





Custodian of The Two Holy Mosques  
**King Abdullah Bin Abdulaziz Al-Saud**



**HRH Prince Naif Bin Abdulaziz Al-Saud**  
Crown Prince, Deputy Prime Minister  
and Minister of Interior

### Head Office

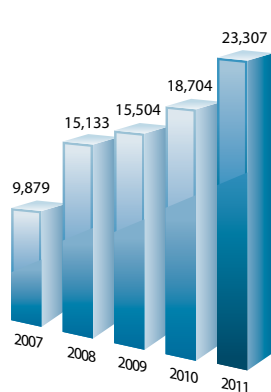
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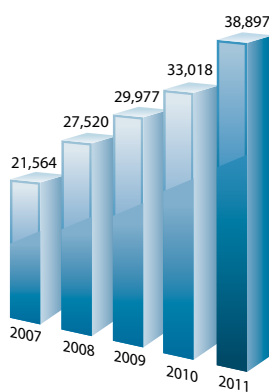
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## Financial Highlights

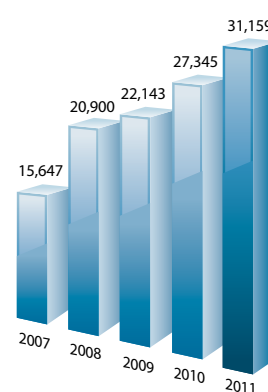
(In SAR millions, except where indicated)	2007	2008	2009	2010	2011
Loans and advances, net	9,879	15,133	15,504	18,704	23,307
Total assets	21,564	27,520	29,977	33,018	38,898
Customer deposits	15,647	20,900	22,143	27,345	31,159
Shareholders' equity	4,698	4,637	4,486	4,516	4,733
Net special commission income	595	631	668	717	781
Fee income	698	538	376	265	356
Gain on investments, exchange and other	153	(32)	127	172	70
Total operating income	1,447	1,137	1,171	1,155	1,208
Net income	805	222	28	29	303
Net income growth (%)	(59.2)	(72.4)	(87.6)	5.0	945
Return on average equity (%)	18.11	4.76	0.60	0.64	6.55
Return on average assets (%)	4.32	0.91	0.10	0.09	0.84
Earnings per share (SAR)	2.68	0.74	0.09	0.10	1.01



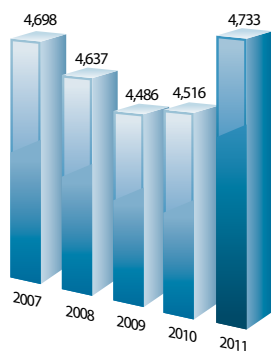
Net Loans and Advances  
SAR millions



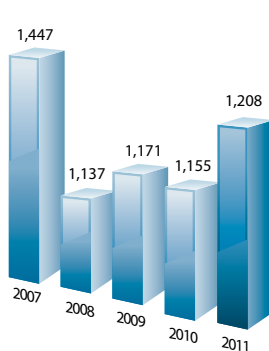
Total Assets  
SAR millions



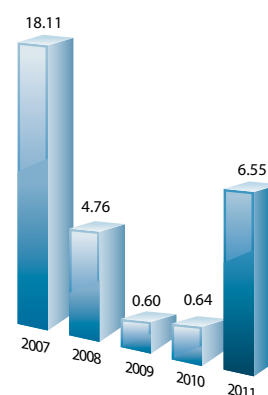
Customer Deposits  
SAR millions



Shareholders' Equity  
SAR millions



Operating Income  
SAR millions



Return on Average Equity  
SAR millions

## OUR MISSION

WE ARE A CLIENT-DRIVEN, SERVICE ORIENTED SAUDI FINANCIAL GROUP WHICH PROVIDES INDIVIDUALS, BUSINESSES AND INSTITUTIONS WITH INNOVATIVE SHARIA'H COMPLIANT FINANCIAL SERVICES THROUGH PROFESSIONAL AND DEDICATED STAFF.



## Board of Directors



**Taha A. Al-Kuwaiz**  
Chairman of the Board



Abdul Majeed I. Al-Sultan



Abdullah S. Kamel



Tarek O. Al-Kasabi



Khalid O. Al-Baltan



Mohammed A. Al-Angari



Khalifa A. Al-Mulhem



Mohammed A. Al-Hagbani

Praises be to Allah, The Almighty, The Lord of the worlds, and Prayers and Peace be upon his Messenger Prophet Mohammed, and his Descendents and all his Followers.

### Dear Shareholders,

On behalf of the Board of Directors of Bank Aljazira, it is my pleasure to present to you the Bank's annual report and financial statements for the fiscal year ended December 31st, 2011.

In the light of the considerable initiatives taken by the Bank at the end of 2010 to enhance its financial performance and ensure greater stability in its various business activities, Bank Aljazira (BAJ) entered 2011 with a cautious optimism against the challenges stemming from the recent global economic crisis, which the various directly impacted countries are still exerting their best efforts to recover from.

During 2011, BAJ succeeded in achieving many qualitative and quantitative milestones, and continued these successes within a clear strategic vision aimed at re-positioning BAJ as the first bank of choice for all those seeking wholly Shari'ah compliant banking and financial products and services.

To achieve this goal, BAJ implemented a series of initiatives focusing the Bank's efforts on diversification of its sources of revenue, reinforcement of its offerings spread, delivery of more products as per customers' needs, prudent management of risks, upgrading of its infrastructure as per market requirements, and solidification of its capital through first ever "Sukuk" issuance to broaden its funding base.

In this aspect, we have continued to increase the number of branches to reinforce our presence in new areas, and to install more ATM machines in

prominent locations. This was also augmented by an enhancement to our electronic delivery channels through upgrading them with the latest technologies and security features to enable us to reach customers wherever they are in an easy, fast, and secure manner, and have continued to enrich these channels with a full bouquet of services.

During 2011, BAJ made considerable achievements in solidifying its core banking activities growth in individual and corporate client funding, coupled with an increase in the net special commission and fee income, and a significant growth in current accounts and time deposits, all of which we are keenly proud of. Additionally, during the course of the year BAJ was able to overcome a myriad of challenges and obstacles and lay down the foundations to capture the available opportunities through a solid base of technical, operational, financial and human capabilities, in order to achieve unprecedented results in the future.

The improved performance of BAJ's activities was reflected in the growth of its profits which registered an increase of 945%, reaching SAR 303 million, as compared to SAR 29 million in 2010, which is the highest percentage of profits BAJ achieved all over its history. Also, the total assets reached SAR 39 billion in 2011, as compared to SAR 33 billion in 2010, representing an increase of 18%. In tandem with the Bank's care to reinforce customer funding which registered an increase of 25%, BAJ was successful in its issuance of the long term Shari'ah compliant "Sukuk" worth SAR 1 billion. The funds generated from the issuance did not only support the Bank's





capital and accommodate its funding requirements, but also count towards setting a benchmark that would be used in BAJ's future activities.

The Sukuk issuance success, which exceeded all expectations, reflects the confidence that customers, associates and investors have in BAJ, and by this issuance, BAJ was the first Shari'ah compliant bank to issue Sukuk in the Kingdom of Saudi Arabia.

Based on the confidence that BAJ has earned and all the effective arrangements taken to enhance its performance towards a better future, the client base was broadened by 45% in 2011 with a significant increase in deposits by 14%, reaching SAR 31.159 billion. This reflects the harmony between BAJ's banking services and customers' expectations, needs and requirements, and helps in upgrading the Bank's activities through offering more unique products aimed at consolidating our footage in the banking sector at all levels and targeted segments.

As we have always done, BAJ paid special attention to corporate social responsibility and community service through its program 'Khair Aljazira le Ahl Aljazira' (The Bounty of the Peninsula for the People of the Peninsula), in collaboration with government institutions, charitable societies and training centres Kingdom-wide through sponsoring numerous activities and training programs, directed towards the development and betterment of the needy individuals in the Saudi community.

Through 'Khair Aljazira le Ahl Aljazira' Program, BAJ financed the training of 1650 youths during 2011 along with its continual support of the "Productive Families" projects. In addition, BAJ is a founding member of the Prince Salman

Center for Disability Research, BAJ contributes in Prince Salman Philanthropic "Waqf" for Disable Children's Association.

On behalf of the Board of Directors, I am pleased to express our appreciation and gratitude for the support extended by the Custodian of the Two Holy Mosques, King Abdullah Bin Abdulaziz Al-Saud; His Royal Highness, Prince Naif Bin Abdulaziz Al-Saud, the Crown Prince, the Deputy Prime Minister, and the Minister of Interior, and all Government Ministers. We are also grateful for the continued support and guidance of the Ministry of Finance, the Ministry of Commerce and Industry, the Saudi Arabian Monetary Agency, and the Saudi Capital Market Authority. The wise counsel and guidance of these regulators have proved of inestimable value in protecting the Kingdom's economy and particularly the banking sector from the turmoil that has so severely affected global finance.

Finally, I would like to take this opportunity to extend our heartfelt thanks and appreciation to BAJ's shareholders, customers, and associates for their continued trust and support, and also thank BAJ's management and staff for their dedication and distinguished achievements.

I deeply extend our sincerest gratitude to Allah Almighty and prayers upon our Messenger Prophet Mohammed – may peace be upon him, his descendents and all his followers.

**Taha Abdullah Al-Kuwaiz**  
Chairman

## Chief Executive Officer's Foreword

Looking back on 2011 we will notice a period of solid growth, as well as the anticipated growth in 2012, building on an already impressive economic platform as the Kingdom seeks to guarantee future growth through investments in infrastructure and human resources.

During 2011, Bank Aljazira (BAJ) achieved a significant package of initiatives that resulted in quantum leaps witnessed by the different sectors of the Bank, and at the same time overcame many of the obstacles and challenges stemmed from the global financial crisis. BAJ, with full confidence, continued to march forward in the implementation of its strategy towards diversifying sources of income and seizing favourable opportunities in the pursuit of strengthening its presence in the banking, financial and investment sectors and competitiveness in various fields.

Moreover, one of our key achievements during the year, was the reinforcement of our presence at all levels including branch network, products, electronic banking channels and most importantly, the Banks' infrastructure. We have expanded our real-estate financing activities via a wide range of housing and real estate investment programs, which meet customer needs and market requirements. As a result of this effort, our Bank captured 8% of the real-estate financing banking sector in 2011.

BAJ has also reinforced its offerings in the area of personal finance, credit cards of all categories, corporate, small and medium-sized enterprises, Kafala Program, financial institutions, government and public sector financing. The Bank also launched new services in the field of payroll management and cash collection as per international standards.

This is in addition to the prominent products launched by our Treasury Group, accompanied by significant development in the area of treasury operations sustained by highly qualified professionals and speedy automated systems, resulted in substantial increase in our treasury cliental base.

Furthermore, as an enhancement to our client service package, we have established a new Customer Call Centre in Riyadh, operated by a highly qualified team coupled with the best high-tech equipment to serve our clients in the best manner.

On the same track, BAJ continued its journey towards expanding its branch network, bringing the number of branches by the end of 2011 to (51) branches and (17) ladies sections, which are all managed by highly qualified Saudi individuals. Simultaneously, BAJ continued to reinforce its ATMs network in terms of readiness or number of machines, which reached 316 as at the end of 2011.

This is in addition to the efforts exerted during 2011 to enhance our electronic channels by adopting latest technology with highest information security features, and offering a suite of comprehensive services through our interactive website "Aljazira Online" and "Aljazira Phone" where our Bank was the first Saudi bank to launch a Mobile Banking Application in the Android Market through its "Aljazira Smart" service and certain points of sale (POS) with the new Smart Chip technology (EMV).

On BAJ's infrastructure front, we performed a complete restructuring of our various sectors, where we introduced a new organizational structure and a new grading system as per market requirements. Additionally, our Human Resources, Operations, Risk Management, Internal Control Departments, and Information Technology were re-structured. We invested in the modern technology to improve the speed and accuracy of execution, provide proper information, and reduce paperwork within our Bank's strict policy towards cost cutting. At the same trend, our Bank was successful in attracting high calibre professionals coupled with an overall enhancement of our Saudization ratio in a way that insures efficiency of performance and accomplishment of targets.

While keeping up the momentum, BAJ maintained, through its investment arm, "Aljazira Capital" its leading position in the local shares brokerage market for the seventh consecutive year, maintaining 15% market share. Moreover, Aljazira Capital continued to expand its global service which included Qatar, UAE and USA stock markets. Moreover, the performance of the Al Taiyebat Shari'ah compliant local equities fund was number ONE among the funds of the same category in 2011.

Additionally, among Aljazira Capital priorities in 2011 was to launch two real estate funds, bearing in mind that Aljazira Capital has already obtained the



Capital Market Authority's consent to offer a fund for the emerging markets.

It is worth mentioning that during the 1st quarter of 2011 BAJ issued Shari'ah compliant sukuk worth SAR one billion. The success of the issuance exceeded all expectations. BAJ was the first Shari'ah compliant bank to issue Sukuk in Saudi Arabia. The success of the issuance did not only reinforce the funding position of the Bank; but also is an obvious indicator of the confidence that customers have in BAJ and its capabilities to accomplish more and face challenges.

Given the leadership role that the Bank played in two key Islamic financing projects, BAJ was presented with two awards from the Euromoney Project Finance Magazine in 2011. Additionally, BAJ received an advanced classification from Forbes Middle East Magazine for the best 73 credit card. Note to mention, that we also obtained two awards from the Jeddah International Real-Estate Financing and Housing Exhibition for the best program for real estate finance, besides being named as one of the top 20 Islamic banks in the Gulf Region in terms of assets by MEED Business Magazine.

In conjunction with the implementation of our strategy to become a multi-level financial group, where we will be the first choice for Shari'ah compliant banking products and services, BAJ looks forward to achieving quantum leaps in 2012 by offering more products in response to customer needs and market requirements, establishing new branches and installing more ATMs to enhance our geographical spread and electronic outlets.

We look forward to increasing our market share in financing small and medium-sized enterprises, and

enhancing of our treasury products and services to meet our customer needs. We will exert all efforts to increase our real-estate financing and personal finance market share by attracting more customers from all segments. Also, we will continue our efforts to increase awareness of the regulatory guidelines reduce costs and diversify sources of income. And on the human resources front, we will continue to invest in our human resources and improve our Saudization ratio. We will also continue our efforts to maintain a leading position in providing excellent services, through the Bank, Aljazira Capital by expanding "Global" service to reach new markets, or even through Aljazira Takaful.

Finally, I am pleased to take this opportunity to extend my thanks and appreciation to the Board of Directors, shareholders and customers for the vote of confidence and to all employees of BAJ Group for their efforts in achieving our goals, implementing our strategies and striving for better future growth.

**Nabil Dawoud Alhoshan**  
Chief Executive Office

## Executive Management



**Mr. Nabil AlHoshan**  
Chief Executive Officer



**Ziad T. Aba Al Khail**  
CEO, Aljazira Capital



**Sager Nedershah**  
CEO, Aljazira Takaful Ta'awuni



**Tarek A. Al Shubaily**  
Senior Vice President & Head of  
Human Capital Group



**Dr. Mohammed Al Ghamdi**  
Senior Vice President &  
Head of Shariah Group



**Yasser Al Hedaithy**  
Senior Vice President &  
Group Treasurer



**Ian Lucy**  
Senior Vice President &  
Chief Operating Officer



**Khalid O. Al-Othman**  
Vice President & Acting Head  
of Retail Banking Group



**Charles Brodie**  
Senior Vice President &  
Chief Risk Officer



**Fahed Al Aqeel**  
Senior Vice President & Head of Strategy  
and Business Transformation Group



**Rizwan Shakoor**  
Senior Vice President &  
Chief Financial Officer



**Osama Al-Ibrahim**  
Vice President & Acting Head of  
Corporate Banking Group



**Ibrahim Al-Hurabi**  
Senior Vice President &  
Head of Internal Audit



**Khalid Al-Miqrin**  
Senior Vice President & Head  
of Legal and Board Secretary



**Dr. Fahid Al-Olyan**  
Executive Director,  
CSR Program



## **Board of Directors' Report**

The Board of Directors is pleased to present the Bank's annual report and consolidated financial statements for the financial year ended 31 December 2011.



## Financial Performance

In spite of the Euro zone debt crisis, temperate slowdown in some developing economies, and rising inflation as some factors adversely affecting the current economic climate, the Kingdom of Saudi Arabia has weathered the storm well due to its sound financial and monetary management policies and strong commodity prices through the higher oil and oil based products, propelling the private consumption and investment growth to remain stable.

Notwithstanding the looming challenges facing the global economy, the world's largest oil exporter's immediate and medium term growth prospects remain strong. Robust oil prices and increased government spending are expected to propel the Kingdom's economy.

Saudi Arabian banking sector continues to be well capitalized and well above those in most other markets as banks in the Kingdom have upgraded their risk management culture in recent years aided by Basel II and now Basel III requirements. The Saudi banks' stability is further supported by strict regulations, close monitoring and systemic support by the Saudi Arabian Monetary Agency (SAMA).

Bank Aljazira (BAJ) embarked on a constructive & aggressive plan in 2011 to restructure and align its People, Products, Systems, Processes and Infrastructure to enhance the value of its offerings and inculcate a culture of sustainable profitability. Although the Financial World embraces a period of tumultuous changes, BAJ maintains a cautious optimistic view of its business and targeted market sectors.

Noticeable decline was achieved in the levels of non-performing loans with provisioning coverage increasing to almost 117%. BAJ maintained a safe Loan to Deposit Ratio of between 75-80% as an average during most of 2011.

BAJ's net income had been adversely impacted in 2009 and 2010 by several factors including higher provisions, continuously decreasing local share brokerage fee income, relatively weak performance in core banking business and BAJ's restructuring. However, BAJ has made significant improvements in 2011 which are summarized in the following paragraphs:

## 2011... The Growth Year

The year saw significant improvements in the areas of Retail, Treasury and Corporate business with sales increasing, costs and defaults decreasing.

The table below depicts the core banking achievements.

FINANCIAL PERFORMANCE					
SR'000	2007	2008	2009	2010	2011
Special commission income	908,969	1,114,431	961,241	868,346	968,116
Special commission expenses	(313,847)	(483,010)	(293,460)	(151,093)	(186,653)
<b>Net special commission income</b>	<b>595,121</b>	<b>631,421</b>	<b>667,781</b>	<b>717,253</b>	<b>781,463</b>
Fees from banking services:					
Local Share Trading, net of brokerage	554,467	328,815	211,148	105,641	143,677
Loan commitment and management fee	48,897	51,616	32,884	47,356	96,515
Trade Finance	15,527	21,072	24,930	21,791	30,943
Takaful Ta'awuni (insurance) wakala fee	54,365	88,257	43,308	34,474	36,679
Fee from ATM transactions	19,015	27,583	35,202	37,312	34,874
Others	6,208	20,172	28,869	18,897	13,520
<b>Total fees</b>	<b>698,479</b>	<b>537,515</b>	<b>376,341</b>	<b>265,471</b>	<b>356,208</b>
Exchange income	17,232	21,708	15,837	18,184	19,927
Trading income/ (loss), net	15,399	(33,940)	36,552	27,804	11,381
Income from FVIS financial instruments	-	-	41,839	67,506	-
Divided Income	12,385	11,532	5,122	10,394	9,719
Gain/ (loss) on non-trading investments	102,503	(34,498)	20,729	-	(6,441)
Other operating income	5,673	2,806	6,835	48,454	35,841
<b>Total operating income</b>	<b>1,446,792</b>	<b>1,136,544</b>	<b>1,171,036</b>	<b>1,155,066</b>	<b>1,208,098</b>
Growth over previous year	28.6%	-21.4%	3.0%	-1.4%	4.6%





#### **Net Special Commission Income:**

Increased from SAR 717 million in 2010 to SAR 781 million in 2011, a growth of 9% due to the increased lending combined with the growth in current account balance.

#### **Fee from Banking Services:**

Grew by SAR 91 million, from SAR 265 million in 2010 to SAR 356 million in 2011. The growth was achieved in various core banking activities including credit management fee with year on year increase of 65%, consumer finance processing fee registered an increase of 175%, trade services 42%, and brokerage 35%, in addition to the increase in SPAN income.

#### **Exchange Income:**

improved by 11%, from SAR 18 million in 2010 to SAR 20 million in 2011.

#### **Trading Income:**

Totaled SAR 11 million, and was lower in current year by SAR 17 million, mainly due to lower gains from the Bank's seed capital investments in its international equity mutual funds, resulting from the international equity market performance in 2011.

#### **Income from FVIS Financial Instruments:**

Was nil, as compared to SAR 68 million in 2010. This income represents the mark-to-market impact of the equity instruments held by Bank, which were reclassified to another category called "Fair Value through Other Comprehensive Income" as a result of implementation of IFRS 9 effective January 1, 2011. Subsequently, any mark-to-market impact of such instruments is directly taken into shareholders' equity.

#### **Other Operating Income:**

Totaled SAR 36 million in 2011 as compared to SAR 48 million in 2010. This income caption mainly represents the gains realized from sale of real estates, in both years under review.

#### **Total Operating Income:**

As an overall result of the above, the total operating income improved by SAR 53 million, or 5% during 2011, as compared to the previous year.

#### **Operating Expenses:**

In order to support the Bank's expansion under its strategic plan, the total operating expenses excluding the provision for credit losses and the non-recurring items, increased by 6% only.

#### **Provision for Credit Losses and NPL Coverage:**

In line with its conservative approach to mitigate and manage credit risks, BAJ charged a net provision for credit losses of SAR 70 million, compared to SAR 362 million during 2010. The coverage against non-performing loans (NPLs) has reached 117% during 2011, as compared to 85% in 2010.

#### **Net Income:**

Registered an increase of 945%, reaching SAR 303 million, as compared to SAR 29 million in the corresponding year, while earnings per share jumped from SR 0.10 in 2010 to SR 1.01 in 2011.

## Financial Position

The table below depicts the financial highlights of the year:

FINANCIAL HIGHLIGHTS					
(In SAR millions, except where indicated)	2007	2008	2009	2010	2011
Loans and advances, net	9,879	15,133	15,504	18,704	23,307
Total assets	21,564	27,520	29,977	33,018	38,898
Customer deposits	15,647	20,900	22,143	27,345	31,159
Shareholders' equity	4,698	4,637	4,486	4,516	4,733
Net special commission income	595	631	668	717	781
Fee income	698	538	376	265	356
Gain on investments, exchange and other	153	(32)	127	172	70
Total operating income	1,447	1,137	1,171	1,155	1,208
Net income	805	222	28	29	303
Net income growth (%)	(59.2)	(72.4)	(87.6)	5.0	945
Return on average equity (%)	18.11	4.76	0.60	0.64	6.55
Return on average assets (%)	4.32	0.91	0.10	0.09	0.84
Earnings per share (SAR)	2.68	0.74	0.09	0.10	1.01

**Loans and Advances, net:** totaled SAR 23.3 billion at the year-end, registering an impressive growth of 25% over SAR 18.7 billion in 2010. BAJ continued to further diversify the loan portfolio over various economic sectors and broadened the client base, thus lowering the concentration of risk.

The consumer lending grew from SAR 4.5 billion at the end of 2010 to SAR 7.2 billion at year end 2011, a year-on-year growth of 60%. Corporate loan book also grew by a net SAR 2 billion during the year.

The table above highlights the growth achieved in the loan portfolio over the last five years. It also reflects the Bank's prudent approach in managing the credit risks inherent in the portfolio through the conservative credit monitoring and provisioning policy; whereby the non-performing loans to gross loans have decreased from 6.7% in 2010 to 4.2% in 2011, whereas the coverage for Non- Performing Loans has reached to 117% in 2011 from 85% in 2010. Considering the collaterals held by the Bank against its non-performing portfolio, the coverage ratio stands at 135%. The NPLs at year-end 2011 totaled SAR 1.03 billion as compared to SAR 1.33 billion at the end of 2010.

**Placements with Other Banks and Other Financial Institutions:** totaled SAR 4.3 billion, lower by 22% compared to SAR 5.6 billion in 2010, representing the net result of the liquidity and risk management.

**Investments Book:** closed at SAR 5.4 billion, higher by 19% from the previous year. The investments mainly include the Murabaha with SAMA, corporate sukuk, and commodity based funds of other local banks. Investments decisions are mainly governed by BAJ's risk diversification strategy, but some of the investments also serve the liquidity management of the Bank as well since these are treated as liquid.

**Total Assets:** BAJ's total assets reached SAR 39 billion in 2011, as compared to SAR 33 billion in 2010, representing an increase of 18%.

## Funding

**Customer Deposits:** increased by 14%, reaching SAR 31.1 billion in 2011, as compared to SAR 27.3 billion in 2010. A healthy trend was noted in the current accounts (demand deposits) which have grown by 34% during 2011 rising from SAR 7.5 billion in 2010 to SAR 10 billion at the end of 2011. Such impressive and sustainable growth results are mostly from the retail banking network expansion and addition of new products. BAJ expects further growth in current account deposits that will help the Bank in the competitive lending environment. The table in the opposite page depicts the various types of customer deposits and growth rates.



#### CUSTOMER DEPOSITS

SR millions	2007	2008	2009	2010	2011
Demand deposits	5,544	5,322	6,053	7,522	10,053
Time deposits					
Time deposits (Corporate)	6,372	10,701	11,026	14,363	17,054
Time deposits (Retail)	3,126	4,701	4,507	4,870	3,586
Total Time deposits	9,498	15,402	15,533	19,233	20,640
Others	605	176	557	590	466
Total Customers' deposits	15,647	20,900	22,143	27,345	31,159
Total % growth of customers' deposits	43.3%	33.6%	5.9%	23.5%	13.9%

**Borrowing from Banks:** BAJ's borrowings from other banks amounted to SAR 1.3 billion in 2011 as compared to SAR 0.4 billion, as at the year-end of 2010.

**Sukuk Issuance:** during the 1<sup>st</sup> quarter of 2011, BAJ issued long term Shari'ah compliant sukuk worth SAR 1 billion. The success of the issuance exceeded all expectations. The funds generated from the issuance did not only help the Bank in its funding positions but also count in the Basel tier two-capital base for the purpose of capital adequacy ratio.

#### BAJ's Subsidiaries and Related Profits:

The Bank's consolidated and unconsolidated subsidiaries include; Al-Thoriya (European) Equities Fund, Al-Khair (global) Equities Fund, and Al-Mashariq (Japanese) Equities Fund (the mutual funds), Aljazira Capital, and Aman Real Estate Development Company. All these subsidiaries are locally registered.

The profit/(loss) of Aljazira Capital and the Mutual Funds including Al-Thoriya (European) Equities Fund and Al-Mashariq (Japanese) Equities Fund, have been consolidated in the Bank's financial statements. Since the Al Khair Mutual Fund falls below the minimum threshold of stake holding and therefore it is not required to be consolidated in line with the IFRS reporting guidelines. The Aman Real Estate and Development Company has been consolidated, however since the Company doesn't generate any revenues, there was no profit from this subsidiary.

#### Mutual Fund Subsidiaries

Al-Thoriya (European) Equities Fund, Al-Khair (global) Equities Fund, and Al-Mashariq (Japanese) Equities Fund (the Mutual Funds) are locally registered. These funds operate under the terms and conditions contained in their respective prospectus documents with a primary objective of providing investment opportunities to the investors. These are managed by our subsidiary the Aljazira Capital Company as per directives of the Capital Markets Authority (CMA). The Bank had invested USD 10 million in each Fund as seed capital and still holds such investments which are reported on mark-to-market basis.

#### Aljazira Capital Company

Aljazira Capital Company is a Closed Joint Stock Company incorporated under Ministerial Resolution No. S/57 dated Safar 20, 1429H corresponding to February 27, 2008. It is locally registered under Registration No. 4030177603 dated Rabi-al-awwal 17, 1429H, corresponding to March 25, 2008, as per the CMA license No. 37/07076. It has a paid up share capital of

SAR 500 million. The Company is engaged in the following activities: dealing, arranging, managing, advising, custodian services, and investing activities.

### **Aman Development and Real Estate Investment Company**

Aman Development and Real Estate Investment Company is a Limited Liability Company registered in the Kingdom of Saudi Arabia under Commercial Registration number 1010221387 dated Jumad Thani 20, 1427H, corresponding to July 16, 2006, owned by Bank Aljazira, with a paid up share capital of SAR 1.0 million, incorporated in the Kingdom of Saudi Arabia, the country of its operations and activities base. The Company is engaged in holding and managing the assets assigned to the Bank and others as collaterals including holding these assets for finance purposes as per the objective of the company.

### **Major Developments during 2011**

As required by the Insurance Law of Saudi Arabia, BAJ has decided to spin off its insurance business into a separate entity under the new Insurance Law of Saudi Arabia. The separate entity is under formation. BAJ and its Subsidiary Aljazira Capital Company will have 35% shareholding in the new insurance company and the remaining will be held by other founding shareholders and offered to the public through an Initial Public Offering (IPO). Once the new insurance company is incorporated and licensed, the assets, liabilities and operations of the insurance business will be transferred to the new insurance company at a valuation to be approved by the Regulator.

BAJ continued its expansion journey in respect to branch net and various electronic channels through using the best of breed technology and best practices and reinforcing such channels with more services that would meet our customers' needs and market requirements.

BAJ also continued to enhance its infrastructure in the areas of operations, information technology and control departments through attracting high caliber professionals and bankers with leadership skills and multi experiences in banking industry so as to achieve our vision towards building a multi-specialist bank compliant with Shari'ah rules, and continuously expand its products and services in away to meet our clients' requirements.

### **Statutory Books of Accounts and Basis of Preparation of the Financial Statements**

BAJ maintains proper books of its accounts and records in an accurate manner. The consolidated financial statements are prepared following the International Financial Reporting Standards, Accounting Standards for Commercial Banks promulgated by SAMA, Provisions of Banking Control Law, Regulations for Companies, and Bank's Articles of Association. The Bank's books of accounts have been maintained properly.

### **Zakat, Tax, and Other Governmental Payments**

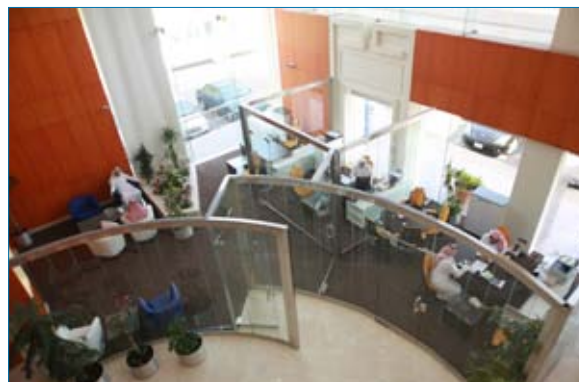
BAJ has made the following payments during the year in respect of the cited captions:

Zakat paid during 2011 (against 2010)	SAR 3.74 million
Income tax and withholding tax	SAR 2.63 million
GOSI (including Bank and the employees)	SAR 34.21 million
Visa, Iqama and related services etc.,	SAR 1.27 million

The zakat liability due for 2011 has been estimated at SAR 10 million that is attributable to Saudi Shareholders. BAJ has adequate provision in the books to settle the estimated zakat liability. An amount of SAR 3.5 million has been estimated as income tax liability attributable to non-Saudi shareholders, and this will be ultimately borne by the non-Saudi shareholders themselves.

### **Strong Shareholder's Equity base**

Shareholder's equity at the year-end totaled SAR 4.73 billion and earnings per share was SAR 1.01. During 2011, BAJ issued long term Shari'ah compliant sukuk worth SAR 1 billion. These sukuk form part of Bank's tier two capital for the purpose of credit ratings and capital adequacy ratio. The capital adequacy ratio for the Risk Weighted Assets for Pillar One under the Basel II regime was 13.6% for its Tier I, and 17.4% for its Tier I & Tier II capital base, respectively.



### Future Operational and Financial Planning

BAJ's vision about its future direction is clear and strong. There have been significant positive developments during 2010 and 2011 in terms of strengthening the Bank's organizational structure, and as well as in the core banking business growth. BAJ has resolved to continue to reinforce its current activities with its focus on retail, Small and Medium Enterprises (SMEs), corporate and treasury. The Bank will also capture new opportunities in the market to further diversify its revenue stream and consolidate its market share.

On the net work horizon, BAJ plans to add around ten branches annually through 2012-2013. Another important facet of the Bank's future expansion strategy is to include more electronic delivery channels to facilitate offering its products and services to our customers. BAJ intends to maintain a healthy pattern of growth in terms of gaining a substantial share of the market within the given constraints and to this end has a firm commitment to enhance the Equity Base of the Bank.

### Future Risks and Challenges

The year 2012 has begun with the international financial markets in a state of confusion as they attempt to come to terms with the fragility of the world economy. The main causes of concern are the deepening crisis within the Eurozone, the levels of outstanding sovereign debts in some of the world's largest economies, and the increasing prospect of a return to economic recession in the developed economies. A recent survey of more than 700 bankers, regulators and observers of the banking industry has indicated that anxiety levels in the global financial sector are at their highest for over 10 years. Fortunately with its very limited exposure to the international markets, BAJ is largely sheltered from these economic uncertainties.

Turning to the key challenges facing BAJ in 2012 and beyond can be summarized as follows:

- There is an increasing international focus on bank regulation with Basel II and the future introduction of Basel III. In order to manage the growing complexity of the new regulations, all banks will have to pay attention to their corporate governance and risk management functions. Risk management has a core strategic role within the Bank's activities and will require more long-term investment in both technology and resources going forward.
- The Saudi banking sector is very competitive and the pricing of products and other services continue to be driven down. In addition, higher capital requirements, greater regulatory / compliance costs and higher stable funding costs will adversely impact future profitability.
- The need to improve / update systems, data management and internal controls as part of the demands of new regulation that will require significant capital investment as the Bank continues to grow.
- The recruitment and retention of high quality staff and the development of the young talent within the BAJ is a systemic issue amongst the Saudi banks but should be an ongoing challenge for the Bank's human capital group.

2012 will undoubtedly be another challenging year for BAJ on a number of fronts; however, the Board is confident that further growth will be achieved and looks forward to reporting another set of impressive results at the end of the year.



## Business continuity

BAJ has complete ability and well defined plan with clear direction to continue and further strengthen its operations based on its well-capacitated financial, organizational and business resources.

