

United Gulf Bank B.S.C.
CONSOLIDATED FINANCIAL STATEMENTS

31 DECEMBER 2011

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF UNITED GULF BANK B.S.C.

Report on the consolidated financial statements

We have audited the accompanying consolidated financial statements of United Gulf Bank B.S.C. [the Bank] and its subsidiaries [together "the Group"], which comprise the consolidated statement of financial position as at 31 December 2011 and the consolidated statements of income, comprehensive income, cash flows and changes in equity for the year then ended, and a summary of significant accounting policies and other explanatory information.

Board of Directors' responsibility for the consolidated financial statements

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

Auditors' responsibility

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

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

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

**INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF
UNITED GULF BANK B.S.C. (continued)**

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 31 December 2011, its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Report on other regulatory requirements

As required by the Bahrain Commercial Companies Law and the Central Bank of Bahrain (CBB) Rule Book (Volume 1), we report that:

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

We are not aware of any violations of the Bahrain Commercial Companies Law, the Central Bank of Bahrain and Financial Institutions Law, the CBB Rule Book (Volume 1 and applicable provisions of Volume 6) and CBB directives, regulations and associated resolutions, rules and procedures of the Bahrain Bourse 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.

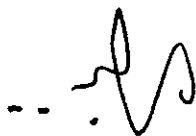
A stylized, handwritten-style signature of 'Ernst & Young' in black ink.

28 February 2012
Manama, Kingdom of Bahrain

United Gulf Bank B.S.C.
CONSOLIDATED STATEMENT OF FINANCIAL POSITION

At 31 December 2011

	Note	2011 US\$ 000	2010 US\$ 000
ASSETS			
Demand and call deposits with banks		17,857	27,914
Placements with banks		102,282	167,257
Investments carried at fair value through statement of income	5	73,183	126,661
Non-trading investments	6	435,028	385,770
Loans and receivables	7	27,942	57,920
Other assets	8	37,490	46,950
Investments in associates and joint ventures accounted for under the equity method	9	1,002,940	1,026,065
Investment properties	10	16,054	21,178
Property and equipment		946	1,074
Goodwill	11	56,782	56,296
TOTAL ASSETS		1,770,504	1,917,085
LIABILITIES AND EQUITY			
LIABILITIES			
Due to banks and other financial institutions		211,795	435,624
Deposits from customers		80,349	139,568
Loans payable	12	731,185	501,432
Bonds	13	-	71,187
Subordinated debt	14	100,000	100,000
Other liabilities	15	44,021	68,500
TOTAL LIABILITIES		1,167,350	1,316,311
EQUITY			
Share capital	16	208,640	208,234
Treasury shares	16	(12,725)	(12,725)
Share premium	16	11,459	10,631
Statutory reserve	16	95,518	95,371
General reserve	16	76,003	75,856
Treasury shares reserve	16	14,308	14,308
Fair value reserve	17	(13,532)	(21,374)
Foreign currency translation reserve	16	40,134	43,465
Retained earnings		142,037	140,860
CAPITAL AND RESERVES ATTRIBUTABLE TO THE SHAREHOLDERS OF THE PARENT		561,842	554,626
Non-controlling interests in equity		41,312	46,148
TOTAL EQUITY		603,154	600,774
TOTAL LIABILITIES AND EQUITY		1,770,504	1,917,085



 Masaud Hayat
Chairman



 Faisal Al Ayyar
Director



 Mohammad Haroon
Acting Chief Executive
Officer

The attached notes 1 to 33 form part of these consolidated financial statements.

United Gulf Bank B.S.C.

CONSOLIDATED STATEMENT OF INCOME

For the year ended 31 December 2011

		2011	2010
	<i>Note</i>	US\$ 000	US\$ 000
Continuing operations			
Investment income - net	18	53,607	108,502
Interest income	19	7,365	12,699
		60,972	121,201
Fees and commissions	20	17,019	30,493
Foreign currency translation (losses) gains - net		(1,151)	2,372
Share of results of associates and joint ventures accounted for under the equity method - net	21	31,705	9,182
Total income		108,545	163,248
Interest expense	22	(53,570)	(49,262)
Operating income before expenses and provisions		54,975	113,986
Salaries and benefits		(23,133)	(26,916)
General and administrative expenses		(10,517)	(21,637)
Operating income before provisions		21,325	65,433
Impairment loss on investments	6,9	(23,961)	(29,280)
(Provision for) write-back of doubtful loans, guarantees and other assets - net		(398)	149
Net (loss) profit for the year from continuing operations		(3,034)	36,302
Discontinued operations			
Net profit for the year from discontinued operations	23	-	6,086
NET (LOSS) PROFIT FOR THE YEAR		(3,034)	42,388
Loss (profit) attributable to non-controlling interests			
- from continuing operations		4,505	(832)
- from discontinued operations		-	(2,899)
		4,505	(3,731)
PROFIT ATTRIBUTABLE TO SHAREHOLDERS OF THE PARENT			
- from continuing operations		1,471	35,470
- from discontinued operations		-	3,187
		1,471	38,657
Earnings per share			
Basic earnings per share (US cents)	24	0.18	4.71
Diluted earnings per share (US cents)	24	0.18	4.70

The attached notes 1 to 33 form part of these consolidated financial statements.

United Gulf Bank B.S.C.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2011

	2011 US\$ 000	2010 US\$ 000
NET (LOSS) PROFIT	(3,034)	42,388
Other comprehensive income (loss):		
Foreign currency translation reserve	(2,832)	7,914
Fair value reserve	(4,819)	9,993
Share of other comprehensive income (loss) of associates and joint ventures accounted for under the equity method	5,085	(3,138)
Cash flow hedges	7,010	3,096
Other comprehensive income	4,444	17,865
TOTAL COMPREHENSIVE INCOME	1,410	60,253
Attributable to:		
Shareholders of the parent		
- from continuing operations	5,982	50,352
- from discontinued operations	-	5,182
	5,982	55,534
Non-controlling interests		
- from continuing operations	(4,572)	1,820
- from discontinued operations	-	2,899
	(4,572)	4,719
	1,410	60,253

The attached notes 1 to 33 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 31 December 2011

	Note	2011 US\$ 000	2010 US\$ 000
OPERATING ACTIVITIES			
Net (loss) profit including profit attributable to non-controlling interests		(3,034)	42,388
Adjustments for non-cash items:			
Depreciation		586	591
Gain on sale of disposal group	18	-	(43,850)
Share of results of associates and joint ventures accounted for under the equity method - net	21	(31,705)	(9,182)
Gain on sale of associated companies	18	(5,344)	(117)
Share of results of disposal group	23	-	(6,086)
Impairment loss on investments		23,961	29,280
Provision for (write-back of) doubtful loans, guarantees and other assets - net		398	(149)
Interest income		(7,365)	(12,699)
Interest expense		53,570	49,262
Dividend income	18	(11,785)	(9,702)
Other non-cash items		(486)	1,484
Change in fair value of investment properties	10	-	(56)
Gain on investments carried at fair value through statement of income	18	(4,814)	(11,945)
(Gain) loss on sale of investment properties	18	(117)	35
Operating profit before working capital changes		13,865	29,254
Changes in operating assets and liabilities:			
Placements with banks with maturities of more than ninety days at original acquisition		(266)	13,318
Investments carried at fair value through statement of income		58,292	40,599
Non-trading investments		(77,472)	256,024
Loans and receivables		29,580	(5,176)
Other assets		16,572	(821)
Due to banks and other financial institutions		(223,829)	(22,723)
Deposits from customers		(59,219)	(87,615)
Other liabilities		(23,996)	2,630
Net assets of disposal group classified as held for sale		-	32,904
Interest received		7,263	12,774
Interest paid		(53,353)	(51,599)
Dividends received	18	11,785	9,702
Donations		(300)	(300)
Directors' remuneration		(400)	(400)
Net cash (used in) from operating activities		(301,478)	228,571
INVESTING ACTIVITIES			
Investments in associates and joint ventures accounted for under the equity method - net		65,259	(318,169)
Proceeds from sale of disposal group	23	-	120,000
Investment properties - net	10	5,241	5,637
Property and equipment - net		(458)	(682)
Net cash from (used in) investing activities		70,042	(193,214)
FINANCING ACTIVITIES			
Loans raised - net		229,753	446
Bonds repaid		(71,187)	-
Proceeds from issue of shares		1,234	1,559
Dividends paid		-	(10,249)
Net cash from (used in) financing activities		159,800	(8,244)
Foreign currency translation adjustments		(3,331)	7,285
Movement in non-controlling interests		(331)	(22,440)
NET CHANGE IN CASH AND CASH EQUIVALENTS		(75,298)	11,958
Cash and cash equivalents at 1 January		195,118	183,160
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	26	119,820	195,118

The attached notes 1 to 33 form part of these consolidated financial statements.

United Gulf Bank B.S.C.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2011

	Attributable to shareholders of the parent												
	Share capital US\$ 000	Treasury shares US\$ 000	Share premium US\$ 000	Statutory reserve US\$ 000	General reserve US\$ 000	Treasury share		Fair value reserve US\$ 000	Foreign currency translation reserve US\$ 000	Retained earnings US\$ 000	Total		
						reserve US\$ 000	share US\$ 000				before non-controlling interests US\$ 000	Non-controlling interests US\$ 000	Total equity US\$ 000
Balance at 1 January 2011	208,234	(12,725)	10,631	95,371	75,856	14,308		(21,374)	43,465	140,860	554,626	46,148	600,774
Profit for the year	-	-	-	-	-	-	-	-	-	1,471	1,471	(4,505)	(3,034)
Other comprehensive income	-	-	-	-	-	-	-	7,842	(3,331)	-	4,511	(67)	4,444
Total comprehensive income for the year	-	-	-	-	-	-	-	7,842	(3,331)	1,471	5,982	(4,572)	1,410
Shares issued	406	-	828	-	-	-	-	-	-	-	1,234	-	1,234
Transfers during the year	-	-	-	147	147	-	-	-	-	(294)	-	-	-
Other movements in non-controlling interests	-	-	-	-	-	-	-	-	-	-	-	(264)	(264)
Balance at 31 December 2011	208,640	(12,725)	11,459	95,518	76,003	14,308		(13,532)	40,134	142,037	561,842	41,312	603,154
Balance at 1 January 2010	207,694	(12,725)	9,612	91,505	71,990	14,308		(30,966)	36,180	119,870	507,468	64,857	572,325
Profit for the year	-	-	-	-	-	-	-	-	-	38,657	38,657	3,731	42,388
Other comprehensive income	-	-	-	-	-	-	-	9,592	7,285	-	16,877	988	17,865
Total comprehensive income for the year	-	-	-	-	-	-	-	9,592	7,285	38,657	55,534	4,719	60,253
Shares issued	540	-	1,019	-	-	-	-	-	-	-	1,559	-	1,559
Transfers during the year	-	-	-	3,866	3,866	-	-	-	-	(7,732)	-	-	-
Dividends (note 16)	-	-	-	-	-	-	-	-	-	(10,249)	(10,249)	-	(10,249)
Dividends of subsidiaries	-	-	-	-	-	-	-	-	-	-	-	(2,580)	(2,580)
Employee share option plan	-	-	-	-	-	-	-	-	-	314	314	-	314
Other movements in non-controlling interests	-	-	-	-	-	-	-	-	-	-	-	(20,848)	(20,848)
Balance at 31 December 2010	208,234	(12,725)	10,631	95,371	75,856	14,308		(21,374)	43,465	140,860	554,626	46,148	600,774

1 INCORPORATION AND PRINCIPAL ACTIVITIES

Incorporation

United Gulf Bank B.S.C. [the Bank] is a joint stock company incorporated in the Kingdom of Bahrain in 1980, under Commercial Registration number 10550 and listed on the Bahrain and Kuwait Stock Exchanges. The address of the Bank's registered office is UGB Tower, Diplomatic Area, P.O. Box 5964, Manama, Kingdom of Bahrain.

The Bank operates in the Kingdom of Bahrain under a Wholesale Banking License issued by the Central Bank of Bahrain [the CBB].

Activities

The principal activities of the Bank and its subsidiaries [the Group] comprise asset management, investment banking and commercial banking. Investment banking includes asset portfolio management, corporate finance, advisory, investment in quoted and private equity funds, real estate, capital markets, international banking and treasury functions. Commercial banking includes extending loans and other credit facilities, accepting deposits and current accounts from corporate and institutional customers.

The Bank's parent and ultimate holding company is Kuwait Projects Company (Holding) K.S.C. (closed) [KIPCO], a company incorporated in the State of Kuwait and listed on the Kuwait Stock Exchange. As at 31 December 2011 KIPCO owned 95.93% of the Bank's outstanding shares (31 December 2010: 95.83%).

These consolidated financial statements were authorised for issue by the Board of Directors on 28 February 2012.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES

Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board (IASB) and the relevant provisions of the Central Bank of Bahrain and Financial Institutions Law and the Bahrain Commercial Companies Law, and the CBB Rulebook (Volume 1 and applicable provisions of Volume 6), relevant CBB directives and regulations and associated resolutions, rules and procedures of the Bahrain Bourse.

Basis of preparation

The consolidated financial statements have been prepared under the historical cost convention as modified by the remeasurement at fair value of investments carried at fair value through statement of income, non-trading investments, investment properties and derivative financial instruments.

Presentation and functional currency

The consolidated financial statements have been presented in US Dollars (US\$) being the functional currency of the Group and are rounded to the nearest US\$ thousands except when otherwise indicated.

New and amended standards and interpretations effective as of 1 January 2011

The accounting policies used in the preparation of these consolidated financial statements are consistent with those used in the previous year except that the Group has adopted the following new and amended IASB Standards and International Financial Reporting Interpretations Committee (IFRIC) Interpretations which became effective in 2011:

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

New and amended standards and interpretations effective as of 1 January 2011 (continued)

IAS 24 Related Party Disclosures (Amendment)

The IASB has issued an amendment to IAS 24 that clarifies the identification of related party relationships, particularly in relation to significant influence or joint controls. The new definitions emphasise a symmetrical view on related party relationships as well as clarifying in which circumstances persons and key management personnel affect related party relationships of an entity. Secondly, the amendment introduces an exemption from the general related party disclosure requirements for transactions with a government and entities that are controlled, jointly controlled or significantly influenced by the same government as the reporting entity. The adoption of the amendment did not have any impact on the financial position or performance of the Group.

IAS 32 Financial instruments: presentation (amendment)

The amendment alters the definition of a financial liability in IAS 32 to enable entities to classify rights issues and certain options or warrants as equity instruments. The amendment is applicable if the rights are given pro-rata to all of the existing owners of the same class of an entity's non-derivative equity instruments, to acquire a fixed number of the entity's own equity instruments for a fixed amount in any currency. The amendment has had no effect on the financial position or performance of the Group as the Group has not issued these type of instruments.

IFRS 7 Financial instruments: Disclosures (amendment)

These amendments introduced new disclosure requirements for transfers of financial assets, including disclosures for:

- financial assets that are not derecognised in their entirety; and
- financial assets that are derecognised in their entirety but for which the entity retains continuing involvement.

Adoption of this amendment did not have any impact on the Group's consolidated financial statements.

Improvements to IFRSs

In May 2010 the IASB issued its third omnibus amendments to its standards, primarily with a view to removing inconsistencies and clarifying wording. There are separate transitional provisions for each standard. The adoption of the following amendments resulted in changes to accounting policies, but did not have any impact on the financial position or performance of the Group.

