

GULF FINANCE HOUSE BSC

CONSOLIDATED FINANCIAL STATEMENTS

31 DECEMBER 2011

Commercial registration	:	44136 (registered with Central Bank of Bahrain as a Islamic wholesale investment Bank)
Registered Office	:	Bahrain Financial Harbour PO Box 10006, Manama, Kingdom of Bahrain Telephone +973 17538538
Directors	:	Dr. Esam Yousif A. Janahi, <i>Chairman</i> Mosabah Saif Al Mautairy Said Al Malki Ahmed Al Mutawa Azzam Al Felaij Naif Al Khodari Abdullah Ali Al Hamli (up to 23 December 2011)
Company Secretary	:	Dr. Haider Majali
Auditors	:	KPMG Fakhro, Bahrain

CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2011

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**CHAIRMAN'S REPORT
for the year ended 31 December 2011**

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

Dear Shareholders,

On behalf of the Board of Directors, it is my privilege to present the financial statements of Gulf Finance House (GFH) for the financial year ended 31st December 2011.

Despite yet another challenging year for the Middle East and North Africa region underscored by shortfalls in market liquidity and rising political tension throughout the region, the year ended positively for GFH with a return to profitability. This came as a direct result of strong shareholder support, investor loyalty, a dedicated management team committed to seeing through the significant restructuring and recapitalization plan that was set in motion in 2010 and hardworking employees.

GFH turned a net profit of US\$381 thousand in 2011 compared to a net loss of US \$349 million in 2010, with operating profit before provisions valued at US\$ 8.5 million compared to a loss of US\$ 93 million in 2010, signalling a restart in GFH income. Additionally, the Bank saw a 37% reduction in operating costs during 2011 as a result of relentless focus on cost reduction across the Bank.

We can now see the positive long-term results of our bold actions as part of the strategy we have put in action early on during the global economic downturn. Our continued adherence to these principles has resulted in the Bank successfully reducing its liabilities and debts. Additionally, the recapitalization plan we had enacted in 2010 targeting GCC sovereign funds and investors was prioritized, and those targeted with these efforts have shown their trust in GFH as an institution with their continued optimism and support.

Furthermore, 2011 saw promising progress made on a number of key projects and investments, highlighting the Bank's commitment to existing infrastructure projects and achieving successful investor exits from said projects. To this end, we began the year by signing with the Wadhwa Group in Mumbai, India for the development of the Mumbai Economic Development Zone (MEDZ) project to the next phase of development. This encompasses core infrastructure of the MEDZ, as well as developing the project vertically and aiming for investors' exit.

This was followed by the announcement of Tunis Financial Harbour (TFH) project beginning the prequalification process for prospective contractors, after the Government of Tunisia announced its support of the project with the allocation of TD 50 million for the completion of major and strategic infrastructure work in relation to access and roads to TFH. The project, which will be a boon for the growing Tunisian financial sector and the country's economy as a whole, includes a variety of quality commercial infrastructure, an array of modern waterfront living and state-of-the-art office space.

Additionally, we entered into the Turkish market, which is growing by leaps and bounds with enormous untapped potential, with the successful tender to acquire Adabank through a partnership between G Capital – a GFH subsidiary – and the Turkish Gürmen Group. This is a significant achievement for us as it opens the doors to further collaboration within the promising Turkish financial sector and demonstrates our seriousness in continuing to add to our impressive track record of creating other financial institutions.

CHAIRMAN'S REPORT
for the year ended 31 December 2011

GFH has come through all of the challenges of the past few years, if not unscathed, at least stronger for the experience. Difficult decisions, trying economic conditions, political tension and the loss of investor confidence as a whole in the banking sector has required us to take a very detailed look at our operations and our procedures. Based on that assessment, we have endeavoured to improve our institution at its most basic level, strengthening our foundations in order to cope with the rapidly changing business environment we now find ourselves in.

We have focused our efforts on realising the value of our existing investment portfolios, making extracting value out of those a priority and identifying unique opportunities in the market to secure consistent sources of income for the Bank and for our shareholders. Throughout 2012, we are planning to keep up the momentum with our infrastructure projects and sign similar strategic partnership agreements to the one signed for MEDZ with the aim of moving vertically at the earliest time possible. We also intend to continue the momentum on the creation and acquisition of other financial institutions where opportunities present themselves. As for the markets of focus for 2012, we will keep an eye on the GCC specifically Saudi and Oman for possible opportunities of entry and will keep a look for further opportunities in the booming Turkish market. As we look forward to 2012, I am confident that, from the position we now find ourselves in, having returned to profitability at the end of 2011 and building upon our strong track record of excellence, we will continue to provide even greater value to our investors and shareholders.

In conclusion, and on behalf of the Board of Directors, I would like to take this opportunity to extend my utmost gratitude and deepest appreciation to the rulers and the government of the Kingdom of Bahrain for their support of Gulf Finance House and our operations through these challenging times. I would also like to thank the leadership and respective governments of the Kingdom of Saudi Arabia, Kuwait, Oman, Qatar, United Arab Emirates, India, Turkey Tunisia and Morocco for their strong economic policies and political governance, as well as for their valued relationships and continued contribution to our achievements. Additionally, I would like to thank the individual regulators in each of these geographies, specifically the Central Bank of Bahrain for their continued support and assistance to the financial sector as a whole.

Last but not least, I would like to sincerely thank all of our valued shareholders, investors and strategic partners for their dedication, loyal support and their trust in GFH over the years, as well as to the Bank's management team and employees for their much appreciated efforts and commitment throughout 2011 and the rough years before it. We were able, by the Grace of Allah and the efforts of all our stakeholders, to achieve an excellent year for the Bank, returning to profitability and overcoming all the obstacles faced by the industry throughout the year. We are confident that 2012 will be a better year for us and that we are cut out to better meet any challenges we may face, and maintain – and increase! – Our newly achieved profitability.

Best regards,



Esam Janahi
Chairman
28 February 2012

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

29 February 2012

Report on the consolidated financial statements

We have audited the accompanying consolidated financial statements of Gulf Finance House BSC (the "Bank") and its subsidiaries (together the "Group") which comprise the consolidated statement of financial position as at 31 December 2011, and the consolidated statements of income, changes in owners' equity, cash flows, changes in restricted investment accounts and sources and uses of charity and zakah fund for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Respective responsibilities of board of directors and auditors

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

Basis of opinion

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

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the financial position of the Group as at 31 December 2011 and of the consolidated results of its operations, its consolidated cash flows, consolidated changes in equity, consolidated changes in restricted investment accounts and consolidated sources and uses of charity and zakah fund for the year then ended in accordance with Financial Accounting Standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions and the Shari'a rules and principles as determined by the Shari'a Supervisory Board of the Bank.

Emphasis of matter

Without qualifying our opinion, we draw attention to note 2 (b) in the consolidated financial statements which discusses material uncertainties relating to the Group's liquidity position and regulatory capital adequacy, which, may cast significant doubt about the appropriateness of the going concern assumption used in the preparation of the consolidated financial statements.

Independent auditors' report to the shareholders
29 February 2012

Report on other regulatory requirements

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



CONSOLIDATED STATEMENT OF FINANCIAL POSITION

as at 31 December 2011

US\$ 000's

	Note	31 December 2011	31 December 2010
ASSETS			
Cash and bank balances	4	3,820	3,770
Placements with financial institutions	5	3,001	56,868
Financing receivables	6	-	14,400
Investment in associates	7	230,442	224,847
'Investment securities	8	220,265	248,794
Investment property	9	259,404	266,412
Other assets	10	108,913	203,150
Total assets		825,845	1,018,241
LIABILITIES			
Investors' funds	12	58,887	138,798
Placements from financial and other institutions	13	116,713	126,241
Financing liabilities	14	331,077	439,504
Other liabilities	15	83,882	195,535
Total liabilities		590,559	900,078
Equity of investment account holders	16	1,898	1,880
OWNERS' EQUITY			
Share capital	17	321,031	145,780
Treasury shares		(12,852)	(24,674)
Share premium		145,708	206,203
Statutory reserve		79,408	88,298
Accumulated losses		(301,687)	(302,068)
Investments fair value reserve		403	975
Other reserves	18	1,377	1,769
Total owners' equity (page 7)		233,388	116,283
Total liabilities, equity of investment account holders and owners' equity		825,845	1,018,241

The consolidated financial statements consisting of pages 5 to 62 were approved by the Board of Directors on 28 February 2012 and signed on its behalf by:



Esam Yousif A. Janahi
Chairman



Mosabah Saif Al Mautairy
Director

The accompanying notes 1 to 39 form an integral part of these consolidated financial statements.