The geographic distribution of income within the Kingdom is shown in the table below:

Regionwise balance - SAR 000	Central Region	Eastern Region	Western Region	Head Office	Total
Total Operating income	397,424	174,321	311,544	324,809	1,208,098
Total Operating expenses	(106,612)	(45,395)	(88,101)	(594,785)	(834,893)
Specific and portfolio provision for credit losses, net	(23,583)	12,996	(20,024)	(39,741)	(70,352)
<b>Net income</b>	<b>267,229</b>	<b>141,922</b>	<b>203,419</b>	<b>(309,717)</b>	<b>302,853</b>

## Major Business Lines

BAJ's activities comprise five main business lines including: Retail, Corporate, Brokerage, Treasury, and Takaful. The Bank's services are conducted through a network of 51 branches spread in all main cities of the Kingdom of Saudi Arabia. The table below depicts information on assets, liabilities, total operating expenses, and net profit for each sector:

2011	Personal Banking	Corporate Banking	(SR'000) Brokerage & Asset Mgt	Treasury	Takaful Ta'awuni	Others	Total
Total assets	9,303,028	15,465,984	440,433	13,463,222	13,513	212,070	38,898,250
Total liabilities	12,565,175	18,419,474	165,811	2,767,404	35,759	7,764	33,961,387
Operating income from external customers	487,694	452,834	156,103	90,396	36,699	(15,628)	1,208,098
Inter – segment operating income/(loss)	(158,232)	(21,112)	47,130	136,543	(260)	(4,069)	-
Total operating income	329,462	431,722	203,233	226,939	36,439	(19,697)	1,208,098
Net special commission	247,298	330,796	11,184	191,419	(260)	1,026	781,463
Fee and commission income, net	53,753	81,842	188,570	(557)	36,677	(4,077)	356,208
Trading income	(5,846)	(5,158)	(54)	16,334	-	6,105	11,381
Operating expense:							
- Impairment charge for credit losses, net	45,661	24,691	-	-	-	-	70,352
- Depreciation	39,963	7,700	13,436	2,224	3,452	-	66,775
Total operating expenses including non-controlling interest	449,238	196,075	133,723	60,507	68,769	(3,067)	905,245
Net (loss)/income attributable to equity holders of the Bank	(119,776)	235,647	69,510	166,432	(32,330)	(16,630)	302,853

## Retail Banking Group

The Retail Banking Group (RBG) has played a significant role in the market following the overall Bank's strategy to strongly penetrate the Retail Banking Sector. RBG offers innovative Islamic banking solutions with unique value propositions that cater to our valued clients' changing needs. Our products range from Current Accounts, Islamic Time Deposits, Personal Finance, and Credit Cards along with a range of specialized Real-Estate products such as "Baiti" Ijara Home Finance, Real-Estate Investment and Secured Finance that has placed BAJ among the top players.

Beside the importance of acquiring, training, and retaining the most talented team members, we have shifted our focus since the beginning of 2011 towards the total relationship management conceptual approach of





## " Baiti " Home Finance Program



offering the market with packages of unique products through our 51 branches, and 17 ladies sections around the Kingdom.

On the Assets side, our Consumer & Credit Cards lending has recorded a 60% growth reaching SAR 7.3 billion with only 0.45% non-performing loans, up from SAR 4.6 billion in 2010. The non-performing ratio in 2010 was 1.3%. This achievement has grown our asset book by 50% to be SAR 9.3 billion from SAR 6.2 billion in 2010. Notably, as BAJ insists on maintaining its leadership in Real-Estate Finance through launching innovative Islamic solutions, we have acquired around one fourth of the 2011 Real-Estate Finance market growth with an overall 8% market share.

On the Liabilities side, we have exceeded the market by recording a 41% growth in Demand Deposits. Yet, due to the market conditions and SIBOR rates, a drop in our Time Deposits portfolio has slowed down the overall liabilities book growth to only 11% reaching SAR 12.6 billion (from SAR 11.3 billion in 2010). We proudly hold a diversified deposits portfolio by serving six individual and business market segments. Our new relationship focused reward schemes have increased the share of individual clients' deposits from 53% to 66%, in line with the Bank's strategic objectives. This has also resulted in a 44% growth of active clients, reaching 179 thousand (from 124 thousand in 2010).

In terms of Electronic Banking Services, we proudly hold the title for being "The First Saudi Bank to Launch a Mobile Banking Application in the Android Market" in October 2011. "AlJazira SMART" recorded a total of 16 thousand financial transactions in a span of two months only. In addition, following the launch of POS services last year, we have managed to install 820 state of the art EMV enabled POS terminals. On the other hand, we have increased our ATM network to reach 316 machines around the Kingdom. Also, our Online Banking platform has been heavily utilized as the number of financial transactions has doubled from 294 thousand in 2010 to 580 thousand this year. And in order to enhance our customer experience, we have launched our New Call Center in Riyadh equipped with the latest state-of-the-art technology and infrastructure.

BAJ is planning to maintain its Real-Estate finance leadership position next year through launching new innovative solutions, and expanding our product offerings to new market sectors. It is also planning to expand our branch network to cover most of the Kingdom's geographic areas in order to extend our offerings to untapped markets. The deployment of Banking Lounges, along with dedicated Relationship Managers, is also a priority in order for us to cater to our various clients' needs. Finally, we will continue investing in developing state-of-the-art e-banking channels that would far more exceed our valued client's expectations.

### Corporate Banking Group

The Corporate Banking Group (CBG) achieved a growth of 11% in its assets portfolio, and posted a total operating income of SAR 432 million, underpinned by expanding products and services, with significant new customer acquisition and landmark financing deals – supported by lower charges for credit losses. Fee income from banking activities grew by SAR 28 million in comparison to the previous year. The non-performing loans decreased to 4.72% of the total loans as compared to 8.71% at the end of year 2010. CBG offers a wide range of Shari'ah-compliant Islamic banking solutions to corporate entities. CBG; as a vital part of the Bank's strategy, will continue striving to expand and innovate by providing tailored pure Islamic banking solutions to our clients.

CBG's activities are concentrated in the 3 major metropolitan areas of the Kingdom - Riyadh, Jeddah and Dammam - with the required expertise and resources in each of the 3 regional offices to handle the banking needs of the customers in each region. CBG comprises the following business units:



### Commercial Banking Division (CBD)

CBG incorporated a specialized division committed to serve small and medium sized enterprises (SMEs) through a wide range of commercial banking services and products, and to expand the base of beneficiaries through the establishment of regional offices that tie up all commercial banking clients around the Kingdom via its various channels. This trend translates the Bank's strategic direction to increase its customer base, benefit from the credit demand, increase lending volume, and increase and diversify the finance portfolio in order to accommodate the requirements of this critical segment, which is considered the fastest growing segment in the Kingdom of Saudi Arabia.

As a result of this clear strategy, CBD offered support and finance through many financing programs designed for the SMEs and Kafala Scheme, which achieved a growth of 217% as at the end of 2011. At the same time, CBD served more than 325 clients representing an estimated growth of 25% over its customer base through a portfolio of SAR 708 million, as at the end of 2011.

CBD will continue to provide more services so as to play a pivotal role in delivering Shari'ah compliant offerings with intensive focus on our customers' requirements and in providing support to all other Bank's business sectors. CBD is closely working with other Bank's sectors through its different offerings to achieve the highest levels of efficiency, productivity and best service to the SME segment.

### Global Transaction Services (GTS)

During 2011, Trade Finance and Cash Management were combined under one department called "Global Transaction Services (GTS)". GTS is increasingly in the forefront of developments in Islamic Cash Management and Trade Finance. GTS has proven to be an efficient and reliable partner to many enterprises in the Kingdom; encompassing SMEs, commercial businesses, large corporate entities, government, quasi-government (Public Sector), and Financial institutions.

Our payment solutions cover the complete spectrum of domestic and international transactions offered via conventional and online/mobile channels, and have culminated in Global Transaction Services writing substantial new business in payroll management and cash collection.

At the same aspect, various new products were initiated and/or launched during 2011, inter alia; Payroll Card, Point of Sales (POS), the e-Corporate Banking Solution and the Islamic trade product 'Musharaka' Letter of Credit.

### Specialized Finance Division (SFD)

In order to position itself in the path of Bank's functional expansion, the Syndication Division was restructured and renamed as 'Specialized Finance Division' (SFD) to comprise three units namely Project & Structured Finance, Syndication and Agency. Re-structuring the Division with properly defined objectives and roles was a natural adaptation to accommodate asset growth in portfolio and achieve the objective of asset diversification and total relationship concept. This business model has proven to strengthen our capability in the whole spectrum of specialized financing and now solidified our visibility in the market.



During the year, SFD was honored by high profile industry awards – the “Euro money Project Finance Deals of the year” – in recognition for its participation in two award-winning project finance deals with most coveted roles of Islamic Facility Agent. SFD has successfully continued to secure additional agency roles in leading landmark transactions, thus enhancing the market visibility of BAJ in the project finance arena and improving the fee-based income.

#### **Financial Institutions Unit (FIU)**

FIU continues to build a substantial network of correspondent banking relationships around the world, enhancing BAJ's capacity to service the needs of its customers internationally by facilitating and financing their transfers and trade transactions. Our relationships include Banks, Financial Institutions, Government & Quasi-government Entities, Investment and Brokerage Firms, Insurance Companies and Export Credit Insurance Corporations.

#### **Public Sector Unit (PSI)**

PSI is dedicated to provide Shari'ah compliant tailor-made solutions (Murabaha, Musharaka, Tawaruq, Ijara, Naqa'a, etc.) to meet the growing needs of a wide range of public sector businesses (i.e. corporate finance, real estate, investment banking, contracting finance, cash management and e-Banking solutions.) The PSI also offers trade finance, capital and debt market products, treasury products and international banking services to our Public Sector clients.

#### **Treasury Group**

In 2011, Treasury Group's focus was to develop its infrastructure which includes human capital, premises, systems, policies & procedures and product development. Treasury has been successful in achieving all its targets for the year. Treasury continuously strives to achieve better understanding of our customer needs in partnership with Corporate and Retail banking groups. Accordingly, developing its Shari'ah compliant product range and offering more sophisticated solutions to our customers.

At the beginning of the year, Treasury embarked on a considerable leap and implemented a full Treasury banking solution which included market and credit risk modules. Also, in line with our growth plans and to expand our reach to our customers to provide world class services & products a full Treasury branch has been opened in Riyadh and a sales office in Eastern region.

Our efforts to grow core funding source continue. As a result customer deposits increased from SAR 27.3 billion in 2010 to SAR 31.2 billion in 2011, by SAR 3.9 billion or 14.3%. Along with customer deposit growth, the success of securing one billion SAR of long term funding by issuing our Sukuk was a breakthrough as the first Shari'ah compliant bank to issue Sukuk in Saudi Arabia.

Treasury's investment portfolio grew from SAR 3.7 billion in 2010, to SAR 4.8 billion in 2011, an increase of SAR 1.1 billion, or 30% in line with the deposit growth.

#### **Aljazira Capital (AJC)**

2011 was a defining year for Aljazira Capital; a year during which the company strengthened itself for business growth and was also successful in maintaining a leading market share of just over 15% in the local brokerage market.

Consistent with the strategic direction of diversifying AJC's revenue stream, a number of significant initiatives were undertaken to strengthen AJC's brokerage capabilities and enhance its Asset Management business product offerings. Equity trading is now offered through AJC's online Global Trading Platform for UAE, Qatari and the US markets. Plans to launch online services for other regional and international markets are already in place. AJC's local brokerage business executed trades worth almost SAR 330 billion during 2011. Total client assets under administration amounted to over SAR 17 billion at the end of 2011.

AJC's commitment to the further development of its Asset Management business is reflected in the fact that assets under management grew by just over 30% during 2011 to SAR 868 million, outperforming the overall market which declined by 10% during the same period. Improved fund management performance during 2011, in particular for AJC's Al Qawafel and Al Taiyebat Funds, resulted in a renewed interest and subscriptions from both individual and institutional investors. We are pleased to report that the performance of the Al Taiyebat Fund (Shari'ah compliant, local equity fund) was #1 in its category for 2011. Fund product development was also a priority during 2011: two Real Estate Funds were launched and an Emerging Markets Fund was approved by CMA during 2011.

AJC's Investment Services business remains a high strategic priority for business growth. 2011 witnessed a significant increase in the size and quality of AJC's advisory and underwriting deal pipeline. Deals completed during 2011, that AJC was proud to be associated with, included the co-participation in the rights issuance of Jabl-e-Omar and as lead underwriter for Al Ahli Takaful Company.

AJC's financial performance for 2011 showed substantial improvement over 2010. Total revenues of SAR 203 million (SAR 161 million in 2010) and total operating expenses of SAR 134 million, (SAR 163 million in 2010) resulted in a net income of SAR 69.5 million in 2011, compared to a net loss of SAR 1.3 million during 2010. Improving market conditions in 2012 are expected to have a positive impact on the further development of AJC's Asset Management and Brokerage businesses, and the net income. AJC expects to benefit from the return of value-conscious international and local investors to local and regional markets.

AJC looks to 2012 with cautious optimism. Management believes that the solid underlying fundamentals for the Saudi economy will exert a positive influence on the further development of Saudi capital market.

### **Aljazira Takaful Taawuni**

Aljazira Takaful division (TTD) is considered as the first Takaful life insurance provider in the Kingdom and through its inception has accounted for around 28% of the protection and saving sector (life insurance) market in the kingdom.

The major highlight of the 2011 was the progress made in the operational regulatory segregation of the company from the Bank (i.e. from the preparation of the CMA file to enhancement of the core life insurance system.) In addition significant work is underway to improve the current operational workflow to achieve an enhanced operational efficiency.

Also during 2011 TTD developed its new corporate identity; the brand as a protection and saving institution. The new visual identity is in line with the overall positioning of Aljazira Takaful as a prestigious contemporary world class insurance organization.

Aljazira Takaful Taawuni will continue to utilize its agency model and build on its already existing 11 TSA Offices allocated in the Kingdom as well as meet client needs through the improved version of TTD flagship product, the individual retirement contract which has been filed with regulators for approval.

### **Finance Group - Control, Policy and Planning**

The financial management and control function of the Bank has been significantly strengthened with the introduction of senior and middle management finance professionals with extensive international and domestic experience. The Group's functions are mainly geared towards developing strategic financial road map for the medium and long term capital planning and financial performance of BAJ in line with the management's and Board's key priorities. In addition, the Group is instrumental in safeguarding the assets and financial interests of the Bank. Compliance with International Accounting Standards, fulfilling the requirements of regulatory bodies, actively planning and ensuring compliance of critical regulatory ratios, are the key responsibilities of the Group, and in this context maintenance of accurate financial records, periodic reporting to regulators, the



Board and Shareholders form a core activity and responsibility of the Group.

Saudi Arabian Monetary Agency (SAMA), Department of Zakat and Taxation, and Saudi Capital Market Authority (SCMA) are the main regulatory bodies that the Group remains continuously engaged with, in addition to, managing Internal and External Audits.

The Group is continuously developing and enhancing the capabilities of financial and management information systems to generate accurate and timely information to manage the Bank's activity, exercise appropriate financial control and regulate the business. As a result of the Group's efforts, implementation of the state of the art MIS System COGNOS was achieved in 2010. The System has been further enhanced during 2011 and provides up to date information to the senior management team and the businesses at all performance levels and has also assisted us in automating our Budgeting, Planning and Fund Transfer Pricing processes.

### Human Capital Group (HCG)

The HCG continues its vital role as a strategic partner of all business functions, setting a culture of fair and healthy competition that strives for continual performance excellence for all bank staff. The HCG continues to address the entire range of HC roles and exercises controlling oversight over all HC and staff issues and practices, including consultative and advisory input to all the business units on all facets and aspects of the HC function.

The full implementation of the 1st ever comprehensive grading system, with standardized compensation and benefit bands, tiers and scales was the biggest HC operational milestone for 2011, followed by the migration of all staff data to the new HRMS management system and followed as well by the survey to explore the employees' views towards how to enhance the Bank's business.

On the Saudization front, the HCG continues working in tandem with all business areas and sources both internally and externally to assure that the Bank retains the high success rate of effective Saudization of over 88%. Training for personal, technical, and business related development, and full regulatory compliance also continues to be a primary focus. The net result was 353 training events, with an average of 4 training days per staff across the entire BAJ Group, including Takaful Taawuni and Aljazira Capital.

### Risk Management Group (RMG)

BAJ maintains a prudent approach to risk taking and considers risk management to be an integral part of the Bank's decision-making process. Today much emphasis is placed on the use of sophisticated techniques to identify, measure and mitigate risk through a robust corporate governance structure, and the leveraging of the collective experience of a disciplined management. Thus BAJ can expect the risk to minimize it at its source.

The RMG is empowered to identify, evaluate and mitigate risk, however and wherever, it may arise from the business and operating activities of BAJ, and through regular reporting to the executive management is able to ensure that credit policy is always aligned with the risk appetite of the Board.

The RMG seeks to achieve an appropriate balance between risk and reward across our various business activities, working in partnership with the business units to assist in delivering our growth targets within a controlled risk environment.



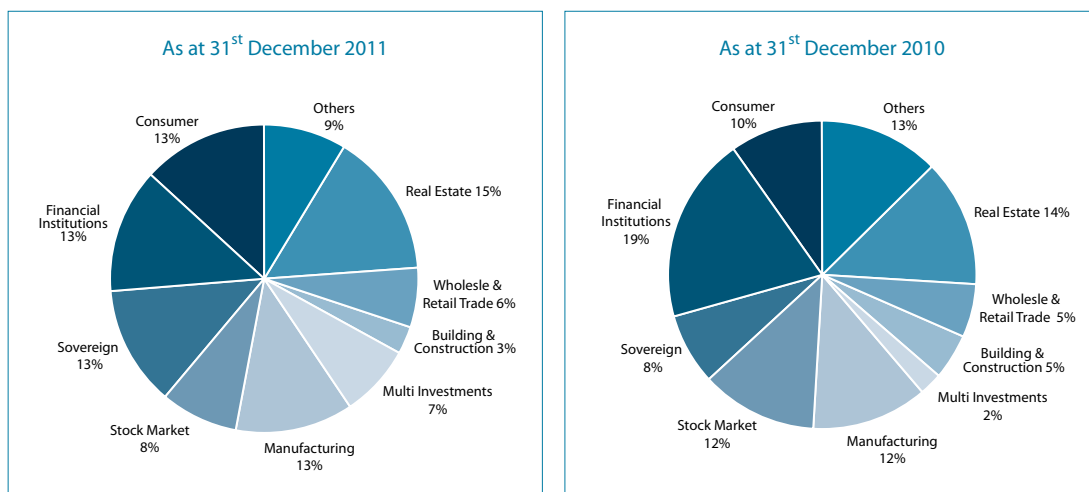
Loans and advances to customers account for the principal source of credit risk to the Bank. BAJ's risk management policies and processes are designed to identify and analyze risk, set appropriate risk appetite, limits and controls, and monitor the risks and adherence to limits by means of reliable and timely data. An area of particular review is risk concentration and this is constantly monitored in terms of industry sector, maturity and risk rating.

2012 will be a challenging year for our RMG as it prepares for the gradual implementation of Basel III. Specific initiatives for 2012 include refinement of our risk management framework to keep pace with the planned growth of the Bank, focus on employing, training and retaining high-quality people, enhancement of our stress-testing framework to align with best practice in providing forward-looking results to assist in capital planning and the mitigation of potential future risks, management of risk concentrations across counterparties, portfolios, and geographic regions, with an increased focus on distribution strategy, and finally focus on operational risk and fraud awareness across the bank in line with industry best practice and the enhancement of our existing systems and processes.

The following charts illustrate the concentrations of the Bank's loans and advances as at 2010 and 2011 year ends.

Outstanding Loans and Advances as at 31 <sup>st</sup> December 2010	SAR 18,704 million
Outstanding Loans and Advances as at 31 <sup>st</sup> December 2011	SAR 23,307 million

### Loans and Advances by Industry

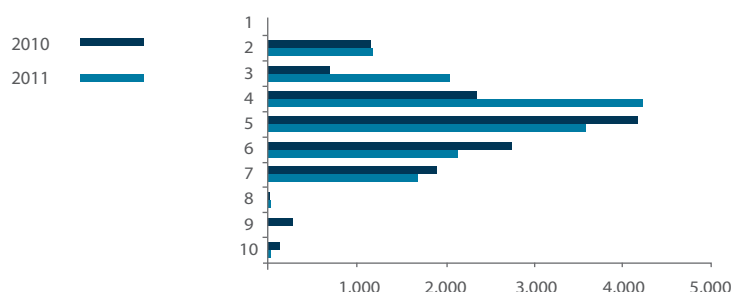


### Maturity Analysis of Loans and Advances to Customers

	Within 3 months	3 – 12 months	1 – 5 years	Over 5 years	No fixed maturity	Total
31 <sup>st</sup> Dec 2010	2,533,647	6,476,595	5,861,465	3,441,825	390,910	18,704,442
31 <sup>st</sup> Dec 2011	3,091,910	8,367,908	7,076,316	4,645,209	126,108	23,307,451



## Loans and Advances to Customers by Risk Rating



## Risk Management Framework

Various committees enable executive management and the Board to evaluate the risks faced by the Bank, as well as the effectiveness of the BAJ's management of these risks. These committees are integral to the Bank's risk governance structure.

## Shari'ah Group

The Shari'ah Group continues to exert efforts to create mass awareness about the Islamic Banking and its various features as BAJ was amongst the leading banks in the Kingdom to lay down the corner stone of the innovative Islamic banking. On the regulatory side, the Shari'ah Group contributed by making suggestions in 6 Shari'ah Committee meetings held at SAMA during 2011 to improve the regulatory environment for the Islamic Banks to easily implement their respective Shari'ah compliance strategies. In compliance with BAJ's Corporate Governance framework guidelines, the Shari'ah Board Charter was enhanced substantially and presented to the Executive management for obtaining the Board's approval so as to enhance the Shari'ah Governance in the Bank.

The Shari'ah Group compliance strategy for 2011 was developed to focus on product process and procedures instead of transaction's Shari'ah compliance only. The Shari'ah Group focused on fixing process and procedure gaps by recommending and implementing preventive, detective, and corrective controls. Thirteen control variables were identified on which the performance and accountability framework was built and implemented in the Shari'ah Group through introduction of the Balanced Score Card.

The Shari'ah Group provided support services to all internal and external stakeholders of the Bank. During 2011 the Shari'ah Group received a total of 97 references compared to 70 received in 2010 showing an increase of 38%. A total of 163 replies, instructions and guidelines were issued to all related internal and external stakeholders compared with 94 replies, instructions and guidelines provided during 2010 showing an increase of 73%.

During 2011, five Shari'ah Board meetings were arranged and conducted, 15 Issues were presented to the Shari'ah Board and 14 decisions made. The Shari'ah compliance reports are presented to the Shari'ah Board periodically. A consolidated 2011 Shari'ah audit report will be presented to the Board of Directors along with BAJ's final 2011 annual financial statements.

The Research and Development Center (RDC) conducted a review of Bank's key products to ensure their compliance with the Shari'ah processes and procedures, and resulted in the identification of 14 probable Shari'ah controls. The RDC conducted also a gap analysis of the existing Credit Cards and recommended Shari'ah compliant process and procedures. The RDC assisted by proposing 6 product structures (2 for Syndication division, 1 for Trade Financing outside KSA, 1 Overdraft Product, 1 Sukuk Structure for Al Jazira Capital customer and 1 diminishing Musharaka for CBG customer).

## Internal Audit Group

The Internal Audit's role is to assist the Bank in accomplishing its objectives by bringing a systematic and disciplined approach to evaluate and improve the effectiveness of the Bank's risk management, control, and governance processes.

The Internal Audit was established by the Board of Directors and its responsibilities are defined by the Audit Committee of the Board as part of their oversight function.

The scope of Internal Audit encompasses the examination and evaluation of the adequacy and effectiveness of the Bank's governance, risk management process, system of internal control structure, and the quality of performance in carrying out assigned responsibilities to achieve the Bank's stated goals and objectives. The Internal Audit also coordinates the review

of quarterly financial statements and annual audits with the external auditors.

The Internal Audit provides an independent and objective appraisal of activity for senior management and furnishes them with analyses, recommendations, and information concerning the activities reviewed. This includes promoting effective controls at reasonable cost to safeguard the Bank's assets and protect the interests of its stakeholders.

### **Compliance**

In order to fully implement the requirements of Compliance Manual published by SAMA, Compliance Group made extraordinary efforts to enhance the level of compliance culture at BAJ; and to implement the compliance manual and compliance program, where 98% of BAJ employees were trained on compliance.

In addition, respective BAJ employees were informed of the latest SAMA, and CMA rules and regulations; some of which were also published on BAJ's Intranet, contributing effectively in enhancing the overall compliance culture.

The Compliance team continued to carry out their routine tasks; such as monitoring the efficient implementation of compliance policy and compliance function within the Bank; review new policies and procedures, products and services, forms and contracts; review samples of accounts opened, outsourcing contracts, and review of Anti Money Laundering policies and procedures.

### **Strategic Management & Business Transformation Group**

To take BAJ to the next level of operational and financial performance excellence, management continues to work on the previously embraced ambitious transformation plan, which defines a list of strategic initiatives designed to achieve our long-term vision to become the bank of choice for Shari'ah compliant banking solutions by the year 2013. The Group is dedicated and working for effective implementation and delivery of all projects, and identifies potential business opportunities.

The group consists of the 5 teams: Change Delivery (CD), Enterprise Projects Management Office (EPMO), Straight through Processing (STP), Quality and Standards (QS), and Procurement Team.

The CD Team is in charge of identifying and analyzing business opportunities and recommending appropriate initiatives that will boost the Bank's profitability. During 2011, the team played a pivotal role in determining best quality proposals that meet all the business requirements and specifications and led negotiations with vendors that saved the Bank a significant amount of money.

The EPMO Team is in charge of projects delivery and execution of the approved initiatives and projects. During 2011, the team has delivered many strategically important projects; such as, space optimization, launching Aljazira Smart service, establishing the new call center in Riyadh, and launching the new Treasury system.

The Procurement Team is in charge of establishing and managing 3rd parties vendors, contracts negotiation & management and assists in evaluating vendors proposals along with CD team. During 2011, the team has made additional saving before releasing the purchase orders and has created vendors data bases and implanted a vendor selection process.

The STP Team is in charge of identifying the processes to be optimized to offer a better quality of services to customers and improve our profitability through the Business Process Re-engineering. During 2011, the team has worked on process reengineering of many processes such as enhancement of customer account opening, vendor selection and requisition function Process, branch expansion process life cycle, ATM deployment process life cycle.

The QS team is in charge of setting the standards across the Bank and monitoring the quality across the Bank. During 2011, the team's focus was on improving the customer compliant process through all the channels and SAMA, creating a standard service level agreement among the different units in the Bank to ensure smooth operational execution and communication, and conduct a "Mystery Shopping" for the branches that aimed to improve the customer services in the branches

### **Support Group (SG)**

The SG played a vital role during 2011 in supporting all Bank's sectors through significant capital investment in Information Technology, Operations re-organization, process reengineering and improved management



skills. The SG selected proper technological solutions to propel the Bank's strategy towards expansion in branch network and electronic channels. The Group performed a comprehensive review over all processes to ensure prompt and accurate execution, cover for the growing number of processed transactions which was increased by 45%, and sustain the typical utilization of human resources skills and experiences.

The SG has embarked on a number of initiatives resulted in the enhancement of performance, cost reduction and income growth; in addition to the reinforcement of communication channels to effectively manage the change. The Group played a vital role in launching "Aljazira Smart" mobile banking service and establishment of the new Customer Call Center in Riyadh with the required equipment, systems, and premises. Also, the Group extended full support in establishing new branches and leveraging Jeddah Head Office space utilization.

During 2011, the SG started the implementation of the automated reconciliation system, introduction of the Loan Management System, establishment of Data and Disaster Recovery Centers as per work requirements, reinforcement of the internal controls on the intranet, establishment of improved IT management processes, and assessment of Bank's web-based security weaknesses and has begun hardening networks against intrusion. At the meantime, the Group exerted a great effort in solidifying the treasury systems, and began to replace the ATM Switch, and renewed the certification of PCI as a mandatory compliance requirement in line with card industry standards. The SG initiated the establishment of working teams based on transparency principle and quality initiatives.

The SG looks forward in 2012 to introducing high level technologies so BAJ would be a leader in providing services to customers through smart phones and tablet-based channels by leveraging high technologies aligned to robust flexible platforms that support branch services as well as other electronic delivery channels.

The Group will continue to exert all efforts through a stable flexible platform to provide integrated capabilities that support reconnaissance of customer requirements and needs by investing in customer overall relationship management applications and establishing a data-driven customer centric platform with which to optimize our brand, customers, staff and ultimately our shareholder value. We will facilitate all the way leading to customer service excellence.

## Credit Ratings

Description	Capital Intelligence as of May-2011	Moody's as of February - 2010	Fitch Ratings as of June - 2011
Foreign currency risk-shortterm	A2		F2
Foreign currency risk-long term	BBB+		A-
Financial strength rating	BBB	D+	
Support rating	2		1
Outlook rating	Stable	Stable	Stable
Bank Deposits		A3/P-2	
Sovereign risk - short term	A1+		AA-
Sovereign risk - long term	AA-		AA-

### Dividends

The Board of Directors, in their meeting No. 172 held on December 26, 2011, has recommended a dividend of SR 0.50 per share against its net income of 2011. The net dividend distribution and the zakat will aggregate to SAR 160 million.

### Statutory Appropriations

The statutory appropriation of SAR 76 million has been made from 2011 Net income to the Statutory Reverse, in accordance with Article 13 of the Banking Control Law.

### Long-Term Borrowing

During 2011, BAJ successfully launched the issuance of Sukuk. Such issuance has demonstrated the Bank's capability of generating the funds as and when needed. The current issuance amounted to SAR 1.0 billion. The Sukuk form part of Bank's tier two capital base for the purpose of capital adequacy ratio, and are listed on Saudi stock market (Tadawul).

### Corporate Governance

#### Dividend Policy

The Bank distributes dividends to the Shareholders in accordance with Article (45) of the Statute of the Bank as follows:

The company's annual net profits will be distributed after deduction of general expenses and other costs, and allotting of reserves for doubtful debts and losses on investments and contingent obligations which the Board of Directors shall consider necessary in accordance with the provisions of the Banking Control Law, as follows:

- (A) The due amounts of Zakat required from Saudi shareholders, and the tax imposed on non-Saudis shall be calculated in accordance with the effective regulations of the Kingdom of Saudi Arabia. The company shall pay these amounts to the competent authorities and the deduction of Zakat paid for the Saudis from their share in net profit. Likewise, the paid tax on non-Saudis shall be deducted from their share in net profit.
- (B) At least 25% of the net profit balance will be transferred after deduction of Zakat and tax, as stated in the above paragraph (A) to the legal reserve until the said reserve becomes at least equal to the paid-up capital.
- (C) After deducting the legal reserve, Zakat and tax, an amount of the remaining profits; not less than (5%) of the paid-up capital, shall be allotted for distribution to shareholders of both Saudis and non-Saudis, provided that the distribution should be made on the basis of the paid-up value of shares of Saudis and non-Saudis as proposed by the Board of Directors and determined by the General Assembly. If the remaining percentage of profits due to any of the concerned shareholders is insufficient, the shareholders then shall not claim to be paid in the following year or the years after, and the General Assembly shall not decide to distribute a percentage of profits more than what was proposed by the Board of Directors.
- (D) The remaining amount shall be used after the allocation of the amounts mentioned in paragraphs (A, B, C) above as proposed by the Board of Directors and as determined by the General Assembly.
- (E) The percentage of shares owned by both Saudis and non-Saudis shall be maintained when calculating the necessary provisions from net profits against the legal reserve and other reserves after deduction of Zakat and taxes. Each of the two shareholder groups, whose contribution to the reserves is made according to their shares in the capital, and their contribution, shall then be deducted from the net profit.

The Board of Directors, in their meeting No. 172 dated December 26, 2011, has made a recommendation to the next General Assembly to distribute dividends to the shareholders at SAR 0.50 per share, upon obtaining the required consent from the respective authorities and shall be in effect following the General Assembly's meeting during the first quarter of 2012.

#### Bank Dealings with Board of Directors, Chief Executive Officer, and Chief Financial Officer

Notwithstanding the information included in note (34) in the Audited Financial Statements "Related Party

Transactions" that have been conducted according to the same terms and conditions as transactions with independent third parties, there are no substantial interests for the Board of Directors, the Chief Executive Officer or the Chief Financial Officer.

#### Contract with Basma Real Estate Assessment Company

The Shareholders General Assembly of Bank Aljazira approved in their meeting No. 46 dated on 01/05/1432 corresponding to April 05, 2011 to renew some of the real estate assessment assignments with Basma Company for one year as per the terms and conditions included in the contractual agreement between the Bank and Basma Company whose registered office is located in Riyadh - where the Bank Board of Directors' member Mr. Khaled bin Omar Al-Baltan owns 40% of its capital. The total fees paid to Basma Company during 2011 were SAR 264 Thousands for real estate evaluations.

The Board of Directors determined in their meeting on October 24, 2011 to terminate the contract with Basma Company as the need of such arrangement is no more required.

#### Governance

BAJ strictly abides by the rules of corporate governance that realize the strict implementation of the overall internal control systems, policies of transparency and commitment to the principles of risk management. BAJ also strives to ensure the overall business is in compliance with regulations and laws of the Kingdom and to continuously bring in the latest performance criteria for the global banking in terms of overseeing the banking performance, including the directives of Saudi Arabian Monetary Agency (SAMA), the Saudi Capital Market Authority (SCMA), and all requirements and recommendations issued by the Basel Committee.

On the basis of paragraphs (c) of Article I and Para (a) of Article IX of the Rules of Corporate Governance in the Kingdom of Saudi Arabia issued by the SCMA, BAJ applies all the provisions contained in the Regulations with the exception of the following Article:

Article No.	Article Content	Paragraph	Reasons for Non- Application
Article 6: Voting Rights	Voting is considered a substantial right for the shareholder, who cannot be ignored by any means, and the company is to avoid any measure that may lead to hindering the use of voting right and all efforts should be exercised to facilitate voting.	B) The method of accumulative voting should be followed when voting to select the directors of the board in the general assembly.	The accumulative voting is not effective yet as a mandatory practice.

All principles of Corporate Governance issued by the SCMA are also included in the corporate governance regulations of BAJ in a detailed manner to ensure monitoring and controlling their effectiveness and developing and modifying them as needed by the Board of Directors.

SAMA, SCMA, GOSI and Municipalities have imposed fines on the Bank with a total of SAR 1.4 million during 2011.

