

Liquidity Management Centre B.S.C. (c)

**SHARI'A SUPERVISORY BOARD REPORT,
REPORT OF THE BOARD OF DIRECTORS,
INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS
AND CONSOLIDATED FINANCIAL STATEMENTS**

31 DECEMBER 2010

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF LIQUIDITY MANAGEMENT CENTRE B.S.C. (c)

We have audited the accompanying consolidated balance sheet of Liquidity Management Centre B.S.C. (c) [the "Bank"] and its subsidiary [together the "Group"] as of 31 December 2010, and the related consolidated statements of income, cash flows and changes in equity for the year then ended. 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 Group's Board of Directors. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with the Auditing Standards 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 consolidated financial statements presentation. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 31 December 2010, the results of its operations, its cash flows and changes in equity for the year then ended in accordance with the Financial Accounting Standards issued by the Accounting and Auditing Organization for Islamic Financial Institutions.

Other Matters

We confirm that, in our opinion, proper accounting records have been kept by the Bank and the consolidated financial statements, and the contents of the Report of the Board of Directors relating to these consolidated financial statements, are in agreement therewith. We further report, to the best of our knowledge and belief, that no violations of the Bahrain Commercial Companies Law, nor of the Central Bank of Bahrain and Financial Institutions Law, nor of the memorandum and articles of association of the Bank, have occurred during the year ended 31 December 2010 that might have had a material adverse effect on the business of the Bank or on its consolidated financial position and that the Bank has complied with the terms of its banking licence and has complied with the Islamic Shari'a Rules and Principles as determined by the Shari'a Supervisory Board of the Group.

Liquidity Management Centre B.S.C. (c)

CONSOLIDATED BALANCE SHEET

31 December 2010

	Note	2010 US\$ 000	2009 US\$ 000
ASSETS			
Cash and balances with banks		4,241	3,676
Due from banks		8,200	23,200
Mudaraba receivables	3	11,389	8,000
Ijarah receivables	4	7,771	10,000
Financing receivable	5	10,125	15,000
Investments	6	183,536	231,396
Investment in properties	8	2,800	-
Property and equipment		5,799	1,351
Other assets	9	2,135	5,780
TOTAL ASSETS		235,996	298,403
LIABILITIES AND EQUITY			
LIABILITIES			
Due to Short Term Sukuk - investors	10	95,115	123,584
Due to banks		82,600	109,205
Other liabilities	11	4,058	3,638
TOTAL LIABILITIES		181,773	236,427
EQUITY			
Share capital	12	51,000	51,000
Reserves	12	9,184	8,612
(Accumulated deficit) / Retained earnings	12	(5,961)	2,224
Proposed appropriations		-	140
TOTAL EQUITY		54,223	61,976
TOTAL LIABILITIES AND EQUITY		235,996	298,403

Emad Al Monayea
Chairman

Khalid Al Dossari
Director

Ahmed Abbas
Chief Executive Officer

The attached notes 1 to 26 form part of these consolidated financial statements

Liquidity Management Centre B.S.C. (c)

CONSOLIDATED STATEMENT OF INCOME

Year ended 31 December 2010

	Note	2010 US\$ 000	2009 US\$ 000
Income from investments		7,765	9,640
Income from Murabaha and due from banks		136	817
Income from financing receivable		998	626
Income from Mudaraba receivables		413	22
Income from Ijarah receivables		679	154
Net gain on held for trading investments		237	143
Net loss from sale of available-for-sale-investments		(1,113)	-
Less: Return to Short Term Sukuk - investors		(2,229)	(3,203)
Less: Return to banks		(2,053)	(1,823)
Less: Return to non banks		-	(223)
		<u>4,833</u>	<u>6,153</u>
Investment banking fees	13	1,409	5,687
Ijarah income / (expense) - net	14	88	(916)
Foreign exchange gain / (loss)		111	(141)
OPERATING INCOME		<u>6,441</u>	<u>10,783</u>
Staff costs		3,618	3,795
Depreciation		313	134
General and administrative expenses	15	1,876	1,536
OPERATING EXPENSES		<u>5,807</u>	<u>5,465</u>
NET PROFIT FOR THE YEAR BEFORE UNREALISED FAIR VALUE CHANGE AND IMPAIRMENT PROVISION		634	5,318
Unrealised fair value loss on available-for-sale-investments through statement of income		(830)	-
Specific impairment provision	16	(3,674)	(1,807)
Collective impairment provision		(5,700)	(310)
NET (LOSS) / PROFIT FOR THE YEAR		<u><u>(9,570)</u></u>	<u><u>3,201</u></u>

