

Licensed as an Islamic Wholesale Bank by the CBB



Annual Report 2011

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His Royal Highness Prince Khalifa Bin Salman Al Khalifa

The Prime Minister The Kingdom of Bahrain



His Majesty King Hamad Bin Isa Al Khalifa

The King of The Kingdom of Bahrain



His Royal Highness Prince Salman Bin Hamad Al Khalifa

The Crown Prince and Deputy Supreme Commander



## **BOARD OF DIRECTORS**

Dr. Abdulaziz Al Bader Chairman

Mr. Hamad Abdulla Al-Ghanim Vice Chairman

Mr. Ahmed Shabib Al Dhahery Member

Mr. Ghassan Al Sultan Member

Mr. Isa Abdulla Al Mannai Member

Mr. Eyad Omar Al-Serri Member

## **EXECUTIVE COMMITTEE**

Mr. Isa Abdulla Al Mannai Chairman

Mr. Ghassan Al Sultan Member

Ahmed Shabeeb Al Dhahery Member

## **AUDIT COMMITTEE**

Mr. Hamad Abdulla Al-Ghanim Chairman

Mr. Eyad Omar Al-Serri Member

Ahmed Shabeeb Al Dhahery Member

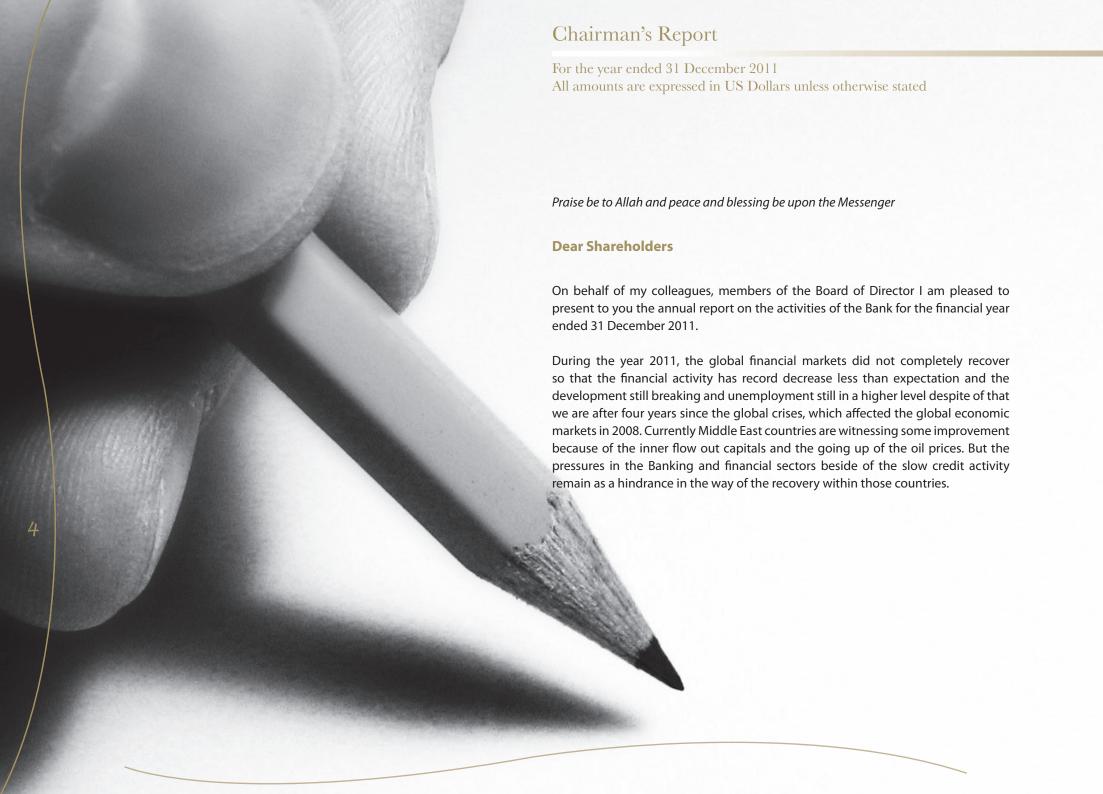
## **SHARI'A BOARD**

Shaikh Dr. AbdulSattar A.Karim Abu Ghuddah Chairman

Shaikh Dr. Ali Mohieddin Al Quradaghi Member

Shaikh Dr. Nedham Mohammed Saleh Yaqoobi Member





#### Dear Brothers,

In fact, GCC banking sector in general and Bahrain in particular because of its last situation reported drops in net profit in year 2011 which seen to be another very difficult year as a result of many banks and companies defaults as well as loses related to the unpaid loans still not disclosed, where GCC governments should give every effort in order to balance between reactivation of the credit and the necessity of supporting financial orders and supervision specially at those courtiers with over exposure.

Investors Bank was also not immune to the prevailing economical slowdown. The Bank suffered a drop in the market prices of "investments at fair value through statement of income" to the tune of US\$ 404,662 (Four Hundred Four Thousand Six Hundred and Sixty Two US Dollar).

Additionally the Bank had to make net provision for impairment of US\$ 2,876,991 (Two Millions Eight Hundred Seventy Six and Nine Hundred Ninety One U.S. Dollar) on account of a drop in the market value of its real estate investments and revaluation of receivables and the drop in market prices of Investments at fair value through equity.

Therefore, for the year ended 31 December 2011 the bank reported a net loss of US\$ 4,914,988 (Four Millions and Nine Hundred Fourteen Thousand and Nine Hundred Eighty Eight U.S. Dollar) (2010: US\$ 27,277,875). We believe that the drop in real estate and investments prices is temporary and our efforts to recover the receivables continue.

The Bank believes that 2012 would be a challenging year for the banking sector as a whole and Investors Bank in particular. The Bank is currently attempting to restructure its activities and implement robust internal processes as per the guidelines of Central Bank of Bahrain. The delicate and uncertain economic situation

demands caution in business approach in the immediate future. We are, therefore, exploring avenues to generate income from the real estate while keeping on eye on the opportunities to book capital gains once the market conditions improve.

#### Dear Shareholders,

We assure that the steps taken by the Bank in last years will have their fruits during the coming period. In spite of all this we do realise that the future challenges will be numerous but we as members of the Board of Directors are quite confident that we have the ability to face them, thanks to God's Grace, the work of the senior management which undertakes the leadership in the working area.

In conclusion I wish to express our gratitude and appreciation to his Majesty King Hamed Bin Isa Al Khalifa, The King of the Kingdom of Bahrain, His Royal Highness Prince Khalifa Bin Salman Al Khalifa, the Prime Minister and his Royal Highness Prince Salman Bin Hamed Al Khalifa, the Crown Prince and Deputy Supreme Commander, to Government of the Kingdom of Bahrain, the Minister of Industry and Commerce, the Central Bank of Bahrain, Bahrain Bourse for their vision, guidance and continuous support for the establishment of a distinguished Islamic Banking Centre in the Kingdom. Gratitude is also extended to the Sharia'a Supervisory Board for their support and valuable guidance, to our investors and to our members of staff: executives and employees whose support is adding value to the bank.

Dr. Abdul- Aziz Al Bader

Chairman

20 February 2012

In the name of Allah, the Beneficent, the Merciful, Prayers and Peace upon the Last Apostle and Messenger, Our Prophet Muhammad.

#### **Dear Shareholders**

The Directors have pleasure to submit their report, together with the financial statements of Investors Bank B.S.C. (c) ("the Bank") for the year ended 31 December 2011.

## **Principal Activities**

The Bank was established in the Kingdom of Bahrain as exempt company on 26 October 1997 and operates under an Islamic Wholesale Bank license granted by the Central Bank of Bahrain (the "CBB"). The Bank commenced commercial operations on 15 June 1998. The legal status of the Bank was changed to a closed Bahraini joint stock company on 3 July 2005.

During the year 2011 the bank did not undertake any new investment transactions. The Bank focused on generating liquidity through renting its buildings, exiting from certain investments and reducing its expenses.

The principal activities of the Bank include investment banking and financial activities, investment transactions, participating in equity investments in projects in conformity with the Islamic Shari'a.

#### **Financial Position and Results**

The detailed financial position of the Bank at 31 December 2011 and the results for the year then ended are set out in the accompanying financial statements.

Financial highlights	2011	2010
Total accet	42,522,024	46 227 022
Total asset	42 ,522,921	46,227,832
Total owner's equity	34,983,480	38,863,382
Net loss for the year	(4,914,988)	(27,277,875)
Movement in accumulated losses	2010	2011
Balance at 1 January	(51,190,737)	(23,912,862)
Net loss for the year	(4,914,988)	(27,277,875)
Balance at 31 December	(56,105,725)	(51,190,737)

#### **Dividends**

The Board of Directors has not made any appropriations for dividends for the year ended 31 December 2011 (2010: nil).

#### **Board of Directors**

The following served as directors of the Bank during the year ended 31 December 2011:

Name Title

Dr. Abdulaziz Al Bader Chairman

Mr. Hamad Abdulla Al-Ghanim Vice-Chairman and Chairman of the Audit Committee

Mr. Ahmed Shabib Al Dhahery Member
Mr. Ghassan Al Sultan Member

Mr. Isa Abdulla Al Mannai Member and Chairman of the Executive Committee

Mr. Eyad Omer Al-Serri Member

#### **Auditors**

Ernst & Young have expressed their willingness to continue in office and a resolution proposing their appointment, as auditors of the Bank for the year ending 31 December 2012, will be submitted to the Annual General Meeting.

#### **Thanks**

We wish to express our gratitude and appreciation to His Majesty King Hamed Bin Isa Al Khalifa The King of the Kingdom of Bahrain, to his Royal Highness Prince Khalifa Bin Salman Al Khalifa, the Prime Minister and His Royal Highness Prince Salman Bin Hamed Al Khalifa, the Crown Prince and Deputy Supreme Commander, to Government of the Kingdom of Bahrain, the Minister of Industry and Commerce, the Central Bank of Bahrain, the Bahrain Bourse for their vision, guidance and continuous support for the establishment of a distinguished Islamic Banking Centre in the Kingdom. Gratitude is also extended to the Shari'a Supervisory Board for their support and valuable guidance, to our investors and to our members of staff, executives and employees.

Dr. Abdulaziz Al Bader

Chairman

Ghassan Al Sultan

Director

20 February 2012

## Shari'a Board's Report

#### In the Name of Allah, The Beneficent, The Merciful

#### To the Shareholders of Investors Bank

Assalam Alaikum Wa Rahmat Allah Wa Baraketuh

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

We have reviewed the principles and the contracts relating to the transactions and applications introduced by the Investors Bank during the period ended 31/12/2011.

We have also conducted our review to form an opinion as to whether Bank has complied with Shari'a Rules and principles and also with the specific fatwas, rulings and guidelines issued by us.

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

We conducted our review which included examining, on a test basis of each type of transaction, the relevant documentation and procedures adopted by the Bank.

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

## In our opinion:

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- (1) the contracts, transactions and dealings entered into by the Bank during the year ended 31/12/2011 that we have reviewed are in compliance with the Islamic Shari'a Rules and Principles;
- (2) the allocation of profit and charging of losses relating to investment accounts conform to the basis that had been approved by us in accordance with Islamic Shari'a Rules and Principles;
- (3) the calculation of Zakah is in compliance with Islamic Shari'a Rules and principles.

We beg Allah the Almighty to grant us all the success and straight-forwardness.

Wassalam Alaikum Wa Rahmat Allah Wa Barakatuh.

27th Rabia I, 1433 Hijri corresponding to 19th February 2012.

**SHARI'A BOARD** 

Shaikh Dr. Ali Mohieddin Al Quradaghi Member Shaikh Dr. Abdul Sattar A.Karim Abu Ghuddah Chairman of the Board Shaikh Nedham Mohammed Saleh Yaqoobi Member

## Financial Statements

31 December 2011





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## INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF INVESTORS BANK B.S.C. (c)

We have audited the accompanying statement of financial position of INVESTORS BANK B.S.C. (c) ["the Bank"] as of 31 December 2011, and the related statements of income, cash flows, changes in owners' equity, changes in off-balance sheet equity of investment accountholders and sources and uses of charity fund for the year then ended. These financial statements and the Bank's undertaking to operate in accordance with Islamic Shari'a Rules and Principles are the responsibility of the Bank's Board of Directors. Our responsibility is to express an opinion on these financial statements based on our audit.

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

## **Opinion**

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Bank as of 31 December 2011, the results of its operations, its cash flows, changes in owners' equity, changes in off-balance sheet equity of investment accountholders and sources and uses of charity fund for the year then ended in accordance with the Financial Accounting Standards issued by AAOIFI.

## **Other Matters**

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

- a) the Bank has maintained proper accounting records and the financial statements are in agreement therewith; and
- b) the financial information contained in the Report of the Board of Directors is consistent with the financial statements.

We are not aware of any violations of the Bahrain Commercial Companies Law, the Central Bank of Bahrain and Financial Institutions Law, the CBB Rule Book (Volume 2 and applicable provisions of Volume 6) and CBB directives or the terms of the Bank's memorandum and articles of association during the year ended 31 December 2011 that might have had a material adverse effect on the business of the Bank or on its financial position. Satisfactory explanations and information have been provided to us by management in response to all our requests. The Bank has also complied with the Islamic Shari'a Rules and Principles as determined by the Shari'a Supervisory Board of the Bank.

