments and other assets		(25,182)	(28,760)
Murabahas and due to banks		(160,689)	224,123
Murabaha and due to non-banks		(40,932)	(65,002)
Customers' current accounts		(1,081)	(53,914)
Other liabilities		5,883	984
Net cash used in operating activities		(291,287)	(239,717)
INVESTING ACTIVITIES			
Acquisition of a subsidiary - net of cash and bank balances acquired	6	-	(8,758)
Purchase of investments		(43,049)	(74,904)
Purchase of investments in associates	11	(850)	(13,999)
Purchase of subsidiary classified as held for sale		-	(11,602)
Purchase of investment properties		(7,705)	(42,206)
Proceeds from sale / maturity of investments		7,400	5,607
Proceeds from refund of advance paid for investment		7,766	-
Proceeds from sale of investment properties		167	8,315
Purchase of intangibles	14	-	(4,859)
Purchase of premises and equipment		(20,084)	(15,933)
Net cash used in investing activities		(56,355)	(158,339)
FINANCING ACTIVITIES			
Proceeds from issue of shares		-	136,881
Cash contributed by non-controlling shareholders in new subsidiaries		-	13,770
Increase in unrestricted investment accounts		188,819	257,383
Net movement in non controlling interests		639	-
Subordinated Murabaha payable		97,189	-
Net cash flows from financing activities		286,647	408,034
(DECREASE) / INCREASE IN CASH AND CASH EQUIVALENTS		(60,995)	9,978
Cash and cash equivalents at 1 January		102,488	92,510
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	28	41,493	102,488

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

Consolidated Statement of Restricted Investment Accounts

For the year ended 31 December 2009

	Balance at 1 January 2009 BD 000	Deposits BD 000	Gross Income BD 000	Mudarib Fee BD 000	Withdrawals / distributions BD 000	Balance at 31 December 2009 BD 000
Murabaha contracts	86,667	57,822	4,103	(101)	(79,594)	68,897
Ijarah Muntahia Bittamleek contracts	6,602	-	378	(189)	(1,492)	5,299
	93,269	57,822	4,481	(290)	(81,086)	74,196

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

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

Notes to the Consolidated Financial Statements

At 31 December 2009

1 CORPORATE INFORMATION

Kuwait Finance House (Bahrain) B.S.C. (c) ["the Bank"] is a closed joint stock company incorporated in the Kingdom of Bahrain on 22 January 2002 under the Bahrain Commercial Companies Law No. 21/2001 and is registered with the Ministry of Industry and Commerce under commercial registration (CR) number 48128. The Bank is regulated and supervised by the Central Bank of Bahrain (the "CBB") and has an Islamic retail banking licence. The Bank operates under Islamic principles and in accordance with all the relevant regulatory guidelines for Islamic banks issued by the CBB. The address of the Bank's registered office is Building 1 W, Isa Al Kabeer Avenue, Block 316, Manama, Kingdom of Bahrain.

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

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

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

The consolidated financial statements were authorized for issue in accordance with a resolution of the Board of Directors passed on 15 February 2010.

2 BASIS OF PREPARATION

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

Statement of Compliance

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

Basis of consolidation

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

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

Subsidiaries are fully consolidated from the date on which control is transferred to the Group. Control is achieved where the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The results of subsidiaries acquired or disposed off during the year are included in the consolidated statement of income from the date of acquisition or up to the date of disposal, as appropriate.

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

Notes to the Consolidated Financial Statements

At 31 December 2009

3 ACCOUNTING POLICIES

3.1 Significant accounting judgments and estimates

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

Going concern

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

Classification of investments

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

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

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

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

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

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

Fair value of financial instruments

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

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

- For investments that are traded in organised financial markets, fair value is determined by reference to the quoted market price prevailing on the date of consolidated statement of financial position.
- For private equity investments, fair value is determined using recent buy or sell transactions with third parties that are either completed or are in progress. Where no recent significant transactions have been completed or are in progress, fair value is determined by reference to valuation models, including net present value of estimated future cash flows, and based on earnings before financing cost, tax, depreciation and amortization ("EBITDA") multiples.
- For equity investments which are primarily set up to invest in real estate, fair value is determined by revaluing the underlying real estate properties of these companies based on the valuations performed by independent valuers.
- Investments in funds, unit trusts, or similar investment entities are carried at the latest net asset valuation provided by the fund administrator.

Impairment losses on financing contracts with customers

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

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

Notes to the Consolidated Financial Statements

At 31 December 2009

3 ACCOUNTING POLICIES (continued)

Impairment of equity investments

The Group treats available for sale equity investments as impaired when there has been a significant or prolonged decline in the fair value below its cost or where other objective evidence of impairment exists. The determination of what is 'significant' or 'prolonged' requires judgment. The Group evaluates factors, such as the historical share price volatility for quoted entities and future cash flows and the discount factors for unquoted entities.

Liquidity

The Group manages its liquidity by maintaining an adequate ratio of liquid assets to customer liabilities and unrestricted investment accounts, which is set out in the liquidity risk disclosures in Note 33.3. This requires judgement with respect to whether assets can be considered liquid.

3.2 Adoption of new standards

During the year, the Group has adopted the following standards effective for the annual periods beginning on or after 1 January 2009:

IAS 1 'Presentation of Financial Statements (Revised)':

The revised standard requires changes in equity arising from transactions with owners in their capacity as owners to be presented in the statement of changes in equity. All other changes in equity (i.e. non-owner changes in equity) are required to be presented separately in the statement of comprehensive income. In addition, an entity has an option to continue presenting a 'traditional' statement of income complemented by a second statement, the statement of comprehensive income (SOCI), or to present a single statement, also named 'statement of comprehensive income', that includes both elements. The Group has taken the option of presenting a statement of income complemented by the statement of comprehensive income.

IFRS 8 'Operating Segments':

The new standard which replaced IAS 14 'Segment reporting' requires a 'management approach' under which segment information is presented on the same basis as that used for internal reporting purposes. This has resulted in change in the reportable segments presented and the segment information is reported in a manner that is more consistent with the internal reporting provided to the chief operating decision-maker.

Amendments to IFRS 7 'Financial Instruments: Disclosures':

The amendments were issued to enhance fair value and liquidity disclosures. With respect to fair value, the amendments require disclosure of a three level fair value hierarchy, by class, for all financial instruments recognized at fair value and specific disclosures relating to the transfers between levels in the hierarchy and detailed disclosures related to level 3 of the fair value hierarchy. In addition, the amendments modified the required liquidity disclosures with respect to financial guarantee contracts in the contractual maturity analysis.

Amendments to IAS 23 'Borrowing Costs (Revised)':

The amendments have removed the option to immediately expense the borrowing cost on assets that require substantial period of time to get ready for use or sale. The amendments do not have any impact on the consolidated financial statements for the year ended 31 December 2009.

Amendments to IAS 40 'Investment Property':

IAS 40 has been amended to bring within its scope investment property under construction. Consequently, such property is measured at fair value. The Group has amended its policy accordingly. The policy has been applied prospectively from 1 January 2009. This amendment has no impact on the consolidated statement of income for the year ended 31 December 2009 as there is no material difference between the fair value and carrying value of the investment property under construction at the date of reclassification and at the date of consolidated statement of financial position.

3.3 Summary of Significant Accounting Policies

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

3.3.1 Foreign currency translation

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

(i) Transactions and balances

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

Notes to the Consolidated Financial Statements

At 31 December 2009

3 ACCOUNTING POLICIES (continued)

Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the date of consolidated statement of financial position. All differences are taken to the consolidated statement of income. The differences on foreign currency borrowings that provide an effective protection against a net investment in a foreign entity are taken to consolidated statement of comprehensive income until the disposal of the net investment, at which time they are recognised in the consolidated statement of income.

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

(ii) Group companies

As at the reporting date, the assets and liabilities of subsidiaries are translated into the Group's presentation currency (the Bahraini Dinars) at the rate of exchange ruling at the date of consolidated statement of financial position, and their statements of income are translated at the weighted average exchange rates for the year. Exchange differences arising on translation are recognized in other comprehensive income. On disposal of a foreign subsidiary, the cumulative amount recognised in other comprehensive income relating to that particular foreign subsidiary is recognised in the consolidated statement of income in 'Other operating expenses' or 'Other income'.