CONSOLIDATED INCOME STATEMENT

for the year ended 31 December 2011

US\$ 000's

	Note	2011	2010
Income from investment banking services		4,320	5,032
Management and other fees		3,601	7,085
Finance income	22	2,091	1,799
Share of profits / (loss) from investment in associates	7	2,595	(11,729)
Income / (loss) from investment securities	19	11,841	(1,380)
Net foreign exchange gain / (loss)		2,120	(426)
Other income, net	20	44,810	7,300
Total income		71,378	7,681
Staff cost	21	10,513	17,635
Investment advisory expenses		6,000	6,990
Finance expense	22	30,501	50,035
Other expenses	23	15,863	25,781
Total expenses		62,877	100,441
Profit / (loss) before provision for impairment		8,501	(92,760)
Impairment allowances	24	(8,120)	(256,119)
Profit / (loss) for the year from continuing operations		381	(348,879)
Discontinued operations			
Loss from discontinued operations		-	(522)
Profit / (loss) for the year		381	(349,401)
Basic and Diluted Earnings per share (US cents)	27		
Continuing operations		0.04	(76.84)
Discontinued operations		-	(0.11)

The accompanying notes 1 to 39 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN OWNERS' EQUITY
for the year ended 31 December 2011

US\$ 000's

	Share capital	Treasury shares	Share premium	Statutory reserve	Accumulated losses	Other reserves (note 18)	Investments fair value reserve	Total
2011								
Balance at 1 January 2011	145,780	(24,674)	206,203	88,298	(302,068)	1,769	975	116,283
Profit for the year	-	-	-	-	381	-	-	381
Changes in fair value of investment securities	-	-	-	-	-	-	(572)	(572)
Total recognised income and expense	-	-	-	-	381	-	(572)	(191)
Conversion of Murabaha to capital (notes 17,18)	175,251		(60,495)		-	(253)	-	114,503
Share grants vesting expense, net of forfeitures (note 21)	-	-	-	-	-	(139)	-	(139)
Sale of treasury shares	-	11,822	-	-	-	-	-	11,822
Loss on sale of treasury shares	-	-	-	(8,890)	-	-	-	(8,890)
Balance at 31 December 2011	321,031	(12,852)	145,708	79,408	(301,687)	1,377	403	233,388

The accompanying notes 1 to 39 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN OWNERS' EQUITY
for the year ended 31 December 2011

US\$ 000's

	Share capital	Treasury shares	Share premium	Statutory reserve	Accumulated losses	Investments fair value reserve	Other reserves (note 18)	Total
2010								
Balance at 1 January 2010	604,079	(52,371)	202,316	106,700	(432,677)	975	4,300	433,322
Loss for the year	-	-	-	-	(349,401)	-	-	(349,401)
Total recognised income and expense	-	-	-	-	(349,401)	-	-	(349,401)
Conversion of Murabaha to capital (note 17)	21,711	-	3,922	-	-	-	(633)	25,000
Adjustment of accumulated losses against share capital (note 17)	(480,010)	-	-	-	480,010	-	-	-
Share issue expenses	-	-	(35)	-	-	-	-	(35)
Share grants vesting expense, net of forfeitures (note 21)	-	-	-	-	-	-	(1,898)	(1,898)
Sale of treasury shares	-	27,697	-	-	-	-	-	27,697
Loss on sale of treasury shares	-	-	-	(18,402)	-	-	-	(18,402)
Balance at 31 December 2010	145,780	(24,674)	206,203	88,298	(302,068)	975	1,769	116,283

The accompanying notes 1 to 39 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS
for the year ended 31 December 2011

US\$ 000's

	2011	2010
OPERATING ACTIVITIES		
Receipts from investment banking services	-	5,032
Placements with financial institutions (more than 90 days), net	(7,145)	(22,643)
Cash receipts from discontinued operations	-	4,902
Disbursement for projects, net	(2,975)	(12,424)
Receipts from financing receivables	450	
Investors' funds paid, net	(3,566)	(40,726)
Management fees received	343	7,085
Income from placements and financing received	893	1,597
Payments for expenses and project costs	(20,434)	(63,917)
Cash used in operating activities	(32,434)	(121,094)
INVESTING ACTIVITIES		
Purchase of investment securities	-	(6,882)
Advance for purchase of investment securities	(3,770)	-
Proceeds from sale of investment securities	3,500	35,647
Proceeds from sale of investment in associates	-	40,000
Dividends received	4,860	2,230
Net cash flows from disposal of a subsidiary	-	(1,309)
Payments for acquisition of equipment	-	(116)
Cash generated from investing activities	4,590	69,570
FINANCING ACTIVITIES		
Financing liabilities, net	(1,045)	(180,449)
Proceeds from issue of ordinary shares	10,491	-
Finance expense paid	(23,001)	(40,350)
Payment for share issue expenses	(11,740)	-
Proceeds from sale of treasury shares	-	9,295
Cash paid to charitable organisations	(130)	(631)
Dividends paid	(548)	(262)
Payments to investment account holders, net	-	(993)
Cash used in financing activities	(25,973)	(213,390)
DECREASE IN CASH AND CASH EQUIVALENTS	(53,817)	(264,914)
Cash and cash equivalents at 1 January	60,638	325,552
CASH AND CASH EQUIVALENTS at 31 December	6,821	60,638
Cash and cash equivalents comprise:		
Cash and bank balances	3,820	3,770
Placements with financial institutions	3,001	56,868
	6,821	60,638

The accompanying notes 1 to 39 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN RESTRICTED INVESTMENT ACCOUNTS
for the year ended 31 December 2011

2011 Company	Balance at 1 January 2011			Movements during the year						Balance at 31 December 2011		
	No of units (000)	Average value per share US\$	Total US\$ 000's	Investment/ withdrawal US\$ 000's	Revalua- tion US\$ 000's	Gross income US\$ 000's	Dividends paid US\$ 000's	Bank's fees as an agent US\$ 000's	Administration expenses US\$ 000's	No of units (000)	Average value per share US\$	Total US\$ 000's
Mena Real Estate Company KSCC	150	0.35	53	-	-	-	-	-	-	150	0.35	53
Kuwait National Real Estate Investment & Services Co. KSCC*	250	0.35	88	(88)	-	-	-	-	-	-	-	-
Gulf Holding Company*	10,000	0.25	2,455	(2,455)	-	-	-	-	-	-	-	-
Gulf North Africa Holding Company KSCC*	11,500	0.24	2,794	(2,794)	-	-	-	-	-	-	-	-
Gulf Real Estate Development Company*	936	12.05	11,272	(11,272)	-	-	-	-	-	-	-	-
Al Basha'er Fund	93	7.59	704	-	(87)	-	-	-	-	93	6.63	617
Pan European Fund	35.85	815.39	29,233	-	(636)	-	-	-	-	35.85	797.67	28,597
Oman Development Company	522.50	3.12	1,628	-	-	-	-	-	-	522.50	3.12	1,628
			48,227	(16,609)	(723)	-	-	-	-			30,895

Revaluation changes of US\$ 644 thousand (2010: US\$ 1,815 thousand) is on account of loss on foreign exchange translation differences.

*The investments in these accounts have been directly registered in the names of the investors and hence have been withdrawn from the statement of changes in restricted investment accounts.

The accompanying notes 1 to 39 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN RESTRICTED INVESTMENT ACCOUNTS
for the year ended 31 December 2011 (continued)

2010 Company	Balance at 1 January 2010			Movements during the year						Balance at 31 December 2010		
	No of units (000)	Average value per share US\$	Total US\$ 000's	Investment US\$ 000's	Revalua- tion US\$ 000's	Gross income US\$ 000's	Dividends paid US\$ 000's	Bank's fees as an agent US\$ 000's	Administration expenses US\$ 000's	No of units (000)	Average value per share US\$	Total US\$ 000's
Mena Real Estate Company KSCC	150	0.35	52	-	1	-	-	-	-	150	0.35	53
Kuwait National Real Estate Investment & Services Co. KSCC	250	0.35	87	-	1	-	-	-	-	250	0.35	88
Gulf Holding Company	10,000	0.24	2,417	-	38	-	-	-	-	10,000	0.25	2,455
Gulf North Africa Holding Company KSCC	11,500	0.24	2,751	-	43	-	-	-	-	11,500	0.24	2,794
Gulf Real Estate Development Company	936	12.05	11,271	-	1	-	-	-	-	936	12.05	11,272
Al Basha'er Fund	93	7.22	671	-	33	-	-	-	-	93	7.59	704
Pan European Fund	35.85	869.32	31,165	-	(1,932)	-	-	-	-	35.85	815.39	29,233
Oman Development Company	522.50	3.12	1,628	-	-	-	-	-	-	522.50	3.12	1,628
			50,042	-	(1,815)	-	-	-	-			48,227

The accompanying notes 1 to 39 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF SOURCES AND USES OF CHARITY AND ZAKAH FUND
for the year ended 31 December 2011

US\$ 000's

	2011	2010
Sources of charity and zakah fund		
Non-Islamic income (note 29)	2	6
Total sources	2	6
Uses of charity fund and zakah fund		
Contributions to charitable organisations	(130)	(631)
Total uses	(128)	(631)
Deficit of uses over sources	(128)	(625)
Undistributed charity and zakah fund at 1 January	10,631	11,256
Undistributed charity and zakah fund at 31 December (note 15)	10,503	10,631
Represented by:		
Charity fund	7,702	7,830
Zakah payable	2,801	2,801
	10,503	10,631

The accompanying notes 1 to 39 form an integral part of these consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2011

US\$ 000's

1 INCORPORATION AND PRINCIPAL ACTIVITY

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

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

Consolidated financial statements

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

2 SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies applied in the preparation of these consolidated financial statements are set out below. These accounting policies have been applied consistently to all periods presented in the consolidated financial statements, and have been consistently applied by Group entities, except for the changes resulting from amendments made to the accounting standards (note 2(c)).

(a) Statement of compliance

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

(b) Basis of preparation

The consolidated financial statements are presented in US Dollars, being the principal currency of the Group's operations. They are prepared on the historical cost basis except for the measurement at fair value of certain investment securities. The Group classifies its expenses in the consolidated income statement by the nature of expense method.