20 February 2012

Manama, Kingdom of Bahrain

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ASSETS	Note	2011 US\$	2010 US\$
Cash and balances with banks	4	158,912	411,444
Investments	5	15,859,440	16,677,570
Deferred payment sale receivables	18	3,680,203	3,680,203
Investment properties	6	18,474,757	20,020,445
Other assets	7	1,385,874	1,594,222
Property and equipment	8	2,963,735	3,843,948
TOTAL ASSETS		42,522,921	46,227,832
LIABILITIES AND OWNERS' EQUITY			
Liabilities			
Due to a financial institution	18	3,670,202	3,670,202
Murabaha payable		3,229,064	3,229,064
Other liabilitie		640,175	465,184
Total Liabilities		7,539,441	7,364,450
Owners' Equity			
Share capital	9	80,000,000	80,000,000
Statutory reserve		7,409,515	7,409,515
Investments fair value reserve		3,679,690	2,644,604
Accumulated losses		(56,105,725)	(51,190,737)
Total owners' equity		34,983,480	38,863,382
TOTAL LIABILITIES AND OWNERS' EQUITY		42,522,921	46,227,832
OFF-BALANCE SHEET ITEMS: EQUITY OF INVESTMENT ACCOUNTHOLDERS		16,546,150	16,424,155

**Dr. Abdulaziz Al Bader** Chairman Ghassan Al Sultan Director

The attached notes 1 to 20 form part of these financial statements.

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T	J

Note	2011 US\$	2010 US\$
10	21,904 (404,662) 629,828	291,792 (3,402,560) 799,515
	247,070	(2,311,253)
11	982,181 503,848 799,038	1,123,068 612,686 1,141,033
	2,285,067	2,876,787
	(2,037,997)	(5,188,040)
12	(2,876,991)	(22,089,835)
	(4,914,988)	(27,277,875)
	10	21,904 (404,662) 629,828  247,070  982,181 503,848 799,038  2,285,067  (2,037,997)  12  (2,876,991)

	Note	2011 US\$	2010 US\$
OPERATING ACTIVITIES			
Net loss for the year		(4,914,988)	(27,277,875)
Adjustments for non-cash items:			
Depreciation		799,038	1,141,033
Gain on disposal of property and equipment		-	(2,035)
Provision for impairment, net		3,111,923	22,089,835
Gain on disposal of investments at fair value through equity		(21,904)	(291,792)
Fair value loss on investments at fair value through statement of income		404,662	3,402,560
Operating loss before changes in operating assets and liabilities:		(621,269)	(938,274)
Working capital adjustments:			
Other assets		28,772	158,212
Other liabilities		174,991	16,133
Net cash used in operating activities		(417,506)	(763,929)
INVESTING ACTIVITIES			
Proceeds from disposal of investments at fair value through equity		170,291	560,590
Proceeds from disposal of property and equipment		-	2,520
Purchase of property and equipment		(5,317)	-
Net cash from investing activities		164,974	563,110
NET DECREASE IN CASH AND CASH EQUIVALENTS		(252,532)	(200,819)
Cash and cash equivalents at 1 January		411,444	612,263
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	4	158,912	411,444
The attached notes 1 to 20 form part of these financial statements.			

			Investments		
	Share	Statutory	fair value	Accumulated	
	capital	reserve	reserve	losses	Total
	US\$	US\$	US\$	US\$	US\$
Balance at 1 January 2011	80,000,000	7,409,515	2,644,604	(51,190,737)	38,863,382
Net loss for the year	_	_	_	(4,914,988)	(4,914,988)
Other comprehensive income during the year (note 5.1.4)	_	-	1,035,086	-	1,035,086
Balance as at 31 December 2011	80,000,000	7,409,515	3,679,690	(56,105,725)	34,983,480
Balance at 1 January 2010	80,000,000	7,409,515	3,411,701	(23,912,862)	66,908,354
Net loss for the year	-	_	_	(27,277,875)	(27,277,875)
Other comprehensive loss during the year (note 5.1.4)	_	_	(767,097)	_	(767,097
Balance as at 31 December 2010	80,000,000	7,409,515	2,644,604	(51,190,737)	38,863,382

# STATEMENT OF CHANGES IN OFF-BALANCE SHEET EQUITY OF INVESTMENT ACCOUNTHOLDER

For the year ended on 31 December 2011

	Balan	ce at 1 January	2011	Movements d	luring the year	Balanc	e at 31 Decemb	er 2011
	No of units (000)	Average value per share US\$	Total US\$	Investment/ (withdrawal) US\$	Revaluations US\$	No of units (000)	Average value per share US\$	Total US\$
Murabaha with Lotus Air Ltd	-	_	317,689	_	-	-	_	317,689
Investments in International Investment Group K.S.C.C. (note 2 below)	12,887	0.44	5,670,202	_	_	12,887	0.44	5,670,202
Portfolio managed by the Bank (Gulf Monetary Group shares)	142,059	0.074	10,436,264	-	121,995	142,059	0.074	10,558,259
			16,424,155	-	121,995			16,546,150
	Balar	nce at 1 January	2010	Movements a	luring the year	Baland	e at 31 Decembe	er 2010
	No of units (000)	Average value per share US\$	Total US\$	Investment/ (withdrawal) US\$	Revaluations US\$	No of units (000)	Average value per share US\$	Total US\$
Murabaha with Lotus Air Ltd	_	_	317,689	-	_	-	_	317,689
Investments in International Investment Group K.S.C.C. (note 2 below)	12,887	0.44	5,670,202	_	_	12,887	0.44	5,670,202
Portfolio managed by the Bank (Gulf Monetary Group shares)	142,059	0.072	10,240,334	_	195,930	142,059	0.074	10,436,264
			16,228,225	-	195,930			16,424,155

- 1. Off-balance sheet investment accounts represent amounts received from and transactions entered on behalf of related parties.
- 2. On the instructions of an off-balance sheet investment account holder, a related party, the Bank has entered into a deferred payment purchase agreement with a financial institution to acquire shares of International Investment Group K.S.C.C ('IIG'). The Bank then entered into a deferred payment sale agreement with the off-balance sheet investment account holder for sale of the these shares. However, due to a legal dispute with the financial institution, the Bank could not effect the transfer of IIG shares to the off-balance sheet investment account holder (note 18).

The attached notes 1 to 20 form part of these financial statements.

2011 US\$		2010 US\$		
	_			
	_			
	_	266		
	_	266		
	-	(266)		
35,28	5	35,551		
35,28	5	35,285		

Note

The attached notes 1 to 20 form part of these financial statements.

Sources of charity fund Non-Islamic income

**Total sources** 

Total uses

Uses of charity fund

**Excess of uses over sources** 

Contributions to charitable organisations

Undistributed charity fund at 1 January

Undistributed charity fund at 31 December

#### 1. INCORPORATION AND ACTIVITIES

Investors Bank B.S.C. (c) ["the Bank"] was established in the Kingdom of Bahrain as an exempt company on 26 October 1997 and operates under an investment banking license [Wholesale Bank (Islamic principles)] granted by the Central Bank of Bahrain ["the CBB"]. The Bank commenced commercial operations on 15 June 1998. The legal status of the Bank was changed to a closed Bahraini joint stock company on 3 July 2005. The postal address of the registered office of the Bank is Seef Star Building, Seef District, PO Box 11818, Manama, Kingdom of Bahrain.

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 banking and financial activities, investment transactions, participating in equity investments in projects in conformity with the Islamic Shari'a. The Bank may, in particular, carry on the following business activities:

- (a) Providing investment account facilities;
- (b) Accepting restricted or unrestricted investment funds commingling the same with those of the Bank and investing them in accordance with the Shari'a;
- (c) Managing the investment of third party funds as an agent for a fixed fee or as a Mudarib and any other banking activities not contravening the provisions of the Shari'a;
- (d) Industrial, commercial and agricultural business activities, either directly or through companies which the Bank may establish, or in which the Bank may acquire shares; and
- (e) Purchasing, leasing and constructing buildings, and the renting thereof.

The Bank has not undertaken any new significant business activity since 2009 on account of losses, termination of key management staff and over all downturn in the global economies.

The financial statements were authorised for issue in accordance with a resolution of the Board of Directors on 20 February 2012.

#### 2 BASIS OF PREPERATION

The financial statements have been prepared under the historical cost convention as modified for the re-measurement of investments at fair value through statement of income and certain investments at fair value through equity.

The financial statements have been presented in United States Dollars ["US\$"], being the functional currency of the Bank.

The Bank incurred a net loss of US\$ 4,914,988 during the year ended 31 December 2011 (2010: US\$ 27,277,875) and as of that date, the Bank's accumulated losses amounted to US\$ 56,105,725 (2010: US\$ 51,190,737). The shareholders are confident that the Bank will generate positive results in the future and, hence, the financial statements have been prepared on a going concern basis.

## **Statement of Compliance**

These financial statements have been prepared in accordance with the Financial Accounting Standards ["FAS"] issued by the Accounting and Auditing Organisation for Islamic Financial Institutions ["AAOIFI"] the Islamic Shari'a Rules and Principles as determined by the Shari'a Supervisory Board of the Bank, the Bahrain Commercial Companies Law ["BCCL"], the CBB's regulations (as contained in volume II of the CBB rulebook) and directives and Financial Institutions Law. In accordance with the requirement of AAOIFI, for matters for which no AAOIFI standards exist, the Bank uses the relevant International Financial Reporting Standards ["IFRS"] issued by the International Accounting Standards Board ["IASB"].

#### 3 SIGNIFICANT ACCOUNTING POLICIES

#### 3.1 Adoption of new and amended standards and interpretations

The accounting policies are consistent with those of the previous year except for the following new and amended FAS interpretations effective as of 1 January 2011:

Statement of financial accounting No.1: Conceptual Framework for the financial reporting by Islamic Financial Institutions

The amended conceptual frame work provides the basis for the financial accounting standards issued by AAOFI. The amended framework introduces the concept of substance and form compared to the concept of form over substance. The framework state that it is necessary that information, transaction and other events are accounted for and presented in accordance with its substance and economic reality as well as the legal form.

The adoption of the new conceptual framework did not have any impact on the accounting policies, financial position or performance of the Bank.

Financial accounting standard (FAS 25) "Investment in sukuk, shares and similar instruments"

The Bank has adopted FAS 25 issued by AAOIFI which covers the recognition, measurement, presentation and disclosure of investment in sukuk, shares and similar investments that exhibit characteristics of debt and equity instruments made by Islamic financial institutions. The adoption of this standard did not have any significant impact on the accounting policies, financial position or performance of the Bank.

## 3.2 Significant accounting judgments and estimates

The application of the accounting policies requires management to make judgments, estimates and assumptions that affect the reported amounts in the financial statements. However, uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of the asset or liability affected in future periods. The most significant judgments and estimates are discussed below:

## **Going concern**

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

## Fair value of investment properties

The fair value of investment properties is determined by independent real estate valuation experts. The determination of the fair value for such assets requires the use of judgment and estimates by the independent valuation experts that are based on local market conditions existing at the date of the statement of financial position.

## Useful life of property and equipment

The Bank's management determines the estimated useful lives of its property and equipment for calculating depreciation. This estimate is determined after considering the expected usage of the asset and physical wear and tear. Management reviews the residual value and useful lives annually and future depreciation charges would be adjusted where the management believes the useful lives differ from previous estimate.

## Impairment of financial assets

The Bank assesses at each statement of financial position date whether there is objective evidence that a specific asset or a group of assets may be impaired. An asset or a group of assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that have occurred

## 3.2 Significant accounting judgments and estimates (continued)

#### Impairment of financial assets (continued)

after the initial recognition of the asset (an incurred "loss event") and that loss event(s) have an impact on the estimated future cash flows of the asset or the group of the assets that can be reliably estimated.

The Bank treats investments at fair value through equity as impaired when there has been a significant or prolonged decline in the fair value below its cost or where other objective evidence of impairment exists. The determination of what is "significant" or "prolonged" requires considerable judgment.

#### Impairment provisions against receivables

The Bank reviews its receivables at each reporting date to assess whether an impairment provision should be recorded in the financial statements. In particular, judgment by management is required in the estimation of the amount and timing of future cash flows when determining the level of provision required. Such estimates are based on assumptions about factors involving varying degrees of judgment and uncertainty and actual results may differ resulting in future changes to the provisions.

#### 3.3 Cash and cash equivalents

Cash and cash equivalents comprise cash and balances with banks with original maturities of less than ninety days.

#### 3.4 Investments

These are classified as either investments at fair value through statement of income or investments at fair value through equity.

## *Initial recognition*

All investments are initially recognised at cost, being the fair value of the consideration on acquisition including related direct expenses. Direct expenses are transaction costs and include fees and commissions paid to agents, advisors and consultants, levies by regulatory agencies and transfer taxes and duties.

## Investments at fair value through statement of income

Subsequent to initial recognition investments that are classified as investments at fair value through statement of income are carried at fair value. The fair value changes of investments at fair value through statement of income are reported in the statement of income.

## *Investments at fair value through equity*

Subsequent to initial recognition, investments that are classified as "investments at fair value through equity" are measured at fair value. The fair value changes of investments at fair value through equity are reported in statement of changes in owners' equity under "investments fair value reserve "until such time the investments are sold, realized or deemed to be impaired, at which time the realized gain or loss is reported in the statement of income.

The losses arising from impairment of such investments are recognized in the statement of income in "provision for impairment, net" and removed from the "investments fair value reserve". Impairment losses recognised in the statement of income for an equity instrument classified as investments at fair value through equity are not reversed through the statement of income.

## 3.5 Deferred payment sale receivables

Receivables arising from deferred payment sale are recognised at the time of contracting and stated at their cost less impairment.

## 3.6 Investment properties

Investment properties are held to earn rentals or for capital appreciation. They are initially recorded at cost, including acquisition charges associated with the properties.

#### 3.6 Investment properties (continued)

Subsequent to initial recognition, buildings classified as investment properties are measured at cost less accumulated depreciation and any accumulated impairment losses. Depreciation is provided on the straight line method at rates intended to write-off the cost of the assets over their estimated useful lives. Freehold land is subsequently measured at cost less accumulated impairment losses.

Expenditure for maintenance and repairs is expensed as incurred. An item of investment property is derecognized upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the statement of income.

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

#### 3.7 Property and equipment

Property and equipment is stated at cost less accumulated depreciation and accumulated impairment losses. Depreciation is provided on the straight line method at rates intended to write-off the cost of the assets over their estimated useful lives.