## A. Board of Directors

The Board of Directors consists of (9) members, including (6) independent and (3) non-executive. The Board held five meetings in 2011 and (four meetings in 2010), as detailed in the following table:

Member's name	Capacity	1st mtg 05/04/2011	2nd mtg 27/05/2011	3rd mtg 13/08/2011	4th mtg 24/10/2011	5th mtg 26/12/2011	TOTAL
Mr. Taha bin Abdullah Al-Kuwaiz	independent	1	1	1	1	1	5
Mr. Abdullah bin Saleh Kamel	independent	1	-	-	1	1	3
Mr. Mohammed bin Abdullah Al-Angari	independent	1	1	-	1	1	4
Eng. Tarek bin Othman Al-Kasabi	non-executive	1	1	1	1	1	5
Mr. Khalifa bin Abdul Latif Al-Mulhem	independent	1	1	1	1	1	5
Mr. Khaled bin Omar Al-Baltan	independent	-	1	1	1	-	3
Eng. Abdul Majeed bin Ibrahim Al-Sultan	non-executive	1	1	1	1	1	5
Mr. Mohammed bin Abdullah Al-Hagbani	non-executive	1	1	-	1	1	4
Mr. Hisham bin Abdul Malik Al-Sheikh	independent	-	1	1	-*	-	2

\*The Board of Directors decided in their meeting No. 171 dated October 24, 2011 to accept Mr. Hisham bin Abdul Malik Al-Sheikh's resignation from the Board's membership, upon his request, effective October 24, 2011. The Board's declaration was published at Tadawul site at closure of trading on the said date as per applicable practice.

In general, the Board of Directors controls the Bank's performance and operation through periodic meetings during the year, develops policies, and ensures proper implementation. In addition, the Board periodically reviews the effectiveness of existing regulations and internal controls and monitors the key sectors of the Bank to make sure that the general policies and risk management levels set by the Board are satisfactory implemented.

Through the Audit Committee, the Board also reviews the financial position of the Bank with the external auditors to ensure the integrity of its financial performance and full compliance with laws and regulations and accounting standards applicable in the Kingdom of Saudi Arabia. The Board of Directors confirms its statutory responsibility for the accuracy of financial statements and that they fairly reflect the financial position of the Bank and its results, and ensure compliance of all its operations with the controls laid-down by the Shariah Board of the Bank.

As regarding the members of the Board of Directors of BAJ; who are also board members in Saudi joint stock companies listed/unlisted in the Trading System (Tadawul) as at the end of December 31, 2011, are as follows:

Board member's name	Membership in other joint-stock companies boards of directors
Mr. Taha bin Abdullah Al-Kuwaiz	Saudi Kayan Petrochemical Company - Member of the Board of Directors
Mr. Abdullah bin Saleh Kamel	Asir Company - Chairman of the Board Amlak International for Real Estate Development and Finance - Chairman of the Board Saudi Research Group - Member of the Board Emaar the Economic City - Member of the Board
Eng. Abdul Majeed bin Ibrahim Al-Sultan	Qassim Cement Company - Member of the Board
Mr. Mohammed bin Abdullah Al-Hagbani	National Petrochemical Company - Member of the Board Representative of the General Organization for Social Insurance (GOSI)
Eng. Tarek bin Othman Al-Kasabi	Aseer Co. - Member of the Board
Mr. Khalifa bin Abdul Latif Al-Mulhem	Advanced Polypropylene Company - Chairman of the Board Nama Chemicals Company - Member of the Board Riyadh Cement Company - Member of the Board
Mr. Khaled bin Omar Al-Baltan	Al Ehssa Development Company – Chairman of the Board of Directors
Mr. Mohammed bin Abdullah Al-Angari	Jeddah Holding Company for Development

It should be noted that the members of the Board had been elected by the Ordinary General Assembly «Forty-fourth» in its meeting held on Muharram, 04 1431H corresponding to December 21, 2009 at the headquarters of the Bank in Jeddah, for the current session which began on January 01, 2010 for a period of three years effective up to December 31, 2012.

Description of any interest in the shares bearing voting rights belonging to persons (except the Board of Directors, Senior Executives, their spouses and under-aged) who reported such equities to the Bank as per Article 30 of the Registration and Listing rules, and changes to such equities during the fiscal year, is as follows:

Name of Person Who has Interest	Beginning of the year 2011		During the year 2011		End of the year 2011	
	No. of shares	Percentage of ownership	No. of shares	Percentage of change	No. of shares	Percentage of change
Rashed Al- Abad al Rahman Al-Rashed & Sons	66,791,880	22.26%	66,791,880	-	66,791,880	-
National Bank of Pakistan	17,500,000	5.83%	17,500,000	-	17,500,000	-
Sheikh/ Saleh Abdullah Mohammed Kamel	15,000,000	5.00%	15,000,000	-	15,000,000	-

Description of any interest, option or prescription rights belonging to Bank's Board of Directors, Senior Executives, their spouses and under-aged in the Bank's shares, debit instruments or any of its subsidiaries, and any change to such interest or rights during the last fiscal year, is as follows:



#### Board of Directors:

Name of Person Who has Interest	Beginning of the year 2011		During the year 2011		End of the year 2011	
	No. of shares	Percentage of ownership	No. of shares	Percentage of change	No. of shares	Percentage of change
Mr. Taha bin Abdullah Al-Kuwaiz	174,333	0.06%	174,333	-	174,333	-
Mr. Abdullah bin Saleh Kamel Al Tafeeq Develop House Co.	10,005,000 2,692,578	3.34% 0.90%	10,005,000 2,692,578	- -	10,005,000 2,692,578	- -
Mr. Mohammed bin Abdullah Al-Angari	526,000	0.18%	527,000	0.29%	530,000	0.47%
Eng. Tarek bin Othman Al-Kasabi	8,999	0.00%	8,999	-	8,999	-
Eng. Abdul Majeed bin Ibrahim Al-Sultan	63,000	0.02%	1,000	98%	1,000	-
Etihad Brothers Develop. Co.	19,781,816	6.59%	19,781,816	-	19,781,816	-
Mr. Khaled bin Omar Al-Baltan	11,990,320	4%	11,990,320	-	11,990,320	-
Mr. Khalifa bin Abdul Latif Al-Mulhem	1,256,451	0.42%	929,701	26%	929,701	-
General Organization for Social Insurance - (represented in the Board of Directors by Mr. Mohammed bin Abdullah Hagbani)	12,275,138	4.09%	12,275,138	-	12,275,138	-
* Mr. Hisham bin Abdul Malik Al-Sheikh	10,000	0.00%	10,000	-	10,000	-

\*The Board of Directors decided in their meeting No. 171 dated October 24, 2011 to accept Mr. Hisham bin Abdul Malik Al-Sheikh's resignation from the Board's membership, upon his request, effective October 24, 2011.

The Board of Directors consists of (9) members representing the legal persons, natural persons and representatives of the Board in their personal capacity.

#### Senior Executives:

Name of Person Who has Interest	Beginning of the year 2011		During the year 2011		End of the year 2011	
	No. of shares	Percentage of ownership	No. of shares	Percentage of change	No. of shares	Percentage of change
Mr. Nabil bin Dawood Al-Hoshan (Chief Executive Officer)	25,000	0.01%	25,000	-	25,000	-

## B. The Main Committees of the Board of Directors

To meet the statutory requirements, achieve optimal performance and benefit from the diverse expertise of the members of the Board, the following key committees have been set up to support its operations:

### 1. Executive Committee

The Executive Committee of BAJ consists of members chosen by the Board of Directors and chaired by the chairperson at this session of the Board. The Board of Directors determines the jurisdiction and powers of this Committee. It is the responsibility of the Executive Committee; in accordance with the delegated powers, to monitor the implementation of the strategy and policies set by the Board of Directors, risk management and control of the Bank's performance, recommend the budget and plan of action submitted for the fiscal year, and ensure proper implementation of the policies of the Board of Directors. In addition, the Committee is responsible for monitoring the efficiency of internal control standards and policies' implementation.

The Executive Committee for the current session has been formed in the Board of Directors' meeting held on Safar 01, 1431 H (corresponding to January 16, 2010), where the Committee held ten meetings during 2011 (nine meetings in 2010), attended by members of the Committee as described in the following table:

Name	Functional duties	No. of meetings attended
Mr. Taha bin Abdullah Al-Kuwaiz	Chairman of the Executive Committee	10
Eng. Tarek bin Othman Al-Kasabi	Member of the Executive Committee	8
Eng. Abdul Majeed bin Ibrahim Al-Sultan	Member of the Executive Committee	10
Mr. Khalifa bin Abdul Latif Al-Mulhem	Member of the Executive Committee	9
Mr. Khaled bin Omar Al-Baltan	Member of the Executive Committee	5

## 2. Audit Committee

This committee plays a key role in helping the Board of Directors to deliver the statutory duties of financial, accounting and audit risk limits in addition to auditing tasks and coordination with external auditors of the Bank. The Committee reviews on quarterly basis the financial statements and assists the Board of Directors in carrying out the evaluation and annual review to ensure the effectiveness of internal controls, identify potential risks and develop strategic plans to counter them.

The results of the annual efficiency audit of the internal control procedures of the Bank have reflected excellent levels. In this regard, BAJ adopts all policies and procedures required by various statutory bodies in addition to international practices.

The Audit Committee consists of the chairperson to be chosen from the non-executive members of the Board of Directors and three independent members from outside the Bank. The meetings of the Audit Committee are attended by the Chief of Internal Audit Department and the Chief Financial Officer on constant basis. The meetings are also attended by the CEO and senior executives as required. The Audit Committee was formed for the current session of the Board on July 04, 2010, where the Committee held five meetings during 2011 (three meetings in 2010), attended by the Chairperson and Members, as shown in the table below:

Name	Functional duties	No. of meetings attended
Mr. Mohammed bin Abdullah Al-Hagbani	Chairman of the Audit Committee	5
Mr. Faraj bin Mansour Abu-Thunain	Member of the Audit Committee	4
Mr. Majid bin Abdallah Al-Haqeel	Member of the Audit Committee	5
Mr. Fawaz bin Mohammed Al-Fawaz	Member of the Audit Committee	4

## 3. Nominations and Remuneration Committee:

Following the issuance of BAJ's compliance charter, this committee was launched as a subcommittee reporting to the Board of Directors. Annex (G) of said charter specifies the bases of committee's structure, its mission and responsibilities, as per the CMA's issued rules and regulations with regard to corporate compliance.

The functions and responsibilities of this committee focus on recommending nominations and remunerations to the Board of Directors as per the approved policies and standards, performing an annual review on the skills required, and reviewing the Board of Directors' structure and recommending those changes that can be carried out, ensuring the independency of independent members and non-existence of any interest of any member who is a member in any other company board of directors, consolidating the recommended assignments with the required skills, potentials and experiences, and developing and reviewing policies attributive to the Board of Directors and senior executives' bonuses and compensations.

The Extraordinary General Assembly ratified; in its meeting No. 42 dated Rabi Thani 10, 1429H corresponding to April 16, 2008, the selection rules of the Committee and its responsibilities in accordance with article No. 15 issued by the CMA and as per the Board of Directors' recommendation.

The Nomination and Remuneration Committee was formed for the current session in the Board's Meeting held on Safar 01, 1431H (corresponding to January 16, 2010), where the Committee held three meetings during 2011 (five meetings during 2010), attended by the Chairman and Members of the Committee as described in the following table:



Name	Functional duties	No. of meetings attended
Mr. Taha bin Abdullah Al-Kuwaiz	Chairman of the Nomination and Remuneration Committee	3
Eng. Tarek bin Othman Al-Kasabi	Member of the Nomination and Remuneration Committee	3
Mr. Khalifa bin Abdul Latif Al-Mulhem	Member of the Nomination and Remuneration Committee	1*

\*The Board of Directors decided on December 15, 2011 to appoint Mr. Khalifa bin Abdul Latif Al-Mulhem as a member of the Nomination and Remuneration Committee to replace the resigned member Mr. Hisham Al-Sheikh who attended one meeting of the Committee held during the 1st half of 2011.

#### 4. Risk Management Committee:

The Committee is responsible for controlling and overseeing the potential risks associated with the Bank's business and checking the Bank's capabilities to manage and counter risks based on the analysis provided by the Bank's Chief of Risk Officer. In addition, the Committee is responsible for developing proper policies and checking-up risk management's scope of functionality and targeted activities.

The Risk Management Committee; which was re-structured within the Board's Committees, comprises three Members as follows:

Name	Functional duties
Mr. Khalifa bin Abdul Latif Al-Mulhem	Chairman of the Risk Management Committee
Mr. Mohammed bin Abdullah Al-Hagbani	Member of the Risk Management Committee
Mr. Hisham bin Abdul Malik Al-Sheikh	Member of the Risk Management Committee

Based on the interchangeability of the Committee's responsibilities and duties with the other subcommittees, the Board of Directors decided to dissolve the Committee at their meeting No. 172 dated December 26, 2011 with immediate effect and transfer its functional responsibilities to the Executive Committee.

#### C. Payments to the Board Members and Senior Executives:

The Bank shall pay the expenses and remuneration for attending the meetings of the Board of Directors and members of the subcommittees. The total of these payments during 2011 for members of the Board of Directors and five senior executives, including the Chief Executive Officer (CEO) and Chief Financial Officer (CFO) are as follows:

##### Remuneration and Allowances Paid to the Board of Directors and Five Senior Executives, including the CEO and CFO

Statement	Executive Members of the Board	Non- Executive / Independent Members of the Board	(SAR thousands) Payments to five Senior Executives, including CEO & CFO
Salaries and compensations	-	-	13,805
Allowances	-	5,309	1,285
Periodic and annual bonuses	-	-	4,550
Incentive plans	-	-	1,500
Any compensation or benefits payable on a monthly or annual basis	-	-	-
<b>Total</b>	<b>-</b>	<b>5,309</b>	<b>21,140</b>

### D. Shareholders' Meetings during 2011:

During 2011, the General Assembly held one meeting which was the Ordinary Shareholders General Assembly No. 46 dated Jamad Awal 01, 1432H corresponding to April 05, 2011. The General Assembly endorsed the financial statements of 2010 and all other related items on the agenda.

### Internal Controls

Being a financial institution, BAJ pays special attention to ensure existence of an internal controlled environment. At BAJ, effective internal control procedures are in place across the Organization and their effectiveness is continuously monitored and tested by the control functions in the Bank, and additionally tested by the independent external auditors and regulatory inspection teams.

### Anti-money Laundering

The Bank's current guidelines respective to anti-money laundering and the financial discipline violations combating are fully conform to the regulatory requirements. System is in place to ensure that business relationships are activated with customers after ensuring that the identity and activities of the customer are legitimate. All relevant information is collected and verified, and any suspicious cases are timely reported to the appropriate levels of Management.

### External Auditors

The external auditors are responsible for the annual audit and quarterly review of Bank AlJazira's financial statements. The Bank's Ordinary General Assembly meeting No. 46 held on April 5, 2011 (corresponding to 01/05/1432) approved the recommendation of the Board of Directors and the Audit Committee to re-appoint Ernst & Young and Deloitte & Touche Bakr AbulKhair & Co as the external auditors of the Bank for 2011.

### Social Responsibility

Bank AlJazira's Board of Directors pays special attention to 'Khair AlJazira le Ahl AlJazira' Program, where the Community Social Responsibility Division (CSR) continues to support the Saudi Community in collaboration with charitable societies and training centers Kingdom-wide to offer numerous activities and programs which would sustain the development of Saudi community individuals. Through 'Khair AlJazira le Ahl AlJazira' Program, BAJ disbursed SAR 7,253 million in 2011.

Moreover, BAJ played a vital role during 2011 in training Saudi young men and women and qualifying them for market through extending its support to the professional and apprenticeship programs and "Biedaiah" program, a training program ending with employment. Also, BAJ supported the training of the needy on computer skills through financing the blind and deaf training programs in collaboration with specialist societies and centers. In addition, BAJ financed a number of small business projects for the benefit of productive families. Young men and women from these needy families were trained in a variety of professions that would improve their living standards and create a steady income for them.

BAJ has paid special attention to the development of computer labs with required equipment in a number of charitable societies in support of their members towards using the modern technology. Also, the CSR held a number of cultural activities for boys and girls of needy families, in an effort to add a touch of joy to their life.

In general, 'Khair AlJazira Le Ahl AlJazira' offered a number of activities to community members in different regions and cities of the Kingdom. Such activities benefited approximately 1,560 young people. Besides being a founding member of the Prince Salman Center for Disability Research, BAJ contributes in Prince Salman WAQF for Disable Children's Association.

## Gratitude

The Board of Directors would like to take this opportunity to express their heartiest gratitude for the path-showing wise vision of the government under the leadership of the Custodian Of The Two Holy Mosques, King Abdullah Bin Abdulaziz Al-Saud, and to his Royal Highness, Prince Naif Bin Abdulaziz Al-Saud, the Crown Prince and the Deputy Prime Minister and the Minister of Interior.

We also offer our thanks to the Ministry of Finance, the Ministry of Commerce and Industry, the Saudi Arabian Monetary Agency and the Saudi Arabian Capital Market Authority for their constructive directives and continued support in the Bank's progress.

Finally, we would like to take this opportunity to extend our heartfelt thanks and appreciation to our shareholders, customers and associates for their confidence and support. We also like to reiterate our appreciation of our management and staff for their devotion and dedication, without which we would not have been able to achieve such excellent milestones and financial performance.



## Shari'ah Advisory Board's Report

Praises be to Allah, The Almighty, The Lord of the worlds, and Prayers and Peace be upon his Messenger Prophet Mohammed, and his descendents and all his followers.

Dear Bank Aljazira Shareholders,

The Shari'ah Board has reviewed and discussed the final annual report prepared by the Bank's Shari'ah Group, comprising the examination of documentation and processes adopted by the Bank, based on samples taken from each transaction type.

BAJ's Shari'ah Board also examined the Financial Statements for the period ending on 31st December 2011, as well as the principles followed, transaction contracts made and products offered by the Bank during the same period, so that the Shari'ah Board can issue opinion, fatwa, guidance and necessary decisions.

It is the Bank Executive Management's responsibility to make sure that Bank Aljazira is operating in compliance with the rules and principles of the Islamic Shari'ah. The Shari'ah Board's responsibility is restricted to providing an independent opinion based on their inspection of the Bank's operations through the Shari'ah Group and providing a report to the General Assembly.

We have performed the said inspection to obtain all information and interpretations that we considered necessary to supply us with sufficient evidence and reasonable confirmation that the Bank has not violated the Islamic Shari'ah rules and principles. Therefore, in our opinion:

1. Contracts, operations and transactions made by the Bank during the above mentioned period covered by this report are wholly compliant with the Islamic Shari'ah. Guidance was given for correction, where required.
2. The Bank did not provide us during the fiscal year any reports pertaining the gains made through sources or methods prohibited by the Islamic Shari'ah, and thus we are not sure if the Bank has disbursed such gains for charitable purposes.
3. The Shari'ah Board has noticed that the Bank is still using accounting terminology such as loans, advances and deposits (with reference to Murabaha) in their financial statements and notes. Therefore, the Shari'ah Board again requests the Bank's Management to comply with the Shari'ah terminology that conforms to the actually used structures.
4. The Shari'ah Board has noticed that the Bank is still keeping SAMBA stocks acquired as a settlement with a client although the Shari'ah Board has confirmed the necessity for disposal of such stocks as soon as possible. Thus, the Board re-urges and requests the Bank to quickly sell those stocks and transfer any amount in excess of the debit to the charitable purpose account.
5. The Shari'ah Board has already advised the Bank to task the chartered accountant to prepare the Zakat amount as per the Shari'ah standards and calculate the Zakat amount per share and present the results to the Shari'ah Board before approval. This remark was also made in our report last year and no report of such type from the chartered accounts has been received by the Shari'ah Board. As thus, the Shari'ah Board is not sure of the method followed in calculating the Shari'ah Zakat on the Bank's financial statements of 2011.

May Allah guide us to the right path

Sheikh Abdulla Bin Suleiman Al-Mane'e  
Chairman

Dr. Abdulla Bin Mohammed Al-Mutlaq  
Member

Dr. Mohammed Ali Al-Guari  
Member

Dr. Hamza Bin Hussain Al-Feir  
Member

Dr. Abdulsattar Abu Ghudah  
Member

Dr. Mohammed Bin Said Al-Ghamdi  
Rappoteur



BAJ is keen to contribute to the community's welfare by supporting charitable societies and activities through its «Khair Aljazera Le Ahl Aljazera» Program.



# Branch Network

## WESTERN REGION

### Makkah Mukarama

#### Aziziah Branch

Tel : (+966) 2 557 1010

Fax : (+966) 2 553 1655

#### Al Shawqiya Branch

Tel : (+966) 2 539 1826

Fax : (+966) 2 538 2493

#### Madinah Munawara

Tel : (+966) 4 845 1111

Fax : (+966) 4 845 1953

#### Madinah Munawara Branch (Ladies)

Tel : (+966) 4 845 1956

Fax : (+966) 4 845 1952

### Jeddah

#### Prince Sultan St. Branch

Tel : (+966) 2 607 5450

Fax : (+966) 2 607 5450 Ext. 208

#### Prince Sultan St. Branch (Ladies)

Tel : (+966) 2 607 0828

Fax : (+966) 2 607 0125

#### Tahlia St. Branch

Tel : (+966) 2 261 0725

Fax : (+966) 2 261 0485

#### Tahlia St. Branch (Ladies)

Tel : (+966) 2 261 0730

Fax : (+966) 2 261 0731

#### Al Musa'adia Branch

Tel : (+966) 2 661 0120

Fax : (+966) 2 661 0108

#### Al Musa'adia Branch (Ladies)

Tel : (+966) 2 667 3700

Fax : (+966) 2 667 3700 Ext. 8357

#### Al Balad Branch

Tel : (+966) 2 648 5533

Fax : (+966) 2 648 4599

#### Khalid Bin Al-Waleed St. Branch

Tel : (+966) 2 651 8070

Fax : (+966) 2 651 8070 Ext. 1012

#### Al Nahda Branch

Tel : (+966) 2 609 8500

Fax : (+966) 2 234 6838

#### Al Nahda Branch (Ladies)

Tel : (+966) 2 609 8520

Fax : (+966) 2 234 7227

#### Alaya Branch

Tel : (+966) 2 694 9224

Fax : (+966) 2 694 9117

#### Al Salama Branch

Tel : (+966) 2 691 9719

Fax : (+966) 2 691 9701

#### Al Safa Branch

Tel : (+966) 2 673 6712

Fax : (+966) 2 673 6874

#### King Fahd St. Branch

Tel : (+966) 2 659 7749

Fax : (+966) 2 659 7251

#### Al Samer Branch

Tel : (+966) 2 271 6058

Fax : (+966) 2 272 1870

#### Al Rabwa Branch (Makrona)

Tel : (+966) 2 682 7683

Fax : (+966) 2 683 6578

#### Rabigh Branch

Tel : (+966) 4 423 3311

Fax : (+966) 4 423 3366

#### Al Taif

##### Shehar Branch

Tel : (+966) 2 742 6678

Fax : (+966) 2 740 1737

#### Khamis Mushait

##### King Khaled St. Branch

Tel : (+966) 7 221 6465

Fax : (+966) 7 220 4230

#### King Khaled St. Branch (ladies)

Tel : (+966) 7 221 6465

Fax : (+966) 7 220 4231

#### Abha

##### King Saud St. Branch

Tel : (+966) 7 226 0798

Fax : (+966) 7 229 6243

#### Najran

##### King Abdulaziz St. Branch

Tel : (+966) 7 523 0421

Fax : (+966) 7 523 8267

## EASTERN REGION

### Dammam

#### Dammam Branch

Tel : (+966) 3 832 1272

Fax : (+966) 3 834 3314

#### Jarir Branch

Tel : (+966) 3 842 1961

Fax : (+966) 3 841 7226

#### Al Jalawea Branch

Tel : (+966) 3 815 3394

Fax : (+966) 3 815 3379

#### Al Faisaliah Branch

Tel : (+966) 3 811 6653

Fax : (+966) 3 811 6702

#### Al Khaleej Branch

Tel : (+966) 3 834 6928

Fax : (+966) 3 834 8156

#### Al Doha Branch

Tel : (+966) 3 891 6148

Fax : (+966) 3 891 2059

#### Al Doha Branch (Ladies)

Tel : (+966) 3 891 6149

Fax : (+966) 3 891 2869

#### Al Khobar

##### Al-Hada District Branch

Tel : (+966) 3 882 0040

Fax : (+966) 3 887 8653

#### Al-Hada District Branch (Ladies)

Tel : (+966) 3 882 8848

Fax : (+966) 3 882 8722

#### King Abdulaziz St. Branch

Tel : (+966) 3 894 2512

Fax : (+966) 3 898 5330

#### Jubail

##### Jubail Industrial City Branch

Tel : (+966) 3 347 1386

Fax : (+966) 3 347 1426

### Qateef

#### Qateef Branch

Tel : (+966) 3 854 5463

Fax : (+966) 3 854 5367

#### Qateef Branch (Ladies)

Tel : (+966) 3 852 9900

Fax : (+966) 3 855 8437

#### Al-Ahsa

##### Al Hofuf Branch

Tel : (+966) 3 586 3555

Fax : (+966) 3 584 3111

#### Al Shahabiya Branch

Tel : (+966) 3 589 3952

Fax : (+966) 3 588 9078

#### Al Nakheel Branch

Tel : (+966) 3 575 4310

Fax : (+966) 3 536 4987



## CENTRAL REGION

## Riyadh

## Olaya Branch

Tel : (+966) 1 215 7000

Fax : (+966) 1 215 7016

## Olaya Branch (Ladies)

Tel : (+966) 1 215 7074

Fax : (+966) 1 215 7052

## King Fahd Road Branch

Tel : (+966) 1 225 6000

Fax : (+966) 1 225 6151

## Al-Suwaidi Branch

Tel : (+966) 1 428 8309

Fax : (+966) 1 428 8735

## Uqba Bin Nafe'a Branch

Tel : (+966) 1 278 1416

Fax : (+966) 1 278 4616

## Uqba Bin Nafe'a Branch (Ladies)

Tel : (+966) 1 278 4387

Fax : (+966) 1 278 4359

## Khurais Road Branch

Tel : (+966) 1 225 6399

Fax : (+966) 1 235 0380

## Al Rayyan Branch

Tel : (+966) 1 208 0166

Fax : (+966) 1 208 0166 Ext. 210

## Al Rayyan Branch (Ladies)

Tel : (+966) 1 208 5366

Fax : (+966) 1 208 0166 Ext. 258

## Dahrat Al-Badiyah Branch

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Fax : (+966) 1 430 3682

## Al Takhaswsi Branch

Tel : (+966) 1 293 6599

Fax : (+966) 1 293 6560

## Al Takhaswsi Branch (Ladies)

Tel : (+966) 1 293 6599

Fax : (+966) 1 293 6560

## King Abdullah St. Branch

Tel : (+966) 1 207 1460

Fax : (+966) 1 207 1362

## King Abdullah St. Branch (Ladies)

Tel : (+966) 1 269 6228

Fax : (+966) 1 269 3650

## Al-Nafi Branch

Tel : (+966) 1 275 1086

Fax : (+966) 1 274 1507

## Al-Nafi Branch (Ladies)

Tel : (+966) 1 275 1086

Fax : (+966) 1 275 1086 Ext. 450

## Al Naseem Branch

Tel : (+966) 1 235 7813

Fax : (+966) 1 235 6876

## Sultana Branch

Tel : (+966) 1 428 5096

Fax : (+966) 1 428 3873

## Al Kharj Branch

Tel : (+966) 1 547 6259

Fax : (+966) 1 547 6273

## Al Rawda Branch

Tel : (+966) 1 254 3847

Fax : (+966) 1 254 3843

## AlShefa Branch

Tel : (966) 1 2715589

Fax : (966) 1 2715590

## Qasim

## Buraidah Branch

Tel : (+966) 6 383 5310

Fax : (+966) 6 383 5306

## Onaizah Branch

Tel : (+966) 6 361 7547

Fax : (+966) 6 361 8412

## SOUTHERN REGION

## Khamis Mushait

## King Khaled Road Branch

Tel : (+966) 7 221 6465

Fax : (+966) 7 220 4230

## King Khaled Road Branch (Ladies)

Tel : (+966) 7 221 6465

Fax : (+966) 7 235 1022

## Abha

## King Saud Road Branch

Tel : (+966) 7 226 0798

Fax : (+966) 7 229 6243

## Najran

## Al Munajim Branch

Tel : (+966) 7 523 0421

Fax : (+966) 7 523 8267

## Jizan

## Airport st. Branch

Tel : (+966) 7 322 8594

Fax : (+966) 7 322 8601

#### WESTERN & SOUTHERN REGIONS

<b>Jeddah</b> <b>Al Musa'adia Investment Center</b> Tel: (+966) 2 660 6020	<b>Al Taif</b> <b>Taif Investment Center</b> (+966) 2 740 9692
<b>Al Musa'adia Investment Center (Ladies)</b> Tel: (+966) 2 668 3600	<b>Abha</b> <b>King Saud St. Investment Center</b> Tel: (+966) 7 226 0851
<b>Al Nahda Investment Center</b> Tel: (+966) 2 6098888	<b>Khamis Mushait</b> <b>Khamis Mushait Investment Center</b> Tel: (+966) 7 221 9580
<b>Makkah Mukarama</b> <b>Maka (Aziziah) Investment Center</b> Tel: (+966) 2 557 2020	<b>Najran</b> <b>Najran Service Center</b> Tel: (+966) 7 523 0421
<b>Madinah Munawara</b> <b>Madinah Munawara Investment Center</b> Tel: (+966) 4 845 1111	<b>Jizan</b> <b>Jizan Service Center</b> Tel: (+966) 7 322 8594

#### CENTRAL REGION

<b>Riyadh</b> <b>King Fahd Road Investment Center</b> Tel: (+966) 1 225 6133	<b>Al Suwadi-Badiah Investment Center</b> Tel: (+966) 1 428 8749
<b>King Fahd Road Service Center (Ladies)</b> Tel: (+966) 1 225 6481	<b>Olaya Service Center</b> Tel: (+966) 1 205 1388
<b>Uqba Bin Nafe' St. Investment Center</b> Tel: (+966) 1 278 1416	<b>Olaya Investment Center (Ladies)</b> Tel: (+966) 1 205 1388
<b>Uqba Bin Nafe' St. Investment Center (Ladies)</b> Tel: (+966) 1 278 1416	<b>Al Riyan Investment Center</b> Tel: (+966) 1 208 3316
<b>Al Nafal Investment Center</b> Tel: (+966) 1 275 1086	<b>Al Riyan Service Center (Ladies)</b> Tel: (+966) 1 208 3316

#### EASTERN REGION

<b>Al Khobar</b> <b>Al Hada Investment Center</b> Tel: (+966) 3 882 0040	<b>Qatif</b> <b>Qatif Investment Center</b> Tel: (+966) 3 854 5463
<b>Dammam</b> <b>Dammam Investment Center</b> Tel: (+966) 3 832 1272	<b>Hafouf</b> <b>Hafouf Investment Center</b> Tel: (+966) 3 586 1590
<b>Jubail</b> <b>Jubail Investment Center</b> Tel: (+966) 3 347 1398	

#### QASSEM REGION

<b>Onaizah</b> <b>Onaizah Investment Center</b> Tel: (+966) 6 361 7547	<b>Buraidah</b> <b>Buraidah Investment Center</b> Tel: (+966) 3 383 5230
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### TAKAFUL TA'AWUNI التكافل التعاوني

#### WESTERN REGION

<b>Headquarter</b> <b>Mosaedia Center</b> , 1st floor P.O. Box 6277 Jeddah 21442, KSA Tel: (+966) 2 668 8877 Fax: (+966) 2 667 7284	<b>Makkah Mukarama</b> <b>Al Rajhi Center (Ladies)</b> , 3rd floor Tel: (+966) 2 561 3980 Fax: (+966) 2 561 3988
<b>Jeddah</b> <b>KBW Building</b> , 3rd floor Tel: (+966) 2 651 8070 Fax: (+966) 2 651 8070 Ext. 4110	<b>Madinah Munawara</b> <b>Ghouth Tower</b> , 6th floor Tel: (+966) 4 822 1572 Fax: (+966) 4 828 3925
<b>Mosaedia Center (Ladies)</b> , 1st floor Tel: (+966) 2 668 8877 Fax: (+966) 2 661 8474	<b>Ghouth Tower (Ladies)</b> , 7th floor Tel: (+966) 4 822 1572 Fax: (+966) 4 821 2147

#### CENTRAL REGION

<b>Riyadh</b> <b>Olaya Center</b> , Mezzanine Tel: (+966) 1 215 7500 Fax: (+966) 1 215 1776	<b>Olaya Center (Ladies)</b> , 2nd floor Tel: (+966) 1 215 7400 Fax: (+966) 1 215 7430
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#### EASTERN REGION

<b>Dammam</b> <b>Al Khurajji Building</b> , Ground floor Tel: (+966) 3 831 1717 Fax: (+966) 3 831 1776	<b>Al Khurajji Building (Ladies)</b> , Ground floor Tel: (+966) 3 833 8330 Fax: (+966) 3 834 9966
<b>Khobar</b> <b>Al Shaikh Center</b> , 1 <sup>st</sup> floor Tel: (+966) 3 882 3804 Fax: (+966) 3 887 0587	<b>Hofuf</b> <b>Al Mousa Center</b> , Ground floor Tel: (+966) 3 585 4747 Fax: (+966) 3 585 4419

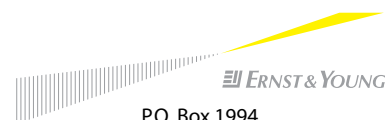
Takaful Ta'awuni Toll free Number 8002440959



# Independent Auditors' Report

## Deloitte.

Deloitte & Touche - Bakr Abulkhair & Co.  
Public Accountants  
P. O. Box 442, Jeddah 21411, Kingdom of Saudi Arabia

  
P.O. Box 1994  
Jeddah 21441, Saudi Arabia

### To the Shareholders of Bank AlJazira (a Saudi Joint Stock Company):

We have audited the accompanying consolidated financial statements of Bank AlJazira (the "Bank") and its subsidiaries (collectively referred to as "the Group"), which comprise the consolidated statement of financial position as at December 31, 2011, and the consolidated income statement, statements of comprehensive income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes from 1 to 42. We have not audited Note 42, nor the information related to "Basel II Pillar 3 disclosures" cross referenced therein, which is not required to be within the scope of our audit.

### Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Accounting Standards for Financial Institutions issued by the Saudi Arabian Monetary Agency ("SAMA"), International Financial Reporting Standards, the provisions of the Regulations for Companies, the Banking Control Law in the Kingdom of Saudi Arabia and the Bank's By-Laws. In addition, management is responsible for such internal controls as management 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 generally accepted auditing standards in the Kingdom of Saudi Arabia and 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 these 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' judgment, 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 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 Bank's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

### Opinion

In our opinion, the consolidated financial statements taken as a whole:

- present fairly, in all material respects, the financial position of the Group as at December 31, 2011, and its financial performance and its cash flows for the year then ended in accordance with Accounting Standards for Financial Institutions in the Kingdom of Saudi Arabia issued by SAMA and with International Financial Reporting Standards; and
- comply with the requirements of the Regulations for Companies, the Banking Control Law in the Kingdom of Saudi Arabia and the Bank's By-Laws in so far as they affect the preparation and presentation of the consolidated financial statements.

for Ernst & Young



Ahmed I. Reda  
Certified Public Accountant  
Licence Number 356



for Deloitte & Touche  
Bakr Abulkhair & Co.