Except for changes resulting from the adoption of Statement of Financial Accounting No.1 'Conceptual framework for the financial reporting by Islamic financial institutions' (SFA 1) and FAS 25 'Investment in sukuk, shares and similar instruments', the accounting policies and methods of computation applied by the Group in the preparation of the interim financial information are the same as those used in the preparation of the audited consolidated financial statements for the year ended 31 December 2010.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2011

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(b) Basis of preparation (continued)

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

Going concern

There are two main reasons why the Group is facing a going concern problem, liquidity and regulatory capital adequacy. Due to lack of sufficient liquid assets, and inability of the Group to generate sufficient liquidity from its operations, the ability of the Group to meet its obligations when due is dependent on a timely disposal of assts. Further, the Group's capital adequacy ratio as at 31 December 2011 stood at 12.41% with certain CBB dispensations (compared to the minimum regulatory requirement ratio of 12%), which restricts the Group's ability to absorb further losses or undertake additional exposures. These factors indicate the existence of material uncertainties which may cast doubt, about the Group's ability to continue as a going concern. To address these two issues, the Group has undertaken a number of initiatives. The Group has embarked on a program of assets sale to generate liquidity as well as approach other institutions for banking lines. The Group has also started the process of constructive negotiation with all its lenders to restructure its debts and has received positive response.

During 2011, holders of convertible murabaha notes of US\$ 175 million exercised their option and converted the notes into ordinary shares, thus strengthening the Group's capital position (note 14)

These steps are expected to improve the Group's liquidity position and its capital adequacy ratio. The Board of Directors have reviewed the Group's future plans and are satisfied with the appropriateness of the going concern assumption used in the preparation of the consolidated financial statements.

(c) **New standards, amendments and interpretations effective from 1 January 2011**

The following standards, amendments and interpretations, which became effective in 2011 are relevant to the Group:

1) *SFA 1: Conceptual framework for the financial reporting by Islamic financial institutions*

The revised conceptual framework for Financial Reporting by Islamic Financial Institutions was issued on 22 July 2010 and is effective from 1 January 2011 on a prospective basis and supersedes the previous SFA 1 and SFA 2.

The conceptual framework has been amended to primarily reflect the following:

- Widening the scope of the framework to a broader spectrum of entities rather than limiting it to only Islamic financial institutions;
- Clarify elements of financial statements and definitions of investment accounts;

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2011

US\$ 000's

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(c) New standards, amendments and interpretations effective from 1 January 2011(continued)

- Provide overall criteria and framework for determination of on and off balance sheet accounts; and
- Changes in terminology and editorial amendments to provide more consistency in understanding of key concepts.

The amended framework introduces and emphasises the generally accepted concept of substance and form compared to the concept of form over substance. The framework states that it is necessary that information, transaction and other events are accounted for and presented in accordance with its substance and economic reality as well as legal form.

The revised conceptual framework has a pervasive impact on financial reporting. However, this has not resulted in any material changes to the accounting policies and the consolidated financial statements of the Group.

2) FAS 25 'Investment in sukuk, shares and similar instruments'

FAS 25 was issued in July 2010 and replaced FAS 17 'Investments'. FAS 25 retains and simplifies the mixed measurement model and establishes two measurement categories for investments: amortised cost and fair value. The standard requires each investment to be first segregated as either debt-type or equity type instruments, and the basis of classification depends on the entity's business model and the contractual cash flow characteristics of the investment. For equity-type investments, an irrevocable election can be made at initial recognition, to recognise unrealised fair value gains and losses (other than impairment) through equity rather than through the income statement. Equity investments at fair value through equity are assessed for impairment if any. Impairment losses are recognised in the income statement. For debt-type investments, based on the cash flow characteristics of the investments, an election can be made at initial recognition to measure the instruments at either amortised cost or fair value. Reclassification between categories is not permitted. The guidance in FAS 17 on 'investment in real estate' continues to apply. The new standard requires retroactive application.

The Group has adopted the revised FAS 25 on its required application date of 1 January 2011. The retroactive adoption of this standard did not result in any impact on the consolidated income statement and owners' equity of the previous period.

On the date of application, the classification and categorisation of investments has been reassessed based on the facts and circumstances on that date. The adoption of the standard resulted in the following re-categorisation of investment securities in the statement of financial position:

		US\$ 000's	
1 January 2010		Revised categorisation	
		Fair value through income statement	Fair value through equity
Previous categorisation as per FAS 17			Total
Fair value through income statement		33,976	-
Available-for-sale		-	315,423
		33,976	315,423
			349,399

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2011

US\$ 000's

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(c) New standards, amendments and interpretations effective from 1 January 2011(continued)

31 December 2010

Previous categorisation as per FAS 17

Fair value through income statement

Available-for-sale

Revised categorisation		
Fair value through income statement	Fair value through equity	Total
25,860	-	25,860
-	222,934	222,934
25,860	222,934	248,794

(d) Basis of consolidation

(i) Subsidiaries

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

(ii) Special purpose entities

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

The Group in its fiduciary capacity manages and administers assets held in trust and other investment vehicles on behalf of investors. The financial statements of these entities are usually not included in these consolidated financial statements. Information about the Group's fiduciary assets under management is set out in note 25.

(iii) Associates

Associates are those enterprises in which the Group holds, directly or indirectly, more than 20% of the voting power or exercises significant influence, but not control, over the financial and operating policies. On initial recognition of investment in each associate, the Group makes an accounting policy choice as to whether the associate shall be equity accounted or designated as an investment at fair value through income statement.

The Group, being a venture capital organisation, designates certain of its investments in associates, as 'investments carried at fair value through income statement. These are managed, evaluated and reported on internally on a fair value basis.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2011

US\$ 000's

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(d) Basis of consolidation (continued)

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

Any excess of the cost of acquisition over the Group's share of the net fair value of the identifiable assets, liabilities and contingent liabilities of an associate recognised at the date of acquisition is recognised as goodwill, which is included within the carrying amount of the investment. Any excess of the Group's share of the net fair value of the identifiable assets, liabilities and contingent liabilities over the cost of acquisition, after reassessment, is recognised immediately in the consolidated income statement. The same policy is followed for any incremental stake acquired while maintaining significant influence.

(iv) Transactions eliminated on consolidation

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

(e) Foreign currency transactions

(i) Functional and presentation currency

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

(ii) Transactions and balances

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

(iii) Group companies

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2011

US\$ 000's

2 *SIGNIFICANT ACCOUNTING POLICIES* (continued)

(f) Offsetting of financing instruments

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

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

(g) Investment securities

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

(i) Classification

The Group segregates its investment securities into debt-type instruments and equity-type instruments. Debt-type instruments are investments that provide fixed or determinable payments of profits and capital to the holder of the instrument. Equity-type instruments are investments that do not exhibit features of debt type instruments and evidence a residual interest in the assets of an entity after deducting its liabilities.

Investment in debt-type instruments are classified as investment at fair value through income statement (FVTIS) or investments carried at amortised cost. The Group currently does not hold any debt type instruments as investment securities.

Investments in equity-type instruments are classified in the following categories: 1) at fair value through income statement (FVTIS) or 2) at fair value through equity (FVTE), consistent with the Group's investment strategy.

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

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

On initial recognition, an equity-type instrument is designated as FVTIS only if the investment is managed and its performance is evaluated and reported on internally by the management on a fair value basis. This category currently includes investment in private equity, funds and certain listed associate companies.

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2011

US\$ 000's

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(g) Investment securities (continued)

(ii) Recognition and de-recognition

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

(iii) Measurement

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

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

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

(iv) Measurement principles

Amortised cost measurement

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

Fair value measurement

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2011

US\$ 000's

2 *SIGNIFICANT ACCOUNTING POLICIES (continued)*

(h) Placements with and from financial and other institutions

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

(i) Financing receivables

Financing receivables comprise shari'a compliant financing provided to Group's projects which are stated at amortised cost.

(j) Cash and cash equivalents

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

(k) Investment property

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

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

(l) Equipment

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

(m) Impairment of assets

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2011

US\$ 000's

2 *SIGNIFICANT ACCOUNTING POLICIES (continued)*

(m) *Impairment of assets (continued)*

Financial assets carried at amortised cost

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

Investments carried at fair value through equity (FVTE)

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

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

Other non-financial assets

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

(n) Financing liabilities

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2011

US\$ 000's

2 *SIGNIFICANT ACCOUNTING POLICIES (continued)*

(n) Financing liabilities (continued)

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

Financing liabilities include compound financial instrument in the form of 'convertible murabaha' issued by the Group that can be converted to share capital at the option of the holder. The liability component of a compound financial instrument is recognised initially at the fair value of a similar liability that does not have an equity conversion option. The equity component is recognised initially at the difference between the fair value of the compound financial instrument as a whole and the fair value of the liability component. Any directly attributable transaction costs are allocated to the liability and equity components in proportion to their initial carrying amounts.

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

(o) Financial guarantees

Financial guarantees are contracts that require the Group to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument. A financial guarantee contract is recognised from the date of its issue. The liability arising from a financial guarantee contract is recognised at the present value of any expected payment, when a payment under the guarantee has become probable. The Group has issued financial guarantees to support its development projects (refer note 36 for details).

(p) Dividends and board remuneration

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

(q) Share capital and reserves

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

Treasury shares

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

Statutory reserve

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2011

US\$ 000's

2 *SIGNIFICANT ACCOUNTING POLICIES (continued)*

(r) Equity of investment account holders

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

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

Restricted investment accounts

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

(s) Revenue recognition

Income from investment banking services is recognised at the fair value of consideration received / receivable and when the service is provided and income is earned. This is usually when the Group has performed all significant acts in relation to a transaction and it is highly probable that the economic benefits from the transaction will flow to the Group. Significant acts in relation to a transaction are determined based on the terms for each transaction.