Freehold land is not depreciated. The estimated useful lives of the assets for the calculation of depreciation are as follows:

Building 25 years Others 3-5 years

Expenditure for maintenance and repairs is expensed as incurred. An item of property and equipment is derecognized upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the statement of income.

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

#### 3.8 Due to financial institutions

Amounts due to banks and financial institutions are initially recognised at cost, being the fair value of consideration received plus accrued profit less amount repaid.

## 3.9 Off-balance sheet equity investment accounts

Off-balance sheet equity investment accounts represent assets acquired by funds provided by holders of off-balance sheet equity investment accounts and their equivalent and managed by the Bank as an investment manager based on either a Mudaraba contract or agency contract. The off-balance sheet equity investment accounts are exclusively restricted for investment in specified investment instruments as directed by the off-balance sheet equity of investment account holders. Assets that are held in such capacity are not included as assets of the Bank in the financial statements.

Off-balance sheet equity investments in quoted securities are valued at their market bid price. Off-balance sheet equity investments in securities for which there are no quoted market prices or other appropriate methods from which to derive fair values, are stated at cost less impairment allowances, if any.

## 3.10 Employees' end of service benefits

The Bank makes contributions to the Social Insurance Organisation scheme for its national employees calculated as a percentage of the employees' salaries. The Bank's obligations are limited to these contributions, which are expensed when due.

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## 3.10 Employees' end of service benefits (continued)

The Bank also provides for end of service benefits to its expatriate employees. The entitlement to these benefits is based upon the employees' final salary and length of service, subject to the completion of a minimum service period. The expected costs of these benefits are accrued over the period of employment.

## 3.11 Recognition of income and expenses

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Bank and the revenue can be reliably measured, regardless of when the payment is being made. Revenue is measured at the fair value of the consideration received or receivable, taking into account contractually defined terms of payment.

Dividend income

Dividend income from investments is recognized when the right to receive the dividend is established.

Rental income

Rental income is recognised on the basis of contractual amounts receivable on a time apportioned basis.

## 3.12 Earnings prohibited by Shari'a

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

## 3.13 Derecognition of financial instruments

Financial instruments consist of cash and balances with banks, due from banks and financial institutions, non-trading investments and receivables.

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

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

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

## 3.14 Foreign currencies

Transactions in foreign currencies are initially recorded at the functional currency rate prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency spot rate of exchange ruling at the statement of financial position date. All differences are taken to the statement of income. Non monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates at the dates of the initial transactions. Non monetary items carried at fair value are retranslated at the functional currency spot rate of exchange ruling at the statement of financial position date. All differences are taken to equity as "investments fair value reserve."

#### 3.15 Fair values

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

For investments where there is no quoted market price, a reasonable estimate of the fair value is determined by reference to the current market value of another instrument which is substantially the same, or is based on an assessment of the value of future cash flows.

#### 3.16 Provisions

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

## 3.17 Offsetting financial instruments

Financial assets and financial liabilities are offset, and the net amount reported in the statement of financial position, if and only if there is a legally enforceable or religious right (as determined by Shari'a) to set off the recognised amounts and the Bank intends to settle on a net basis.

#### 3.18 Zakah

In the absence of appointment of the Bank to pay zakah on behalf of Shareholders, the responsibility of payment of zakah is on individual shareholders of the Bank.

4	CASH AND BALANCES WITH BANKS	

Cash in hand
Cash at banks

#### 5 INVESTMENTS

Investments at fair value through statement of income
Investments at fair value through equity

2011	2010
US\$	US\$
1,326	1,326
157,586	410,118
158,912	411,444
2011	2010
US\$	US\$
1,804,360	2,209,022
14,055,080	14,468,548
15,859,440	16,677,570

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## 5 INVESTMENTS (continued)

## 5.1 Investments at fair value through equity

		2011	2010
		US\$	US\$
Quoted equity securities Unquoted equity securities (at cost) Investment in funds	5.1.1 5.1.2	19,917,004 1,787,830 853,562	19,029,985 1,778,727 862,985
		22,558,396	21,671,697
Provision for impairment	5.1.3	(8,503,316)	(7,203,149)
		14,055,080	14,468,548

- **5.1.1** As at 31 December, investments with a carrying value of US\$ 1,921,772 (2010: US\$ 2,778,466) are under dispute and in the custody of the court as more fully explained in note 18. In addition investments with a carrying value of US\$ 5,760,487 (2010: US\$ 5,760,487) are pledged against amounts due to a financial institution.
- **5.1.2** These investments are carried at cost as their fair value could not be reliably measured.
- **5.1.3** Movement in the provision for impairment on investments at fair value through equity during the year was as follows:

	2011 US\$	2010 US\$
At 1 January Charge for the year Provision reversed due to disposal of investment	7,203,149 1,300,167 –	802,005 6,553,149 (152,005)
At 31 December	8,503,316	7,203,149

**5.1.4** Other comprehensive income represents fair value gains on investments classified at fair value through equity.

INVESTMENT PROPERTIES		2011	
	Freehold land US\$	Buildings US\$	Total US\$
Cost: At 1 January 2011 Reversal of disposal	18,742,649 	13,488,761 69,141	32,231,410 69,141
At 31 December 2011	18,742,649	13,557,902	32,300,551
Depreciation and impairment: At 1 January 2011 Impairment Charge for the year	8,464,134 1,193,634	3,746,831 - 421,195	12,210,965 1,193,634 421,195
At 31 December 2011	9,657,768	4,168,026	13,825,794
Net carrying values: At 31 December 2011	9,084,881	9,389,876	18,474,757
		2010	
	Freehold land US\$	Buildings US\$	Total US\$
Cost: At 1 January 2010 Disposal	18,742,649 –	15,434,430 (1,945,669)	34,177,079 (1,945,669)
At 31 December 2010	18,742,649	13,488,761	32,231,410
Depreciation and impairment: At 1 January 2010 Impairment Charge for the year Disposals	5,154,943 3,309,191 - -	1,450,732 1,857,782 574,075 (135,758)	6,605,675 5,166,973 574,075 (135,758)
At 31 December 2010	8,464,134	3,746,831	12,210,965
Net carrying values: At 31 December 2010	10,278,515	9,741,930	20,020,445

The fair value of investment properties at the year end was US\$ 19,557,287 (2010: US\$ 21,448,792) determined based on valuations performed by independent professional valuers at 31 December.

#### 7 OTHER ASSETS

Dividends receivable (note 18)
Other receivables
Statutory deposit with CBB
Prepaid expenses
Qard Hassan
Refundable deposit

2011	2010
US\$	US\$
887,733	887,733
475,000	653,473
13,263	13,263
5,034	7,110
3,213	31,144
1,631	1,499
1,385,874	1,594,222

7.1 These dividends have been pledged against amounts due to a financial institution along with the pledged shares as disclosed in note 18.

8 P	PR	O	PE	R	ΤY	<b>AND</b>	EQ	UIPI	<b>MENT</b>
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THOI ENTI AND EQUI MENT	2011						
	Freehold land US\$	Building US\$	Motor vehicles US\$	Office equipment & furniture US\$	Fixtures US\$	Total US\$	
Cost:							
At 1 January 2011 Additions	3,535,847	3,793,497	58,045 	839,778 3,062	1,346,991 2,255	9,574,158 5,317	
At 31 December 2011	3,535,847	3,793,497	58,045	842,840	1,349,246	9,579,475	
Depreciation and impairment:							
At 1 January 2011	1,413,831	2,732,489	58,045	719,001	806,844	5,730,210	
Charge for the year	_	45,634	_	62,588	269,621	377,843	
Impairment	507,687					507,687	
At 31 December 2011	1,921,518	2,778,123	58,045	781,589	1,076,465	6,615,740	
Net carrying values:							
At 31 December 2011	1,614,329	1,015,374		61,251	272,781	2,963,735	

7.1

The property and equipment mainly represents land and building in the Kingdom of Bahrain. The impairment charge is based on valuations performed by independent professional valuers at 31 December.

## 8 PROPERTY AND EQUIPMENT (continued)

	2010					
	Freehold land US\$	Building US\$	Motor vehicles US\$	Office equipment & furniture US\$	Fixtures US\$	Total US\$
Cost:						
At 1 January 2010	3,535,847	3,793,497	58,045	872,227	1,346,991	9,606,607
Additions	_	_	_	(33.440)	_	(22.440)
Disposals				(32,449)		(32,449)
At 31 December 2010	3,535,847	3,793,497	58,045	839,778	1,346,991	9,574,158
Depreciation and impairment:						
At 1 January 2010	1,228,548	113,805	58,045	570,049	537,445	2,507,892
Charge for the year	-	116,643	_	180,916	269,399	566,958
Impairment	185,283	2,502,041	_	-	-	2,687,324
Disposals				(31,964)		(31,964)
At 31 December 2010	1,413,831	2,732,489	58,045	719,001	806,844	5,730,210
Net carrying values:						
At 31 December 2010	2,122,016	1,061,008		120,777	540,147	3,843,948

## 9 OWNERS' EQUITY

Share capital

Authorised:

303,030,303 ordinary shares of US\$ 0.33 each

Issued and fully paid up
As at the beginning and end of the year
242,424,242 shares of US\$ 0.33 each

2011		2010
US\$		US\$
	l	
100,000,000		100,000,000
	·	
80,000,000		80,000,000
	:	

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2011

## 9 OWNERS' EQUITY (continued)

## Statutory reserve

In accordance with the Bahrain Commercial Companies Law and the Bank's articles of association, 10% of the net profit for the year is transferred to the statutory reserve until such time the reserve reaches 50% of the Bank's paid-up share capital. This reserve is not available for distribution, but can be utilised as security for the purpose of distribution in such circumstances as stipulated in the Bahrain Commercial Companies Law and other applicable statutory regulations. No transfers were made during the year as the Bank incurred a loss.

#### Investments fair value reserve

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

#### 10 OTHER INCOME

		US\$	US\$
	Net income from investment properties	503,681	625,034
	Other income	125,914	168,579
	Dividend income	233	5,902
		629,828	799,515
11	ADMINISTRATIVE AND GENERAL EXPENSES		
		2011	2010
		US\$	US\$
	Consultancy and legal expenses	135,866	181,272
	Professional fees	79,576	91,512
	License and registration	36,147	35,385
	Shari'a Supervisory Board meetings> expenses and attendance allowances	27,851	30,070
	Board of Directors and Committees meetings expenses and attendance allowances	20,984	20,696
	Advertising and promotion	14,874	16,415
	Communication	12,052	13,023
	Business development	4,703	4,881
	Brokerage fees	4,584	331
	Foreign exchange loss	460	41
	Others	166,751	219,060
		503,848	612,686

#### 12 PROVISION FOR IMPAIRMENT

Investments at fair value through equity Investment properties Other assets Property & equipment Provision written back

2011	2010
US\$	US\$
1,300,167	6,553,149
1,193,634	5,166,973
179,576	7,682,389
507,687	2,687,324
(304,073)	-
2,876,991	22,089,835

#### 13 FAIR VALUE OF FINANCIAL INSTRUMENTS

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

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

Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;

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

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

The Bank's quoted equity investments with a carrying value of US\$ 14,071,610 (2010: US\$ 14,685,858) fall under level 1 of the fair value heirarchy. The Bank does not have financial instruments qualifying for Level 2 or Level 3. The other investments at fair value through equity are carried at cost less impairment, if any.

#### 14 CAPITAL MANAGEMENT

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

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

The Bank's capital structure is primarily made up of its paid up capital, including reserves. From a regulation perspective, the significant amount of the Bank's capital is in tier 1 form as defined by the CBB, i.e., most of the capital is of permanent nature.

2011

## 14 CAPITAL MANAGEMENT (continued)

The classification of the Bank's capital in accordance with the regulatory requirements is as follows:

	US\$	US\$
Tier 1 Capital		1
Issued and fully paid ordinary shares	80,000,000	80,000,000
Legal / statutory reserves	7,409,515	7,409,515
Accumulated losses	(56,105,725)	(51,190,737)
Unrealised gross losses arising from valuing equity securities	(688)	(6,494)
	31,303,102	36,212,284
Excess amount over maximum permitted large exposure limit	(15,676,895)	(15,007,956)
Total Tier 1 Capital	15,626,207	21,204,328
Tier 2 Capital		
Unrealised gross gains arising from fair valuing equities (45% only)	1,656,170	1,192,994
	1,656,170	1,192,994
Excess amount over maximum permitted large exposure limit	(1,656,170)	(1,192,994)
Total Tier 2 Capital	_	
·		
Total Eligible Capital	15,626,207	21,204,328

To assess its capital adequacy requirements in accordance with the CBB requirements, the Bank adopts the Standardised approach for its Credit Risk, Basic Indicator Approach for its Operational Risk and Standardised Measurement Approach for its Market Risk. The Capital requirements for these risks are as follows:

Credit Risk Weighted Exposures Market Risk Weighted Exposures Operational Risk Weighted Exposures	50,002,447 6,133,112 41,130,394		55,618,005 6,389,437 41,130,394
Total Risk Weighted Exposures	97,265,953		103,137,836
Capital Adequacy Ratio	16.07%	=	20.56%

#### 15 RELATED PARTY TRANSACTIONS AND BALANCES

Related parties comprise major shareholders, directors of the Bank, Shari'a Supervisory Board members, entities owned or controlled, jointly controlled or significantly influenced by them and companies affiliated by virtue of shareholding in common with that of the Bank.

Transactions with related parties are undertaken on terms agreed between the parties which may not necessarily be on arm's length basis.

