

GULF FINANCE HOUSE BSC

CONSOLIDATED FINANCIAL STATEMENTS

31 DECEMBER 2012

Commercial registration	:	44136 (registered with Central Bank of Bahrain as a Islamic wholesale investment Bank)
Registered Office	:	Bahrain Financial Harbour Office 2901, 29 th Floor, Building 1398, East Tower, Block 346, Road 4626 Manama, Kingdom of Bahrain Telephone +973 17538538
Directors	:	Dr. Esam Yousif A. Janahi, <i>Chairman</i> Ahmed Al Mutawa Mosabah Saif Al Mutairy Azzam Al Felaj Naif Al Khodari
Acting Chief Executive Officer	:	Hisham Alrayes
Company Secretary	:	Mohammed Abdulsalam
Auditors	:	KPMG Fakhro, Bahrain

GULF FINANCE HOUSE BSC

**CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2012**

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**CHAIRMAN'S REPORT
for the year ended 31 December 2012**

IN THE NAME OF ALLAH, THE BENEFICIENT, THE MERCIFUL, PRAYERS AND PEACE BE UPON THE LAST APOSTLE AND MESSENGER, OUR PROPHET MOHAMMED.

Dear Shareholders,

On behalf of the Board of Directors, it is my privilege to present the financial statements of Gulf Finance House (GFH) for the financial year ended 31st December 2012.

This has truly been a remarkable year for GFH. The bank has returned to its profitable ways, successfully executed its restructuring plans, and continued to deliver unique investment opportunities that serve as a testimony to the Bank's dedication in creating value to its shareholders and investors.

We attribute this positive turnaround to the shareholders strong support, investors' loyalty, hardworking employees, and to the executive management team which is committed to seeing through the set-out strategic plans.

GFH posted net profits in all the four quarters of 2012; an achievement we are proud of given the hard times faced since year 2008. GFH attained a net profit of US\$10.027 million in 2012 compared to a net profit of US\$387 thousand in 2011, with operating profit before provisions at US\$ 20.427 million compared to a profit of US\$ 9 million in 2011, an increase of 140%.

Additionally, the Bank saw a 31% reduction in operating costs during 2012, a continuation of the various measures undertaken in 2010 to help restructure the Bank's operations & its balance sheet.

The Year 2012 saw our pursuit to restructuring debt come to fruition. Earlier in 2012, GFH successfully restructured the remaining debt of US\$ 45 million over a period of six years, including a two-year grace period on a syndicated Wakala facility led by Bahrain-based Liquidity Management Centre (LMC). The Wakala facility was initially of US\$ 100 million of which US\$ 55 was settled till 2012.

GFH was also successful in obtaining the approval of the Sukuk holders to restructure the debt outstanding of US\$ 105 million. The new terms extended the repayment of Sukuk over six-year period also provided a two-year grace period for the repayment of principal amount in 2012 and 2013.

Furthermore, GFH is in the process of finalizing the restructuring of WestLB Murabaha Facility for which the approvals of 32 members of the syndicate have already been obtained. Once documentation is executed, the remaining US\$ 80 million from the US\$ 300 million facility will be extended over a six-year period.

On another high note, GFH, through its 100% owned subsidiary, GFH Capital Limited completed the 100% acquisition of Leeds United City Holdings Limited and Leeds United Football Club (LUFC); a fully integrated and one of the best supported clubs in English Football with a large fan base. LUFC promises to be a high yielding investment opportunity, which GFH is successfully placing with its investors.

Furthermore, 2012 saw continued progress on a number of key projects and investments, as well as the reviving of others. This stresses the Bank's commitment to existing infrastructure projects and achieving successful investor exits.

Positive news came in the form of a reiteration by the newly appointed Tunisian government to support the Tunis Financial Harbor (TFH) project, in which they expressed their commitment to ensuring the development of the project side by side with GFH according to the plan. With this, we see Tunisia becoming the leading Financial and Business Centre in North Africa upon the completion of TFH.

CHAIRMAN'S REPORT *(continued)*
for the year ended 31 December 2012

This was followed by a major announcement regarding the Mumbai Economic Development Zone (MEDZ) project where partnership was signed for joint development with Wadhwa Group. The Project Company acquired the access channel linking the project to the Mumbai - Pune Highway, which allows smooth access to and from the main National Highway and is one of the most vital industrial corridors in India; considering. This would add significant value to the project making it ever more distinguished. India project investors visited the project and were updated about the project progress. The project has started exiting investors during 2012.

GFH announced the adjustments in the Royal Ranches Marrakesh (RRM) Project to adapt to the changing market conditions within the region, thereby including affordable residential units and medical health facilities, rather than the ranches and large scale villas which were initially planned.

GFH has come through all of the challenges of the past few years, if not unscathed, at least stronger for the experience. Difficult decisions, trying economic conditions, geo-political tension and the loss of investor confidence as a whole in the investment banking sector has required us to take a very detailed look at our operations and our procedures.

Based on that assessment, we have endeavoured to improve our institution at its most basic level, strengthening our foundations in order to cope with the rapidly changing business environment we now find ourselves in.

We have focused our efforts on realising the value of our existing investment portfolios, making extracting value out of those a priority and identifying unique opportunities in the market to secure consistent sources of income for the Bank and for our shareholders. We have a strong pipeline of high income yielding opportunities, which will be offered to our clients in 2013

Throughout 2013, we are planning to keep up the momentum with our infrastructure projects and sign similar strategic partnership agreements to the one signed for MEDZ with the aim of moving vertically at the earliest time possible.

We also intend to continue the momentum on the target acquisition of unique income generating and high growth equities capital where opportunities present themselves. As for the markets of focus for 2013, we will keep an eye on the GCC specifically Kingdom of Saudi and UAE for possible opportunities of entry and will keep a look for further opportunities in the booming Turkish market and bellwether UK.

As we look forward to 2013, I am confident that, from the position we now find ourselves in, having returned to profitability, improving our liquidity balance and building upon our strong track record of excellence, we will continue to provide even greater value to our investors and shareholders.

In conclusion, and on behalf of the Board of Directors, I would like to take this opportunity to extend my utmost gratitude and deepest appreciation to the rulers and the government of the Kingdom of Bahrain for their continued support of Gulf Finance House and our operations.

I would also like to thank the leadership and respective governments of the Kingdom of Saudi Arabia, Kuwait, Oman, Qatar, United Arab Emirates, India, Tunisia and Morocco for their strong economic policies and political governance, as well as for their valued relationships and continued contribution to our achievements.

Additionally, I would like to thank the individual regulators in each of these geographies, specifically the Central Bank of Bahrain for their continued support and assistance to the financial sector as a whole.

CHAIRMAN'S REPORT *(continued)*
for the year ended 31 December 2012

Last but not least, I would like to sincerely thank all of our valued shareholders, investors and strategic partners for their dedication, loyal support and their trust in GFH over the years, as well as to the Bank's management team and employees for their much appreciated efforts and commitment throughout 2012 and the rough years before it.

We were able, by the Grace of Allah and the efforts of all our stakeholders, to achieve an excellent year for the Bank, returning to profitability and overcoming all the obstacles faced by the industry throughout the year.

We are confident that 2013 will be a better year for us and that we are cut out to better meet any challenges we may face, and maintain – and increase! – Our newly achieved profitability.

Best Regards,



Esam Yousif Janahi
Chairman
21 February 2013

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INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS
GULF FINANCE HOUSE BSC
Manama, Kingdom of Bahrain

21 February 2013

Report on the consolidated financial statements

We have audited the accompanying consolidated financial statements of Gulf Finance House BSC (the "Bank") and its subsidiaries (together the "Group") which comprise the consolidated statement of financial position as at 31 December 2012, and the consolidated statements of income, changes in owners' equity, cash flows, changes in restricted investment accounts and sources and uses of charity and zakah fund for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Respective responsibilities of board of directors and auditors

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

Basis of opinion

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

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the financial position of the Group as at 31 December 2012, and of the consolidated results of its operations, its consolidated cash flows, consolidated changes in equity, consolidated changes in restricted investment accounts and consolidated sources and uses of charity and zakah fund for the year then ended in accordance with Financial Accounting Standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions and the Shari'a rules and principles as determined by the Shari'a Supervisory Board of the Bank.

Report on other regulatory requirements

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



CONSOLIDATED STATEMENT OF FINANCIAL POSITION

as at 31 December 2012

US\$ 000's

	Note	31 December 2012	31 December 2011
ASSETS			
Cash and bank balances	4	3,216	3,820
Placements with financial institutions	5	14,767	3,001
Equity-accounted investees	6	235,383	230,442
Investment securities	7	174,017	220,265
Investment property	8	259,404	259,404
Assets held-for-sale	9	88,139	-
Other assets	10	115,531	108,913
Total assets		890,457	825,845
LIABILITIES			
Investors' funds	11	31,428	58,887
Placements from financial and other institutions	12	126,017	116,713
Financing liabilities	13	232,827	331,077
Liabilities held-for-sale	9	42,655	-
Other liabilities	14	73,871	83,882
Total liabilities		506,798	590,559
Equity of investment account holders	15	2,353	1,898
OWNERS' EQUITY			
Share capital	16	595,087	321,031
Treasury shares		(2,995)	(12,852)
Share premium		13,235	145,708
Statutory reserve		66,356	79,408
Accumulated losses		(291,280)	(301,687)
Investments fair value reserve		-	403
Other reserves	17	903	1,377
Total owners' equity (page 7)		381,306	233,388
Total liabilities, equity of investment account holders and owners' equity		890,457	825,845

The consolidated financial statements consisting of pages 5 to 62 were approved by the Board of Directors on 21 February 2013 and signed on its behalf by:



Esam Yousif A. Janahi
Chairman



Ahmed Al Mutawa
Vice Chairman



Hisham Alrayes
Acting Chief Executive Officer

The accompanying notes 1 to 38 form an integral part of these consolidated financial statements.

CONSOLIDATED INCOME STATEMENT

for the year ended 31 December 2012

US\$ 000's

	Note	2012	2011
Management and other fees		2,985	7,921
Income from placements with financial institutions	21	130	2,091
Share of profits of equity-accounted investees	6	4,941	2,595
Gain on acquisition of assets held-for-sale	9	10,369	-
Income from investment securities, net	18	2,050	11,841
Foreign exchange gain, net		5,466	2,120
Other income, net	19	37,639	44,810
Total income		63,580	71,378
Staff cost	20	8,245	10,513
Investment advisory expenses		4,309	6,000
Finance expense	21	19,267	30,501
Other expenses	22	11,332	15,863
Total expenses		43,153	62,877
Profit before provision for impairment		20,427	8,501
Impairment allowances	23	(10,400)	(8,120)
Profit for the year		10,027	381
Earnings per share			
Basic and diluted earnings per share (US cents)	26	0.68	0.04

The accompanying notes 1 to 38 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN OWNERS' EQUITY
for the year ended 31 December 2012

US\$ 000's

	Share capital	Treasury shares	Share premium	Statutory reserve	Accumulated losses	Investments fair value reserve	Other reserves (note 18)	Total
2012								
Balance at 1 January 2012	321,031	(12,852)	145,708	79,408	(301,687)	403	1,377	233,388
Profit for the year	-	-	-	-	10,027	-	-	10,027
Changes in fair value of investment securities	-	-	-	-	-	(403)	-	(403)
Total recognised income and expense	-	-	-	-	10,027	(403)	-	9,624
Conversion of Murabaha to share capital (notes 13 & 16)	274,056	(37,876)	(132,473)	-	-	-	-	103,707
Transfer to retained earnings on settlement of convertible murabaha	-	-	-	-	380	-	(380)	-
Sale of treasury shares	-	47,733	-	-	-	-	-	47,733
Loss on sale of treasury shares	-	-	-	(13,052)	-	-	-	(13,052)
Share grants vesting expense, net of forfeitures (note 20)	-	-	-	-	-	-	(94)	(94)
Balance at 31 December 2012	595,087	(2,995)	13,235	66,356	(291,280)	-	903	381,306

The accompanying notes 1 to 38 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN OWNERS' EQUITY
for the year ended 31 December 2012 *(continued)*

US\$ 000's

2011	Share capital	Treasury shares	Share premium	Statutory reserve	Accumulated losses	Investments fair value reserve	Other reserves (note 18)	Total
Balance at 1 January 2011	145,780	(24,674)	206,203	88,298	(302,068)	975	1,769	116,283
Profit for the year	-	-	-	-	381	-	-	381
Changes in fair value of investment securities	-	-	-	-	-	(572)	-	(572)
Total recognised income and expense	-	-	-	-	381	(572)	-	(191)
Conversion of Murabaha to share capital (notes 13 & 16)	175,251	-	(60,495)	-	-	-	(253)	114,503
Sale of treasury shares	-	11,822	-	-	-	-	-	11,822
Loss on sale of treasury shares	-	-	-	(8,890)	-	-	-	(8,890)
Share grants vesting expense, net of forfeitures (note 20)	-	-	-	-	-	-	(139)	(139)
Balance at 31 December 2011	321,031	(12,852)	145,708	79,408	(301,687)	403	1,377	233,388