3.3.2. Financial instruments - Initial recognition and subsequent measurement

Date of recognition

All financial assets and liabilities are initially recognized on the trade date, i.e. the date that the Group becomes a party to the contractual provisions of the instrument. This includes purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the marketplace.

Initial measurement of financial instruments

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

(i) Murabaha due from banks

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

(ii) Financing contracts with customers

(a) Murabaha receivables

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

(b) Musharaka contracts

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

(c) Ijarah Muntahia Bittamleek

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

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

(iii) Investments

These are classified as follows:

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

Notes to the Consolidated Financial Statements

At 31 December 2009

3 ACCOUNTING POLICIES (continued)

(a) Carried at fair value through statement of income

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

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

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

(b) Available for sale

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

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

(iv) Murabaha and due to banks

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

(v) Murabaha and due to non banks

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

(vi) Unrestricted investment accounts

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

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

The provisions against financing contracts with customers are charged to both the shareholders and the holders of the unrestricted investment accounts, considering the allocation of various assets. Any reversal in provision is charged to shareholders or the holders of the unrestricted investment accounts to the extent it was charged to them. Expenses are allocated in proportion to average unrestricted investment accounts to total average assets of the Bank.

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

Notes to the Consolidated Financial Statements

At 31 December 2009

3 ACCOUNTING POLICIES (continued)

3.3.3 Derecognition of financial assets and financial liabilities

(i) Financial assets

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

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

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

(ii) Financial liabilities

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

3.3.4 Impairment of financial assets

The Group assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred ‘loss event’) and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated.

Evidence of impairment may include indications that the counterparty or a group of counterparties is experiencing significant financial difficulty, default or delinquency of amount due, the probability that they will enter bankruptcy or other financial reorganisation and where observable data indicates that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

(i) Murabaha due from banks, financing contracts with customers and other receivables

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

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

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

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

Notes to the Consolidated Financial Statements

At 31 December 2009

3 ACCOUNTING POLICIES (continued)

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

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

(ii) Available for sale investments

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

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

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

3.3.5 Offsetting financial instruments

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

3.3.6 Land and development costs

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

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

3.3.7 Recognition of income and expense

(i) Income recognition

(a) Murabaha

Where the income is quantifiable and contractually determined at the commencement of the contract, income is recognized on a time-apportioned basis over the period of the contract based on the principal amounts outstanding. Accrual of income is suspended when the Group believes that the recovery of these amounts may be doubtful.

(b) Ijarah Muntahia Bittamleek

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

(c) Musharaka

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

(d) Dividends

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

(e) Fees and commission income

Fees and commission income is recognized when earned.

Notes to the Consolidated Financial Statements

At 31 December 2009

3 ACCOUNTING POLICIES (continued)

(f) Sale of property under development

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

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

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

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

(g) Service income

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

(h) Revenue from sale of goods

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

(ii) Expense recognition

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

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

(b) Profit on unrestricted investment accounts

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

3.3.8 Investment in associates

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

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

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

3.3.9 Investment properties

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

Investment properties are derecognised when they have been disposed of or permanently withdrawn from use and no future economic benefit is expected from its disposal. Any gains or losses on the retirement or disposal of investment property are recognised in the consolidated statement of income in the year of retirement or disposal.

Notes to the Consolidated Financial Statements

At 31 December 2009

3 ACCOUNTING POLICIES (continued)

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

3.3.10 Premises and equipment

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

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

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

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

3.3.11 Business combinations and goodwill

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

Goodwill acquired in a business combination is initially measured at cost being the excess of the cost of the business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities acquired. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is reviewed for impairment, annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired.

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

3.3.12 Intangible assets

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

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

3.3.13 Impairment of non financial assets

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

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

Notes to the Consolidated Financial Statements

At 31 December 2009

3 ACCOUNTING POLICIES (continued)

3.3.14 Financial guarantees

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

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

3.3.15 Provisions

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

3.3.16 Fiduciary assets

The Group has placed certain investments with investors. These investments are managed by the Group in fiduciary capacity and are not reported in the consolidated financial statements, as they are not the assets of the Group.

3.3.17 Segment reporting

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

3.3.18 Investment revaluation reserve

Unrealized net gains / loss resulting from revaluation of investments classified as fair value through statement of income and investment properties, are appropriated to investment revaluation reserve and are not available for distribution to shareholders.

3.3.19 Cash and cash equivalents

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

3.3.20 Restricted investment accounts

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

3.3.21 Inventories

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

3.4 Future changes in accounting policies

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

- IAS 27 - Consolidated and separate financial statements (Revised), July 2009
- IFRS 3 - Business combinations (Revised), July 2009
- IFRS 9 - Financial Instruments, January 2013

Notes to the Consolidated Financial Statements

At 31 December 2009

3 ACCOUNTING POLICIES (continued)

Management expects that amended IAS 27 and IFRS 3 will introduce a number of changes in the accounting for business combination occurring from the beginning of the period of initial application. This will impact the amount of goodwill recognised, the reported results in the period the acquisition occurs and future reported results. IAS 27 revised requires that a change in the ownership interest of a subsidiary (without loss of control) is accounted for as an equity transaction. Therefore, such a transaction will no longer give rise to goodwill, nor will it give rise to a gain or loss.

IFRS 9 has been issued to improve and simplify the approach for classification and measurement of financial assets compared with the requirements of IAS 39. It applies a consistent approach, based on the business model of the entity for managing the financial assets and the contractual cash flow characteristics of the financial asset. All the financial assets will be measured subsequently either at amortised cost or fair value. The option of recognizing fair value gain/loss in other comprehensive income will be available only for equity instruments. The management is considering the implications of the Standard on the financial statements in the year of adoption.

4 INVESTMENT IN SUBSIDIARIES

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

Subsidiary	Activities	Year of incorporation	Country of incorporation	Ownership %
Miracle Graphics Company W.L.L.	The company is engaged in the business of ordinary photography, printing and publishing.	2003	Kingdom of Bahrain	70.00
Baytik Investment Advisory W.L.L.	The principal activity of the company is providing advisory services to the Bank and its affiliates.	2003	Kingdom of Bahrain	100.00
Al-Enma House for Real Estate B.S.C. (c)	The company is engaged in property management of commercial, industrial and residential buildings and the provision of security services to buildings and facilities.	2003	Kingdom of Bahrain	59.28
Bayan Group for Property Investments W.L.L.	The principal activity of the company is to buy, sell and lease properties and to undertake joint ventures with other companies engaged in similar activities.	2004	Kingdom of Bahrain	100.00
Al Kindi Pharmaceutical Industries (Public Shareholding Company)	The company is engaged in the manufacture of drugs in all their pharmaceutical dosage forms and the manufacturing of semi-pharmaceutical products specialized for skin care and cosmetics.	1997	Hashemite Kingdom of Jordan	82.20
Kuwait Finance House - Jordan and its subsidiaries	The company and its subsidiaries are engaged in investment advisory and investments in private equities and real estate development.	2007	Hashemite Kingdom of Jordan	100.00
Ishbiliya Village W.L.L.	The principal activity of the company is to invest in and develop real estate projects and consequently buying, selling and marketing of such properties.	2005	Kingdom of Bahrain	73.72
Motherwell Bridge Limited	The Company is engaged in design, engineering, construction management and manpower management of engineering projects principally in the oil, gas, petrochemical and steel industries.	2008	United Kingdom	85.00

Notes to the Consolidated Financial Statements

At 31 December 2009

5 CLASSIFICATION OF FINANCIAL INSTRUMENTS BY MEASUREMENT BASIS

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

	Financial assets at fair value through statement of income BD 000	Financial assets as available for sale BD 000	Financial assets at cost/ amortised cost BD 000	Financial liabilities at cost/ amortised cost BD 000	Total 2009 BD 000
ASSETS					
Cash and balances with banks and Central Bank of Bahrain	-	-	41,111	-	41,111
Murabaha due from banks	-	-	24,612	-	24,612
Financing contracts with customers	-	-	658,748	-	658,748
Investments	182,358	45,023	-	-	227,381
Receivables	-	-	41,573	-	41,573
Assets of disposal group classified as held for sale	-	-	3,712	-	3,712
	182,358	45,023	769,756	-	997,137