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

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

Income from financing receivables is recognised using the effective profit rates of the receivables over the period of the contract.

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

(t) Earnings prohibited by Shari'a

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2011

US\$ 000's

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(u) Zakah

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

(v) Employees benefits

(i) Short-term benefits

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

(ii) Post employment benefits

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

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

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

(iii) Share-based employee incentive scheme

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

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2011

US\$ 000's

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

v) Employee benefits (continued)

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

(w) Provisions

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

3 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

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

Judgements

(i) Classification of investments

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

(ii) Special purpose entities

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2011

US\$ 000's

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

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

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

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

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

(iii) Investment property

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**for the year ended 31 December 2011**

US\$ 000's

3 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES (continued)**(iv) Impairment of receivables**

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

(v) Impairment of cash generating units

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

Value in use for the investment in associate was determined by discounting the future cash flows expected to be generated from the continuing operations. The calculation of the value in use was based on the following key assumptions.

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

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

4 CASH AND BANK BALANCES

	31 December 2011	31 December 2010
Cash on hand	16	8
Bank balances	3,804	3,762
	3,820	3,770

5 PLACEMENTS WITH FINANCIAL INSTITUTIONS

	31 December 2011	31 December 2010
Gross placements	3,002	56,870
Less: Deferred profits	(1)	(2)
	3,001	56,868

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2011

US\$ 000's

6 FINANCING RECEIVABLES

	31 December 2011	31 December 2010
Murabaha financing receivables	-	14,400
Wakala financing receivables	62,650	62,650
	62,650	77,050
	-	-
Less: Provision for impairment	(62,650)	(62,650)
	-	14,400

Murabaha financing receivables are net of deferred profits of US\$ NIL (2010: US\$ 1,832 thousand).

7 INVESTMENT IN ASSOCIATES

Investment in associates comprise:

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

The movement in investment in associates is given below:

	2011	2010
At 1 January	224,847	376,424
Acquisitions during the year	3,000	35,152
Share of profits / (losses) from associates	2,595	(11,729)
Disposals during the year, at carrying value	-	(175,000)
At 31 December	230,442	224,847

The investment in KHCB has a carrying value of US\$ 162,629 thousand (31 December 2010: US\$ 158,550 thousand) and a fair value based on a quoted price of US\$ 57,554 thousand (31 December 2010: US\$ 93,457 thousand). Based on an assessment of the value-in-use of the associate, the Group has concluded that the investment is not impaired (note 2(m)).

The Group's investment in KHCB is pledged towards a Murabaha financing facility and the investment in CIC is allocated against the asset pool of the Sukuk certificates (refer note 14).

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

	2011	2010
Total assets	1,590,555	1,417,983
Total liabilities	498,089	363,381
Total revenues	124,826	62,839
Total net profits / (losses)	5,812	(66,466)

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8 INVESTMENT SECURITIES**Equity type instruments***Fair value through income statement*

- Quoted securities	990	3,140
- Unquoted funds	4,202	2,500
- Unquoted securities	-	20,220

Fair value through equity

- Quoted securities	475	475
- Unquoted securities	214,598	222,459
	220,265	248,794

a) At fair value through equity

	2011	2010
At 1 January	222,934	315,423
Acquisitions during the year	8,907	155,265
Changes in fair value of investments	(521)	-
Disposals during the year, at carrying value	(8,127)	(103,233)
Provision for impairment during the year	(8,120)	(144,521)
At 31 December	215,073	222,934

Investments at fair value through equity include private equity investments managed by external investment managers or investments in projects promoted by the Group. Investments at fair value through equity of US\$ 214,598 (31 December 2010: 222,459 thousand) are carried at cost less impairment in the absence of a reliable measure of fair value. The Group plans to exit these investments principally by means of strategic sell outs, sale of underlying assets or through initial public offerings.

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

b) At fair value through income statement

	2011	2010
At 1 January	25,860	33,976
Acquisitions during the year	-	1,617
Disposals during the year, at carrying value	(20,220)	(4,233)
Fair value changes during the year	(448)	(5,500)
At 31 December	5,192	25,860

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8 INVESTMENT SECURITIES (continued)

Summarised financial information of associates designated at fair value through income statement not adjusted for the percentage ownership held by the Group (based on most recent audited / unaudited management accounts):

	2011	2010
Total assets	26,063	112,969
Total liabilities	9,079	25,826
Total revenues	8,590	76,838
Total (losses) / net profits	(1,785)	4,865

9 INVESTMENT PROPERTY

In 2010, the Group received plots of land in exchange for the Group's investment in an associate and settlement of certain receivables. The Group has classified the plots of land as investment property and follows the cost model for measurement. Investment property of carrying amount of US\$ 203 million (2010: US\$ 203 million) is pledged against a Wakala facility (note 14) and any proceeds from the investment property would be first applied towards the repayment of the facility.

During 2011, the Group recognised an impairment allowance of US\$ Nil thousand (2010: US\$ 12 million) against the investment property based on assessment of its recoverable amount. The fair value of the Group's investment property at 31 December 2011 was US\$ 261,199 thousand (31 December 2010: US\$ 276,627 thousand) based on a valuation carried out by an independent external valuer.

10 OTHER ASSETS

	31 December 2011	31 December 2010
Financing to projects *	66,970	73,716
Equipment (note 11)	2,454	7,137
Reimbursement right (note 36)	35,000	121,111
Prepayment and other receivables	4,489	1,186
	108,913	203,150

* Financing to projects represents working capital and other funding facilities provided to projects promoted by the Group in the normal course of business. The financing is expected to be recovered from the operating cash flows of the underlying project assets. Financing to projects and other receivables are net of impairment allowance of US\$ 135,907 thousand (31 December 2010: US\$ 135,907 thousand).

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11 EQUIPMENT

	Furniture	Fixtures and equipment	Motor vehicles	Computers	2011 Total	2010 Total
Cost						
At 1 January	2,023	15,475	160	11,450	29,108	29,086
Additions	-	1	-	2	3	609
Disposals	-	(145)	(93)	(2,374)	(2,612)	(587)
Impairment allowances	-	(3,000)	-	-	(3,000)	-
At 31 December	2,023	12,331	67	9,078	23,499	29,108
Depreciation						
At 1 January	1,064	7,779	96	10,032	18,971	13,459
Charge for year	387	2,956	6	1,224	4,573	5,896
Disposals	-	(138)	(62)	(2,299)	(2,499)	(384)
At 31 December	1,451	10,597	40	8,957	21,045	18,971
Provision for impairment during the year	-	-	-	-	-	(3,000)
Net book value At 31 December	572	1,734	27	121	2,454	7,137

12 INVESTORS' FUNDS

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

13 PLACEMENTS FROM FINANCIAL AND OTHER INSTITUTIONS

These comprise placements (murabaha and wakala) accepted from financial and other institutions (including corporates) as part of the Group's treasury activities.

14 FINANCING LIABILITIES

	31 December 2011	31 December 2010
Murabaha financing	102,832	101,796
Wakala financing	51,535	66,288
Sukuk liability	162,190	152,123
Convertible murabaha (2009)	14,520	23,437
Advance received for convertible murabaha (2010)	-	95,860
	331,077	439,504

Murabaha financing

Murabaha financing comprise a medium-term financing from a syndicate of banks of US\$ 100 million (31 December 2010: US\$ 100 million). The financing is repayable in July 2013 (extendable by 1 year provided 25% of the facility is repaid in 2012) and carries a profit rate of 2.50% over the benchmark rate (LIBOR) payable semi annually and an additional profit mark up of 1.25% payable at maturity. The Murabaha financing facilities are secured by a pledge over the Group's investment in an associate of carrying value of US\$ 162.63 million (note 7).

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14 FINANCING LIABILITIES (continued)*Wakala financing*

Wakala financing is a syndicate facility from a number of financial institutions. During the year, the Group renegotiated the facility. As per the revised terms, the balance is repayable over a period of two years till April 2013 at an agreed profit rate of 8%. The Wakala financing facility is secured by a pledge over the Group's investment property of carrying value of US\$ 203 million. The Group is currently negotiating to restructure the facility and has also deferred the payment pertaining to September 2011 instalment.

Sukuk

The Sukuk have a tenure of 5 years maturing in June 2012 and returns based on an agreed spread of 175 bps over the benchmark rate (LIBOR). The Sukuk are backed by a pool of assets of the Group and has a liquidity facility provided by the Bank to support timely payments of distributions. The Sukuk are traded on the London Stock Exchange's Gilt Edged and Fixed Interest Market. The Sukuk Certificates are backed by the Group's investment securities with carrying values of US\$ 199,669 thousand (31 December 2010: US\$ 183,923 thousand).

During the year, the Group was in technical breach of certain financial covenants of the Sukuk programme and the Group is currently in discussion with the sukuk note holders for revising the covenant terms. Subsequent to the year end, the Bank has commenced negotiation with the lenders for extension of the repayment terms.

During 2011, the Group repurchased Sukuk Certificates of nominal value US\$ 2 million (2010: US\$ 15 million) and resold Sukuk Certificates of face value US\$ 12 million and incurred a loss of US\$ 4.8 million due to amortised cost remeasurement which has been included under "Finance expense" (note 22).