Husam H. Sadagah  
Certified Public Accountant  
Licence Number 73



February 7, 2012  
Rabi-Al- Awwal 15, 1433 H

## Financial Statements

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# Consolidated Statement of Financial Position

As at December 31, 2011 and 2010

	Notes	2011 SR'000	2010 SR'000
<b>ASSETS</b>			
Cash and balances with SAMA	3	4,379,043	2,607,890
Due from banks and other financial institutions	4	4,331,024	5,579,852
Investments	5	5,396,915	4,546,171
Loans and advances, net	6	23,307,451	18,704,442
Other real estate, net	6e	680,778	679,800
Property and equipment, net	7	446,829	462,493
Other assets	8	356,210	437,573
<b>Total assets</b>		<b>38,898,250</b>	<b>33,018,221</b>
<b>LIABILITIES AND EQUITY</b>			
<b>LIABILITIES</b>			
Due to banks and other financial institutions	10	1,305,778	388,719
Customers' deposits	11	31,158,531	27,344,918
Other liabilities	12	497,078	478,902
Subordinated sukuk	13	1,000,000	-
<b>Total liabilities</b>		<b>33,961,387</b>	<b>28,212,539</b>
<b>EQUITY ATTRIBUTABLE TO EQUITY HOLDERS OF THE BANK</b>			
Share capital	14	3,000,000	3,000,000
Statutory reserve	15	1,474,000	1,398,000
General reserve	15	68,000	68,000
Other reserve	16	24,250	739
Retained earnings		6,287	48,779
Proposed dividend	26	160,000	-
<b>Total equity attributable to equity holders of the Bank</b>		<b>4,732,537</b>	<b>4,515,518</b>
<b>Non-controlling interest</b>		<b>204,326</b>	<b>290,164</b>
<b>Total equity attributable to equity holders of the Bank and non-controlling interest</b>		<b>4,936,863</b>	<b>4,805,682</b>
<b>Total liabilities and equity</b>		<b>38,898,250</b>	<b>33,018,221</b>

The accompanying notes 1 to 42 form an integral part of these consolidated financial statements.

# Consolidated Income Statement

For the years ended December 31, 2011 and 2010

	Notes	2011 SR'000	2010 SR'000
Special commission income	18	968,116	868,346
Special commission expense	18	(186,653)	(151,093)
<b>Net special commission income</b>		<b>781,463</b>	<b>717,253</b>
Fees and commission income, net	19	356,208	265,471
Foreign exchange income, net		19,927	18,184
Trading income, net	20	11,381	27,804
Income from FVIS financial instruments		-	67,506
Dividend income	21	9,719	10,394
Loss on non-trading investments	22	(6,441)	-
Other operating income	23	35,841	48,454
<b>Total operating income</b>		<b>1,208,098</b>	<b>1,155,066</b>
Salaries and employee-related expenses		482,842	434,004
Rent and premises-related expenses		62,864	64,597
Depreciation	7	66,775	81,268
Other general and administrative expenses		187,206	175,014
Impairment charge for credit losses, net	6	70,352	362,232
Other operating expenses	24	35,148	9,376
<b>Total operating expenses</b>		<b>905,187</b>	<b>1,126,491</b>
<b>Net income for the year</b>		<b>302,911</b>	<b>28,575</b>
<b>Attributable to:</b>			
Equity holders of the Bank		302,853	28,912
Non-controlling interest		58	(337)
<b>Net income for the year</b>		<b>302,911</b>	<b>28,575</b>
<b>Earning per share (expressed in SR per share)</b>			
Basic and diluted earnings per share	25	1.01	0.10

The accompanying notes 1 to 42 form an integral part of these consolidated financial statements.

# Consolidated Statement of Comprehensive Income

For the years ended December 31, 2011 and 2010

	2011 SR'000	2010 SR'000
Net income for the year	302,911	28,575
<b>Other comprehensive (loss) / income</b>		
Cash flow hedges:		
Fair value gain on cash flow hedges	5,585	-
Net amount transferred to consolidated income statement	(374)	-
Net changes in fair value of investment classified as at Fair Value through other comprehensive income (FVTOCI) (from 1 January 2011)	(91,045)	-
Net changes in fair value of available for sale investments (prior to 1 January 2011)	-	739
Other comprehensive (loss) / income for the year	(85,834)	739
<b>Total comprehensive income for the year</b>	<b>217,077</b>	<b>29,314</b>
<b>Attributable to:</b>		
Equity holders of the Bank	217,019	29,651
Non-controlling interest	58	(337)
<b>Total comprehensive income for the year</b>	<b>217,077</b>	<b>29,314</b>

The accompanying notes 1 to 42 form an integral part of these consolidated financial statements.



# Consolidated Statements of Changes in Equity

For the years ended December 31, 2011 and 2010

		Share capital	Statutory reserve	General reserve	Other reserve	Retained earnings	Proposed dividend	Total equity attributable to equity holders of the Bank	Non-controlling interest	Total
	Notes	SR'000	SR'000	SR'000	SR'000	SR'000	SR'000	SR'000	SR'000	SR'000
<b>2011</b>										
Balance at January 1, 2011		3,000,000	1,398,000	68,000	739	48,779	-	4,515,518	290,164	4,805,682
Effect of early adoption of IFRS 9 (note 2c (xii))		-	-	-	109,345	(109,345)	-	-	-	-
Net income / (loss) for the year		-	-	-	-	302,853	-	302,853	58	302,911
Other comprehensive income		-	-	-	(85,834)	-	-	(85,834)	-	(85,834)
Total comprehensive income / (loss)		-	-	-	(85,834)	302,853	-	217,019	58	217,077
Transfer to statutory reserve	15	-	76,000	-	-	(76,000)	-	-	-	-
Net changes in non-controlling interest		-	-	-	-	-	-	-	(85,896)	(85,896)
Proposed dividend for 2011	26	-	-	-	-	(160,000)	160,000	-	-	-
Balance at December 31, 2011		3,000,000	1,474,000	68,000	24,250	6,287	160,000	4,732,537	204,326	4,936,863
<b>2010</b>										
Balance at January 1, 2010		3,000,000	1,390,000	68,000	-	27,867	-	4,485,867	208,467	4,694,334
Net income / (loss) for the year		-	-	-	-	28,912	-	28,912	(337)	28,575
Other comprehensive income		-	-	-	739	-	-	739	-	739
Total comprehensive income / (loss)		-	-	-	739	28,912	-	29,651	(337)	29,314
Transfer to statutory reserve	15	-	8,000	-	-	(8,000)	-	-	-	-
Net changes in non-controlling interest		-	-	-	-	-	-	-	82,034	82,034
Balance at December 31, 2010		3,000,000	1,398,000	68,000	739	48,779	-	4,515,518	290,164	4,805,682

The accompanying notes 1 to 42 form an integral part of these consolidated financial statements.

# Consolidated Statements of Cash Flows

For the years ended December 31, 2011 and 2010

	Notes	2011 SR'000	2010 SR'000
<b>OPERATING ACTIVITIES</b>			
<b>Net income for the year attributable to equity holders of the Bank</b>		302,853	28,912
<b>Adjustments to reconcile net income to net cash from / (used in) operating activities:</b>			
Trading income	20	(11,381)	(27,804)
Income from FVIS financial instruments, net		-	(67,506)
Loss on non-trading investments	22	6,441	-
Depreciation	7	66,775	81,268
Dividend Income		(9,719)	(10,394)
(Gain)/Loss on disposal of property and equipment, net		(31,494)	615
Impairment charge for credit losses	6c	70,352	362,232
		<b>393,827</b>	<b>367,323</b>
<b>Net (increase) / decrease in operating assets:</b>			
Statutory deposit with SAMA		(124,265)	(249,970)
Due from banks and other financial institutions maturing after three months from the date of acquisition		790,408	1,611,074
Investments held as at FVTIS (including trading investments)		971,481	-
Investment held for trading		-	(902,528)
Loans and advances		(4,673,361)	(3,562,580)
Other real estate, net		(978)	11,867
Other assets		83,923	(72,253)
<b>Net increase / (decrease) in operating liabilities:</b>			
Due to banks and other financial institutions		917,059	(2,301,920)
Customers' deposits		3,691,113	5,202,442
Other liabilities		16,124	27,309
		<b>2,065,331</b>	<b>130,764</b>
<b>Net cash from operating activities</b>		<b>2,065,331</b>	<b>130,764</b>
<b>INVESTING ACTIVITIES</b>			
Proceeds from sales and maturities of non-trading investments		2,742,371	3,393,750
Acquisition of non-trading investments		(4,733,609)	(2,585,321)
Acquisition of property and equipment	7	(65,931)	(43,490)
Proceeds from sale of property and equipment		46,314	165
Dividend received		9,719	10,394
		<b>(2,001,136)</b>	<b>775,498</b>
<b>Net cash (used in)/from investing activities</b>		<b>(2,001,136)</b>	<b>775,498</b>
<b>FINANCING ACTIVITIES</b>			
Dividends paid		(353)	(103)
Net movements in non-controlling interest		2,126	1,521
Issue of subordinated sukuk		1,000,000	-
		<b>1,001,773</b>	<b>1,418</b>
<b>Net cash from financing activities</b>		<b>1,001,773</b>	<b>1,418</b>
Net increase in cash and cash equivalents		1,065,968	907,680
Cash and cash equivalents at the beginning of the year		4,905,463	3,997,783
		<b>5,971,431</b>	<b>4,905,463</b>
<b>Cash and cash equivalents at the end of the year</b>	27	<b>5,971,431</b>	<b>4,905,463</b>
Special commission received during the year		941,079	882,798
Special commission paid during the year		178,581	155,556
<b>SUPPLEMENTAL NON-CASH INFORMATION</b>			
Net changes in fair values		(85,834)	739
Real estate acquired in settlement of loans and advances	6 (e)	2,628	-

The accompanying notes 1 to 42 form an integral part of these consolidated financial statements.

# Notes to the Consolidated Financial Statement

For the years ended December 31, 2011 and 2010

## 1. GENERAL

Bank Aljazira (the Bank) is a Joint Stock Company incorporated in the Kingdom of Saudi Arabia and formed pursuant to Royal Decree number 46/M dated Jumad Al-Thani 12, 1395H (June 21, 1975). The Bank commenced its business on Shawwal 16, 1396H (October 9, 1976) with the takeover of The National Bank of Pakistan's branches in the Kingdom of Saudi Arabia and operates under commercial registration number 4030010523 dated Rajab 29, 1396H (July 27, 1976) issued in Jeddah, through its 51 branches (2010: 50 branches) in the Kingdom of Saudi Arabia and employed 1,574 staff (2010: 1,616 staff). The Bank's Head Office is located at the following address:

Bank AlJazira  
Nahda Center, Malik Street, P. O. Box 6277  
Jeddah 21442, Kingdom of Saudi Arabia

The objective of the Bank is to provide a full range of banking services.

The Bank provides its customers Shari'ah compliant (non-commission based) banking products comprising of Murabaha, Istisna'a, Ijarah and Tawaraq, which are approved and supervised by an independent Shari'ah Board established by the Bank.

The Bank's subsidiaries are as follows:

	Country of incorporation	Nature of business	Ownership (direct and indirect) December 31, 2011	Ownership (direct and indirect) December 31, 2010
Al-Mashareq Japanese Equities Fund	Saudi Arabia	Mutual fund	23%	27%
Al-Thoraiya European Equities Fund	Saudi Arabia	Mutual fund	28%	32%
Al-Khair Global Equities Fund	Saudi Arabia	Mutual fund	-	20%
AlJazira Capital Company	Saudi Arabia	Brokerage and asset management	100%	100%
Aman Real Estate	Saudi Arabia	Holding and managing collateral on behalf of the Bank	98%	98%

The Bank has control over the entities listed above and therefore, such entities are considered to be subsidiaries.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### a) Basis of presentation

The consolidated financial statements are prepared in accordance with Accounting Standards for Financial Institutions promulgated by the Saudi Arabian Monetary Agency (SAMA), and with International Financial Reporting Standards (IFRS). The Bank also prepares its consolidated financial statements to comply with the Banking Control Law, the Regulations for Companies in the Kingdom of Saudi Arabia and the Bank's Articles of Association.

The consolidated financial statements are prepared on the historical cost convention except for the following material items in the consolidated statement of financial position.

- assets and liabilities held for trading are measured at fair value;
- financial instruments designated at fair value through income statement are measured at fair value;
- investments in equity instruments are measured at fair value;
- Other financial assets, not held in a business model whose objective is to hold assets to collect contractual cash flows or whose contractual terms do not give rise solely to payments of principal and special commission, are measured at fair value (policy is applicable from 1 January 2011);
- financial assets or liabilities that are hedged in a fair value hedging relationship, and otherwise carried at cost, are carried at fair value to the extent of risk being hedged;
- available for sale financial assets are measured at fair value (policy applicable prior to 1 January 2011).

### b) Basis of consolidation

The consolidated financial statements comprise the financial statements of Bank AlJazira and its subsidiaries drawn up to December 31 each year. The financial statements of subsidiaries are prepared for the same reporting year as that of the Bank, using consistent accounting policies.

Al-Khair Global Equities Fund was consolidated in the financial statements of the Bank up to 31 December 2010. Due to the reduction in ownership interest of the Bank in Al-Khair Global Equities Fund to 18.67% the Bank has ceased to

consolidate this fund with effect from 1 January 2011, as management believes that the control is transferred from the Bank.

Subsidiaries are all entities over which the Bank has the power to govern the financial and operating policies so as to obtain benefits from its activities generally accompanying a shareholding of more than one half of the voting rights. Subsidiaries are consolidated from the date on which control is transferred to the Bank and cease to be consolidated from the date on which the control is transferred from the Bank. The results of subsidiaries acquired or disposed of during the year, are included in the consolidated income statement from the date of the acquisition or up to the date of disposal, as appropriate.

The consolidated financial statements have been prepared using uniform accounting policies and valuation methods for like transactions and other events in similar circumstances. The accounting policies of subsidiaries have been changed when necessary to align them with the policies adopted by the Bank.

Non-controlling interests represent the portion of net income (loss) of net assets not owned, directly or indirectly, by the Bank in its subsidiaries and are presented separately in the consolidated income statement and within equity in the consolidated statement of financial position, separately from Bank's shareholders' equity. Any losses applicable to the non-controlling interest in a subsidiary are allocated to the non-controlling interests even if doing so cause the non-controlling interest to have a deficit balance.

Acquisitions of non-controlling interests are accounted for using the Parent extension method whereby, the difference between the consideration and the fair value of the share of the net assets acquired is recognised as goodwill. The Bank elects on a transaction-by-transaction basis whether to measure non-controlling interest at its fair value, or at its proportionate share of the recognised amount of the identifiable net assets, at the acquisition date.

All significant inter-company transactions and balances have been eliminated upon consolidation.

These consolidated financial statements comprise the financial statements of Bank AlJazira and its subsidiaries, namely, Al-Mashareq Japanese Equities Fund, Al-Thoraiya European Equities Fund, AlJazira Capital Company and Aman Real Estate (collectively the "Group").

#### **c) Changes in accounting policies**

The accounting policies adopted are consistent with those followed in the preparation of the Group's consolidated financial statement for the year ended December 31, 2010, except for early adoption of International Financial Reporting Standard (IFRS) 9 with effect from 1 January 2011 (see note 5). The adoption of the new and amended standards and interpretation applicable to the Group, other than IFRS 9 as explained below did not have any significant financial impact on the financial statements, for the year ended December 31, 2011.

#### **IAS 24 - Related party disclosures (revised 2009)**

The revised IAS 24 Related Party Disclosure amends the definition of a related party and modifies certain related party disclosure requirements for government-related entities.

#### **Amendment to IFRS 7 - Financial instruments: Disclosure for Transfer of Financial Assets:**

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

- a) financial assets that are not derecognized in their entirety; and
- b) financial assets that are derecognized in their entirety but there is a continuing involvement

#### **Improvement to IFRS 7 Financial instruments: Disclosure**

The amendments add an explicit statement that qualitative disclosures 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. In addition, the IASB amended and removed certain existing disclosure requirements.

#### **Improvements to IFRSs 2010 – IAS 1 Presentation of Financial Statements**

IAS 1 is amended to clarify that disaggregation of changes in each component of equity arising from transactions recognised in other comprehensive income also is required to be presented, but is permitted to be presented either in the statement of changes in equity or in the notes.

#### **Improvements to IFRSs 2010 – IFRIC 13 Customer Loyalty Programmes**

The amendments clarify that the fair value of award credits takes into account the amount of discounts or incentives that otherwise would be offered to customers that have not earned the award credits.

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

IFRS 3 – Business Combinations.

IFRS 7 – Financial Instruments: Disclosures (related to maximum credit exposure, collateral, and renegotiated loan.

IAS 27 – Consolidated and Separate Financial Statements

IAS 32 – Financial Instruments: Presentation

# Notes to the Consolidated Financial Statement (continued)

For the years ended December 31, 2011 and 2010

## EARLY ADOPTION OF IFRS 9

The Group has early adopted IFRS 9 Financial Instruments, issued in November 2009 and revised in October 2010 and related consequential amendments in advance of its effective date.

IASB issued exposure draft (ED) "Mandatory effective date of IFRS 9" that proposes to move the mandatory effective date to periods beginning on or after 1 January 2015 with early application continued to be permitted.

The date of initial application of IFRS 9 (i.e. the date on which the Group has assessed its existing financial assets and financial liabilities) is 1 January 2011 in accordance with the transitional provisions of IFRS 9. All other financial assets are measured at fair value. The standard eliminates the existing IAS 39 categories of held to maturity, available-for-sale and loans and receivables. The Group has voluntarily adopted this standard, as this is considered to result in a presentation that better reflects the performance and operations of the Group.

The Group has not restated comparative information as permitted by the transitional provisions of IFRS 9 and has recognized impact of early adoption of IFRS 9 as at 1 January 2011, the opening retained earnings and other reserves as of that date (see note 16 for quantification of the impact).

IFRS 9 (phase 1) has been applied by the Group for the classification and measurement of financial assets and financial liabilities. IAS 39 is still being followed for impairment of financial assets and hedge accounting, as these will be covered through phase 2 and phase 3 of IFRS 9, respectively, which have not yet been completed by the International Accounting Standards Board (IASB). As IASB completes these phases, it will delete the relevant portions of IAS 39 and create chapters in IFRS 9 that would replace the requirements in IAS 39.

### Policy applicable prior to 1 January 2011

All investment securities are financial assets which are initially recognised at cost, being the fair value of the consideration given, including incremental direct transaction cost except for those transaction charges related to investments held as FVIS or for trading, which are not added to the cost at initial recognition and are charged to the consolidated statement of income. Premiums are amortised and discounts are accreted on a systematic basis to their maturity and are taken to special commission income.

For securities that are traded in organized financial markets, fair value is determined by reference to exchange quoted market bid prices at the close of business on the reporting date.

For securities where there is no quoted market price, a reasonable estimate of the fair value is determined by reference to the current market value of another instrument, which is substantially the same, or is based on the expected cash flows or the underlying net asset base of the security.

Following initial recognition, subsequent transfers between the various classes of investments are not ordinarily permissible. The subsequent period-end reporting values for each class of investment are determined on the basis as set out in the following paragraphs:

#### i) Held for trading and held at fair value through income statement (FVIS)

Investments in this category are classified as either investment held for trading or those designated as FVIS on initial recognition. Investments held for trading are acquired principally for the purpose of selling or repurchasing in short term and are recorded in the statement of financial position at fair value. An investment may be designated as FVIS by the management if it satisfies the criteria laid down by IAS 39 except for equity instruments that do not have a quoted market price in an active market and whose fair values cannot be reliably measured.

After initial recognition, investments are measured at fair value and any change in the fair value is recognised in the consolidated income statement for the period in which it arises. Transaction costs, if any, are not added to the fair value measurement at initial recognition of held for trading and held at FVIS investments. Dividend income received on investment held for trading and held at FVIS is reflected as either trading income or income from FVIS financial instruments in the consolidated income statement.

#### ii) Available for sale

Available-for-sale investments are those equity and debt securities that are intended to be held for an unspecified period of time, which may be sold in response to needs for liquidity or changes in special commission rates, exchange rates or equity prices.

Investments, which are classified as available for sale, are subsequently measured at fair value. For available for sale investments where the fair value has not been hedged, unrealised gain or loss arising from a change in their fair values is recognised in consolidated statement of comprehensive income. On derecognition, any cumulative gain or loss previously recognised in consolidated statement of comprehensive income is included in the consolidated income statement for the year. Dividend income is recognised in consolidated income statement when the Bank becomes entitled to the dividend.



### iii) Held to maturity

Investments having fixed or determinable payments and fixed maturity that the Bank has the positive intention and ability to hold to maturity are classified as held to maturity. Held to maturity investments are subsequently measured at amortised cost, less provision for impairment in value. Amortised cost is calculated by taking into account any discount or premium on acquisition using effective yield method. Any gain or loss on such investments is recognised in the consolidated income statement when the investment is derecognised or impaired.

Investments classified as held to maturity cannot ordinarily be sold or reclassified without impacting the Bank's ability to use this classification and cannot be designated as a hedged item with respect to commission rate or prepayment risk, reflecting the longer-term nature of these investments.

### iv) Other investments held at amortised cost

Investments securities with fixed or determinable payments that are not quoted in an active market are classified as "Other investments held at amortised cost". Such investments whose fair values have not been hedged are stated at amortised cost, less provision for impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition using effective yield method. Any gain or loss is recognised in the consolidated income statement when the investment is derecognised or impaired.

### v) Loans and advances

Loans and advances are non-derivative financial assets originated by the Bank with fixed or determinable payments. Loans and advances are recognised when cash is advanced to borrowers. These are derecognised when either the borrower repays the obligation or the loans are sold or written off, or substantially all the risk and rewards of ownership are transferred.

All loans and advances are initially measured at fair value, including acquisition charges associated with the loans and advances except for loans held at FVLS.

Following initial recognition, loans and advances originated or acquired by the Bank that are not quoted in an active market and for which fair value has not been hedged, are stated at cost less any amount written off and provisions for impairment.

For presentation purposes, provision for credit losses is deducted from loans and advances.

### vi) Impairment of financial assets

An assessment is made at each reporting date to determine whether there is objective evidence that a financial asset or a group of financial assets may be impaired. If such evidence exists, the estimated recoverable amount of that asset is determined and any impairment loss, based on the net present value of future anticipated cash flows, is recognised for changes in its carrying amounts as follows:

#### *Impairment of financial assets held at amortised cost*

A financial asset is classified as impaired when there is an objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the financial asset or group of financial assets and that a loss event(s) has an impact on the estimated future cash flows of the financial asset or group of financial assets that 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 special commission rate.

In addition to specific provision for credit losses, 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. 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 Bank has had in dealing with a borrower or group of borrowers and available historical default information.

For financial assets at amortised cost, the carrying amount of the asset is adjusted through the use of an allowance account and the amount of the adjustment is included in the consolidated income statement.

#### *Impairment of financial assets held at fair value*

For financial assets held at fair value, where a loss has been recognised in consolidated statement of comprehensive income, the cumulative net loss recognised in consolidated statement of comprehensive income is transferred to the consolidated income statement when the asset is considered to be impaired.

For equity investments held as available-for-sale, a significant or prolonged decline in fair value below its cost represents objective evidence of impairment. The impairment loss cannot be reversed through consolidated income statement as long as the asset continues to be recognised, i.e. any increase in fair value after impairment has been recorded can only be recognised in equity. On derecognition, any cumulative gain or loss previously recognised in equity is included in the consolidated income statement for the year.

## Notes to the Consolidated Financial Statement (continued)

For the years ended December 31, 2011 and 2010

The Group writes off its financial assets when the respective business units determine that the financial assets are uncollectible. This determination is reached after considering information such as the occurrence of significant changes in the borrower/issuer's financial position such that the borrower/issuer can no longer pay the obligations, or that proceeds from collateral will not be sufficient to pay back the entire exposure. The financial assets are, then, written off only in circumstances where effectively all possible means of recovery have been exhausted. For consumer loans, write off decisions are generally based on a product specific past due status. When a financial asset is uncollectible, it is written off against the related provision for impairment, if any, and any amounts in excess of available provision are directly charged to consolidated income statement.

Once a financial asset has been written down to its estimated recoverable amount, special commission income is thereafter recognised based on the rate of commission that was used to discount the future cash flows for the purpose of measuring the recoverable amount.

If, in a subsequent period, the amount of the impairment loss on investments, other than available for sale equity investments, decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the issuer's credit rating), the previously recognised impairment loss is reversed by adjusting the provision account. The amount of the reversal is recognised in the consolidated income statement as reversal of provision for impairment for other financial assets.

Loans whose terms have been renegotiated are no longer considered to be past due but are treated as new loans. Restructuring policies and practices are based on indicators or criteria which indicate that payment will most likely continue. The loans continue to be subject to an individual or collective impairment assessment.

### *Policy applicable from 1 January 2011*

IFRS 9 introduces new classification and measurement requirements for financial assets that are within the scope of IAS 39 Financial Instruments: Recognition and Measurement.

Specifically, IFRS 9 requires all financial assets to be classified and subsequently measured at either amortised cost or fair value on the basis of the entity's business model for managing the financial assets and the contractual cash flow characteristics of the financial asset. (Refer Note 2c (vii)).

At inception, financial asset are classified at amortized cost or fair value.

### **vii) Investment in debt instruments classified as at amortised cost:**

Debt instruments that meet the following conditions are subsequently measured at amortised cost less impairment loss (except for debt investments that are designated as at fair value through income statement on initial recognition):

- The asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows; and
- The contractual terms of the instrument give rise on specified dates to cash flows that are solely payments of principal and commission on the principal amount outstanding.

If a financial asset does not meet both of these conditions, then it is measured at fair value.

The Group makes an assessment of a business model at portfolio level as this reflects best the way the business is managed and information is provided to management.

In making an assessment of whether an asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows, the Group considers:

- Management's stated policies and objectives for the portfolio and the operation of those policies in practice;
- How management evaluates the performance of the portfolio;
- Whether the management's strategy focus on earning contractual commission income;
- The degree of frequency of any expected asset sales;
- The reason for any asset sales; and
- Whether assets that are sold are held for an extended period of time relative to their contractual maturity or are sold shortly after acquisition or an extended time before maturity.

Financial assets held for trading are not held within a business model whose objective is to hold the asset in order to collect contractual cash flows.

Income is recognised on an effective profit basis for debt instruments measured subsequently at amortised cost. Commission income is recognised in consolidated income statement.

Debt instruments that are subsequently measured at amortised cost are subject to impairment.

#### viii) Financial assets classified as at Fair Value through Income Statement (FVTIS)

Investments in equity instruments are classified as at FVTIS, unless the Group designates an investment that is not held for trading as at fair value through other comprehensive income (FVTOCI) on initial recognition (see note 5 below).

Debt instruments that do not meet the amortised cost criteria are measured at FVTIS. In addition, debt instruments that meet the amortised cost criteria but are designated as at FVTIS are measured at fair value through income statement. A debt instrument may be designated as at FVTIS upon initial recognition if such designation eliminates or significantly reduces a measurement or recognition inconsistency that would arise from measuring assets or liabilities or recognising the gains and losses on them on different bases. The Group has not designated any debt instrument as at FVTIS on the date of initial application of IFRS 9 (i.e. 1 January 2011).

Debt instruments are reclassified from amortised cost to FVTIS when the business model is changed such that the amortised cost criteria are no longer met. Reclassification of debt instruments that are designated as at FVTIS on initial recognition is not allowed.

Financial assets at FVTIS are measured at fair value at the end of each reporting period, with any gains or losses arising on remeasurement recognised in consolidated income statement.

Commission income on debt instruments as at FVTIS is included in the consolidated income statement.

Dividend income on investments in equity instruments at FVTIS is recognised in consolidated income statement when the Group's right to receive the dividends is established in accordance with IAS 18 - Revenue and is included in the consolidated income statement.

#### ix) Investment in equity instruments designated as at Fair Value through Other Comprehensive Income (FVTOCI)

On initial recognition, the Group can make an irrevocable election (on an instrument-by-instrument basis) to designate investments in equity instruments as at FVTOCI. Designation as at FVTOCI is not permitted if the equity investment is held for trading.

A financial asset or financial liability is held for trading if:

- a) it is acquired or incurred principally for the purpose of selling or repurchasing it in the near term;
- b) on initial recognition it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking; or
- c) it is a derivative (except for a derivative that is a financial guarantee contract or a designated and effective hedging instrument).

Investments in equity instruments at FVTOCI are initially measured at fair value plus transaction costs. Subsequently, they are measured at fair value with gains and losses arising from changes in fair value recognised in other comprehensive income and accumulated in other reserves. Gain and losses on such equity instruments are never reclassified to consolidated income statement and no impairment is recognised in consolidated income statement. Investment in unquoted equity instruments which were previously accounted for at cost in accordance with IAS 39, are now measured at fair value. The cumulative gain or loss will not be reclassified to consolidated income statement on disposal of the investments.

The Group has designated all investments in equity instruments that are not held for trading as at FVTOCI on initial application of IFRS 9.

Dividends on these investments in equity instruments are recognised in consolidated income statement when the Groups right to receive the dividends is established in accordance with IAS 18 Revenue, unless the dividends clearly represent a recovery of part of the cost of the investment. Dividends earned are recognised in consolidated income statement.

Fair value reserve includes the cumulative net change in fair value of equity investment measured at fair value through other comprehensive income. When such equity instruments are derecognised, the related cumulative amount in the fair value reserve is transferred to retained earnings.

#### x) Financial liabilities

Financial liabilities carried at amortised cost under IAS 39 have been classified and measured at amortised cost using the effective yield method under IFRS 9 and no changes in the classification and measurement have been made.

One major change in the classification and measurement of financial liabilities under IFRS 9 relates to the accounting for changes in fair value of a financial liability (designated as at Fair Value through Income Statement (FVTIS)) attributable to changes in the credit risk of that liability. For financial liabilities that are designated as at FVTIS, the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability is recognised in other comprehensive income, unless the recognition of the effects of changes in the liability's credit risk in other comprehensive income would create or enlarge an accounting mismatch in consolidated income statement. Changes in fair value attributable to a financial liability's credit risk are not subsequently reclassified to consolidated income statement. Previously, under IAS 39, the entire amount of the change in the fair value of the financial liability designated as at FVTIS was recognised in the income statement.

## Notes to the Consolidated Financial Statement (continued)

For the years ended December 31, 2011 and 2010

The liability credit reserve includes the cumulative changes in the fair value of the financial liabilities designated as at fair value through income statement that are attributable to changes in the credit risk of these liabilities and which would not create or enlarge accounting mismatch in consolidated income statement. Amount presented in liability credit reserve are not subsequently transferred to consolidated income statement. When such investments are derecognised, the related cumulative amount in the liability credit reserve is transferred to retained earnings.

At 31 December 2010, there were no financial liabilities designated by the Group as at Fair Value Through Income Statement (FVTIS). On the date of initial application of IFRS 9 (i.e. 1 January 2011), the Group has also not designated any financial liability as at FVTIS.

### xi) Impairment of financial assets

At each reporting date the Group assesses whether there is objective evidence that financial assets carried at amortised cost are impaired. A financial asset or a group of financial assets is impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset(s), and that the loss event has an impact on the future cash flows of the asset(s) that can be estimated reliably.

Objective evidence that financial assets are impaired can include significant financial difficulty of the borrower or issuer, default or delinquency by a borrower, restructuring of a loan or advance by the Bank on terms that the Bank would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group.

The Group considers evidence of impairment for loans and advances and investment securities measured at amortised costs at both a specific asset and collective level. All individually significant loans and advances and investment securities measured at amortised cost are assessed for specific impairment. All individually significant loans and advances and investment securities measured at amortised cost found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Loans and advances and investment securities measured at amortised cost that are not individually significant are collectively assessed for impairment by grouping together loans and advances and investment securities measured at amortised cost with similar risk characteristics.

Impairment losses on assets carried at amortised cost are measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the asset's original effective yield rate. Impairment losses are recognised in consolidated income statement and reflected in an allowance account against loans and advances. Commission on impaired assets continues to be recognised through the unwinding of the discount. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through consolidated income statement. The Group writes off loans and advances and investment securities when they are determined to be uncollectible.

### xii) IMPACT OF EARLY ADOPTION OF IFRS 9

#### Impact on other reserves and retained earnings

The impact of the early adoption on the opening retained earnings and other reserves classified in equity as at 1 January 2011, and on the classification of financial assets as at 1 January 2011, is as follows:

#### Impact on other reserves and retained earnings

	Carrying amount as at 31 December 2010 SR'000	Carrying amount as at 1 January 2011 upon adoption of IFRS 9 SR'000	Impact of early adoption SR'000
Other reserves	739	110,084	109,345
Retained earnings	48,779	(60,566)	(109,345)

Cumulative fair value gains of SR 109.3 million recognised in the consolidated income statement for periods up to 31 December 2010, in relation to the Bank's investment in equity shares previously designated as at FVIS under IAS 39, have been reclassified from opening retained earnings as at 1 January 2011 to other reserves as at 1 January 2011 (see impact on classification of financial asset below for more details).

Had the Bank not early adopted IFRS 9, the net income for the year ended 31 December 2011 would have been lower by SR 91.7 million, retained earnings as at 31 December 2011 would have been higher by SR 17.6 million and other reserves in equity as at 31 December 2011 would have been lower by SR 17.6 million.

Had the Bank not early adopted IFRS 9, the basic and diluted earnings per share for the year ended 31 December 2011 would have been SR 0.7 per share.

#### **Impact on classification of financial assets**

The adoption of IFRS 9 has resulted in a change in the classification of financial assets, although this has not impacted the value of those financial assets.

The Bank's investment in equity shares that were previously designated as at FVIF under IAS 39, have been designated as FVTOCI under IFRS 9 as at 1 January 2011, as the new classification is considered to result in a presentation that better reflects the performance and operations of the Bank (also see note 5c).

#### **Impact on classification of financial liabilities**

As stated earlier, financial liabilities carried at amortised cost under IAS 39 have been classified and measured at amortised cost using the effective yield method under IFRS 9 and no changes in the classification and measurement have been made.

For derivatives, see notes 9. In respect of derivatives, there is no impact of the early adoption on the consolidated financial statements of the Group.

#### **d) Critical accounting judgements, estimates and assumptions**

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting judgements, estimates and assumptions that affect the reported amounts of assets and liabilities. It also requires management to exercise its judgment in the process of applying the Group's accounting policies. Such judgements, estimates and assumptions are continually evaluated and are based on historical experience and other factors, including obtaining professional advices and expectations of future events that are believed to be reasonable under the circumstances.