LIABILITIES AND UNRESTRICTED INVESTMENT ACCOUNTS

Murabaha and due to banks	-	-	-	152,738	152,738
Murabaha and due to non-banks	-	-	-	183,948	183,948
Customers' current accounts	-	-	-	52,155	52,155
Other liabilities	-	-	-	35,052	35,052
Subordinated Murabaha payable	-	-	-	97,189	97,189
Liabilities associated with disposal group classified as held for sale	-	-	-	1,890	1,890
Unrestricted Investment accounts	-	-	-	499,293	499,293
	-	-	-	1,022,265	1,022,265

Notes to the Consolidated Financial Statements

At 31 December 2009

5 CLASSIFICATION OF FINANCIAL INSTRUMENTS BY MEASUREMENT BASIS (continued)

	Financial assets at fair value through statement of income BD 000	Financial assets as available for sale BD 000	Financial assets at cost/ amortised cost BD 000	Financial liabilities at cost/ amortised cost BD 000	Total 2008 BD 000
ASSETS					
Cash and balances with banks and Central Bank of Bahrain	-	-	69,791	-	69,791
Murabaha due from banks	-	-	64,421	-	64,421
Financing contracts with customers	-	-	578,482	-	578,482
Investments	160,238	44,405	-	-	204,643
Receivables	-	-	70,162	-	70,162
Assets of disposal group classified as held for sale	-	-	6,699	-	6,699
	160,238	44,405	789,555	-	994,198
LIABILITIES AND UNRESTRICTED INVESTMENT ACCOUNTS					
Murabaha and due to banks	-	-	-	301,452	301,452
Murabaha and due to non-banks	-	-	-	224,880	224,880
Customers' current accounts	-	-	-	53,236	53,236
Other liabilities	-	-	-	26,268	26,268
Liabilities associated with disposal group classified as held for sale	-	-	-	15,896	15,896
Unrestricted Investment accounts	-	-	-	310,474	310,474
	-	-	-	932,206	932,206

6 BUSINESS COMBINATION

During the prior year, the Bank acquired 85% stake in Motherwell Bridge Limited (MBL), a company incorporated in the United Kingdom. MBL specializes in the design, engineering, construction management and manpower management of engineering projects principally in the oil, gas, petrochemical and steel industries. MBL was acquired with a view to selling down majority of the equity stake within a period of one year from the date of acquisition. Accordingly, the gross amount of assets, liabilities and non-controlling interest of MBL were disclosed as separate line items in the consolidated financial statements for the year ended 31 December 2008 in accordance with the requirements of IFRS 5, "Non Current Assets Held for Sale and Discontinued Operations". Due to the market conditions during the year, the management decided not to pursue the plan to sell MBL. Accordingly, MBL has been consolidated on a line by line basis during the year. This has no significant impact on the income statement presentation for the year ended 31 December 2008.

Notes to the Consolidated Financial Statements

At 31 December 2009

6 BUSINESS COMBINATION (continued)

On the date of acquisition, the carrying value and the fair value of identifiable assets and liabilities of MBL were as follows:

	Carrying Value BD 000	Fair Value BD 000
Assets		
Premises and equipment	1,821	1,821
Receivables, prepayments and other assets	8,929	8,929
Cash and bank balances	11,302	11,302
	22,052	22,052
Liabilities		
Liabilities	8,147	8,147
Net assets	13,905	13,905
Non-controlling interest		2,175
Net assets acquired by the Bank		11,730
Goodwill arising on acquisition		30,812
Cost of acquisition		42,542
Cash outflow on acquisition:		
Cash acquired with the subsidiary		11,302
Cash paid		(42,542)
Net cash outflow		(31,240)

7 CASH AND BALANCES WITH BANKS AND CENTRAL BANK OF BAHRAIN

	2009 BD 000	2008 BD 000
Cash	3,903	2,526
Balances with banks	12,962	33,389
Balances with Central Bank of Bahrain	7.1 24,246	33,876
	7.2 41,111	69,791

7.1 This includes mandatory reserve of BD 24,230 (2008: BD 31,724) thousand, which is not available for use in the Group's day to day operation.

7.2 This includes BD 27,718 (2008: BD 32,173) thousand financed by Unrestricted Investment Accounts (URIA) to meet the mandatory reserve requirement of the CBB and day to day operational cash requirements of the Bank.

8 MURABAHA DUE FROM BANKS

	2009 BD 000	2008 BD 000
Murabaha receivables from banks - international commodities	24,637	64,464
Deferred profits	(25)	(43)
	24,612	64,421

The above amounts are entirely financed through URIA Holders' funds. These carry profit rates ranging from 0.55% to 0.75% per annum (2008: 0.5% to 5.5% per annum).

Notes to the Consolidated Financial Statements

At 31 December 2009

9 FINANCING CONTRACTS WITH CUSTOMERS

	Self financed*		URIA financed**		Total	
	2009 BD 000	2008 BD 000	2009 BD 000	2008 BD 000	2009 BD 000	2008 BD 000
Murabaha receivables	88,639	200,278	343,171	170,747	431,810	371,025
Deferred profits	(9,859)	(17,423)	(26,967)	(14,924)	(36,826)	(32,347)
Individual impairment	(1,183)	(941)	-	-	(1,183)	(941)
	77,597	181,914	316,204	155,823	393,801	337,737
Ijarah Muntahia Bittamleek (Note 9.1)	162,283	177,766	95,031	58,057	257,314	235,823
Individual impairment	-	(76)	-	-	-	(76)
	162,283	177,690	95,031	58,057	257,314	235,747
Musharaka contracts	19,488	17,257	-	-	19,488	17,257
	259,368	376,861	411,235	213,880	670,603	590,741
Collective impairment					(11,855)	(12,259)
					658,748	578,482

* Represents financing contracts financed through funds other than URIA.

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

9.1 These mainly comprise of land and building and are presented net of accumulated depreciation amounting to BD 21,041 (2008: BD 18,479) thousand.

9.2 The gross amount of financings individually determined to be impaired, before deducting any individually assessed impairment allowance is BD 1,676 (2008: BD 1,257) thousand.

9.3 The Group considers the promise made in the Murabaha to the purchase order as obligatory.

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

	Individual impairment 2009 BD 000	Collective impairment 2009 BD 000	Total 2009 BD 000	Individual impairment 2008 BD 000	Collective impairment 2008 BD 000	Total 2008 BD 000
At 1 January	1,017	12,259	13,276	336	9,418	9,754
Charge / (reversal) for the year	166	(404)	(238)	681	2,841	3,522
At 31 December	1,183	11,855	13,038	1,017	12,259	13,276

10 INVESTMENTS

The Group's investments are classified as follows:

		2009 BD 000	2008 BD 000
Investments at fair value through statement of income	10.1	182,358	160,238
Available for sale investments	10.2	45,023	44,405
		227,381	204,643

Notes to the Consolidated Financial Statements

At 31 December 2009

10 INVESTMENTS (continued)

10.1 Investments at fair value through statement of income

	2009 BD 000	2008 BD 000
Designated upon initial recognition at fair value through statement of income:		
Equities - quoted	10,653	9,862
Equities - unquoted	162,171	139,270
Managed funds - at Net Asset Value	9,534	11,106
	182,358	160,238

10.2 Available for sale investments

Equities - quoted *	8,414	7,757
Equities - unquoted *	881	2,273
Government sukuk **	11,447	16,455
Other sukuk **	24,281	17,920
	45,023	44,405

* These are stated net of impairment loss of BD 4,621 (2008: 3,802) thousand.

** As at 31 December 2009, investment in sukuku is entirely financed through URIA Holders' funds.

The composition of the investment portfolio is as follows:

	New Zealand/ Australia BD 000	Middle East BD 000	Total	
			2009 BD 000	2008 BD 000
Commercial and technology	5,883	-	5,883	9,217
Real estate development	-	164,846	164,846	128,920
Banking and financial services	-	55,898	55,898	45,679
Others	-	754	754	20,827
	5,883	221,498	227,381	204,643

10.3 Reclassification of investments

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

As at 31 December 2009 the carrying and fair value of reclassified investments is BD 2,100 (31 December 2008: BD 2,143) thousand. During the year, the Group has recognized fair value loss of BD 43 (31 December 2008: BD 2,266) thousand on the above investments in the consolidated statement of comprehensive income. Had there been no reclassification the said loss would have been recognised in the consolidated statement of income.