Convertible murabaha 2009

During 2009, the Group issued a compound financial instrument ("Notes") in the form of unsecured convertible murabaha facility. The Notes had tenure of 3 years maturing in October 2012 unless converted into ordinary shares of the Bank at the option of the holder, at an exchange price of US\$ 1.52 per share (adjusted for the 2010 share consolidation). The Notes provide for returns of 8% p.a. payable quarterly to the holder. During 2011, Note holders amounting to US\$ 10 million exchanged the 2009 Notes with the 2010 series of the convertible murabaha (see below).

Convertible Murabaha 2010

In 2010, the Group launched a new series of convertible murabaha to raise additional capital. The new series of convertible murabaha provide for returns of 12% p.a. payable quarterly to the holder and has a tenure of 3.5 years from the date of issue, unless converted into ordinary shares of the Bank at the option of the holder, at an exchange price of US\$ 0.31 per share. During the year, Note holders of US\$ 175.25 million exercised their option to convert resulting in the issue of 569,921 thousand ordinary shares as per the terms of the convertible murabaha (refer note 17).

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15 OTHER LIABILITIES

	31 December 2011	31 December 2010
Employee related accruals (note 21)	2,252	22,898
Unclaimed dividends	7,592	8,140
Provision for employees' leaving indemnities	945	472
Charity and zakah fund (page 12)	10,503	10,631
Provision against financial guarantees (note 36)	35,000	121,111
Accounts payable	14,694	3,053
Accrued expenses and other payables	12,896	29,230
	83,882	195,535

16 EQUITY OF INVESTMENT ACCOUNT HOLDERS

Unrestricted investment accounts comprise Mudarabah deposits accepted by the Bank. The average gross rate of return in respect of unrestricted investment accounts was 0.27% for 2011 (2010: 0.67%). Approximately 0.27% / US\$ 19 thousand (2010: 0.67% / US\$ 14 thousand) was distributed to investors and the balance was either set aside for provisions and/or retained by the Bank as a Mudarib fee. Unrestricted investment accounts include profit equalisation reserve of US\$ 5 thousand (2010: US\$ 4 thousand) and investment risks reserve of US\$ 3 thousand (2010: US\$ 2 thousand). The funds received from equity of investment account holders have been commingled and jointly invested with the Group in placements with financial institutions.

17 SHARE CAPITAL

	31 December 2011	31 December 2010
Authorised: 1,136,363,636 shares of US\$ 0.3075 each (2010: 1,136,363,636 shares of US\$ 0.3075 each)	349,431	349,431
Issued and fully paid up: 1044,004,808 shares of US\$ 0.3075 each (2010: 474,083,141 shares of US\$ 0.3075 each)	321,031	145,780

The movement in the share capital during the year ended 31 December 2011 is as follows:

	2011	2010
At 1 January	145,780	604,079
Conversion of murabaha to share capital (note 14)	175,251	21,711
Adjustment of accumulated losses for capital reduction		(480,010)
At 31 December	321,031	145,780

During the year, the paid up capital of the Bank was increased from US\$ 145,780 thousand to US\$ 321,031 thousand as a result of exercise of conversion option by the holders of the convertible murabaha (note 14). As per the terms of the convertible murabaha, 569,921 thousand shares of par value US\$ 0.3075 thousand has been issued on conversion. The effective conversion price is below the par value per share and the resulting difference and the related share issue expenses has been adjusted against the share premium account (note 14).

At 31 December 2011, the Bank held 6,404,016 (31 December 2010: 2,803,305) treasury shares. Treasury shares disposed during the year, represent shares transferred at market price towards settlement of a payable to a related party towards acquisition of additional stake in an associate.

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17 Share capital (continued)

During 2010, pursuant to the approval of the shareholders in the Extraordinary general meeting on 14 November 2010, the paid -up capital of the Bank decreased from US\$ 625,790 thousand to US\$ 145,780 thousand as a result of the following:

- consolidation of issued and fully paid -up shares of the Bank at a ratio of 4:1 thereby reducing number of shares from 1,896,332,565 to 474,083,141;
- adjustment of accumulated losses to the extent of US\$ 480 million against the paid up share capital of the Bank; and
- reduction of par value per share from US\$ 0.33 to US\$ 0.3075 per share.

Additional information on shareholding pattern

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

Categories*	Number of shares	Number of shareholders	% of total outstanding shares
Less than 1%	495,254,254	7,228	47.44
1% up to less than 5%	265,655,611	9	25.45
More than 10%	283,094,943	2	27.12
	1,044,004,808	7,239	100

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

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

Name	Nationality	No. Of shares
Royal Guard of Oman	Omani	127,412,612
Dr. Esam Yousif Abdulkarim Janahi	Bahraini	155,682,331

18 OTHER RESERVES

	2011			2010		
	Share grant reserve	Equity component of convertible murabaha	Total	Share grant reserve	Equity component of convertible murabaha	Total
At 1 January	1,136	633	1,769	3,034	1,266	4,300
Transfer on conversion	-	(253)	(253)	-	(633)	(633)
Vesting expense, net of forfeiture (note 21)	(139)	-	(139)	(1,898)	-	(1,898)
At 31 December	997	380	1,377	1,136	633	1,769

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19 INCOME / (LOSS) FROM INVESTMENT SECURITIES

	2011	2010
Dividend income	7,492	2,230
Profit on disposal of investment securities	4,797	1,890
Fair value changes of investments designated at fair value through income statement	(448)	(5,500)
	11,841	(1,380)

20 OTHER INCOME

Other income includes US\$ 20.33 million of 2008 employee incentive scheme accruals written back on the directive of the regulator, US\$ 17.94 million of excess board fees and other accruals written back and US\$ 6.525 million of profit on sale of a land purchased and sold during the year.

21 STAFF COST

	2011	2010
Salaries and benefits	10,019	16,904
Social insurance expenses	494	731
	10,513	17,635

The Bank operates a share incentive scheme for its employees. The share awards granted under the scheme have an initial lock-in period of 3 years and shall vest rateably over varied vesting periods of up to 10 years as per the terms of the scheme. Of the cumulative 16.09 million (2010: 16.09 million) share awards granted under the terms of the scheme, 12.6 million were forfeited (2010: 11.15 million) due to failure to satisfy service conditions specified at grant date. At 31 December 2011, 3.49 million (31 December 2010: 4.94 million) share awards are outstanding to be exercised at a price of US\$ 0.75 per share in future periods on satisfaction of the vesting conditions. A net reversal of vesting charge amounting to US\$ 139 thousand (2010: US\$ 1,898 thousand) was recognised during the year primarily due to the forfeitures of share awards on non-satisfaction of service conditions (note 18).

22 TOTAL FINANCE INCOME AND EXPENSE

	2011	2010
TOTAL FINANCE INCOME		
Income from placements with financial institutions	893	1,148
Income from financing receivables	1,198	651
	2,091	1,799
TOTAL FINANCE EXPENSE		
Investors' funds	3,040	5,585
Placements from financial and other institutions	3,060	10,753
Financing liabilities	19,582	29,460
Loss on disposal of sukuk (note 14)	4,800	4,223
Equity of investment account holders (note 16)	19	14
	30,501	50,035
NET FINANCE EXPENSE	(28,410)	(48,236)

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23 OTHER EXPENSES

	2011	2010
Rent	2,989	3,149
Professional and consultancy fee	3,240	7,025
Legal expenses	1,004	2,307
Depreciation	4,573	5,896
Other operating expenses	4,057	7,404
	15,863	25,781

24 IMPAIRMENT ALLOWANCES

	2011	2010
Investment securities (note 8)	8,120	144,521
Investment property (note 9)	-	12,000
Receivable from investment banking services	-	60,540
Other receivables	-	36,058
Equipment (note 11)	-	3,000
	8,120	256,119

25 ASSETS UNDER MANAGEMENT

The Group provides corporate administration, investment management and advisory services to its project companies, which involve the Group making decisions on behalf of such entities. Assets that are held in such capacity are not included in these consolidated financial statements. At the reporting date, the Group had assets under management of US\$ 2,180,529 thousand (31 December 2010: US\$ 2,282,415 thousand). During the year, the Group has charged management fees amounting to US\$ 1,476 thousand (2010: US\$ 7,085 thousand) for the activities related to management of assets.

26 RELATED PARTY TRANSACTIONS

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

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

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26 RELATED PARTY TRANSACTIONS (continued)

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

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

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26 RELATED PARTY TRANSACTIONS (continued)

	Associates	Key management personnel	Significant shareholders / entities in which directors are interested	Assets under management including special purpose entities	Total
2010					
Assets					
Cash and bank balances	583	-	-	-	583
Financing receivables	-	-	14,400	-	14,400
Investment in associates	224,847	-	-	-	224,847
Investment securities	25,860	-	55,897	121,314	203,071
Other assets	93	-	-	194,706	194,799
Liabilities					
Investors' funds	60,762	-	-	77,837	138,599
Placements from financial and other institutions	27	-	13,392	-	13,419
Financing liabilities	-	50,492	-	-	50,492
Other liabilities	-	-	-	121,111	121,111
Income					
Income from investment banking services	-	-	-	4,982	4,982
Management fees	-	-	-	7,085	7,085
Income from financing receivables	-	-	415	-	415
Loss from investment in associates	(11,729)	-	-	-	(11,729)
Loss from investment securities, net	(5,500)	-	-	6,811	1,311
Other Income	1,760	-	498	3,740	5,998
Expenses					
Finance expense	-	334	606	2,296	3,236
Impairment allowances	-	-	-	197,561	197,561
Commitments					
Commitment to extend finance	16,500	-	-	-	16,500

Key management personnel

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

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

Categories*

10% upto less than 20%

**Number of
Shares**

155,682,331

**Number of
Directors**

1

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

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26 RELATED PARTY TRANSACTIONS (continued)

Details of material contracts involving directors' include:

	2011	2010
Directors' participation in investments promoted by the Group	-	7,160

The key management personnel compensation is as follows:

	2011	2010
Board member fees	27	2,477
Salaries and other short-term benefits	2,550	2,625
Post employment benefits	392	54

27 EARNINGS PER SHARE
Basic earnings per share

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

	2011	2010
Profit / (loss) for the year from continuing operations (US\$ 000's)	381	(348,879)
Loss for the year from discontinued operations (US\$ 000's)	-	(522)
Weighted average number of ordinary shares (Nos. in 000's)	912,166	454,021
Basic and diluted earnings per share from continuing operations (in US cents)	0.04	(76.84)
Basic and diluted earnings per share from discontinued operations (in US cents)	-	(0.11)

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

Diluted earnings per share

Diluted earnings per share is calculated by adjusting the weighted average number of ordinary shares outstanding to assume conversion of all dilutive potential ordinary shares. Potential ordinary shares are considered to be dilutive when, and only when, their conversion to ordinary shares would decrease earnings per share or increase the loss per share. The Bank has two categories of dilutive potential ordinary shares: convertible murabaha notes (note 14) and share awards granted to employees (note 21).