##### **i) Business model – Applicable from 1 January 2011**

In making an assessment whether a business model's objective is to hold assets in order to collect contractual cash flows, the Group considers at which level of its business activities such assessment should be made. Generally, a business model is a matter of fact which can be evidenced by the way business is managed and the information provided to management. However, in some circumstances it may not be clear whether a particular activity involves one business model with some infrequent asset sales or whether the anticipated sales indicate that there are two different business models.

In determining whether its business model for managing financial assets is to hold assets in order to collect contractual cash flows the Group considers:

- management's stated policies and objectives for the portfolio and the operation of those policies in practice;
- how management evaluates the performance of the portfolio;
- whether management's strategy focuses on earning contractual special commission income;
- the degree of frequency of any expected asset sales;
- the reason for any asset sales; and
- whether assets that are sold are held for an extended period of time relative to their contractual maturity or are sold shortly after acquisition or an extended time before maturity.

##### **ii) Contractual cash flows of financial assets – Applicable from 1 January 2011**

The Group exercises judgement in determining whether the contractual terms of financial assets it originates or acquires give rise on specific dates to cash flows that are solely payments of principal and commission income on the principal outstanding and so may qualify for amortised cost measurement. In making the assessment the Group considers all contractual terms, including any prepayment terms or provisions to extend the maturity of the assets, terms that change the amount and timing of cash flows and whether the contractual terms contain leverage.

##### **iii) Impairment for credit losses on loans and advances and investment carried at amortised cost**

At each reporting date the Group assesses whether there is objective evidence that financial assets carried at amortised cost are impaired. A financial asset or a group of financial assets is impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset(s), and that the loss event has an impact on the future cash flows of the asset(s) that can be estimated reliably.

Objective evidence that financial assets are impaired can include significant financial difficulty of the borrower or issuer, default or delinquency by a borrower, restructuring of a loan or advance by the Bank on terms that the Bank would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group.

The Group considers evidence of impairment for loans and advances and investment securities measured at amortised costs at both a specific asset and collective level. All individually significant loans and advances and investment securities measured at amortised cost are assessed for specific impairment. All individually significant loans and advances and investment securities measured at amortised cost found not to be specifically impaired are then collectively assessed for any impairment that has

## Notes to the Consolidated Financial Statement (continued)

For the years ended December 31, 2011 and 2010

been incurred but not yet identified. Loans and advances and investment securities measured at amortised cost that are not individually significant are collectively assessed for impairment by grouping together loans and advances and investment securities measured at amortised cost with similar risk characteristics.

Impairment losses on assets carried at amortised cost are measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the asset's original effective yield rate. Impairment losses are recognised in consolidated income statement and reflected in an impairment for credit losses. Commission on impaired assets continues to be recognised through the unwinding of the discount.

When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through consolidated income statement.

The Group writes off loans and advances and investment securities when they are determined to be uncollectible.

#### iv) Going concern

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

#### e) Settlement date accounting

All regular way purchases and sales of financial assets are recognised and derecognised on the settlement date, i.e. the date on which the asset is delivered to the counterparty. Changes in fair value between the trade date and the settlement date are accounted for in the same way as acquired assets. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulations or convention in the market place.

#### f) Derivative financial instruments and hedge accounting

Derivative financial instruments including foreign exchange contracts, commission rate futures, forward rate agreements, currency and commission rate swaps, currency and commission rate options (both written and purchased) are initially measured at fair value.

All derivatives, are carried at their fair value as assets, where the fair value is positive, and as liabilities, where the fair value is negative. Fair values are obtained by reference to quoted market prices, discounted cash flow models and pricing models, as appropriate.

The treatment of changes in their fair value depends on their classification into following categories:

##### i) Derivatives held for trading

Any changes in the fair value of derivatives that are held for trading purposes are taken directly to the consolidated income statement and disclosed in trading income. Derivatives held for trading also includes those derivatives, which do not qualify for hedge accounting.

##### ii) Hedge Accounting

The Group designates certain derivatives as hedging instruments in qualifying hedging relationships.

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

In addition, at the inception of the hedge 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 each quarter. It is expected to be highly effective if the changes in fair value or cash flow 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%.

##### Fair Value Hedge

Fair value hedges are used to hedge the exposure to changes in fair value of a recognized asset or liability, or an unrecognized firm commitment or an identified portion of such an asset, liability or firm commitment, that is attributable to a particular risk and could affect the reported net gain or loss.

For designated and qualifying fair value hedge, the change in the fair value of a hedging derivative is recognized in the consolidated income statement in 'trading income, net'. The change in the fair value of



the hedged item attributable to the risk hedged is recorded as part of the carrying value of the hedged item and is also recognised in the consolidated income statement in 'trading income, net'.

If the hedging instrument expires or is sold, terminated or exercised, or where the hedge no longer meets the criteria for hedge accounting, the hedge relationship is terminated.

For hedged items recorded at amortised cost, the difference between the carrying value of the hedged item on termination and the face value is amortised over the remaining term of the original hedge using the Effective rate of return (ERR). If the hedged item is derecognised, the unamortised fair value adjustment is recognised immediately in the consolidated income statement.

#### **Cash Flow Hedge**

Cash flow hedge are used to hedge the exposure to variability in cash flow that is attributable to a particular risk associated with a recognized asset or liability or highly probable forecast transaction and could affected the reported gain or loss.

For designated and qualifying cash flow hedges, the effective portion of the gain or loss on the hedging instrument is initially recognized directly in equity in the other reserve. The ineffective portion of the gain or loss on the hedging instrument is recognized immediately in trading income, net.

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

#### **g) Derecognition of financial instruments**

A financial asset (or a part of a financial asset, or a part of a group of similar financial assets) is derecognised, when the contractual rights to the cash flows from the financial asset expires.

In instances where the Group is assessed to have transferred a financial asset, the asset is derecognised if the Group has transferred substantially all the risks and rewards of ownership. Where the Group has neither transferred nor retained substantially all the risks and rewards of ownership, the financial asset is derecognised only if the Group has not retained control of the financial asset. The Group recognises separately as assets or liabilities any rights and obligations created or retained in the process.

A financial liability (or a part of a financial liability) can only be derecognised when it is extinguished, that is when the obligation specified in the contract is either discharged, cancelled or expires.

On derecognition of a financial asset, measured at amortised cost, the difference between the asset's carrying amount and the sum of the consideration received and receivable is recognised in consolidated income statement.

On derecognition of a financial asset that is classified as FVTOCI, the cumulative gain or loss previously accumulated in investments revaluation reserve is not reclassified to consolidated income statement, but is reclassified to retained earnings.

#### **h) Foreign currencies**

The consolidated financial statements are denominated and presented in Saudi Arabian Riyals, which is also the functional currency of the Bank.

Transactions denominated in foreign currencies are translated into Saudi Riyal (SR) at spot exchange rates prevailing at transaction dates. Monetary assets and liabilities at the year end, denominated in foreign currencies, are translated into Saudi Riyal (SR) at the exchange rates prevailing at the year end.

Foreign exchange gains or losses on translation of monetary assets and liabilities denominated in foreign currencies are recognised in the consolidated income statement. Translation gains or losses on non-monetary items carried at fair value are included as part of the fair value adjustment either in the consolidated income statement or in other comprehensive income depending on the underlying financial asset.

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 initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value is determined.

The accounting records of the Bank's subsidiaries are maintained in United States Dollar (USD) or Saudi Riyal (SR). As the rate of exchange of the United States Dollar (USD) against the Saudi Riyal was constant throughout the last two years, no exchange difference has arisen on the translation of the subsidiaries' financial statements for the purposes of consolidation.

# Notes to the Consolidated Financial Statement (continued)

For the years ended December 31, 2011 and 2010

## i) Offsetting financial instrument

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

## j) Revenue recognition

Special commission income and expense including the fees which are considered an integral part of the effective yield of a financial instrument, are recognised in the consolidated income statement on an effective yield basis and include premiums amortised and discounts accreted during the year.

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 special commission rate and the change in carrying amount is recorded as income or expense.

The calculation of the effective special commission rate includes all fees and points paid or received, transaction costs, and discounts or premiums that are an integral part of the effective special commission rate. Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of financial asset or liability.

Foreign exchange income / loss is recognised when earned / incurred.

Fees and commissions are recognised on an accrual basis when the service has been provided. Loan commitment fees for loans that are likely to be drawn down are deferred and, together with the related direct cost, are recognised if material, as an adjustment to the effective yield on the loan. Portfolio and other management advisory and service fees, including fees for managing investment funds, are recognised based on the applicable service contracts, usually on a time-proportionate basis. Other fees and commission expense relate mainly to transaction and service fee, which are expensed as services are received.

Dividend income is recognised when the right to receive income is established. Dividends are reflected as a component of net trading income, net income from FVTIS financial instruments or other operating income based on the underlying classification of the equity instrument.

## k) Sale and repurchase agreements

Assets sold with a simultaneous commitment to repurchase at a specified future date (repos) continue to be recognised in the consolidated statement of financial position and are measured in accordance with related accounting policies for investments as at FVTIS, FVTOCI and amortised cost. The counterparty liability for amounts received under these agreements is included in "due to banks and other financial institutions" or "customers' deposits", as appropriate. The difference between the sale and repurchase price is treated as special commission expense and is accrued over the life of the repo agreement using the effective special commission rate. Assets purchased with a corresponding commitment to resell at a specified future date (reverse repos) are not recognised in the consolidated statement of financial position, as the Bank does not obtain control over the assets. Amounts paid under these agreements are included in "cash and balances with SAMA", "due from banks and other financial institutions" or "loans and advances", as appropriate. The difference between the purchase and resale price is treated as special commission income and is accrued over the life of the reverse repo agreement using the effective special commission rate.

## l) Other real estate

The Bank, in the ordinary course of business, acquires certain real estate against settlement of due loans and advances. Such real estate are considered as assets held for sale and are initially stated at the lower of the net realizable value of due loans and advances and the current fair value of related properties, less any costs to sell. No depreciation is charged on such real estate. Rental income from other real estate is recognised in the consolidated income statement.

Subsequent to the initial recognition, such real estate are revalued on a periodic basis. Any unrealised losses on revaluation, realized losses or gains on disposal and rental income are recognised in the consolidated income statement. Any subsequent gain in the fair value less costs to sell of these assets to the extent this does not exceed the cumulative write down is recognised as income together with any gain/ loss on disposal.

## m) Property and equipment

Property and equipment are stated at cost and presented net of accumulated depreciation. Freehold land is not depreciated. The cost of other property and equipment is depreciated using the straight-line method over the estimated useful lives of the assets as follows:

Buildings	33 years
Leasehold improvements	Over the lease period or 10 years, whichever is shorter
Furniture, equipment and vehicles	4 to 10 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each reporting date.

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in consolidated income statement.

All assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Any carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

#### **n) Liabilities**

All money market deposits, customer deposits and subordinated sukuk are initially recognised at cost, which represents fair value.

Subsequently, all commission-bearing financial liabilities, other than those held at FVTIS (previously FVIS) or where fair values have been hedged, are measured at amortised cost. Amortised cost is calculated by taking into account any discount or premium. Premiums are amortised and discounts accreted on effective yield basis to maturity and taken to special commission expense.

For financial liabilities carried at amortised cost, any gain or loss is recognised in the consolidated income statement when derecognised.

#### **o) Financial guarantees**

In the ordinary course of business, the Bank gives financial guarantees, consisting of letters of credit, guarantees and acceptances. Financial guarantees are initially recognised in the financial statements at fair value in other liabilities, being the value of the premium received. Subsequent to initial recognition, the Bank's liability under each guarantee is measured at the higher of the amortised premium and the best estimate of expenditure required to settle any financial obligations arising as a result of guarantees. Any increase in the liability relating to the financial guarantee is taken to the consolidated statement of income in impairment charge for credit losses. The premium received is recognised in the consolidated income statement on a straight line basis over the life of the guarantee.

#### **p) Provisions**

Provisions are recognised when a reliable estimate can be made by the Group for a present legal or constructive obligation as a result of past events and it is more likely than not that an outflow of resources will be required to settle the obligation.

#### **q) Accounting for leases**

Leases entered into by the Bank as a lessee are all operating leases. Payments made under operating leases are charged to the consolidated income statement on a straight-line basis over the period of the lease.

When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

#### **r) Cash and cash equivalents**

For the purpose of the consolidated statement of cash flows, cash and cash equivalents are defined as those amounts included in cash, balances with SAMA, excluding statutory deposits, and due from banks and other financial institutions with original maturity of three months or less from the date of acquisition.

#### **s) Zakat and income tax**

Under Saudi Arabian Zakat and Income tax laws, zakat and income tax are the liabilities of Saudi and foreign shareholders, respectively. Zakat is computed on the Saudi shareholders' share of equity or net income using the basis defined under the zakat regulations. Income tax is computed on the foreign shareholder's share of net income for the year.

Zakat and income taxes, relating to the shareholders of the Bank, are not charged to the Bank's consolidated income statement as they are deducted from the dividends paid to the shareholders.

Zakat and income tax relating to AlJazira Capital are included in the consolidated statement of changes in equity.

#### **t) Fiduciary assets**

Assets held in trust or in a fiduciary capacity are not treated as assets of the Group and, accordingly, are not included in the accompanying consolidated financial statements.

# Notes to the Consolidated Financial Statement (continued)

For the years ended December 31, 2011 and 2010

## u) Shari'ah compliant (non-interest based) banking products

The Bank offers its customers Shari'ah compliant (non-interest based) banking products, which are approved by its Shari'ah Board, as follows:

**Murabaha** is an agreement whereby the Bank sells to a customer a commodity or an asset, which the Bank has purchased and acquired based on a promise received from the customer to buy. The selling price comprises the cost plus an agreed profit margin.

**Ijarah** is an agreement whereby the Bank, acting as a lessor, purchases or constructs an asset for lease according to the customer request (lessee), based on his promise to lease the asset for an agreed rent and specific period that could end by transferring the ownership of the leased asset to the lessee.

**Musharaka** is an agreement between the Bank and a customer to contribute to a certain investment enterprise or the ownership of a certain property ending up with the acquisition by the customer of the full ownership. The profit or loss is shared as per the terms of the agreement.

**Tawaraq** is a form of Murabaha transactions where the Bank purchases a commodity and sells it to the customer. The customer sells the underlying commodity at spot and uses the proceeds for his financing requirements.

## v) Shari'ah compliant (non-interest based) banking products

**Wa'ad Fx** is an agreement whereby a client in consideration for the payment of a fee agrees to enter into one or series of trades. One party (promisor) gives a commitment as unilateral undertaking to a second party (promisee).

**Sukuk** are Islamic instrument which represents an individual proportionate ownership interest in an asset and corresponding right to the income streams generated by the assets.

All Shari'ah compliant (non-interest based) products are accounted for using International Financial Reporting Standards and in conformity with the accounting policies described in these financial statements.

## w) End of Service Benefits

The provision of end of service benefits is based on the rules stated under The Saudi Arabian Labor and Workmen Law and in accordance with the local statutory requirements.

## 3. CASH AND BALANCES WITH SAMA

	2011 SR'000	2010 SR'000
Cash in hand	737,657	444,769
Statutory deposit	1,347,386	1,223,121
Current account	2,294,000	940,000
<b>Total</b>	<b>4,379,043</b>	<b>2,607,890</b>

In accordance with the Banking Control Law and regulations issued by Saudi Arabian Monetary Agency (SAMA), the Bank is required to maintain a statutory deposit with SAMA at stipulated percentages of its demand, time and other deposits, calculated at the end of each Gregorian month. The statutory deposit with SAMA is not available to finance the Bank's day-to-day operations and therefore is not part of cash and cash equivalents. Furthermore, an amount of SR 122.5 million is included in Cash in hand for 2011, being restricted as share capital of Al Jazira Takaful, pending its initial public offering.

## 4. DUE FROM BANKS AND OTHER FINANCIAL INSTITUTIONS

	2011 SR'000	2010 SR'000
Current accounts	154,024	97,391
Money market placements	4,177,000	5,482,461
<b>Total</b>	<b>4,331,024</b>	<b>5,579,852</b>

The money market placements represent funds placed on a Shari'ah compliant (non-interest based) Murabaha basis.

## 5. INVESTMENTS

a) As of 31 December 2011, investments are classified as follows:

i) Mandatorily measured at FVTI

	Domestic	International	Total
	2011 SR'000	2011 SR'000	2011 SR'000
Mutual funds	565,440	-	565,440

ii) Designated as at FVTIS

	Domestic	International	Total
	2011 SR'000	2011 SR'000	2011 SR'000
Equities	-	293,824	293,824

iii) FVTOCI

	Domestic	International	Total
	2011 SR'000	2011 SR'000	2011 SR'000
Equities	295,445	2,872	298,317
	295,445	2,872	298,317

iv) Amortised cost

	Domestic	International	Total
	2011 SR'000	2011 SR'000	2011 SR'000
Murabaha investments	1,648,971	-	1,648,971
Sukuk investments	1,508,410	1,081,953	2,590,363
Total	3,157,381	1,081,953	4,239,334
Grand Total	4,018,266	1,378,649	5,396,915

b) As of December 31, 2010, investments were classified as follows:

i) Held at FVIS

	Domestic	International	Total
	2010 SR'000	2010 SR'000	2010 SR'000
Equities	384,055	-	384,055

ii) Held for trading

	Domestic	International	Total
	2010 SR'000	2010 SR'000	2010 SR'000
Equities	2,611	398,300	400,911
Mutual funds	1,509,207	-	1,509,207
	1,511,818	398,300	1,910,118

## Notes to the Consolidated Financial Statement (continued)

For the years ended December 31, 2011 and 2010

### iii) Available for sale

	Domestic	International	Total
	2010	2010	2010
	SR'000	SR'000	SR'000
Equities	3,250	2,057	5,307

### vi) Other investments held at amortised cost

	Domestic	International	Total
	2010	2010	2010
	SR'000	SR'000	SR'000
Murabaha investments	1,335,321	-	1,335,321
Sukuk investments	911,370	-	911,370
Other investments held at amortised cost	2,246,691	-	2,246,691
Total investments	4,145,814	400,357	4,546,171

- c) The following table summarises the transitional classification and measurement adjustments to the Group's financial assets on 1 January 2011, the date of initial application of IFRS 9 by the Group.

Description of financial assets	Previous classification under IAS 39	Carrying amount as at 31 December 2010 SR'000	Classification/ designation under IFRS 9	Carrying amount as at 1 January 2011 SR'000
• Equity investments not held for trading and previously classified as available for sale	Available for sale	5,307	Fair Value through Other Comprehensive Income (FVTOCI)	5,307
• Equity investments not held for trading but previously designated as at FVIS on initial recognition	Designated as at FVIS on initial recognition	384,055	Fair Value through Other Comprehensive Income (FVTOCI)	384,055
• Equity investments held for trading	FVIS (held for trading)	400,911	Designated as at Fair Value through Income Statement (FVTIS)	400,911
• Mutual Funds held for trading	FVIS (held for trading)	1,509,207	Mandatorily Fair Value through Income Statement (FVTIS)	1,509,207
• Investments in Sukuk and Murabaha classified as other investments held at amortised cost	Loans and advances (held at amortised cost)	2,246,691	Amortised cost	2,246,691
• Loans and advances, net	Loans and advances (held at amortised cost)	18,704,442	Amortised cost	18,704,442
• Due from banks and other financial institutions	Loans and advances (held at amortised cost)	5,579,852	Amortised cost	5,579,852



d) The analysis of the composition of investments is as follows:

	2011			2010		
	Quoted SR'000	Unquoted SR'000	Total SR'000	Quoted SR'000	Unquoted SR'000	Total SR'000
Murabaha investments	-	1,648,971	1,648,971	-	1,335,321	1,335,321
Sukuk investments	1,791,025	799,338	2,590,363	911,370	-	911,370
Equities	588,703	3,438	592,141	786,835	3,438	790,273
Mutual fund	565,440	-	565,440	1,509,207	-	1,509,207
<b>Investments</b>	<b>2,945,169</b>	<b>2,451,746</b>	<b>5,396,915</b>	<b>3,207,412</b>	<b>1,338,759</b>	<b>4,546,171</b>

e) The analysis of unrealized gains and losses and the fair values of investments at amortised costs are as follows:

	2011				2010			
	Carrying value SR'000	Gross unrealized gains SR'000	Gross unrealized losses SR'000	Fair value SR'000	Carrying value SR'000	Gross unrealized gains SR'000	Gross unrealized losses SR'000	Fair value SR'000
Murabaha investments	1,648,971	-	-	1,648,971	1,335,321	-	-	1,335,321
Sukuk investments	2,590,363	3,975	(361)	2,593,977	911,370	1,463	(10,888)	901,945
<b>Total</b>	<b>4,239,334</b>	<b>3,975</b>	<b>(361)</b>	<b>4,242,948</b>	<b>2,246,691</b>	<b>1,463</b>	<b>(10,888)</b>	<b>2,237,266</b>

f) The analysis of investments by counterparty is as follows:

	2011 SR'000	2010 SR'000
Government and quasi Government	2,663,346	1,335,321
Corporate	1,872,495	1,314,151
Banks and other financial institutions	861,074	1,896,699
<b>Total</b>	<b>5,396,915</b>	<b>4,546,171</b>

The portion Bank's investment in equity shares that were previously designated as at FVIs under IAS 39, have been designated as FVTOCI under IFRS 9 as at 1 January 2011. For impact of the early adoption of IFRS 9, please refer note 2c and 5c.

The outstanding balance of investments held at FVTOCI, as at 31 December 2011, includes an amount of SR 292.92 million relating to equity securities. Prior to 1 January 2011 the amount was designated as at FVIs on initial recognition under IAS 39, with a carrying value of SR 384.05 million as at 31 December 2010. These equity securities were acquired in the settlement of loan in 2009 amounting to SR 274.6 million.

Fair value through income statement (FVTIS) represents Shari'ah compliant equity and other investments, having a carrying value of SR 859 million, which have been measured at fair value.

Amortised costs comprise murabaha investments of SR 1,649 million (2010: SR 1,335 million) and Sukuk investments of SR 2,590 million (2010: SR 911 million) that are carried at amortised cost. The fair values of these investments are not significantly different from their carrying values. The Sukuk investments (disclosed in 5d) are quoted in a market but not actively traded.

## Notes to the Consolidated Financial Statement (continued)

For the years ended December 31, 2011 and 2010

### 6. LOANS AND ADVANCES, NET

**Consumer** includes loans and advances related to individuals for personal needs.

**Commercial** include loans and advances to corporate, small and medium sized business and institutional customers.

**Others** include loans and advances to staff

#### a) Loans and advances, net comprise the following:

	SR'000			
<b>2011</b>	<b>Consumer</b>	<b>Commercial</b>	<b>Others</b>	<b>Total</b>
Performing loans and advances	7,230,960	16,169,005	87,242	23,487,207
Non-performing loans and advances	57,886	972,802	-	1,030,688
<b>Total loans and advances</b>	<b>7,288,846</b>	<b>17,141,807</b>	<b>87,242</b>	<b>24,517,895</b>
Impairment charge for credit losses				
Specific provision	(28,115)	(876,465)	-	(904,580)
Portfolio provision	(101,497)	(204,367)	-	(305,864)
<b>Total impairment charge</b>	<b>(129,612)</b>	<b>(1,080,832)</b>	<b>-</b>	<b>(1,210,444)</b>
<b>Loans and advances, net</b>	<b>7,159,234</b>	<b>16,060,975</b>	<b>87,242</b>	<b>23,307,451</b>

	SR'000			
<b>2010</b>	<b>Consumer</b>	<b>Commercial</b>	<b>Others</b>	<b>Total</b>
Performing loans and advances	4,500,902	13,923,255	74,014	18,498,171
Non-performing loans and advances	58,746	1,271,589	-	1,330,335
<b>Total loans and advances</b>	<b>4,559,648</b>	<b>15,194,844</b>	<b>74,014</b>	<b>19,828,506</b>
Impairment charge for credit losses				
Specific provision	(24,648)	(914,777)	-	(939,425)
Portfolio provision	(45,586)	(139,053)	-	(184,639)
<b>Total impairment charge</b>	<b>(70,234)</b>	<b>(1,053,830)</b>	<b>-</b>	<b>(1,124,064)</b>
<b>Loans and advances, net</b>	<b>4,489,414</b>	<b>14,141,014</b>	<b>74,014</b>	<b>18,704,442</b>

Loans and advances, net represents Shari'ah Compliant (non-interest based) products in respect of Murabaha agreements, Istisna'a and Tawaraq.

#### b) Movements in impairment for credit losses are as follows:

	SR'000			
<b>2011</b>	<b>Consumer</b>	<b>Commercial</b>	<b>Others</b>	<b>Total</b>
Balance at the beginning of the year	70,234	1,053,830	-	1,124,064
Provided during the year, net	65,076	70,496	-	135,572
Bad debts written off	(421)	(2,375)	-	(2,796)
Reclassification	(300)	300	-	-
Reclassification from other liabilities (Refer Note 12)	-	11,245	-	11,245
Recoveries of amounts previously provided	(4,977)	(52,664)	-	(57,641)
<b>Balance at the end of the year</b>	<b>129,612</b>	<b>1,080,832</b>	<b>-</b>	<b>1,210,444</b>

<u>2010</u>	SR'000			
	Consumer	Commercial	Others	Total
Balance at the beginning of the year	37,332	756,275	-	793,607
Provided during the year, net	34,325	339,010	-	373,335
Bad debts written off	(64)	(31,711)	-	(31,775)
Reclassification	243	(243)	-	-
Recoveries of amounts previously provided	(1,602)	(9,501)	-	(11,103)
Balance at the end of the year	70,234	1,053,830	-	1,124,064

c) **Net impairment charge for credit losses for the year in the consolidated income statement is as follows:**

	<u>2011</u> <u>SR'000</u>	<u>2010</u> <u>SR'000</u>
Addition during the year, net	135,572	373,335
Recoveries of amounts previously provided	(57,641)	(11,103)
Recoveries of debts previously written off	(7,579)	-
Impairment charge for credit losses, net	70,352	362,232

d) **Economic sector risk concentrations for the loans and advances and provision for credit losses are as follows:**

<u>2011</u>	<u>Performing</u> <u>SR'000</u>	<u>Non performing, net</u> <u>SR'000</u>	<u>Impairment charge for credit losses</u> <u>SR'000</u>	<u>Loans and advances, net</u> <u>SR'000</u>
Banks and other financial institutions	711,692	-	-	711,692
Agriculture and fishing	57,549	-	-	57,549
Manufacturing	4,846,965	81,418	(56,974)	4,871,409
Mining and quarrying	12,182	-	-	12,182
Electricity, water, gas and health services	10,112	16,744	(15,996)	10,860
Building and construction	3,877,097	126,614	(89,287)	3,914,424
Commerce	2,436,343	671,032	(671,032)	2,436,343
Transportation and communication	162,049	-	-	162,049
Services	460,449	62,617	(32,617)	490,449
Consumer loans and credit cards	7,230,960	57,886	(28,115)	7,260,731
Share trading	1,293,016	10,677	(10,339)	1,293,354
Others	2,388,793	3,700	(220)	2,392,273
	23,487,207	1,030,688	(904,580)	23,613,315
Portfolio provision	-	-	(305,864)	(305,864)
<b>Total</b>	<b>23,487,207</b>	<b>1,030,688</b>	<b>(1,210,444)</b>	<b>23,307,451</b>

## Notes to the Consolidated Financial Statement (continued)

For the years ended December 31, 2011 and 2010

2010	Performing SR'000	Non performing, net SR'000	Impairment charge for credit losses SR'000	Loans and advances, net SR'000
Banks and other financial institutions	423,938	-	-	423,938
Agriculture and fishing	36,019	-	-	36,019
Manufacturing	3,878,661	86,541	(86,541)	3,878,661
Mining and quarrying	6,409	-	-	6,409
Electricity, water, gas and health services	33,699	16,744	(16,744)	33,699
Building and construction	4,016,014	130,914	(87,797)	4,059,131
Commerce	2,154,622	943,141	(665,516)	2,432,247
Transportation and communication	225,076	-	-	225,076
Services	337,185	65,175	(33,336)	369,024
Consumer loans and credit cards	4,500,902	58,746	(24,648)	4,535,000
Share trading	970,716	8,102	(6,487)	972,331
Others	1,914,930	20,972	(18,356)	1,917,546
	18,498,171	1,330,335	(939,425)	18,889,081
Portfolio provision	-	-	(184,639)	(184,639)
Total	18,498,171	1,330,335	(1,124,064)	18,704,442

### e) Other real estate, net

	2011 SR'000	2010 SR'000
Balance at the beginning of the year	693,800	705,667
Additions	2,628	-
Disposal	(1,650)	(11,867)
	694,778	693,800
Provision for unrealised revaluation losses	(14,000)	(14,000)
Balance at the year end	680,778	679,800

## 7. PROPERTY AND EQUIPMENT, NET

	Land and buildings SR'000	Leasehold improvements SR'000	Furniture, equipment and vehicles SR'000	Capital work in progress SR'000	Total 2011 SR'000	Total 2010 SR'000
<b>Cost</b>						
Balance at the beginning of the year	190,484	265,010	404,643	19,603	879,740	837,926
Additions	-	1,776	16,360	47,795	65,931	43,490
Transfers	-	4,946	7,183	(12,129)	-	-
Disposals	(14,725)	-	(1,309)	-	(16,034)	(1,676)
Write off	-	-	-	-	-	-
<b>Balance at the end of the year</b>	<b>175,759</b>	<b>271,732</b>	<b>426,877</b>	<b>55,269</b>	<b>929,637</b>	<b>879,740</b>
<b>Accumulated depreciation</b>						
Balance at the beginning of the year	4,434	111,294	301,519	-	417,247	336,875
Charge for the year	151	26,858	39,766	-	66,775	81,268
Disposals	-	-	(1,214)	-	(1,214)	(896)
<b>Balance at the end of the year</b>	<b>4,585</b>	<b>138,152</b>	<b>340,071</b>	<b>-</b>	<b>482,808</b>	<b>417,247</b>
<b>Net book value</b>						
<b>At December 31, 2011</b>	<b>171,174</b>	<b>133,580</b>	<b>86,806</b>	<b>55,269</b>	<b>446,829</b>	
<b>At December 31, 2010</b>	<b>186,050</b>	<b>153,716</b>	<b>103,124</b>	<b>19,603</b>		<b>462,493</b>

## 8. OTHER ASSETS

	2011 SR'000	2010 SR'000
Accrued special commission receivable:		
Banks and other financial institutions	5,900	13,876
Investments	12,878	4,425
Loans and advances	213,852	186,016
Total accrued special commission receivable	232,630	204,317
Advances and prepayments	28,437	68,419
Positive fair value of derivatives	3,715	-
Other	91,428	164,837
<b>Total</b>	<b>356,210</b>	<b>437,573</b>

## 9. DERIVATIVES

In the ordinary course of business, the Bank utilizes the following derivative financial instruments for both trading and strategic hedging purposes:

### a) Swaps

Swaps are commitments to exchange one set of cash flows for another. For special commission rate swaps, counterparties generally exchange fixed and floating rate commission payments in a single currency without exchanging principal. For cross-currency commission rate swaps, principal, fixed and floating commission payments are exchanged in different currencies.

### b) Options (Wa'ad Fx)

Foreign exchange option, whereby a client in consideration for the payment of a fee agrees to enter into one or series of trades. Where one party (promisor) gives a commitment as unilateral undertaking to a second party (promisee).

Option would be a unilateral promise or combination of promises. The Bank does the option depending on the client risk profile, where client may promise to buy, sell or (buy & sell) a currency with or without conditions for hedging his exposure.

### c) Held for trading purposes

Most of the Bank's derivative trading activities relate to sales, positioning and arbitrage. Sales activities involve offering products to customers and banks in order, to enable them to transfer, modify or reduce current and future risks. Positioning involves managing market risk positions with the expectation of profiting from favourable movements in prices, rates or indices. Arbitrage involves identifying, with the expectation of profiting from price differentials between markets or products.

### d) Held for hedging purposes

The Bank uses Shariah compliant derivatives for hedging purposes in order to reduce its exposure to commission rate risk.

The Bank has adopted a comprehensive system for the measurement and management of risk. Part of the risk management process involves managing the Bank's exposure to fluctuations in foreign exchange and commission rates to reduce its exposure to currency and commission rate risks to acceptable levels as determined by the Board of Directors within the guidelines issued by SAMA.

The Bank also uses special commission rate swaps to hedge against the cash flow risk arising on certain floating rate exposures. In all such cases, the hedging relationship and objective, including details of the hedged items and hedging instrument are formally documented and the transactions are accounted for as fair value or cash flow hedges.

### e) Cash flow hedges

The Bank is exposed to variability in future special commission cash flows on non-trading assets and liabilities which bear special commission at a variable rate. The Bank uses special commission rate swaps as cash flow hedges of these special commission rate risks. Below is the schedule indicating as at 31 December, the periods when the hedged cash flows are expected to occur and when they are expected to affect consolidated income statement:

2011	Within 1 year	1-3 years	3-5 years	Over 5 years
Cash inflows (assets)	5,251	15,495	20,883	-
Cash out flows (liabilities)	-	-	-	-
Net cash inflow	5,251	15,495	20,883	-

## Notes to the Consolidated Financial Statement (continued)

For the years ended December 31, 2011 and 2010

The net gains on cash flow hedges reclassified to the consolidated income statement during the year was as follows;

	2011 SR'000	2010 SR'000
Balance at the beginning of the year	-	-
Gains from change in fair value recognised directly in equity, net (effective portion)	5,585	-
(Gain) removed from equity and transferred to consolidated income statement	(374)	-
Balance at the year end	5,211	-

The discontinuation of hedge accounting resulted in reclassification of the associated cumulative gains of SR 0.37 million from equity to consolidated income statement for the year ended December 31, 2011.

The table below sets out the net fair value of the Bank's derivative financial instrument, together with its notional amount. The notional amount, which provides an indication of the volume of transactions outstanding at the year end, does not necessarily reflect the amount of future cash flows involved. The notional amount, therefore, is neither indicative of the Bank's exposure to credit risk, which is generally limited to the positive fair value of the derivatives, nor market risk.

2011 SR'000								
Derivative financial instruments	Positive fair value	Negative fair value	Notional amount	Within 3 months	3-12 months	1-5 years	Over 5 years	Monthly average
<b>Held for trading</b>								
Options	14,292	14,292	4,379,140	-	1,311,336	3,067,804	-	228,440
<b>Held as cash flow hedge:</b>								
Special commission rate swaps	3,715	-	365,000	-	-	365,000	-	178,252
Special commission rate swaps	-	1,430	425,250	-	-	425,250	-	207,675
<b>Total</b>	<b>18,007</b>	<b>15,722</b>	<b>5,169,390</b>	<b>-</b>	<b>1,311,336</b>	<b>3,858,054</b>	<b>-</b>	<b>614,367</b>

2010 SR'000								
Derivative financial instruments	Positive fair value	Negative fair value	Notional amount	Within 3 months	3-12 months	1-5 years	Over 5 years	Monthly average
<b>Held for trading</b>								
Special commission rate swaps	1,915	-	187,500	-	-	187,500	-	187,500
<b>Total</b>	<b>1,915</b>	<b>-</b>	<b>187,500</b>	<b>-</b>	<b>-</b>	<b>187,500</b>	<b>-</b>	<b>187,500</b>

### 10. DUE TO BANKS AND OTHER FINANCIAL INSTITUTIONS

	2011 SR'000	2010 SR'000
Current accounts	111,368	43,707
Money market deposits from banks and other financial institutions	1,194,410	345,012
<b>Total</b>	<b>1,305,778</b>	<b>388,719</b>

The money market deposits from banks and other financial institutions comprise deposits received on Murabaha basis.