Notes to the Consolidated Financial Statements

At 31 December 2009

11 INVESTMENT IN ASSOCIATES

The Group has the following associates as at 31 December 2009:

Name of the associate	Nature of business	Country of incorporation	Percentage holding
Durrat Khaleej Al Bahrain B.S.C.(c) ("Durrat")	Development of Durrat Al Bahrain project with a view to sell land, residential and commercial properties.	Kingdom of Bahrain	48%
Deera Investment and Real Estate Development Company ("Deera")	Real estate project development and property management.	Hashemite Kingdom of Jordan	28%
Energy Central B.S.C.(c) ("Energy")	Providing district cooling, sea water desalination, waste water treatment and related services.	Kingdom of Bahrain	33.50%

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

	2009 BD 000	2008 BD 000
Current assets	231,607	224,684
Non current assets	51,554	49,035
Current liabilities	(60,284)	(57,084)
Non current liabilities	(86,749)	(100,628)
Net assets	136,128	116,007

	2009 BD 000	2008 BD 000
Revenue	58,498	138,117
Net income for the year	13,147	42,885

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

	2009 BD 000	2008 BD 000
Carrying amount at 1 January	71,180	41,356
Investment during the year	850	13,999
Transfers during the year	-	917
Adjustment on purchase of investment properties	-	811
Share of fair value changes on available for sale investments	(499)	(3,177)
Share of results	7,514	21,034
Other movements	(1,476)	(3,760)
Carrying amount at 31 December	77,569	71,180

Notes to the Consolidated Financial Statements

At 31 December 2009

12 INVESTMENT PROPERTIES

	2009 BD 000	2008 BD 000
Cost		
At 1 January	102,936	91,395
Additions	7,705	19,803
Disposals	(167)	(8,262)
Transfer to premises and equipment	(2,171)	-
Transfer from premises and equipment	4,545	-
Other movements	1,866	-
At 31 December	114,714	102,936
Fair value adjustment		
At 1 January	22,048	13,702
Unrealised gain on investment properties	158	9,220
Relating to disposals	-	(874)
At 31 December	22,206	22,048
Total	136,920	124,984

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

	2009 BD 000	2008 BD 000
Buildings	50,619	39,790
Lands	86,301	85,194
	136,920	124,984

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

These include certain properties in which the Bank's share is valued at BD 353 (2008: BD 353) thousand which are jointly owned with third parties and are subject to normal conditions applicable to joint ownership.

13 RECEIVABLES, PREPAYMENTS AND OTHER ASSETS

	2009 BD 000	2008 BD 000
Land and development cost (Note 13.1)	78,823	23,852
Performance and management fees receivable (Note 29)	20,658	15,545
Project expenses receivable	2,790	4,864
Inventories	2,157	2,695
Profit receivable	1,276	5,065
Receivable relating to investment property (Note 29)	-	4,522
Trade receivables of subsidiaries	9,728	29,341
Prepaid expenses	1,996	1,067
Advance for purchase of investment	380	6,024
Investment liquidation proceeds receivable	3,793	-
Other assets	2,948	4,801
	124,549	97,776

Notes to the Consolidated Financial Statements

At 31 December 2009

13.1 Land and development costs

	2009 BD 000	2008 BD 000
Land	51,982	19,276
Development costs	26,841	4,576
	78,823	23,852

This development cost represents construction, consultancy and borrowing cost capitalised relating to various real estate projects being undertaken by the Group.

14 GOODWILL AND INTANGIBLES

	Goodwill 2009 BD 000	Other intangible assets 2009 BD 000	Total 2009 BD 000	Goodwill 2008 BD 000	Other intangible assets 2008 BD 000	Total 2008 BD 000
Cost						
At 1 January	4,221	7,600	11,821	4,221	2,741	6,962
Additions	25,513	-	25,513	-	4,859	4,859
Transfer to assets of disposal group classified as held for sale	-	(7,600)	(7,600)	-	-	-
Other movements	(3,007)	-	(3,007)	-	-	-
At 31 December	26,727	-	26,727	4,221	7,600	11,821
Amorisation and impairment						
At 1 January	1,129	93	1,222	-	35	35
Amortisation charge for the year	-	225	225	-	58	58
Impairment loss for the year	426	-	426	1,129	-	1,129
Transfer to assets of disposal group classified as held for sale	-	(318)	(318)	-	-	-
At 31 December	1,555	-	1,555	1,129	93	1,222
Net book value						
At 1 January	3,092	7,507	10,599	4,221	2,706	6,927
At 31 December	25,172	-	25,172	3,092	7,507	10,599

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

	2009 BD 000	2008 BD 000
Miracle Graphics Company W.L.L.	800	1,226
Motherwell Bridge Limited	24,372	-
Al-Enma House for Real Estate B.S.C. (c)	-	1,866
	25,172	3,092

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

The recoverable amount of each cash generating unit's goodwill is based on value in use calculations using cash flow projections from financial budgets approved by senior management, extrapolated for five years using 2% growth rate. The discount rate of 12.5% has been applied to cash flow projections, which represents weighted average cost of capital adjusted for appropriate risk premium for these cash generating units. The key assumptions used in estimating recoverable amounts of cash generating units were sensitised to test the resilience of value in use calculations. On this basis, management believes that reasonable changes in key assumptions used to determine the recoverable amount of the Group's cash generating units will not result in an impairment.

Notes to the Consolidated Financial Statements

At 31 December 2009

15 INVESTMENT HELD FOR SALE

During second half of the year, the Group decided to dispose off Mena Telecom Limited ("Mena") which is a wholly owned subsidiary of the Group, incorporated in the Kingdom of Bahrain and engaged in the business of telecommunication. Accordingly the assets and liabilities of Mena have been classified as disposal group held for sale.

The results of Mena, included in the consolidated statement of income, are as follow:

	2009 BD 000	2008 BD 000
Revenues	11,789	7,715
Cost of sales	(7,051)	(6,994)
Gross profit	4,738	721
Other operating expenses	(7,004)	(1,805)
Loss for the year	(2,266)	(1,084)

The major classes of assets and liabilities of Mena, classified as held for sale as at 31 December 2009, are as follows:

	2009 BD 000
ASSETS	
Plant, equipment and intangible assets	27,876
Inventories	349
Prepayments	1,022
Trade and other receivables	3,642
Cash and bank balances	70
	32,959
LIABILITIES	
Trade and other payables	1,890
	1,890

	2009 BD 000	2008 BD 000
The net cash flows incurred by Mena are as follows:		
Cash flows used in operating activities	(6,165)	2,349
Cash flows used in investing activities	(16,360)	(4,965)
	(22,525)	(2,616)

16 FUNDS UNDER MANAGEMENT

At 31 December 2009, clients' funds managed in a fiduciary capacity amounted to BD 113,892 (2008: BD 113,892) thousand.

Notes to the Consolidated Financial Statements

At 31 December 2009

17 OTHER LIABILITIES

	2009 BD 000	2008 BD 000
Payable against purchase of investment properties (Note 29)	4,103	4,542
Pay orders issued not presented	3,133	3,141
Payable on account of financing contracts	1,116	789
Staff related accruals	2,395	2,967
Profit payable on account of murabaha due to banks and non-banks	1,377	1,599
Profit payable on unrestricted investment accounts	2,559	1,995
Trade payables of subsidiaries	12,366	9,952
Others	8,003	1,283
	35,052	26,268

18 SUBORDINATED MURABAHA PAYABLE

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

During the year, an amount of BD 752 thousand (2008: BD Nil) has been charged to the consolidated statement of income in respect of subordinated Murabaha payable.