- *IFRS 3 Business Combinations*: The measurement options available for non-controlling interest (NCI) have been amended. Only components of NCI that constitute a present ownership interest that entitles their holder to a proportionate share of the entity's net assets in the event of liquidation must be measured at either fair value or at the present ownership instruments' proportionate share of the acquiree's identifiable net assets. All other components are to be measured at their acquisition date fair value.
- *IFRS 7 Financial Instruments – Disclosures*: The amendment was intended to simplify the disclosures provided, by reducing the volume of disclosures around collateral held and improving disclosures by requiring qualitative information to put the quantitative information in context. Other amendments added an explicit statement that qualitative disclosure should be made in the context of the quantitative disclosures to better enable users to evaluate an entity's exposure to risks arising from financial instruments.
- *IAS 1 Presentation of Financial Statements*: The amendment clarifies that an analysis of each component of other comprehensive income may be presented either in the statement of changes in equity or in the notes to the financial statements.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

New and amended standards and interpretations effective as of 1 January 2011 (continued)

Other amendments resulting from improvements to IFRSs to the following standards did not have any material impact on the accounting policies, financial position or performance of the Group:

- IFRS 3 Business Combinations (Contingent consideration arising from business combination prior to adoption of IFRS 3 (as revised in 2008);
- IFRS 3 Business Combinations (Un-replaced and voluntarily replaced share-based payment award);
- IAS 27 Consolidated and Separate Financial Statements;
- IAS 34 Interim Financial Reporting; and
- IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments.

Significant accounting policies are set out below:

Principles of consolidation

The consolidated financial statements include the financial statements of the Bank and its subsidiaries [the Group]. Subsidiaries are those entities controlled by the Bank, other than in a fiduciary capacity. The reporting dates of the subsidiaries and the Bank are identical and the subsidiaries' accounting policies conform to those used by the Bank for like transactions and events in similar circumstances.

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

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

Losses within a subsidiary are attributed to the non-controlling interest even if that results in a deficit balance. A change in the ownership interest of a subsidiary, without a loss of control, is accounted for as an equity transaction. If the Group loses control over a subsidiary, it:

- a) Derecognises the assets (including goodwill) and liabilities of the subsidiary;
- b) Derecognises the carrying amount of any non-controlling interest;
- c) Derecognises the cumulative transaction differences, recorded in equity;
- d) Recognises the fair value of consideration received;
- e) Recognises the fair value of any investment retained;
- f) Recognises any surplus or deficit in the consolidated statement of income; and
- g) Reclassifies the parent's share of a component previously recognised in other comprehensive income to consolidated statement of income.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2011

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)**Principles of consolidation (continued)**

The principal subsidiaries of the Bank are as follows:

Name of the subsidiary	Country of incorporation	Effective ownership as at		Year of incorporation
		31 December 2011	31 December 2010	
Held directly				
KIPCO Asset Management Company [KAMCO]	Kuwait	86%	86%	1998
United Gulf Bank Securities Company *	Bahrain	-	96%	1998
Hatoon Real Estate Company	Kuwait	98%	98%	2008
Syria Gulf Investment Company	Syria	99%	99%	2007
United Gulf Financial Services Company-North Africa	Tunisia	77%	77%	2008
Held through KAMCO				
Al-Nuzoul Holding Company K.S.C. (Closed)	Kuwait	60%	60%	2005
Al-Janah Holding Company K.S.C. (Closed)	Kuwait	60%	60%	2005
KAMCO Real Estate Company S.P.C.	Bahrain	100%	100%	2005
Al Zad Real Estate W.L.L.	Kuwait	100%	100%	2007
Al Dhiyafa United Real Estate Company W.L.L.	Kuwait	100%	100%	2007
First North Africa Real Estate Co. W.L.L.	Kuwait	100%	100%	2007
Al Raya Real Estate Projects Company W.L.L.	Kuwait	100%	100%	2007
Orange Real Estate Co. W.L.L.	Kuwait	100%	100%	2005
Al Rawabi International Real Estate Co. W.L.L.	Kuwait	96%	99%	2009
First Homes Real Estate Co. W.L.L.	Kuwait	99%	99%	2009

* Liquidated during 2011.

Business combinations

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

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

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

Any contingent consideration to be transferred by the acquirer will be recognised at fair value at the acquisition date. Subsequent changes to the fair value of the contingent consideration which is deemed to be an asset or liability, will be recognised in accordance with IAS 39 either in the consolidated statement of income or as a change to other comprehensive income. If the contingent consideration is classified as equity, it should not be remeasured until it is finally settled within equity.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Investments in associates and joint ventures accounted for under the equity method

Associated companies

An associated company (or associate) is one in which the Group exercises significant influence (but not control) over its operations, generally accompanying, directly or indirectly, a holding between 20% and 50% of the voting power of the investee and is accounted for under the equity method.

Under the equity method, the investment in the associate is initially recognised at cost and adjusted thereafter for the post-acquisition change in the Group's share of net assets of the investee. The Group recognises, in the consolidated statement of income, its share of the total recognised profit or loss of the associate from the date that influence or ownership effectively commences until the date that it effectively ceases. Distributions received from an associate reduce the carrying amount of the investment. Adjustments to the carrying amount may also be necessary for changes in the Group's share in the associate arising from changes in its comprehensive income that have not been recognised in the associate's statement of income. The Group's share of those changes is recognised directly in the statement of comprehensive income.

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

Unrealised gains and losses resulting from transactions with an associate are eliminated to the extent of the Group's share in the associate.

Joint ventures

A joint venture is a contractual arrangement whereby the Group undertakes an economic activity with another entity that is subject to joint control. The joint venture is accounted for using the equity method of accounting. Under the equity method, the joint venture is carried in the statement of financial position at cost plus post-acquisition changes in the Group's share of net assets of the joint venture. The statement of income reflects the Group's share of the results of operations of the joint venture. Where there has been a change recognised directly in the other comprehensive income of the joint venture, the Group recognises its share of any changes and discloses this, when applicable, in the statement of comprehensive income. Unrealised gains and losses resulting from transactions between the Group and the joint venture are eliminated to the extent of the Group's interest in joint venture.

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

Investments in associates and joint ventures are reviewed for impairment when there is an indication that the investments have been impaired, or that impairment losses recognised in prior years no longer exist. Whenever the impairment requirements of IAS 36 indicate that investments in associates or joint ventures may be impaired, the entire carrying amount of the investments is tested by comparing recoverable amounts with carrying values. The recoverable amount of an asset or a cash-generating unit is the higher of its fair value less costs to sell, and its value in use. Goodwill is included in the carrying amount of investment in an associate or a joint venture and, therefore, is not separately tested for impairment.

Goodwill

Goodwill represents the excess of the cost of acquisition over the Group's share of the fair value of the net identifiable assets of the acquired subsidiary, associate or joint venture at the date of the acquisition. Goodwill arising on the acquisition of an associate or a joint venture is included in the carrying amount of the respective associate or joint venture and, therefore, is not separately tested for impairment. Goodwill arising on the acquisition of a subsidiary is recognised as a separate asset in the consolidated statement of financial position. Any excess, at the date of acquisition, of the Group's share in the fair value of the net identifiable assets acquired over the cost of the acquisition is recognised as negative goodwill. Negative goodwill arising on an acquisition is recognised immediately in the consolidated statement of income.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Goodwill (continued)

Goodwill acquired in a business combination is initially measured at cost, being the excess of the cost of the business combination over the Bank's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities acquired.

Goodwill is stated at cost less impairment losses. Goodwill of subsidiaries is allocated to cash-generating units and is tested annually for impairment. If the recoverable amount of the cash generating unit is less than the carrying amount of the unit, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit and then to the other assets of the unit pro-rata on the basis of the carrying amount of each asset in the unit. The recoverable amount of a cash-generating unit is the higher of the cash-generating unit's fair value less costs to sell, and its value in use. Any impairment loss recognised for goodwill is not reversed in a subsequent period.

On disposal of a part of a subsidiary, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

Non-current assets held for sale and discontinued operations

When non-current assets and disposal group are classified as held for sale, these are measured at the lower of carrying amount and fair value less costs to sell. Non current assets and disposal groups are classified as held for sale if their carrying amounts will be recovered through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the assets or disposal group is available for immediate sale in its present condition. Management must be committed to the sale, which should be expected to qualify for recognition as a completed sale within one year from the date of classification. At 31 December 2011, there were no discontinued operations or non-current assets classified as held for sale (31 December 2010: same).

In the consolidated statement of income of the reporting period, and of the comparable period of the previous year, income and expenses from the discontinued operations are reported separately from income and expenses relating to continuing operations down to the level of profit after taxes, even when the Group retains a non-controlling interest in the subsidiary after the sale. The resulting profit or loss (after taxes) is reported separately in the consolidated statement of income.

Investments carried at fair value through statement of income

Investments classified as carried at fair value through the statement of income comprise of two categories 'investments held for trading' and 'investments designated at fair value through statement of income'.

An investment is classified as 'held for trading' if it is acquired or incurred principally for the purpose of selling in the near term or if on initial recognition is part of a portfolio of identifiable financial investments that are managed together and for which there is evidence of a recent actual pattern of short-term profit taking. Derivatives which are not used as hedge are also categorised as held for trading.

Investments designated at fair value through statement of income are investments that are not classified as held for trading but are managed, and their performance is evaluated on a fair value basis in accordance with the Group's investment strategy.

These investments are initially recognised at fair value. Transaction costs are immediately expensed in the consolidated statement of income. Subsequent to initial recognition, investments designated at fair value through statement of income are remeasured at fair value and gains and losses arising from such remeasurement are included in the consolidated statement of income.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Non-trading investments

These are classified as follows:

- Held to maturity
- Available-for-sale

Held to maturity

Investments with fixed or determinable payments and fixed maturities are classified as held to maturity when the Group has the positive intention and ability to hold these investments to maturity. These investments are initially recognised at fair value, including directly attributable transaction costs.

After initial recognition investments held to maturity are carried at amortised cost using the effective interest rate method. Any gain or loss on such investments is recognised in the consolidated statement of income when the investment is derecognised or impaired. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate. The amortisation is included in 'interest income' in the consolidated statement of income. The losses, if any, arising from impairment of such investments are recognised in the consolidated statement of income.

Investments available-for-sale

Investments available-for-sale are those non-derivative financial assets that are designated as available-for-sale or are not classified as investment at fair value through statement of income, investments held to maturity or loans and receivables.

These investments are initially recognised at fair value, including directly attributable transaction costs.

After initial recognition, available-for-sale investments are measured at fair value with gains and losses being recognised in the consolidated statement of comprehensive income until the investment is derecognised or determined to be impaired at which time the cumulative gains or losses previously reported in the consolidated statement of comprehensive income are recognised in the consolidated statement of income. Investments whose fair value cannot be reliably measured are carried at cost less impairment losses, if any.

Dividends are included in 'dividend income'. Interest income on available-for-sale investments is recorded in 'interest income' in the consolidated statement of income, using the effective interest yield method.

Loans and receivables

Loans and receivables include non-derivative financial assets with fixed or determinable payments that are not quoted in an active market other than;

- (a) those that the Group intends to sell immediately or in the near term and those that the Group upon initial recognition designates as at fair value through statement of income;
- (b) those that the Group, upon initial recognition, designates as available for sale; or
- (c) those for which the Group may not recover substantially all of its initial investment, other than because of credit deterioration.

Loans and receivables are initially recognised at fair value which is the cash consideration to originate or purchase the loan including any transaction costs. Subsequently loans and receivables are carried at amortised cost, less any amount written off, and net of any provision for impairment.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Derivatives and hedge accounting

The Group makes use of derivative instruments to manage exposure to foreign currency risk and interest rate risk. In order to manage a particular risk, the Group applies hedge accounting to transactions which meet the specified criteria. The Group enters into derivative instruments, mainly forward foreign exchange contracts, interest rate and forward currency swaps in the foreign exchange markets.

Derivatives are initially recognised, and subsequently measured at fair value with transaction costs taken directly to the consolidated statement of income. The fair value of a derivative is the equivalent of the unrealised gain or loss from marking to market the derivative. Derivatives with positive fair values (unrealised gains) are included in other assets and derivatives with negative fair values (unrealised losses) are included in other liabilities in the consolidated statement of financial position.

Derivatives embedded in other financial instruments are treated as separate derivatives and recorded at fair value, when their economic characteristics and risks are not closely related to those of the host contract and the host contract is not carried as held for trading. The embedded derivatives are, where material, separated from the host contract and carried at fair value with the changes in fair value recognised in the consolidated statement of income.

At the inception of the hedging relationship, the Group formally documents the relationship between the hedged item and the hedging instrument, including the nature of the risk, objectives and strategy for undertaking the hedge and the method that will be used to assess the effectiveness of the hedging relationship.

Also, at the inception of the hedging relationship, a formal assessment is undertaken to ensure the hedging instrument is expected to be highly effective in offsetting the designated risk in the hedged item. Hedges are formally assessed at the end of each quarter. A hedge is regarded as highly effective if the changes in the fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated are expected to offset in a range of 80% to 125%.

For the purpose of hedge accounting, hedges are classified into three categories: (a) fair value hedges which hedge the exposure to changes in the fair value of a recognised asset or liability; (b) cash flow hedges which hedge exposure to variability in cash flows of a recognised asset or liability or a forecasted transaction; and (c) hedge of net investment in a foreign operation.

Fair value hedges

In relation to fair value hedges, that qualify for hedge accounting, any gain or loss from remeasuring the hedging instrument to fair value, as well as related changes in fair value of the item being hedged, are recognised immediately in the consolidated statement of income. At 31 December 2011, there were no hedges classified as fair value hedges.

Cash flow hedge

In relation to cash flow hedges the effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognised directly in the fair value reserve in the consolidated statement of comprehensive income. The gain or loss relating to the ineffective portion is recognised in the consolidated statement of income.

When the hedged cash flow affects the consolidated statement of income, the gain or loss on the hedging instrument is recycled in the corresponding income or expense line of the consolidated statement of income. When the hedging instrument expires or is sold, terminated or exercised or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at the time remains in equity and is recognised when the hedged forecast transaction is ultimately recognised in the consolidated statement of income. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the consolidated statement of income.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Derivatives and hedge accounting (continued)

Hedge of net investments in foreign operations

Hedges of a net investment in a foreign operation are accounted for in a way similar to cash flow hedges. On the disposal of the foreign operation, the cumulative value of any such gains or losses recognised in equity through other comprehensive income is transferred to the consolidated statement of income.

Derivatives are stated at fair values and carried as assets when their fair value is positive and as liabilities when their fair value is negative. For hedges which do not qualify for hedge accounting and held for trading derivatives, any gains or losses arising from changes in the fair value of the hedging instrument are taken directly to the consolidated statement of income for the year.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. For discontinued fair value hedges of financial instruments with fixed maturities any adjustment arising from hedge accounting is amortised over the remaining term to maturity. For discontinued cash flow hedges, any cumulative gain or loss on the hedging instrument recognised in equity remains in equity until the hedged transaction occurs. If the hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the consolidated statement of income.

Investment properties

All properties held for rental or for capital appreciation purposes, or both, are classified as investment properties. Where a property is partially occupied by the Group and the portions could be sold separately, the Group accounts for the portions separately either as an investment property or property and equipment, as appropriate. If the portions cannot be sold separately, the property is classified as an investment property only if an insignificant portion is held for own use.

The Group applies the fair value model of accounting for investment properties. All investment properties are initially recorded at cost, including acquisition expenses associated with the property.