## 11. CUSTOMERS' DEPOSITS

	2011 SR'000	2010 SR'000
Demand	10,052,986	7,522,240
Time	20,639,890	19,233,171
Other	465,655	589,507
<b>Total</b>	<b>31,158,531</b>	<b>27,344,918</b>

Time deposits comprise deposits received on Shari'ah Compliant (non-interest based) Murabaha basis.

Other customers' deposits include SR 266 million (2010: SR 318 million) of margins held for irrevocable commitments.

The above include foreign currency deposits as follows:

	2011 SR'000	2010 SR'000
Demand	246,915	352,948
Time	5,274,975	3,700,343
Other	31,989	49,053
<b>Total</b>	<b>5,553,879</b>	<b>4,102,344</b>

## 12. OTHER LIABILITIES

	2011 SR'000	2010 SR'000
Accrued special commission payable:		
Banks and other financial institutions	1,528	479
Customers' deposits	59,734	62,149
Total accrued special commission payable	61,262	62,628
AlJazira Philanthropic Program (see note below)	76,905	83,004
Accounts payable	144,947	138,997
Dividend payable	25,162	25,515
Negative fair value of derivatives	1,430	-
Provision for indirect facilities (see note below)	-	11,245
Other	187,372	157,513
<b>Total</b>	<b>497,078</b>	<b>478,902</b>

During 2006, the Board of Directors approved the contribution to a philanthropic program to carry out the Bank's social responsibilities towards the Saudi society, through the charitable contributions to various benevolent efforts that promote the general welfare of the society.

For this purpose, the Bank contributed SR 100 million to this program during 2006.

A Social Committee has been established to coordinate this program, consisting of three board members, and it is the intention of the Board of Directors to seek assistance of other independent members' from the business community and the Shari'ah Board of the Bank to overview and provide guidance for the activities of the program.

The provision for indirect facilities has been re-classified to impairment for credit losses and presented under note 6(b).

## Notes to the Consolidated Financial Statement (continued)

For the years ended December 31, 2011 and 2010

### 13. SUBORDINATED SUKUK

On March 29, 2011, the Bank issued 1,000 Subordinated Sukuk Certificates (Sukuk) of SR 1 million each, with a profit distribution rate based on 6 months Saudi Inter-Bank Offered Rate (SIBOR), reset semi annually in advance, plus a margin of 170 basis point per annum and payable semi-annually in arrears on 29 March and 29 September each year until 29 March 2021, on which date the Sukuk will expire. The proceeds of the Sukuk will be used by the Bank for strengthening its capital base as it is intended that Sukuk will comprise Tier II capital for Saudi Arabian regulatory purposes. The proceeds of the Sukuk will be used by the Issuer to grow its banking and finance activities. The obligation of the issuer to the Sukukholders is not secured by any assets or security or guaranteed by third party and is subordinated. The Sukuk are due in 2021 with a step up in margin to 550 basis point in 2016. The Bank has a call option which can be exercised after March 29, 2016 on meeting certain conditions and as per the terms mentioned in the related Offering Circular dated March 28, 2011. The Sukuk may also be called upon occurrence of certain other conditions as per the terms specified in the above Offering Circular. These Sukuk are registered with Saudi stock exchange (Tadawul).

### 14. SHARE CAPITAL

The authorized, issued and fully paid share capital of the Bank consists of 300 million shares of SR 10 each (2010: 300 million shares of SR 10 each).

The ownership of the Bank's share capital is as follows:

	2011	2010
Saudi shareholders	94.17%	94.17 %
Non Saudi shareholder - National Bank of Pakistan	5.83%	5.83 %

### 15. STATUTORY AND GENERAL RESERVES

In accordance with Saudi Arabian Banking Control Law and the Articles of Association of the Bank, a minimum of 25% of the annual net income is required to be transferred to a statutory reserve until this reserve equals the paid-up capital of the Bank. Accordingly, SR 76 million has been transferred from net income for 2011 (2010: SR 8 million). The statutory reserve is currently not available for distribution.

In addition, when considered appropriate, the Bank makes an appropriation to a general reserve for general banking risks.

### 16. OTHER RESERVE

2011	Cash flow hedges SR' 000	Fair value reserve SR' 000	Total SR' 000
Balance at beginning of the year	-	739	739
Effect of early adoption of IFRS 9 (Note 2c(xii))	-	109,345	109,345
Net change in fair value	5,585	(91,045)	(85,460)
Transfer to consolidated income statement	(374)	-	(374)
Net movement during the year	5,211	18,300	23,511
<b>Balance at end of the year</b>	<b>5,211</b>	<b>19,039</b>	<b>24,250</b>

2010	Available for sale investments SR' 000	Total SR' 000
Balance at beginning of the year	-	-
Net change in fair value	739	739
Transfer to (consolidated) income statement	-	-
Net movement during the year	739	739
<b>Balance at end of the year</b>	<b>739</b>	<b>739</b>

## 17. COMMITMENTS AND CONTINGENCIES

### a) Legal proceedings

At December 31, 2011, there were legal proceedings of a routine nature outstanding against the Bank. No significant provision has been made as related professional legal advice indicates that it is unlikely that any significant loss will eventually arise.

### b) Capital commitments

At December 31, 2011, the Bank had capital commitments of SR 46.2 million (2010: SR 18.3 million) in respect of the construction of branches.

### c) Credit related commitments and contingencies

The primary purpose of these instruments is to ensure that funds are available to customers as required.

Guarantee and standby letters of credit, which represents irrevocable assurances that the Bank will make payments in the event that a customer cannot meet his obligations to third parties, carry the same credit risk as loans and advances. Cash requirements under guarantees and standby letters of credit are considerably less than the amount of the related commitment because the Bank does not generally expect the third party to draw funds under the agreement.

Documentary letters of credit, which are written undertakings by the Bank on behalf of a customer authorizing a third party to draw drafts on the Bank up to a stipulated amount under specific terms and conditions, are generally collateralized by the underlying shipments of goods to which they relate and, therefore, have significantly less credit risk.

Acceptances comprise undertakings by the Bank to pay bills of exchange drawn on customers. The Bank expects most acceptances to be presented before being reimbursed by customers.

Commitments to extend credit represent the unused portion of authorizations to extend credit, principally in the form of loans and advances, guarantees and letters of credit. With respect to credit risk on commitments to extend credit, the Bank is potentially exposed to a loss in an amount equal to the total unused commitments. However, the likely amount of loss, which cannot be readily quantified, is expected to be considerably less than the total unused commitments as most commitments to extend credit are contingent upon customers maintaining specific credit standards. The total outstanding commitments to extend credit do not necessarily represent future cash requirements, as many of the commitments could expire or terminate without being funded.

i) The contractual maturity structure for the Bank's commitments and contingencies is as follows:

(SR'000)					
2011	Within 3 months	3-12 months	1-5 years	Over 5 years	Total
Letters of credit	461,111	141,770	-	-	602,881
Letters of guarantee	810,766	1,152,895	506,369	2,988	2,473,018
Acceptances	407,612	-	-	-	407,612
Irrevocable commitments to extend credit	-	14,286	-	650,131	664,417
Total	1,679,489	1,308,951	506,369	653,119	4,147,928
(SR'000)					
2010	Within 3 months	3-12 months	1-5 years	Over 5 years	Total
Letters of credit	407,682	165,514	-	-	573,196
Letters of guarantee	909,516	747,065	579,264	6,902	2,242,747
Acceptances	115,661	-	-	-	115,661
Irrevocable commitments to extend credit	-	-	176,745	1,624,376	1,801,121
Total	1,432,859	912,579	756,009	1,631,278	4,732,725

The outstanding unused portion of commitments as at December 31, 2011, which can be revoked unilaterally at any time by the Bank, amounts to SR 2.6 billion (2010: SR 1.1 billion).

# Notes to the Consolidated Financial Statement (continued)

For the years ended December 31, 2011 and 2010

ii) The analysis of commitments and contingencies by counterparty is as follows:

	2011 SR'000	2010 SR'000
Corporate	3,992,240	4,599,050
Banks and other financial institutions	155,688	133,675
<b>Total</b>	<b>4,147,928</b>	<b>4,732,725</b>

## e) Operating lease commitments

The future minimum lease payments under non-cancellable operating leases where the Bank is the lessee are as follows:

	2011 SR'000	2010 SR'000
Less than 1 year	1,766	2,661
1 to 5 years	4,249	1,579
Over 5 years	-	1,349
<b>Total</b>	<b>6,015</b>	<b>5,589</b>

## 18. NET SPECIAL COMMISSION INCOME

	2011 SR'000	2010 SR'000
<b>Special commission income</b>		
Investment:		
Other investments held at amortised costs (prior to 1 January 2011)	-	25,303
Investment held as at amortised cost (from 1 January 2011)	31,777	-
Due from banks and other financial institutions	34,489	50,933
Loans and advances	901,850	792,110
<b>Total</b>	<b>968,116</b>	<b>868,346</b>
<b>Special commission expense</b>		
Due to banks and other financial institutions	7,550	8,287
Customers' deposits	148,060	134,658
Subordinated Sukuk	19,223	-
Others	11,820	8,148
<b>Total</b>	<b>186,653</b>	<b>151,093</b>
<b>Net special commission income</b>	<b>781,463</b>	<b>717,253</b>

## 19. FEES AND COMMISSION INCOME, NET

	2011 SR'000	2010 SR'000
<b>Fee and commission income</b>		
Local share trading	203,475	149,200
Takaful Ta'awuni (insurance) wakala fee	43,381	38,883
Loan commitment and management fee	96,515	47,356
Trade finance	30,943	21,791
International share trading	2,775	4,102
Mutual funds fee	1,838	3,423
Fee from ATM transactions	34,874	37,312
Others	8,907	11,372
<b>Total fee and commission income</b>	<b>422,708</b>	<b>313,439</b>
<b>Fee and commission expense</b>		
Brokerage Fee	(59,798)	(43,559)
Takaful Ta'awuni – sales commission	(6,702)	(4,409)
<b>Net</b>	<b>356,208</b>	<b>265,471</b>

## 20. TRADING INCOME

	2011 SR'000	2010 SR'000
Equities	(12,633)	7,198
Mutual funds	12,235	11,826
Dividends on equity investments held for trading	6,104	6,865
Derivatives	5,675	1,915
<b>Total</b>	<b>11,381</b>	<b>27,804</b>

## 21. DIVIDEND INCOME

	2011 SR'000	2010 SR'000
Investments held at FVIS and available for sale (prior to 1 January 2011)	-	10,394
Investments held at FVTOCI (from 1 January 2011)	9,719	-

## 22. (LOSS) / GAIN ON NON-TRADING INVESTMENTS

	2011 SR'000	2010 SR'000
Held as at amortised cost investments (from 1 January 2011)	(6,441)	-

During the year, the Bank sold a murabaha investment (Sukuk) held as at amortised cost as the investment sold no longer meet the Bank's investment policy as allowed by IFRS 9 i.e. the credit rating of the investment declined below the level required as per Bank's policy.

## 23. OTHER OPERATING INCOME

	2011 SR'000	2010 SR'000
Rental income	-	40
Gain on sale of property and equipment	32,013	45,831
Other	3,828	2,583
<b>Total</b>	<b>35,841</b>	<b>48,454</b>

## 24. OTHER OPERATING EXPENSES

	2011 SR'000	2010 SR'000
Takaful accelerated receivable written off	26,743	-
Provision for other losses	6,600	-
Other operating expenses	1,805	9,376
<b>Total</b>	<b>35,148</b>	<b>9,376</b>

## 25. EARNINGS PER SHARE

Basic earnings per share for the years ended December 31, 2011 and 2010 is calculated by dividing the net income for the year attributable to equity holders of the Bank by weighted average number of ordinary shares in issue during the year. The weighted average number of ordinary shares outstanding during 2011 was 300 million (2010: 300 million).

The calculations of basic and diluted earnings per share are same for the Bank.

# Notes to the Consolidated Financial Statement (continued)

For the years ended December 31, 2011 and 2010

## 26. PROPOSED GROSS DIVIDEND, ZAKAT AND INCOME TAX

The Board of Directors approved a proposed gross dividend on December 26, 2011, for the year ended December 31, 2011 of SR 160 million. The dividends are paid to the Saudi and non-Saudi shareholders after deduction of zakat and income tax, respectively, as follows:

a) **Saudi shareholders:**

The zakat attributable to Saudi shareholders for 2011 amounted to SR 10 million (2010: SR 3.7 million) will be deducted from their share of dividend, resulting in a net dividend to Saudi Shareholders of SAR 0.5 per share (2010: Nil per share).

b) **Non-Saudi shareholder:**

The income tax payable on the current year's share of income for Non-Saudi shareholder amounted to SR 3.5 million (2010: SR 0.5 million).

Income Tax and Zakat assessment for the years upto 2000 have been finalised

For the years 2001 through 2004 the Department of Zakat and Income Tax (DZIT) has raised assessment with additional liability of SR 12.3 million. The Bank has filed appeals with the Higher Appeal Committee [HAC] against Preliminary Appeal Committee (PAC) decisions confirming the DZIT's assessments. The Bank has also lodged Bank Guarantee for the disputed liability. The DZIT for the year 2005 raised assessment with an additional liability of SR 1.03 million, BAJ has settled additional liability of SR 457 thousand "under protest" and filed an appeal against additional liability of SR 578 thousand.

Assessments for the years 2006 through 2010 have not yet been raised by the DZIT. However, during 2010, the DZIT issued initial assessment disallowing investments from the zakat base with an additional zakat of SR 128.8 million. Bank filed an appeal against DZIT's assessment.

## 27. CASH AND CASH EQUIVALENTS

Cash and cash equivalents included in the consolidated statement of cash flows comprise the following:

	2011 SR'000	2010 SR'000
Cash and balances with SAMA, excluding statutory deposit and restricted share capital for AlJazira Takaful (note 3)	2,909,157	1,384,769
Due from banks and other financial institutions with an original maturity of three months or less from the date of acquisition	3,062,274	3,520,694
<b>Total</b>	<b>5,971,431</b>	<b>4,905,463</b>

## 28. OPERATING SEGMENTS

The operating segments have been identified on the basis of internal reports about components of the Group that are regularly reviewed by the chief decision maker in order to allocate resources to the segments and to assess their performance.

All of the Group's operations are based in the Kingdom of Saudi Arabia.

Transactions between business segments are recorded based on the Group's transfer pricing methodologies. Segment assets and liabilities mainly comprise operating assets and liabilities.

### Fund Transfer Pricing

During the year, the Group has redefined and modified its funds transfer pricing system in order to achieve the objective of better product pricing, profitability and liquidity management. The assigned transfer rate within the operating segments is based on its maturity and prevailing commission rates. Long maturity pools receive a long-term commission rate, while short-term pools receive a transfer rate reflective of their shorter tenor. The Group has developed an assumption based model for each class of asset and liability and the pricing is applied to the funds accordingly. The pricing is based on the market rate prevailing at the time of transaction. The segmental results for the year ended December 31, 2011 have been prepared under the revised methodology. The segmental results for the year ended December 31, 2010 were prepared using a single commission rate for all maturity pools.

For management purposes, the Group is organized into following main operating segments:

### Personal Banking

Deposit, credit and investment products for individuals.



### Corporate Banking

Loans, deposits and other credit products for corporate, small and medium sized business and institutional customers.

### Brokerage and asset management

Provides shares brokerage services to customers (this segment includes the activities of the Bank's subsidiary AlJazira Capital Company).

### Treasury

Treasury includes money market, foreign exchange, trading and treasury services. Commission is charged to business segments based on a pool rate, which approximates the marginal cost of funds.

### Takaful Ta'awuni

Takaful Ta'awuni provides protection and saving products services and is fully Shariah compliant and is substitute to conventional life insurance products.

## 28. OPERATING SEGMENTS (continued)

The Group's total assets and liabilities and its income from operations and net income for the year by operating segment are as follows:

(SR'000)							
2011	Personal Banking	Corporate Banking	Brokerage and asset management	Treasury	Takaful Ta'awuni	Others	Total
Total assets	9,303,028	15,465,984	440,433	13,463,222	13,513	212,070	38,898,250
Total liabilities	12,565,175	18,419,474	165,811	2,767,404	35,759	7,764	33,961,387
Operating income from external customers	487,694	452,834	156,103	90,396	36,699	(15,628)	1,208,098
Inter – segment operating income/(loss)	(158,232)	(21,112)	47,130	136,543	(260)	(4,069)	-
Total operating income	329,462	431,722	203,233	226,939	36,439	(19,697)	1,208,098
Net special commission	247,298	330,796	11,184	191,419	(260)	1,026	781,463
Fee and commission income, net	53,753	81,842	188,570	(557)	36,677	(4,077)	356,208
Trading income	(5,846)	(5,158)	(54)	16,334	-	6,105	11,381
<b>Operating expenses:</b>							
- Impairment charge for credit losses, net	45,661	24,691	-	-	-	-	70,352
- Depreciation	39,963	7,700	13,436	2,224	3,452	-	66,775
Total operating expenses including non-controlling interest	449,238	196,075	133,723	60,507	68,769	(3,067)	905,245
Net (loss) / income attributable to equity holders of the Bank	(119,776)	235,647	69,510	166,432	(32,330)	(16,630)	302,853

## Notes to the Consolidated Financial Statement (continued)

For the years ended December 31, 2011 and 2010

	(SR'000)						
2010	Personal banking	Corporate banking	Brokerage and asset management	Treasury	Takaful ta'awuni	Others	Total
Total assets	6,228,876	13,986,811	537,846	11,909,807	56,083	298,798	33,018,221
Total liabilities	11,276,200	3,151,604	48,089	13,686,073	41,919	8,654	28,212,539
Operating income from external customers	347,547	582,486	117,214	19,279	34,761	53,779	1,155,066
Inter – segment operating income/(loss)	4,529	(72,999)	44,097	24,711	(338)	-	-
Total operating income	352,076	509,487	161,311	43,990	34,423	53,779	1,155,066
Net special commission	237,323	506,306	-	(26,038)	(338)	-	717,253
Fee and commission income, net	30,239	54,740	149,059	358	34,750	(3,675)	265,471
Trading income	-	-	371	20,568	-	6,865	27,804
<b>Operating expenses:</b>							
- Impairment Charge for credit losses, net	32,351	329,881	-	-	-	-	362,232
- Depreciation	37,719	5,787	15,961	18,015	3,786	-	81,268
Total operating expenses including non-controlling interest	401,831	442,128	162,599	84,133	49,190	(13,727)	1,126,154
Net (loss) / income attributable to equity holders of the Bank	(49,755)	67,359	(1,288)	(40,143)	(14,767)	67,506	28,912

Had the revised fund transfer pricing methodology, been applied to the year ended December 31, 2010 as if this had been in place throughout the year, the impact on the segment results for the year ended December 31, 2010 would be as follows:

	(SR'000)						
2010	Personal banking	Corporate banking	Brokerage and asset management	Treasury	Takaful ta'awuni	Others	Total
Total operating income	273,479	451,799	161,310	197,168	34,479	36,831	1,155,066
Net (loss) / income attributable to equity holders of the Bank	(120,556)	(36,547)	(1,288)	148,022	(11,275)	50,556	28,912

a) The Group's credit exposure by operating segment is as follows:

2011	Personal banking	Corporate banking	Brokerage and asset management	Treasury	Takaful ta'awuni	Others	Total
Consolidated statement of financial position assets	8,567,711	14,789,835	-	10,188,440	-	-	33,545,986
Commitments and contingencies	-	2,281,725	-	-	175,000	-	2,456,725
Derivatives	-	-	-	51,693	-	-	51,693

2010	Personal banking	Corporate banking	Brokerage and asset management	Treasury	Takaful ta'awuni	Others	Total
Consolidated statement of financial position assets	5,589,300	13,301,103	9,250	7,840,956	-	-	26,740,609
Commitments and contingencies	-	1,866,449	-	-	175,000	-	2,041,449
Derivatives	-	-	-	1,875	-	-	1,875

Credit exposure comprises the carrying value of consolidated statement of financial position assets excluding cash, property and equipment, other real estate, investment in equities and mutual fund, certain other assets. Additionally and the credit equivalent values of commitments, contingencies and derivatives are also included in the credit exposure.

Credit risk, which is the result of failure by counterparty to meet its financial and/or contractual obligations to the Group, is managed in accordance with the Group's comprehensive risk management control framework. Two credit committees are responsible for the oversight of credit risk, the Executive Committee and the Management Credit Committee. These committees have clearly defined mandates and delegated authorities, which are reviewed regularly.

The Group assesses the probability of default of counterparties using either internal rating models or external ratings as assessed by major rating agencies.

The Group attempts to control credit risk by monitoring credit exposures, limiting transactions with specific counterparties, and continually assessing the creditworthiness of counterparties.

The Group's credit policy aims at maintaining the high quality of the loan portfolio and ensuring proper risk diversification. The credit policy sets the basic criteria for acceptable risks and identifies risk areas that require special attention.

The Group manages the credit exposures relating to its trading activities by monitoring credit limits, entering into master netting agreements and collateral arrangements with counterparties in appropriate circumstances, and limiting the duration of exposure.

Concentrations of credit risk 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 of credit risk indicate the relative sensitivity of the Group's performance to developments affecting a particular industry or geographical location. The Group seeks to manage its credit risk exposure through the diversification of lending activities to ensure that there is no undue concentration of risks with individuals or groups of customers in specific locations or business.

The debt securities included in the investment portfolio are mainly sovereign risk. Analysis of investments by counter-party is provided in note 5. For details of the composition of loans and advances, refer to note 6. Information on credit risk relating to commitments and contingencies is provided in note 17. Information on the Bank's maximum credit exposure by operating segment is given in note 28.

The Bank in the ordinary course of its lending activities will often seek to take collateral to provide an alternative source of repayment in the event that customers or counterparties are unable to meet their obligations. Assets taken as collateral include promissory note, time and other cash deposits, financial guarantees, local and international equities subject to an appropriate margin to reflect price volatility, real estate and other physical assets. The Bank holds real estate collateral against the transfer of title deed. Collateral generally is not held over due from banks & other financial institutions, except when securities are held as part of reverse repurchase. Collateral usually is not held against investment securities, and no such collateral was held at December 31, 2011 and 2010. Customer agreements often include requirements for provision of additional collateral should valuations decline or credit exposure increase.

The Bank uses an internal credit classification and review system to manage the credit risk within its wholesale loans portfolio. The classification system includes ten grades, of which seven grades relate to the performing portfolio as follows:

- Standard-low risk: represents risk ratings 1 to 3;
- Standard-medium risk: represents risk ratings 4 to 6; and
- Special mention: represents risk rating 7

Three grades relate to the non-performing portfolio (substandard, doubtful and loss; risk ratings 8 to 10). Loans and advances under the standard category are performing, have sound fundamental characteristics and include those that exhibit neither actual nor potential weaknesses. Specific provisions for impairment are maintained in respect of the non performing portfolio based on each borrower's grade, which is determined by the Bank's Credit Control Division using specific criteria such as activities, cash flows, capital structure, securities and delinquency. Portfolio provisions are created for losses, where there is objective evidence that unidentified losses are present at the reporting date. These are estimated based upon credit gradings allocated to the borrower or group of borrowers as well as the current economic climate in which the borrowers operate together with the experience and the historical default patterns that are embedded in the components of the credit portfolio. The Bank's Internal Audit Division independently reviews the overall system on a regular basis.

## Notes to the Consolidated Financial Statement (continued)

For the years ended December 31, 2011 and 2010

The Bank regularly reviews its risk management policies and systems to reflect changes in markets, products and emerging best practice.

**a) Credit quality of financial assets (Loans and advances and Due from banks and other financial institutions)**

The table below shows the credit quality by class of asset.

	SR'000 Loans and advances					Due from Banks and Other Financial Institutions	Total
	Consumer	Commercial	Others	Sub total			
<b>2011</b>							
<b>Performing</b>							
<i>Neither past due nor impaired (performing)</i>							
Standard – low risk	-	3,230,166	-	3,230,166	4,331,024	7,561,190	
Standard – medium risk	-	9,935,105	-	9,935,105	-	9,935,105	
Standard – unclassified	7,041,289	1,255,231	87,242	8,383,762	-	8,383,762	
Sub total - standard	7,041,289	14,420,502	87,242	21,549,033	4,331,024	25,880,057	
Special mention	-	1,669,340	-	1,669,340	-	1,669,340	
<b>Sub total</b>	<b>7,041,289</b>	<b>16,089,842</b>	<b>87,242</b>	<b>23,218,373</b>	<b>4,331,024</b>	<b>27,549,397</b>	
<i>Past due but not impaired</i>							
Less than 30 days	150,849	48,931	-	199,780	-	199,780	
30-60 days	29,038	30,232	-	59,270	-	59,270	
60-90 days	6,663	-	-	6,663	-	6,663	
Over 90 days	3,121	-	-	3,121	-	3,121	
<b>Total</b>	<b>7,230,960</b>	<b>16,169,005</b>	<b>87,242</b>	<b>23,487,207</b>	<b>4,331,024</b>	<b>27,818,231</b>	
Less: portfolio provision	(101,497)	(204,367)	-	(305,864)	-	(305,864)	
<b>Net performing</b>	<b>7,129,463</b>	<b>15,964,638</b>	<b>87,242</b>	<b>23,181,343</b>	<b>4,331,024</b>	<b>27,512,367</b>	
<b>Non Performing</b>							
Total non Performing	57,886	972,802	-	1,030,688	-	1,030,688	
Less: Specific provision	(28,115)	(876,465)	-	(904,580)	-	(904,580)	
<b>Net non performing</b>	<b>29,771</b>	<b>96,337</b>	<b>-</b>	<b>126,108</b>	<b>-</b>	<b>126,108</b>	

SR'000 Loans and advances						
<u>2010</u>	Consumer	Commercial	Others	Sub total	Due from Banks and Other Financial Institutions	Total
<i>Performing</i>						
<i>Neither past due nor impaired (performing)</i>						
Standard – low risk	-	1,822,052	-	1,822,052	5,579,852	7,401,904
Standard – medium risk	-	9,159,394	-	9,159,394	-	9,159,394
Standard – unclassified	4,399,389	1,028,184	74,014	5,501,587	-	5,501,587
Sub total - standard	4,399,389	12,009,630	74,014	16,483,033	5,579,852	22,062,885
Special mention	-	1,798,929	-	1,798,929	-	1,798,929
Sub total	4,399,389	13,808,559	74,014	18,281,962	5,579,852	23,861,814
<i>Past due but not impaired</i>						
Less than 30 days	85,629	66,545	-	152,174	-	152,174
30-60 days	3,269	31,595	-	34,864	-	34,864
60-90 days	4,926	12,441	-	17,367	-	17,367
Over 90 days	7,689	4,115	-	11,804	-	11,804
Total	4,500,902	13,923,255	74,014	18,498,171	5,579,852	24,078,023
Less: portfolio provision	(45,586)	(139,053)	-	(184,639)	-	(184,639)
Net performing	4,455,316	13,784,202	74,014	18,313,532	5,579,852	23,893,384
<i>Non Performing</i>						
Total non Performing	58,746	1,271,589	-	1,330,335	-	1,330,335
Less: Specific provision	(24,648)	(914,777)	-	(939,425)	-	(939,425)
Net non performing	34,098	356,812	-	390,910	-	390,910

Standard unclassified mainly comprise consumer, credit cards, small business, employee and share trading loans.

Others mainly comprise employee loans.

Performing loans as at December 31, 2011 include renegotiated loans restructured due to deterioration in the borrower's financial position) of SR 969.9 million (2010: SR 768 million).

The special mention / watchlist category includes loans and advances that are performing, current and up to date in terms of principal and special commission payments. However, they require close management attention as they may have potential weaknesses that might, at some future date, result in the deterioration of the repayment prospects of either the principal or the special commission payments. The special mention / watchlist loans and advances do not expose the Bank to sufficient risk to warrant a lower classification.

## Notes to the Consolidated Financial Statement (continued)

For the years ended December 31, 2011 and 2010

### b) Credit quality Investments as at Amortised Cost

The credit quality of investments include debt instrument held as at amortised cost is managed using credit ratings of Moody's.

Unrated investments are debt instrument which have not been rated by any external credit rating agency.

The table below shows the credit quality by class of asset.

	2011 SR'000	2010 SR'000
<b>Performing</b>		
High grade (AAA – BBB)	2,553,966	1,654,811
Standard grade (BA1 – B2)	-	-
Sub-standard grade (BA3 – C)	-	-
Unrated	1,685,368	591,880
Total performing	4,239,334	2,246,691
Less: portfolio provision	-	-
<b>Net performing</b>	4,239,334	2,246,691
<b>Overall Investments, net</b>	4,239,334	2,246,691

As at December 31, 2011 and 2010, no provision was required for the impairment in the value of investments held as at amortised cost.

### c) An economic sector analysis of Bank's loans and advances

The tables below show an economic sector analysis of Bank's loans and advances, net of specific and portfolio provisions; after taking into account total collateral held for both performing and non-performing loans and advances. Collateral includes time and cash deposits, local and international equities, real estate, counter guarantees and assignment of receivables.

	Maximum exposure		
2011	On-balance sheet position, net of provisions SR'000	Off-balance sheet credit – related commitments and contingencies, net of provisions SR'000	Total SR'000
Banks and other financial institutions	702,745	155,688	858,433
Agriculture and fishing	56,826	14,828	71,654
Manufacturing	4,810,475	607,034	5,417,509
Mining and quarrying	12,029	93,750	105,779
Electricity, water, gas and health services	10,733	1,515	12,248
Building and construction	3,865,683	1,404,601	5,270,284
Commerce	2,405,714	476,426	2,882,140
Transportation and communication	160,012	160,730	320,742
Services	484,660	84,610	569,270
Consumer loans and credit cards	7,159,234	-	7,159,234
Share trading	1,277,099	-	1,277,099
Other	2,362,241	1,137,591	3,499,832
Maximum exposure	23,307,451	4,136,773	27,444,224
Less: collateral for performing and non performing	(9,710,792)	(1,314,362)	(11,025,154)
<b>Net maximum exposure</b>	13,596,659	2,822,411	16,419,070

<u>2010</u>	Maximum exposure		
	On-balance sheet position, net of provisions SR'000	Off-balance sheet credit – related commitments and contingencies, net of provisions SR'000	Total SR'000
Banks and other financial institutions	148,704	133,675	282,379
Agriculture and fishing	35,658	1,637	37,295
Manufacturing	4,112,063	1,169,455	5,281,518
Mining and quarrying	6,345	61,876	68,221
Electricity, water, gas and health services	33,361	1,724	35,085
Building and construction	4,018,857	2,158,952	6,177,809
Commerce	2,410,640	371,799	2,782,439
Transportation and communication	222,819	28,194	251,013
Services	365,643	98,920	464,563
Consumer loans and credit cards	4,489,414	-	4,489,414
Share trading	962,596	-	962,596
Other	1,898,342	695,248	2,593,590
Maximum exposure	18,704,442	4,721,480	23,425,922
Less: collateral for performing and non performing	(8,195,713)	(1,132,660)	(9,328,373)
Net maximum exposure	10,508,729	3,588,820	14,097,549

### 30. GEOGRAPHICAL CONCENTRATION

- a) The distribution by geographical region for major categories of assets, commitments and contingencies, and credit exposure are as follows:

<u>2011</u> Assets	(SR'000)						Total
	Saudi Arabia	GCC and Middle East	Europe	North America	South East Asia	Other Countries	
Cash and balances with SAMA	4,365,341	-	11,720	-	1,982	-	4,379,043
Due from banks and other financial institutions	2,030,353	2,220,797	49,201	25,831	4,741	101	4,331,024
Investments	4,018,345	67,688	133,691	25,151	402,041	749,999	5,396,915
Loans and advances, net	23,237,260	70,191	-	-	-	-	23,307,451
<b>Total</b>	<b>33,651,299</b>	<b>2,358,676</b>	<b>194,612</b>	<b>50,982</b>	<b>408,764</b>	<b>750,100</b>	<b>37,414,433</b>
<b>Commitments and Contingencies</b>	<b>4,013,133</b>	<b>7,094</b>	<b>98,452</b>	<b>-</b>	<b>2,272</b>	<b>16,977</b>	<b>4,147,928</b>
<b>Credit exposure (credit equivalent)</b>							
Commitments and contingencies	2,386,677	10,565	49,641	-	1,136	8,706	2,456,725
Derivatives	21,895	25,423	4,375	-	-	-	51,693



## Notes to the Consolidated Financial Statement (continued)

For the years ended December 31, 2011 and 2010

(SR'000)							
2010 Assets	Kingdom of Saudi Arabia	Other GCC and Middle East	Europe	North America	South East Asia	Other Countries	Total
Cash and balances With SAMA	2,597,251	-	3,022	3,536	4,081	-	2,607,890
Due from banks and other financial institutions	2,690,001	2,824,944	58,451	3,256	2,759	441	5,579,852
Investments	4,145,814	188	160,918	74,872	142,620	21,759	4,546,171
Loans & advances, net	18,592,556	111,886	-	-	-	-	18,704,442
Total	28,025,622	2,937,018	222,391	81,664	149,460	22,200	31,438,355
Commitments and Contingencies	4,606,270	26,432	96,010	-	-	4,013	4,732,725
Credit exposure (credit equivalent)							
Commitments and contingencies	1,971,929	18,703	48,005	-	-	2,812	2,041,449
Derivatives	-	-	1,875	-	-	-	1,875

Credit equivalent of commitments and contingencies is calculated according to SAMA's prescribed methodology.

**b) The distributions by geographical concentration of non-performing loans and advances and impairment for credit losses are as follows:**

	Non performing loans, net		Impairment for credit losses	
	2011 SR' 000	2010 SR' 000	2011 SR' 000	2010 SR' 000
Kingdom of Saudi Arabia	1,030,688	1,330,335	1,210,444	1,124,064

### 31. MARKET RISK

Market risk is the risk that the Group's earnings or capital, or its ability to meet business targets, will be adversely affected by changes in the level or volatility in market prices, such as special commission rates, credit spreads (not relating to changes in the obligor's / issuer's credit standing), equity prices and foreign exchange rates. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return.

The Group separates its exposure to market risk between trading and non-trading portfolios. Trading portfolios mainly are held by the Treasury division and include equity investments and mutual funds that are managed on a fair value basis.