The accompanying notes 1 to 38 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS
for the year ended 31 December 2012

US\$ 000's

	2012	2011
OPERATING ACTIVITIES		
Placements with / from financial institutions, net	(1,264)	(7,145)
Financing to projects, net	(4,475)	(2,975)
Receipts from financing receivables	-	450
Investors' funds, net	(1,220)	(3,566)
Management and other fees received	860	343
Income received from placements with financing institution	130	893
Payments for expenses and project costs	(19,470)	(20,434)
Cash used in operating activities	(25,439)	(32,434)
INVESTING ACTIVITIES		
Advance for acquisition of investment securities	-	(3,770)
Net cash paid for acquisition of subsidiary held-for-sale (note 9)	(33,226)	-
Acquisition of investment securities	(460)	-
Proceeds from sale of investment securities	6,285	3,500
Dividends received	956	4,860
Cash (used in) / generated from investing activities	(26,445)	4,590
FINANCING ACTIVITIES		
Financing liabilities, net	(24,772)	(1,045)
Finance expense paid	(19,824)	(23,001)
Proceeds from issue of convertible murabaha	60,210	10,491
Payment for share issue expenses	-	(11,740)
Proceeds from sale of treasury shares	34,681	-
Dividends paid	(50)	(548)
Payments to charitable organisations	(77)	(130)
Cash generated from / (used in) financing activities	50,168	(25,973)
DECREASE IN CASH AND CASH EQUIVALENTS	(1,716)	(53,817)
Cash and cash equivalents at 1 January	6,821	60,638
CASH AND CASH EQUIVALENTS at 31 December	5,105	6,821
Cash and cash equivalents comprise:		
Cash and bank balances	3,216	3,820
Cash and bank balances included in assets held-for-sale	1,889	-
Placements with financial institutions	-	3,001
	5,105	6,821

The accompanying notes 1 to 38 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN RESTRICTED INVESTMENT ACCOUNTS
for the year ended 31 December 2012

2012 Company	Balance at 1 January 2012			Movements during the year						Balance at 31 December 2012		
	No of units (000)	Average value per share US\$	Total US\$ 000's	Investment/ withdrawal / impairment US\$ 000's	Revalua- tion US\$ 000's	Gross income US\$ 000's	Dividends paid US\$ 000's	Bank's fees as an agent US\$ 000's	Administration expenses US\$ 000's	No of units (000)	Average value per share US\$	Total US\$ 000's
Mena Real Estate Company KSCC	150	0.35	53	-	-	-	-	-	-	150	0.35	53
Al Basha'er Fund	93	6.63	617	-	(267)	-	-	300	-	93	6.69	650
Pan European Fund	35.85	797.67	28,597	(28,597)	-	-	-	-	-	-	-	-
Oman Development Company	522.50	3.115	1,628	-	-	-	-	-	-	522.50	3.115	1,628
			30,895	(28,597)	(267)	-	-	300	-			2,331

Revaluation changes of US\$ 267 thousand (2011: US\$ 636 thousand) is on account of loss on foreign exchange translation differences.

The accompanying notes 1 to 38 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN RESTRICTED INVESTMENT ACCOUNTS
for the year ended 31 December 2012 (continued)

2011 Company	Balance at 1 January 2011			Movements during the year						Balance at 31 December 2011		
	No of units (000)	Average value per share US\$	Total US\$ 000's	Investment/ withdrawal US\$ 000's	Revalua- tion US\$ 000's	Gross income US\$ 000's	Dividends paid US\$ 000's	Bank's fees as an agent US\$ 000's	Administration expenses US\$ 000's	No of units (000)	Average value per share US\$	Total US\$ 000's
Mena Real Estate Company KSCC	150	0.353	53	-	-	-	-	-	-	150	0.35	53
Kuwait National Real Estate Investment & Services Co. KSCC	250	0.352	88	(88)	-	-	-	-	-	-	-	-
Gulf Holding Company	10,000	0.245	2,455	(2,455)	-	-	-	-	-	-	-	-
Gulf North Africa Holding Company KSCC	11,500	0.243	2,794	(2,794)	-	-	-	-	-	-	-	-
Gulf Real Estate Development Company	936	12.042	11,272	(11,272)	-	-	-	-	-	-	-	-
Al Basha'er Fund	93	7.567	704	-	(87)	-	-	-	-	93	6.63	617
Pan European Fund	35.85	815.42	29,233	-	(636)	-	-	-	-	35.85	797.67	28,597
Oman Development Company	522.50	3.115	1,628	-	-	-	-	-	-	522.50	3.115	1,628
			48,227	(16,609)	(723)	-	-	-	-			30,895

The accompanying notes 1 to 38 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF SOURCES AND USES OF CHARITY AND ZAKAH FUND
for the year ended 31 December 2012

US\$ 000's

	2012	2011
Sources of charity and zakah fund		
Non-Islamic income (note 28)	1	2
Total sources	1	2
Uses of charity fund and zakah fund		
Contributions to charitable organisations	(77)	(130)
Total uses	(77)	(130)
Deficit of uses over sources	(76)	(128)
Undistributed charity and zakah fund at 1 January	10,503	10,631
Undistributed charity and zakah fund at 31 December (note 14)	10,427	10,503
Represented by:		
Charity fund	7,652	7,702
Zakah payable	2,775	2,801
	10,427	10,503

The accompanying notes 1 to 38 form an integral part of these consolidated financial statements.

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

US\$ 000's

1 REPORTING ENTITY

Gulf Finance House BSC ("the Bank") was incorporated in 1999 in the Kingdom of Bahrain under Commercial Registration No. 44136. The Bank's shares are listed on the Bahrain, Kuwait and Dubai Financial Market Stock Exchanges. The Bank's Global Depository Receipts ('GDR') are listed in the London Stock Exchange. The Bank operates as an Islamic Wholesale Investment Bank under a license granted by the Central Bank of Bahrain ("CBB").

The Bank's activities are regulated by the CBB and supervised by a Religious Supervisory Board whose role is defined in the Bank's Memorandum and Articles of Association. The principal activities of the Bank include investment advisory services and investment transactions which comply with Islamic rules and principles according to the opinion of the Bank's Shari'a Supervisory Board.

Consolidated financial statements

The consolidated financial statements for the year comprise the financial statements of the Bank and its subsidiaries (together referred to as "the Group"). The principal subsidiaries of the Bank include GFH Sukuk Limited, KHCB Asset Company, GFH Capital Limited (formerly G Capital Limited) and LUFC Holdings Limited, which are wholly owned.

The Bank has other SPE holding companies and subsidiaries which are set up to supplement the activities of the Bank and its principal subsidiaries.

2 SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies applied in the preparation of these consolidated financial statements are set out below. These accounting policies have been applied consistently to all periods presented in the consolidated financial statements, and have been consistently applied by Group entities.

(a) Statement of compliance

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

(b) Basis of preparation

The consolidated financial statements are prepared on the historical cost basis except for the measurement at fair value of certain investment securities. The Group classifies its expenses in the consolidated income statement by the nature of expense method. The consolidated financial statements are presented in United States Dollars (US\$), being the functional currency of the Group's operations. All financial information presented in US\$ has been rounded to the nearest thousands, except when otherwise indicated.

The preparation of consolidated financial statements requires the use of certain critical accounting estimates. It also requires management to exercise judgement in the process of applying the Group's accounting policies. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected. Management believes that the underlying assumptions are appropriate and the Group's consolidated financial statements therefore present the financial position and results fairly. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in note 3.

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

US\$ 000's

2 SIGNIFICANT ACCOUNTING POLICIES (continued)**(b) Basis of preparation (continued)***Going concern*

As at 31 December 2012, the Group had accumulated losses of US\$ 291 million. During the year, the Group has successfully restructured its financial liabilities by extending the tenure of its obligations (refer note 13). To improve its liquidity position, the Group has raised additional capital through the issue of convertible murabaha instruments (refer notes 13 and 16).

The Board of Directors' have reviewed the Group's future plans and are satisfied with the appropriateness of the going concern assumption used in the preparation of the consolidated financial statements.

(c) Basis of consolidation**(i) Business combinations**

Business combinations are accounted for using the acquisition method as at the acquisition date, which is the date on which control is transferred to the Group. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, the Group takes into consideration potential voting rights that currently are exercisable.

The Group measures goodwill at the acquisition date as:

- the fair value of the consideration transferred; plus
- the recognised amount of any non-controlling interest in the acquiree; plus
- if the business combination achieved in stages, the fair value of the pre-existing equity interest in the acquiree; less
- the net recognised amount (generally fair value) of the identifiable assets acquired and liabilities assumed.

When the excess is negative, a bargain purchase gain is recognised immediately in the consolidated income statement.

The consideration transferred does not include amounts related to settlement of pre-existing relationships. Such amounts are generally recognised in the consolidated income statement.

Transaction costs, other than those associated with the issue of debt or equity securities, that the Group incurs in connection with a business combination are expensed as incurred.

Any contingent consideration payable is measured at fair value at the acquisition date. If the contingent consideration is classified as equity, then it is not remeasured and settlement is accounted within equity. Otherwise subsequent changes in the fair value of the contingent consideration are recognised in the consolidated income statement.

(ii) Subsidiaries

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

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

US\$ 000's

2 *SIGNIFICANT ACCOUNTING POLICIES (continued)*(c) *Basis of consolidation (continued)***(iii) Special purpose entities**

Special purpose entities (SPEs) are entities that are created to accomplish a narrow and well-defined objective such as the securitisation of particular assets, or the execution of a specific borrowing or investment transaction. An SPE is consolidated if, based on an evaluation of the substance of its relationship with the Group and the risks and rewards transferred by the SPE, the Group concludes that it controls the SPE. The assessment of whether the Group has control over an SPE is carried out at inception and normally no further reassessment of control is carried out in the absence of changes in the structure or terms of the SPE, or additional transactions between the Group and the SPE.

Where the Group's voluntary actions, such as lending amounts in excess of existing liquidity facilities or extending terms beyond those established originally, change the relationship between the Group and an SPE, the Group performs a reassessment of control over the SPE.

The Group in its fiduciary capacity manages and administers assets held in trust and other investment vehicles on behalf of investors. The financial statements of these entities are usually not included in these consolidated financial statements. Information about the Group's fiduciary assets under management is set out in note 24.

(iv) Loss of control

Upon the loss of control, the Group derecognises the assets and liabilities of the subsidiary, any non-controlling interests and the other components of equity related to the subsidiary. Any surplus or deficit arising on the loss of control is recognised in income statement. If the Group retains any interest in the previous subsidiary, then such interest is measured at fair value at the date that control is lost. Subsequently it is accounted for as an equity-accounted investee or in accordance with the Group's accounting policy for financial instruments depending on the level of influence retained.

(v) Investment in associates (Equity-accounted investees)

Associates are those entities in which the Group has significant influence, but not control or joint control, over the financial and operating policies. Significant influence is presumed to exist when the Group holds between 20% and 50% of the voting power of another entity.

On initial recognition of an associate, the Group makes an accounting policy choice as to whether the associate shall be equity accounted or designated as at fair value through income statement. The Group makes use of the exemption in FAS 24 – Investment in Associates for venture capital organisation and designates certain of its investment in associates, as 'investments carried at fair value through income statement'. These investments are managed, evaluated and reported on internally on a fair value basis (refer to note 2 (f)).

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

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2 **SIGNIFICANT ACCOUNTING POLICIES (continued)**(c) **Basis of consolidation (continued)****(vi) Transactions eliminated on consolidation and equity accounting**

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

(d) Foreign currency transactions**(i) Functional and presentation currency**

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

(ii) Transactions and balances

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

(iii) Other group companies

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

(e) Offsetting of financing instruments

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Group has a legal right to set off the recognised amounts and it intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

Income and expense are presented on a net basis only when permitted under AAOIFI, or for gains and losses arising from a group of similar transactions.

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2 **SIGNIFICANT ACCOUNTING POLICIES** (continued)**(f) Investment securities**

Investment securities may comprise of debt and equity instruments, but exclude investment in subsidiaries and equity-accounted investees (note 2 (c)).

(i) Classification

The Group segregates its investment securities into debt-type instruments and equity-type instruments.

Debt-type instruments:

Debt-type instruments are investments that provide fixed or determinable payments of profits and capital. Investments in debt-type instruments are classified in the following categories:

At fair value through income statement (FVTIS)

These investments are either not managed on contractual yield basis or designated on initial recognition to FVTIS to avoid any accounting mismatch that would arise on measuring the assets or liabilities or recognising the gains or losses on them on different bases. Currently, the Group does not have any investment under this category.