Significant balances with related parties at 31 December comprise:

	2011	2010
	US\$	US\$
Assets		
Investments at fair value through statement of income	1,733,030	2,075,605
Investments at fair value through equity	8,594,567	8,798,413
Deferred payment sale receivables	3,680,203	3,680,203
	14,007,800	14,554,221
Liabilities		
Murabaha payables	3,229,064	3,229,064
Other Liabilities	174,199	170,947
	3,403,263	3,400,011
OFF-BALANCE SHEET ITEMS:	16 220 461	16 106 466
EQUITY OF INVESTMENT ACCOUNTHOLDERS	16,228,461	16,106,466
The income and expenses with related parties included in the financial statements are as follows:		
	2011	2010
	US\$	US\$
Income		
Fair value loss on investments at fair value through statement of income	(342,576)	(3,336,033)
Other income	2,122	10,080
	(340,454)	(3,325,953)
Expenses		
Provision for impairment	203,562	7,686,891
Board of Directors and Committees meetings' expenses and attendance allowances	20,984	20,696
Shari'a Supervisory Board meetings' expenses and attendance allowances	27,851	30,070
Sharra Supervisory Board meetings expenses and attendance anowances		
	252,397	7,737,657

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#### 15 RELATED PARTY TRANSACTIONS AND BALANCES (continued)

Key management personnel of the Bank comprise key members of management having authority and responsibility for planning, directing and controlling the activities of the Bank. The key management personnel compensation is as follows:

Salaries and other short-term benefits Post employment benefits

US\$	2010 US\$
126,038 11,034	233,094 16,475
137,072	249,569

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#### 16 SHARI'A SUPERVISORY BOARD

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

#### 17 RISK MANAGEMENT

The Bank is exposed to credit risk, liquidity risk and market risk along with other operational risks.

The Bank's Board of Directors has the overall responsibility for the establishment and oversight of the Bank's risk management framework. The Board has established an Executive Committee, which is responsible for developing and monitoring the Bank's operations and policies across various functions including the risk management policies. The Executive Committee consists of three non-executive directors of the Bank along with the acting Chief Executive Officer ["CEO"] as an attendee. The Executive Committee reviews and approves the acting CEO's recommendations for investment strategies, investment proposals, various products and services and where deemed necessary, also refers decisions to the Board of Directors.

The Bank's Audit Committee is responsible for monitoring compliance with the risk management policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Bank. The Audit Committee is assisted in these functions by an outsourced Internal Audit function.

#### Credit risk

Credit risk is the risk that a counterparty to a financial transaction does not discharge its obligations on due dates and causes the other party to incur a financial loss.

The Bank's credit risk arises mainly from balances with banks, deferred payment sale receivables and other assets.

The Bank manages it credit risk on bank balances by placing funds with reputable banks having good credit ratings.

The Bank's maximum exposure to credit risk at 31 December was as follows:

	033	033
Balances with banks Deferred payment sale receivable Other assets	157,586 3,680,203 1,367,579	410,118 3,680,203 1,573,849
Maximum exposure to credit risk	5,205,368	5,664,170

## 17 RISK MANAGEMENT (continued)

## Credit risk (continued)

Analysis of the Bank's exposure to credit risk:

Neither past due nor impaired

Past due but not impaired

Individually impaired

Gross amount

Provision for impairment

Net

Total exposure to credit risk

Neither past due nor impaired
Past due but not impaired
Individually impaired Gross amount Provision for impairment
Net
Total exposure to credit risk

		2011		
		Deferred		
	Receivables	payment	Other	
Balances	from sale of	sale	financial	
with banks	investments	receivables	assets	Total
US\$	US\$	US\$	US\$	US\$
157,586	-	-	4,846	162,432
-	-	3,680,203	887,733	4,567,936
_	16,786,726	_	16,685,392	33,472,118
-	(16,786,726)	-	(16,210,392)	(32,997,118)
			475,000	475,000
157,586		3,680,203	1,367,579	5,205,368

		2010		
Balances with banks US\$	Receivables from sale of investments US\$	Deferred payment sale receivables US\$	Other financial assets US\$	Total US\$
410,118	_	-	31,144	441,262
-	_	3,680,203	1,067,705	4,747,908
-	16,786,726 (16,786,726)	- -	16,806,891 (16,331,891)	33,593,617 (33,118,617)
			475,000	475,000
410,118		3,680,203	1,573,849	5,664,170

## 17 RISK MANAGEMENT (continued)

## **Concentration risk**

The Bank's assets and liabilities are distributed over the following industry sectors and geographical areas:

	2011			
	Banks and financial institutions US\$	Investment companies US\$	Others US\$	Total US\$
Assets				
Balances with banks	158,912	_	_	158,912
Investments	12,767,796	31,936	3,059,708	15,859,440
Deferred payment sale receivables	_	3,680,203	-	3,680,203
Investment properties	_	-	18,474,757	18,474,757
Other assets	900,996	-	484,878	1,385,874
Property and equipment	_	-	2,963,735	2,963,735
Total assets	13,827,704	3,712,139	24,983,078	42,522,921
Liabilities				
Due to a financial institution	3,670,202	_	_	3,670,202
Murabaha payable	3,229,064	-	_	3,229,064
Other liabilities	69,751	-	570,424	640,175
Total liabilities	6,969,017		570,424	7,539,441
OFF-BALANCE SHEET ITEMS:				
EQUITY OF INVESTMENT ACCOUNTHOLDERS	5,670,202	10,558,259	317,689	16,546,150

# 17 RISK MANAGEMENT (continued)

# **Concentration risk (continued)**

	2010			
	Banks and financial institutions US\$	Investment companies US\$	Others US\$	Total US\$
Assets				
Balances with banks	411,444		_	411,444
Investments	12,919,354	244,921	3,513,295	16,677,570
Deferred payment sale receivables	_	3,680,203	_	3,680,203
Investment properties	_	-	20,020,445	20,020,445
Other assets	900,996	-	693,226	1,594,222
Property and equipment	-	-	3,843,948	3,843,948
Total assets	14,231,794	3,925,124	28,070,914	46,227,832
Liabilities				
Due to a financial institution	3,670,202	-	_	3,670,202
Murabaha payable	3,229,064	-	-	3,229,064
Other liabilities	19,149	-	446,035	465,184
Total liabilities	6,918,415	_	446,035	7,364,450
OFF-BALANCE SHEET ITEMS:				
EQUITY OF INVESTMENT ACCOUNTHOLDERS	5,670,202	10,436,264	317,689	16,424,155

# Geographical concentration

Assets and liabilities of the Bank as at 31 December 2011 and 31 December 2010 are primarily concentrated in the Middle East region.

# 17 RISK MANAGEMENT (continued)

# **Maturity Profile**

The table below summarizes the maturity profile of the Bank's financial assets and liabilities based on contractual cash flows. The other balances have been presented

based on expected cash flows:

				2011			
	Up to 1 month US\$	1 to 3 months US\$	3 months to 1 year US\$	Total Within 1 year US\$	1 to 3 years US\$	No fixed maturity US\$	Total US\$
Assets							
Cash and balances with banks	158,912	-	_	158,912	-	-	158,912
Investments	-	-	1,804,360	1,804,360	-	14,055,080	15,859,440
Deferred payment sale receivables	3,680,203	-	_	3,680,203	-	-	3,680,203
Investment properties	-	-	_	-	-	18,474,757	18,474,757
Other assets	-	-	8,246	8,246	-	1,377,628	1,385,874
Property and equipment	-	-	-	-	-	2,963,735	2,963,735
Total assets	3,839,115		1,812,606	5,651,721	_	36,871,200	42,522,921
Liabilities							
Due to a financial institution	3,670,202	-	_	3,670,202	-	-	3,670,202
Murabaha payable	3,229,064	-	_	3,229,064	-	-	3,229,064
Other liabilities	198,333	118,306	267,098	583,737	-	56,438	640,175
Total liabilities	7,097,599	118,306	267,098	7,483,003	_	56,438	7,539,441
Net	(3,258,484)	(118,306)	1,545,508	(1,831,282)		36,814,762	

# 17 RISK MANAGEMENT (continued)

# **Maturity Profile (continued)**

				2010			
	Up to 1 month US\$	1 to 3 months US\$	3 months to 1 year US\$	Total Within 1 year US\$	1 to 3 years US\$	No fixed maturity US\$	Total US\$
Assets							
Cash and balances with banks	411,444	_	_	411,444	_	_	411,444
Investments	-	_	2,209,022	2,209,022	_	14,468,548	16,677,570
Deferred payment sale receivables	3,680,203	_	-	3,680,203	_	_	3,680,203
Investment properties	_	_	_	_	_	20,020,445	20,020,445
Other assets	_	_	7,110	7,110	31,144	1,555,968	1,594,222
Property and equipment	_	_	_	-	-	3,843,948	3,843,948
Total assets	4,091,647		2,216,132	6,307,779	31,144	39,888,909	46,227,832
Liabilities							
Due to a financial institution	3,670,202	_	_	3,670,202	_	_	3,670,202
Murabaha payable	3,229,064	_	_	3,229,064	_	_	3,229,064
Other liabilities	92,272	155,557	168,729	416,558	-	48,626	465,184
Total liabilities	6,991,538	155,557	168,729	7,315,824		48,626	7,364,450
Net	(2,899,891)	(155,557)	2,047,403	(1,008,045)	31,144	39,840,283	

### 17 RISK MANAGEMENT (continued)

# Liquidity risk

Liquidity risk is defined as the risk that funds will not be available to meet liabilities as they fall due.

It is the Bank's policy to keep a significant part of its assets in the form of liquid assets such as trading and available-for-sale investments.

# **Currency risk**

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

The Bank has the following significant exposures in a foreign currency at the date of statement of financial position:

		2011	
	Assets US\$	Liabilities US\$	Net US\$
Kuwaiti Dinar	4,796,387	-	4,796,387
		2010	
	Assets US\$	Liabilities US\$	Net US\$
Kuwaiti Dinar	4,587,029	-	4,587,029

# Sensitivity Analysis:

The following table demonstrate the sensitivity to a reasonable possible change in foreign exchange rates, with all other variables held constant, of the Bank's statement of income for balances as of 31 December:

	Change in rate	Effect on net inc	ome for the year
		2011	2010
		US\$	US\$
Kuwaiti Dinar	5%	239,819	229,351

The decrease in rate will have an opposite impact on net income.

### 17 RISK MANAGEMENT (continued)

## **Equity price risk**

Equity price risk is the risk that Bank's quoted equity investments will depreciate in value due to movements in the quoted equity prices. The Bank has a few listed equity exposures in the trading book as well as the available-for-sale portfolio. The price movement of these exposures are monitored by the Bank on a daily basis.

The following table demonstrate the sensitivity to a reasonable possible change in equity prices, with all other variables held constant, of the Bank's statement of income or equity based on the position as of 31 December:

Sensitivity Analysis:

	Change in Price	Effect on net inco	Effect on net income for the year		
		2011	2010		
		US\$	US\$		
Particulars					
Investments at fair value through statement of income	20%	360,872	441,804		
Investments at fair value through equity	20%	2,453,450	2,495,367		

The decrease in rate will have an opposite impact on net income.

# **Operational Risk**

Operational risk is defined as the risk of loss arising from inadequate or failed internal processes, people and systems or from external events which includes but is not limited to legal risk and Shari'a compliance risk. This definition excludes strategic and reputational risk.

The Bank has implemented an operational risk framework of the Basic Indicator Approach ["BIA"], as defined by the CBB guidelines. This framework includes measuring, monitoring and managing operational risk across the Bank. This framework uses tools like Risk and Control Self Assessment, identification of Key Risk Indicators, preparation of operational loss database etc.

The operational risk framework will evolve with the changing needs of the Bank's businesses and regulatory guidance, taking into account internal and external operational risk events, business environment and internal control factors.

While individual units have direct responsibility for the control and mitigation of operational risk, the proposed framework provides a consistent methodology across the Bank. The Bank attempts to manage operational risk through appropriate controls, appropriate training of the employees, and internal checks and balances including internal audit and compliance.

### 18 LITIGATION AND CLAIMS

In 2004, the Bank entered into a sale and purchase agreement with a financial institution to purchase shares of a related party on behalf of another related party. The net amount due to the financial institution was US\$ 3,670,202 (31 December 2010: US\$ 3,670,202). In accordance with the terms of the agreement, the Bank pledged certain equity shares with a carrying value of US\$ 1,921,772 as at 31 December 2011 (2010: US\$ 2,778,466) in addition to dividends received on these shares

### 18 LITIGATION AND CLAIMS (continued)

amounting to US\$ 887,733 (2010: US\$ 887,733). Subsequently, the agreement was terminated by the financial institution due to disputes with the Bank and as a result, the pledged investments have been retained by the financial institution. In the opinion of the Bank's lawyers and management, the agreement was wrongfully terminated and following the financial institution's refusal to settle the matter amicably, the Bank has filed a legal case in the courts of Bahrain against the financial institution for possession of the Bank's investments.

As a result, the court has taken custody of the shares under dispute and the related dividends. The related party on whose behalf the transaction was executed has provided a manager's cheque for an equal amount which has been deposited with the court amounting to US\$ 3,680,203 (2010: US\$ 3,680,203).

The related party on whose behalf the transaction was entered into has also agreed to reimburse the Bank for legal expenses and any losses arising on final settlement with the financial institution. Accordingly, in the opinion of the directors, no provision is required to be made in the financial statements against the investments pledged with the financial institution or for contingent claims that might arise on final settlement.

### 19 SEGMENTAL INFORMATION

The Bank operates solely in the Kingdom of Bahrain and no geographic segment information has been presented.

### **20 SOCIAL RESPONSIBILITY**

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

# Investors Bank BSC (c) Public Disclosures Document

31st December 2011

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### 1. EXECUTIVE SUMMARY

Basel 2 based guidelines of the Central Bank of Bahrain ["the CBB"] outlining the capital adequacy framework for banks incorporated in the Kingdom of Bahrain became effective from 1 January 2008 in the Kingdom of Bahrain.

This document encompasses the detailed qualitative and quantitative public disclosure requirements (to enhance corporate governance and transparency). The document contains a description of following major aspects of Investors Bank ["the Bank" or "IB"]:

Corporate Governance;

Capital Adequacy Policies and Practices; and

Risk Management

The Bank has adopted the Standardised Approach to determine the capital requirement for credit risk and market risk, and the Basic Indicator Approach for operational risk.