The Board approves market risk appetite for trading and non-trading activities. The Market Risk Policy Committee is responsible for the Market Risk Framework and under the delegated authority of the Board sets a limits framework within the approved market risk appetite. A daily market risk report details the Group's market risk exposures against agreed limits. This daily report is reviewed by the Treasurer and Chief Risk Officer. The market risk for the trading book and non-trading book is managed and monitored using sensitivity analysis.

**a) MARKET RISK TRADING BOOK**

Market risk on trading mainly arises from the foreign currency exposures and changes in equity prices and the net asset value of mutual fund.

**i) FOREIGN EXCHANGE RISK**

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Group manages exposure to the effects of fluctuations in prevailing foreign currency exchange rates on its financial position and cash flows. The Board has set limits on positions by currency. Positions are monitored daily to ensure positions are maintained within established limits.

At the end of the year, the Group has the following significant exposure, net of non controlling interest, in its trading book, denominated in foreign currencies as at December 31:

	2011 SR'000	2010 SR'000
USD	13,107	14,303
Euro	12,118	17,152
Pound Sterling	19,040	18,112
Japanese Yen	32,584	36,110

The table below indicates the extent to which the Group was exposed to currency risk at December 31, 2011 on its foreign currency positions. The analysis is performed for a reasonable possible movement of the currency rate against the Saudi Riyal with all other variables held constant, including the effect of hedging instrument, on the consolidated income statement. A negative amount in the table reflects a potential net reduction in consolidated income statement, while a positive amount reflects a net potential increase. The sensitivity analysis does not take account of actions that might be taken by the Group to mitigate the effect of such changes.

Currency	2011		2010	
	Increase in currency rate in %	Effect on net income SR'000	Increase in currency rate in %	Effect on net income SR'000
USD	± 0.375	± 49	± 0.375	± 54
Euro	± 6.450	± 782	± 9.84	± 1,688
Pound Sterling	± 10.630	± 2,024	± 8.81	± 1,596
Japanese Yen	± 7.210	± 2,349	± 8.77	± 3,167

## ii) EQUITY PRICE RISK

Equity price risk is the risk that the fair value of equities decreases as a result of changes in the levels of equity index and the value of individual stocks.

The financial instruments included in the FVTIS portfolio are equity securities held by two mutual funds that are subsidiaries of the Bank and mutual fund. The Bank manages the risk relating to the mutual funds by monitoring changes in net asset value of the mutual funds. The investments in equity securities held by the subsidiaries of the Bank are managed by the Bank in conjunction with professional investment advisors, and the equity price risk is monitored by the Group on a portfolio basis for each mutual fund. The effect on the consolidated income statement as a result of a change in the fair value of equity instruments held for trading at December 31, 2011 and 2010 due to reasonably possible changes in the underlying respective fund's net asset value, with all other variables held constant, is as follows:

Portfolio	2011		2010	
	Increase / decrease in equity price %	Effect on consolidated income statement SR'000	Increase / decrease in equity price %	Effect on consolidated income statement SR'000
Al Thoraiya	± 8.29	± 3,146	± 8.9	± 3,842
Al Khair	± 6.11	± 1,373	± 8.18	± 2,089
Al Mashareq	± 17.34	± 5,296	± 3.15	± 1,097

The effect on the consolidated income statement as a result of a change in the fair value of mutual fund investments as at FVTIS at December 31, 2011 and 2010 due to reasonably possible change in the net asset value (NAV) of the fund, with all other variables held constant, is as follows:

Portfolio	2011		2010	
	Increase / decrease in NAV %	Effect on consolidated income statement SR'000	Increase / decrease in NAV %	Effect on consolidated income statement SR'000
Mutual Fund	± 5	± 28,227	± 5	± 7,546

## Notes to the Consolidated Financial Statement (continued)

For the years ended December 31, 2011 and 2010

The effect on the consolidated income statement as a result of a change in the fair value of equity instruments held at FVTIS at December 31, 2011, previously FVIS at 31 December 2010 due to reasonably possible changes in the following market index, with all other variables held constant, is as follows:

	2011		2010	
	Increase / decrease in index %	Effect on shareholders' equity (other reserve) SR'000	Increase / decrease in index %	Effect on shareholders' equity (other reserve) SR'000
Market index				
Tadawul	-	-	± 7.79%	± 29,918

### b) MARKET RISK – NON TRADING OR BANKING BOOK

Market risk on non-trading or banking positions mainly arises from the special commission rate, foreign currency exposures and equity price changes.

#### i) SPECIAL COMMISSION RATE RISK

Special commission rate risk arises from the possibility that changes in special commission rates will affect future cash flows or the fair values of financial instruments. The Group's Assets Liabilities Committee (ALCO) has established limits on the special commission rate gap. Positions are monitored on a daily basis and reported on a monthly basis to ALCO to ensure positions are maintained within the established limits. In case of stressed market conditions, the asset-liability gap may be reported to ALCO more frequently.

The following table depicts the sensitivity due to reasonably possible changes in special commission rates, with other variables held constant, on the Group's consolidated income statement. The sensitivity of the income is the effect of the assumed changes in special commission rates on the net special commission income for one year, based on the special commission bearing non-trading financial assets and financial liabilities held as at December 31, 2011 including the effect of hedging instrument. All the non-trading book exposures are monitored and analyzed in currency concentrations and relevant sensitivities are disclosed in local currency. The sensitivity analysis does not take account of actions that might be taken by the Group to mitigate the effect of such changes.

Currency	2011		2010	
	Increase / decrease in basis point	Sensitivity of special commission income SR'000	Increase / decrease in basis point	Sensitivity of special commission income SR'000
SR	+25	13,136	+25	2,425
SR	-25	(13,136)	-25	(2,425)
USD	+25	(3,617)	+25	(785)
USD	-25	3,617	-25	785
Qatari Riyal	+25	83	+25	1,412
Qatari Riyal	-25	(83)	-25	(1,412)

#### Commission rate sensitivity of assets, liabilities and off-balance sheet items

The Group manages exposure to the effects of various risks associated with fluctuations in the prevailing levels of market commission rates on its financial position and cash flows.

The table below summarizes the Group's exposure to commission rate risks. Included in the table are the Group's assets and liabilities at carrying amounts, categorized by the earlier of the contractual re-pricing or the maturity dates. The Group is exposed to commission rate risk as a result of mismatches or gaps in the amounts of assets and liabilities and off-balance sheet instruments that mature or re-price in a given period. The Group manages this risk by matching the re-pricing of assets and liabilities through risk management strategies.

(SR'000)							
<u>2011</u>	<u>Within 3 Months</u>	<u>3-12 months</u>	<u>1-5 years</u>	<u>Over 5 years</u>	<u>Non commission bearing</u>	<u>Total</u>	<u>Effective commission rate</u>
<b>Assets</b>							
Cash and balances with SAMA	2,293,984	-	-	-	2,085,059	4,379,043	-
Due from banks and other financial institutions	3,749,774	581,250	-	-	-	4,331,024	0.71%
Investments	2,511,209	1,115,000	613,125	-	1,157,581	5,396,915	1.00%
Loans and advances, net	7,133,516	8,959,935	6,052,651	1,035,241	126,108	23,307,451	4.25%
Other real estate, net	-	-	-	-	680,778	680,778	-
Property and equipment, net	-	-	-	-	446,829	446,829	-
Other assets	-	-	-	-	356,210	356,210	-
<b>Total assets</b>	<b>15,688,483</b>	<b>10,656,185</b>	<b>6,665,776</b>	<b>1,035,241</b>	<b>4,852,565</b>	<b>38,898,250</b>	<b>-</b>
<b>Liabilities and equity</b>							
Due to banks and other financial institutions	1,194,410	-	-	-	111,368	1,305,778	1.02%
Customers' deposits	15,480,492	4,650,169	59,289	-	10,968,581	31,158,531	0.89%
Other liabilities	-	-	-	-	497,078	497,078	-
Subordinated Sukuk	-	1,000,000	-	-	-	1,000,000	-
Equity including non-controlling interests	-	-	-	-	4,936,863	4,936,863	-
<b>Total liabilities and Equity</b>	<b>16,674,902</b>	<b>5,650,169</b>	<b>59,289</b>	<b>-</b>	<b>16,513,890</b>	<b>38,898,250</b>	<b>-</b>
<b>On-balance sheet gap</b>	<b>(986,419)</b>	<b>5,006,016</b>	<b>6,606,487</b>	<b>1,035,241</b>	<b>(11,661,325)</b>	<b>-</b>	<b>-</b>
<b>Commission rate sensitivity – off balance sheet</b>	<b>5,054,390</b>	<b>115,000</b>	<b>(5,169,390)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Total commission rate sensitivity gap</b>	<b>4,067,971</b>	<b>5,121,016</b>	<b>1,437,097</b>	<b>1,035,241</b>	<b>(11,661,325)</b>	<b>-</b>	<b>-</b>
<b>Cumulative commission rate sensitivity gap</b>	<b>4,067,971</b>	<b>9,188,987</b>	<b>10,626,084</b>	<b>11,661,325</b>	<b>-</b>	<b>-</b>	<b>-</b>

## Notes to the Consolidated Financial Statement (continued)

For the years ended December 31, 2011 and 2010

(SR' 000)							
<u>2010</u>	Within 3 Months	3-12 months	1-5 years	Over 5 years	Non commission bearing	Total	Effective commission rate
<b>Assets</b>							
Cash and balances	-	-	-	-	2,607,890	2,607,890	-
with SAMA							
Due from banks and							
other financial	4,319,553	1,162,908	-	-	97,391		1.19%
institutions						5,579,852	
Investments	1,211,370	1,035,321	-	-	2,299,480	4,546,171	1.02%
Loans and advances, net	5,304,747	6,825,729	5,964,121	218,935	390,910	18,704,442	4.57%
Other real estate, net	-	-	-	-	679,800	679,800	-
Property and equipment, net	-	-	-	-	462,493	462,493	-
Other assets	-	-	-	-	437,573	437,573	-
<b>Total assets</b>	<b>10,835,670</b>	<b>9,023,958</b>	<b>5,964,121</b>	<b>218,935</b>	<b>6,975,537</b>	<b>33,018,221</b>	<b>-</b>
<b>Liabilities and equity</b>							
Due to banks and other							
financial institutions	180,012	165,000	-	-	43,707	388,719	0.46%
Customers' deposits	13,981,128	4,838,472	413,626	-	8,111,692	27,344,918	0.95%
Other liabilities	-	-	-	-	478,902	478,902	-
Equity including non-controlling interests	-	-	-	-	4,805,682	4,805,682	-
<b>Total liabilities and Equity</b>	<b>14,161,140</b>	<b>5,003,472</b>	<b>413,626</b>	<b>-</b>	<b>13,439,983</b>	<b>33,018,221</b>	<b>-</b>
On-balance sheet gap	(3,325,470)	4,020,486	5,550,495	218,935	(6,464,446)	-	-
Commission rate sensitivity – off balance sheet	187,500	-	(187,500)	-	-	-	-
<b>Total commission rate sensitivity gap</b>	<b>(3,137,970)</b>	<b>4,020,486</b>	<b>5,362,995</b>	<b>218,935</b>	<b>(6,464,446)</b>	<b>-</b>	<b>-</b>
Cumulative commission rate sensitivity gap	(3,137,970)	882,516	6,245,511	6,464,446	-	-	-

The effective commission rate (effective yield) of a monetary financial instrument is the rate that, when used in a present value calculation, results in the carrying amount of the instrument. The rate is a historical rate for a fixed rate instrument carried at amortised cost and a current market rate for a floating rate instrument or an instrument carried at fair value.

### ii) 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 manages exposure to the effects of fluctuations in prevailing foreign currency exchange rates on its financial position and cash flows. The Board has set limits on positions by currency. Positions are monitored on a daily basis to ensure positions are maintained within established limits.

At the end of the year, the Group has the following significant net exposures denominated in foreign currencies as at December 31:

	2011 SR' 000 <u>Long (short)</u>	2010 SR' 000 <u>Long (short)</u>
USD	194,063	(66,015)
Qatari Riyals	(1,915)	566,335

The table below indicates the currencies to which the Group has significant exposure as at December 31, 2011. The analysis is performed for a reasonable possible movement of the currency rate against the Saudi Riyal with all other variables held constant, including the effect of hedging instrument, on the consolidated income statement. A negative amount in the table reflects a potential net reduction in consolidated income statement, while a positive amount reflects a net potential increase. The sensitivity analysis does not take account of actions that might be taken by the Group to mitigate the effect of such changes.

Currency	2011		2010	
	Increase / decrease in currency rate in %	Effect on net income SR'000	Increase in currency rate in %	Effect on net income SR'000
USD	± 0.05	± 97	± 0.05	± 33
Qatari Riyals	± 0.05	± 1	± 0.05	± 283

### iii) EQUITY PRICE RISK

Equity price risk is the risk that the fair value of equities decreases as a result of changes in the levels of equity index and the value of individual stocks.

The effect on shareholders' equity (other reserves) as a result of a change in the fair value of equity instruments as at FVTOCI at December 31, 2011 and available for sale at 31 December 2010 due to reasonably possible changes in the following market index, with all other variables held constant, is as follows:

Market index	2011		2010	
	Increase / decrease in index %	Effect on shareholders' equity (other reserve) SR'000	Increase / decrease in index %	Effect on shareholders' equity (other reserve) SR'000
New York Stock Exchange	± 6.11%	± 164	± 8%	± 150
Tadawul	± 3.22%	± 9,418	-	-

## 32. LIQUIDITY RISK

Liquidity risk is the risk that the Group will be unable to meet its payment obligations when they fall due under normal and stressed circumstances. Liquidity risk can be caused by market disruptions or credit downgrades, which may cause certain sources of funding to be less readily available. To mitigate this risk, management has diversified funding sources in addition to its core deposit base, manages assets with liquidity in mind, maintaining an appropriate balance of cash, cash equivalents and readily marketable securities and monitors future cash flows and liquidity gaps on a daily basis. The Group also has committed lines of credit that it can access to meet liquidity needs.

In accordance with the Banking Control Law and the regulations issued by SAMA, the Bank maintains a statutory deposit with SAMA at 7% of total demand deposits and 4% of savings and time deposits. In addition to the statutory deposit, the Bank also maintains liquid reserves of not less than 15% of the deposit liabilities, in the form of cash or assets that can be converted into cash within a period not exceeding 30 days. The Bank has the ability to raise additional funds through repo facilities available with SAMA up to 75% of the value of Murabaha placements with SAMA.

The liquidity position is assessed and managed under a variety of scenarios, giving due consideration to stress factors relating to both the market in general and specifically to the Group. One of these methods is to maintain limits on the ratio of liquid assets to deposit liabilities, set to reflect market conditions. Liquid assets consist of cash, short term bank deposits, Murabaha placements with SAMA and liquid debt securities available for immediate sale. Deposits liabilities include both customers and Banks, excluding non-resident Bank deposits in foreign currency. The Bank also monitors the loan to deposit ratio. The liquidity ratio during the year was as follows:

	2011 %	2010 %
As at 31 December	33	42
Average during the period	33	39
Highest	47	48
Lowest	26	35

### a) Analysis of financial liabilities by remaining contractual maturities

The table below summarises the maturity profile of the Bank's financial liabilities at December 31, 2011 and 2010 based on contractual undiscounted repayment obligations. As special commission payments up to contractual maturity are included in the table, totals do not match with the statement of financial position. The contractual maturities of liabilities have been determined on the basis of the remaining period at the reporting date to the contractual maturity date and do not take into account the effective expected maturities as shown on note (b) below (Maturity analysis of assets and liabilities for the expected maturities). Repayments

## Notes to the Consolidated Financial Statement (continued)

For the years ended December 31, 2011 and 2010

which are subject to notice are treated as if notice were to be given immediately. However, the Bank expects that many customers will not request repayment on the earliest date the Bank could be required to pay and the table does not reflect the expected cash flows indicated by the Bank's deposit retention history.

(SR'000)

	On demand	Less than 3 months	3-12 months	1-5 years	Over 5 years	Total
<b>Financial liabilities</b>						
<b>As at 31 December 2011</b>						
Due to banks and other financial institutions	111,368	1,179,404	20,161	-	-	1,310,933
Customers' deposits	10,069,636	16,566,598	4,028,226	1,133,087	-	31,797,547
Subordinated Sukuk	-	6,018	11,775	1,094,200	-	1,111,993
Derivatives	-	894	1,317,913	3,893,617	-	5,212,424
<b>Total undiscounted financial liabilities 2011</b>	<b>10,181,004</b>	<b>17,752,914</b>	<b>5,378,075</b>	<b>6,120,904</b>	<b>-</b>	<b>39,432,897</b>

### Financial liabilities

As at 31 December 2010

Due to banks and other financial institutions	43,719	180,406	165,739	-	-	389,864
Customers' deposits	7,529,199	14,507,278	4,410,955	1,045,826	-	27,493,258
Derivatives	-	1,083	3,309	203,983	-	208,375
<b>Total undiscounted financial liabilities 2010</b>	<b>7,572,918</b>	<b>14,688,767</b>	<b>4,580,003</b>	<b>1,249,809</b>	<b>-</b>	<b>28,091,497</b>

The contractual maturity structure of the Bank's credit-related contingencies and commitments are shown under note 17.

### b) Maturity analysis of assets and liabilities

The table below shows an analysis of assets and liabilities analysed according to when they are expected to be recovered or settled. See note (a) above for the Bank's contractual undiscounted financial liabilities. For presentation purposes demand deposits are included in "No fixed maturity" category.

(SR'000)

<b>2011</b>	<b>Within 3 months</b>	<b>3-12 months</b>	<b>1-5 years</b>	<b>Over 5 years</b>	<b>No fixed maturity</b>	<b>Total</b>
<b>Assets</b>						
Cash and balances with SAMA	-	-	-	-	4,379,043	4,379,043
Due from banks and other financial institutions	1,499,910	2,482,364	348,750	-	-	4,331,024
Investments	1,449,838	124,976	2,239,519	425,000	1,157,582	5,396,915
Loans and advances, net	3,091,910	8,367,908	7,076,316	4,645,209	126,108	23,307,451
Other real estate, net	-	-	-	-	680,778	680,778
Property and equipment, net	-	-	-	-	446,829	446,829
Other assets	137,479	111,616	52,575	45,009	9,531	356,210
<b>Total assets</b>	<b>6,179,137</b>	<b>11,086,864</b>	<b>9,717,160</b>	<b>5,115,218</b>	<b>6,779,871</b>	<b>38,898,250</b>
<b>Liabilities and equity</b>						
Due to banks and other financial institutions	879,702	293,234	-	-	132,842	1,305,778
Customers' deposits	4,659,207	12,067,528	3,913,155	-	10,518,641	31,158,531
Subordinated Sukuk	-	-	1,000,000	-	-	1,000,000
Other liabilities	46,913	11,197	3,152	-	435,816	497,078
Equity including non-controlling interests	-	-	-	-	4,936,863	4,936,863
<b>Total liabilities and equity</b>	<b>5,585,822</b>	<b>12,371,959</b>	<b>4,916,307</b>	<b>-</b>	<b>16,024,152</b>	<b>38,898,250</b>



(SR'000)						
2010	Within 3 months	3-12 months	1-5 years	Over 5 years	No fixed maturity	Total
<b>Assets</b>						
Cash and balances with SAMA	-	-	-	-	2,607,890	2,607,890
Due from banks and other financial institutions	1,766,778	3,115,329	697,745	-	-	5,579,852
Investments	300,000	227,064	1,544,627	175,000	2,299,480	4,546,171
Loans and advances, net	2,533,647	6,476,595	5,861,465	3,441,825	390,910	18,704,442
Other real estate, net	-	-	-	-	679,800	679,800
Property and equipment, net	-	-	-	-	462,493	462,493
Other assets	234,325	117,822	39,063	44,020	2,343	437,573
<b>Total assets</b>	<b>4,834,750</b>	<b>9,936,810</b>	<b>8,124,900</b>	<b>3,660,845</b>	<b>6,442,916</b>	<b>33,018,221</b>
<b>Liabilities and equity</b>						
Due to banks and other financial institutions	135,000	210,000	-	-	43,719	388,719
Customers' deposits	4,042,446	10,861,224	4,329,501	-	8,111,747	27,344,918
Other liabilities	43,680	15,763	3,185	-	416,274	478,902
Equity including non-controlling interests	-	-	-	-	4,805,682	4,805,682
<b>Total liabilities and equity</b>	<b>4,221,126</b>	<b>11,086,987</b>	<b>4,332,686</b>	<b>-</b>	<b>13,377,422</b>	<b>33,018,221</b>

### 33. FAIR VALUES OF FINANCIAL ASSETS AND LIABILITIES

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

The fair values of on balance sheet financial instruments are not significantly different from the carrying values included in the consolidated financial statements. The estimated fair values of other investment held at amortised costs are based on quoted market prices, when available. The fair values of these investments are disclosed in note 5.

#### Determination of fair value and fair value hierarchy

The Group uses the following hierarchy for determining and disclosing the fair value of financial instruments:

- Level 1: quoted prices in active markets for the identical assets or liabilities.
- Level 2: quoted prices in active markets for similar assets and liabilities or other valuation techniques for which all significant inputs are based on observable market data.
- Level 3: valuation techniques for which any significant input is not based on observable market data.

2011 (SR'000)				
	Level 1	Level 2	Level 3	Total
<b>Financial assets</b>				
FVTIS	859,264	-	-	859,264
FVTOCI	294,879	-	3,438	298,317
Derivatives	-	2,285	-	2,285
<b>Total</b>	<b>1,154,143</b>	<b>2,285</b>	<b>3,438</b>	<b>1,159,866</b>

2010 (SR'000)				
	Level 1	Level 2	Level 3	Total
<b>Financial assets</b>				
Held at FVIS	384,055	-	-	384,055
Held for trading	1,910,118	-	-	1,910,118
Available for sale	1,869	-	3,438	5,307
Derivatives	-	1,915	-	1,915
<b>Total</b>	<b>2,296,042</b>	<b>1,915</b>	<b>3,438</b>	<b>2,301,395</b>

## Notes to the Consolidated Financial Statement (continued)

For the years ended December 31, 2011 and 2010

During the year there were no transfer between levels and it remained as it was at December 31, 2010. The classification of investment has been changed due to the early adoption of IFRS 9 and further new investments acquired during the year are classified under the relevant categories.

### 34. RELATED PARTY TRANSACTIONS

In the ordinary course of its activities, the Bank transacts business with related parties. In the opinion of management and the Board of Directors, the related party transactions are conducted at market rates. The related party transactions are governed by the limits set by the Banking Control Law and regulations issued by SAMA.

The balances as at December 31 resulting from such transactions included in the consolidated financial statements are as follows:

	2011 SR' 000	2010 SR' 000
<b>National Bank of Pakistan (shareholder)</b>		
Due from banks and other financial institutions	-	207
Due to banks and other financial institutions	506	579
Other receivables	369	20
Commitments and contingencies	1,347	2,711
<b>Directors, key management personnel, other major shareholders and their affiliates</b>		
Loans and advances	1,480,022	1,226,861
Customers' deposits	3,883,162	4,010,653
Commitments and contingencies	10,730	2,111

Other major shareholders represent shareholdings of more than 5% of the Bank's issued share capital.

Income, expenses and other transactions with related parties included in the consolidated financial statements are as follows:

	2011 SR' 000	2010 SR' 000
Special commission income	49,444	59,751
Special commission expense	41,992	47,305
Fees and commission income	110	528
Fees and commission expense	264	-
Directors' remunerations	5,109	702

The total amount of compensation paid to directors and key management personnel during the year is as follows:

	2011 SR' 000	2010 SR' 000
Short-term employee benefits	51,472	38,583
Termination benefits	12,277	14,084

Key management personnel are those persons, including executive directors, having authority and responsibility for planning, directing and controlling the activities of the Bank, directly or indirectly.

### 35. COMPENSATION

Categories of employees	Number of employees	Fixed compensation	Variable compensation	Total
		SR' 000	SR' 000	SR' 000
Senior Executives that require SAMA no objection	12	20,655	5,353	26,008
Employees involved in control function	110	29,937	3,867	33,804
Employees involved in risk taking activities	29	7,911	775	8,686
Other employees	1,721	291,350	46,310	337,660
Outsourced employees	749	27,707	169	27,876
<b>Total</b>	<b>2,621</b>	<b>377,560</b>	<b>56,474</b>	<b>434,034</b>
<b>Variable Compensation accrued in 2011 and other employee related benefits</b>				48,808
<b>Total Salaries and employee-related expenses</b>				<b>482,842</b>

Categories of employees	Number of employees	Fixed compensation	Variable compensation	Total
		SR' 000	SR' 000	SR' 000
Senior Executives that require SAMA no objection	12	17,356	7,217	24,573
Employees involved in control function	15	5,540	1,100	6,640
Employees involved in risk taking activities	98	21,631	2,965	24,596
Other employees	1,690	279,483	50,085	329,568
Outsourced employees	577	14,475	48	14,523
<b>Total</b>	<b>2,392</b>	<b>338,485</b>	<b>61,415</b>	<b>399,900</b>
<b>Variable Compensation accrued in 2010 and other employee related benefits</b>				34,104
<b>Total Salaries and employee-related expenses</b>				<b>434,004</b>

#### The compensation and benefits program philosophy

The compensation and benefits program of Bank is designed to attract, motivate and retain the best talent to support robust business performance, and achieve superior business strategy goals, aims and objectives, while managing and mitigating any associated risks, and ensuring due compliance with all regulatory requirements and mandates.

The spirit and letter of the Bank's compensation philosophy is to reasonably and accurately reward and recognize staff for achieving their personal best highest level of customer services.

### 36. CAPITAL ADEQUACY

The Bank's objectives when managing capital are to comply with the capital requirements set by SAMA to safeguard the Bank's ability to continue as a going concern and to maintain a strong capital base.

The Bank monitors the adequacy of its capital using ratios established by SAMA. These ratios measure capital adequacy by comparing the Bank's eligible capital with its consolidated statement of financial position assets, commitments and notional amount of derivatives at a weighted amount to reflect their relative risk. Capital adequacy and the use of regulatory capital are monitored daily by the Bank's management. SAMA requires to hold the minimum level of the regulatory capital and maintain a ratio of total eligible capital to the risk-weighted assets at or above the agreed minimum of 8%.

## Notes to the Consolidated Financial Statement (continued)

For the years ended December 31, 2011 and 2010

	2011		2010	
	Eligible capital SR '000	Capital adequacy ratio %	Eligible capital SR '000	Capital adequacy ratio %
Core capital (Tier 1)	4,732,537	13.64%	4,515,518	15.11%
Supplementary capital (Tier 2)	1,305,864		184,639	
Core and supplementary capital (Tier 1 + Tier 2)	6,038,401	17.40%	4,700,157	15.72%

Tier 1 capital of the Bank at the year end comprises share capital, statutory, other reserves, retained earnings, proposed dividend and non-controlling interest less other prescribed deductions. Tier 2 capital comprises a prescribed amount of eligible portfolio provisions (collective provisions) less prescribed deductions.

The Bank has implemented Basel II effective January 1, 2008 as stipulated by SAMA. The Bank uses the Standardized approach of Basel II to calculate the risk weighted assets and required Regulatory Capital for Pillar -1 (including credit risk, market risk and operational risk). The Bank's Risk Management Division is responsible for ensuring that minimum required Regulatory Capital calculated is compliant with Basel II requirements. Quarterly prudential returns are submitted to SAMA showing the Capital Adequacy Ratio.

	2011 SR '000	2010 SR '000
Credit risk	30,819,867	24,804,376
Operational risk	2,102,541	2,043,119
Market risk	1,785,681	3,046,425
Total pillar-1 – risk weighted assets	34,708,089	29,893,920

### 37. INVESTMENT MANAGEMENT AND BROKERAGE SERVICES

The Bank's subsidiary AlJazira Capital Company (AJC) (note 1) offers investment management and advisory services to its customers, compliant with the principle of Shari'ah (non-interest based). These services include portfolio management on discretionary and non discretionary basis and management of investment funds in conjunction with professional investment advisors. Five such funds for which AJC acts as the manager are Al-Khair Global Equities Fund, Al-Thoraiya European Equities Fund, Al-Mashareq Japanese Equities Fund, Al-Taiyebat Saudi Equities Fund and Al-Qawafel commodities Fund. All are open-ended mutual funds for Saudi and foreign nationals. Al-Khair Global Equities Fund, Al-Thoraiya European Equities Fund and Al-Mashareq Japanese Equities Fund invest in foreign equities, while Al-Taiyebat Saudi Equities Fund invests in local equities. Al-Qawafel Commodities Fund trades in commodities through Murabaha. The financial statements of Al-Thoraiya European Equities Fund, and Al-Mashareq Japanese Equities Fund are consolidated with these financial statements.

The Group also provides investment management and other services to the policyholders of its Takaful Ta'awuni program.

The asset held by the Group under the investment management and brokerage services are amounted to SR 1.29 billion (2010: SR 1.07 billion).

### 38. TAKAFUL TA'AWUNI DIVISION

As required by Insurance Law of Saudi Arabia, the Group has decided to spin off its insurance business in a separate entity formed under the new Insurance Law of Saudi Arabia. The Bank and AlJazira Capital Company will have 35% shareholding in the new insurance company and remaining will be held by other founding shareholders and offered to the public by way of the Initial Public Offering. Once the new insurance company is incorporated and licensed, the assets, liabilities and operations of the insurance business will be transferred to the new insurance company at a valuation to be approved by the Regulator.

### 39. PROSPECTIVE CHANGES IN ACCOUNTING STANDARDS

Standards issued but not yet effective up to date of issuance of the Group's consolidated financial statement 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 when they become effective

Effective From periods beginning on or after	Standard, amendment or interpretation	Summary of requirements
1-July-2012	IAS 1 - Presentation of Items of Other Comprehensive Income	The amendments require that an entity present separately the items of other comprehensive income that would be reclassified to consolidated income statement in the future if certain conditions are met from those that would never be reclassified to consolidated income statement
1-January-2013	IFRS 10 Consolidated Financial Statements	<p>IFRS 10 introduces a new approach to determining which investees should be consolidated and provides a single model to be applied in the control analysis for all investees</p> <p>An investor controls an investee when:</p> <ul style="list-style-type: none"> <li>• it is exposed or has rights to variable returns from its involvement with that investee;</li> <li>• it has the ability to affect those returns through its power over that investee; and</li> <li>• there is a link between power and returns.</li> </ul> <p>Control is re-assessed as facts and circumstances change IFRS 10 supersedes IAS 27 (2008) and SIC -12 Consolidation – Special Purpose Entities.</p>
1-January-2013	IFRS 12 Disclosure of Interests in Other Entities	<p>IFRS 12 contains the disclosure requirements for entities that have interests in subsidiaries, joint arrangements (i.e. joint operations or joint ventures), associates and/or unconsolidated structured entities, aiming to provide information to enable users to evaluate:</p> <ul style="list-style-type: none"> <li>• the nature of, and risks associated with, an entity's interests in other entities; and</li> <li>• the effects of those interests on the entity's financial position, financial performance and cash flows.</li> </ul>
1-January-2013	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 when it is required or permitted by other IFRSs
1-January-2013	IAS 27 Separate Financial Statements (2011)	IAS 27 (2011) supersedes IAS 27 (2008). IAS 27 (2011) carries forward the existing accounting and disclosure requirements for separate financial statements, with some minor clarifications.
1-January-2013	IAS 28 Investments in Associates and Joint Ventures (2011)	<p>IAS 28 (2011) supersedes IAS 28 (2008). IAS 28 (2011) makes the following amendments:</p> <ul style="list-style-type: none"> <li>• IFRS 5 applies to an investment, or a portion of an investment, in an associate or a joint venture that meets the criteria to be classified as held for sale; and</li> <li>• on cessation of significant influence or joint control, even if an investment in an associate becomes an investment in a joint venture or vice versa, the entity does not remeasure the retained interest.</li> </ul>

## Notes to the Consolidated Financial Statement (continued)

For the years ended December 31, 2011 and 2010

### 40. BOARD OF DIRECTORS' APPROVAL

The consolidated financial statements were authorized for issue by the Board of Directors on 7 February 2012.

### 41. COMPARATIVE FIGURES

Certain of the prior year figures have been reclassified to conform with the current year presentation.

### 42. BASEL II PILLAR 3 DISCLOSURES

Under Basel II pillar 3, certain quantitative and qualitative disclosures are required, and these disclosures, will be made available on the Bank's website [www.baj.com.sa](http://www.baj.com.sa) and the annual report, respectively as required by the Saudi Arabian Monetary Agency (SAMA). Such disclosures are not subject to audit or review by the external auditors of the Bank.

## Basel II – Pillar 3 Qualitative Disclosures

For the Year ended December 31, 2011

### BASIS OF DISCLOSURES

Bank AlJazira Group (including its subsidiaries) prepares its consolidated financial statements ("consolidated accounts") under International Financial Reporting Standards ("IFRS").

The disclosures contained in this report have been prepared as at 31 December 2011. These disclosures cover both the Pillar 3 qualitative and quantitative disclosure requirements. The Pillar 3 disclosures have been prepared to explain the basis on which the Bank has prepared and disclosed capital requirements and information about the management of certain risks. The name of the top corporate entity in the Group to which these regulations and disclosures pertain, is Bank Al Jazira. The following table lists the entities that are consolidated in the Bank financial statements, where control exists, for accounting and regulatory purposes:

Entity Name	Consolidation	
	Accounting	Regulatory
AlJazira Capital Company	Yes	Yes
Aman Real Estate	Yes	Yes
Al-Mashareq Japanese Equities Fund	Yes	NR
Al-Thoraiya European Equities Fund	Yes	NR
Al-Khair American Equities Fund	NR	NR*

\*not required

#### Al Jazira Capital Company (JAZC):

Al Jazira Capital Company is a Closed Joint Stock Company incorporated under Ministerial Resolution No. S/57 dated Safar 20, 1429H corresponding to February 27, 2008. It is a locally registered under Registration No. 4030177603 dated Rabi-al-awwal 17, 1429H, corresponding to March 25, 2008. It has paid up share capital of SAR 500 million. The Company is engaged in the activities including dealing, arranging, managing, advising, custodian services, and investing activities, as per the CMA's resolution No. 37-07076.

#### Aman Development & Real Estate Company:

Aman Company is a Limited Liability Company registered in the Kingdom of Saudi Arabia under Commercial Registration number 1010221387 dated 20 Jumad Thani 1427H, corresponding to 16 July 2006, owned by Bank AlJazira, with a paid up share capital of SAR 1.0 million, operating with headquarters-based in KSA. The Company is engaged in holding and managing the assets assigned to the Bank and others as collaterals including holding these assets for finance purposes as per the objective of the company, which started its operations in 2006.