Subsequent to initial recognition, all investment properties are remeasured at fair value and changes in fair value are recognised in the consolidated statement of income. The Group engages independent valuation specialists to determine the fair value of investment properties.

Property and equipment

Property and equipment are stated at cost less accumulated depreciation and impairment losses. When assets are sold or retired, their cost and accumulated depreciation are eliminated from the statement of financial position and any gain or loss resulting from disposal is included in the consolidated statement of income.

Depreciation is computed on a straight-line basis over estimated useful lives of 3 to 20 years on all property and equipment other than freehold land which is deemed to have an indefinite life. Expenditure for maintenance and repairs is expensed as incurred.

Financial liabilities

Financial liabilities comprise of due to banks and other financial institutions, deposits from customers, loans, bonds and subordinated debt and other liabilities. These are stated at amortised cost. Transaction costs are amortised over the period of the debt using the effective yield method. Deposits from customers include deposits from both external customers and other group companies.

Treasury shares and treasury share reserve

Treasury shares are own equity instruments of the Bank which are reacquired by the Bank or any of its subsidiaries. These are stated at cost and deducted from equity. Any gain or loss arising on reissuance of treasury shares is taken directly to treasury share reserve in the consolidated statement of changes in equity.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Cash and cash equivalents

Cash and cash equivalents include cash, demand and call deposits, highly liquid investments that are readily convertible into cash and placements (excluding escrow balances) with original maturities up to ninety days from the date of acquisition.

Fiduciary assets

Assets held in a fiduciary capacity are not treated as assets of the Group in the consolidated statement of financial position.

Dividends on ordinary shares

Dividends on ordinary shares are recognised as a liability and deducted from equity when they are approved by the Bank's shareholders. Dividends for the year that are approved after the statement of financial position date are disclosed as an event after the statement of financial position date.

Taxes

There is no tax on corporate income in the Kingdom of Bahrain. Taxation on foreign operations is provided in accordance with the fiscal regulations of the respective countries in which the Group operates.

Derecognition

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

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

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

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

Offsetting

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

Trade and settlement date accounting

All "regular way" purchases and sales of financial assets are recognised on the settlement date, i.e. the date the asset is delivered to the counterparty.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Employees benefits

The Group provides for end of service benefits to all its employees. Entitlement to these benefits is usually based upon the employees' length of service and the completion of a minimum service period. The expected costs of these benefits are accrued over the period of employment. National employees of the Bank are also covered by the Social Insurance Organisation scheme and the Bank's obligations are limited to the amount contributed to the scheme.

The Group operates an equity-settled, share-based Employee Stock Option Plan (ESOP or the plan). Under the terms of the plan, share options are granted to permanent employees, which are exercisable in a future period. The fair value of the options is recognised as an expense over the vesting period with a corresponding credit to equity. The fair value of the options is determined using the Black-Scholes option pricing model.

The proceeds received are credited to share capital (nominal value) and share premium when the options are exercised.

Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) arising from a past event and the costs to settle the obligation are both probable and reliably measurable.

Impairment of financial assets

An assessment is made at each statement of financial position date to determine whether there is objective evidence that a specific financial asset may be impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation and where observable data indicates that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults. If such evidence exists, an impairment loss, is recognised in the consolidated statement of income.

Financial assets carried at amortised cost

A financial asset is considered impaired when there is an objective evidence of credit-related impairment as a result of one or more loss event(s) that occurred after the initial recognition of the asset and those loss events have an impact on the estimated future cash flows of the financial asset or group of financial assets and can be reliably estimated.

A specific provision for credit losses, due to impairment of a loan or any other financial asset held at amortised cost, is established if there is objective evidence that the Group will not be able to collect all amounts due. The amount of the specific provision is the difference between the carrying amount and the estimated recoverable amount. The estimated recoverable amount is the present value of expected cash flows, including amounts estimated to be recoverable from guarantees and collateral, discounted based on the original effective yield basis.

In addition to a specific provision for credit losses, a provision for collective impairment is made on a portfolio basis for credit losses where there is an objective evidence that unidentified losses exist at the reporting date. These are based on any deterioration in the risk rating (i.e. downward migration of risk ratings) of the financial asset since it was originally granted. This provision is estimated based on various factors including credit ratings allocated to a borrower or group of borrowers, the current economic conditions, the experience the Group has had in dealing with a borrower or group of borrowers and available historical default information.

The carrying amount of the asset is adjusted through the use of a provision for impairment account and the amount of the adjustment is included in the consolidated statement of income.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Impairment of financial assets (continued)

Investments available-for-sale

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

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

In the case of debt instruments classified as available-for-sale, impairment is assessed based on the same criteria as financial assets carried at amortised cost. However, the amount recorded for impairment is the cumulative loss measured as the difference between the amortised cost and the current fair value, less any impairment loss on that investment previously recognised in the statement of income. If, in a subsequent year, the fair value of a debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the consolidated statement of income, the impairment loss is reversed through the consolidated statement of income.

Impairment of non-financial assets

Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised in the consolidated statement of income for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell, and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash inflows (cash-generating units). The impairment test also can be performed on a single asset when the fair value less costs to sell or the value in use can be determined reliably. Non-financial assets other than goodwill that suffer impairment are reviewed for possible reversal of the impairment at each reporting date.

Fair values

For financial instruments traded in an active market, fair value is determined by reference to quoted market bid prices for assets and quoted market offer prices for liabilities, without deduction for transaction costs. The fair value of investments in managed funds or similar investment vehicles, where available, are based on last published bid price.

A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. If the above criteria are not met, the market is regarded as being inactive. Indications that a market is inactive are when there is a wide bid-offer spread or significant increase in the bid-offer spread or there are few recent transactions.

For financial instruments where there is no active market, fair value is determined using appropriate valuation techniques. Such techniques may include the following:

- brokers' quotes
- recent transactions
- the expected cash flows discounted at current rates applicable for items with similar terms and risk characteristics
- option pricing models

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Fair values (continued)

The estimated fair value of deposits with no stated maturity, which includes non-interest bearing deposits, is the amount payable on demand.

The fair value of forward foreign exchange contracts is determined using forward exchange rates at the statement of financial position date with the resulting value discounted back to present value.

The fair value of interest rate swaps is determined by discounting estimated future cash flows based on the terms and maturity of each contract and using market interest rates for a similar instrument at the measurement date.

Foreign currencies

The consolidated financial statements have been presented in US Dollars being the functional and presentational currency of the Bank. Each entity in the Group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency.

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

Translation of foreign currency transactions and balances

Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the reporting date. Exchange differences arising on the retranslation of monetary items, are included in consolidated statement of income for the year. Non-monetary items measured at fair value in a foreign currency are retranslated using the exchange rates at the date when the fair value was determined. Exchange differences arising on the retranslation of non-monetary investments carried at fair value through the statement of income are included in the consolidated statement of income for the year. Exchange differences arising on the retranslation of available for sale equity investments, other than those which are carried at cost, are recognised directly in a fair value reserve in the consolidated statement of comprehensive income. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions.

Translation of financial statements of foreign operations

Assets (including goodwill) and liabilities of foreign operations are translated at the exchange rates prevailing at the statement of financial position date. Income and expense items are translated at average exchange rates for the relevant period. All resulting exchange differences are taken directly to a foreign currency translation reserve in equity through other comprehensive income.

On disposal of a foreign operation, the component of other comprehensive income relating to that particular foreign operation is recognised in the consolidated statement of income.

Recognition of income and expenses

Interest income and related fees are recognised using the effective yield method, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the effective interest rate, but not future credit losses. The carrying amount of the financial asset or financial liability is adjusted if the Group revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest income or expense.

Recognition of interest income is suspended when the related financial asset becomes impaired. Notional interest is recognised on impaired financial assets based on the rate used to discount future cash flows to their net present value.

Commission income and other fees are recognised when earned.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Recognition of income and expenses (continued)

Rental income on investment properties is recognised on a straight line basis.

Dividend income is recognised when the Group's right to receive the dividend is established.

Contingent liabilities and contingent assets

Contingent liabilities are not recognised in the financial statements, but are disclosed unless the possibility of an outflow of resources embodying economic benefits is remote.

Contingent assets are not recognised in the financial statements, but are disclosed when an inflow of economic benefits is probable.

Segment information

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker is the person or group that allocates resources to and assesses the performance of the operating segments of an entity. The Group has determined the Acting Chief Executive Officer of the Bank as its chief operating decision-maker.

All transactions between business segments are conducted on an arm's length basis, with intra-segment revenue and expenses being eliminated at Group level. Income and expenses directly associated with each segment are included in determining business segment performance.

Significant assumptions, accounting judgements and estimates

In the process of applying the Group's accounting policies, management has made the following assumptions, judgements and estimates in determining the amounts recognised in the consolidated financial statements:

Going concern

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

Classification of investments

Management decides on acquisition of an investment whether it should be classified as carried at fair value through statement of income, held to maturity or available-for-sale.

The Group classifies investments as held for trading if they are acquired primarily for the purpose of making short term profit. Classification of investments designated as fair value through statement of income depends on how management monitors the performance of these investments.

Securities which are eligible for reclassification in accordance with IAS 39 and the Group has an intention and ability to hold for the foreseeable future are reclassified as non-trading investments. An analysis of reclassified assets is disclosed in note 6.

For those deemed to be held to maturity, management ensures that the requirements of IAS 39 are met and in particular the Group has the intention and ability to hold these to maturity.

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

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

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Significant assumptions, accounting judgements and estimates (continued)

Impairment of investments

The Group treats available-for-sale equity investments as impaired when there has been a significant or prolonged decline in the fair value below its cost or where other objective evidence of impairment exists. The determination of what is 'significant' or 'prolonged' requires considerable judgment.

Impairment of goodwill

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

Impairment losses on loans and receivables

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

Collective impairment provisions on loans and receivables

In addition to specific provisions against individually significant loans and receivables, the Group also makes a collective impairment provision against loans and receivables, which although not specifically identified against a loan, have a greater risk of default than when originally granted. This collective provision is based on any deterioration in the internal grade of the loan since it was granted. The amount of the provision is based on the historical loss pattern for loans within each grade and is adjusted to reflect current economic changes.

These internal gradings take into consideration factors such as any deterioration in country risk, industry, technological obsolescence as well as identified structural weaknesses or deterioration in cash flows.

Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded in the statement of financial position cannot be derived from active markets, they are determined using valuation techniques including discounted cash flow models. The inputs to these models are taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. The judgments include considerations of inputs such as liquidity risk, credit risk and volatility. Changes in assumptions about these factors could affect the reported fair value of financial instruments.

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

- recent arm's length market transactions;
- current fair value of another instrument that is substantially the same; and
- other valuation methods (note 32).

Reclassification of financial assets

Effective from 1 July 2008, the Group may reclassify, in certain circumstances, non-derivative financial assets out of the 'held-for-trading' category and into the 'available-for-sale', 'loans and receivables', or 'held-to-maturity' categories. From this date it may also reclassify, in certain circumstances, financial instruments out of the 'available-for-sale' category and into the 'loans and receivables' category. Reclassifications are recorded at fair value at the date of reclassification, which becomes the new amortised cost.

The Group may reclassify a non-derivative trading asset out of the 'held-for-trading' category and into the 'loans and receivables' category if it meets the definition of loans and receivables and the Group has the intention and ability to hold the financial asset for the foreseeable future or until maturity. If a financial asset is reclassified, and if the Group subsequently increases its estimates of future cash receipts as a result of increased recoverability of those cash receipts, the effect of that increase is recognised as an adjustment to the effective interest rate from the date of the change in estimate.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Significant accounting judgements and estimates (continued)

Reclassification of financial assets (continued)

For a financial asset reclassified out of the 'available-for-sale' category, any previous gain or loss on that asset that has been recognised in other comprehensive income is amortised to profit or loss over the remaining life of the investment using the effective interest rate. Any difference between the new amortised cost and the expected cash flows is also amortised over the remaining life of the asset using the effective interest rate. If the asset is subsequently determined to be impaired then the amount recorded in other comprehensive income is recycled to the statement of income.

Reclassification is at the election of management, and is determined on an instrument by instrument basis. The Group does not reclassify any financial instrument into the fair value through statement of income category after initial recognition. An analysis of reclassified assets is disclosed in note 6.

3 PROSPECTIVE CHANGES IN ACCOUNTING POLICIES

Standards issued but not yet effective up to the date of issuance of the Group's consolidated financial statements are listed below. This listing is of standards and interpretations issued, which the Group reasonably expects to be applicable at a future date. The Group intends to adopt those standards (where applicable) when they become effective:

IAS 1 *Financial Statement Presentation*

The amendments becomes effective for annual periods beginning on or after 1 July 2012 and require that an entity present separately, the items of other comprehensive income that would be reclassified (or recycled) to profit or loss in the future if certain conditions are met (for example, upon derecognition or settlement), from those that would never be reclassified to profit or loss. The amendment affects presentation only and, therefore, will have no impact on the Group's financial position or performance.

IFRS 9 *Financial Instruments*

IFRS 9 as issued reflects the first phase of the IASB's work on the replacement of IAS 39 and applies to classification and measurement of financial assets and financial liabilities as defined in IAS 39.

It replaces the parts of IAS 39 that relate to the classification and measurement of financial instruments. IFRS 9 requires financial assets to be classified into two measurement categories: those measured as at fair value and those measured at amortised cost. The determination is made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument.

For financial liabilities, the standard retains most of the IAS 39 requirements. The main change is that, in cases where the fair value option is taken for financial liabilities, the part of a fair value change due to an entity's own credit risk is recorded in other comprehensive income rather than the income statement, unless this creates an accounting mismatch.

It also includes those paragraphs of IAS 39 dealing with how to measure fair value and accounting for derivatives embedded in a contract that contains a host that is not a financial asset, as well as the requirements of IFRIC 9 *Reassessment of Embedded Derivatives*.

The standard is currently effective for annual periods beginning on or after 1 January 2013. The IASB issued an exposure draft (ED) "Mandatory effective date of IFRS 9" - that proposes the meaning of the mandatory effective date to periods beginning on or after 1 January 2015 with early application continuing to be permitted. In subsequent phases, the IASB will address hedge accounting and impairment of financial assets.

The Group will quantify the effect of adoption of this Standard, in conjunction with the other phases, when issued, to present a comprehensive picture.

3 PROSPECTIVE CHANGES IN ACCOUNTING POLICIES (continued)

IAS 19 Employee benefits

The IASB has issued numerous amendments to IAS 19, which are effective for annual periods beginning on or after 1 January 2013. These include the elimination of the corridor approach and recognising all actuarial gains and losses in the other comprehensive income as they occur; immediate recognition of all past service costs; and replacement of interest cost and expected return on plan assets with a net interest amount that is calculated by applying the discount rate to the net defined benefit liability (asset); and certain clarifications and re-wording. The Group is currently assessing the full impact of these amendments.

IFRS 10 Consolidated financial statements

IFRS 10 introduces a new approach to determining which investees should be consolidated and provides a single consolidation model that identifies control as the basis for consolidation for all types of entities.

An investor controls an investee when:

- it is exposed or has rights to variable returns from its involvement with that investee;
- it has the ability to affect those returns through its power over that investee; and
- there is a link between power and returns.

Control is re-assessed as facts and circumstances change.

IFRS 10 replaces IAS 27 *Consolidated and Separate Financial Statements* and SIC-12 *Consolidation - Special Purpose Entities*. IFRS 10 is effective for annual periods beginning on or after 1 January 2013 and earlier application is permitted. The Group is currently assessing the full impact of this new standard.