The disclosed Tier 1 and total capital adequacy ratios comply with the minimum capital requirements under the CBB's Basel 2 framework.

The disclosures in this report are in addition to the disclosures set out in the financial statements for the year ended 31 December 2011 in accordance with Financial Accounting Standards issued by the Auditing Organisation for Islamic Financial Institutions and the Shari'a rules and principles as determined by the Shari'a Supervisory Board of the Bank.

### 2. Management Discussion and Analysis

During the year 2011, the global financial markets did not completely recover so that the financial activity has record decrease less than expectation and the development still breaking and unemployment still in a higher level. Currently Middle East countries are witnessing some improvement because of the inner flow out capitals and the going up of the oil prices.

In fact, GCC banking sector in general reported drop in net profit in year 2011 which seen to be another very difficult year as a result of many banks and companies defaults as well as loses related to the unpaid loans.

Investors Bank was also not immune to the prevailing economical slowdown. The Bank suffered a drop in the market prices of "investment at fair value through statement of income" to the tune of US\$ 404,662 (Four Hundred four thousand six Hundred and sixty two US Dollar).

Additionally the Bank had to make net provision for impairment of US\$ 2,876,991 (Two millions Eight Hundred Seventy Six and Nine Hundred Ninety one U.S. Dollar) on account of a drop in the market value of its real estate investments and revaluation of receivables and the drop in market prices of Investment at fair value through equity.

During the year 2011 the bank did not undertake any new investment transactions. The Bank focused on generating liquidity through renting its buildings, exiting from certain investments and reducing its expenses.

Therefore, for the year ended 31 December 2011 the bank reported a net loss of US\$ 4,914,988 (Four Millions and nine hundred Fourteen thousand and Nine Hundred Eighty Eighty (2010: US\$ 27,277,875 U.S. Dollar). We believe that the drop in real estate and investments prices is temporary and our efforts to recover the receivables continue.

The Bank believes that 2012 would be a challenging year for the banking sector as a whole and Investors Bank in particular. The Bank is currently attempting to restructure its activities and implement robust internal processes as per the guidelines of Central Bank of Bahrain. The delicate and uncertain economic situation demands caution in

business approach in the immediate future. We are, therefore, exploring avenues to generate income from the real estate while keeping on eye on the opportunities to book capital gains once the market conditions improve.

# **Financial ratios for five years:**

Ratio name	2011	2010	2009	2008	2007
ROAE	- 13.31	- 51.58	- 27.45	- 32.08	- 7.59
ROAA	- 11.08	- 45.28	- 25.07	- 30.06	- 7.20
STAFF COST/INCOME	397.53	N/A	321.17	N/A	N/A
COST/INCOME	2,089.31	N/A	5,184.63	N/A	N/A
EPS (\$)	- 0.02	- 0.11	- 0.09	- 0.14	- 0.04

# 3. Corporate Governance

# 3.1 Ownership structure of the Bank

The ownership structure of the Bank is given below:

# 3.1.1 Distribution of ownership by Directors, Senior Managers, on an individual basis

On an individual basis, the following is the distribution of ownership by Board of Directors:

Name	No. of shares	Ownership percentage
Ahmed Shabib Al Dhahery	2,579,393	1.06%

The Bank's other Board of Directors and Senior Managers do not own any shares in Bank on an individual basis

# 3.1.2 Distribution of ownership by Nationality

Country	No. Of Shares	Ownership %
Kuwait	198,149,182	81.75%
Bahrain	30,726,460	12.67%
Qatar	6,934,298	2.86%
UAE	5,266,423	2.17%
Oman	130,909	0.05%
KSA	1,216,970	0.50%
Total	242,424,242	100.00%

# 3.1.3 Distribution of ownership of shares by size of shareholder

Ownership size	No of shareholders	Total ownership	
0 - 5%	94	37.95%	
5 - 15%	2	12.70%	
> 15%	2	49.35%	

The following table shows the names of the shareholders who own 5% or more in the Bank's capital:

Shareholder Name	No of shareholders	Total ownership
Ajal Holding Company	82,844,459	34.17%
International Investment Group	36,780,742	15.17%
Fahad Sultan Sons & Co.	15,709,091	6.48%
Gulf Monetary Group	15,069,091	6.22%
Total	150,403,383	62.04%

### 3.1.4 Ownership by Govt.

No sovereign Govt. owns any shares in the Investors Bank

### 3.2 The Board of Directors

The Board of Directors is responsible for approving the Bank's overall business strategy, monitoring its operations, and taking critical business decisions. The Board, elected by the shareholders, is the ultimate decision making body of the Bank and has the following broad responsibilities, as enunciated in the Corporate Governance Manual of the Bank:

Providing effective governance over the Bank's affairs for the benefit of its shareholders, employees, customers and other stakeholders;

overseeing the conduct of the Bank's business so that it is effectively managed in the long-term interest of shareholders;

selecting, evaluating and compensating the Chief Executive Officer (CEO) and planning for CEO succession, as well as monitoring management's succession planning for other key executives;

reviewing, approving and monitoring the Bank's strategic plans and objectives;

approving the policies of the Bank with respect to various risks and for ensuring that the management takes the steps necessary to identify, measure, monitor, and control these risks. The Board shall also approve policies that identify lines of authority and responsibility for managing risk exposures.

monitoring the Bank's accounting and financial reporting practices and reviewing the Bank's financial and other controls; and

overseeing the Bank's compliance with applicable laws and regulations.

The Board shall also ensure the integrity of the Bank's accounting and financial reporting system through regular independent review by internal and external auditors. The Audit Committee is responsible for review of the integrity of the Bank's financial reporting and report to the Board.

The Board of Directors (BoD) aspires to the highest standards of ethical conduct: doing what it says; reporting results with accuracy and transparency; and maintaining full compliance with the laws, rules and regulations that govern the Bank's business. The Board attempts to monitors compliance of the ethical conduct through periodic reviews by compliance and the internal audit functions.

Review of internal control, processes & procedure is carried out by internal Audit department where the bank has outsourced its internal audit function to PricewaterhouseCoopers (PWC), Bahrain in 2009, 2010 and 2011.

As per the Articles of Association of the Bank, the Board should have not less than three and not more than 9 members. Currently the Bank has six members on its Board of Directors, of which the following three are independent:

- Mr. Ahmed Shabib Al Dhahery
- Mr. Hamad Al Ghanim
- Mr. Eyad Omar Al-Serri

Currently the Bank does not have a pre-defined process to induct, educate and orient new directors.

### 3.2.1 The election system of the Board of Directors

As per the Articles of Association (AOA), The Ordinary General Assembly may appoint a number of members from amongst those who have experience and expertise in the Board of Directors from other than the founders of the Company and the shareholders in the number and specialization that the Board believes that the interest of the Company so requires and in order to make available qualified, technical, management, academic and practical expertise

# 3.2.2 Termination of Board's membership

As per the AOA, the membership of the director may terminate in the following cases:

- If he is appointed or elected in contrary to the provisions of the Memorandum and Articles of Association.
- If he misuses his membership to carry out business in competition with the Company or causes actual damages to it.
- If he fails to attend three consecutive meetings without legitimate cause and this issue is notified to the Board of Directors in writing and the Board takes an appropriate action in respect thereof.
- If he resigns, relinquishes or is dismissed from his office provided that this done in an appropriate time otherwise he shall be required to compensate the Company.
- If he occupies another position within the Company for consideration other than the position that the Board of Directors may resolve from time to time to pay a remuneration for the person who occupies such position due to its executive nature

### 3.3 Profiles of Members of the Board of Directors

### Dr. Abdulaziz Al Bader - Chairman

Dr. Al Jenaei is in the Board of Investors Bank since 10th June 2007. He has a Doctorate degree in comparative Fiqh (Jurisprudence), from Azhar University in Egypt. He has over 31 years experience in various fields including Sharia supervisory in a number of Islamic investment companies, Research, Shari'a and Islamic education etc. He is currently the Vice Chariman and Chief Executive Officer of Grand Real Estate Company, Kuwait. He has been an Assistant Undersecretary of Awqaf (Endowments) and Islamic Affairs, Cultural Affairs, Member of the Board of Directors of Research Centre for History, Arts and Culture (Istanbul), Media Advisor in supreme advisory committee aiming at fulfilment of implementation of Islamic Shari'a provisions, Seconded Professor at Faculty of Shari'a, Seconded Professor at the Public Authority for Applied Education etc. Dr. Al Jenaei has attended various training courses including on Strategic Planning and Top Management (London), Motivation Strategies, leadership and Crisis Management, Change Strategy Management etc.

Additionally, Dr.Al Jenaei has been an active contributor for the benefit of society.

Dr.Al Jenaei is the Mosque orator on Fridays, Imam for His Highness, Amir of Kuwait. Dr.Al Jenaei is also an Ex-member of the Board of Literacy Supreme Council, Shari'a authenticator since 1986 etc.

### Mr. Hamad Abdulla Al Ghanim - Vice Chairman

Mr. Al Ghanim has around 28 years experience in Banking, Overseas Trading and Managing Investments Projects. He is currently the General Manager of First Holding Company and also the Chairman of Wara Constructions Company. He has been a Board Member of Central Bank of Kuwait, Assistant Deputy Minister of Ministry of Commerce and Industry and also the Investment Projects Manager of the Kuwaiti Company for Trading and Contracting and Foreign Investments.

Mr. Al Ghanim has been in the Board of Directors of Investors Bank since 29th April, 2010

Educationally, Mr. Al Ghanim has a Bachelor degree in Business Management from Sonoma State University in U.S.A.

### Mr. Ahmed Shabib Al Dhahery - Member

Mr. Dhahery is the Executive Director of the Abu Dhabi Investment Authority. He is also a Board member in Tunis and Emirates Bank (Tunis), Federal National Council, National Advisory Council for College of Business Sciences (Zyed University, Abu Dhabi), Arab Tourism Organisation, Al Ain Sports Club etc. He has been a Board Member of Gulf Air Company, Abu Dhabi Fund for Development etc.

Mr. Dhahery has been in the Board of Directors of Investors Bank since 5th August, 2004.

Educationally, currently Mr. Dhahery is enrolled in Abu Dhabi University for Master of Human Resources Management Program. He is also an MBA from Abu Dhabi University, Master in International Business from Ecole Nationale Des Ponts Et Chaussees (ENPC) – Paris and is Bachelor in Economics from University of La Verne – California, USA.

## Mr. Ghassan Al Sultan - Member

Mr. Sultan has more than 30 Years of experience in real estate and investments. Mr. Sultan is currently the Chairman of the Board of Gulf Petroloum Company (K.S.C.C.), also he is a Board Member of Salloum & Co. – Riviera Hotel and the Chairman and General Manager of Riviera Holding – Lenabon SAL. He has also been in the positions of Chairman and Managing Director of Gulf United real Estate and Tourism Investment Company (K.S.C.C.), Chairman- Managing Director and General Manager of Pearl of Kuwait Real Estate Company, Director of Finance and International Investments in Fahad Sultan Sons & Co. W.L.L., Managing Director of Kuwait Computer Services Company etc.

Mr. Sultan is in the Board of Directors of Investors Bank since 15th June 1998.

Educationally, Mr. Sultan has a Bachelors Degree in Industrial Engineering from University of Portland, Oregon USA.

### Mr. Isa Abdulla Al Mannai - Member

Mr. Mannai has over 30 years' experience in the Construction Industry. He is currently the Chairman of the Mannai Technical Services W.L.L., Isa Mannai Technical Services Est, Saudi Arabia, Chairman of Computer Systems Protection Chambers and Integrated Communications Co. Ltd Saudi Arabia and Director of Manorchem Engineering Pvt. Ltd in Chennai India.

Mr. Mannai is in the Board of Directors of Investors Bank since 10th June 2007.

Educationally, Mr. Mannai is MSc. (Engineering Management) from the Catholic University, Washington DC and BSc (Civil Engineering) University of Washington, Seattle.

# Mr. Eyad Omar Al Serri – Member

Mr. Serri has around 19 years experience in Banking, Investment and Real Estate industry. Currently he is a Board Member of Grand Real Estate Projects Company, Kuwait. Mr. Serri has been a Board Member of Osoul Investment Company, Kuwait, Managing Director of Ajal Finance & Investment Company, Kuwait and Chairman and Managing Director of Wared Lease and Finance Company, Kuwait.

Mr. Serri is in the Board of Investors Bank since 29th April, 2010

Educationally, Mr. Serri has B.A. – Business Management from Sonoma State University in U.S.A.

### 3.4 Board Committees

Consistent with the industry practices, the Board has established the following board sub-committees with defined roles and responsibilities:

### 3.4.1 Executive Committee (EXCOM)

As per the chart the Executive Committee consists of three non-executive directors of the Bank with the Chief Executive Officer (CEO) as an attendee. The EXCOM provides direction to the executive management on all business matters. The Executive Committee reviews and approves the recommendations for investment strategies, investment proposals, various products and services and where deemed necessary, also refers decisions to the Board of Directors.

The EXCOM is also responsible for business matters concerning risk management, strategy review and recommendation to the Board.

### **EXCOM Members:**

Mr. Isa Abdulla Al Mannai – Chairman

Mr. Ghassan Al Sultan - Member

Mr. Ahmed Shabib Al Dhahery – Member (Independent)

### 3.4.2 Audit Committee

The Audit Committee has the responsibility to assist the Board in discharging its oversight duties relating to matters such as risk and compliance, including the integrity of the Bank's financial statements, financial reporting process and systems, internal controls and financial controls. The Committee also liaises between the External Auditors and the Board. The audit and non-audit fees will be discussed at the Annual General Meeting, in addition the reappointment of the external auditors will be decided at the Annual General Meeting scheduled for on 29th April 2012.