19 UNRESTRICTED INVESTMENT ACCOUNTS

The mudarib share on investment accounts ranges from 20% to 40% (2008: 20% to 35%) depending on the investment period and in the case of saving accounts, where there is no restriction of cash withdrawal, the mudarib share ranges from 50% to 60% (2008: 50% to 60%). However, during the year, in addition to investors' share of profit, the Bank has distributed profit to investors from its own share of mudarib share. The rate of return for URIA holders, as at 31 December, for the last three financial years for various types of URIA is as follows:

	2009 Rate of return %	2008 Rate of return %	2007 Rate of return %
Saving Accounts	1.00	2.00	1.25
VIP Saving Accounts	1.25	2.50	1.75
One Month TCD	3.50	5.30	4.38
Three Months TCD	4.00	5.50	4.50
Six Months TCD	4.50	5.75	4.75
1 Year TCD	5.00	6.00	5.00

20 SHARE CAPITAL

	Note	2009 BD 000	2008 BD 000
Authorised share capital as of 31 December 2009 represents 3,500,000 thousand (2008: 3,500,000 thousand) shares of BD 0.1 (2008: BD 0.1) each.		350,000	350,000
Issued and fully paid-up share capital as of 31 December 2009 represents 1,771,405 thousand (2008: 1,610,368 thousand) shares of BD 0.1 (2008: BD 0.1) each	20.1 & 20.2	177,140	161,036

Notes to the Consolidated Financial Statements

At 31 December 2009

20 SHARE CAPITAL (continued)

20.1 Following a resolution passed by the shareholders of the Bank at Annual General Meeting (AGM) held on 19 April 2009 the Bank has:

(a) issued 161,037 thousand bonus shares (10% of the share capital) amounting to BD 16,104 thousand by transfer from general reserve resulting in increase in share capital to BD 177,140 thousand;

(b) transferred BD 16,744 thousand from retained earnings to general reserve.

20.2 Out of the issued and paid up capital, 120,456 thousands shares (2008: 109,505 thousands shares) of BD 0.1 (2008: BD 0.1) each are held under Employee Share Ownership Plan.

21 STATUTORY RESERVE

As required by Bahrain Commercial Companies Law ("BCCL") and the Bank's articles of association, 10% of the net income for the year has been transferred to the statutory reserve. However, as allowed under BCCL the Bank may resolve to discontinue such annual transfers when the reserve totals 50% of paid up share capital. The reserve is not distributable except in such circumstances as stipulated in the BCCL and following the approval of the CBB.

22 COMMITMENTS AND CONTINGENT ITEMS

	2009 BD 000	2008 BD 000
Contingent liabilities:		
Letters of credit	18,866	19,751
Guarantees	17,837	29,011
	36,703	48,762
Irrevocable commitments to extend credit:		
Original term to maturity of one year or less	43,681	149,255
Investment commitments	226	-
	80,610	198,017

Operating lease commitments

At 31 December 2009, the Group had commitments in respect of non cancellable operating leases amounting to BD 10,285 (2008: BD 5,967) thousand relating to leasehold premises. Of the commitments in respect of operating leases, BD 1,082 (2008: BD 1,308) thousand are due within one year, BD 5,813 (2008: BD 4,885) thousand are due in one to five years and the remaining over five years.

Capital commitments

At 31 December 2009, the Group had commitments of BD Nil (2008: BD 1,392) thousand principally relating to the office premises.

Construction commitments

At 31 December 2009, the Group had commitments in respect of construction contracts amounting to BD 12,786 (2008: BD 13,039) thousand.

Notes to the Consolidated Financial Statements

At 31 December 2009

23 INCOME FROM RETAIL AND CORPORATE BANKING ACTIVITIES

	2009 BD 000	2008 BD 000
Income from Murabaha receivables	25,552	15,313
Income from Ijarah Muntahia Bittamleek (Note 23.1)	21,842	17,417
Income from Musharaka contracts	2,328	735
Income from Murabaha with banks	352	2,286
Financing income from retail and corporate banking activities	50,074	35,751
Mudarib share on restricted investment accounts	291	987
Fees and commission	883	1,926
	51,248	38,664

23.1 This is presented net of depreciation on Ijarah Muntahia Bittamleek assets amounting to BD 6,531 (2008: BD 13,337) thousand.

23.2 Financing income from retail and corporate banking activities includes mudarib share amounting to BD 4,228 (2008: BD 997) thousand on unrestricted investment accounts.

24 INCOME FROM INVESTMENT ACTIVITIES

		2009 BD 000	2008 BD 000
Unrealised (loss) / gain on investments	24.1	(850)	9,783
Loss on sale of investments		-	(302)
Unrealised gain on investment properties	24.2	158	9,220
Gain on sale of investment properties		-	2,026
Performance and management fees		3,341	4,666
Dividend income		1,118	979
Income from sukuk		1,258	1,192
Other income		1,582	2,864
		6,607	30,428

24.1 This includes gain of BD Nil (2008: BD 636) thousand relating to held for trading investments.

24.2 This includes loss of BD 29 (2008: gain of BD 1,248) thousand relating to non-controlling shareholders of a subsidiary.

25 INCOME AND EXPENSE RELATING TO FINANCING CONTRACTS

	2009 BD 000	2008 BD 000
Financing income from retail and corporate banking activities	50,074	34,754
Profit on Murabaha due to banks, non-banks and subordinated Murabaha payable	9,194	14,870
Profit on unrestricted investment accounts	20,817	9,865
	30,011	24,735
	20,063	10,019

Notes to the Consolidated Financial Statements

At 31 December 2009

26 PROVISIONS

	2009 BD 000	2008 BD 000
Provisions / (reversals) against financing contracts with customers	(238)	3,522
Provision against investments	819	3,802
Provision for goodwill impairment	426	1,129
	1,007	8,453

27 OTHER OPERATING EXPENSES

	2009 BD 000	2008 BD 000
Business development	1,730	3,399
Technology and communication	1,787	1,388
Legal, consulting and outsourcing	2,653	1,132
Premises - rentals and maintenance	2,032	891
Administration, selling and others	6,498	4,878
	14,700	11,688

28 CASH AND CASH EQUIVALENTS

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

	2009 BD 000	2008 BD 000
Cash	3,903	2,526
Balances with banks	12,962	33,389
Balances with CBB excluding mandatory reserve	16	2,152
Murabaha due from banks	24,612	64,421
	41,493	102,488

Notes to the Consolidated Financial Statements

At 31 December 2009

29 RELATED PARTY TRANSACTIONS

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

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

	Associated companies BD 000	Parent and its major shareholders BD 000	Directors and key management personnel BD 000	Other related parties BD 000	2009 BD 000	2008 BD 000
Murabaha due from banks	-	-	-	-	-	56,550
Financing contracts with customers	10,000	-	17,977	92,742	120,719	62,265
Performance and management fees receivable (Note 13)	17,256	-	-	3,402	20,658	15,545
Project expenses receivable	3	-	-	84	87	4,864
Receivable relating to investment property (Note 13)	-	-	-	-	-	4,522
Murabaha and due to banks	-	29,788	-	-	29,788	182,253
Murabaha and due to non-banks	-	-	-	51,246	51,246	40,735
Customers' current accounts	5,120	1,358	144	584	7,206	14,264
Payable against purchase of investment properties (Note 17)	4,103	-	-	-	4,103	4,542
Other liabilities	151	-	-	-	151	151
Subordinated Murabaha payable	-	97,189	-	-	97,189	-
Unrestricted investment accounts	7,666	-	830	61,890	70,386	28,223
Letters of credit	20	-	-	8,706	8,726	8,726
Guarantees	-	-	-	-	-	2,460
Commitments to extend credit	12,000	-	-	5,609	17,609	-

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

	Associated companies BD 000	Parent and its major shareholders BD 000	Directors and key management personnel BD 000	Other related parties BD 000	2009 BD 000	2008 BD 000
Income from Murabaha with banks	-	320	-	22	342	1,044
Income from financing contracts relating to customers	280	-	247	6,097	6,624	1,349
Performance and management fees (Note 24)	1,007	-	-	9	1,016	4,666
Profit on Murabaha and due to banks	-	-	-	11	11	2,480
Profit on Murabaha and due to non-banks	189	3,088	-	831	4,108	1,781
Profit on subordinated Murabaha payable	-	752	-	-	752	-
Profit on unrestricted investment accounts	287	-	30	2,042	2,359	772
Operating expenses	-	-	-	937	937	900

Notes to the Consolidated Financial Statements

At 31 December 2009

29 RELATED PARTY TRANSACTIONS (continued)

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

	2009 BD 000	2008 BD 000
Short term employee benefits	3,108	3,697
Long term employee benefits	177	136

Director's remuneration for the year ended 31 December 2009 amounted to BD 551 thousand.

30 SEGMENT INFORMATION

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

Corporate & Retail Banking Group Principally engaged in Shari'a compliant profit sharing investment arrangements, providing Shari'a compliant financing contracts and other facilities to corporate, retail and institutional customers.