IFRS 11 Joint arrangements

IFRS 11 establishes principles for the financial reporting by parties to a joint arrangement and improves on IAS 31 by establishing principles that are applicable to the accounting for all joint arrangements.

IFRS 11 classifies joint arrangements into two types – joint operations and joint ventures; and defines joint control as the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities (i.e. activities that significantly affect the returns of the arrangement) require the unanimous consent of the parties sharing control.

IFRS 11 supersedes IAS 31 *Interests in Joint Ventures* and SIC-13 *Jointly Controlled Entities – Non-monetary Contributions by Venturers*. IFRS 11 is effective for annual periods beginning on or after 1 January 2013 and earlier application is permitted. The Group is currently assessing the full impact of this new standard.

IFRS 12 Disclosure of interests in other entities

IFRS 12 combines, enhances and replaces the disclosure requirements for subsidiaries, joint arrangements, associates and unconsolidated structured entities. As a consequence of these new IFRSs, the IASB also issued amended and retitled IAS 27 *Separate Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures*.

IFRS 12 aims to provide information to enable users to evaluate:

- the nature of, and risks associated with, an entity's interests in other entities; and
- the effect of those interests on the entity's financial position, financial performance and cash flows.

IFRS 12 is effective for annual periods beginning on or after 1 January 2013 and earlier application is permitted. The Group is currently assessing the full impact of this new standard.

IFRS 13 Fair value measurement

IFRS 13 replaces the fair value measurement guidance contained in individual IFRSs with a single source of fair value measurement guidance. It defines fair value, establishes a framework for measuring fair value and sets out disclosure requirements for fair value measurements. It explains how to measure fair value when it is required or permitted by other IFRSs. IFRS 13 does not extend the use of fair value accounting but provides guidance on how it should be applied where its use is already required or permitted by other standards within IFRSs.

3 PROSPECTIVE CHANGES IN ACCOUNTING POLICIES (continued)

IFRS 13 *Fair value measurement (continued)*

IFRS 13 is effective for annual periods beginning on or after 1 January 2013 and earlier application is permitted. The Group is currently assessing the full impact of this new standard.

IAS 27 *Separate Financial Statements (as revised in 2011)*

IAS 27 (2011) supersedes IAS 27 (2008). As a consequence of the new IFRS 10 and IFRS 12 aforementioned, IAS 27 (2011) carries forward the existing accounting and disclosure requirements for separate financial statements, with some minor clarifications.

IAS 27 (2011) is effective for annual periods beginning on or after 1 January 2013 and earlier application is permitted. The Bank does not present separate financial statements.

IAS 28 *Investments in Associates and Joint Ventures Separate Financial Statements (as revised in 2011)*

IAS 28 (2011) supersedes IAS 28 (2008). As a consequence of the new IFRS 11 and IFRS 12 (refer above), IAS 28 has been renamed IAS 28 *Investments in Associates and Joint Ventures*, and describes the application of the equity method to investments in joint ventures in addition to associates.

IAS 28 (2011) is effective for annual periods beginning on or after 1 January 2013 and earlier application is permitted. The Group is currently assessing the full impact of this revised standard.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2011

4 FINANCIAL ASSETS AND LIABILITIES

The table below summarises the accounting classification of the Group's financial assets and financial liabilities:

	<i>Held for trading</i>	<i>Designated at fair value through statement of income</i>	<i>Available-for-sale</i>	<i>Amortised cost / Loans and receivables</i>	<i>Total</i>
31 December 2011	US\$ 000	US\$ 000	US\$ 000	US\$ 000	US\$ 000
Demand and call deposits with banks	-	-	-	17,857	17,857
Placements with banks	-	-	-	102,282	102,282
Investments carried at fair value through statement of income	24,232	48,951	-	-	73,183
Non-trading investments	-	-	435,028	-	435,028
Loans and receivables	-	-	-	27,942	27,942
Other assets	-	-	-	31,949	31,949
Total financial assets	24,232	48,951	435,028	180,030	688,241
Due to banks and other financial institutions	-	-	-	211,795	211,795
Deposits from customers	-	-	-	80,349	80,349
Loans	-	-	-	731,185	731,185
Bonds	-	-	-	-	-
Subordinated debt	-	-	-	100,000	100,000
Other liabilities	-	-	-	44,021	44,021
Total financial liabilities	-	-	-	1,167,350	1,167,350
	<i>Held for trading</i>	<i>Designated at fair value through statement of income</i>	<i>Available-for-sale</i>	<i>Amortised cost / Loans and receivables</i>	<i>Total</i>
31 December 2010	US\$ 000	US\$ 000	US\$ 000	US\$ 000	US\$ 000
Demand and call deposits with banks	-	-	-	27,914	27,914
Placements with banks	-	-	-	167,257	167,257
Investments carried at fair value through statement of income	29,196	97,465	-	-	126,661
Non-trading investments	-	-	385,770	-	385,770
Loans and receivables	-	-	-	57,920	57,920
Other assets	-	-	-	43,538	43,538
Total financial assets	29,196	97,465	385,770	296,629	809,060
Due to banks and other financial institutions	-	-	-	435,624	435,624
Deposits from customers	-	-	-	139,568	139,568
Loans	-	-	-	501,432	501,432
Bonds	-	-	-	71,187	71,187
Subordinated debt	-	-	-	100,000	100,000
Other liabilities	-	-	-	40,140	40,140
Total financial liabilities	-	-	-	1,287,951	1,287,951

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2011

5 INVESTMENTS CARRIED AT FAIR VALUE THROUGH STATEMENT OF INCOME

	2011 US\$ 000	2010 US\$ 000
Investments held for trading		
Quoted equities	24,232	29,196
Investments designated at fair value through statement of income		
Managed funds	48,951	97,465
	73,183	126,661

Managed funds primarily represent private equity funds invested through unlisted companies and limited partnership interests. The fund managers have created these legal structures for tax efficiency and to meet other investors' requirements. The underlying investments in these funds are primarily in quoted debt and equity instruments in Kuwait and other international markets.

6 NON-TRADING INVESTMENTS

Non-trading investments comprise of available-for-sale investments as follows:

	2011 US\$ 000	2010 US\$ 000
Quoted		
Equities	43,395	45,102
Unquoted		
Equities	81,705	132,558
Real estate managed funds	16,560	18,636
Other managed funds	280,160	179,025
Debt securities	13,208	10,449
Total unquoted	391,633	340,668
Total non-trading investments	435,028	385,770

In October 2008, the International Accounting Standards Board [IASB] issued amendments to IAS 39 "Financial Instruments: Recognition and Measurement" and IFRS 7 "Financial Instruments: Disclosures" entitled "Reclassification of Financial Assets". The amendments to IAS 39 permit reclassification of financial assets from the "held for trading" category to the "available-for-sale" category in certain circumstances.

The amendments to IFRS 7 introduce additional disclosure requirements if an entity has reclassified financial assets in accordance with the IAS 39 amendments. The amendments were effective retrospectively from 1 July 2008.

As per the amendments, the Group reclassified certain financial assets from the "held for trading" category to the "available-for-sale" category. The assets were reclassified with retrospective effect as on 1 July 2008. The carrying value of these financial assets, as at date of reclassification, was US\$ 19,082 thousand.

The carrying values and fair values of the financial assets reclassified are as follows:

	2011 US\$ 000	2010 US\$ 000
Carrying value and fair value as at 31 December	9,323	11,768

The fair value loss that would have been recognised in the consolidated statement of income for the period from the date of reclassification to 31 December 2011 had the financial assets not been reclassified amounts to US\$ nil (31 December 2010: US\$ 1,709 thousand).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2011

6 NON-TRADING INVESTMENTS (continued)

Included under non-trading investments are unquoted available-for-sale investments, primarily representing nominal equity stakes up to 13% (31 December 2010: 13%) in various geographically and sectorally dispersed companies, amounting to US\$ 87,943 thousand (31 December 2010: US\$ 116,040 thousand) for which fair value cannot be determined with sufficient accuracy, as future cash flows are not determinable. Accordingly, these investments are carried at cost less provisions for impairment.

During the year an impairment loss of US\$ 23,961 thousand (31 December 2010: US\$ 13,499 thousand) has been recognised and adjusted against the gross amount of non-trading investments of US\$ 141,304 thousand (31 December 2010: US\$ 131,759 thousand).

The movement in provision for non-trading investments was as follows:

	2011 US\$ 000	2010 US\$ 000
At 1 January	55,395	32,802
Charge for the year	23,961	13,499
Written off	(9,514)	(427)
Other movements	(3,868)	9,521
Net charge during the year	10,579	22,593
At 31 December	65,974	55,395
Gross amount of individually impaired investments	141,304	131,759

7 LOANS AND RECEIVABLES

	2011 US\$ 000	2010 US\$ 000
Commercial loans	27,365	57,376
Overdrafts	-	488
Staff loans	3,306	2,762
	30,671	60,626
Less: Provision for impairment	(2,729)	(2,706)
	27,942	57,920

The movements in the provision for impairment are as follows:

At 1 January	2,706	5,158
Written off during the year	-	(2,394)
Charge for the year	8	3
Other adjustments	15	(61)
At 31 December	2,729	2,706

Provision for impairment mainly relates to commercial loans.

Individual impairment	1,711	1,697
Collective impairment	1,018	1,009
	2,729	2,706
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	1,995	2,016

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2011

8 OTHER ASSETS

	2011 US\$ 000	2010 US\$ 000
Due from customers	26,584	34,524
Accounts receivable	5,027	4,900
Prepayments	5,541	3,412
Interest receivable	338	236
Others	-	3,878
	37,490	46,950

Due from customers is stated net of provision of US\$ 9,039 thousand (31 December 2010: US\$ 8,497 thousand). The net provision for impairment of other assets charged for the year amounted to US\$ 468 thousand (31 December 2010: US\$ 169 thousand).

9 INVESTMENTS IN ASSOCIATES AND JOINT VENTURES ACCOUNTED FOR UNDER THE EQUITY METHOD

Investments in associates and joint ventures

			Carrying value 2011 US\$ 000	Ownership % 2011	Carrying value 2010 US\$ 000	Ownership % 2010
	Activity					
a)	Al Dhiyafa Holding Company K.S.C. (closed)	Hotel and tourism	-	-	54,984	32
b)	Al Sharq Financial Brokerage Co.	Brokerage and investment business	19,685	19	19,572	20
c)	Dhow Development Company	Real estate	-	20	27	20
d)	Burgan Bank S.A.K.	Commercial banking	463,782	18	424,099	17
e)	KAMCO Energy Services Fund	Fund	8,173	36	-	-
f)	Kuwait Private Equity Opportunities	Private equity fund	12,411	45	14,184	45
g)	Manafae Investment Company	Islamic investment	25,312	31	28,221	30
h)	Millennium Private Equity Limited	Asset management	-	50	-	50
i)	North Africa Holding Company	Investments	75,470	45	80,440	44
j)	Overland Real Estate Company	Real estate	47,042	45	46,503	44
k)	Royal Capital Company P.S.C.	Asset management and financial services	35,701	45	35,426	43
l)	SSH Dar International W.L.L.	Architectural consulting services	-	-	2,955	29
m)	Syria Gulf Bank	Commercial banking	18,182	31	19,634	31
n)	Takaud Savings and Pensions B.S.C. (c)	Offering of personal pension and saving products	5,000	50	-	-

9 INVESTMENTS IN ASSOCIATES AND JOINT VENTURES ACCOUNTED FOR UNDER THE EQUITY METHOD (continued)

Investments in associates and joint ventures (continued)

			Carrying value 2011 US\$ 000	Ownership % 2011	Carrying value 2010 US\$ 000	Ownership % 2010
Activity						
o)	United Capital Transport Co K.S.C.C.	Transport	11,413	40	-	-
p)	United Industries Company	Industrial and manufacturing	113,162	32	110,525	32
q)	United Network Company	Telecommunication	13,050	28	13,277	28
r)	United Real Estate Company	Real estate	154,473	20	145,579	19
s)	United Real Estate Company - Syria	Real estate	84	20	2,918	40
t)	United Real Estate Company - Jordan	Real estate	-	-	27,037	47
u)	United Universal Real Estate Company	Real estate	-	-	684	20
			1,002,940		1,026,065	

Summarised financial information of the Group's investments in associates and joint ventures is set out below:

	2011 US\$ 000	2010 US\$ 000
Total assets	20,014,573	18,309,489
Total liabilities	(16,206,946)	(14,411,447)
Net assets	3,807,627	3,898,042
Revenue	1,104,576	1,013,826
Profit for the year	244,345	68,276

The Group has no share of any contingent liabilities or capital commitments, as at 31 December 2011 and 31 December 2010 related to its joint ventures and associates.

- Al-Dhiyafa Holding Company K.S.C. (closed) is a company incorporated in the State of Kuwait during 2005. During the year, the Group sold its 32% (31 December 2010: 32%) ownership to a related party.
- Al Sharq Financial Brokerage Co. is a closed company incorporated in the State of Kuwait during 2005. At 31 December 2011, the Bank indirectly owns a 19% interest in the associate through its subsidiary KAMCO (31 December 2010: directly owned 15% and indirectly owned 5% through KAMCO). The Group has the ability to exercise significant influence on Al Sharq through representation on the board of directors of Al Sharq.
- Dhow Development Company is held through the Bank's subsidiary KAMCO and is incorporated in the State of Kuwait. The investment has been fully provided for.

9 INVESTMENTS IN ASSOCIATES AND JOINT VENTURES ACCOUNTED FOR UNDER THE EQUITY METHOD (continued)

Investments in associates and joint ventures (continued)

- d) Borgan Bank S.A.K. is a listed commercial bank incorporated in the State of Kuwait. The Bank directly owns an 18% (31 December 2010: 17%) equity interest in Borgan Bank. The Group has the ability to exercise significant influence on Borgan Bank through representation of 2 directors on the board of directors of Borgan Bank.
- e) During the year, the Bank acquired a 36% equity stake in KAMCO Energy Service Fund through its subsidiary KAMCO. KAMCO Energy Service Fund was incorporated in the State of Kuwait in 2007.
- f) Kuwait Private Equity Opportunities Fund is a closed ended fund incorporated in the State of Kuwait in 2004. At 31 December 2011, the Bank indirectly owns a 45% interest in the associate through its subsidiary KAMCO (31 December 2010: directly owned 15% and indirectly owned 30% through KAMCO).
- g) The Bank indirectly owns 31% (31 December 2010: 30%) of Manafae Investment Company through its subsidiary KAMCO.
- h) During 2009 the Group acquired a 50% stake in Millennium Private Equity Limited (MPE) through a share swap of Millennium Finance Corporation Limited (MFC) a jointly controlled company incorporated in the United Arab Emirates. MPE is engaged in managing private equity funds. In 2010, an impairment loss of US\$ 15,781 thousand has been recognised against MPE.
- i) The Bank directly owns 35% (31 December 2010: 34%) of North Africa Holding Company (NAHC), a closed company incorporated in the State of Kuwait in 2006, and indirectly owns an additional 10% (31 December 2010: 10%) through its subsidiary KAMCO.
- j) The Bank indirectly owns 45% (31 December 2010: 44%) of Overland Real Estate Company through its subsidiary KAMCO.
- k) The Bank directly owns 19% (31 December 2010: 18%) of Royal Capital, a closed company incorporated in the United Arab Emirates in 2007, and indirectly owns an additional 26% (31 December 2010: 25%) through its subsidiary KAMCO.
- l) SSH Dar International W.L.L. was owned through the Bank's subsidiary KAMCO. During the current year, the Group disposed of its interest in the entity to a third party.
- m) Syria Gulf Bank (SGB) is a commercial bank incorporated in the Syrian Arab Republic. SGB commenced commercial operations in 2007. The Bank directly owns a 31% (31 December 2010: 31%) equity stake of SGB.
- n) During 2011, the Bank and KIPCO (Parent) established a joint venture (with an equal 50% equity interest) named Takaad Savings and Pensions B.S.C. (c) (Takaad) in Bahrain with a total paid up capital of US\$ 10 million. Takaad has not commenced its operations at the date of statement of financial position. Takaad aims to offer wide range of personal pension and saving products to its customers.
- o) United Capital Transport Company K.S.C.C. (UniCap) was incorporated in State of Kuwait in 2011. The Bank owns a 40% equity stake through its subsidiary KAMCO. UniCap is a dedicated leasing solutions provider to governments, international oil companies and varied construction, mining and industrial services businesses.
- p) The Bank indirectly owns 32% (31 December 2010: 32%) of United Industries Company K.S.C. (closed) ("UIC"), a company incorporated in the State of Kuwait in 1979 and listed on the Kuwait Stock Exchange, through its subsidiary KAMCO. UIC is in litigation with Al Atoun Steel Industries S.S.C. (Closed) ("AL Atoun Steel") (and the sponsors of Al Atoun Steel) for the recovery of its investment in Al Atoun Steel amounting to US\$ 44,813 thousand (KD 12,483 thousand). The management of UIC is confident that the investment in Al Atoun Steel will be recovered in full.
- q) The Bank directly owns 20% (31 December 2010: 20%) of United Network Company, a closed company incorporated in the State of Kuwait in 2001, and indirectly owns an additional 8% (31 December 2010: 8%) through its subsidiary KAMCO.