At amortised cost

This classification is for debt-type instruments which are not designated as FVTIS and are managed on contractual yield basis. These include investments in medium to long-term sukuk.

Equity-type instruments:

Equity-type instruments are investments that do not exhibit features of debt-type instruments and include instruments that evidence a residual interest in the assets of an entity after deducting all its liabilities. Investments in equity type instruments are classified in the following categories:

At fair value through income statement (FVTIS)

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

Investments are classified as held-for-trading if acquired or originated principally for the purpose of generating a profit from short-term fluctuations in price or dealers margin or that form part of a portfolio where there is an actual pattern of short-term profit taking. The Group currently does not have any of its investments classified as investments held-for-trading purposes.

On initial recognition, an equity-type instrument is designated as FVTIS only if the investment is managed and its performance is evaluated and reported on internally by the management on a fair value basis. This category currently includes investment in private equity, funds and equity-accounted investees (refer note 2 (c) (v))

At fair value through equity (FVTE)

Equity-type instruments other than those designated at FVTIS are classified as at fair value through equity. These include investments in certain quoted and unquoted equity securities.

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2 *SIGNIFICANT ACCOUNTING POLICIES* (continued)(f) *Investment securities* (continued)**(ii) Recognition and de-recognition**

Investment securities are recognised at the trade date i.e. the date that the Group commits to purchase or sell the asset, at which date the Group becomes party to the contractual provisions of the instrument. Investment securities are derecognised when the rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all risk and rewards of ownership.

(iii) Measurement

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

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

Investments at FVTE where the entity is unable to determine a reliable measure of fair value on a continuing basis, such as investments that do not have a quoted market price or there are no other appropriate methods from which to derive reliable fair values, are stated at cost less impairment allowances.

(iv) Measurement principles*Amortised cost measurement*

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

Fair value measurement

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction on the measurement date. When available, the Group measures the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions on an arm's length basis. If a market for a financial instrument is not active, the Group establishes fair value using a valuation technique. Valuation techniques include using recent arm's length transactions between knowledgeable, willing parties (if available), discounted cash flow analyses and other valuation models with accepted economic methodologies for pricing financial instruments.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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2 *SIGNIFICANT ACCOUNTING POLICIES (continued)***(g) Placements with and from financial and other institutions**

These comprise inter-bank and non bank placements made or received under shari'a compliant contracts. Placements are usually short term in nature and are stated at their amortised cost.

(h) Cash and cash equivalents

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

(i) Investment property

Investment property comprise land plots. Investment property is property held to earn rentals and/or for capital appreciation. Investment property is measured initially at cost, including transaction costs. Subsequent to initial recognition, investment property is carried at cost less accumulated impairment allowances (if any). Cost includes expenditure that is directly attributable to the acquisition of the investment property.

An investment property is derecognised upon disposal or when the investment property is permanently withdrawn from use and no future economic benefits are expected from the disposal. Any gain or loss arising on derecognition of the property (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the consolidated income statement in the period in which the property is derecognised.

(j) Equipment

Equipment are stated at cost, net of accumulated depreciation and impairment, if any. Depreciation is computed using the straight-line method to write-off the cost of the assets over their estimated useful lives ranging from 1 to 5 years for furniture, fixtures and equipments, motor vehicles and computers. The assets residual values and useful lives are reviewed, and adjusted if appropriate, at each reporting date.

(k) Impairment of assets

The Group assesses at each reporting date whether there is objective evidence that a asset is impaired. Objective evidence that financial assets are impaired can include default or delinquency by a borrower, restructuring of a loan or advance by the Group on terms that the Group would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group.

Financial assets carried at amortised cost

For financial assets carried at amortised cost, impairment is measured as the difference between the carrying amount of the financial assets and the present value of estimated cash flows discounted at the assets' original effective profit rate. Losses are recognised in consolidated income statement and reflected in an allowance account. When a subsequent event causes the amount of impairment loss to decrease, the impairment loss is reversed through the consolidated income statement.

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2 SIGNIFICANT ACCOUNTING POLICIES (continued)**(k) Impairment of assets (continued)***Investments carried at fair value through equity (FVTE)*

In the case of equity type instruments carried at fair value through equity, a significant or prolonged decline in the fair value of the security below its cost is objective evidence of impairment resulting in recognition of an impairment loss. If any such evidence exists for equity type instruments, the unrealised re-measurement loss shall be transferred from equity to the income statement. Impairment losses recognised in income statement for an equity investment are reversed directly through equity.

For equity type instruments carried at cost due to the absence of reliable fair value, the Group makes an assessment of whether there is an objective evidence of impairment for each investment by assessment of financial and other operating and economic indicators. Impairment is recognised if the expected recoverable amount is assessed to be below the carrying amount of the investment. All impairment losses are recognised through the income statement and is not reversed.

Other non-financial assets

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

(l) Financing liabilities

Financing liabilities comprise shari'a compliant financing facilities from financial institutions, and financing raised through Sukuk. Financing liabilities are initially measured at fair value plus transaction costs, and subsequently measured at their amortised cost using the effective profit rate method. Financing cost, dividends, losses and gains relating to the financial liabilities are recognised in the income statement as finance expense. The Group derecognises a financial liability when its contractual obligations are discharged, cancelled or expire.

If any financing liability is extinguished by issuing the Bank's ordinary shares, the Group recognises the difference between the carrying amount of the financing liability extinguished and fair value of the shares issued in the income statement.

Financing liabilities include compound financial instrument in the form of 'convertible murabaha' issued by the Group that can be converted to share capital at the option of the holder. The liability component of a compound financial instrument is recognised initially at the fair value of a similar liability that does not have an equity conversion option. The equity component is recognised initially at the difference between the fair value of the compound financial instrument as a whole

and the fair value of the liability component. Any directly attributable transaction costs are allocated to the liability and equity components in proportion to their initial carrying amounts.

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2 *SIGNIFICANT ACCOUNTING POLICIES (continued)*

(l) *Financing liabilities (continued)*

Subsequent to initial recognition, the liability component of the convertible murabaha is measured at amortised cost using the effective profit rate method. The equity component of a compound financial instrument is not remeasured subsequent to initial recognition.

(m) **Financial guarantees**

Financial guarantees are contracts that require the Group to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument. A financial guarantee contract is recognised from the date of its issue. The liability arising from a financial guarantee contract is recognised at the present value of any expected payment, when a payment under the guarantee has become probable. The Group has issued financial guarantees to support its development projects (refer note 35 for details).

(n) **Dividends and board remuneration**

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

(o) **Share capital and reserves**

Ordinary shares are classified as equity. The Group classifies capital instruments as financial liabilities or equity instruments in accordance with the substance of the contractual terms of the instruments. Equity instruments of the group comprise ordinary shares and equity component of share-based payments and convertible instruments. Incremental costs directly attributable to the issue of an equity instrument are deducted from the initial measurement of the equity instruments.

Treasury shares

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

Statutory reserve

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

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

Equity of investment account holders are funds held by the Group, which it can invest at its own discretion. The investment account holder authorises the Group to invest the account holders' funds in a manner which the Group deems appropriate without laying down any restrictions as to where, how and for what purpose the funds should be invested. The Group charges management fee (Mudarib fees) to investment account holders. Of the total income from investment accounts, the income attributable to customers is allocated to investment accounts after setting aside provisions, reserves and deducting the Group's share of income. The allocation of income is determined by the management of the Group within the allowed profit sharing limits as per the terms and conditions of the investment accounts. Administrative expenses incurred in connection with the management of the funds are borne directly by the Group and are not charged separately to investment accounts. Equity of Investment account holders are carried at their book values and include amounts retained towards profit equalisation and investment risk reserves.

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2 SIGNIFICANT ACCOUNTING POLICIES (continued)**(p) Equity of investment account holders (continued)**

Profit equalisation reserve is the amount appropriated by the Bank out of the Mudaraba income, before allocating the Mudarib share, in order to maintain a certain level of return to the deposit holders on the investments. Investment risk reserve is the amount appropriated by the Bank out of the income of investment account holders, after allocating the Mudarib share, in order to cater against future losses for investment account holders. Creation of these reserves results in an increase in the liability towards the pool of investment accounts holders.

Restricted investment accounts

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

(q) Assets held-for-sale and discounted operations***i) Classification***

The Group classifies non-current assets or disposal groups as held-for-sale if its carrying amount is expected to be recovered principally through a sale transaction rather than through continuing use within twelve months. A disposal group is a group of assets to be disposed of, by sale or otherwise, together as a group in a single transaction, and liabilities directly associated with those assets that will be transferred in the transaction. A subsidiary acquired exclusively with a view to resale is initially recognised at its fair value less costs to sell and is classified as disposal group held-for-sale and income and expense from its operations are presented as part of discontinued operation.

If the criteria for classification as held for sale are no longer met, the entity shall cease to classify the asset (or disposal group) as held for sale and shall measure the asset at the lower of its carrying amount before the asset (or disposal group) was classified as held-for-sale, adjusted for any depreciation, amortisation or revaluations that would have been recognised had the asset (or disposal group) not been classified as held-for-sale and its recoverable amount at the date of the subsequent decision not to sell.

Any impairment loss on a disposal group is allocated first to goodwill, and then to the remaining assets and liabilities on a pro rata basis, except that no loss is allocated to financial assets and investment property carried at fair value, which continue to be measured in accordance with the Group's other accounting policies. Impairment losses on initial classification as held-for-sale and subsequent gains and losses on remeasurement are recognised in the consolidated income statement. Gains are not recognised in excess of any cumulative impairment loss.

ii) Measurement

Non-current assets or disposal groups classified as held for sale, other than financial instruments, are measured at the lower of its carrying amount and fair value less costs to sell. Financial instruments that are non-current assets and 'held-for-sale' continue to be measured in accordance with their stated accounting policies. On classification of equity-accounted investee as held-for-sale, equity accounting is ceased at the time of such classification as held-for-sale.

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US\$ 000's

2 SIGNIFICANT ACCOUNTING POLICIES (continued)**(q) Assets held-for-sale and discounted operations (continued)****iii) Discounted operations**

A discontinued operation is a component of the Group's business, the operations and cash flows of which can be clearly distinguished from the rest of the Group and which:

- represents a separate major line of business or geographical area of operations;
- is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations; or
- is a subsidiary acquired exclusively with a view to re-sale.

Classification as a discontinued operation occurs on disposal or when the operation meets the criteria to be classified as held-for-sale, if earlier. When an operation is classified as a discontinued operation, the comparative consolidated income statement is re-presented as if the operation had been discontinued from the start of the comparative year.

(r) Revenue recognition

Revenue is recognised to the extent that it is possible that the economic benefits will flow to the Group and the revenue can be reliably measured. Revenue earned by the Group and gain / loss on assets are recognised on the following basis:

Management and other fees are recognised as income when earned and the related services are performed.

Income from placements with / from financial institutions are recognised on a time-apportioned basis over the period of the related contract using the effective profit rate.

Dividend income from investment securities is recognised when the right to receive is established. This is usually the ex-dividend date for equity securities.

Fair value gain / (loss) on investment securities (unrealised gain or loss) is recognised on each measurement date in accordance with the accounting policy for equity-type instruments carried at fair value through income statement (refer note 2 (f))

Gain on sale of investment securities (realised gain) is recognised on trade date at the time of derecognition of the investment securities. The gain or loss is the difference between the carrying value on the trade date and the consideration received or receivable.

(s) Earnings prohibited by Shari'a

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

(t) Zakah

Pursuant to the decision of the shareholders', the Group is required to pay Zakah on its undistributed profits. The Group is also required to calculate and notify, under a separate report, individual shareholders of their pro-rata share of the Zakah payable by them on distributed profits. These calculations are approved by the Group's Shari'a Supervisory Board.

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2 *SIGNIFICANT ACCOUNTING POLICIES (continued)***(u) Employees benefits****(i) Short-term benefits**

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. A provision is recognised for the amount expected to be paid under short-term cash bonus or profit-sharing plans if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably. Termination benefits are recognised as an expense when the Group is committed demonstrably, without realistic possibility of withdrawal, to a formal detailed plan to either terminate employment before the normal retirement date, or to provide termination benefits as a result of an offer made to encourage voluntary redundancy.

(ii) Post employment benefits

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

Expatriate and certain Bahraini employees on fixed contracts are entitled to leaving indemnities payable, based on length of service and final remuneration. Provision for this unfunded commitment, has been made by calculating the notional liability had all employees left at the reporting date. These benefits are in the nature of a "defined benefit scheme" and any increase or decrease in the benefit obligation is recognised in the income statement.

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

(iii) Share-based employee incentive scheme

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

The grant date fair value of equity instruments granted to employees is recognised as an employee expense, with a corresponding increase in equity over the period in which the employees become unconditionally entitled to the share awards.