Investment Banking Group Principally engaged in investment banking activities, including private equity, real estate investments, treasury and other activities.

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

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

The following table presents revenue, net profit and total assets of the Group's segments for the year ended 31 December 2009:

	Corporate & Retail Banking Group BD 000s	Investment Banking Group BD 000s	Total BD 000s
Revenues	52,108	12,972	65,080
Segment profit	23,694	(17,562)	6,132
Assets	620,026	734,795	1,354,821
Unallocated assets			18,557
Total assets			1,373,378

The following table shows the distribution of the Group's net income and non current assets by geographical segments, based on the location in which the transactions and assets are recorded, for the year ended 31 December 2009.

	Bahrain BD 000	Other countries BD 000	Total BD 000
Revenues	49,721	15,359	65,080
Non current assets	312,588	63,654	376,242

Other countries namely represent Kuwait, Hashemite Kingdom of Jordan and United Kingdom.

Notes to the Consolidated Financial Statements

At 31 December 2009

30 SEGMENT INFORMATION (continued)

The following table presents revenue, net profit and total assets of the Group's segments for the year ended 31 December 2008:

	Corporate & Retail Banking Group BD 000	Investment Banking Group BD 000	Total BD 000
Revenues	32,805	64,987	97,792
Segment profit	11,293	24,393	35,686
Assets	576,717	662,143	1,238,860
Unallocated assets			45,815
Total assets			1,284,675

The following table shows the distribution of the Group's net income and non current assets by geographical segments, based on the location in which the transactions and assets are recorded, for the year ended 31 December 2008.

	Bahrain BD 000	Other countries BD 000	Total BD 000
Revenues	93,779	4,013	97,792
Non current assets	248,447	48,729	297,176

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

31 FAIR VALUE OF FINANCIAL INSTRUMENTS

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

At 31 December 2009 and 2008, the fair value of financial instruments approximate their carrying values.

Financial instruments recorded at fair value

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

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

Notes to the Consolidated Financial Statements

At 31 December 2009

31 FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

	Level 1 2009 BD 000	Level 2 2009 BD 000	Level 3 2009 BD 000	Total fair value 2009 BD 000
Investments at fair value through statement of income				-
Equities - quoted	10,653	-	-	10,653
Equities - unquoted	-	-	162,171	162,171
Managed funds	-	5,349	4,185	9,534
Available for sale investments				
Equities - quoted	8,414	-	-	8,414
Equities - unquoted	-	-	881	881
Sukuk	35,728	-	-	35,728
	54,795	5,349	167,237	227,381

During the year ended 31 December 2009, there were no transfers between Level 1 and Level 2 fair value measurements, and no transfers into and out of Level 3 fair value measurements.

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

	Unquoted equities 2009 BD 000	Managed funds 2009 BD 000
Balance at 1 January 2009	141,532	3,739
Investments made during the year	32,910	358
Fair value gain recognised - unrealised	598	-
Impairment loss recognised	(819)	-
Refunds of advance paid for purchase of investment	(7,896)	-
Other movements	(3,273)	88
	163,052	4,185

Notes to the Consolidated Financial Statements

At 31 December 2009

31 FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

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

	Carrying amount 2009 BD 000	Effect of reasonably possible alternative assumption 2009 BD 000
Investments at fair value through statement of income		
Equities - unquoted	162,171	16,217
Managed funds	4,185	419
Available for sale investments		
Equities - unquoted	881	88
	167,237	16,724

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

For equities, the Group adjusted the underlying price earning ratios and real estate prices by changing the assumed prices by ten percent, which is considered by the Group to be within a range of reasonably possible alternatives based on the price earning ratios of similar companies and real estate prices of properties in similar locations.

For funds, the Group values its investments based on net asset value, which is based on the valuation of underlying investments. The valuation of underlying investments maybe effected by movement in market factors, which can influence the predictability of the future cash flows and the discount rate used.

Notes to the Consolidated Financial Statements

At 31 December 2009

32 MATURITY ANALYSIS OF ASSETS, LIABILITIES AND URIA

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

	Up to one year			Over one year			Subtotal Over 1 year 2009 BD 000	Total 2009 BD 000		
	Up to 3 months 2009 BD 000	3 months to 12 months 2009 BD 000	Subtotal up to 12 months 2009 BD 000	1 to 5 years 2009 BD 000	5 to 10 years 2009 BD 000	Over 10 years 2009 BD 000				
	Assets									
	Cash and balances with banks and Central Bank of Bahrain	26,617	-	26,617	-	-			14,494	14,494
Murabaha due from banks	24,505	107	24,612	-	-	-	-	24,612		
Financing contracts with customers	123,095	187,983	311,078	253,332	81,678	12,660	347,670	658,748		
Investments	19,067	1,777	20,844	148,703	57,834	-	206,537	227,381		
Investment in associates	-	-	-	-	-	77,569	77,569	77,569		
Investment properties	-	-	-	136,920	-	-	136,920	136,920		
Receivables, prepayments and other assets	5,285	13,646	18,931	74,704	30,914	-	105,618	124,549		
Goodwill and intangibles	-	-	-	25,172	-	-	25,172	25,172		
Premises and equipment	-	-	-	-	-	24,358	24,358	24,358		
Assets of disposal group classified as held for sale	-	32,959	32,959	-	-	-	-	32,959		
Total	198,569	236,472	435,041	638,831	170,426	129,081	938,338	1,373,379		
Liabilities and unrestricted investment accounts										
Murabaha and due to banks	26,476	17,342	43,818	108,920	-	-	108,920	152,738		
Murabaha and due to non-banks	77,364	36,852	114,216	69,732	-	-	69,732	183,948		
Customers' current accounts	32,336	19,819	52,155	-	-	-	-	52,155		
Other liabilities	9,267	8,735	18,002	12,796	4,254	-	17,050	35,052		
Liabilities of disposal group classified as held for sale	-	1,890	1,890	-	-	-	-	1,890		
Unrestricted investment accounts	94,006	120,850	214,856	93,854	93,854	96,729	284,437	499,293		
Subordinated Murabaha payable	-	-	-	-	97,189	-	97,189	97,189		
Total	239,449	205,488	444,937	285,302	195,297	96,729	577,328	1,022,265		
Net	(40,880)	30,984	(9,896)	353,529	(24,871)	32,352	361,010	351,114		

Notes to the Consolidated Financial Statements

At 31 December 2009

32 MATURITY ANALYSIS OF ASSETS, LIABILITIES AND URIA (continued)

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

Notes to the Consolidated Financial Statements

At 31 December 2009

33 RISK MANAGEMENT

33.1 Introduction

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

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

Risk management structure

The Board of Directors is ultimately responsible for identifying and controlling risks; however, there are separate independent bodies responsible for managing and monitoring risks.

Board of Directors

The Board of Directors is responsible for the overall risk management approach and for approving the risk strategies, policies and risk appetite of the Bank.

Audit, Risk, Governance and Compliance Committee (ARGC Committee)

The ARGC committee is appointed by the Board of Directors and consists of four members, three of whom are Non-Executive Directors and one member is an independent member. As an Audit Committee, it assists the Board in carrying out its responsibilities with respect to assessing the quality and integrity of financial reporting, the audit thereof, the soundness of the internal controls of the Bank, the measurement system of risk assessment and relating these to the Bank's capital, and the methods for monitoring compliance with laws, regulations and supervisory and internal policies. As a Risk Committee, it has the overall responsibility for the development of the risk strategy and implementing principles, frameworks, policies and limits. It is responsible for the fundamental risk issues and manages and monitors relevant risk decisions. The committee also decides the corporate governance structure and manages the compliance requirements of the Bank.

Asset and Liability Committee (ALCO)

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

Shari'a Supervisory Board

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

Risk Management Group

The Risk Management Group is responsible for implementing and maintaining risk related procedures to ensure an independent control process. It also helps the ALCO in establishing risk strategies, policies and limits, across the Bank. The group is also responsible for the independent control of risks, including monitoring the risk of exposures against limits and the assessment of risks of new products and structured transactions. This group also ensures the complete capture of the risks in risk measurement and reporting systems and performs stress tests on the various portfolios of the bank.