9 INVESTMENTS IN ASSOCIATES AND JOINT VENTURES ACCOUNTED FOR UNDER THE EQUITY METHOD (continued)**Investments in associates and joint ventures (continued)**

- r) United Real Estate Company (URC), is a company listed on the Kuwait Stock Exchange. At 31 December 2011, the Bank directly owns 20% (31 December 2010: 19%) of URC. The Group has the ability to exercise significant influence on URC through representation on the board of directors of URC.
- s) United Real Estate Company - Syria is a closed company incorporated in the Syrian Arab Republic in 2008. At 31 December 2011, the Bank directly owns 20% of the associate through its subsidiary KAMCO (31 December 2010: directly owned 20% and indirectly owned 20% through KAMCO).
- t) United Real Estate Company - Jordan is a company incorporated in the Kingdom of Jordan during 2007. During the year, the group sold its 47% (31 December 2010: 47%) ownership to a related party.
- u) United Universal Real Estate Company was owned through the Bank's subsidiary KAMCO. During the current year, the Group disposed of its interest in the entity to a third party.

Investments in associates include quoted associates with a carrying value of US\$ 774,906 thousand (31 December 2010: US\$ 728,058 thousand) which have a total quoted market price of US\$ 596,525 thousand at 31 December 2011 (31 December 2010: US\$ 641,572 thousand). In accordance with IAS 36, 'Impairment of Assets', the group's recoverable amount of these associates (higher of fair value less costs to sell, and value in use) was in excess of their carrying values and accordingly no impairment was recognised during the year ended 31 December 2011.

10 INVESTMENT PROPERTIES

	2011 US\$ 000	2010 US\$ 000
Cost	21,178	21,122
Disposals	(5,124)	-
Cumulative fair value adjustments	-	56
	<u>16,054</u>	<u>21,178</u>

The movement in investment properties is as follows:

At 1 January	21,178	26,794
Disposals	(5,124)	(5,616)
At 31 December	<u>16,054</u>	<u>21,178</u>

Investment properties consist of the following:

Buildings	14,707	19,831
Land	1,347	1,347
	<u>16,054</u>	<u>21,178</u>

Investment properties are stated at fair values, determined based on independent valuations performed by external professional valuers at the year end.

11 GOODWILL

	2011 US\$ 000	2010 US\$ 000
At 1 January	56,296	55,168
Foreign currency translation adjustments	486	1,128
At 31 December	<u>56,782</u>	<u>56,296</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2011

11 GOODWILL (continued)

The goodwill is related to KAMCO (a subsidiary) and is allocated to the asset management and investment banking operating segment, a cash generating unit (a CGU). The recoverable amount of the CGU is determined based on a value in use calculation using cash flow projections from financial budgets approved by the Group's senior management covering a five year period. The key assumptions used in the value in use calculation include a perpetuity growth rate of 3% (2010: 3%) and discount factor of 11% (2010: 8.7%). There was no impairment identified in 2011 or 2010 as the recoverable amount of the CGU was higher than its net book value.

The calculation of value in use for the CGU is sensitive primarily to market risk premium, growth risk rate, risk free rate and country risk premium.

12 LOANS PAYABLE

31 December 2011	Currency*	Parent US\$ 000	Subsidiary US\$ 000	Total US\$ 000
Floating rate loans				
<i>Maturing within one year</i>				
Loan due on 15 January 2012	KWD	-	8,077	8,077
Loan due on 28 February 2012	KWD	-	3,590	3,590
Loan due on 26 April 2012	KWD	-	10,770	10,770
Loan due on 31 May 2012	KWD	-	39,490	39,490
Loan due on 30 June 2012	KWD	-	1,795	1,795
Loan due on 2 July 2012	US\$	200,000	-	200,000
Loan due on 31 December 2012	KWD	-	4,487	4,487
Loan due on 31 December 2012	KWD	-	1,795	1,795
Loan due on 31 December 2012	KWD	-	3,590	3,590
		200,000	73,594	273,594
<i>Maturing after one year</i>				
Loan due on 28 February 2013	KWD	-	3,590	3,590
Loan due on 30 June 2013	KWD	-	1,795	1,795
Loan due on 31 December 2013	KWD	-	4,488	4,488
Loan due on 31 December 2013	KWD	-	3,590	3,590
Loan due on 31 December 2013	KWD	-	1,795	1,795
Loan due on 28 February 2014	KWD	-	10,771	10,771
Loan due on 11 May 2014	US\$	239,500	-	239,500
Loan due on 17 June 2014	KWD	-	71,800	71,800
Loan due on 20 June 2014	KWD	70,000	-	70,000
Loan due on 30 June 2014	KWD	-	1,795	1,795
Loan due on 31 December 2014	KWD	-	4,488	4,488
Loan due on 31 December 2014	KWD	-	1,795	1,795
Loan due on 31 December 2014	KWD	-	7,180	7,180
Loan due on 30 June 2015	KWD	-	1,795	1,795
Loan due on 31 December 2015	KWD	-	4,488	4,488
Loan due on 31 December 2015	KWD	-	1,795	1,795
Loan due on 30 June 2016	KWD	-	8,976	8,976
Loan due on 31 December 2016	KWD	-	17,950	17,950
		309,500	148,091	457,591
		509,500	221,685	731,185

* KWD represents Kuwaiti Dinar.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2011

12 LOANS PAYABLE (continued)

31 December 2010	Currency*	Parent US\$ 000	Subsidiary US\$ 000	Total US\$ 000
Floating rate loans				
<i>Maturing within one year</i>				
Loan due on 5 January 2011	KWD	-	3,559	3,559
Loan due on 7 January 2011	KWD	-	3,559	3,559
Loan due on 31 January 2011	KWD	-	7,118	7,118
Loan due on 31 January 2011	KWD	-	32,924	32,924
Loan due on 2 April 2011	KWD	-	44,492	44,492
Loan due on 31 May 2011	KWD	-	17,797	17,797
Loan due on 17 June 2011	KWD	-	26,696	26,696
Loan due on 30 June 2011	US\$	115,000	-	115,000
Loan due on 20 December 2011	KWD	-	28,476	28,476
Loan due on 31 December 2011	KWD	-	3,559	3,559
		115,000	168,180	283,180
<i>Maturing after one year</i>				
Loan due on 2 July 2012	US\$	200,000	-	200,000
Loan due on 31 December 2012	KWD	-	3,559	3,559
Loan due on 1 June 2013	SYP	-	4,014	4,014
Loan due on 31 December 2013	KWD	-	3,559	3,559
Loan due on 31 December 2014	KWD	-	7,120	7,120
		200,000	18,252	218,252
		315,000	186,432	501,432

* KWD represents Kuwaiti Dinar and SYP represents Syrian Pound.

13 BONDS

	2011 US\$ 000	2010 US\$ 000
Bonds - issued by a subsidiary	-	71,187

In June 2004, the Bank's subsidiary KAMCO issued floating rate bonds of Kuwaiti Dinar (KWD) 10,000 thousand (US\$ 35,900 thousand) at a rate of Central Bank of Kuwait discount rate plus 2.75% per annum and fixed rate bonds of KWD 10,000 thousand (US\$ 35,900 thousand) at a rate of 7.5% per annum each. These bonds matured and were repaid on 21 June 2011 at their principal amounts.

14 SUBORDINATED DEBT

On 13 October 2006, the Bank issued floating rate notes amounting to US\$ 100 million for a term of 10 years maturing on 12 October 2016. For the first five years the notes carried interest at the rate of 1.8% per annum above LIBOR for 3 month US dollar deposits after which the notes now carry interest at the rate of 2.7% per annum above LIBOR for 3 month US dollar deposits. The notes carried a call option to repurchase the notes at par value exercisable by the Bank at its 5th anniversary on 13 October 2011, which the Bank did not exercise.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2011

15 OTHER LIABILITIES

	2011 US\$ 000	2010 US\$ 000
Due to customers and other payables	8,903	18,113
Accrued expenses	8,533	20,807
Staff related payables	18,625	21,798
Interest payable	5,827	5,610
Dividends payable	2,133	2,172
	44,021	68,500

16 EQUITY**Share capital**

The Bank's authorised share capital as of 31 December 2011 comprised 1 billion shares of US\$ 0.25 each (31 December 2010: 1 billion shares of US\$ 0.25 each).

The issued and fully paid up share capital as of 31 December 2011 comprised 834,560,885 shares of US\$ 0.25 each (31 December 2010: 832,935,594 shares of US\$ 0.25 each). The increase is due to exercise of share options by employees under the Employee Share Option Plan.

Treasury shares and treasury shares reserve

At 31 December 2011, the Bank held 11,056,255 treasury shares (31 December 2010: 11,056,255 shares). These treasury shares do not carry any voting rights and are not entitled to dividends. The net gain or loss on reissuance of treasury shares is taken to treasury share reserve in the consolidated statement of changes in equity and is not available for distribution. The value of treasury shares based on the last bid price as of 31 December 2011 was US\$ 8.2 million (31 December 2010: US\$ 14.7 million).

Share premium

Share premium represents a non-distributable reserve arising from the exercise of the Bank's Employee Share Option Plan. The reserve is credited with the difference between the proceeds from the exercise of share options and the par value of the shares issued under the plan.

Statutory reserve

In accordance with the Bahrain Commercial Companies Law and the Bank's articles of association, 10% of the profit for the year is transferred to a statutory reserve until such time as the reserve reaches 50% of the Bank's paid-up share capital. The reserve is not available for distribution, except in circumstances as stipulated in the Bahrain Commercial Companies Law and following the approval of the Central Bank of Bahrain.

General reserve

The Directors have approved a transfer of 10% (31 December 2010: 10%) of the profit of the Group for the year to general reserve in accordance with the Bank's Articles of Association. The transfer is subject to shareholders' approval at the forthcoming Annual General Meeting. The general reserve is distributable subject to the approval of the Central Bank of Bahrain.

Dividend paid

In 2010, the Bank paid a final dividend for 2009 of US cents 1.25 per issued share for a total amount of US\$ 10,249 thousand. No dividend was proposed for 2010.

Foreign currency translation reserve

The foreign currency translation reserve represents the net foreign exchange gain (loss) arising from translating the financial statements of the Bank's foreign subsidiaries and associated companies from their functional currencies into United States Dollars.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2011

17 FAIR VALUE RESERVE

	2011 US\$ 000	2010 US\$ 000
Non-trading investments		
Balance at 1 January	(11,522)	(18,018)
Transferred to consolidated statement of income upon:		
- sale related to continuing operations (note 18)	(30,478)	(3,239)
- sale related to the disposal group	-	(802)
- impairment (note 6)	23,961	13,499
Net movement in unrealised fair value during the year	7,349	(2,962)
Balance at 31 December	<u>(10,690)</u>	<u>(11,522)</u>
Cash flow hedges		
Balance at 1 January	(9,852)	(12,948)
Net movement in the fair values during the year	7,010	3,096
Balance at 31 December	<u>(2,842)</u>	<u>(9,852)</u>
	<u>(13,532)</u>	<u>(21,374)</u>

18 INVESTMENT INCOME

	2011 US\$ 000	2010 US\$ 000
Gain on acquisition of an associate	-	69,661
Loss on dilution of investment in an associate	-	(31,421)
Gain on investments carried at fair value through statement of income	4,814	11,945
Dividend income	11,785	9,702
Gain on sale of disposal group	-	43,850
Gain on sale of an associate	5,344	117
Gain on sale of available-for-sale investments (note 17)	30,478	3,239
Rental income from investment properties	307	612
Gain (loss) on sale of investment properties	117	(35)
Others	762	832
	<u>53,607</u>	<u>108,502</u>

Gain on sale of available-for-sale investments includes a loss of US\$ 1.1 million (31 December 2010: gain of US\$ 1.06 million) on the sale of securities with a carrying value of US\$ 76.3 million (31 December 2010: US\$ 0.5 million) that were carried at cost.

19 INTEREST INCOME

	2011 US\$ 000	2010 US\$ 000
Placements with banks	555	1,254
Loans and receivables	6,785	4,466
Non-trading investments	5	6,845
Demand and call deposits with banks	20	134
	<u>7,365</u>	<u>12,699</u>

20 FEES AND COMMISSIONS

	2011 US\$ 000	2010 US\$ 000
Management fees from fiduciary activities	13,316	26,913
Advisory fees	2,179	3,564
Credit related fees, commissions and other income	1,524	16
	<u>17,019</u>	<u>30,493</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2011

21 SHARE OF RESULTS OF ASSOCIATES AND JOINT VENTURES ACCOUNTED FOR UNDER THE EQUITY METHOD - NET

	2011	2010
	US\$ 000	US\$ 000
Al-Dhiyafa Holding Company K.S.C. (closed)	(300)	(352)
Al Sharq Financial Brokerage Co.	69	345
Dhow Development Company	-	-
Burgan Bank	33,771	4,539
KAMCO Energy Service Fund	(2,628)	-
Kuwait Private Equity Opportunities Fund	(2,524)	(1,202)
Manafae Investment Company	(2,419)	(642)
Millennium Private Equity Limited	-	(1,906)
North Africa Holding Company	(5,774)	(2,651)
Overland Real Estate Company	(1,091)	-
Royal Capital Company P.S.C.	(987)	(764)
SSH Dar International W.L.L.	(708)	1,284
Syria Gulf Bank	1,560	(1,129)
Takaful Savings and Pensions B.S.C. (c)	-	-
United Capital Transport Company	4,492	-
United Industries Company	1,495	6,372
United Network Company	(317)	179
United Real Estate Company	7,117	5,602
United Real Estate Company - Syria	-	-
United Real Estate Company - Jordan	(51)	(333)
United Universal Real Estate Company	-	50
Kuwait Education Fund	-	(210)
	31,705	9,182

22 INTEREST EXPENSE

	2011	2010
	US\$ 000	US\$ 000
Loans payable	38,269	23,446
Due to banks and other financial institutions	5,641	10,032
Subordinated debt	2,209	1,941
Deposits from customers	5,306	9,326
Bonds	2,145	4,517
	53,570	49,262

23 PROFIT FROM DISCONTINUED OPERATIONS

Pursuant to a master transfer agreement [MTA] with Burgan Bank, a related party, the Group had, at 31 December 2008, classified two subsidiaries Gulf Bank Algeria [GBA] and Tunis International Bank [TIB] and an associated company, Bank of Baghdad [BOB] as assets held for sale (disposal group) in accordance with IFRS 5. Subsequently, the transfers of GBA and BOB were completed in March 2009.