Non-vesting conditions are taken into account when estimating the fair value of the equity instrument but are not considered for the purpose of estimating the number of equity instruments that will vest. Service and non-market performance conditions attached to the transactions are not taken into account in determining fair value but are considered for the purpose of estimating the number of equity instruments that will vest. The amount recognised as an expense is adjusted to reflect the number of share awards for which the related service and non-market performance vesting conditions are expected to be met, such that the amount ultimately recognised as an expense is based on the number of share awards that do

meet the related service and non-market performance conditions at the vesting date. Amount recognised as expense are not trued-up for failure to satisfy a market condition.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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US\$ 000's

2 *SIGNIFICANT ACCOUNTING POLICIES (continued)*

(v) **Provisions**

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

(w) **Onerous contracts**

A provision for onerous contracts is recognised when the expected benefits to be derived by the Group from the contract are lower than the unavoidable cost of meeting its obligations under the contract. The provision is measured at the present value of the lower of the expected cost of terminating the contract and the expected net cost of continuing with the contract.

(x) **Trade date accounting**

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

3 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

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

Judgements

(i) **Classification of investments**

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

(ii) **Special purpose entities**

The Group sponsors the formation of special purpose entities (SPE's) primarily for the purpose of allowing clients to hold investments. The Group provides corporate administration, investment management and advisory services to these SPE's, which involve the Group making decisions on behalf of such entities. The Group administers and manages these entities on behalf of its clients, who are by and large third parties and are the economic beneficiaries of the underlying investments. The Group does not consolidate SPE's that it does not have the power to control. In determining whether the Group has the power to control an SPE, judgements are made about the objectives of the SPE's activities, its exposure to the risks and rewards, as well as about the Group intention and ability to make operational decisions for the SPE and whether the Group derives benefits from such decisions.

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3 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES (continued)

Estimations**(i) Fair value of investments**

The Group determines fair value of investments designated at fair value that are not quoted in active markets by using valuation techniques such as discounted cash flows and recent transaction prices. Fair value estimates are made at a specific point in time, based on market conditions and information about the investee companies. These estimates are subjective in nature and involve uncertainties and matters of significant judgement and therefore, cannot be determined with precision. There is no certainty about future events (such as continued operating profits and financial strengths). It is reasonably possible, based on existing knowledge, that outcomes within the next financial year that are different from assumptions could require a material adjustment to the carrying amount of the investments. In case where discounted cash flow models have been used to estimate fair values, the future cash flows have been estimated by the management based on information from and discussions with representatives of the management of the investee companies, and based on the latest available audited and unaudited financial statements. The basis of valuation have been reviewed by the Management in terms of the appropriateness of the methodology, soundness of assumptions and correctness of calculations and have been approved by the Board of Directors for inclusion in the consolidated financial statements.

(ii) Impairment on investments carried at fair value through equity

Equity-type instruments classified as investments at FVTE but carried at cost less impairment due to the absence of reliable measure of fair value are tested for impairment. A significant portion of the Group's equity-type investments comprise investments in long-term real estate and infrastructure development projects. In making an assessment of impairment, the Group evaluates among other factors, liquidity of the project, evidence of a deterioration in the financial health of the project, impacts of delays in execution, industry and sector performance, changes in technology, and operational and financing cash flows. The Group has exposures to investments and projects that operate in countries and geographies where business and political environment are subject to rapid changes. The performance of the investments and recoverability of exposures is based on condition prevailing and information available with management as at the reporting date. It is the management's opinion that the current level of provisions are adequate and reflect prevailing conditions and available information. It is reasonably possible, based on existing knowledge, that the current assessment of impairment could require a material adjustment to the carrying amount of the investments within the next financial year due to significant changes in the assumptions underlying such assessments.

(iii) Investment property

The Group conducts valuation of its investment property periodically using external independent valuers to assess for impairment. The fair value is determined based on the market value of the property through the comparable method, analysing the land rates in the vicinity for similar assumed zoning regulations. All of the Group's investment property is situated in Bahrain. Given the dislocation in the local property market and infrequent property transactions, it is reasonably possible, based on existing knowledge, that the current assessment of impairment could require a material adjustment to the carrying amount of these assets within the next financial year due to significant changes in assumptions underlying such assessments.

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3 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES (continued)

(iv) Impairment of receivables

Each counterparty exposure is evaluated individually for impairment and is based upon management's best estimate of the present value of the cash flows that are expected to be received. In estimating these cash flows, management makes judgements about a counterparty's financial situation. Each impaired asset is assessed on its merits, and the workout strategy and estimate of cash flows considered recoverable are independently evaluated by the Risk Management Department.

(v) Impairment of cash generating units

Cash generating units includes the Group's investments in certain subsidiaries and equity-accounted investees that generate cash flows that are largely independent from other assets and activities of the Group. The basis of impairment assessment for such cash generating units is described in accounting policy 2 (k). For equity-accounted investees with indicators of impairment, the recoverable amounts have been determined based on value in use calculations.

Value in use for the equity-accounted investee was determined by discounting the future cash flows expected to be generated from the continuing operations.

The calculation of the value in use was based on the following key assumptions.

- Cash flows were projected based on past experience, actual operating results for 2011 and the 4-year business plan with a growth rate of 2%. The forecast period is based on the Group's long-term perspective with respect to the investment; and
- Discount rates of 15.2% percent was applied in determining the recoverable amounts for the equity-accounted investee. These discount rates were estimated based on past experience and the weighted average cost of capital, size of the investment and risk associated with implementation of new strategy.

The key assumptions described above may change as economic and market conditions change. The Group estimates that reasonably possible changes in these assumptions are not expected to cause the recoverable amount to decline below the carrying amount.

4 CASH AND BANK BALANCES

	31 December 2012	31 December 2011
Cash on hand	8	16
Bank balances	3,208	3,804
	3,216	3,820

5 PLACEMENTS WITH FINANCIAL INSTITUTIONS

	31 December 2012	31 December 2011
Gross placements	14,767	3,002
Less: Deferred profits	-	(1)
	14,767	3,001

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6 EQUITY-ACCOUNTED INVESTEEES

Equity-accounted investees comprise:

Name	Country of incorporation	% holding	Nature of business
Khaleeji Commercial Bank BSC (KHCB)	Bahrain	46.965%	Islamic retail bank
Cemena Investment Company (CIC)	Cayman Islands	38.97%	Investment Holding Company for cement manufacturing

The movement in equity-accounted investees is given below:

	2012	2011
At 1 January	230,442	224,847
Acquisitions during the year	-	3,000
Share of profits of equity-accounted investees	4,941	2,595
At 31 December	235,383	230,442

The investment in KHCB has a carrying value of US\$ 163,567 thousand (31 December 2011: US\$ 162,629 thousand) and a fair value based on a quoted price of US\$ 60,431 thousand (31 December 2011: US\$ 57,554 thousand). Based on an assessment of the value-in-use of the associate, the Group has concluded that the investment is not impaired.

The Group's investment in KHCB is pledged towards a Murabaha financing facility and the investment in CIC is allocated against the asset pool of the Sukuk certificates (refer note 13).

Summarised financial information of associates that have been equity-accounted not adjusted for the percentage ownership held by the Group (based on most recent audited financial statements):

	2012	2011
Total assets	1,625,889	1,590,555
Total liabilities	464,868	498,089
Total revenues	163,410	124,826
Total net profits	15,828	5,812

7 INVESTMENT SECURITIES**Equity type investments***At fair value through income statement*

	31 December 2012	31 December 2011
- Quoted securities	2,548	990
- Unquoted funds	3,868	4,202

At fair value through equity

- Quoted securities	-	475
- Unquoted securities	167,601	214,598

174,017**220,265**

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7 *INVESTMENT SECURITIES (continued)*

a) **At fair value through income statement**

	2012	2011
At 1 January	5,192	25,860
Acquisitions during the year	2,250	-
Fair value changes	(724)	(20,668)
Distributions during the year	(302)	-
At 31 December	6,416	5,192

b) **At fair value through equity**

	2012	2011
At 1 January	215,073	222,934
Acquisitions during the year	460	8,907
Changes in fair value of investments	-	(521)
Redemptions during the year	(250)	-
Disposals during the year, at carrying value	(41,282)	(8,127)
Provision for impairment during the year	(6,400)	(8,120)
At 31 December	167,601	215,073

Unquoted equity securities classified as fair value through equity include private equity investments managed by external investment managers or investments in projects promoted by the Group. Investments at fair value through equity of US\$ 167,601 thousand (31 December 2011: US\$ 214,598 thousand) are carried at cost less impairment in the absence of a reliable measure of fair value. The Group plans to exit these investments principally by means of strategic sell outs, sale of underlying assets or through initial public offerings.

Investments at fair value through equity are primarily in unlisted equities in various real estate and infrastructure development projects in different countries. Impairment allowance has been established based on management's assessment of the current market conditions, the marketability of the investments and the assessment of recoverable amounts.

8 INVESTMENT PROPERTY

In 2010, the Group received plots of land in exchange for the Group's investment in an associate and settlement of certain receivables. The Group has classified the plots of land as investment property and follows the cost model for measurement. Investment property of carrying amount of US\$ 203 million (2011: US\$ 203 million) is pledged against a Wakala facility (note 13) and any proceeds from the investment property would be first applied towards the repayment of the facility and the remaining investment property of carrying value US\$ 56 million (31 December 2011: Nil) was pledged towards other financing liabilities (note 13).

The fair value of the Group's investment property at 31 December 2012 was US\$ 261,520 thousand (31 December 2011: US\$ 261,199 thousand) based on a valuation carried out by an independent external valuer.

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9 ASSETS AND LIABILITIES HELD-FOR-SALE

On 21 December 2012, the Group acquired 100% stake in Leeds City Holdings Limited (LCHL), a holding company for a number of trading entities whose activities form the operations of Leeds United Football Club (LUFC) in the United Kingdom. The acquisition was carried out through LUFC Holdings Company, a company incorporated in the Cayman Island and a wholly owned subsidiary of GFH Capital Limited.

The acquisition has resulted in the consolidation of LUFC as at 31 December 2012 and recognition of identifiable assets (including intangible assets and favourable lease contracts) of US\$ 88,319 thousand and identifiable liabilities (including contingent consideration) of US\$ 42,655 thousand, representing the estimated fair value less cost to sell of the investment. The acquisition of LCHL resulted in a bargain purchase and the Group has recognised negative goodwill of US\$ 10,369 thousand which is included in the income statement under 'Gain on acquisition of assets held-for-sale'. The bargain purchase was due to pressure on the sellers to exit their holdings due to change in their business plans.

The Group has an active plan to sell its stake in LUFC Holdings Limited, and accordingly, the asset and liabilities acquired were classified as held-for-sale and presented in the consolidated statement of financial position. Subsequent to the year end, the Group has commenced negotiations relating to the sale of its stake in LUFC Holdings Limited.

10 OTHER ASSETS

	31 December 2012	31 December 2011
Financing to projects *	67,192	66,970
Equipment	1,379	2,454
Reimbursement right (note 35)	35,000	35,000
Prepayment and other receivables	11,960	4,489
	115,531	108,913

* Financing to projects represents working capital and other funding facilities provided to projects promoted by the Group. The financing is expected to be recovered from the operating cash flows of the underlying project assets (refer note 36 (a) for details of impairment).

11 INVESTORS' FUNDS

These represent funds of projects set-up and promoted by the Group and placed with the Group pending disbursement to the projects concerned.

12 PLACEMENTS FROM FINANCIAL AND OTHER INSTITUTIONS

These comprise placements (murabaha and wakala) accepted from financial and other institutions (including corporates) as part of the Group's treasury activities. This includes US\$ 84 million of funds placed by a non-financial entity originally in Euro currency in 2010, which is currently subject to regulatory sanctions. Accordingly, the funds have been frozen until such sanctions are formally lifted and are re-denominated into US\$.

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13 FINANCING LIABILITIES

	31 December 2012	31 December 2011
Murabaha financing	80,170	102,832
Wakala financing	46,744	51,535
Sukuk liability	105,913	162,190
Convertible murabaha (2009)	-	14,520
	232,827	331,077

During the year, the Group has repurchased / settled financing of US\$ 90.83 million and has realised a gain of US\$ 27.7 million which was included in "other income". Of the total repurchased / settled financing during the period, US\$ 54.543 million has been settled by issue of convertible murabaha.

Murabaha financing

Murabaha financing comprise a medium-term financing from a syndicate of banks. The financing was repayable in August 2012 and carries a profit rate of 2.50% over the benchmark rate (LIBOR) payable semi annually and an additional profit mark up of 1.25% payable at maturity. During the year, the Group obtained approval from the syndicate for restructuring of the Murabaha facility to be repaid over 6 years on semi annual basis commencing from August 2014.