Bank Treasury

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

Internal Audit

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

Notes to the Consolidated Financial Statements

At 31 December 2009

33 RISK MANAGEMENT (continued)

Compliance Department

The compliance department is responsible for managing all the compliance related issues with external parties and regulators. It also monitors compliance with internal risk policies of the Bank.

Risk measurement and reporting systems

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

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

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

As part of the Risk Management's reporting framework, tailored risk reports are prepared and distributed in order to ensure that all business divisions have access to extensive, necessary and up-to-date information. Periodic briefing is given to the Managing Director and Chief Executive Officer and all other relevant members of the Bank on the utilisation of market limits, proprietary investments and liquidity and any other risk developments.

Excessive risk concentration

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

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

33.2 Credit Risk

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

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

Credit-related commitments risks

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

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

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

Notes to the Consolidated Financial Statements

At 31 December 2009

33 RISK MANAGEMENT (continued)

	Gross maximum exposure 2009 BD 000	Gross maximum exposure 2008 BD 000
Balances with banks	12,962	33,389
Murabaha due from banks	24,612	64,421
Financing contracts with customers	671,786	591,682
Investments - sukuks	35,728	34,375
Receivables	41,573	70,162
Total	786,661	794,029
Credit commitments and contingent items	80,610	198,017
Total credit risk exposure	867,271	992,046

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

Risk concentrations of the maximum exposure to credit risk

At 31 December 2009, the amount of credit exposure in excess of 10% of the Bank's equity to individual counterparties was BD 86,550 thousand (2008: BD 93,223 thousand).

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

	Middle East 2009 BD 000	North America 2009 BD 000	Europe 2009 BD 000	New Zealand / Australia 2009 BD 000	Other 2009 BD 000	Total 2009 BD 000
Balances with banks	8,057	2,958	1,947	-	-	12,962
Murabaha due from banks	24,612	-	-	-	-	24,612
Financing contracts with customers	656,381	673	-	258	1,436	658,748
Investments	35,728	-	-	-	-	35,728
Receivables	30,227	-	7,553	3,793	-	41,573
Credit commitments and contingent items	80,610	-	-	-	-	80,610
Total	835,615	3,631	9,500	4,051	1,436	854,233

Notes to the Consolidated Financial Statements

At 31 December 2009

33 RISK MANAGEMENT (continued)

	Middle East 2008 BD 000	North America 2008 BD 000	Europe 2008 BD 000	New Zealand / Australia 2008 BD 000	Other 2008 BD 000	Total 2008 BD 000
Balances with banks	33,381	-	-	-	8	33,389
Murabaha due from banks	64,421	-	-	-	-	64,421
Financing contracts with customers	573,914	-	789	1,280	2,499	578,482
Investments	34,375	-	-	-	-	34,375
Receivables	69,723	416	16	2	5	70,162
Credit commitments and contingent items	198,017	-	-	-	-	198,017
Total	973,831	416	805	1,282	2,512	978,846

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

	Trading and manufacturing 2009 BD 000	Banking and financial 2009 BD 000	Construction and real estate 2009 BD 000	Other 2009 BD 000	Total 2009 BD 000
Balance with banks	-	12,962	-	-	12,962
Murabaha due from banks	-	24,612	-	-	24,612
Financing contracts with customers	60,554	96,592	375,084	126,518	658,748
Investments	-	16,008	19,720	-	35,728
Receivables	-	-	32,268	9,305	41,573
Credit commitments and contingent items	41,007	-	39,431	172	80,610
Total	101,561	150,174	466,503	135,995	854,233

	Trading and manufacturing 2008 BD 000	Banking and financial 2008 BD 000	Construction and real estate 2008 BD 000	Other 2008 BD 000	Total 2008 BD 000
Balance with banks	-	33,389	-	-	33,389
Murabaha due from banks	-	64,421	-	-	64,421
Financing contracts with customers	120,829	54,242	280,455	122,956	578,482
Investments	-	19,641	14,734	-	34,375
Receivables	20,343	2,913	31,584	15,322	70,162
Credit commitments and contingent items	21,712	28,161	148,144	-	198,017
Total	162,884	202,767	474,917	138,278	978,846

Notes to the Consolidated Financial Statements

At 31 December 2009

33 RISK MANAGEMENT (continued)

Collateral and other credit enhancements

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

The main types of collateral obtained are as follows:

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

The Bank also obtains personal guarantees from the owners for financings to their companies. Management monitors the market value of collateral, requests additional collateral in accordance with the underlying agreement, and monitors the market value of collateral obtained periodically and at the time its review of the facility.

Credit quality per class of financial assets

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

Good

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

Special mention

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

Sub-standard

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

Doubtful

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

Loss - Individually impaired

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

Credit quality per class of financial assets

	Neither past due nor impaired			Past due or	Total 2009 BD 000
	Good 2009 BD 000	Special mention 2009 BD 000	Substandard and Doubtful 2009 BD 000	individually impaired 2009 BD 000	
Balance with banks	12,962	-	-	-	12,962
Murabaha due from banks	24,612	-	-	-	24,612
Financing contracts with customers	502,959	-	72,577	96,250	671,786
Investments - sukuks	35,728	-	-	-	35,728
Receivables	41,573	-	-	-	41,573
Total	617,834	-	72,577	96,250	786,661

Notes to the Consolidated Financial Statements

At 31 December 2009

33 RISK MANAGEMENT (continued)

	Neither past due nor impaired			Past due or	Total 2008 BD 000
	Good 2008 BD 000	Special mention 2008 BD 000	Substandard and Doubtful 2008 BD 000	individually impaired 2008 BD 000	
Balance with banks	12,962	-	-	-	12,962
Murabaha due from banks	64,421	-	-	-	64,421
Financing contracts with customers	559,976	18,696	-	13,010	591,682
Investments - sukuks	34,375	-	-	-	34,375
Receivables	70,162	-	-	-	70,162
Total	741,896	18,696	-	13,010	773,602

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

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

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

	Less than 30 days 2009 BD 000	31 to 60 days 2009 BD 000	61 to 90 days 2009 BD 000	More than 90 days 2009 BD 000	Total 2009 BD 000
Financing contracts with customers	19,335	2,228	51,660	21,351	94,574

	Less than 30 days 2008 BD 000	31 to 60 days 2008 BD 000	61 to 90 days 2008 BD 000	More than 90 days 2008 BD 000	Total 2008 BD 000
Financing contracts with customers	10,518	232	251	752	11,753

The estimated value of collateral held by the Bank against past due financing contracts amounts to BD 93,312 (2008: BD 6,265) thousand.

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

The outstanding amount of collateralized financing contracts with customers, whose terms have been renegotiated (restructured facilities) during the year, amounts to BD 55,372 (2008: Nil) thousand. These restructured facilities are secured by collateral amounting to BD 104,360 (2008: Nil) thousand. The Group has asked for the partial settlement and/or further collateral as a condition to rescheduling.

The outstanding amount also includes financing contracts with a related party amounting to BD 23,640 (2008: Nil) thousand, whose terms have been renegotiated. This financing was given on a clean basis.

Impairment assessment

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

Notes to the Consolidated Financial Statements

At 31 December 2009

33 RISK MANAGEMENT (continued)

Individually assessed provisions

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

Collectively assessed provisions

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

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

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

33.3 Liquidity risk and funding management

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

The Group maintains a portfolio of highly marketable and diverse assets that can be easily liquidated in the event of an unforeseen interruption of cash flow. The Group also has committed lines of credit that it can access to meet liquidity needs. In addition, the Bank maintains a mandatory reserve with the Central Bank of Bahrain equal to 5% of customer deposits denominated in Bahrain Dinars, excluding deposits from resident subsidiaries. The liquidity position is assessed and managed under a variety of scenarios, giving due consideration to stress factors relating to both the market in general and specifically to the Bank. The most important of these is to maintain limits on the ratio of liquid assets to customer liabilities. Liquid assets consists of cash and balances with banks and Central Bank of Bahrain, Murabaha due from banks, investment in quoted securities and liquid sukuk. Customer liabilities consists of current accounts, unrestricted investment accounts and Murabaha and due to non banks. The ratios during the year were as follows:

	2009 %	2008 %
31 December	14.73	25.60
During the year:		
Average	17.13	28.19
Highest	25.65	35.86
Lowest	14.04	20.89

Notes to the Consolidated Financial Statements

At 31 December 2009

33 RISK MANAGEMENT (continued)

Analysis of financial liabilities and URIA by remaining contractual maturities

The table below summarises the maturity profile of the Group's financial liabilities and URIA at 31 December 2009 and 2008 based on contractual undiscounted repayment obligations. Maturity analysis of assets, liabilities and URIA for the expected maturities of these liabilities and URIA is disclosed in Note 32. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Group expects that many customers will not request repayment on the earliest date the Group could be required to pay and the table does not reflect the expected cash flows indicated by the Group's deposit retention history.