On 29 June 2010, the Bank transferred the ownership of TIB to Burgan Bank for a total consideration of US\$ 120,000 thousand to conclude the transfer of disposal group to Burgan Bank as per the MTA.

The results of disposal group are as follows:

*Period from
1 January
2010 to
29 June 2010
US\$ 000*

Investment income	1,983
Interest income	3,412
Fees and commissions	1,574
Foreign currency translation gains - net	2,109
Share of results of associates forming part of discontinued operations	
Gulf Bank Algeria	2,585
Bank of Baghdad	-
Total income	11,663
Interest expense	(959)
Operating income before expenses and provisions	10,704
Salaries and benefits	(1,812)
General and administrative expenses	(2,331)
Operating income before provisions	6,561
Provision for doubtful loans, guarantees and other assets - net	(475)
Net profit from discontinued operations	6,086
Earnings per share from discontinued operations	
Basic earnings per share (US cents)	0.39
Diluted earnings per share (US cents)	0.39

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2011

24 EARNINGS PER SHARE*Basic*

Basic earnings per share is calculated by dividing the profit attributable to the equity shareholders of the Bank by the weighted average number of shares outstanding during the year as follows:

	2011 US\$ 000	2010 US\$ 000
Profit attributable to equity shareholders of the Bank	1,471	38,657
Weighted average number of shares outstanding during the year (in thousands)	822,873	821,106
Basic earnings per share (US cents)	0.18	4.71

Diluted

Diluted earnings per share is calculated by dividing the income attributable to the equity shareholders of the Bank, adjusted for the effect of conversion of employees' share options, by the weighted average number of ordinary shares outstanding during the year plus the weighted average number of ordinary shares that would be issued on the conversion of all employees' share options. The Bank has outstanding share options, issued under the Employee Stock Options Plan, which have a dilutive effect on earnings.

	2011 US\$ 000	2010 US\$ 000
Profit attributable to equity shareholders of the Bank	1,471	38,657
Weighted average number of shares outstanding during the year (in thousands)	822,873	821,106
Effect of dilutive potential ordinary shares:		
Share options (in thousands)	304	736
	823,177	821,842
Diluted earnings per share (US cents)	0.18	4.70

25 FUNDS UNDER MANAGEMENT

At 31 December 2011, the Group holds assets amounting to US\$ 7,070 million (31 December 2010: US\$ 8,006 million) under its management on behalf of third parties. As these are third party funds managed in a fiduciary capacity, without risk or recourse to the Group, these are not included in assets in the consolidated statement of financial position.

26 CASH AND CASH EQUIVALENTS

	2011 US\$ 000	2010 US\$ 000
Demand and call deposits with banks	17,857	27,914
Placements with original maturities of ninety days or less	101,963	167,204
	119,820	195,118

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2011

27 SEGMENTAL INFORMATION

Following the management approach of IFRS 8, operating segments are reported in accordance with the internal reporting provided to the Acting Chief Executive Officer (the chief operating decision-maker), who is responsible for allocating resources to the reportable segments and assessing their performance. All operating segments reported by the Group meet the definition of a reportable segment under IFRS 8.

For management purposes, the Group is organised into business units based on the nature of their operations and services. The Group has two reportable operating segments being 'asset management and investment banking' and 'commercial banking'.

Asset management and investment banking Undertaking asset portfolio management, corporate finance, advisory, investments in quoted and private equity/funds, real estate, capital markets, international banking and treasury activities.

Commercial banking Loans and other credit facilities, deposit and current accounts from corporate and institutional customers.

Management monitors the operating results of its business units separately for the purpose of making decisions about resource allocation and performance assessment. Transactions between segments are generally recorded at estimated market rates.

Segmental information relating to the Group's continuing and discontinued operations for the year ended 31 December 2011 was as follows:

Statement of income	Asset management and investment banking US\$ 000	Commercial banking US\$ 000	Eliminations US\$ 000	Total US\$ 000
Income from external customers	76,840	-	-	76,840
Share of results of associates and joint ventures accounted for using the equity method	(3,626)	35,331	-	31,705
Total income	73,214	35,331	-	108,545
Operating income before provisions	21,325	-	-	21,325
Impairment loss on investments	(23,961)	-	-	(23,961)
Write-back of (provision for) doubtful loans, guarantees and other assets - net	(398)	-	-	(398)
Profit for the year	(3,034)	-	-	(3,034)
Income attributable to equity shareholders of the parent				1,471
Loss attributable to non-controlling interests				(4,505)
				(3,034)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2011

27 SEGMENTAL INFORMATION (continued)

	Asset management and investment banking US\$ 000	Commercial banking US\$ 000	Eliminations US\$ 000	Total US\$ 000
Statement of financial position				
Investments in associates and joint ventures accounted for under equity method	539,158	463,782	-	1,002,940
Segment assets	1,306,722	463,782	-	1,770,504
Segment liabilities	1,167,350	-	-	1,167,350

Segmental information for the year ended 31 December 2010 was as follows:

	Asset management and investment banking US\$ 000	Commercial banking* US\$ 000	Eliminations US\$ 000	Total US\$ 000
Statement of income				
Income from external customers	154,066	9,078	-	163,144
Share of results of associates and joint ventures accounted for using equity method	5,772	5,995	-	11,767
Total income	159,838	15,073	-	174,911
Operating income before provisions	65,433	6,561	-	71,994
Impairment loss on investments	(29,280)	-	-	(29,280)
Write back of (provision for doubtful), loans, guarantees and other assets - net	149	(475)	-	(326)
Profit for the year	36,302	6,086	-	42,388
Income attributable to equity shareholders of the parent				38,657
Profit attributable to non-controlling interests				3,731
				42,388
Statement of financial position				
Investments in associates and joint venture accounted for under equity method	582,332	443,733	-	1,026,065
Segment assets	1,473,352	443,733	-	1,917,085
Segment liabilities	1,316,311	-	-	1,316,311

* Includes income (loss) on assets held as disposal group.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2011

27 SEGMENTAL INFORMATION (continued)

Geographical segments

The Group operates in five geographic markets: Domestic region (G.C.C.*), Middle East and North Africa, Europe, North America and others. The following table shows the distribution of the Group's total income and non-current assets by geographical segment, allocated based on the location of the customers and assets for the years ended 31 December 2011 and 2010:

	<i>G.C.C.</i> <i>US\$ 000</i>	<i>Middle East and North Africa US\$ 000</i>	<i>Europe US\$ 000</i>	<i>North America US\$ 000</i>	<i>Others US\$ 000</i>	<i>Total US\$ 000</i>
31 December 2011						
Total income (loss)	73,192	(1,187)	7,282	29,258	-	108,545
Non-current assets	1,240,722	21,369	27,831	179,511	-	1,469,433
31 December 2010						
Total income	110,057	54,902	4,323	5,548	81	174,911
Non-current assets	1,239,146	108,311	29,528	69,366	-	1,446,351

* The Gulf Co-operation Council (G.C.C.) countries are Kingdom of Bahrain, State of Kuwait, Kingdom of Saudi Arabia, State of Qatar, the United Arab Emirates and the Sultanate of Oman.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2011

28 RELATED PARTY TRANSACTIONS

Related parties represent the parent, associates and joint ventures, directors and key management personnel and entities which are controlled, jointly controlled or significantly influenced by any of the above mentioned parties.

The income and expenses in respect of related parties transactions during the year and included in the consolidated financial statements are as follows:

	2011			Total US\$ 000
	Parent US\$ 000	Associates and joint ventures US\$ 000	Other related parties US\$ 000	
Loss on investments carried at fair value through statement of income, net	-	(81)	(83)	(164)
Gain on sale of non-trading investments	-	-	23,136	23,136
Gain on sale of an associate	-	4,757	-	4,757
Fees and commissions	2,604	359	8,222	11,185
Dividend income	5	-	3	8
Interest income	1	971	842	1,814
Interest expense	(3,795)	(8,688)	(2,229)	(14,712)
Others	-	-	759	759
Sales transactions				
Investments carried at fair value through statement of income	-	14,655	-	14,655
Non-trading investments	-	83,240	45,000	128,240
Investments in associated companies	-	63,811	-	63,811
Purchase transactions				
Non-trading investments	88,021	-	45,000	133,021
Investments in associated companies	-	1,157	4,111	5,268
	2010			Total US\$ 000
	Parent US\$ 000	Associates and joint ventures US\$ 000	Other related parties US\$ 000	
Gain on investments carried at fair value through statement of income, net	148	2,610	949	3,707
Gain on acquisition of an associate	-	-	69,661	69,661
Loss on sale of non-trading investments	(1)	-	(1,490)	(1,491)
Gain on sale of disposal group	-	-	43,850	43,850
Gain on sale of an associate	109	8	-	117
Fees and commissions	8,061	7,238	7,910	23,209
Dividend income	8	227	1,634	1,869
Interest income	-	8,444	1,157	9,601
Interest expense	(8,637)	(10,350)	(1,413)	(20,400)
Others	-	477	642	1,119
Sales transactions				
Investments in associated companies	-	-	38,453	38,453
Disposal group	-	120,000	-	120,000
Purchase transactions				
Non-trading investments	-	-	18,904	18,904
Investments in associated companies	220,978	-	-	220,978

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2011

28 RELATED PARTY TRANSACTIONS (continued)

The year-end balances in respect of related parties included in the consolidated financial statements are as follows:

	2011			
	Parent US\$ 000	Associates and joint ventures US\$ 000	Other related parties US\$ 000	Total US\$ 000
Demand and call deposits with banks	-	9,446	536	9,982
Placements with banks	-	1,077	9,827	10,904
Investments, carried at fair value through statement of income	1,752	2,046	2,536	6,334
Investments, carried at fair value through statement of income, in funds managed by related party	-	-	12,036	12,036
Non-trading investments	-	-	12,378	12,378
Loans and receivables	-	2,741	8,849	11,590
Other assets	995	19,812	7,771	28,578
Due to banks and other financial institutions	-	(130,687)	(20,105)	(150,792)
Deposits from customers	(183)	(12)	(61,824)	(62,019)
Loans	-	(355,629)	-	(355,629)
Other liabilities	-	(4,886)	(3,652)	(8,538)
<i>Off statement of financial position items:</i>				
Letters of credit	-	500	18,485	18,985
Letters of guarantee	-	18,309	32,642	50,951
Funds managed or advised by the Group (including funds under management)	-	-	74,155	74,155
	2010			
	Parent US\$ 000	Associates and joint ventures US\$ 000	Other related parties US\$ 000	Total US\$ 000
Demand and call deposits with banks	-	12,310	111	12,421
Placements with banks	-	7,119	4,889	12,008
Investments, carried at fair value through statement of income	1,592	-	16,712	18,304
Investments, carried at fair value through statement of income, in funds managed by related party	-	-	11,967	11,967
Non-trading investments	-	-	63,148	63,148
Loans and receivables	-	31,822	2,755	34,577
Other assets	895	21,075	11,776	33,746
Due to banks and other financial institutions	-	(227,400)	(25,331)	(252,731)
Deposits from customers	(40,708)	(71,201)	(19,672)	(131,581)
Loans	-	(114,556)	-	(114,556)
Other liabilities	(229)	(1,002)	(2,007)	(3,238)
<i>Off statement of financial position items:</i>				
Letters of credit	-	500	20,275	20,775
Letters of guarantee	-	356	18,733	19,089
Funds managed or advised by the Group (including funds under management)	-	-	81,546	81,546

At 31 December 2011

28 RELATED PARTY TRANSACTIONS (continued)**Compensation of key management personnel was as follows:**

	2011 US\$ 000	2010 US\$ 000
Short term employee benefits	8,792	11,502
Share based payments	33	1,176
Total compensation	<u>8,825</u>	<u>12,678</u>

29 COMMITMENTS AND CONTINGENCIES***Credit-related commitments***

Credit-related commitments include commitments to extend credit, standby letters of credit, guarantees and acceptances which are designed to meet the requirements of the Group's customers.

Letters of credit, guarantees (including standby letters of credit) and acceptances commit the Group to make payments on behalf of customers if certain conditions are met under the terms of the contract.

The Group has the following credit and investment related commitments:

	2011 US\$ 000	2010 US\$ 000
Credit related		
Letters of credit	18,984	20,775
Letters of guarantee	50,951	19,089
	<u>69,935</u>	<u>39,864</u>
Investment related *	122,182	86,349
	<u>192,117</u>	<u>126,213</u>

* Investment related commitments represent commitments for capital calls of fund structures. These commitments can be called during the investment period of the fund which is normally 1 to 5 years.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2011

30 DERIVATIVES

In the ordinary course of business the Group enters into various types of transactions that involve derivative financial instruments.

	<i>Positive fair value US\$ 000</i>	<i>Negative fair value US\$ 000</i>	<i>Notional amounts by term to maturity</i>			
			<i>Notional amount Total US\$ 000</i>	<i>Within 3 months US\$ 000</i>	<i>3 - 12 months US\$ 000</i>	<i>1 - 5 years US\$ 000</i>
31 December 2011						
<i>Derivatives held for trading *</i>						
Forward foreign exchange contracts	3,454	(3,104)	300,534	131,444	82,882	86,208
<i>Derivatives used as hedge of net investments in foreign operations</i>						
Forward foreign exchange contracts	1,887	(120)	847,225	656,944	46,796	143,485
Cross currency swaps	-	(6,412)	406,411	-	406,411	-
<i>Derivatives used as cash flow hedges</i>						
Interest rate swap	-	(2,842)	200,000	100,000	100,000	-
31 December 2010						
<i>Derivatives held for trading *</i>						
Forward foreign exchange contracts	2,213	(2,085)	334,184	210,326	123,858	-
<i>Derivatives used as hedge of net investments in foreign operations</i>						
Forward foreign exchange contracts	47	(1,060)	801,344	770,109	31,235	-
Cross currency swaps	-	(4,648)	404,648	-	-	404,648
<i>Derivatives used as cash flow hedges</i>						
Interest rate swap	-	(9,852)	300,000	-	-	300,000

Forward foreign exchange contracts are contractual agreements to either buy or sell a specified currency, at a specific price and date in the future, and are customised contracts transacted in the over-the-counter market.

* The Group uses foreign currency denominated borrowings and forward currency contracts to manage some of its transaction exposures. These currency forward contracts are not designated as cash flow, fair value or net investment in foreign operations hedges and are entered into for periods consistent with currency transaction exposures.

Swaps are contractual agreements between two parties to exchange interest or foreign currency differentials based on a specific notional amount. For interest rate swaps, counterparties generally exchange fixed and floating rate interest payments based on a notional value in a single currency.