### **Audit Committee Members:**

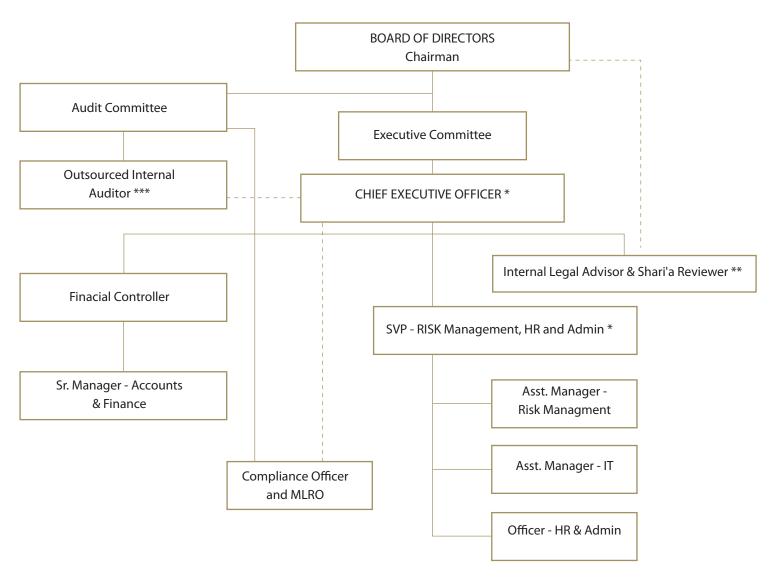
Mr. Hamad Al Ghanim - Chairman (Independent)

Mr. Eyad Al Serri – Member (Independent)

Mr. Ahmed Shabib Al Dhahery – Member (Independent)

Members of management, representatives of internal and External Auditors, independent consultants and other specialists may be invited to attend meetings at the request of the Chairman of the Audit Committee.

Striving to enhance the Corporate Governance practices, commensurate with the size of operations and feasibility, the Bank may introduce additional board subcommittees (like Board Risk Committee) as well as management level committees to manage its affairs in an efficient and transparent manner.



<sup>\*</sup> Currently Vacant

<sup>\*\*</sup> Also the Board Secretary

<sup>\*\*\*</sup> Price Waterhouse Cooper (PWC) - Bahrain

# 3.6 Board Meetings

As per the Corporate Governance Manual, the Board is expected to meet minimum four times during a year. There were four Board and Sub Committee meeting during the 2011.

The dates and attendance details of the Board meetings are given below:

Date & location of meeting	Names of Directors present or participated by phone/video link	Names of directors not present
23/6/2011 –	Dr. Abdulaziz Al Bader	Mr. Hamad Al Ghanim
Bahrain	Mr. Ahmed Shabib AlDhahery	
	Mr. Isa Al Mannai	
	Mr. Ghassan Al Sultan	
	Mr. Eyad Al Serri	
16/10/2011 –	Dr. Abdulaziz Al Bader	Mr. Eyad Al Serri
Bahrain	Mr. Hamad Al Ghanim	
	Mr. Ghassan Al Sultan	
	Mr. Ahmed Shabib Al Dhahery	
	Mr. Isa Al Mannai	
17/11/2011 –	Dr. Abdulaziz Al Bader (By Phone)	Mr. Ghassan Al Sultan
Bahrain	Mr. Hamad Al Ghanim (By Phone)	
	Mr. Ahmed Shabib Al Dhahery (By Phone)	
	Mr. Eyad Al Serri (By Phone)	
	Mr. Isa Al Mannai	
29/12/2011 –	Dr. Abdulaziz Al Bader (By Phone)	
Bahrain	Mr. Ghassan Al Sultan (By Phone)	
	Mr. Hamad Al Ghanim (By Phone)	
	Mr. Ahmed Shabib Al Dhahery (By Phone)	
	Mr. Eyad Al Serri (By Phone)	
	Mr. Isa Al Mannai	

The dates and attendance details of the Executive Committee meetings are given below:

Date & location of meeting	Names of Committee members present or participated by phone/video link	Names of Committee members not present
24/4/2011 –	Mr. Isa Al Manni	
Bahrain	Mr. Ghassan Al Sultan (By Phone)	
	Mr. Ahmed Al Dhahery (By Phone)	
16/6/2011 –	Mr. Isa Al Mannai	
Bahrain	Mr. Ghassan Al Sultan (By Phone)	
	Mr. Ahmed Al Dhahery (By Phone)	
27/9/2011 –	Mr. Isa Al Mannai	
Bahrain	Mr. Ghassan Al Sultan	
	Mr. Ahmed Al Dhahery (By Phone)	
17/10/2011 –	Mr. Isa Al Mannai	
Bahrain	Mr. Ghassan Al Sultan	
	Mr. Ahmed Al Dhahery (By Phone)	
24/11/2011 –	Mr. Isa Al Mannai	
Bahrain	Mr. Ghassan Al Sultan (By Phone)	
	Mr. Ahmed Al Dhahery (By Phone)	
8/12/2011 –	Mr. Isa Al Mannai	
Bahrain	Mr. Ghassan Al Sultan (By Phone)	
	Mr. Ahmed Al Dhahery (By Phone)	

The dates and attendance details of the Executive Committee meetings are given below:

Date & location of meeting	Names of Committee members present or participated by phone/video link	Names of Committee members not present
8/8/2011 –	Mr. Hamad Al Ghanim	
Bahrain	Mr. Eyad Al Serri	
17/10/2011 –	Mr. Hamad Al Ghanim	Mr. Eyad Al Serri
Bahrain	Mr. Ahmed Al Dhahery	
17/11/2011 –	Mr. Hamad Al Ghanim (By Phone)	
Bahrain	Mr. Eyad Al Serri (By Phone)	
	Mr. Ahmed Al Dhahery (By Phone)	
29/12/2011 –	Mr. Hamad Al Ghanim (By Phone)	
Bahrain	Mr. Eyad Al Serri (By Phone)	
	Mr. Ahmed Al Dhahery (By Phone)	

# 3.7 Approval authority structure

The materiality level for transactions that require board approval varies for different activities and is governed by the Board approved delegation of authority document.

In addition as per the Board Charter, decisions made by the Board, other than those made at Annual General Meetings and Extraordinary General Meetings may be made through circulation. In all such cases:

- The Board secretary shall ensure and confirm circulation of necessary information and documentation; and
- A decision through circulation will not be valid unless approved by more than half of the responding members, which should not be less than two.
- All Board members shall be required to respond to the Board Secretary within three working days of circulation.
- If the Board Secretary does not receive the response from any Board member within three working days of circulation, his/her response shall be considered as approved.

### 3.8 Code of Conduct

The Bank has in place a written document of the "Code of Conduct", and as per the Board Charter The Bank will adopt a Code of Conduct and other internal policies and guidelines designed to support the mission statement set forth above and to comply with the laws, rules and regulations that govern the Bank's business operations. The Code of Conduct will be documented, published and communicated throughout the Bank. The Code of Conduct will apply to all employees of the Bank and its subsidiaries, as well as to Directors, temporary workers and other independent contractors and consultants when engaged by or otherwise representing the Bank and its interests. The Code of Conduct will be communicated throughout the Bank, so that the Board, senior management and staff understand the importance of conducting business based on good corporate governance values and understand their accountabilities to various stakeholders of the Bank.

The Board Charter lists all the Code of Conduct that all directors have to adopt and adhere to in their behaviour.

### 3.9 Evaluation of Board Performance

The Board shall, through the Nomination and Remuneration Committee, conduct an annual review of the Board's performance. This review shall include an overview of the talent base of the Board as a whole as well as an individual assessment of each director's qualification under corporate governance rules and all other applicable laws, rules and regulations regarding directors; consideration of any changes in a director's responsibilities that may have occurred since the director was first elected to the Board and such other factors as may be determined by the Committee to be appropriate for review.

The Board of Directors shall review the performance of the Chairman and the CEO in order to ensure they are providing the best leadership for the Bank.

# 3.10 Social Responsibility

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

### 3.11 Conflict of Interest

As per the Board Charter:

- Directors and employees of the Bank shall act ethically at all times and in accordance with the Bank's applicable Code of Conduct. If an actual or potential conflict of interest arises in respect of a director, the director shall promptly disclose such conflict to the Board.
- The Board will establish and disseminate to its members and management policies and procedures for the identification, reporting, disclosure, prevention or strict limitation of potential conflicts of interest. It is senior management's responsibility to implement these policies.
- Any decision to enter into transactions, under which Board members or any member of executive management may have a conflict of interest that is material, shall be formally and unanimously approved by the Board.
- Executive directors shall absent themselves from any discussions or decision-making that involve a subject where they are incapable of providing objective advice, or which involves a subject or (proposed) transaction where a conflict of interest exists.
- Directors shall disclose to the Board any potential conflict of interest in their activities with other organisations.
- All Board members and members of executive management must declare to the Board in writing, on an annual basis, all of their other interests in other institutions, whether as a shareholder of five percent (5%) or more of the voting capital of the company, a manager or other form of significant participation.

# 3.12 Management Profile

### Mr. Aref Hussain, Financial Controller

Mr. Hussain has over 13 years of experience in Telecommunication sector and over 5 years of experience in the Banking sector. He has experience across project management, management reporting, international and wholesale financial services, regulatory control and financial control. His experience includes positions of head of management reporting at Bahrain Telecommunication Company (Batelco); manager of international and wholesale financial services at Bahrain Telecommunication Company (Batelco) and manager of regulatory accounts at Telecommunication Regulatory Authority (TRA - Bahrain).

Mr. Hussain holds a Bachelor degree in Accounting from University of Bahrain and is a CMA (Certified management accountant) from Institute of Management Accountants from the United States of America.

### Mr. Ismaeel Omar Ahmed Elnasri, Legal Advisor (Internal), Shari'a Reviewer and Secretary to the Board of Directors

Mr. Elnasri has an extensive experience of 10 years experience in Law. He has worked as an advocate in the Commissioner's office in Khartoum and with various other law firms as a Legal Advisor in Bahrain. He also has the responsibility of the secretary to General Assembly, Executive Committee, Audit Committee, Secretary to Sharia Board and Internal Sharia Controller.

Educationally he is a B. A. in Law with first class Honors Degree, University of Elneelain, Khartoum – Sudan. Mr. Elnasri is a member of the Sudanese lawyers` Bar Association and a member of the Sudanese Network of the International Humanitarian Law. Mr. Elnasri has attended various training programs on Islamic Banking, Intellectual Property Rights, Human Rights and Human Law.

### Mr. Faisal Isa Hussain, Compliance Officer and MLRO

Mr. Hussain has over 8 years experience in the Banking and Financial institutions sector in Bahrain. He has experience and strong background in accounting and finance and good knowledge in risk management and compliance and money laundering functions. He was hired by Bahrain institute of Banking and Finance to teach accounting, finance and banking classes and to develop new offerings in these areas.

Educationally, Mr. Hussain holds a Master in Finance from Royal Melbourne Institute of Technology (RMIT), Australia, and Bachelor degree in Accounting from University of Bahrain.

Mr. Hussain reports functionally to the Audit Committee and administratively to the CEO.

# 3.13 Managerial Committee

The Bank does not have any managerial committee as on December 31st, 2011. The Board has approved the formation of "Investment Committee" in October 2009; however it has not been formed as on December 31st, 2011.

The committee is proposed to be the most senior management level authority on all investment credit and asset liability management related decisions. The overall role of the Investment Committee as approved by the Board will be to facilitate:

the investment and credit business of the Bank in the most effective and efficient manner within the risk guidelines specified by the Board;

to oversee and perform Asset Liability Management activities; and

to oversee credit, market, liquidity, profit rate risk and other risks that the Bank is exposed to.

The Investment Committee is expected to be headed by the CEO and will comprise of heads of other departments as members e.g. Head of Risk, Head of Investments (currently vacant), Head of Finance and Control, etc.

### 3.14 Remuneration and Incentives

The remuneration to the Board of Directors is governed by the Articles of Association of the Bank, which states the following:

- The General Assembly shall determine the remunerations of the members of the Board of Directors, provided that such remunerations shall not exceed ten percent (10%) of the net profit in each financial year after deducting statutory reserves and after distributing a profit of not less than five percent (5%) of the Company's paid capital to the shareholders. However, this provision shall not oblige the Company to pay five percent (5%) of any other amount. Such remunerations shall be distributed to the members of the Board in proportion to their actual attendance of the meetings of the Board of Directors and the committees connected to it as per the minutes of meetings approved by the Company.
- The General Assembly may decide to pay an annual remuneration to the members of the Board of Directors during the years in which the Company does not post any profit or during the years in which it does not pay out dividends to the shareholders, subject to the approval of the Minister of Commerce. The Board of Directors' report to the General Assembly shall contain a full account of everything paid to the members of the Board of Directors during the financial year in the form of salaries., dividends, allowance for attendance, allowance for representation and expenses, etc. Such report shall also contain what the members of the Board have received in their capacities as staff members or administrators or what they have received in consideration for technical, administrative or administrative work or any other work.

The Bank provides fixed annual fees to the Shariah Board and does not provide any performance linked incentives.

The remuneration to the employees of the Bank is on the basis of the employment contracts of the individuals. There is a system of annual appraisal based on which the terms of the contract are reviewed every year. Any bonus/ex-gratia payment is purely at the discretion of the Bank. The Articles of Association provides the guidelines for the employee incentive programme that has currently not been implemented.

# 3.15 Corporate Governance Events

- Departure of the Chief Executive Officer, Mr. Ghalib Khaleel Al- Moayyed.

  Mr. Al Moayyed resigned from the position of the CEO of the Bank in December 2011. The Bank has not yet appointed a new CEO to take over his responsibilities.

  As per the Bank's Board approved succession plan the Board of directors appointed an executive transition committee in order to run the business of the Bank till the appointment of the new CEO.
- Assistant Risk Management resigned on 11th December 2011, Mr. Ruchit Chaturvedi, resigned from the position of the Assistant Risk Management of the Bank.
   The Bank has not yet appointed anybody else to take over his responsibilities, and consequently the Risk Management Department remains vacant.
- The Board has appointed Mr. Ahmed Shabeeb Al Dhahery as a member of the Audit Committee effective 16th October 2011.