The proposed profit rate on the facility is 6 months LIBOR plus margin (subject to a minimum of 5%). The Group is in the process of finalising the documentation of the restructured terms. The Murabaha financing facilities are secured by a pledge over the Group's investment in an associate of carrying value of US\$ 163,567 thousand (note 6) and an investment property of carrying value US\$ 24.6 million (note 8).

Wakala financing

Wakala financing is a syndicated facility from a number of financial institutions. During the year, the Group renegotiated the facility and as per the revised terms, the balance is repayable over a period of six years till April 2018 at an agreed profit rate of 8%. The Wakala financing facility is secured by a pledge over the Group's investment property of carrying value of US\$ 203 million.

Sukuk

The Sukuk had a tenure of 5 years maturing in June 2012 and returns based on an agreed spread of 175 bps over the benchmark rate (LIBOR). The Sukuk are backed by a pool of assets of the Group and has a liquidity facility provided by the Bank to support timely payments of distributions. The Sukuk are traded on the London Stock Exchange's Gilt Edged and Fixed Interest Market. Currently the Sukuk are suspended from trading.

The Sukuk Certificates are backed by the Group's investment securities with carrying values of US\$ 117,603 thousand (31 December 2011: US\$ 199,669 thousand) and an investment property of carrying value of US\$ 31.5 million (note 8).

During the year, the Group obtained approval of the sukuk holders to restructure the facility to 2018. The revised terms include the extension of the tenure for a period of 6 years with periodic repayment starting July 2014, with final installment in July 2018. The restructured terms propose a profit rate of LIBOR plus a margin of 3%, with a minimum profit rate of 5%. During the year, the Group was in technical breach of certain financial covenants of the Sukuk programme.

Convertible murabaha (2009 series)

During the year, the Group had settled the outstanding convertible murabaha notes.

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13 *FINANCING LIABILITIES (continued)*

Convertible Murabaha (bilateral)

During the year, the Group has entered into bilateral convertible murabaha agreements with certain investors to raise additional capital. The convertible murabaha provide for returns of 12% p.a. to the holder and has a tenure of 42 months from the date of issue, unless converted into ordinary shares of the Bank at the option of the holder, at an exchange price of US\$ 0.31 per share. The agreement also provides additional share based incentives on early conversion. During the year, the Bank received subscription of US\$ 60,210 thousand and all the note holders have exercised their option to convert the notes to share capital resulting in issue of 448,259,881 number of equity shares as per the terms of the convertible murabaha and the balance number of equity shares of 442,977,065 have been issued for settlement of various liabilities.

14 **OTHER LIABILITIES**

	31 December 2012	31 December 2011
Employee related accruals)	1,992	2,252
Unclaimed dividends	7,542	7,592
Provision for employees' leaving indemnities	649	945
Charity and zakah fund (page 12)	10,427	10,503
Provision against financial guarantees (note 35)	35,000	35,000
Accounts payable	13,984	14,694
Accrued expenses and other payables	4,277	12,896
	73,871	83,882

15 **EQUITY OF INVESTMENT ACCOUNT HOLDERS**

Unrestricted investment accounts comprise Mudarabah deposits accepted by the Bank. The average gross rate of return in respect of unrestricted investment accounts was 0.23% for 2012 (2011: 0.27%). Approximately 0.23% / US\$ 23 thousand (2011: 0.27% / US\$ 19 thousand) was distributed to investors and the balance was either set aside for provisions and/or retained by the Bank as a Mudarib fee. Unrestricted investment accounts include profit equalisation reserve of US\$ 6 thousand (2011: US\$ 5 thousand) and investment risks reserve of US\$ 4 thousand (2011: US\$ 3 thousand). The funds received from equity of investment account holders have been commingled and jointly invested with the Group in placements with financial institutions.

16 **SHARE CAPITAL**

	31 December 2012	31 December 2011
Authorised: 4,878,048,780 shares of US\$ 0.3075 each (2011:4,878,048,780 shares of US\$ 0.3075 each)	1,500,000	1,500,000
Issued and fully paid up: 1,935,241,754 shares of US\$ 0.3075 each (2011: 1,044,004,808 shares of US\$ 0.3075 each)	595,087	321,031

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16 *Share capital (continued)*

The movement in the share capital during the year is as follows:

	2012	2011
At 1 January	321,031	145,780
Conversion of murabaha to share capital	274,056	175,251
At 31 December	595,087	321,031

During the year, the paid up capital of the Bank was increased from US\$ 321,031 thousand to US\$ 595,087 thousand as a result of exercise of conversion option by the holders of the convertible murabaha. As per the terms of the convertible murabaha, 891,237 thousand shares of par value US\$ 0.3075 has been issued on conversion. The effective conversion price is below the par value per share and the resulting difference and the related share issue expenses has been adjusted against the share premium account (note 13).

At 31 December 2012, the Bank held 20,848,870 (31 December 2011: 6,404,016) treasury shares.

Additional information on shareholding pattern

- (i) The Bank has only one class of equity shares and the holders of these shares have equal voting rights.
- (ii) Distribution schedule of equity shares, setting out the number of holders and percentage in the following categories:

Categories*	Number of shares	Number of shareholders	% of total outstanding shares
Less than 1%	1,456,346,640	8,699	75
1% up to less than 5%	230,073,752	6	12
5% to less than 10%	248,821,362	2	13
	1,935,241,754	8,707	100

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

- (iii) Shareholders who hold more than 5% are as follows:

Name	Nationality	No. Of shares
Dr. Esam Yousif Abdulkarim Janahi	Bahraini	146,146,616
Muthanna Investment Company	Kuwaiti	102,674,746

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17 OTHER RESERVES

	2012			2011		
	Share grant reserve	Equity component of convertible murabaha	Total	Share grant reserve	Equity component of convertible murabaha	Total
At 1 January	997	380	1,377	1,136	633	1,769
Transfer on conversion	-	(380)	(380)	-	(253)	(253)
Vesting expense, net of forfeiture (note 20)	(94)	-	(94)	(139)	-	(139)
At 31 December	903	-	903	997	380	1,377

18 INCOME FROM INVESTMENT SECURITIES

	2012	2011
Dividend income	885	7,492
Profit on disposal of investment securities	1,889	4,797
Fair value changes of investments designated at fair value through income statement	(724)	(448)
	2,050	11,841

19 OTHER INCOME

Other income primarily includes US\$ 27.7 million from settlement of financing liabilities (note 13), gain on sale of equipment of US\$ 1.5 million, recovery of expenses of US\$ 2 million, rental income of US\$ 1.5 million and reversal of liabilities of US\$ 2.3 million.

20 STAFF COST

	2012	2011
Salaries and benefits	7,865	10,019
Social insurance expenses	380	494
	8,245	10,513

The Bank operates a share incentive scheme for its employees. The share awards granted under the scheme have an initial lock-in period of 3 years and shall vest rateably over varied vesting periods of up to 10 years as per the terms of the scheme. Of the cumulative 16.09 million (2011: 16.09 million) share awards granted under the terms of the scheme, 13.60 million were forfeited (2011: 12.6 million) due to failure to satisfy service conditions specified at grant date. At 31 December 2012, 2.49 million (31 December 2011: 3.49 million) share awards are outstanding to be exercised at a price of US\$ 0.75 per share in future periods on satisfaction of the vesting conditions. A net reversal of vesting charge amounting to US\$ 94 thousand (2011: US\$ 139 thousand) was recognised during the year primarily due to the forfeitures of share awards on non-satisfaction of service conditions (note 17).

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21 TOTAL FINANCE INCOME AND EXPENSE

	2012	2011
TOTAL FINANCE INCOME		
Income from placements with financial institutions	130	2,091
	130	2,091
TOTAL FINANCE EXPENSE		
Investors' funds	4	3,040
Placements from financial and other institutions	3,797	3,060
Financing liabilities	15,443	19,582
Loss on disposal of Sukuk	-	4,800
Equity of investment account holders (note 15)	23	19
	19,267	30,501
NET FINANCE EXPENSE	(19,137)	(28,410)

22 OTHER EXPENSES

	2012	2011
Rent	2,491	2,989
Professional and consultancy fee	1,048	3,240
Legal expenses	571	1,004
Depreciation	2,427	4,573
Other operating expenses	4,795	4,057
	11,332	15,863

23 IMPAIRMENT ALLOWANCES

	2012	2011
Investment securities (note 7b)	6,400	8,120
Financing to projects (note 10)	4,000	-
	10,400	8,120

24 ASSETS UNDER MANAGEMENT

The Group provides corporate administration, investment management and advisory services to its project companies, which involve the Group making decisions on behalf of such entities. Assets that are held in such capacity are not included in these consolidated financial statements. At the reporting date, the Group had assets under management of US\$ 2,160,929 thousand (31 December 2011: US\$ 2,180,529 thousand). During the year, the Group had charged management fees amounting to US\$ 860 thousand (2011: US\$ 1,476 thousand) for the activities related to management of assets.

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25 RELATED PARTY TRANSACTIONS

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

A significant portion of the Group's management fees are from entities over which the Group exercises influence (assets under management). Although these entities are considered related parties, the Group administers and manages these entities on behalf of its clients, who are by and large third parties and are the economic beneficiaries of the underlying investments. The transactions with these entities are based on agreed terms.

The significant related party balances and transactions (excluding compensation to key management personnel) included in these consolidated financial statements are as follows:

	Associates	Key management personnel	Significant shareholders / entities in which directors are interested	Assets under management including special purpose entities and other entities	Total
2012					
Assets					
Cash and bank balances	279	-	-	-	279
Placements with financial institutions	14,767	-	-	-	14,767
Equity-accounted investees	235,383	-	-	-	235,383
Investment securities	4,840	-	28,957	112,282	146,079
Other assets	69	-	2,003	80,537	82,609
Liabilities					
Investors' funds	-	-	-	25,921	25,921
Placements from financial and other institutions	27	-	10,309	-	10,336
Other liabilities	-	-	-	35,000	35,000
Income					
Management fees	175	-	-	2,510	2,685
Share of profit of equity-accounted investees	4,941	-	-	-	4,941
Income from investment securities, net	66	-	-	-	66
Other income	-	-	2,003	-	2,003

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25 RELATED PARTY TRANSACTIONS (continued)

2012	Associates	Key management personnel	Significant shareholders / entities in which directors are interested	Assets under management including special purpose entities and other entities	Total
Expenses					
Impairment allowances	-	-	-	10,400	10,400
Commitments					
Commitment to extend finance	-	-	-	77,636	77,636

2011	Associates	Key management personnel	Significant shareholders / entities in which directors are interested	Assets under management including special purpose entities and other entities	Total
Assets					
Cash and bank balances	708	-	-	-	708
Placements with financial institutions	3,001	-	-	-	3,001
Equity-accounted investees	230,442	-	-	-	230,442
Investment securities	5,192	-	63,165	122,563	190,920
Other assets	-	-	-	80,626	80,626
Liabilities					
Investors' funds	26,691	-	-	32,146	58,837
Placements from financial and other institutions	27	-	-	11,955	11,982
Other liabilities	-	-	-	35,000	35,000
Income					
Income from investment banking services	-	-	-	4,320	4,320
Management fees	535	-	-	2,775	3,310
Income from financing receivables	-	-	1,198	-	1,198
Share of profit of equity accounted investees	2,595	-	-	-	2,595
Income from investment securities, net	13,555	-	-	-	13,555
Other income	270	-	344	3,000	3,614
Expenses					
Impairment allowances	-	-	-	6,345	6,345
Equity					
Sale of Treasury shares	-	2,932	-	-	2,932
Commitments					
Commitment to extend finance	-	-	-	82,636	82,636

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25 RELATED PARTY TRANSACTIONS (continued)

Key management personnel

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

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

Categories*	Number of Shares	Number of Directors
5% upto less than 10%	146,146,616	1
10% upto less than 20%	-	-

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

Details of material contracts involving directors' or entities where they are interested include:

	2012	2011
Directors' participation in investments promoted by the Group	14,000	-
Directors' participation in convertible murabaha	6,940	94,609

The key management personnel compensation is as follows:

	2012	2011
Board member fees	157	27
Salaries, other short-term benefits and expenses	1,733	2,550
Post employment benefits	145	392

26 EARNINGS PER SHARE

Basic earnings per share

Basic earnings per share is calculated by dividing the profit / (loss) for the year by the weighted average number of equity shares outstanding during the year.

	2012	2011
Profit for the year (US\$ 000's)	10,027	381
Weighted average number of ordinary shares (Nos. in 000's)	1,484,548	930,409
Basic and diluted earnings per share from continuing operations (in US cents)	0.68	0.04

The weighted average number of ordinary equity shares for the comparative periods presented are adjusted for the issue of shares during the year without corresponding change in resources.