Hedge of net investments in foreign operations

The Bank has designated certain forward foreign exchange contracts and cross currency swaps to hedge against changes in the value of investments in associated companies for an amount of US\$ 658.8 million (KWD 183.5 million) [2010: US\$ 621 million (KWD 174.5 million)]. Gains or losses on the retranslation of these forward foreign exchange contracts are transferred to equity through other comprehensive income to offset any gains or losses on the translation of the net investments in associates.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2011

30 DERIVATIVES (continued)**Cash flow hedges**

The Group is exposed to variability in interest cash flows on liabilities which bear interest at a variable rate. The Group uses interest rate swaps as cash flow hedges of these interest rate risks. A schedule indicating as at 31 December 2011 the periods when the net cash flows are expected to occur and when they are expected to affect the consolidated statement of income is as follows:

	2011		2010	
	<i>Within</i>		<i>Within</i>	
	1 year	1-5 years	1 year	1-5 years
	US\$ 000	US\$ 000	US\$ 000	US\$ 000
Net cash outflows (Liabilities)	1,926	-	7,545	9,980
Statement of income	(2,842)	-	-	(9,852)

31 RISK MANAGEMENT**a) Introduction**

Risk is inherent in the Group's activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is considered critical to the Group's continuing profitability.

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

The major risks to which the Group is exposed while conducting its business and operations, and the means and organisational structure it employs to manage them strategically for building shareholder value, are outlined below.

Risk management structure

Each subsidiary within the Group is responsible for managing its own risks and has its own Board Committees, including Audit and Executive Committees in addition to other management committees such as Credit/Investment Committee and (in the case of major subsidiaries) Asset and Liability Committees (ALCO), or equivalent, with responsibilities generally the same as the Bank's committees.

The Board's role is to approve investment strategies of the Bank. However, it has delegated authority for the day-to-day decision making to the Executive Committee so that risk can be effectively managed within the Bank.

The Board of Directors has delegated the Executive Management of the Bank to the Acting Chief Executive Officer (who is not a Director) and has appointed several Board Committees to work with him and to form and define policies and approve procedures for all of the Bank's activities.

The Executive Management of the Bank is headed by the Acting Chief Executive Officer who is broadly responsible for the day to day conduct of the Bank's business in line with the Board's approved policies and procedures and complements and facilitates the Board in meeting its responsibility towards all stakeholders. He is assisted by the seven members of the Bank's management team, each of whom is responsible for his or her respective department. Several management committees have been formed which are chaired by the Acting Chief Executive Officer.

Executive Committee

The Executive Committee comprises of four directors including the Chairman, Vice Chairman and two other directors. Board meetings are held through circulation to approve all proposals not within the Investment Committee's risk authority, as well as to act on all matters within the Board's remit.

31 RISK MANAGEMENT (continued)

a) Introduction (continued)

Risk management structure (continued)

Investment Committee

The Investment Committee is mainly responsible for approving or recommending approval to the Executive Committee limits for individual exposures, investments and concentrations towards banks, countries, industries, risk rating classes, or other special risk asset categories. In addition, the Committee also monitors the overall risk profile of the Bank and recommends provision levels to the Executive Committee. The Investment Committee is constituted by a majority motion passed in the Executive Committee. Currently the Committee consists of four members.

Audit Committee

The Audit Committee is appointed by the Board and consists of three members who are Directors, including one non-executive Director. The Board Audit Committee assists the Board in carrying out its responsibilities with respect to assessing (a) the quality and integrity of financial reporting, (b) the audit thereof, (c) the soundness of the internal controls of the Bank, (d) the risk assessment of the Bank's activities, and (e) the methods for monitoring compliance with laws, regulations and supervisory and internal policies.

Risk and Compliance Committee

The Risk and Compliance Committee is responsible for the monitoring and assessment of risks facing the Bank, the review of compliance with internal and external guidelines, the review and recommendation of provisioning requirements, the assessment of the impact on the Bank from new regulatory requirements, and review of Investment Committee decisions. The Committee comprises of eight senior executives of the Bank including the Acting Chief Executive Officer. Additionally, the Head of Internal Audit and Quality Assurance participates in the Committee meetings in the capacity of an observer.

Asset and Liability Committee

The Asset and Liability Committee establishes policies and objectives for the asset and liability management of the Bank's statement of financial position in terms of structure, distribution, risk and return and its impact on profitability. It also monitors the cash flow, tenor and cost/yield profiles of assets and liabilities and evaluates the Bank's financial position both from interest rate sensitivity and liquidity points of view, making corrective adjustments based upon perceived trends and market conditions, monitoring liquidity, monitoring foreign exchange exposures and positions. The Committee comprises of seven senior executives of the Bank including the Acting Chief Executive Officer.

Management Committee

The Management Committee acts as the steering committee of the Bank as well as a management forum to discuss any relevant issues. It meets on a weekly basis and consists of the Acting Chief Executive Officer and all Department Heads as well as Internal Audit and Quality Assurance. It also serves to follow up on a weekly basis on the daily conduct of the Bank's business activities. The Committee is headed by the Acting Chief Executive Officer.

Insider Trading Committee

The Insider Trading Committee comprises three members constituted from the Board of Directors and the Acting Chief Executive Officer as the alternate member. The Committee is mainly responsible for the supervision of adequacy of compliance with the Central Bank of Bahrain guidelines on insider trading.

Monitoring and controlling risks is primarily performed based on limits established by the Bank. These limits reflect the business strategy and market environment of the Bank as well as the level of risk that the Bank is willing to accept, with additional emphasis on selected geographies and industry sectors. In addition, the Bank monitors and measures the overall risk bearing capacity in relation to the aggregate risk exposure across all risk types and activities.

On 15 March 2011, the Ministry of Commerce and Industry of the Kingdom of Bahrain introduced a Corporate Governance Code (the Code) applicable to the Group. The Code is based upon nine core Principles of Corporate Governance that adhere to international best practices. The Code includes recommendations to apply the Principles, as well as recommendations which support the implementation of good corporate governance. The Code is issued in a "comply or explain" framework, which means companies should comply with the recommendations, or give an explanation in the case of non-compliance.

31 RISK MANAGEMENT (continued)

a) Introduction (continued)

Risk management structure (continued)

The Central Bank of Bahrain also adopted the Code and incorporated the principles in its rulebook for all locally incorporated banks. The effective date of implementation of the Code is 31 December 2011. Accordingly, during the year, significant efforts were made by the Group to further enhance its Corporate Governance practices; an additional 16 policies and procedures pertaining to Corporate Governance were approved. The overall Committee structure was also reviewed. The Directors endorsed the creation of the Nominating & Remunerations Committee, which will be a permanent committee of the Board. The CBB's approval to appoint independent Directors was received in December 2011. Consequently, this committee will be constituted after the election of independent Directors, at the next Annual General Meeting. The Board Audit Committee's scope has been expanded to include the implementation and subsequent review of the Corporate Governance requirements.

Risk mitigation

As part of its overall risk management, the Group uses derivatives and other instruments to manage exposures resulting from changes in interest rates and foreign currency transactions.

The risk profile is assessed before entering into hedge transactions, which are authorised by the appropriate level of seniority within the Group.

Where warranted, the Group enters into legally enforceable netting arrangements covering its money market and foreign exchange trading activities whereby the only net amounts may be settled at maturity. With regard to the credit risk in the off statement of financial statement exposures, third party guarantees are obtained wherever possible as a risk mitigation measure.

Concentration risk

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

In order to avoid excessive concentrations of risk, the Group's policies and procedures include specific guidelines to focus on country and counterparty limits and maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly. Robust limit structures put in place by the Board ensures effective monitoring and control of concentration risk and any limit breaches are immediately rectified and reported to the Board.

b) Credit risk

Credit risk arises from the extension of credit facilities in the Group's banking and trading activities as well as in investment activities where there is a possibility that a counterparty may fail to honour its commitment whenever an investment may fail.

Credit risk is mitigated through:

- (i) Establishing an appropriate credit risk environment;
- (ii) Operating under a sound credit and investment approval process;
- (iii) Maintaining appropriate credit administration, measurement and monitoring processes; and
- (iv) Ensuring adequate controls over the credit risk management process.

The Group has well defined policies approved at the individual board level. These provide carefully documented guidelines for credit risk management. There is a two tier committee structure to approve and review credit and investment risk. The Investment Committee (IC) comprises of the Acting Chief Executive Officer, Head of Investment Banking and Asset Management and the Chief Financial Officer. The Head of Credit and Risk Management acts as a non-voting member to the Committee. Exposures beyond IC limits are approved by the Board's Executive Committee or by the full Board.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2011

31 RISK MANAGEMENT (continued)**b) Credit risk (continued)****Maximum exposure to credit risk without taking account of any collateral or other credit enhancements**

The table below shows the Group's maximum exposure to credit risk for the components of on and off statement of financial position exposure. The maximum exposure shown is gross before the effect of mitigation through the use of master netting and collateral arrangements, but after any provision for impairment.

	2011 US\$ 000	2010 US\$ 000
Demand and call deposits with banks	17,857	27,914
Placements with banks	102,282	167,257
Non-trading investments	13,153	10,449
Loans and receivables	27,942	57,920
Other assets	31,948	43,538
Letters of credit	18,984	20,775
Letters of guarantee	50,951	19,089
Derivative financial assets	5,341	2,260
	268,458	349,202

Risk concentrations of the maximum exposure to credit risk

Concentration of risk is managed by client/counterparty, by geographical region and by industry sector. The maximum credit exposure to any single client or counterparty as of 31 December 2011 was US\$ 52.5 million (31 December 2010: US\$ 50 million) before taking account of collateral or other credit enhancements.

An analysis of the Group's financial assets by geographical region, before taking into account collateral held or other credit enhancements, is as follows:

	G.C.C. US\$ 000	Middle East and North Africa US\$ 000	Europe US\$ 000	North America US\$ 000	Others US\$ 000	Total US\$ 000
Demand and call deposits with banks	14,471	529	277	2,261	319	17,857
Placements with banks	92,406	9,876	-	-	-	102,282
Non-trading investments	13,153	-	-	-	-	13,153
Loans and receivables	4,678	2,742	16,514	4,008	-	27,942
Other assets	27,341	4,303	14	288	2	31,948
Letters of credit	18,484	500	-	-	-	18,984
Letters of guarantee	50,951	-	-	-	-	50,951
Derivative financial assets	1,393	-	3,948	-	-	5,341
31 December 2011	222,877	17,950	20,753	6,557	321	268,458
Demand and call deposits with banks	22,345	4,026	349	990	204	27,914
Placements with banks	132,367	-	30,000	4,890	-	167,257
Non-trading investments	10,449	-	-	-	-	10,449
Loans and receivables	31,934	-	23,268	2,718	-	57,920
Other assets	40,421	39	34	3,041	3	43,538
Letters of credit	20,275	500	-	-	-	20,775
Letters of guarantee	19,089	-	-	-	-	19,089
Derivative financial assets	-	102	2,158	-	-	2,260
31 December 2010	276,880	4,667	55,809	11,639	207	349,202

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2011

31 RISK MANAGEMENT (continued)**b) Credit risk (continued)****Risk concentrations of the maximum exposure to credit risk (continued)**

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

	<i>Trading and manufacturing</i>	<i>Banks and other financial institutions</i>	<i>Construction and real estate</i>	<i>Individuals</i>	<i>Others</i>	<i>Total</i>
	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>
At 31 December 2011						
Demand and call deposits						
with banks	-	17,857	-	-	-	17,857
Placements with banks	-	102,282	-	-	-	102,282
Non-trading investments	-	13,153	-	-	-	13,153
Loans and receivables	-	3,008	2,740	19,019	3,175	27,942
Other assets	-	5,898	-	18	26,032	31,948
Letters of credit	-	500	-	-	18,484	18,984
Letters of guarantee	-	18,309	-	-	32,642	50,951
Derivative financial assets	-	5,341	-	-	-	5,341
	-	166,348	2,740	19,037	80,333	268,458
At 31 December 2010						
Demand and call deposits						
with banks	-	27,914	-	-	-	27,914
Placements with banks	-	167,257	-	-	-	167,257
Non-trading investments	-	10,449	-	-	-	10,449
Loans and receivables	-	-	30,822	25,100	1,998	57,920
Other assets	5,676	7,651	20,410	4,619	5,182	43,538
Letters of credit	-	500	-	-	20,275	20,775
Letters of guarantee	-	356	-	-	18,733	19,089
Derivative financial assets	-	2,260	-	-	-	2,260
	5,676	216,387	51,232	29,719	46,188	349,202

Collateral and other credit enhancements

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are implemented regarding the acceptability of types of collateral and valuation parameters.

The main types of collateral obtained for commercial lending include charges over real estate properties, inventory, trade receivables, trading securities and bank guarantees.

The Group also obtains guarantees from parent companies for loans to their subsidiaries.

Management monitors the market value of collateral and requests additional collateral in accordance with the underlying agreement, during its review of the adequacy of the allowance for impairment losses.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2011

31 RISK MANAGEMENT (continued)**b) Credit risk (continued)****Collateral and other credit enhancements (continued)**

An industry sector analysis of the Group's gross loans and advances, before and after taking into account collateral held or other credit enhancements, is as follows:

	Gross maximum exposure 2011 US\$ 000	Net maximum exposure 2011 US\$ 000	Gross maximum exposure 2010 US\$ 000	Net maximum exposure 2010 US\$ 000
Commercial loans	27,365	10,851	57,376	34,596
Overdrafts	-	-	488	488
Staff loans	3,306	-	2,762	-
	30,671	10,851	60,626	35,084

Credit risk exposure for each credit rating

	Investment grade US\$ 000	Non- investment grade US\$ 000	Unrated US\$ 000	Total US\$ 000
At 31 December 2011				
Demand and call deposits with banks	16,929	388	540	17,857
Placements with banks	92,405	5,000	4,877	102,282
Non-trading investments	-	-	13,153	13,153
Loans and receivables	-	-	27,942	27,942
Other assets	-	-	31,948	31,948
Letters of credit	-	-	18,984	18,984
Letters of guarantee	359	-	50,592	50,951
Derivative financial assets	5,341	-	-	5,341
	115,034	5,388	148,036	268,458

At 31 December 2010

Demand and call deposits with banks	27,651	177	86	27,914
Placements with banks	162,367	-	4,890	167,257
Non-trading investments	872	9,577	-	10,449
Loans and receivables	-	-	57,920	57,920
Other assets	2,968	1,525	39,045	43,538
Letters of credit	-	-	20,775	20,775
Letters of guarantee	-	-	19,089	19,089
Derivative financial assets	2,260	-	-	2,260
	196,118	11,279	141,805	349,202

It is the Group's policy to maintain accurate and consistent risk ratings across the credit portfolio. This facilitates focused management of the applicable risk and the comparison of credit exposures across all business lines, geographic regions and products. All externally rated credit risk exposures are rated by the relevant External Credit Assessment Institutions ("ECAIs").

Additionally, the internal risk ratings of the Group's externally unrated credit risk exposures which are largely subjective, are tailored to the various categories and are derived in accordance with the internal rating policy and practices. The attributable internal risk ratings are assessed and updated on a regular basis.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2011

31 RISK MANAGEMENT (continued)**b) Credit risk (continued)**

The table above reflects the risk ratings of the credit risk exposures rated by the relevant ECAs. All of the externally unrated credit risk exposures have been classified under "Unrated" category.