During the year, all the note holders of the convertible murabaha facility 2010 have exercised their rights to convert the notes to equity shares of the Bank. Further, in case of the share awards granted to employees, as the average market value of shares during the current year was lower than the assumed issue price of shares under the scheme, the share awards are not considered to be dilutive as at 31 December 2011. Also, in case of the convertible murabaha series issued in 2009, the average market value of shares during the year was lower than the convertible price as per the convertible murabaha series 2009. Accordingly, no adjustment for dilution has been made for the purposes of computation of diluted earnings per share.

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28 ZAKAH

Zakah is directly borne by the shareholders on distributed profits and investors in restricted investment accounts. The Bank does not collect or pay Zakah on behalf of its shareholders and investors in restricted investment accounts. Zakah payable by the shareholders is computed by the Bank on the basis of the method prescribed by the Bank's Shari'a Supervisory Board and notified to shareholders annually. Zakah payable by the shareholders for the year ended 31 December 2011 is US\$ Nil (2010: Nil).

29 EARNINGS PROHIBITED BY SHARI'A

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

The Group receives interest from deposits placed with the Central Bank of Bahrain and other incidental or required deposits. These earnings are utilised exclusively for charitable purposes and amounts to US\$ 2 thousand (2010: US\$ 6 thousand).

30 SHARI'A SUPERVISORY BOARD

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

31 SOCIAL RESPONSIBILITY

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

32 MATURITY PROFILE

The table below shows the maturity profile of the Group's assets and liabilities and unrecognised commitments on the basis of their expected realisation/ payment and the Group's contractual maturity and amount of cash flows on these instruments may vary significantly from this analysis. For contractual maturity of financial liabilities refer note 37 (b).

31 December 2011	Up to 3 months	3 to 6 months	6 months-1 year	1 to 3 years	Over 3 years	Total
Assets						
Bank balances	3,804	-	-	-	-	3,804
Placements with financial institutions	3,001	-	-	-	-	3,001
Investment in associates	-	-	-	230,442	-	230,442
Investment securities	25,000	20,140	-	175,125	-	220,265
Investment property	-	-	-	259,404	-	259,404
Other financial assets	-	2,312	-	63,421	1,251	66,984
Total assets	31,805	22,452	-	728,392	1,251	783,900

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32 *MATURITY PROFILE (continued)*

31 December 2011	Up to 3 months	3 to 6 months	6 months-1 year	1 to 3 years	Over 3 years	Total
Financial liabilities						
Investors' funds	41,781	-	17,106	-	-	58,887
Placements from financial and other institutions	12,734	13,687	716	89,576	-	116,713
Financing liabilities	5,500	-	42,021	283,556	-	331,077
Other financial liabilities	40,041	-	-	43,841	-	83,882
Total liabilities	100,056	13,687	59,843	416,973	-	590,559
Equity of Investment account holders	1,898	-	-	-	-	1,898
Off-balance sheet items						
Restricted investment accounts	-	-	-	30,895	-	30,895
Commitments	-	-	-	83,249	-	83,249

31 December 2010	Up to 3 months	3 to 6 months	6 months-1 year	1 to 3 years	Over 3 years	Total
Assets						
Bank balances	3,762	-	-	-	-	3,762
Placements with financial institutions	56,868	-	-	-	-	56,868
Financing receivables	2,000	-	4,000	8,400	-	14,400
Investment in associates	-	-	-	-	224,847	224,847
Investment securities	20,220	-	-	228,574	-	248,794
Investment property	18,000	-	-	248,412	-	266,412
Other financial assets	-	4,944	-	189,825	1,244	196,013
Total assets	100,850	4,944	4,000	675,211	226,091	1,011,096
Financial liabilities						
Investors' funds	21,063	17,197	6,514	94,024	-	138,798
Placements from financial and other institutions	9,949	946	104,861	10,485	-	126,241
Financing liabilities	32,179	-	20,000	291,466	95,859	439,504
Other financial liabilities	71,911	-	-	123,624	-	195,535
Total liabilities	135,102	18,143	131,375	519,599	95,859	900,078
Equity of Investment account holders	1,880	-	-	-	-	1,880
Off-balance sheet items						
Restricted investment accounts	-	-	-	48,227	-	48,227
Commitments	16,500	6,000	-	613	-	23,113

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

33 CONCENTRATION OF ASSETS, LIABILITIES AND EQUITY OF INVESTMENT ACCOUNT HOLDER

(a) Industry sector

31 December 2011

Assets

	Trading and manufacturing	Banks and financial institutions	Development Infrastructure	Technology	Others	Total
Cash and bank balances	-	3,809	-	-	11	3,820
Placements with financial institutions	-	3,001	-	-	-	3,001
Investment in associates	67,811	162,631	-	-	-	230,442
Investment securities	-	7,482	199,640	4,202	8,941	220,265
Investment property	-	-	259,404	-	-	259,404
Other assets	17	1,287	102,339	-	5,270	108,913

Total assets

67,828 178,210 561,383 4,202 14,222 825,845

Liabilities

Investors' funds	30,984	-	27,903	-	-	58,887
Placements from financial and other institutions	-	11,982	-	-	104,731	116,713
Financing liabilities	-	331,077	-	-	-	331,077
Other liabilities	-	741	38,670	-	44,471	83,882

Total liabilities

30,984 343,800 66,573 - 149,202 590,559

Equity of Investment account holders

1,898 1,898

Off-Balance sheet items

Restricted investment accounts	-	-	30,895	-	-	30,895
Commitments	-	-	83,249	-	-	83,249

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

(a) *Industry sector (continued)*

31 December 2010	Trading and manufacturing	Banks and financial institutions	Development Infrastructure	Technology	Others	Total
Assets						
Cash and bank balances	-	3,770	-	-	-	3,770
Placements with financial institutions	-	56,868	-	-	-	56,868
Financing receivables	-	14,400	-	-	-	14,400
Investment in associates	66,297	158,550	-	-	-	224,847
Investment securities	23,370	13,548	200,190	2,500	9,186	248,794
Investment property	-	-	266,412	-	-	266,412
Other assets	17	95	192,073	-	10,965	203,150
Total assets	89,684	247,231	658,675	2,500	20,151	1,018,241
Liabilities						
Investors' funds	63,106	-	75,692	-	-	138,798
Placements from financial and other institutions	-	20,865	-	-	105,376	126,241
Financing liabilities	-	439,504	-	-	-	439,504
Other liabilities	-	413	-	-	195,122	195,535
Total liabilities	63,106	460,782	75,692	-	300,498	900,078
Equity of investment account holders	-	-	-	-	1,880	1,880
Off-Balance sheet items						
Restricted investment accounts	-	-	48,227	-	-	48,227
Commitments	-	16,500	613	-	6,000	23,113

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33 *Concentration of assets, liabilities and equity of investment account holders (continued)*

(b) Geographic region

31 December 2011

Assets

	GCC countries	Other MENA	Other Asia	UK	Europe (excluding UK)	USA	Total
Cash and bank balances	3,021	-	-	82	-	717	3,820
Placements with financial institutions	3,001	-	-	-	-	-	3,001
Investment in associates	230,442	-	-	-	-	-	230,442
Investment securities	133,694	48,117	36,823	-	1,631	-	220,265
Investment property	259,404	-	-	-	-	-	259,404
Other assets	50,683	29,129	29,101	-	-	-	108,913

Total assets

680,245 77,426 65,924 82 1,631 717 825,845

Liabilities

Investors' funds	34,622	24,201	-	-	64	-	58,887
Placements from financial and other institutions	27,137	89,576	-	-	-	-	116,713
Financing liabilities	213,723	-	-	117,354	-	-	331,077
Other liabilities	83,882	-	-	-	-	-	83,882

Total liabilities

359,364 113,777 - 117,354 64 - 590,559

Equity of investment account holders

1,898 1,898

Off-Balance sheet items

Restricted investment accounts	30,895	-	-	-	-	-	30,895
Commitments	82,636	613	-	-	-	-	83,249

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2011

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33 *Concentration of assets, liabilities and equity of investment account holders (continued)*

(b) *Geographic region (continued)*

31 December 2010

Assets

	GCC countries	Other MENA	Other Asia	UK	Europe (excluding UK)	USA	Total
Cash and bank balances	3,105	7	1	205	5	447	3,770
Placements with financial institutions	31,868	-	-	-	25,000	-	56,868
Financing receivables	14,400	-	-	-	-	-	14,400
Investment in associates	224,847	-	-	-	-	-	224,847
Investment securities	154,851	52,590	36,572	-	1,631	3,150	248,794
Investment property	266,412	-	-	-	-	-	266,412
Other assets	141,207	25,157	36,786	-	-	-	203,150

Total assets	836,690	77,754	73,359	205	26,636	3,597	1,018,241
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Liabilities

Investors' funds	96,863	33,319	8,417	-	199	-	138,798
Placements from financial and other institutions	35,018	91,223	-	-	-	-	126,241
Financing liabilities	314,270	-	-	125,234	-	-	439,504
Other liabilities	195,535	-	-	-	-	-	195,535

Total liabilities	641,686	124,542	8,417	125,234	199	-	900,078
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Equity of investment account holders	1,880	-	-	-	-	-	1,880
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Off-Balance sheet items

Restricted investment accounts	48,227	-	-	-	-	-	48,227
Commitments	22,500	613	-	-	-	-	23,113

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34 OPERATING SEGMENTS

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

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

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

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

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

The Group has primary operations in Bahrain and the Group does not have any significant overseas branches/divisions. The geographic concentration of assets and liabilities is disclosed in note 34 (b) to the consolidated financial statements.