Diluted earnings per share

Diluted earnings per share is calculated by adjusting the weighted average number of ordinary shares outstanding to assume conversion of all dilutive potential ordinary shares. Potential ordinary shares are considered to be dilutive when, and only when, their conversion to ordinary shares would decrease earnings per share or increase the loss per share. The Bank has two categories of dilutive potential ordinary shares: convertible murabaha notes (note 13) and share awards granted to employees (note 20).

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26 EARNINGS PER SHARE (continued)

During the year, all the note holders of the convertible murabaha have exercised their rights to convert the notes to equity shares of the Bank. Further, in case of the share awards granted to employees, as the average market value of shares during the current year was lower than the assumed issue price of shares under the scheme, the share awards are not considered to be dilutive as at 31 December 2012. Accordingly, no adjustment for dilution has been made for the purposes of computation of diluted earnings per share.

27 ZAKAH

Zakah is directly borne by the shareholders on distributed profits and investors in restricted investment accounts. The Bank does not collect or pay Zakah on behalf of its shareholders and investors in restricted investment accounts. Zakah payable by the shareholders is computed by the Bank on the basis of the method prescribed by the Bank's Shari'a Supervisory Board and notified to shareholders annually. Zakah payable by the shareholders for the year ended 31 December 2012 is US\$ Nil (2011: Nil).

28 EARNINGS PROHIBITED BY SHARI'A

The Group is committed to avoid recognising any income generated from non-Islamic sources. Accordingly, all non-Islamic income is credited to a charity account where the Group uses these funds for charitable means. Movements in non-Islamic funds are shown in the statement of sources and uses of charity funds.

The Group receives interest from deposits placed with the Central Bank of Bahrain and other incidental or required deposits. These earnings are utilised exclusively for charitable purposes and amounts to US\$ 1 thousand (2011: US\$ 2 thousand).

29 SHARI'A SUPERVISORY BOARD

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

30 SOCIAL RESPONSIBILITY

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

31 MATURITY PROFILE

The table below shows the maturity profile of the Group's assets and liabilities and unrecognised commitments on the basis of their expected realisation/ payment and the Group's contractual maturity and amount of cash flows on these instruments may vary significantly from this analysis. For contractual maturity of financial liabilities refer note 36 (b).

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31 MATURITY PROFILE (continued)

	Up to 3 months	3 to 6 months	6 months-1 year	1 to 3 years	Over 3 years	Total
31 December 2012						
Assets						
Cash and bank balances	3,216	-	-	-	-	3,216
Placements with financial institutions	14,767	-	-	-	-	14,767
Equity-accounted investees	-	-	-	235,383	-	235,383
Investment securities	-	-	-	174,017	-	174,017
Investment property	-	-	-	259,404	-	259,404
Assets held-for-sale	-	-	88,139	-	-	88,139
Other assets	-	43,505	-	70,081	1,945	115,531
Total assets	17,983	43,505	88,139	738,885	1,945	890,457
31 December 2012						
Financial liabilities						
Investors' funds	9,944	-	21,484	-	-	31,428
Placements from financial and other institutions	10,799	14,994	15,621	84,603	-	126,017
Financing liabilities	265	-	2,718	85,000	144,844	232,827
Liabilities held-for-sale	-	-	42,655	-	-	42,655
Other liabilities	29,275	35,000	-	9,596	-	73,871
Total liabilities	50,283	49,994	82,478	179,199	144,844	506,798
Equity of Investment account holders	2,353	-	-	-	-	2,353
Off-balance sheet items						
Restricted investment accounts	-	-	-	2,331	-	2,331
Commitments	153	-	-	77,636	-	77,789

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31 MATURITY PROFILE (continued)

31 December 2011	Up to 3 months	3 to 6 months	6 months-1 year	1 to 3 years	Over 3 years	Total
Assets						
Cash and bank balances	3,820	-	-	-	-	3,820
Placements with financial institutions	3,001	-	-	-	-	3,001
Equity-accounted investees	-	-	-	230,442	-	230,442
Investment securities	25,000	20,140	-	175,125	-	220,265
Investment property	-	-	-	259,404	-	259,404
Other assets	-	37,312	-	67,896	3,705	108,913
Total assets	31,821	22,452	-	732,867	3,705	825,845
31 December 2011						
Financial liabilities						
Investors' funds	41,781	-	17,106	-	-	58,887
Placements from financial and other institutions	12,734	13,687	716	89,576	-	116,713
Financing liabilities	5,500	-	42,021	283,556	-	331,077
Other liabilities	5,041	35,000	-	43,841	-	83,882
Total liabilities	65,056	48,687	59,843	416,973	-	590,559
Equity of Investment account holders	1,898	-	-	-	-	1,898
Off-balance sheet items						
Restricted investment accounts	-	-	-	30,895	-	30,895
Commitments	-	-	-	83,249	-	83,249

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32 CONCENTRATION OF ASSETS, LIABILITIES AND EQUITY OF INVESTMENT ACCOUNT HOLDER**(a) Industry sector****31 December 2012****Assets**

	Trading and manufacturing	Banks and financial institutions	Development Infrastructure	Technology	Others	Total
Cash and bank balances	-	3,205	-	-	11	3,216
Placements with financial institutions	-	14,767	-	-	-	14,767
Equity-accounted investees	71,818	163,565	-	-	-	235,383
Investment securities	-	6,262	161,114	3,867	2,774	174,017
Investment property	-	-	259,404	-	-	259,404
Assets held-for-sale	-	-	-	-	88,139	88,139
Other assets	88	1,299	108,213	-	5,931	115,531

Total assets

71,906	189,098	528,731	3,867	96,855	890,457
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Liabilities

Investors' funds	970	5,650	24,808	-	-	31,428
Placements from financial and other institutions	-	94,937	29,841	-	1,239	126,017
Financing liabilities	-	232,827	-	-	-	232,827
Liabilities held-for-sale	-	-	-	-	42,655	42,655
Other liabilities	-	4,301	39,000	-	30,570	73,871

Total liabilities

970	337,715	93,649	-	74,464	506,798
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Equity of Investment account holders

-	-	-	-	2,353	2,353
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Off-Balance sheet items

Restricted investment accounts	-	-	2,331	-	-	2,331
Commitments	-	-	77,789	-	-	77,789

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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32 *Concentration of assets, liabilities and equity of investment account holders (continued)*
(a) *Industry sector (continued)*

	Trading and manufacturing	Banks and financial institutions	Development Infrastructure	Technology	Others	Total
31 December 2011						
Assets						
Cash and bank balances	-	3,809	-	-	11	3,820
Placements with financial institutions	-	3,001	-	-	-	3,001
Equity-accounted investees	67,811	162,631	-	-	-	230,442
Investment securities	-	7,482	199,640	4,202	8,941	220,265
Investment property	-	-	259,404	-	-	259,404
Other assets	17	1,287	102,339	-	5,270	108,913
Total assets	67,828	178,210	561,383	4,202	14,222	825,845
Liabilities						
Investors' funds	30,984	-	27,903	-	-	58,887
Placements from financial and other institutions	-	11,982	-	-	104,731	116,713
Financing liabilities	-	331,077	-	-	-	331,077
Other liabilities	-	741	38,670	-	44,471	83,882
Total liabilities	30,984	343,800	66,573	-	149,202	590,559
Equity of Investment account holders					1,898	1,898
Off-Balance sheet items						
Restricted investment accounts	-	-	30,895	-	-	30,895
Commitments	-	-	83,249	-	-	83,249

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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32 Concentration of assets, liabilities and equity of investment account holders (continued)

(b) Geographic region**31 December 2012****Assets**

	GCC countries	Other MENA	Other Asia	UK	Europe (excluding UK)	USA	Total
Cash and bank balances	3,078	3	-	-	32	103	3,216
Placements with financial institutions	14,767	-	-	-	-	-	14,767
Equity-accounted investees	235,383	-	-	-	-	-	235,383
Investment securities	89,789	46,024	36,572	-	1,632	-	174,017
Investment property	259,404	-	-	-	-	-	259,404
Assets held-for-sale	-	-	-	88,139	-	-	88,139
Other assets	54,085	32,350	29,096	-	-	-	115,531

Total assets

656,506	78,377	65,668	88,139	1,664	103	890,457
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Liabilities

Investors' funds	9,710	21,662	-	-	56	-	31,428
Placements from financial and other institutions	41,415	84,602	-	-	-	-	126,017
Financing liabilities	152,657	-	-	80,170	-	-	232,827
Liabilities held-for-sale	-	-	-	42,655	-	-	42,655
Other liabilities	73,871	-	-	-	-	-	73,871

Total liabilities

277,653	106,264	-	122,825	56	-	506,798
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Equity of investment account holders

2,353	-	-	-	-	-	2,353
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Off-Balance sheet items

Restricted investment accounts	2,331	-	-	-	-	-	2,331
Commitments	77,789	-	-	-	-	-	77,789

Concentration by location for financial assets is measured based on the location of the underlying operating assets, and not based on the location of the investment (which is generally based in tax efficient jurisdictions).

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32 *Concentration of assets, liabilities and equity of investment account holders (continued)*
 (b) *Geographic region (continued)*

31 December 2011	GCC countries	Other MENA	Other Asia	UK	Europe (excluding UK)	USA	Total
Assets							
Cash and bank balances	3,021	-	-	82	-	717	3,820
Placements with financial institutions	3,001	-	-	-	-	-	3,001
Equity-accounted investees	230,442	-	-	-	-	-	230,442
Investment securities	133,694	48,117	36,823	-	1,631	-	220,265
Investment property	259,404	-	-	-	-	-	259,404
Other assets	50,683	29,129	29,101	-	-	-	108,913
Total assets	680,245	77,246	65,924	82	1,631	717	825,845
Liabilities							
Investors' funds	34,622	24,201	-	-	64	-	58,887
Placements from financial and other institutions	27,137	89,576	-	-	-	-	116,713
Financing liabilities	213,723	-	-	117,354	-	-	331,077
Other liabilities	83,882	-	-	-	-	-	83,882
Total liabilities	359,364	113,777	-	117,354	64	-	590,559
Equity of investment account holders	1,898						1,898
Off-Balance sheet items							
Off-Balance sheet items	82,636	613	-	-	-	-	83,249
Restricted investment accounts	30,895	-	-	-	-	-	30,895

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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33 OPERATING SEGMENTS

The Group has two distinct operating segments, Development infrastructure and Banking, which are the Group's strategic business units. The strategic business units offer different products and services, and are managed separately because they require different strategies for management and resource allocation within the Group. For each of the strategic business units, the Group's Board of Directors (chief operating decision makers) review internal management reports on a quarterly basis.

The following summary describes the operations in each of the Group's operating reportable segments:

- **Development infrastructure:** This business unit primarily is involved in origination and management of large scale economic infrastructure projects. The business unit also covers the Group's investment in real estate and related assets.
- **Banking:** The Banking segment of the Group is focused on private equity, commercial and investment banking domains. The private equity activities include acquisition of interests in unlisted or listed businesses at prices lower than anticipated values. The commercial banking activities focuses on establish new banks in the MENA region, and exploring external partnerships or acquisitions to extend GFH's capabilities. The investment banking activities focuses on providing structuring capabilities in Islamic asset-backed and equity capital markets, Islamic financial advisory and mid-sized mergers and acquisition transactions.

The performance of each operating segment is measured based on segment results and are reviewed by the management committee and the Board of Directors on a quarterly basis. Segment results is used to measure performance as management believes that such information is most relevant in evaluating the results of certain segments relative to other entities that operate within these industries. Inter-segment pricing, if any is determined on an arm's length basis.

The Group classifies directly attributable revenue and cost relating to transactions originating from respective segments as segment revenue and segment expenses respectively. Indirect costs is allocated based on cost drivers/factors that can be identified with the segment and/ or the related activities. The internal management reports are designed to reflect revenue and cost for respective segments which are measured against the budgeted figures. The unallocated revenues, expenses, assets and liabilities related to entity-wide corporate activities and treasury activities at the Group level.

The Group has primary operations in Bahrain and the Group does not have any significant overseas branches/divisions. The geographic concentration of assets and liabilities is disclosed in note 32 (b) to the consolidated financial statements.