# 3.16 Communications Policy

The Bank has a Board approved public disclosure policy, in compliance with CBB regulations under PD Module of the Volume 2 of CBB Rulebook, to disclose material information about its activities to various stakeholders. As a policy, the Bank maintains at least three years of financial data on its website.

The disclosure policy applies to all modes of communication to the public including written, oral and electronic communications. These disclosures are made on a timely basis in a manner required by applicable laws and regulatory requirements.

Management seeks to respond to shareholders' questions and concerns on a prompt basis, subject to the limitations imposed by law and the confidentiality of certain information. The Bank maintains a website at www.investorsb.com, which includes information of interest to various stakeholders including the regulatory authorities. Information available on the website includes the Annual Report and reviewed quarterly financials of the Bank.

### 3.17 Shari'a Compliance

All the transactions entered into by the Bank are presented to Shari`a Supervisory Board, which comprises of three Shari'a scholars, for review on an annual basis and to ensure that the respective agreements are in compliance the principles of Shari`a. The internal legal advisor of the Bank is also the internal Sharia`a reviewer and Secretary to the Shari`a Board.

The Bank strives to make sure that it does not engage in non Shari'a compliant earning. However if there are any non compliant earnings, they are dealt with through cleansing principles as recommended by the Shari'a Board.

### 3.18 Zakah contributions

In the absence of appointment of the Bank to pay zakah on behalf of Shareholders, the responsibility of payment of zakah is on individual shareholders of the Bank.

# 4. Capital Adequacy and Management

The Central Bank of Bahrain (CBB) Basel 2 guidelines became effective from 1st January 2008 as the common framework for the implementation of the Basel Committee on Banking Supervision's (Basel Committee) Basel 2 capital adequacy framework for banks incorporated in the Kingdom of Bahrain.

Investors Bank follows CBB guidelines for the capital requirements of the Bank and maintains sufficient capital to ensure compliance with the minimum capital requirements of the CBB.

The Bank's regulatory capital is analysed in two tiers as per CBB guidelines and include:

Tier 1: Core Capital - This includes issued and fully paid ordinary shares, statutory reserves, accumulated losses and 45% of the unrealised net gains recognised in income statement arising from fair valuing unlisted equities; and

Tier 2: Supplementary Capital – retained profits and 45% of the unrealised gains arising on the re-measurement of fair valuing equities classified as available for sale.

# **4.1 Capital Structure**

The Bank has capital in the form of equity and does not have any other equity related instrument including innovative, complex or hybrid capital instruments.

CAPITAL STRUCTURE		
Components of capital	Tier One	Tier Two
Core capital - Tier I:		
Issued and fully paid ordinary shares	80,000,000	
Legal / statutory reserves	7,409,515	
Accumulated losses	(56,105,725)	
Less:		
Unrealized gross losses arising from valuing equity securities	(688)	
Tier 1 Capital	31,303,102	
Unrealized gross gains arising from fair valuing equities (45% only)	-	1,656,170
Tier 2 Capital	-	1,656,170
Total Available Capital	31,303,102	1,656,170
Deductions:		
Excess amount over maximum permitted large exposure limit		
- Tier 1	(15,676,895)	
- Tier 2	-	(1,656,170)
Net Available Capital	15,626,207	
Total Eligible Capital		15,626,207

# 4.2 Capital Adequacy

Investors Bank follows CBB guidelines for the capital requirements of the Bank and maintains sufficient capital to ensure compliance with the minimum capital requirements of the CBB.

The Bank determines Risk Weighted Assets according to the Standardised Approaches for credit and market risk and Basic Indicator Approach for operational risk as per CBB guidelines that seek to reflect the varying levels of risk attached to the assets.

The Bank's policy is to maintain a capital adequacy ratio, at all times, in excess of the minimum required by CBB. The current minimum capital adequacy ratio (CAR) requirement for the Bank has been increased from 12% (in 2008) to 15%. This increase in CAR has been stipulated by CBB as the Bank did not have three years' positive gross income required for operational risk capital charge calculation (the Bank had only one year of positive income during last five years).

Risk Assets / Categories	Risk Weighted Assets (RWA)	Capital Charge @ 15% of RWA	
Credit Risk			
- Cash and balances with banks	31,517	4,728	
- Available for sale investments			
- Listed equities	5,517,937	827,691	
- Unlisted equities	1,899,296	284,894	
- Deferred payment sale receivables	1,267,837	190,176	
- Investment properties	36,949,515	5,542,427	
- Other assets	1,372,610	205,892	
- Property and equipment	2,963,735	444,560	
Total Credit Risk	50,002,447	7,500,368	
Market Risk			
- Equity position risk	1,336,725	200,509	
- Foreign exchange risk	4,796,387	719,458	
Total Market Risk	6,133,112	919,967	
Total Operational Risk	41,130,394	6,169,559	
Total Risk Weighted Assets (a)	97,265,953		
Total Eligible Capital (b)	15,626,207		
Total Capital Adequacy Ratio [(b)/(a)]		16.07%	

# 5 Risk Management

The Bank is exposed to the credit, market and liquidity risk during the course of its business along with other operational risks.

The Bank's Board of Directors has the overall responsibility for the establishment and oversight of the Bank's risk management framework. The Board has established an Executive Committee (EXCOM), a board level sub committee that is responsible for developing and monitoring the Bank's operations and policies across various functions including the risk management framework.

The Bank's Audit Committee is responsible for monitoring compliance with the risk management policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Bank. The Audit Committee is assisted in these functions by outsourced Internal Audit function.

The Bank has an internal risk management function to provide independent review, monitoring and control of the various risks faced by the Bank. It works closely with the executive management and other functions. Various operating departments (the business units and the support functions) primarily manage the risks of their respective functions.

The Bank has established and implemented various exposure limits as well as set levels of risk that the Bank is willing to accept in relation to its available capital. The limit structure includes single obligor level limits, large exposure limits, industry level limits, country level limits etc. All limits have been set as per CBB guidelines and Bank's internal limits and policy.

The risk management philosophy of the Bank, as enunciated in the Risk Management Manual, is to identify, capture, monitor and manage the various dimensions of risk with the objective of protecting asset values and income streams so that the interests of the Bank's shareholders (and the Bank's creditors / lenders) are safeguarded.

### 5.1 Credit Risk

Credit risk is the risk that a counterparty to a financial transaction does not discharge its obligations on due dates and causes the other party to incur a financial loss. Credit risk may arise from all products and services where counterparties of the Bank fail to meet their payment obligations in accordance with terms and conditions of the contract. This risk exists in all activities of the Bank, including the Banking Book and both "on" or "off" the balance sheet.

The Bank's credit risk arises mainly from cash and balances with banks, deferred payment sale receivables and other assets.

The Bank manages its credit risk on cash and bank balances by placing funds with reputable banks having good credit ratings.

The following table demonstrates Bank's credit risk exposure:

Credit Risk Exposure (all figures in US Dollars)				
Own capital and current account				
Portfolios	Total gross credit risk exposure  Average gross credit exposure over the period *			
Cash and balances with banks	158,912	213,843		
Available-for-sale investments	14,055,080	13,766,154		

Deferred payment sale receivables	3,680,203	3,680,203
Investment properties	18,474,757	18,896,783
Other assets	1,385,874	1,539,633
Property and equipment	2,963,735	3,229,360
Total	40,718,561	41,325,976

<sup>\*</sup>These have been computed based on a quarterly average.

As part of the Bank's credit risk strategy, the Bank has established a credit risk appetite which is quantified in terms of a limit structure for credit risk. The limit structure also helps the Bank's control over the credit risk and to maintain a proper diversification of its activities and thereby attempt to avoid concentration of risks for counterparty, country, sector, industry and region. The Bank manages credit risk of its exposures by constant monitoring of the limit structure. The updated limit structure, approved by the Board in October 2009, covers new investment exposures by the Bank. The Bank continues to have certain exposures, originated in earlier years that exceed the limit stipulated under the CBB guidelines and the internal limit structure of the Bank.

The Risk Management Department ["RMD"] coordinates with the Bank's management in reviewing investment/credit proposals and "post sanction" review and monitoring, at all stages of the deal cycle.

For "Balances with banks", the Bank uses ratings assigned by External Credit Assessment Institutions ["ECAI"] for risk assessment and calculating risk weighted equivalents. ECAIs considered by the Bank are Standard and Poor's, Moody's and Fitch.

Analysis of Bank's exposure to Credit Risk (Past due and impaired):

	Banking and financial institutions	Investment Companies	Others	Total
Past due but not impaired Islamic financing contracts	887,733	3,680,203	-	4,567,936
Impaired financing	16,088,101	6,125,125	11,258,892	33,472,118
contracts				
Total	16,975,834	9,805,328	11,258,892	38,040,054

	Banking and financial institutions	Investment Companies	Others	Total
Less than 3 months	-	-	-	-
3 months – 1 year	-	-	-	-
1 year – 3 years	-	-	9,044,321	9,044,321
Over 3 years	16,975,834	9,805,328	2,214,571	28,995,733
Total	16,975,834	9,805,328	11,258,892	38,040,054

Movement in specific provisions during the year:

	Banking and financial institutions	Investment Com- panies	Others	Total
Balance at the beginning of the year	16,088,101	6,125,125	10,908,389	33,121,615
Net provision for impairment for the year	-	-	(124,497)	(124,497)
Balance at the end of the year	16,088,101	6,125,125	10,783,892	32,997,118

Past due exposures are those on which payments are not being made on time and are behind schedule, although partial payments may have been made.

The management of the Bank analyses its credit risk portfolio on a periodical basis to assess its recoverability. Impairment provisions for assets are based on the management's assessment of the expected realisations. Specific impairments are identified by the Bank based on the various specific factors, which include financial health of the investee and any expected cash for in kind settlements.

# 5.1.1 Credit Risk Mitigation

The Bank does not generally engage in lending against collateral and does so by exception.

However, the Bank has designed guidelines (covered in the Credit policy approved in July 2010) for collateral valuation and management (wherever required) and will extend credit facilities only where it is supported by adequate tangible security and/or audited financial statements of its customers/counterparties.

Also the market value of security offered by prospective and existing customers/counterparties will be evaluated by the Bank based on market information.

### 5.1.2 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 Bank seeks to manage its concentration risk by establishing geographic and industry wise concentration limits. Presently, most of the Bank's assets are, however, in GCC region as this has strategic fit with Bank's overall business approach and also the current market imperatives.

The Bank's assets are distributed over the following geographical areas and industry sectors:

### Own capital

Asset category	Geographic area				
	Bahrain	Kuwait	Others countries	Total	
Cash and balances with banks	143,331	15,581	-	158,912	
Available for sale investment	10,007,304	3,047,776	1,000,000	14,055,080	
Deferred payment sale receivables	3,680,203	-	-	3,680,203	
Investment properties	15,240,580	-	3,234,177	18,474,757	
Other assets	910,874	-	475,000	1,385,874	
Property and equipment	2,963,735	-	-	2,963,735	
Total	32,946,027	3,063,357	4,709,177	40,718,561	

### **Own capital**

	Industry sector			
Asset category	Banks and financial institutions	Investment com- panies	Others	Total
Funded				
Cash and balances with banks	158,912	-	-	158,912
Available for sale investments	12,696,466	31,936	1,326,678	14,055,080
Deferred payment sale receivables	-	3,680,203	-	3,680,203
Investment properties	-	-	18,474,757	18,474,757
Other assets	900,996	-	484,878	1,385,874
Property and equipments	-	-	2,963,735	2,963,735
Total	13,756,374	3,712,139	23,250,048	40,718,561

The Bank does not have any unfunded exposures.

As required by CBB, the Bank must not incur an exposure to an individual counterparty or group of closely related counterparties, which exceeds 15% of the bank's capital base without the prior written approval of the CBB. Also the Bank's shareholders with significant ownership of the Bank's capital are not allowed to obtain financing facilities from the Bank (i.e. a 0% limit). The Bank's concentrations of exposure to individual counterparties and group of closely related counterparties in excess of 15% and significant shareholders with limit exposure of greater then 0% are given below:

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Concentration of risk	
Counterparties	Own capital
	Total exposure
Counterparty # 1 – Individual - Significant Shareholder – 0% limit	5,673,195
Counterparty # 2 – Individual – Individual Counterparty – 15% limit	7,771,808
Counterparty # 3 – Individual – Restricted Investment – 30% limit	10,558,259
Counterparties – Closely Related – Including Counterparties 2 & 3	24,563,065

Additionally, Bank's past due exposures broken-down by geographical areas are given in the table below:

Impaired exposures, Past Due exposures and allow	ances	
Own capital		
Geographic area	Past due Islamic financing contracts	Specific impairment provision
Bahrain	4,747,512	179,576
Kuwait	32,009,007	32,009,007
Others countries	1,283,535	808,535
Total	38,040,054	32,997,118

### 5.2 Market Risk

The Central Bank of Bahrain defines market risk as "the risk of losses in on and off-balance sheet positions arising from movements in market prices".

Market risk is the risk of changes in the value of the security or transaction due to changes in underlying market exposure. Market risk may arise from movements in market dynamics such as reference rates, foreign exchange markets, equity markets or commodity markets.

The Bank has following sources of market risk:

Equity price risk in the trading book (for listed equities); and

Currency risk on account of foreign currency denominated investments in the trading as well as banking book.

The Bank's trading book equity positions are listed in some GCC stock exchanges and have a ready market. The FX positions in the Banking book are structural in nature and have a ready market. Additionally, as part of trading book, the Bank does not have exposure to assets that do not have a ready market.