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34 OPERATING SEGMENTS (continued)

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

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

2010	Development infrastructure	Banking	Unallocated	Total
Segment revenue	10,056	(4,325)	2,376	8,107
Segment expenses	286,218	56,826	14,464	357,508
Segment result	(276,162)	(61,151)	(12,088)	(349,401)
Segment assets	656,282	349,815	12,144	1,018,241
Segment liabilities	580,418	236,986	82,674	900,078
<u>Other material items:</u>				
Finance income	-	-	1,799	1,799
Finance expense	32,638	17,397	-	50,035
Loss from investment in associates	-	(11,729)	-	(11,729)
Depreciation	-	-	5,896	5,896
Impairment allowances	250,619	2,500	3,000	256,119
Capital expenditure	-	-	-	-
Investment in associates (equity accounted)	-	224,847	-	224,847
Commitments	16,500	6,613	-	23,113
Restricted investment accounts	47,523	704	-	48,227

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2011

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35 FINANCIAL INSTRUMENTS

a) FAIR VALUES OF FINANCIAL INSTRUMENTS

Fair value is an amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Other than certain investments carried at cost of US\$ 214,598 thousand (31 December 2010: US\$ 222,459 thousand) (note 8) and sukuk of US\$ 162,190 thousand (31 December 2010: US\$ 152,123 thousand) carried at amortised cost, the estimated fair values of the Group's other financial instruments are not significantly different from their book values as at 31 December 2011.

Investments amounting to US\$ 214,598 thousand (31 December 2010: US\$ 222,459 thousand) in unquoted equity securities are carried at cost less impairment in the absence of a reliable measure of fair value. Such investments are either private equity investments managed by external investment managers or represent investments in development infrastructure projects promoted by the Group for which a reliable estimate of fair value cannot be determined. The Group intends to exit these investments principally by means of strategic sell outs, sale of underlying assets or through initial public offerings.

The Group has Sukuk liability of US\$ 162,192 thousand (31 December 2010: US\$ 152,123 thousand) with a fair value based on quoted price of US\$ 92,891 thousand as of 31 December 2011 (31 December 2010: USD\$ 79,300 thousand)

b) FAIR VALUE HIERARCHY

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

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

31 December 2011

Investment securities

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

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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35 FINANCIAL INSTRUMENTS (continued)

b) FAIR VALUE HIERARCHY (continued)

31 December 2010	Level 1	Level 2	Level 3	Total
Investment securities				
- designated at fair value through income statement			25,860	25,860
- designated at fair value through equity	475	-	-	475
	475	-	25,860	26,335

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

	2011	2010
At 1 January	25,860	33,976
Total gains or losses		
- In income statement	6,161	(5,500)
Purchases	-	1,617
Disposals	(26,829)	(4,233)
At 31 December	5,192	25,860

36 COMMITMENTS AND CONTINGENCIES

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

	31 December 2011	31 December 2010
Commitments to invest	613	6,613
Commitments to extend finance	82,636	16,500
Capital commitments	-	-

The Group potentially has a commitment under a constructive obligation to extend finance to one of its projects of up to US\$ 23 million (31 December 2010: US\$ 150 million).

During the year, one of the Group's project company had successfully renegotiated the terms of its facility with its lenders. As a result the Group has reversed the provision recognised earlier to the extent of US\$ 86.11 million included in other liabilities and also an equivalent amount of "reimbursement right" included in 'other assets'. However, the Group is continuing to act as a guarantor for the lenders until the repayment of the facility by its project company and this has been included under commitments.

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36 COMMITMENTS AND CONTINGENCIES (continued)

Further, based on the Group's assessment of the likelihood that another project will not be able to meet the financing obligation when they fall due, the Group has estimated that its financial guarantee of US\$ 35 million may be enforced. The Group has recognised a provision of US\$ 35 million (31 December 2010: US\$ 121.11) towards these liabilities until revised / renegotiated terms are agreed with the lenders of the project companies and included in other liabilities and recognised an equivalent amount of 'reimbursement right' receivable included in 'other assets' (note 10).

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

Performance obligations

During the ordinary course of business, the Group may enter into performance obligations in respect of its infrastructure development projects. It is the usual practice of the Group to pass these performance obligations, wherever possible, on to the companies that own the projects. In the opinion of the management, no liabilities are expected to materialise on the Group at 31 December 2011 due to the performance of any of its projects.

Contingencies

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

37 FINANCIAL RISK MANAGEMENT**Overview**

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

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

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

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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*37 FINANCIAL RISK MANAGEMENT (continued)***Risk management framework**

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

During the year 2011, the Bank appointed its new Board of Directors. The Board of Directors has overall responsibility for establishing our risk culture and ensuring that an effective risk management framework is in place. The Board has delegated its authority to the Board Audit and Risk Committee, which is responsible for implementing risk management policies, guidelines and limits and ensuring that monitoring processes are in place. The RMD, together with the Internal Audit and Compliance Departments, provide independent assurance that all types of risk are being measured and managed in accordance with the policies and guidelines set by the Board of Directors.

The RMD submits a quarterly Risk Overview Report along with a detailed Liquidity Risk Report to the Board Audit and Risk Committee. The Risk Overview Report describes the potential issues for a wide range of risk factors and classifies the risk factors from low to high. The report also provides comments as to how risk factors are being addressed by the Group and the change in risk rating from the previous quarter. The Liquidity Risk Report measure the Group's liquidity risk profile against policy guidelines and regulatory benchmarks. An additional report is prepared by the respective investment units that give updated status and impairment assessment of each investment, a description of significant developments on projects or issues as well as an update on the strategy and exit plan for each project.

a) Credit risk

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

Management of investment and credit risk

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

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

- Ensuring that the Group has in place investment and credit policies, covering credit assessment, risk reporting, documentary and legal procedures, whilst the Compliance Department is responsible for ensuring compliance with regulatory and statutory requirements.
- Overseeing the establishment of the authorisation structure for the approval and renewal of investment and credit facilities. Authorisation limits are also allocated to the Management Investment and Credit Committee. Larger facilities require approval by BIC and the Board of Directors based on the authority limits structure of the Group.
- Reviewing and assessing credit risk. Risk Management department assesses all investment and credit exposures in excess of designated limits, prior to investments / facilities being committed. Renewals and reviews of investments / facilities are subject to the same review process.

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37 FINANCIAL RISK MANAGEMENT (continued)

- Monitoring concentrations of exposure to counterparties, geographies and industries.
- Ongoing review of credit exposures. The risk assessment approach is used in determining where impairment provisions may be required against specific investment / credit exposures. The current risk assessment process classifies credit exposures into two broad categories "Unimpaired" and "Impaired", reflecting risk of default and the availability of collateral or other credit risk mitigation. Risk is assessed on an individual basis for each investment / receivable and is reviewed at least once a year. The Group does not perform a collective assessment of impairment for its credit exposures as the credit characteristics of each exposure is considered to be different. Risk profile of exposures are subject to regular reviews.
- Reviewing compliance of business units with agreed exposure limits, including those for selected industries, country risk and product types. Providing advice, guidance and specialist skills to business units to promote best practice throughout the Group in the management of investment / credit risk.