Renegotiated loans

Where possible, the Group seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, the loan is no longer considered past due. The Group had no renegotiated loans as of 31 December 2011 or 31 December 2010.

c) Market risk

Market risk is defined as the risk of losses in the value of on-or-off statement of financial position financial instruments caused by a change in market prices or rates, (including changes in interest rates and foreign exchange rates). The Group's policy guidelines for market risk have been vetted by the Board of Directors in compliance with the rules and guidelines provided by the Central Bank of Bahrain. The Central Bank of Bahrain guidelines introduced a risk measurement framework whereby all locally incorporated banks in Bahrain are required to measure and apply capital charges in respect of their market risk in addition to capital requirements for credit risk and operational risk.

The market risk subject to capital charge normally arises from changes in value due to market forces in the following exposures:

- Interest rate instruments and securities in the trading book; and
- Foreign exchange throughout the banking book.

The Group has entered into interest rate swaps and forward foreign exchange contracts for hedging purposes and does not actively trade in derivatives.

Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments. Positions are monitored on a daily basis and hedging strategies are used to ensure positions are maintained within the established limits.

The following table demonstrates the sensitivity to a reasonably possible change in interest rates, with all other variables held constant, of the Group's consolidated statement of income based on the consolidated statement of financial position as of 31 December:

Currency	Sensitivity of		Sensitivity of	
	Increase in	net interest	Increase in	net interest
	basis	income	basis	income
	points	2011	points	2010
	2011	US\$ 000	2010	US\$ 000
Kuwaiti Dinar	+ 25	(954)	+ 25	(1,165)
United States Dollar	+ 25	(830)	+ 25	(442)
Euro	+ 25	(13)	+ 25	(46)
Pound Sterling	+ 25	1	+ 25	(1)
Others	+ 25	(114)	+ 25	(44)

The decrease in the basis points will have an opposite impact on the net interest income.

The sensitivity of the consolidated statement of income is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate financial assets and financial liabilities held at 31 December 2011, including the effect of hedging instruments.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2011

30 RISK MANAGEMENT (continued)**c) Market risk (continued)****Currency risk**

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Group considers the United States Dollar as its functional currency. Positions are monitored on a daily basis and hedging strategies used to ensure positions are maintained within established limits.

The table below indicates the effect on profit before tax for the positions as at statement of financial position date as a result of change in the currency rate with all other variables held constant.

Currency

	<i>Change in currency rate in % 2011</i>	<i>Effect on profit before tax 2011 US\$ 000</i>	<i>Effect on equity 2011 US\$ 000</i>	<i>Change in currency rate in % 2010</i>	<i>Effect on profit before tax 2010 US\$ 000</i>	<i>Effect on equity 2010 US\$ 000</i>
Kuwaiti Dinar	+2	(15,871)	2,719	+1	(10,431)	1,903
	-2	15,871	(2,719)	-1	10,431	(1,903)
Euro	+2	(303)	-	+1	(279)	223
	-2	303	-	-1	279	(223)
Jordanian Dinar	+2	-	-	+1	-	6
	-2	-	-	-1	-	(6)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2011

31 RISK MANAGEMENT (continued)

c) Market risk (continued)

Equity price risk

Equity price risk arises from the change in fair values of equity investments. The Group manages this risk through diversification of investments in terms of geographical distribution and industry concentration.

The geographical distribution of the Group's equity investments is as follows:

Geographical distribution

At 31 December 2011	Middle East/ North Africa US\$ 000	Europe US\$ 000	North America US\$ 000	Total US\$ 000
Investments carried at fair value through statement of income				
Quoted equities	24,130	-	102	24,232
Managed funds	25,958	16,596	6,397	48,951
	50,088	16,596	6,499	73,183
Non-trading investments				
Quoted equities	43,395	-	-	43,395
Unquoted equities	51,952	22,973	6,780	81,705
Managed funds	119,365	4,859	172,496	296,720
	214,712	27,832	179,276	421,820
Total	264,800	44,428	185,775	495,003
At 31 December 2010	Middle East/ North Africa US\$ 000	Europe US\$ 000	North America US\$ 000	Total US\$ 000
Investments carried at fair value through statement of income				
Quoted equities	29,137	-	59	29,196
Managed funds	62,406	19,466	15,593	97,465
	91,543	19,466	15,652	126,661
Non trading investments				
Quoted equities	45,102	-	-	45,102
Unquoted equities	100,956	25,280	6,376	132,612
Managed funds	130,396	4,221	62,990	197,607
	276,454	29,501	69,366	375,321
Total	367,997	48,967	85,018	501,982

Any change in equity price index or the net asset values of the above financial instruments will have a direct impact on income or equity. The majority of the equities in the Middle East/North Africa region are quoted on the Kuwait Stock Exchange.

For unquoted investments carried at cost the impact of the changes in the equity prices will only be reflected in the consolidated statement of income when the investment is sold or deemed to be impaired.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2011

31 RISK MANAGEMENT (continued)

d) Liquidity risk

Analysis of financial liabilities by remaining contractual maturities

The table below summarises the maturity profile of the Group's financial liabilities at 31 December 2011 based on contractual undiscounted repayment obligations. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Group expects that many customers will not request repayment on the earliest date the Group could be required to pay and the table does not reflect the expected cash flows indicated by the Group's deposit retention history.

At 31 December 2011

Financial liabilities

	On demand US\$ 000	1 - 6 months US\$ 000	6 - 12 months US\$ 000	1 - 5 years US\$ 000	5 - 10 years US\$ 000	Total US\$ 000
Due to banks and other financial institutions	197,614	15,063	251	-	-	212,928
Deposits from customers	22,556	56,783	1,411	-	-	80,750
Loans payable	8,094	56,688	211,621	525,614	-	802,017
Subordinated debt	-	-	-	114,834	-	114,834
Other liabilities	5,827	-	27,158	11,036	-	44,021
Total non-derivative undiscounted financial liabilities	234,091	128,534	240,441	651,484	-	1,254,550

Total non-derivative undiscounted financial liabilities

Off statement of financial position items

	1 - 6 months US\$ 000	6 - 12 months US\$ 000	1 - 5 years US\$ 000	Total US\$ 000
Net cash outflows on interest rate swaps	2,844	-	-	2,844
Gross settled foreign currency derivatives	918,065	406,412	229,693	1,554,170
Letters of credit	-	18,984	-	18,984
Letters of guarantee	-	50,951	-	50,951

United Gulf Bank B.S.C.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2011

31 RISK MANAGEMENT (continued)

d) Liquidity risk (continued)

At 31 December 2010

	On demand US\$ 000	1 - 6 months US\$ 000	6 - 12 months US\$ 000	1 - 5 years US\$ 000	5 - 10 years US\$ 000	Total US\$ 000
Financial liabilities						
Due to banks and other financial institutions	193,066	209,582	35,757	-	-	438,405
Deposits from customers	128,557	5,938	-	10,937	-	145,432
Loans payable	47,337	206,478	33,611	227,224	-	514,650
Bonds	-	73,326	-	-	-	73,326
Subordinated debt	-	1,050	1,068	10,602	99,542	112,262
Other liabilities	5,610	25,826	-	8,704	-	40,140
Total non-derivative undiscounted financial liabilities	374,570	522,200	70,436	257,467	99,542	1,324,215

Off statement of financial position items

	1 - 6 months US\$ 000	6 - 12 months US\$ 000	1 - 5 years US\$ 000	Total US\$ 000
Net cash outflows on interest rate swaps	-	7,545	9,980	17,525
Gross settled foreign currency derivatives	1,066,338	69,191	404,647	1,540,176
Letters of credit	-	20,775	-	20,775
Letters of guarantee	-	-	19,089	19,089

The Group expects that not all of contingent items or commitments will be drawn before expiry of the commitments.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2011

31 RISK MANAGEMENT (continued)**d) Liquidity risk (continued)**

In order to ensure that the Group can meet its financial obligations as they fall due, there is a close monitoring of its assets / liabilities position. Besides other functions, the Asset-Liability Committee evaluates the statement of financial position both from a liquidity and an interest rate sensitivity point of view. The whole process is aimed at ensuring sufficient liquidity to fund its ongoing business activities and to meet its obligations as they fall due. A diversified funding base has evolved in deposits raised from the interbank market, deposits received from customers and medium term funds raised through syndicated and commodity based murabaha transactions. These, together with the strength of its equity and the asset quality, ensure that funds are made available on competitive rates.

The maturity analysis of assets and liabilities analysed according to when they are expected to be recovered or settled are as follows:

At 31 December 2011

	<i>Less than 12 months US\$ 000</i>	<i>Over 12 months US\$ 000</i>	<i>Total US\$ 000</i>
Demand and call deposits with banks	17,539	318	17,857
Placements with banks	102,282	-	102,282
Investments carried at fair value through statement of income	73,183	-	73,183
Non-trading investments	43,395	391,633	435,028
Loans and receivables	27,181	761	27,942
Other assets	37,490	-	37,490
Investments in associates and joint ventures	-	1,002,940	1,002,940
Investment properties	-	16,054	16,054
Property and equipment	-	946	946
Goodwill	-	56,782	56,782
Total assets	301,070	1,469,434	1,770,504
Due to banks and other financial institutions	211,795	-	211,795
Deposits from customers	80,349	-	80,349
Loans payable	273,596	457,589	731,185
Subordinated debt	-	100,000	100,000
Other liabilities	32,985	11,036	44,021
Total liabilities	598,725	568,625	1,167,350
Net	(297,655)	900,809	603,154

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2011

31 RISK MANAGEMENT (Continued)**d) Liquidity risk (continued)**

At 31 December 2010

	<i>Less than 12 months US\$ 000</i>	<i>Over 12 months US\$ 000</i>	<i>Total US\$ 000</i>
Demand and call deposits with banks	27,861	53	27,914
Placements with banks	167,257	-	167,257
Investments carried at fair value through statement of income	126,661	-	126,661
Non-trading investments	45,102	340,668	385,770
Loans and receivables	56,922	998	57,920
Other assets	46,930	20	46,950
Investments in associates and joint venture	-	1,026,065	1,026,065
Investment properties	-	21,178	21,178
Property and equipment	-	1,074	1,074
Goodwill	-	56,296	56,296
Total assets	470,733	1,446,352	1,917,085
Due to banks and other financial institutions	200,624	235,000	435,624
Deposits from customers	128,889	10,679	139,568
Loans payable	283,180	218,252	501,432
Bonds	71,187	-	71,187
Subordinated debt	-	100,000	100,000
Other liabilities	59,796	8,704	68,500
Total liabilities	743,676	572,635	1,316,311
Net	(272,943)	873,717	600,774

e) Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. When controls fail to perform operational risk can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Group cannot expect to eliminate all operational risks, but through a control framework and by monitoring and responding to potential risks, the Group is able to manage the risks. Controls include effective segregation of duties, access, authorisation and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2011

32 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.

Fair values of quoted securities are derived from quoted market prices in active markets, if available. For unquoted securities, fair value is estimated using appropriate valuation techniques. Such techniques may include using recent arm's length market transactions; reference to the current fair value of another instrument that is substantially the same; discounted cash flow analysis or other valuation models.

The fair values of the funds that are listed on active markets are determined by reference to their quoted bid prices. The fair values of unlisted funds are based on net asset values which are determined by the fund manager using the quoted market prices of the underlying assets, if available, or other acceptable methods such as a recent price paid by another investor or the market value of a comparable company.

The Group 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 following table shows an analysis of financial instruments recorded at fair value by level of the fair value hierarchy at 31 December 2011:

	Level 1 US\$ 000	Level 2 US\$ 000	Level 3 US\$ 000	Total US\$ 000
Investments carried at fair value through statement of income				
Quoted equities	24,232	-	-	24,232
Quoted managed funds	19,076	-	-	19,076
Unquoted managed funds	-	29,875	-	29,875
	43,308	29,875	-	73,183
Non-trading investments				
<i>Quoted securities</i>				
Equities	43,395	-	-	43,395
<i>Unquoted securities</i>				
Equities	-	13,831	1,560	15,391
Real estate managed funds	-	8,537	8,023	16,560
Other managed funds	-	249,580	8,952	258,532
Debt securities	-	-	13,207	13,207
	43,395	271,948	31,742	347,085
	86,703	301,823	31,742	420,268

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2011

32 FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

The following table shows an analysis of financial instruments recorded at fair value by level of the fair value hierarchy at 31 December 2010:

	<i>Level 1</i> <i>US\$ 000</i>	<i>Level 2</i> <i>US\$ 000</i>	<i>Level 3</i> <i>US\$ 000</i>	<i>Total</i> <i>US\$ 000</i>
Investments carried at fair value through statement of income				
Quoted equities	29,196	-	-	29,196
Quoted managed funds	51,116	-	-	51,116
Unquoted managed funds	-	46,349	-	46,349
	<u>80,312</u>	<u>46,349</u>	<u>-</u>	<u>126,661</u>
Non-trading investments				
<i>Quoted securities</i>				
Equities	44,690	-	412	45,102
<i>Unquoted securities</i>				
Equities	-	28,437	2,309	30,746
Real estate managed funds	-	9,223	9,411	18,634
Other managed funds	-	157,234	7,565	164,799
Debt securities	-	-	10,449	10,449
	<u>44,690</u>	<u>194,894</u>	<u>30,146</u>	<u>269,730</u>
	<u>125,002</u>	<u>241,243</u>	<u>30,146</u>	<u>396,391</u>

Transfers between Level 1, Level 2 and Level 3

During the year ended 31 December 2011 there were no transfers between Level 1 and Level 2 fair value measurements and no transfers into or out of Level 3 fair value measurement.

The fair values of other on statement of financial position financial instruments are not significantly different from the carrying values included in the consolidated financial statements except for non-trading investments carried at cost (note 6) and the following:

The table below sets out the carrying value and the fair value of the financial instruments where fair values are materially different from their carrying values:

	<i>2011</i>		<i>2010</i>	
	<i>Carrying value</i>	<i>Fair value</i>	<i>Carrying value</i>	<i>Fair value</i>
	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>
Subordinated debt	100,000	72,125	100,000	49,000

33 CAPITAL ADEQUACY

The Bank maintains an actively managed capital base to cover risks inherent in the business. The adequacy of the Bank's capital is monitored using, among other measures, the rules and ratios established by the Basel Committee on Banking Supervision ("BIS rules/ratios") as adopted by the Central Bank of Bahrain.

Capital management

The primary objectives of the Group's capital management are to ensure that the Group complies with capital requirements of the Central Bank of Bahrain and that the Group maintains strong credit ratings and healthy capital ratios in order to support its business and to maximise shareholders' value. In order to maintain or adjust the capital structure, the Bank may adjust the amount of dividend payment to shareholders, or issue equity securities. No changes were made in the capital management objectives, policies and processes from previous years.

The risk asset ratio calculated in accordance with the capital adequacy guidelines issued by the Central Bank of Bahrain, for the Group is as follows:

	2011	2010
	US\$ 000	US\$ 000
Capital base:		
Tier 1 capital	422,795	414,502
Tier 2 capital	-	77,525
Total capital base (a)	422,795	492,027
Credit risk weighted exposure	2,103,951	2,186,779
Market risk weighted exposure	161,675	275,175
Operational risk weighted exposure	56,526	66,834
Total risk weighted exposure (b)	2,322,152	2,528,788
Capital adequacy (a/b * 100)	18.21%	19.46%
Minimum requirement	12.0%	12.0%

Regulatory capital consists of Tier 1 capital, which comprises share capital, share premium, statutory reserve, general reserve, treasury share reserve, foreign currency reserve, retained earnings and non-controlling interests less goodwill. The other component of regulatory capital is Tier 2 capital, which includes subordinated long term debt and fair value reserves.