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

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33 OPERATING SEGMENTS (continued)

Information regarding the results of each reportable segment is included below:

2012	Development infrastructure	Banking	Unallocated	Total
Segment revenue	9,169	45,257	9,154	63,580
Segment expenses	20,329	26,927	6,297	53,553
Segment result	(11,160)	18,330	2,857	10,027
Segment assets	520,687	364,178	5,592	890,457
Segment liabilities	290,923	182,857	33,018	506,798
Other material items:				
Finance income	-	130	-	130
Finance expense	7,929	11,338	-	19,267
Share of profit of equity-accounted investees	-	4,941	-	4,941
Depreciation	-	-	2,427	2,427
Impairment allowances	10,400	-	-	10,400
Equity-accounted investees	-	235,383	-	235,383
Commitments	77,789	-	-	77,789
Restricted investment accounts	2,331	650	-	2,981

2011	Development infrastructure	Banking	Unallocated	Total
Segment revenue	16,176	20,090	35,112	71,378
Segment expenses	32,127	30,378	8,492	70,997
Segment result	(15,951)	(10,288)	26,620	381
Segment assets	553,797	267,039	5,009	825,845
Segment liabilities	381,650	160,523	48,386	590,559
Other material items:				
Finance income	-	2,091	-	2,091
Finance expense	20,578	9,923	-	30,501
Share of profit of equity-accounted investees	-	2,595	-	2,595
Depreciation	-	-	4,573	4,573
Impairment allowances	7,937	183	-	8,120
Equity-accounted investees	-	230,442	-	230,442
Commitments	83,249	-	-	83,249
Restricted investment accounts	30,278	617	-	30,895

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34 FINANCIAL INSTRUMENTS**a) FAIR VALUES OF FINANCIAL INSTRUMENTS**

Fair value is an amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Other than certain investments carried at cost of US\$ 167,601 thousand (31 December 2011: US\$ 214,598 thousand) (note 7) and sukuk liability of US\$ 105,913 thousand (31 December 2011: US\$ 162,190 thousand) carried at amortised cost, the estimated fair values of the Group's other financial instruments are not significantly different from their book values as at 31 December 2012.

Investments amounting to US\$ 167,601 thousand (31 December 2011: US\$ 214,598 thousand) in unquoted equity securities are carried at cost less impairment in the absence of a reliable measure of fair value. Such investments are either private equity investments managed by external investment managers or represent investments in development infrastructure projects promoted by the Group for which a reliable estimate of fair value cannot be determined. The Group intends to exit these investments principally by means of strategic sell outs, sale of underlying assets or through initial public offerings.

b) FAIR VALUE HIERARCHY

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

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

31 December 2012

Investment securities
 - designated at fair value
 through income statement

	Level 1	Level 2	Level 3	Total
	1,575	-	4,841	6,416
	1,575	-	4,841	6,416

31 December 2011

Investment securities
 - designated at fair value
 through income statement
 - designated at fair value
 through equity

	Level 1	Level 2	Level 3	Total
	-	-	5,192	5,192
	475	-	-	475
	475	-	5,192	5,667

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34 *FINANCIAL INSTRUMENTS (continued)*

b) *FAIR VALUE HIERARCHY (continued)*

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

	2012	2011
At 1 January	5,192	25,860
Total gains or losses		
- In income statement	(49)	6,161
Disposals	(302)	(26,829)
At 31 December	4,841	5,192

35 COMMITMENTS AND CONTINGENCIES

The commitments contracted in the normal course of business of the Group are as follows:

	31 December 2012	31 December 2011
Commitments to invest	153	613
Commitments to extend finance	77,636	82,636
Capital commitments		-

The Group potentially has a commitment under a constructive obligation to extend finance to one of its projects of up to US\$ 26.5 million (31 December 2011: US\$ 23 million).

Based on the Group's assessment of the likelihood that a project will not be able to meet the financing obligation when they fall due, the Group has estimated that its financial guarantee of US\$ 35 million may be enforced. Accordingly, the Group has recognised a provision of US\$ 35 million (31 December 2011: US\$ 35 million) towards these liabilities until revised / renegotiated terms are agreed with the lenders of the project company and included in other liabilities and recognised an equivalent amount of 'reimbursement right' receivable included in 'other assets' (note 10).

In the opinion of the management, all facilities that are due are being renegotiated and based on the current status of discussions, it is not expected that the Group will have to make payments against any of these guarantees. In the event any payment is required to be made, the Group will repay the existing lenders and the amounts will be recovered from the future cash flows generated from the operation of the relevant project.

Performance obligations

During the ordinary course of business, the Group may enter into performance obligations in respect of its infrastructure development projects. It is the usual practice of the Group to pass these performance obligations, wherever possible, on to the companies that own the projects. In the opinion of the management, no liabilities are expected to materialise on the Group at 31 December 2012 due to the performance of any of its projects.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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35 COMMITMENTS AND CONTINGENCIES (continued)*Litigations, claims and contingencies**Litigations and claims*

The Group is facing certain claims and litigations filed in connection with projects promoted by the Bank in the past and certain transactions and agreements. Further, claims against the Bank have been filed by former Bank employees. Based on the advice the Bank received from its external legal counsel, it is premature to quantify the amount or timing of liability, if any. The external legal counsels had also confirmed that the Bank has strong grounds to successfully defend itself against these claims. Accordingly, no provision for these claims has been made in the consolidated financial statements. No further disclosures regarding contingent liabilities arising from any of such claims are being made by the Bank as the directors of the Bank believe that such disclosures may be prejudicial to the Bank's position.

Contingencies

The Group has contingent claims arising from the decision to not proceed with a project development agreement. The Group is currently negotiating with the counter party for an amicable settlement. While liability is not admitted, if defense against the action is unsuccessful, the claim and associated costs could amount to approximately US\$ 36 million. The management do not expect any significant liability to arise on final closure.

36 FINANCIAL RISK MANAGEMENT**Overview**

Financial assets of the Group comprise bank balances, placements with financial and other institutions, investment securities and other receivable balances. Financial liabilities of the Group comprise investors' funds, placements from financial and other institutions, financing liabilities and other payable balances. Accounting policies for financial assets and liabilities are set out in note 2.

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

- credit risk;
- liquidity risk;
- market risks; and
- operational risk

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

Risk management framework

The key element of our risk management philosophy is for the Risk Management Department ('RMD') to provide independent monitoring and control while working closely with the business units which ultimately own the risks. The Head of Risk Management reports to the Board Audit and Risk Committee.

The Board of Directors has overall responsibility for establishing our risk culture and ensuring that an effective risk management framework is in place. The Board has delegated its authority to the Board Audit and Risk Committee, which is responsible for implementing risk management policies, guidelines and limits and ensuring that monitoring processes are in place. The RMD, together with the Internal Audit and Compliance Departments, provide independent assurance that all types of risk are being measured and managed in accordance with the policies and guidelines set by the Board of Directors.

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36 FINANCIAL RISK MANAGEMENT (continued)

The RMD submits a quarterly Risk Overview Report along with a detailed Liquidity Risk Report to the Board of Directors. The Risk Overview Report describes the potential issues for a wide range of risk factors and classifies the risk factors from low to high. The Liquidity Risk Report measure the Group's liquidity risk profile against policy guidelines and regulatory benchmarks. An additional report is prepared by the respective investment units that give updated status and impairment assessment of each investment, a description of significant developments on projects or issues as well as an update on the strategy and exit plan for each project. During the year, the Board Audit & Risk Committee was not fully functional due to issues with quorum requirements and its functions were carried out directly by the Board of Directors.

a) Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Group's, placements with financial institutions, financing assets and other receivables from project companies. For risk management reporting purposes, the Group considers and consolidates all elements of credit risk exposure (such as individual obligor default risk, country and sector risk).

Management of investment and credit risk

The Board of Directors has delegated responsibility for the management of credit risk to its Board Investment Committee (BIC). This committee establishes operating guidelines and reviews and endorses the Management Investment and Credit Committee recommendations for investment strategies, products and services. Its actions are in accordance with the investment policies adopted by the Board of Directors.

The RMD is responsible for oversight of the Group's credit risk, including:

- Ensuring that the Group has in place investment and credit policies, covering credit assessment, risk reporting, documentary and legal procedures, whilst the Compliance Department is responsible for ensuring compliance with regulatory and statutory requirements.
- Overseeing the establishment of the authorisation structure for the approval and renewal of investment and credit facilities. Authorisation limits are governed by the Board approved Delegated Authority Limits (DAL) Matrix.
- Reviewing and assessing credit risk. Risk Management department assesses all investment and credit exposures in excess of designated limits, prior to investments / facilities being committed. Renewals and reviews of investments / facilities are subject to the same review process.
- Ongoing review of credit exposures. The risk assessment approach is used in determining where impairment provisions may be required against specific investment / credit exposures. The current risk assessment process classifies credit exposures into two broad categories "Unimpaired" and "Impaired", reflecting risk of default and the availability of collateral or other credit risk mitigation. Risk is assessed on an individual basis for each investment / receivable and is reviewed at least once a year. The Group does not perform a collective assessment of impairment for its credit exposures as the credit characteristics of each exposure is considered to be different. Risk profile of exposures are subject to regular reviews.
- Reviewing compliance of business units with agreed exposure limits, including those for selected industries, country risk and product types. Providing advice, guidance and specialist

skills to business units to promote best practice throughout the Group in the management of investment / credit risk.

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36 FINANCIAL RISK MANAGEMENT (continued)

a) Credit risk (continued)

The Risk Management Department works alongside the Investment Department at all stages of the deal cycle, from pre-investment due diligence to exit, and provides an independent review of every transaction. A fair evaluation of investments takes place periodically with inputs from the Investment department. Quarterly updates of investments are presented to the Board of Directors or their respective committees. Regular audits of business units and Group credit processes are undertaken by Internal Audit.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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36 *FINANCIAL RISK MANAGEMENT (continued)*a) *Credit risk (continued)*

The Group's maximum exposure to risk at 31 December 2012 is as follows:

Exposure to credit risk

31 December 2012

Neither past due nor impaired - Carrying amount

Impaired

Gross amount

Allowance for impairment

Carrying amount – Impaired**Carrying amount**

31 December 2011

Neither past due nor impaired - Carrying amount

Impaired

Gross amount

Allowance for impairment

Carrying amount – Impaired**Carrying amount**

	Bank balances	Placement with financial institutions	Financing receivables	Other financial assets
Neither past due nor impaired - Carrying amount	3,208	14,767	-	41,048
Impaired				
Gross amount	-	-	-	417,577
Allowance for impairment	-	-	-	(379,473)
Carrying amount – Impaired				38,104
Carrying amount	3,208	14,767	-	79,152
31 December 2011				
Neither past due nor impaired - Carrying amount	3,804	3,001	-	33,634
Impaired				
Gross amount	-	-	62,650	413,298
Allowance for impairment	-	-	(62,650)	(375,473)
Carrying amount – Impaired	-	-	-	37,825
Carrying amount	3,804	3,001	-	71,459

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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36 *FINANCIAL RISK MANAGEMENT (continued)*a) *Credit risk (continued)***Impaired receivables**

Impaired receivables are those for which the Group determines that it is probable that it will be unable to collect all or a portion of payments due according to the contractual terms of the receivables agreement(s). These exposures are graded "Impaired" in the Group's assessment process.

The Group establishes an allowance for impairment losses that represents its estimate of incurred losses in its receivables. This allowance is a specific loss component that relates to individually significant exposures based on individual assessment for impairment.

The movement in the impairment allowances for equity-accounted investees, investment securities and investment property are given in notes 6,7 and 8 respectively. The movement in impairment allowance for other financial assets are as given below:

	Financing receivables	Financing to projects	Receivable from investment banking services	Other receivables	Total
2012					
At 1 January 2012	70,150	77,382	153,630	74,311	375,473
Impairment allowance during the year	-	4,000	-	-	4,000
At 31 December 2012	70,150	81,382	153,630	74,311	379,473

	Financing receivables	Financing to projects	Receivable from investment banking services	Other receivables	Total
2011					
At 1 January 2011	70,150	77,382	153,630	74,311	375,473
Impairment allowance during the year	-	-	-	-	-
At 31 December 2011	70,150	77,382	153,630	74,311	375,473

Receivables with renegotiated terms

During the year, the Group has renegotiated certain financing receivables and financing to projects due to changes in the financial position of the borrower. The financing receivables were renegotiated for terms and condition similar to original terms. Financing to projects of US\$ 67.19 million (31 December 2011: US\$ 66.97 million) were renegotiated for an extended period and do not have specified terms of repayment. The Group assesses the recoverability and timing of collection based on underlying stream of cash flows that will be generated by its projects.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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US\$ 000's

*36 FINANCIAL RISK MANAGEMENT (continued)**a) Credit risk (continued)***Write-off policy**

The Group writes off a receivable (and any related allowances for impairment losses) when it is determined that the receivables are uncollectible and after obtaining approval from the CBB where required. This determination is reached after considering information such as the occurrence of significant changes in the payee / issuer's financial position such that the payee / issuer can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure. No amounts have been written off during the year.

Concentration risk

Concentration risk arises when a number of counterparties are engaged in similar economic 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. The Group seeks to manage its concentration risk by establishing and constantly monitoring geographic and industry wise concentration limits.

The geographical and industry wise distribution of assets and liabilities are set out in note 32 (a) and (b).

b) Liquidity risk

Liquidity risk is defined as the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset.

Management of liquidity risk

The Group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation. In 2012, focus has been on restructuring the term debts and raising capital in the form of debt or equity.