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

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37 FINANCIAL RISK MANAGEMENT (continued)

The Group's maximum exposure to risk at 31 December 2011 is as follows:

Exposure to credit risk

31 December 2011

Neither past due nor impaired - Carrying amount

Impaired

Gross amount

Allowance for impairment

Carrying amount – Impaired

Carrying amount

Bank balances	Placement with financial institutions	Financing receivables	Other financial assets
3,804	3,001	-	33,634
-	-	62,650	413,298
-	-	(62,650)	(375,473)
-	-	-	37,825
3,804	3,001	-	71,459

31 December 2010

Neither past due nor impaired

Carrying amount

Past due but not impaired (30 – 60 days)

Carrying amount – Past due but not impaired

Impaired

Gross amount

Allowance for impairment

Carrying amount – Impaired

Carrying amount

3,762	56,868	12,400	162,203
-	-	2,000	-
-	-	2,000	-
-	-	62,650	409,283
-	-	(62,650)	(375,473)
-	-	-	33,810
3,762	56,868	14,400	196,013

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US\$ 000's

37 *FINANCIAL RISK MANAGEMENT (continued)*

a) *Credit risk (continued)*

Impaired receivables

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

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

The movement in the impairment allowances for investment in associates, investment securities and investment property are given in notes 7, 8 and 9 respectively. The movement in impairment allowance for other financial assets are as given below:

	Financing receivables	Financing to projects	Receivable from investment banking services	Other receivables	Total
2011					
At 1 January	70,150	77,382	147,186	74,311	369,029
Impairment allowance during the year	-	-	-	-	-
At 31 December	70,150	77,382	147,186	74,311	369,029
2010					
At 1 January	70,150	77,382	86,646	38,253	272,431
Impairment allowance during the year	-	-	60,540	36,058	96,598
At 31 December	70,150	77,382	147,186	74,311	369,029

Receivables with renegotiated terms

During the year, the Group has renegotiated certain financing receivables and financing to projects due to changes in the financial position of the borrower. The financing receivables were renegotiated for terms and condition similar to original terms. Financing to projects of US\$ 62.95 million (31 December 2010: US\$ 70.22 million) were renegotiated for an extended period and do not have specified terms of repayment. The Group assesses the recoverability and timing of collection based on underlying stream of cash flows that will be generated by its projects.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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*37 FINANCIAL RISK MANAGEMENT (continued)**a) Credit risk (continued)***Write-off policy**

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

Concentration risk

Concentration risk arises when a number of counterparties are engaged in similar economic activities or activities in the same geographic region or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. The Group seeks to manage its concentration risk by establishing and constantly monitoring geographic and industry wise concentration limits.

The geographical and industry wise distribution of assets and liabilities are set out in note 34 (a) and (b).

b) Liquidity risk

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

Management of liquidity risk

The Group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation. Whilst this is the policy, the Group's current position is under severe stress with contractual liabilities exceeding liquid assets. Focus has therefore been on extending the maturity of liabilities and raising capital in the form of debt or equity.

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

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

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37 *FINANCIAL RISK MANAGEMENT (continued)*

b) *Liquidity risk (continued)*

The table below shows the undiscounted cash flows on the Group's financial liabilities, including issued financial guarantee contracts, and unrecognised financing commitments on the basis of their earliest possible contractual maturity. For issued financial guarantee contracts, the maximum amount of the guarantee is allocated to the earliest period in which the guarantee could be called. The Group's expected cash flows on these instruments vary significantly from this analysis. Refer note 32 for the expected maturity profile of assets and liabilities.

31 December 2011	Gross undiscounted cash flows						Carrying amount
	Up to 3 months	3 to 6 months	6 months-1 year	1 to 3 years	Over 3 years	Total	
Financial liabilities							
Investors' funds	41,781	-	17,106	-	-	58,887	58,887
Placements from financial institutions	102,356	14,123	745	-	-	117,224	116,713
Financing liabilities	8,948	210,802	51,175	108,577	-	379,502	331,077
Other financial liabilities	40,040	-	-	43,842	-	83,882	83,882
Total financial liabilities	193,125	224,925	69,026	152,419	-	639,495	590,559
Equity of investment account holders	1,898	-	-	-	-	1,898	1,898
Off-balance sheet items							
Commitments	-	-	-	83,249	-	-	

To manage the liquidity risk arising from financial liabilities, the Group aims to hold liquid assets comprising cash and cash equivalents, placements with financial institutions and treasury shares for which there is an active and liquid market. These assets can be readily sold to meet liquidity requirements. At 31 December 2011, the Group's current contractual liabilities exceeded its liquid assets.

The Group has focussed on strengthening its liquidity position in 2011 by undertaking an asset sale programme; restructuring of its financing liabilities and raising additional capital through the convertible murabaha (note 14). The Group plans to further strengthen its liquidity in 2012 by undertaking a wider asset sale program and target additional capital raising that will target to provide the necessary additional liquidity needed to support the Group's funding requirements. These initiatives will help to improve the liquidity profile of the Group. Also, the Group has commenced renegotiations with lenders for the dues repayable in 2012. The Group is confident of its ability to meet its future contractual liabilities when due.

Further, the Group is focussed on developing a pipeline of steady revenues and has undertaken cost reduction exercises that would improve its operating cash flows. The Group is also evaluating other options to arrange liquidity with the support of its major shareholders and strengthen its position over the next twelve months.

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37 *FINANCIAL RISK MANAGEMENT (continued)*

b) *Liquidity risk (continued)*

	Gross undiscounted cash flows						Carrying amount
	Up to 3 months	3 to 6 months	6 months-1 year	1 to 3 years	Over 3 years	Total	
31 December 2010							
Financial liabilities							
Investors' funds	139,798	-	-	-	-	139,798	138,798
Placements from financial institutions	114,952	982	10,730	-	-	126,664	126,241
Financing liabilities	31,064	3,460	26,070	353,377	95,859	509,830	439,504
Other financial liabilities	71,911	-	-	123,624	-	195,535	195,535
Total financial liabilities	357,725	4,442	36,800	477,001	95,859	971,827	900,078
Equity of investment account holders	1,880	-	-	-	-	1,880	1,880
Off-balance sheet items							
Commitments	16,500	6,000	-	43,133	-	65,633	

Measures of liquidity

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

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

Liquidity coverage ratio

30 days
60 days
90 days

2011	2010
0.29	0.45
0.21	0.42
0.16	0.35

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

Net stable funding ratio

2011	2010
0.42	0.56

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

	Liquid asset / Total asset	
	2011	2010
At 31 December	0.83%	6.15%
Average for the year	2.73%	3.22%
Maximum for the year	4.16%	6.15%
Minimum for the year	0.83%	1.99%

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37 *FINANCIAL RISK MANAGEMENT (continued)*

c) Market risks

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

Management of market risks

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

Exposure to profit rate risk

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

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

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

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37 *FINANCIAL RISK MANAGEMENT (continued)*

c) *Market risks (continued)*

31 December 2010	Up to 3 months	3 to 6 months	6 months-1 year	1 to 3 years	Over 3 years	Total
Assets						
Placements with financial institutions	56,868	-	-	-	-	56,868
Financing receivables	2,000	-	4,000	8,400	-	14,400
Total assets	58,868	-	4,000	8,400	-	71,268
Liabilities						
Investors' funds	138,798	-	-	-	-	138,798
Placements from financial and other institutions	114,530	981	10,730	-	-	126,241
Financing liabilities	32,180	-	20,000	291,465	95,859	439,504
Total liabilities	285,508	981	30,730	291,465	95,859	704,543
Equity of investment account holders	1,880	-	-	-	-	1,880
Profit rate sensitivity gap	(228,520)	(981)	(26,730)	(283,065)	(95,859)	(635,155)

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

100 bps parallel increase / (decrease)	2011	2010
At 31 December	± 5,056	± 6,351
Average for the year	± 5,118	± 6,092
Maximum for the year	± 5,433	± 6,351
Minimum for the year	± 4,834	± 5,937

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

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37 *FINANCIAL RISK MANAGEMENT (continued)*

c) *Market risks (continued)*

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

	2011	2010
Placements with financial institutions	1.49%	0.68%
Financing receivables	5.70%	2.88%
Investors' funds	-	0.72%
Placements from financial and other institutions	4.12%	4.72%
Financing liabilities	5.63%	6.84%
Equity of investment account holders	0.27%	0.67%

Exposure to foreign exchange risk

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

	2011 US\$ '000 Equivalent	2010 US\$'000 Equivalent
Sterling Pounds	1,007	-
Euros	(68,975)	(69,645)
Jordanian Dinar	2,268	17,438
Kuwaiti Dinars	12,832	16,778
Other GCC Currencies (*)	(45,420)	(247,871)

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

The management of foreign exchange risk against net exposure limits is supplemented by monitoring the sensitivity of the Group's financial assets and liabilities to various foreign exchange scenarios. Standard scenarios that are considered include a 5% plus / minus increase in exchange rates, other than GCC pegged currencies. An analysis of the Group's sensitivity to an increase or decrease in foreign exchange rates (assuming all other variables, primarily profit rates, remain constant) is as follows:

	2011 US\$ '000 Equivalent	2010 US\$'000 Equivalent
Sterling Pounds	±50	-
Euros	±3,448	±3,482
Jordanian Dinar	±113	±872
Kuwaiti Dinars	±641	±839

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

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

d) Operational risk

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

38 CAPITAL MANAGEMENT

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

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

The Group is required to comply with the provisions of the Capital Adequacy Module of the CBB (which is based on the Basel II and IFSB framework) in respect of regulatory capital. The Group has adopted the standardised approach to credit risk and market risk and basic indicator approach for operational risk management under the revised framework. During 2011, the Group's capital adequacy ratio has been deteriorating and the Group is in constant communication with its regulator in relation to its capital adequacy plan.

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

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38 CAPITAL MANAGEMENT (continued)

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

	2011	2010
Total risk weighted assets	1,879,341	1,931,686
Tier 1 capital	232,608	204,746
Tier 2 capital	568	6
Total regulatory capital base	233,176	204,752
Total regulatory capital expressed as a percentage of total risk weighted assets	12.41%	10.60%

The capital adequacy ratio as at 31 December 2011 was close to the minimum regulatory capital requirement of 12%. Based on the planned asset sales program and operating plans, the Group expects to improve its risk weighted assets profile and capital adequacy ratio.

39 COMPARATIVES

Certain prior year amounts have been regrouped to conform to the current year's presentation. Such regrouping did not affect previously reported loss or equity except that arising from adoption of new standards as given in note 2.