Financial liabilities and URIA	On demand BD 000	Less than 3 months BD 000	3 to 12 months BD 000	1 to 5 years BD 000s	Over 5 years BD 000	Total BD 000
At 31 December 2009						
Murabaha and due to banks	2,123	105,274	34,847	11,224	-	153,468
Murabaha and due to non-banks	-	170,518	2,712	11,042	-	184,272
Customers' current accounts	52,155	-	-	-	-	52,155
Other liabilities	-	7,251	8,735	12,796	4,035	32,817
Unrestricted investment accounts	43,871	406,902	52,523	-	-	503,296
Subordinated Murabaha payable	-	1,531	1,531	15,307	109,435	127,804
Total undiscounted liabilities 2009	98,149	691,476	100,348	50,369	113,470	1,053,812
At 31 December 2008						
Murabaha and due to banks	22,975	278,720	-	-	-	301,695
Murabaha and due to non-banks	-	191,830	34,378	-	-	226,208
Customers' current accounts	53,236	-	-	-	-	53,236
Other liabilities	-	5,800	17,458	-	-	23,258
Unrestricted investment accounts	36,092	27,429	256,191	-	-	319,712
Total undiscounted financial liabilities 2008	112,303	503,779	308,027	-	-	924,109

Credit commitments and contingent items

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

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

Notes to the Consolidated Financial Statements

At 31 December 2009

33 RISK MANAGEMENT (continued)

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

	On demand BD 000	Less than 3 months BD 000	3 to 12 months BD 000	1 to 5 years BD 000	Total BD 000
At 31 December 2009					
Commitments on behalf of customers:					
Letters of credit	3,760	-	15,106	-	18,866
Guarantees	17,837	-	-	-	17,837
Irrevocable commitments to extend credit	-	8,564	32,597	2,520	43,681
Total	21,597	8,564	47,703	2,520	80,384

At 31 December 2008

Commitments on behalf of customers:

Letters of credit	-	4,829	5,141	9,781	19,751
Guarantees	29,011	-	-	-	29,011
Irrevocable commitments to extend credit	-	8,960	140,295	-	149,255
Total	29,011	13,789	145,436	9,781	198,017

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

33.4 Market risk

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

Profit rate risk

Profit rate risk arises from the possibility that changes in profit rates will affect future profitability or the fair values of financial instruments. The Bank measures the profit rate risk by measuring and managing the repricing gaps. It also performs sensitivity analysis.

The following table demonstrates the sensitivity to reasonably possible change in profit rates, with all other variables held constant of the Group's consolidated statement of income. The sensitivity of the consolidated statement of income is the effect of the assumed changes in profit rates on the consolidated net income for the year, based on the non-trading financial assets and financial liabilities held at 31 December 2009.

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

	2009 BD 000	Change in basis points	Effect on net income for the year BD 000
ASSETS			
Murabaha due from banks	24,612	+25	62
Financing contracts with customers	257,314	+25	643
Investments - sukuk	35,728	+25	89
LIABILITIES AND UNRESTRICTED INVESTMENT ACCOUNTS			
Murabaha and due to banks	152,738	+25	(382)
Murabaha and due to non-banks	183,948	+25	(460)
Subordinated Murabaha payable	97,189	+25	(243)
Unrestricted investment accounts	499,293	+25	(1,248)
Total			(1,539)

Notes to the Consolidated Financial Statements

At 31 December 2009

33 RISK MANAGEMENT (continued)

	2008 BD 000	Change in basis points	Effect on net income for the year BD 000
ASSETS			
Murabaha due from banks	64,421	+25	161
Financing contracts with customers	235,747	+25	589
Investments - sukuk	34,375	+25	86
LIABILITIES AND UNRESTRICTED INVESTMENT ACCOUNTS			
Murabaha and due to banks	301,452	+25	(754)
Murabaha and due to non-banks	224,880	+25	(562)
Unrestricted investment accounts	310,474	+25	(776)
Total			(1,256)

Currency risk

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

The tables below indicate the currencies to which the Group had significant exposure at 31 December 2009 on all its monetary assets and liabilities. The analysis calculates the effect of a reasonably possible movement of the currency rate against the Bahraini Dinar, with all other variables held constant, on the consolidated statement of income.

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

	Change in currency rate %	Effect on profit 2009 BD 000	Effect on equity 2009 BD 000	Effect on profit 2008 BD 000	Effect on equity 2008 BD 000
NZD	+20	29	-	520	164
KWD	+20	(781)	-	(1,288)	-
JOR	+20	7,636	-	7,521	-
GBP	+20	226	-	470	-
EUR	+20	(290)	-	-	-
Total		6,820	-	7,223	164

Equity price risk

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

The effect on income and equity (as a result of a change in the fair value of equity instruments at 31 December 2009) due to a reasonably possible change (i.e. +15%) in the value of individual investments, with all other variables held constant, is BD 27,353 thousand and BD 1,394 thousand, respectively (2008: 24,036 thousand and BD 1,505 thousand, respectively). The effect of decrease in the value of individual investments is expected to be equal and opposite to the effect of the increase shown.

33.5 Prepayment risk

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

Notes to the Consolidated Financial Statements

At 31 December 2009

33 RISK MANAGEMENT (continued)

33.6 Investment property price risk

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

The effect on income and equity due to a reasonably possible change (i.e. +15%) in the value of individual investment properties, with all other variables held constant, is BD 20,538 (2008: 18,748) thousands. The effect of decrease in the value of individual investment is expected to be equal and opposite to the effect of the increase shown.

33.7 Operational risk

Operational risk is the risk of loss arising from systems failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Group cannot expect to eliminate all operational risks, but through a control framework and by monitoring and responding to potential risks. The Bank has implemented Risks Controls and Self Assessment process (RCSA) whereby each of the units have identified the risks in their processes, identified key risk indicators and implemented controls. They report the key risk indicators, values and actual incidents to the operational risk unit, which in turn is reported to senior management for action. Controls include effective segregation of duties, access, authorisation and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

34 CAPITAL MANAGEMENT

The Group maintains an actively managed capital base to cover risks inherent in the business. The adequacy of the Group's capital is monitored using, among other measures, the rules and ratios established by the Basel Committee on Banking Supervision ("BIS rules/ratios") and adopted by the Central Bank of Bahrain in supervising the Group. The Bank has also implemented the Internal Capital Adequacy and Assessment Plan (ICAAP) as per the CBB guidelines based on Pillar II recommendations of the Basel Committee. The Bank had identified the capital requirement for future five years based on the Bank's business strategy and the risk charges required for credit risk, market risk, profit rate risk, liquidity risk, investments risks and operational risks. The Board of Directors have reviewed the ICAAP plan for both normal and stress conditions.

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

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

Regulatory capital

	2009 BD 000	2008 BD 000
Tier 1 capital	191,244	185,402
Tier 2 capital	55,425	-
Total capital	246,669	185,402
Risk weighted assets	1,055,837	1,024,840
Total capital ratio	23.4%	18.1%
Minimum requirement	12.5%	12.5%

Notes to the Consolidated Financial Statements

At 31 December 2009

34 CAPITAL MANAGEMENT (continued)

Regulatory capital consists of Tier 1 capital, which comprises share capital, share premium, general reserve, statutory reserve and retained earnings, less unrealised loss arising from fair valuing equities. The other component of regulatory capital is Tier 2 capital, which includes subordinated murabaha payable, collective impairment provision and asset revaluation reserves. Certain adjustments are made to IFRS-based results and reserves, as prescribed by the Central Bank of Bahrain.

35 EARNINGS AND EXPENSES PROHIBITED BY SHARI'A

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

36 SOCIAL RESPONSIBILITY

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

37 ZAKAH

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