Treasury receives information from other business units regarding the liquidity profile of their financial assets and liabilities and details of other projected cash flows arising from projected future business. Treasury then aims to maintain a portfolio of short-term liquid assets, largely made up of short-term placements with financial and other institutions and other inter-bank facilities, to ensure that sufficient liquidity is maintained within the Group as a whole. The liquidity requirements of business units are met through treasury to cover any short-term fluctuations and longer term funding to address any structural liquidity requirements.

The daily liquidity position is monitored and regular liquidity stress testing is conducted under a variety of scenarios covering both normal and more severe market conditions. All liquidity policies and procedures are subject to review and approval by the Board of Directors. Daily reports cover the liquidity position of the Bank and is circulated to Executive Committee (ExComm). Moreover, quarterly reports are submitted to the Board of Directors on the liquidity position by RMD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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36 *FINANCIAL RISK MANAGEMENT (continued)*b) *Liquidity risk (continued)*

The table below shows the undiscounted cash flows on the Group's financial liabilities, including issued financial guarantee contracts, and unrecognised financing commitments on the basis of their earliest possible contractual maturity. For issued financial guarantee contracts, the maximum amount of the guarantee is allocated to the earliest period in which the guarantee could be called. The Group's expected cash flows on these instruments vary significantly from this analysis. Refer note 31 for the expected maturity profile of assets and liabilities.

	Gross undiscounted cash flows					Total	Carrying amount
	Up to 3 months	3 to 6 months	6 months-1 year	1 to 3 years	Over 3 years		
31 December 2012							
Financial liabilities							
Investors' funds	9,944	-	21,484	-	-	31,428	31,428
Placements from financial and other institutions	96,278	15,555	16,909	-	-	128,742	126,017
Financing liabilities	3,187	2,587	6,175	103,390	199,168	314,507	232,827
Liabilities held-for-sale	-	-	42,665	-	-	42,665	42,655
Other financial liabilities	-	25,930	-	12,941	-	38,871	38,871
Total financial liabilities	109,409	44,072	87,233	116,331	199,168	556,213	471,798
Equity of investment account holders							
	2,353	-	-	-	-	2,353	2,353
Off-balance sheet items							
Commitments	153	-	-	77,636	-	-	

To manage the liquidity risk arising from financial liabilities, the Group aims to hold liquid assets comprising cash and cash equivalents, placements with financial institutions and treasury shares for which there is an active and liquid market. These assets can be readily sold to meet liquidity requirements.

The Group had focussed on strengthening its liquidity position in 2012 by undertaking an asset sale programme; restructuring of its financing liabilities and raising additional capital through the convertible murabaha (note 13). The Group plans to further strengthen its liquidity in 2013 by undertaking a wider asset sale program and target additional capital raising that will target to provide the necessary additional liquidity needed to support the Group's funding requirements. These initiatives further strengthen the liquidity profile of the Group.

Further, the Group is focussed on developing a pipeline of steady revenues and has undertaken cost reduction exercises that would improve its operating cash flows.

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US\$ 000's

36 *FINANCIAL RISK MANAGEMENT (continued)*b) *Liquidity risk (continued)*

	Gross undiscounted cash flows						Carrying amount
	Up to 3 months	3 to 6 months	6 months-1 year	1 to 3 years	Over 3 years	Total	
31 December 2011							
Financial liabilities							
Investors' funds	41,781	-	17,106	-	-	58,887	58,887
Placements from financial and other institutions	102,356	14,123	745	-	-	117,224	116,713
Financing liabilities	8,948	210,802	51,175	108,577	-	379,502	331,077
Other financial liabilities	40,040	-	-	8,842	-	48,882	48,882
Total financial liabilities	193,125	224,925	69,026	117,419	-	604,495	555,559
Equity of investment account holders	1,898	-	-	-	-	1,898	1,898
Off-balance sheet items							
Commitments	-	-	-	83,249	-	-	

Measures of liquidity

The Group has recently introduced new measures of liquidity. These revised metrics are intended to better reflect the liquidity position from a cash flow perspective and provide a target for the Group. These are liquidity coverage ratio, net stable funding ratio (both based on the consultative paper of Basel 3) and stock of liquid assets.

For this purpose, the liquidity coverage ratio identifies the amount of unencumbered, high quality liquid assets the Group holds that can be used to offset the net cash outflows it would encounter under an acute short-term stress scenario (30, 60 and 90 days time horizon). The net stable funding ratio measures the amount of long-term, stable sources of funding employed by an institution relative to the liquidity profiles of the assets funded and the potential for contingent calls on funding liquidity arising from off-balance sheet commitments and obligations.

Liquidity coverage ratio

30 days
60 days
90 days

	2012	2011
30 days	1.35	0.29
60 days	1.31	0.21
90 days	1.32	0.16

The Group also holds certain listed equities and treasury shares which can be sold to meet the liquidity requirements.

Net stable funding ratio

	2012	2011
Net stable funding ratio	0.84	0.42

Details of the ratio of liquid assets to total assets at the reporting date and during the year were as follows:

	Liquid asset / Total asset	
	2012	2011
At 31 December	2.01%	0.83%
Average for the year	2.00%	2.73%
Maximum for the year	4.42%	4.16%
Minimum for the year	0.71%	0.83%

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36 *FINANCIAL RISK MANAGEMENT (continued)***c) Market risks**

Market risk is the risk that changes in market prices, such as profit rate, equity prices, foreign exchange rates and credit spreads (not relating to changes in the obligor's / issuer's credit standing) will affect the Group's income, future cash flows or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

Management of market risks

As a matter of general policy, the Group shall not assume trading positions on its assets and liabilities, and hence the entire balance sheet is a non-trading portfolio. All foreign exchange risk within the Group is transferred to Treasury. The Group seeks to manage currency risk by continually monitoring exchange rates. Profit rate risk is managed principally through monitoring profit rate gaps and by having pre-approved limits for repricing bands. Overall authority for market risk is vested in the Board Audit and Risk Committee. RMD is responsible for the development of detailed risk management policies (subject to review and approval of the Board Audit & Risk Committee of Directors).

Exposure to profit rate risk

The principal risk to which non-trading portfolios are exposed is the risk of loss from fluctuations in the future cash flows or fair values of financial instrument because of a change in market profit rates. Majority of the Group's profit based asset and liabilities are short term in nature, except for certain long term liabilities which have been utilised to fund the Group's strategic investments in its associates.

A summary of the Group's profit rate gap position on non-trading portfolios is as follows:

31 December 2012	Up to 3 months	3 to 6 months	6 months-1 year	1 to 3 years	Over 3 years	Total
Assets						
Placements with financial institutions	-	-	14,767	-	-	14,767
Total assets	-	-	14,767	-	-	14,767
Liabilities						
Investors' funds	9,944	-	21,484	-	-	31,428
Placements from financial and other institutions	10,799	14,994	15,622	84,602	-	126,017
Financing liabilities	265	-	2,718	85,000	144,844	232,827
Total liabilities	21,008	14,994	39,824	169,602	144,844	390,272
Equity of investment account holders	2,353	-	-	-	-	2,353
Profit rate sensitivity gap	(23,361)	(14,994)	(25,057)	(169,602)	(144,844)	(377,858)

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36 *FINANCIAL RISK MANAGEMENT (continued)*c) *Market risks (continued)*

	Up to 3 months	3 to 6 months	6 months-1 year	1 to 3 years	Over 3 years	Total
31 December 2011						
Assets						
Placements with financial institutions	3,001	-	-	-	-	3,001
Total assets	3,001	-	-	-	-	3,001
Liabilities						
Investors' funds	41,781	-	17,106	-	-	58,887
Placements from financial and other institutions	12,734	13,687	716	89,576	-	116,713
Financing liabilities	5,500	-	42,021	283,556	-	331,077
Total liabilities	60,015	13,687	59,843	373,132	-	506,677
Equity of investment account holders	1,898	-	-	-	-	1,898
Profit rate sensitivity gap	(58,912)	(13,687)	(59,843)	(373,132)	-	(505,574)

The management of profit rate risk against profit rate gap limits is supplemented by monitoring the sensitivity of the Group's financial assets and liabilities to various standard and non-standard profit rate scenarios. Standard scenarios that are considered include a 100 basis point (bp) parallel fall or rise in all yield curves worldwide. An analysis of the Group's sensitivity to an increase or decrease in market profit rates (assuming no asymmetrical movement in yield curves and a constant statement of financial position) is as follows:

100 bps parallel increase / (decrease)

At 31 December
Average for the year
Maximum for the year
Minimum for the year

	2012	2011
	±3,778	± 5,056
	±4,030	± 5,118
	±4,561	± 5,433
	±3,688	± 4,834

Overall, profit rate risk positions are managed by Treasury, which uses placements from / with financial institutions to manage the overall position arising from the Group's activities.

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36 *FINANCIAL RISK MANAGEMENT (continued)*c) *Market risks (continued)*

The effective average profit rates on the financial assets, liabilities and unrestricted investment accounts are as follows:

	2012	2011
Placements with financial institutions	2.35%	1.49%
Financing receivables	-	5.70%
Placements from financial and other institutions	4.34%	4.12%
Financing liabilities	5.83%	5.63%
Equity of investment account holders	2.35%	0.27%

Exposure to foreign exchange risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Groups major exposure is in GCC currencies, which are primarily pegged to the US Dollar. The Group had the following significant net exposures denominated in foreign currency as of 31 December from its financial instruments:

	2012 US\$ '000 Equivalent	2011 US\$'000 Equivalent
Sterling Pounds	807	1,007
Euro	(2,219)	(68,975)
Jordanian Dinar	-	2,268
Kuwaiti Dinars	-	12,832
Other GCC Currencies (*)	209,102	(45,420)

(*) These currencies are pegged to the US Dollar.

Exposure from Euro was primarily arising from "placements from a non financial institution" which had been redenominated to US\$ during the year (note 12). The management of foreign exchange risk against net exposure limits is supplemented by monitoring the sensitivity of the Group's financial assets and liabilities to various foreign exchange scenarios. Standard scenarios that are considered include a 5% plus / minus increase in exchange rates, other than GCC pegged currencies. An analysis of the Group's sensitivity to an increase or decrease in foreign exchange rates (assuming all other variables, primarily profit rates, remain constant) is as follows:

	2012 US\$ '000 Equivalent	2011 US\$'000 Equivalent
Sterling Pounds	± 40	±50
Euros	±110	±3,448
Jordanian Dinar	-	±113
Kuwaiti Dinars	-	±641

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36 *FINANCIAL RISK MANAGEMENT (continued)**Exposure to foreign exchange risk (continued)***Exposure to other market risks**

Equity price risk on quoted investments is subject to regular monitoring by the Group. The Group's equity type instruments carried at cost are exposed to risk of changes in equity values. The significant estimates and judgements in relation to impairment assessment of fair value through equity investments carried at cost are included in note 3 (ii). The Group manages exposure to other price risks by actively monitoring the performance of the equity securities.

d) Operational risk

Operational risk is the risk of loss arising from systems and control failures, fraud and human errors, which can result in financial and reputation loss, and legal and regulatory consequences. The Group manages operational risk through appropriate controls, instituting segregation of duties and internal checks and balances, including internal audit and compliance. The Risk Management Department facilitates the management of Operational Risk by way of assisting in the identification of, monitoring and managing of operational risk in the Group. The Group has finalized the risk and control assessments for majority of its departments and has identified the important Key Risk Indicators.

37 CAPITAL MANAGEMENT

The Group's regulator Central Bank of Bahrain (CBB) sets and monitors capital requirements for the Group as a whole. In implementing current capital requirements CBB requires the Group to maintain a prescribed ratio of total capital to total risk-weighted assets. The total regulatory capital base is net of prudential deductions for large exposures based on specific limits agreed with the regulator. Banking operations are categorised as either trading book or banking book, and risk-weighted assets are determined according to specified requirements that seek to reflect the varying levels of risk attached to assets and off-balance sheet exposures. The Group does not have a trading book.

The Group aims to maintain strong capital base so as to maintain investor, creditor and market confidence and to sustain the future development of the business.

The Group is required to comply with the provisions of the Capital Adequacy Module of the CBB (which is based on the Basel II and IFSB framework) in respect of regulatory capital. The Group has adopted the standardised approach to credit risk and market risk and basic indicator approach for operational risk management under the revised framework.

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

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37 *CAPITAL MANAGEMENT (continued)*

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

	2012	2011
Total risk weighted assets	1,833,157	1,879,341
Tier 1 capital	343,615	232,608
Tier 2 capital	10	568
Total regulatory capital base	343,625	233,176
Total regulatory capital expressed as a percentage of total risk weighted assets	18.74%	12.41%

The Group has complied with the externally imposed capital requirements set by the regulator for its consolidated capital adequacy ratio throughout the year.

38 COMPARATIVES

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