The following table demonstrates the sensitivity to a reasonable possible change in equity prices, with all other variables held constant, of the Bank's income statement based on the balance sheet position as of 31 December:

Particulars	20% decrease	20% increase
Investments at fair value through statement of income	(360,872)	360,872

As part of the overall market risk strategy, the Bank attempts to proactively measure and monitor market risk in its portfolio using appropriate measurement techniques (standardised measurement methodology suggested by CBB). Additionally, in order to control market risk the Bank holds sufficient capital in line with Pillar 1 regulatory capital requirements of the CBB. The Bank has also established a limit structure to provide a ceiling on the market risk exposure that can be taken by the Bank.

Bank's capital requirements for Market Risk using the Standardised measurement method

Particulars	Gross exposure	Risk weighted assets (RWA)	Capital requirements @ 15% of RWA	Maximum capital requirement during the year	Minimum capital requirement during the year
Equity Position	1,804,360	1,336,725	200,509	261,664	200,509
Foreign Exchange Position	4,796,387	4,796,387	719,458	719,458	575,473

# 5.2.1 Currency Risk

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

The Bank had the following net foreign currency exposures as at 31 December 2011:

Currency	2011 (USD Equivalent)
Bahraini Dinar	29,305,710
Kuwaiti Dinar	4,796,387
United Arab Emirates Dirham	3,234,177

# Sensitivity Analysis:

The following table demonstrates the sensitivity to a reasonable possible change in foreign exchange rates, with all other variables held constant, of the Bank's income statement based on the balance sheet position as of 31 December:

Currency	5% decrease	5% increase
Kuwaiti Dinar	(239,819)	239,819

Note: Bahraini Dinar and UAE Dirham exposures are not considered to represent significant currency risk as both currencies are pegged to the US\$.

# 5.3 Operational Risk

Operational risk is defined as the risk of loss arising from inadequate or failed internal processes, people and systems or from external events which includes but is not limited to legal risk and Shari'a compliance risk. This definition excludes strategic and reputational risk.

The Bank has implemented an operational risk framework of the Basic Indicator Approach ["BIA"], as defined by the CBB guidelines. This framework includes measuring, monitoring and managing operational risk across the Bank. This framework uses tools like Risk and Control Self Assessment, identification of Key Risk Indicators etc.

The operational risk framework will evolve with the changing needs of the Bank's businesses and regulatory guidance, taking into account internal and external operational risk events, business environment and internal control factors.

While individual units have direct responsibility for the control and mitigation of operational risk, the proposed framework provides a consistent methodology across the Bank. The Bank attempts to manage operational risk through appropriate controls, appropriate training to the employees, and internal checks and balances including internal audit and compliance.

### 5.3.1 Risk and Control Self Assessment

The Bank has established RCSA methodology to provide an annual, forward-looking process for identifying and assessing risks, evaluating controls, establishing thresholds for risks and controls and determining the appropriate level of risk mitigation. This process will enable the Bank to better understand its risk profile and ensure that operational risk-taking is aligned with the Bank's risk appetite.

RCSA exercise is undertaken on an annual basis by the business and support units in co-ordination with RMD. The Bank has been performing RCSA of its activities on an annual basis since 2008.

### 5.3.2 Operational Risk Loss Database

The Bank has a policy to collect loss events' information for preparing Operational Risk Loss Database. The functional units of the Bank have to map their risk events and collect/record related operational loss event data as defined in the Basel II Accord. This data tracking provides a mechanism for early reporting and response to operational risk events and losses.

On occurrence basis, all process owners collect and record operational risk loss event data, using the template provided by the RMD in accordance with Basel II risk categorization framework.

The RMD is responsible for maintaining a comprehensive database for loss events reported as per the Basel II guidelines.

# 5.3.3 Operational Risk capital charge

Bank's capital charge for Operational Risk using Basic Indicator Approach

Particulars	Average gross	Risk weighted	Capital
	income	exposures	charge
Operational risk	21,936,210	41,130,394	3,290,432

As required by CBB under section CA 6.2.3 of the CBB Rulebook, the operational risk capital charge is 15% of the average of annual gross income of last 3 years' profit. Figure for any year in which annual gross income is negative or zero has been excluded from both the numerator and denominator when calculating the average.

Bank's indicators of Operational Risk exposures for Basic Indicator Approach

Particulars	Amount
Gross Income	21,936,210
Amount of non-Shari'a-compliant income*	None
Number of Shari'a violations that were identified and reported during the financial year	None

The non-Shari'a compliant income is the interest income on the Bank's current accounts and forms part of undistributed charity funds (as approved by the Shari'a Board).

As per CBB rulebook, Gross income is defined as:

Net income from financing activities which is gross of any provisions, operating expenses, realised profits/losses from the sale of securities in the banking book, and depreciation of Ijarah assets;

Net income from investment activities; and

Fee income (e.g. commission and agency fee)

Less

Investment account holders' share of income

Takaful income

### 5.3.4 Legal Risk - Current Litigations and Claims

The Bank has an internal legal counsel that prepares and reviews all the legal documents. The Bank has appointed external legal advisor(s) for advice on various legal issues including legal documentation.

The current litigations and claims of the Bank are given below:

• In 2004, the Bank entered into a sale and purchase agreement with a financial institution to purchase shares of a related party on behalf of another related party. The net amount due to the financial institution as 31st December 2011 is US\$ 3,670,202 (31 December 2010: US\$ 3,670,202). In accordance with the terms of the agreement, the Bank pledged certain equity shares with a carrying value of US\$ 1,921,772 as at 31 December 2011 (2010: US\$ 2,778,466) in addition to dividends received on these shares amounting to US\$ 887,733 (2010: US\$ 887,733). Subsequently, the agreement was terminated by the financial institution due to disputes with the Bank and as a result, the pledged investments have been retained by the financial institution. In the opinion of the Bank's lawyers and management, the agreement was wrongfully terminated and following the financial institution's refusal to settle the matter amicably, the Bank has filed a legal case in the courts of Bahrain against the financial institution for possession of the Bank's investments.

The related party (IIG) on whose behalf the transaction was entered into has also agreed to reimburse the Bank for legal expenses and any losses arising on final settlement with the financial institution. Accordingly, in the opinion of the directors, no provision is required to be made in the financial statements against the investments pledged with the financial institution or for contingent claims that might arise on final settlement.

• There are three labour cases running against the bank from three former employees seeking compensations as a result of alleged unfair termination of their services with the bank. The Bank's legal position is strong and a material liability to the Bank is not expected from the cases.

The Bank has appointed external law firm(s) to deal with the above cases.

### 5.4 Market Risk

Liquidity risk is defined as the risk that funds will not be available to meet liabilities as they fall due.

It is the Bank's policy to keep a significant part of its assets in liquid assets such as trading and available-for-sale investments.

The Bank funds its exposures mainly from equity and does not take restricted or unrestricted deposits to fund its exposures. The Bank has established a limit structure to monitor the prevailing liquidity position and to control negative mismatches that may affect the fulfilment of short term obligations of the Bank.

The maturity profile of for cash and cash equivalents, Murabaha payables has been presented using contractual cash flows. For other balances, maturity profile is based on expected cash flows/ settlement profile.

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Period 2011	Up to 1 month	1 to 3 months	3 months to 1 year	Within 1 year	1 to 3 years	No fixed maturity	Total
Assets							
Cash and balances with banks	158,912	-	-	158,912	-	-	158,912
Investments	-	-	1,804,360	1,804,360	-	14,055,080	15,859,440
Deferred payment sale receivables							
	3,680,203	-	-	3,680,203	-	-	3,680,203
Investment properties	-	-	-	-	-	18,474,757	18,474,757
Other assets	-	-	8,246	8,246	-	1,377,628	1,385,874
Property & equipment	-	-	-	-	-	2,963,735	2,963,735
Total assets	3,839,115	-	1,812,606	5,651,721	-	36,871,200	42,522,921

Period 2011	Up to 1 month	1 to 3 months	3 months to 1 year	Within 1 year	1 to 3 years	No fixed maturity	Total
Liabilities							
Due to a financial institution	3,670,202	-	-	3,670,202	-	-	3,670,202
Murabaha payable	3,229,064	-	-	3,229,064	-	-	3,229,064
Other liabilities	198,333	118,306	267,098	583,737	-	56,438	640,175
Total liabilities	7,097,599	118,306	267,098	7,483,003	-	56,438	7,539,441
Cumulative Liquidity Gap	(3,258,484)	(3,376,790)	(1,831,282)	(1,831,282)	(1,831,282)	34,983,480	

Following are the key liquidity ratios as at 31 December 2011:

Description	Ratio
Short Term Assets : Total Assets	13%
Short Term Assets : Short Term Liabilities (Times)	8.6

### 5.5 Rate of Return Risk

Rate of return risk arises due to different timing of re-pricing of the Bank's assets and liabilities. The Bank's exposure to rate of return risk is limited to cash and cash equivalents. The cash and cash equivalents amount as on 31st December 2011 is USD 158,912. The Bank does not have significant rate of return risk sensitivity due to the short-term nature of its cash and cash equivalents.

# 5.6 Equity Price Risk in the Banking book

Equity price risk is the risk that quoted equity investments will depreciate in value due to movements in the quoted equity prices. The Bank has a few listed equity exposures in the available-for-sale portfolio. The price movement of these exposures are closely monitored by the Bank and reported to the management.

Sensitivity Analysis:

The following table demonstrates the sensitivity to a reasonable possible change in equity prices, with all other variables held constant, of the Bank's equity based on the balance sheet position as of 31 December:

Particulars	20% decrease	20% increase	
Investments at fair value through equity	(2,453,450)	2,453,450	

### 5.6.1 Equity Price Risk in the Banking book

The Bank measures the fair value of quoted investments using the market bid-prices in an active market for that instrument. Fair value for unquoted managed funds is the fund's net assets value as determined by the fund manager.

# 5.6.2 Equity based financing

The Bank has the following investments classified as quoted on an active market or privately held:

Types And Nature of Investments				
	Publicly traded	Privately held		
Investment in shares	12,267,250	1,787,830		
Investment in managed funds	-	-		
Total	12,267,250	1,787,830		

Additionally the Bank has following cumulative realized gains or losses arising from sales or liquidations, total unrealized gains and losses recognized in the balance sheet but not through the profit and loss statement, and any unrealized gains and losses included in Tier 1 and Tier 2 capital:

Particulars	Amount
Cumulative realized gains (losses) arising from sales or liquidations in the reporting period	21,904
Total unrealized gains (losses) recognized in the balance sheet but not through P&L	3,679,690
Unrealized gains (losses) included in Tier One Capital	(688)
Unrealized gains (losses) included in Tier Two Capital	1,656,170

The Bank has following capital requirements broken down by equity groupings:

Equity grouping	Risk weighted assets (RWA)	Capital requirements @ 15% of RWA
Investment in shares	7,417,233	1,112,585
Investment in managed funds	-	-
Total	7,417,233	1,112,585

# **5.7 Displaced Commercial Risk**

The risk when an Islamic bank is under pressure to pay its investors-depositors a rate of return higher then what should be payable under actual terms of the investment contract.

Since the Bank does not take deposits from outside parties, displaced commercial risk is not currently relevant for the Bank.

### **6** Restricted Investment Accounts

The Bank has not, as a focused business proposition, opened Investment Accounts or accepted Investment Account deposit (restricted or unrestricted) except for certain transactions involving related parties in three cases and hence does not have any formal policies and procedures. The specific RIAs were opened according to the underlying arrangements. The Bank accepted certain funds from a related party in 1999 under a Mudaraba arrangement which were deployed in a Murabaha with a non-related party. The Murabaha was partially repaid and the balance amount has been impaired. Appropriable impairment provisions have been made in the RIA.

Exposures	No of units (000)	Average value per share US\$	Tota US\$
Murabaha with Lotus Air Ltd	-	-	317,689
Investments in International Investment Group K.S.C.C. *	12,887	0.44	5,670,202
Portfolio managed by the Bank **	142,059	0.074	10,558,259
Total			16,546,150

<sup>\*</sup> On the instructions of a restricted investment account holder, a related party, the Bank had entered into a deferred payment purchase agreement with a financial institution to acquire shares of International Investment Group K.S.C.C. ('IIG'). The Bank then entered into a deferred payment sale agreement with the restricted investment account holder for sale of these shares. However, due to a legal dispute with the financial institution, the Bank could not effect the transfer of the IIG shares to the restricted investment account holder.

This account does not have a specific maturity due to it being a subject of litigation in the Bahrain courts.

\*\* Managed Portfolio

During 2009, the Bank signed a Portfolio Management Agreement with some related parties. The underlying assets of the portfolio comprise the shares of one of the related parties that is also a partial owner of the portfolio.

This portfolio may be liquidated on the instructions of the owners after due regulatory approvals are obtained and hence has no fixed maturity.

# 7 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 also include directors and shareholders of the Bank and companies in which they have an ownership interest.

A significant portion of the Bank's income arises from transactions with related parties. Transactions with related parties are undertaken on terms agreed between the parties which may not necessarily be on arm's length basis.

As per the Investment Policy (approved in July 2010), adequate due-diligence should be carried out before undertaking any investment exposure (whether to a related party or an outside investment). Additionally all the exposures to connected counterparties are justified only when undertaken for the clear commercial advantage for the Bank, when negotiated and undertaken on terms agreed between the parties which may not be necessary be on an arm's length basis and when included in the policy statement agreed with CBB. The investments in related parties need to be approved by the Board of Directors and a prior approval from CBB is also required.

# Significant balances with related parties at 31 December 2011 comprise:

	2011	2010
Assets	14,007,800	14,554,221
Liabilities	3,403,263	3,400,011
Restricted Investment Accounts	16,228,461	16,106,466

# Significant transactions with related parties include:

	2011	2010
Income	(340,454)	(3,325,953)
Expenses	252,397	7,737,657

The Group entities include those entities, which are subject to common control or influence of certain shareholders of the Bank.

Key management personnel of the Bank comprise the Board of Directors and key members of management having authority and responsibility for planning, directing and controlling the activities of the Bank. The key management personnel compensation is as follows:

	2011	2010
Salaries, short term benefits and post employment benefits	137,072	249,569