#### Entities that are not consolidated for Regulatory Purposes are:

Two entities namely Al-Mashareq, and Al-Thoraiya, the international mutual funds operated by the Bank are not consolidated for regulatory purposes; all are incorporated in Saudi Arabia. The Bank consolidates these funds for accounting purposes due to the Bank's holding of units in these funds and the indirect control through its subsidiary AlJazira Capital Company.

Due to the nature of the funds with units being subscribed to and/or redeemed on a daily basis and since the risk associated with the third parties' units do not affect the financial position of the Bank; these funds are not consolidated for regulatory purposes. Furthermore, the units held by the Bank are held as part of the Held for Trading Investments and are considered for the purpose of calculating capital adequacy under Pillar I.

There are no restrictions, or other major impediments, on transfer of funds or regulatory capital within the Bank.

### CAPITAL STRUCTURE

The components of the regulatory capital for Bank Al Jazira are as follows:

	SR'000
<b>Tier One Capital:</b>	
Paid up share capital	3,000,000
Eligible statutory and general reserve	1,542,000
Retained earnings	166,287
IAS type adjustments	24,250
Deduction from Tier I:	
Reciprocal holding of bank capital at 50% deduction	-
<b>Total Tier One Capital</b>	<b>4,732,537</b>
<b>Tier Two Capital:</b>	
Subordinated Sukuk	1,000,000
Portfolio provision	305,865
<b>Total Tier One and Tier Two Capital</b>	<b>6,038,402</b>



## Basel II – Pillar 3 Qualitative Disclosures (continued)

For the Year ended December 31, 2011

The major components of Tier One & Tier Two Capital of the Bank are:

### 1. Eligible Share Capital

The issued and outstanding share capital of the Bank consists of 300 million ordinary shares at SR 10 each. These shares carry equal voting rights.

### 2. Eligible Reserves

Eligible reserves are created by accumulated appropriations of profits and are maintained for future growth. In accordance with Saudi Arabian Banking Control Law and the Articles of Association of the Bank, a minimum of 25% of the annual net income is required to be transferred to a statutory reserve until this reserve equals the paid-up capital of the bank. It also includes any general reserves created out of the earnings.

### 3. Eligible Retained Earnings

This represents the accumulated undistributed profits that are available for future dividend distributions as recommended by the Board and approved by the General Assembly or to be eventually capitalized.

### 4. Portfolio Provision

This is the portfolio provision created under IAS 39 to cover the incurred but not reported losses in the loan portfolio.

### 5. Issuance of Sukuk

On 29 March 2011, the Bank issued 1,000 Subordinated Sukuk Certificates (Sukuk) of SR 1 million each, with a profit distribution rate based on 6 months Saudi Inter-Bank Offered Rate (SIBOR), reset semi annually in advance, plus a margin of 170 basis points per annum and payable semi-annually in arrears on 29 March and 29 September each year until 29 March 2021, on which date the Sukuk will expire. The proceeds of the Sukuk will be used by the Bank for strengthening its capital base as it is intended that Sukuk will comprise Tier II capital for Saudi Arabian regulatory purposes. The proceeds of the Sukuk will be used by the Issuer to grow its banking and finance activities. The obligation of the issuer to the Sukukholders is not secured by any assets or security or guaranteed by third party and is subordinated. The Sukuk are due in 2021 with a step up in margin to 550 basis points in 2016. The Bank has a call option which can be exercised after 29 March 2016 on meeting certain conditions and as per the terms mentioned in the related Offering Circular dated 28 March 2011. The Sukuk may also be called upon occurrence of certain other conditions as per the terms specified in the above Offering Circular. These Sukuk are registered with Saudi stock exchange (Tadawul).

### 6. IAS Type Adjustments

The profit/(loss) of Aljazira Capital and the Mutual Funds including Al-Thoriya (European) Equities Fund and Al-Mashariq (Japanese) Equities Fund, have been consolidated in the Bank's financial statements. Since the Al Khair Mutual Fund falls below the minimum threshold of stake holding and therefore it is not required to be consolidated in line with the IFRS reporting guidelines. The Aman Real Estate and Development Company has been consolidated, however since the Company doesn't generate any revenues, there was no profit from this subsidiary.

## CAPITAL ADEQUACY

When assessing the adequacy of its capital, BAJ takes the following objectives into consideration:

### Primary Capital Objectives

#### • Core Capital Purpose

- i. The directors' objective is to extend the BAJ proposition in Saudi Arabia with a future intention of expansion in the high growth region of the Gulf for Shari'ah compliant Financial Services. The directors' presented program is one of expansion and building on success for long term growth, with the majority of capital held to support the expansion.
- ii. Capital is held with the purpose to generate the required expected shareholders' returns from the successful provision of innovative Shari'ah compliant banking services to individuals, businesses, and institutions.
- iii. Capital is held to safeguard the Bank's ability to continue as a going concern and to maintain an adequate capital base in order to preserve the rights of all stakeholders including; shareholders, depositors, the community and its employees.
- iv. Capital is held with the purpose to meet the assessed Capital Adequacy Requirements, for Pillar I and II, so that the actual Tier 1 and Tier 2 capital meets regulatory targets, by the greater of the:
  - a. Minimum regulatory capital requirements (Directors ICAAP); or
  - b. Minimum Supervisory ICAAP Guidance (SAMA's ICAAP assessment)

#### • External Credit Rating

BAJ's second objective is to achieve a longer term "steady" rating in the A+ to A- range for credit rating to:

## Basel II – Pillar 3 Qualitative Disclosures (continued)

For the Year ended December 31, 2011

- i. Facilitate short term transactions in the inter-bank deposit market with tenors up to 2 years for funding and balance sheet management; and
- ii. Support the issue of medium term, 3-7 year, Sukuks, Shari'ah compliant commercial paper and Musharaka programs are proposed to consist of sound ring-fenced income generating assets.

### Specific Capital Objectives

#### • Investment Capital

BAJ specific strategy is to grow and expand the investment in financial services in range and service offering with investment opportunities. The directors holding in the investment capital is to support the risk uncertainty and price volatility on exposures (Foreign Exchange, Property Exposures, Mutual Funds, Equities & etc.) providing a level of comfort for depositors.

#### • Trading Services

BAJ has a specific objective of holding capital to engage in trading through identifiable channels:

- i. Credit Risk Capital for Shari'ah compliant financing services are:
  - a. Tawarq and Murabaha contracts. Products descriptions are Dinar, Naqa'a and Tamam;
  - b. Trade financing advances – Letters of Credit/Guarantees;
  - c. Istisna'a contracts; and
  - d. Ijara transactions.
- ii. Market Risk Capital for Shari'ah compliant trading are:
  - a. Treasury trading;
  - b. Musharaka.
- iii. Operational Risk Capital in respect of the provision of payment, transaction and professional services which could expose BAJ to operational risk failures.

## RISK EXPOSURE AND ASSESSMENT GENERAL QUALITATIVE DISCLOSURE REQUIREMENTS

### Current Methodology and Assumptions

The current methodology adopted by the Bank on the implementation of SAMA requirements for implementation of Basel II is structured in two phases.

The Bank initial elected Internal Capital Adequacy Assessment Plan (ICAAP) methodology for the implementation program is to calculate Pillar 1 capital requirements and then add the Pillar 2 assessments.

The Pillar 1 risks (credit, market and operational) have been assessed under the following approaches:

- Credit Risk – Standardized Approach,
- Market Risk – Standardized Approach, and
- Operational Risk – Basic Indicator Approach.

The Bank has been in compliance with Basel II since January 2008.

### Future Methodology

The Bank's methodology for Phase II is to build and develop the risk management capabilities, processes, records and testing to support the implementation of:

- Credit Risk – IRB Foundation Approach over the medium term, and
- Market and Operational Risk – Standardized Approach.

The development and implementation of the infrastructure and resources will enhance the risk management capabilities and capacity.

## RISK MANAGEMENT

### Risk Framework

The Bank assumes a variety of risks in undertaking its business activities. Risk is defined as any event that could: damage the core earnings capacity of the Bank; increase earnings or cash-flow volatility; reduce capital; threaten business reputation or viability; and/or breach regulatory or legal obligations.

The key elements of the Bank's Risk Management framework are:

- Risk philosophy;
- Risk appetite;

## Basel II – Pillar 3 Qualitative Disclosures (continued)

For the Year ended December 31, 2011

- Risk governance and risk management organisation;
- Risk identification and assessment process; and
- Stress and scenario testing.

### Risk Appetite

The Bank's risk appetite is defined as the maximum amount of risk that it is prepared to accept in order to deliver on its strategic and business objectives. The Bank's risk appetite framework seeks to encourage appropriate risk taking to ensure that risks are aligned with risk strategy and business objectives. Its risk appetite is captured through a range of Board / Executive Committee approved limits and tolerances. The Board is currently in the process of reviewing the Risk Appetite Framework, which groups the bank's material risks into the following categories:

- Financial Soundness,
- Credit Risk,
- Market Risk
- and Operational and Regulatory Risk

For each category of risk, a set of quantitative limits has been established to set out the bank's appetite or tolerance for risk, which is used as a basis for periodic reporting of risk profile against risk appetite to the Board/Executive Committee.

### Risk Governance and Risk Management Organisation

The Board, the Executive Committee and senior management have ultimate responsibility for the governance of all risk taking activity in the Bank. Risk management is being embedded in the Bank as an intrinsic process and it is the intention that this should be a core competency of all its employees. The Risk Management and Human Capital Groups will be tasked with developing an introductory training programme during 2012.

The Bank's internal audit function reports to the Board Audit Committee and provides independent validation of the business units' compliance with risk policies and procedures and the adequacy and effectiveness of the risk management framework on a bank wide basis.

The Executive Committee is the highest forum for risk governance in the Bank. The Executive Committee acts as the ultimate parent body of a number of other risk committees, namely:

- the Management Credit Committee,
- the Market Risk Policy Committee,
- the Risk Review Committee and
- the Asset and Liability Committee.

The Chief Risk Officer has oversight of the Bank's risk management activities across all risk types. The CRO's responsibilities include:

- providing assurance to Senior Management and the Board that material risks are identified across all risk types and managed by line management and that the Bank is in compliance with risk policies, processes and limits;
- developing and maintaining the Risk Management framework;
- providing reporting on all risk issues, including the risk appetite and risk profile of the Bank;

### Stress Testing

The Bank uses stress testing to supplement its risk assessment processes and to meet regulatory requirements. The objective of stress testing is to assess the Bank's exposure to extreme, but plausible, events. The Bank undertakes regular stress tests across its material risks as part of meeting its requirements under Pillars 1 and 2 of the Capital Requirements Directive. The Bank will continue to develop its stress testing capabilities as a core risk management tool, and to meet additional regulatory requirements in this area.

## CREDIT RISK

Credit risk is the risk that the Bank will incur losses as a result of a customer or counterparty being unable or unwilling to meet a commitment that it has entered into. Credit exposure arises in relation to lending activities to customers and banks, including 'off-balance sheet' guarantees and commitments, financial investments and derivatives. Concentrations in particular portfolio sectors, such as property can impact the overall level of credit risk.

The Bank has adopted the standardized approach for Pillar 1 credit risk. The parameters used for risk weighted assets represent the rates approved by SAMA.

The Bank uses external ratings (where available) from Fitch and Moody's to supplement internal ratings during the process of determining the credit limits of counterparties. Unrated exposures are risk weighted as per SAMA guidelines for capital adequacy purposes. The Bank uses these guidelines to map the credit assessment ratings provided by eligible external credit assessment institutions (ECALs) to determine risk weighted exposures.

## Basel II – Pillar 3 Qualitative Disclosures (continued)

For the Year ended December 31, 2011

### Credit Risk on Lending Activities to Customers and Banks

The Bank lends to personal, retail customers, commercial entities and banks. Credit risk arises on the drawn amount of loans and advances, but also as a result of loan commitments, such as undrawn loans and overdrafts, and other credit related commitments such as guarantees performance bonds and letters of credit. These credit related commitments are subject to the same credit assessment and management as loans and advances.

### Key Features of Corporate Credit Risk Management

- Credit facilities are granted based on detailed credit risk assessments which include prevailing and potential macro-economic factors, industry trends and the customer's positioning within its industry.
- In compliance with SAMA regulations, lending to connected parties is secured as per the requirements specified in Banking Control Law and supervisory authority rules and monitored by the Executive Committee. Such transactions are made on substantially the same terms, including commission rates and collateral, as those prevailing at the time for comparable transactions with other parties. All such facilities are approved by the Board of Directors through the Executive Committee. The Bank limits its exposure per connected party to 10% of the Bank's capital and reserves.
- The internationally accepted Moody's KMV Risk Analyst rating model has been successfully rolled out and is regularly backtested by the Bank's risk management function to enhance it in line with Basel II requirements and industry credit risk management "best practices". The Bank is working with SAMA and the other Saudi banks in finalizing and implementing a facility rating model for the Commercial Banking [SME] group and an internal rating model for financial institutions. Assessment of financial institution obligations are presently managed using external credit ratings of internationally recognized rating agencies.
- All new proposals and/or material changes to existing credit facilities are reviewed and approved by the appropriate credit committee outlined below:
  1. Executive Committee
  2. Management Credit Committee
  3. Commercial Credit Committee
- The credit facility administration process is undertaken by a segregated Credit Administration and Control function to ensure proper execution of all credit approvals and maintenance of documentation, and proactive control over maturities, expiry of limits, collateral valuation and legal covenants.
- Country limits are determined based on the outlook of economic and political factors, along with the review of reports by rating agencies on the country (where available).
- Cross-border exposures are committed after obtaining supervisory authority prior approval and are monitored by credit risk management function.

### Key Features of Consumer Credit Risk Management

- Credit-scoring models are used to facilitate the underwriting and the monitoring of credit facilities to retail/consumer customers and certain small businesses.
- Applicant "scoring" is used for underwriting purposes. Scoring is used in tandem with the assessment of the applicant's "Ability to Repay" using debt-to-income ratio, minimum income and caps on advances by product type.
- The Bank applies its lending policy which incorporates supervisory authority guidelines and individual policies related to consumer credit products.

### Credit Risk on Derivatives

The credit risk on derivative contracts is the risk that the Bank's counterparty in the contract defaults prior to maturity at a time when the Bank has a claim on the counterparty under the contract. The Bank would then have to replace the contract at the current market rate, which may result in a loss. Derivatives are used by the Bank to meet customer needs, to reduce interest rate risk and currency risk.

### Country Risk

Credit risk is also influenced by country risk, where country risk is defined as the risk that circumstances arise in which customers and other counterparties within a given country may be unable to fulfill or are precluded from fulfilling their obligations to the Bank due to economic or political circumstances. Country risk is managed by setting appropriate maximum risk limits to reflect each country's overall creditworthiness. These limits are established using independent credit information from international sources. Risks and limits are monitored on an ongoing basis.

### Risk Identification and Assessment

All customer requests for credit, ranging from large corporate cases through mid-sized commercial and down to smaller SME/consumer loans, are subject to a credit assessment process. The assessment process is assisted by standard application formats in order to assist

## Basel II – Pillar 3 Qualitative Disclosures (continued)

For the Year ended December 31, 2011

the credit decision maker in making an informed credit decision. The credit approval authority is dependent on the size of the credit application and the rating of the borrower. Delegated authority is a key credit risk management tool. The Board determines the credit

authority for the Executive Committee and the Management Credit Committee, together with the authorities of the Chief Executive Officer and Chief Risk Officer.

Another key tool used to assess credit risk is credit rating for each borrower or transaction both prior to approval of the credit exposure and subsequently. Quantitative models are used to provide an estimate of Probability of Default ("PD") for the borrower.

In the retail consumer and small and medium sized enterprise ("SME") book, which is characterised by a large number of customers with small individual exposures, risk assessment is largely informed through statistically-based scoring techniques. Both application scoring for new customers and behavioral scoring for existing customers are used to assess and measure risk as well as to facilitate the management of these portfolios. In the commercial, corporate and interbank books, the rating system utilizes a combination of objective information, essentially financial data and qualitative assessments of non-financial risk factors such as management quality and competitive position within its sector/industry. Credit concentration risk is identified and assessed at single name counterparty level and at portfolio level. The Bank's Large Exposures Policy, which is in line with SAMA Regulations, sets the maximum limit for exposures to individual counterparties or group of connected entities.

### Risk Mitigation

An obligor risk rating system facilitates the early identification and management of any deterioration in loan quality. Changes in the objective information (i.e. financial and business variables as describe above) are reflected in the credit grade of the borrower with the resultant rating influencing the management of individual loans. The credit risk management process is underpinned by a joint business and risk management system of credit review.

Credit policy and credit management standards are controlled and set centrally by the Risk Management Group. Material credit policies are approved by the Board or the Executive Committee. Levels of concentrations by geography, industry sector and product are set through the Risk Appetite Statement which will be approved by the Board and reviewed on an annual basis.

In relation to individual exposures, while the perceived strength of a borrower's repayment capacity is the primary factor in granting a loan, the Bank uses various approaches to help mitigate risks relating to individual credits including: transaction structure, collateral and guarantees. Collateral provided by the customer shall not be considered as a primary source for repayment but is taken by the Bank in order to protect its claims. Guidelines covering the acceptability of different forms of security and how it should be valued are outlined in policy. The type and quality of collateral depends on the type of transaction, the counterparty and risks involved. The Bank ensures that the collateral held is sufficiently liquid, legally effective and regularly valued. The method and frequency of revaluation depends on the nature of the collateral involved.

The Bank also has in place an interbank exposure policy which establishes the maximum exposure for each counterparty bank depending on credit grade. Each bank is assessed for the appropriate exposure limit within the policy.

Concentration of credit risk arise from exposure to customers having similar characteristics in terms of the industry and business sector in which they are engaged, such that their ability to discharge contractual obligations may be similarly affected by change in political, economic or other conditions.

The Bank's comprehensive risk management framework has specific guidelines that focus on maintaining a diversified portfolio to avoid excessive concentration of risk which is implemented through customer and economic sector limit structures. This risk is managed by diversification of the portfolio which is implemented through client, industry, geographic and product.

Risk transfer in the form of syndicated loans or risk participation arrangements with other banks is common practices to limit the banks' exposure.

The Bank uses pledge agreements as another mitigation technique which allows the Bank to net-off credit and debit balances in the event of default of the counter party.

As a Shari'ah compliant Bank, the nature of the Islamic Murabaha and Ijara products entitle the Bank to take ownership of the goods in a Murabaha contract and the possession of the leased assets in the Ijara product.

### Risk Monitoring and Reporting

The Risk Management Group pro-actively manages the Bank's credit risk exposures at transaction and relationship level. Credit risk at a portfolio level is monitored and reported regularly to senior management and the Board. A detailed risk review, including information on provisions, is prepared quarterly. Single name counterparty concentrations are monitored at transaction level. Large exposures and portfolio concentrations are reported regularly to senior management and the Board.

The risk management function also ensures that:

## Basel II – Pillar 3 Qualitative Disclosures (continued)

For the Year ended December 31, 2011

- The overall business strategy is consistent with the Bank's risk appetite.
- Risk policies, procedures and methodologies are consistent with the Bank's risk appetite.
- Appropriate risk management architecture and systems are developed and implemented.

Standing procedures, outlined in the Bank's credit policy manual, require that all credit proposals be subjected to detailed screening by the Risk Management Group pending submission to the Management Credit Committee and/or Executive Credit Committee. In addition, all credit facilities are continually monitored based on periodical review of the credit performance and obligor rating.

A comprehensive risk management framework enables the Bank to identify, assess, limit and monitor risks using a range of quantitative and qualitative tools. Some of these tools are common to a number of risk categories, while others are tailored to the particular features of specific risk categories and enable generation of information such as:

- Credit risk in commercial and consumer lending and other asset exposures such as collateral coverage ratio, limit utilization, past-due alerts, etc.
- Quantification of the susceptibility of the market value of single positions or portfolios to changes in market parameters (sensitivity analysis.)
- Quantification of exposure to losses due to extreme movements in market prices or rates.

The Bank continuously assesses the adequacy and effectiveness of its reporting tools in light of the changing risk environment.

### Provisioning for Impairment

In managing its portfolio, the Bank utilizes ratings and other measures and techniques which seek to take account of all aspects of perceived risk. Credit exposures classified as "High" quality are those where the ultimate risk of financial loss from the obligator's failure to discharge its obligation is assessed to be low. These include facilities to corporate entities with financial condition, risk indicators and capacity to repay which are considered to be good to excellent. Credit exposures classified as "Standard" quality comprise all other facilities whose payment performance is fully compliant with contractual conditions and which are not impaired. The ultimate risk of possible financial loss on "Standard" quality is assessed to be higher than that for the exposures classified within the "High" quality range.

The Bank classifies its exposure into ten risk categories. Of these, seven categories are for performing and three for non-performing. Each borrower is rated on an internal risk rating model that evaluates risk based on quantitative financial as well as qualitative factors such as management strength, industry characteristics and account conduct. Assigned ratings are reviewed periodically and at the time of the annual review of granted facilities. Exposures falling below a certain classification threshold (8 to 10) are considered to be impaired and appropriate specific provisions are made against them. The amount of the specific impairment provision will reflect the financial position of the borrower and the net realizable value of any security held for the loan or Bank of loans. In practice, the specific impairment provision is the difference between the present value of expected future cash flows for the impaired loan(s) discounted at the original effective profit rate and the carrying value of the loan(s) as prescribed by IAS 39. Collective impairment is also measured and recognized on a portfolio basis for groups of similar credits that are not individually identified as impaired.

A credit facility is considered as "impaired" if the profit or principal installments are past due for more than 90 days, or the borrower exhibits an inability to meet his obligations to the Bank based on objective evidence of possible loss events. The types of loss events include;

- significant financial difficulty of the borrower;
- a breach of contract, such as being past due typically for ninety days in profit or principal payments;

The Bank provides for impairment in a prompt and consistent way across the credit portfolios.

As part of its impairment methodology, the Bank makes use of two types of impairment provision:

- Specific;
- General which represents a collective provision relating to the portfolio of performing loans.

### Specific impairment provisions

Specific impairment provisions arise when the recovery of a specific loan or Bank of loans is in doubt based on specific impairment triggers as described above and an assessment that all the expected future cash flows either from the loan itself or the associated collateral will not be sufficient to repay the loan.

Past-due and impaired facilities are managed and monitored as "irregular facilities" and are classified into the following three categories which are then used to guide the provisioning process:

Category	Criteria	Grades	Provision
Substandard	Irregular for a period between 91 and 180 days	8	25%
Doubtful	Irregular for a period between 181 and 365 days	9	50%
Loss	Irregular for a period exceeding 365 days	10	100%

## Basel II – Pillar 3 Qualitative Disclosures (continued)

For the Year ended December 31, 2011

The Bank may also include a credit facility in one of the above categories based on management's judgment of a customer's financial and/or non-financial circumstances.

As real estate loans or loans secured by real estate represent a significant concentration within the bank's advances, some key principles have been applied in respect of real estate collateral held by the Bank. The Bank's preference is to work with the obligor to progress the realization of the collateral although in some cases the Bank will foreclose its security to protect its position.

The Bank uses external professional valuations to assist in reaching appropriate valuations for the collateral held. The valuers are external to the Bank and are familiar with the location and asset for which the valuation is being requested.

### Standardized Approach and Supervisory Risk Weights

The External Credit Assessment Institutions (ECAIs) that the Bank utilizes for the purpose of assessing the credit under the Standardized Approach are Fitch and Moody's.

### Management of Credit Collateral and Valuation

The main types of collateral accepted by the Bank are:

1. Real Estate
2. Quoted Shares
3. Cash
4. Bank Guarantees
5. Acknowledged Assignment of Contract Proceeds

In accordance with the Bank's credit policies, banks, creditworthy companies and high net worth individuals are accepted as guarantor counterparties, subject to credit risk assessment. In accordance with the SAMA/Basel II framework, only cash collateral and bank guarantees are recognized for capital adequacy purposes.

The method and frequency of the revaluation depends on the nature of the collateral involved. The custody and revaluation of collateral is performed independent of the business units.

### MARKET RISK – Standardised Approach

Market risk is the risk relating to the uncertainty of returns attributable to fluctuations in market factors such as adverse movements in the level or volatility of market prices of items such as debt instruments, equities and currencies. Where the uncertainty is expressed as a potential loss in value, it represents a risk to the income and capital position of the Bank.

The market risk management framework governs the Bank's trading and non-trading related market risk appetite. Market risk stemming from trading activities is managed by the relevant group. The management and oversight of market risk inherent within the Bank's non-trading activities is the primary responsibility of the Bank's Asset and Liability Committee. All activities giving rise to market risk are conducted within a structure of approved credit and position limits.

Market risk management in the Bank is administered on the basis of clearly delegated authorities that reflect the appropriate segregation of duty, fit for purpose trading environments with enabling technology and competent personnel with relevant skill and experience.

A comprehensive suite of policies and standards clarifies roles and responsibilities, and provides for effective risk assessment measurement, monitoring and review of trading positions.

Quantitative and qualitative information is used to identify, assess and respond to market risk. The actual format and frequency of risk disclosure depends on the audience. For example, front office and risk functions receive the full range of daily control and activity, valuation, sensitivity and risk measurement reports, while the Board receives a monthly market risk commentary.

All instruments and exposures that are subject to market risk are assessed using the standardized approach for Pillar I market risk.

An independent market risk function within the Risk Management Group is tasked with capturing all material sources of market risk.

The Bank's core risk measurement methodology is based on risk factor sensitivities.

As historical data becomes available, the Bank intends to move to the industry standard Value at Risk ("VaR") technique that incorporates the portfolio diversification effect within each standard risk factor (interest rate, foreign exchange, equity, as applicable). Although an important measure of risk, VaR has limitations as a result of its use of historical data, assumed distribution, holding periods and frequency of calculation. Furthermore, the use of confidence intervals does not convey any information about potential loss when the confidence level is exceeded. The Bank recognizes these limitations and will continue to supplement its use with a variety of other techniques.



## Basel II – Pillar 3 Qualitative Disclosures (continued)

For the Year ended December 31, 2011

Stress-testing is employed on an ongoing basis to gauge the Bank's vulnerability to loss under stressful market conditions.

In managing and overseeing market risk, the Bank makes a distinction between its trading and non-trading activities.

### Monitoring of "Market" Risk from "Trading" Activities

All trading positions arise in a dealing room environment, are subject to the rigor of the Group's market risk management framework and are overseen by the Market Risk Policy Committee.

### Monitoring of Non-Trading Market Risk in the "Banking" Activities

All other positions most of which are structural in nature are considered 'non-trading' and are subject to a governance framework that is overseen by the Asset and Liability Management Committee [ALCO]. The Bank's key non-trading market risk is the sensitivity of its net commission income to movements in commission rates.

Commission rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market commission rates.

Currently, the Bank uses the following risk measures and limits to identify measure and monitor the market risk in the trading and banking book:

- Open Position limits;
- Commission rate sensitivity;
- Commission rate gaps;
- Maturity gaps; and
- Liquidity ratios limit.

These limits and exposures are reviewed in the monthly ALCO and MRPC meetings.

### Equities in the Banking Book

The Bank is also exposed to market risk as a result of changes in the "fair value" of its strategic equity and investment positions held as Available for Sale Investments.

Equity price risk is the risk that fair values of equities will fluctuate as a result of changes in the level of equity indices or the value of individual share prices. The Bank conducts periodic scenario analysis in the banking book to gauge changes in economic value under extreme market conditions and provides timely inputs to senior management.

### Commission Rate Risk in the Banking Book

The commission rate risk in the "banking" book is managed through a "gap" limit structure which is supplemented by periodic analysis of scenarios to capture the extreme indicative measure of exposure to commission rate changes. The analysis of scenarios showed an impact in the banking book as follows:

31 December 2011	+25bp	-25bp	Shock Stress + / - 150bp
31 December 2010	+25bp	-25bp	

The Bank is exposed to commission rate risk as a result of mismatches or gaps in the amounts of assets and liabilities that mature or re-price in a given period. The Bank manages this risk by matching the re-pricing of assets and liabilities through risk management strategies.

## LIQUIDITY RISK

Liquidity risk is defined as the inability to generate sufficient financial resources to meet all obligations and commitments as they fall due, or having to access funds to meet payment obligations at an excessive cost. It is the policy of the Bank to maintain adequate liquidity at all times.

The Bank applies a prudent mix of liquidity controls which provide security of access to funds without undue exposure to increased costs of funds from the liquidation of assets, or aggressive bidding for deposits. Liquidity risk is monitored and evaluated daily by Treasury to ensure that, over the short term and by major currency, the profile of projected future cash inflows is adequately matched to the maturity of the liabilities.

The Bank uses a mixed approach of cash flow match approach and liquid assets approach. Under the cash flow approach the Bank attempts to match the cash outflow against the contractual cash inflow leaving around one month cash requirements at all times to absorb unexpected cash movement. The excess liquidity for over one month is managed on the basis of liquid asset approach and as per SAMA guidelines.

The Bank has to maintain liquid assets of at least 20% of deposit liabilities in the form of cash or assets that can be converted into cash within a period not exceeding 30 days.

## Basel II – Pillar 3 Qualitative Disclosures (continued)

For the Year ended December 31, 2011

In accordance with Banking Control Law and the regulations issued by SAMA, the Bank maintains a statutory deposit with SAMA. The Bank has the ability to raise additional funds through repo facilities with SAMA.

To address these risks, management seeks to diversify funding sources to match the growth of its assets with funding.

The Bank conducts regular stress tests to assess liquidity under a mild and severe stress scenario.

The market risk department is in the process of implementing an advanced market recognized third party financial risk management system that will enable the Bank to measure and monitor the risk more effectively and frequently. It will provide tools to enable sophisticated what-if-analyses at various levels of the Bank's portfolios and its trading and banking book. Further, it will allow dynamic simulation, scenario analysis and stress tests at various levels of granularities of portfolio.

### STRUCTURAL FOREIGN EXCHANGE RISK

Foreign exchange risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

Foreign exchange risks are controlled through limits pre-established by the MRPC on currency position exposures and in total for overnight positions which are monitored daily. Assets are typically funded in the same currency to minimize exchange exposures. Appropriate segregation of duties exists between the front and back office functions, while compliance with position limits is monitored on an ongoing basis.

### OPERATIONAL RISK

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. The operational risk arises largely as a result of unauthorized activities such as fraud, human error, inefficiencies, system failure or other external factors. Currently, the bank is utilizing the basic indicator approach for operational risk capital charges under Pillar I.

#### Operational Risk Management Framework

The bank has adopted a dynamic enterprise risk management approach to comply with sound practices of operational risk management as mandated by Basel Committee and SAMA. The risk management policies, methodologies and processes are aimed to comply with Basic Indicator Approach. Operational risk capital is assessed at 15% of average gross revenue for recent three years as per guidelines for BIA approach.

An independent operational risk management function has been established, reporting to the Chief Risk Officer, to manage operational risks. This department is responsible to assess and report on the status of operational risk. The Bank has acquired a technology system (Control and Risk Environment system) to build a database of all risks, mitigating controls and losses / errors. The risk assessment of major activities of the Bank was performed with collective participation of operational experts from the relevant departments, Internal Audit and Risk Management. Any risk not adequately mitigated, is targeted for enhancement of procedures and systems. For every entity, a risk profile is prepared showing major weaknesses and recommended action for enhancement of controls.

Compliance self assessment guidelines have been developed for all key controls to ensure that the controls are deployed as required. All key controls are tested by the Unit Head and reports are sent to Risk Management to update CARE data base. Internal Audit is also required to independently verify during annual audits that all controls are working as desired.

Periodically, a risk summary report is generated that shows gaps in the control environment, critical risks not fully mitigated and recommendations pending for enhancement of systems and controls. This report is used by the management to evaluate operational risk governance and provide guidance on the strategy and approach.

The Bank's business processes are closely monitored to identify, assess, control and prevent potentially illicit use of the Bank's services for laundering money or financing terrorism. The Bank's "anti money laundering" and "combating terrorism financing" initiatives are regularly reviewed to ensure compliance with local regulatory requirements and international best practices.

The Bank has established a Fraud Investigation Committee to investigate any internal and external fraudulent activity, its causes and recommend preventive actions to the executive management.

#### Business Continuity

The Bank has a business continuity management planning process under which critical activities of the bank are identified as well as the resources required to continue those activities in case of a disaster.

### REGULATORY COMPLIANCE RISK

The Bank's Compliance function is specifically responsible for independently identifying and assessing current and forward looking 'conduct of business' compliance obligations, including antimoney laundering and regulation on privacy and data

## Basel II – Pillar 3 Qualitative Disclosures (continued)

For the Year ended December 31, 2011

protection. The identification, interpretation and communication roles relating to other legal and regulatory obligations have been assigned to functions with specialist knowledge in those areas. For example, employment law is assigned to Human Resources, and prudential regulation to the Finance and Risk functions.

Compliance undertakes a periodic detailed assessment of the key 'conduct of business' compliance risks and associated mitigants. These are collated and processed by Compliance into an overall bank-wide review of compliance risks. This is reviewed by the Executive Committee.

### Risk Management and Mitigation

The Board, operating through the Audit Committee, has approved the Bank's compliance policy and the mandate for the Compliance function. The Audit Committee reviews the Group's key compliance risks on a regular basis to assess the extent to which they are being managed effectively.

Management is responsible for ensuring that the Bank complies with its regulatory responsibilities. The Executive Committee's responsibilities in respect of compliance include the establishment and maintenance of the framework for internal controls and the control environment in which compliance policy operates thereby ensuring that Regulatory Compliance is suitably independent from business activities and that it is adequately resourced.

The primary role of the Compliance function is to provide direction and advice to enable management to discharge its responsibility for managing the Bank's compliance risks. Compliance is also mandated to conduct investigations of possible breaches of compliance policy.

The principal compliance risk mitigants are risk identification, assessment, measurement and the establishment of suitable controls at business level.

### Risk Monitoring and Reporting

Compliance undertakes risk-based monitoring of compliance with relevant policies, procedures and regulatory obligations. Monitoring is undertaken both on a business unit and a process basis. Issues emerging from compliance monitoring are escalated for management attention, and action plans and implementation dates are agreed. The implementation of these action plans is monitored by Compliance. Compliance report to the Executive Committee, and independently to the Board of Directors (through the Audit Committee) on the effectiveness of the processes established to ensure compliance with laws and regulations.

## CAPITAL AND CAPITAL MANAGEMENT

The objectives of the Bank's capital management policy are to at all times comply with regulatory capital requirements and to ensure that the Bank has sufficient capital to cover the current and future risks of its business and support its future development. The Bank does this through an Internal Capital Adequacy Assessment Process ("ICAAP"), which is subject to supervisory review and evaluation. The capital adequacy requirements set by SAMA, which reflect the requirements of the Capital Requirements Directive ("CRD") establish a floor of 8%. Actual capital adequacy ratios as of the end of 2011 and 2010 have been presented in Note 36 in the financial statements for the year ended December 31, 2011.





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