The attached notes 1 to 26 form part of these consolidated financial statements

Liquidity Management Centre B.S.C. (c)

CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended 31 December 2010

	2010	2009
Note	US\$ 000	US\$ 000
OPERATING ACTIVITIES		
Net (loss) / profit for the year	(9,570)	3,201
Adjustments for:		
Depreciation	313	134
Amortisation of premium on investments	(382)	(281)
Net unrealised loss on held for trading investments	39	160
Net realised gain on held for trading investments	(276)	(303)
Unrealised fair value loss on available-for-sale-investments through statement of income	(830)	-
Net loss from sale of available-for-sale-investments	1,113	-
Specific impairment provision	(3,674)	1,807
Collective impairment provision	(5,700)	310
Directors' remuneration	140	100
Operating profit before changes in operating assets and liabilities:	(18,827)	5,128
Changes in:		
Mudaraba receivables	(3,389)	(8,000)
Ijarah receivables	2,229	(10,000)
Financing receivable	4,875	(15,000)
Other assets	9 3,502	(2,032)
Due to Short Term Sukuk - investors	(28,469)	(38,164)
Due to banks	(26,605)	66,208
Due to non bank	-	(13,604)
Other liabilities	420	1,506
Purchase of investments held to maturity	(18,577)	(11,500)
Sale/redemption proceeds from investments held to maturity	51,371	25,226
Purchase of available-for-sale investments	(3,970)	(29,357)
Sale/redemption proceeds from investment available-for-sale	10,649	28,030
Purchase of trading investments - net	(351)	(305)
Directors' remuneration paid	(140)	(100)
Net cash used in operating activities	(27,282)	(1,964)
INVESTING ACTIVITIES		
Purchase of properties and equipment - net	(4,761)	(1,116)
Investment in properties	8 (2,800)	-
Net cash used in investing activities	(7,561)	(1,116)
DECREASE IN CASH AND CASH EQUIVALENTS		
Cash and cash equivalents at 1 January	26,876	29,956
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	(7,967)	26,876
Cash and cash equivalents at year end comprise of:		
Cash and balances with banks	4,241	3,676
Due from banks with original maturity of ninety days or less	8,200	23,200
	12,441	26,876

The attached notes 1 to 26 form part of these consolidated financial statements

Liquidity Management Centre B.S.C. (c)

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

Year ended 31 December 2010

	Reserves				Total reserves US\$ 000	(Accumulated deficit)/ Retained earnings US\$ 000	Proposed appropriations US\$ 000	Total equity US\$ 000
	Share capital US\$ 000	Statutory reserve US\$ 000	General reserve US\$ 000	Investment fair value reserve US\$ 000				
Balance at 1 January 2010	51,000	2,226	2,226	4,160	8,612	2,224	140	61,976
Cumulative changes in fair value*	-	-	-	1,817	1,817	-	-	1,817
Transfer to (accumulated deficit) / retained earnings	-	-	-	(415)	(415)	415	-	-
Directors' remuneration	-	-	-	-	-	140	(140)	-
Total income and expenses recognised directly in equity	-	-	-	1,402	1,402	555	(140)	1,817
Net loss for the year	-	-	-	-	-	(9,570)	-	(9,570)
Transfer of unrealised fair value loss to reserve	-	-	-	(830)	(830)	830	-	-
Total income and expenses recognised during the year	-	-	-	572	572	(8,185)	(140)	(7,753)
Balance at 31 December 2010	51,000	2,226	2,226	4,732	9,184	(5,961)	-	54,223
Balance at 1 January 2009	51,000	1,930	1,930	1,695	5,555	(245)	-	56,310
Cumulative changes in fair value*	-	-	-	2,095	2,095	-	-	2,095
Transfer to statement of income	-	-	-	370	370	-	-	370
Directors' remuneration	-	-	-	-	-	(140)	140	-
Total income and expenses recognised directly in equity	-	-	-	2,465	2,465	(140)	140	2,465
Net profit for the year	-	-	-	-	-	3,201	-	3,201
Total income and expenses recognised during the year	-	-	-	2,465	2,465	3,061	140	5,666
Transfer to statutory reserve	-	296	-	-	296	(296)	-	-
Transfer to general reserve	-	-	296	-	296	(296)	-	-
Balance at 31 December 2009	51,000	2,226	2,226	4,160	8,612	2,224	140	61,976

* This represents movement in available for sale investments through equity which consists of equities, funds and sukuks (sukuk value cannot exceed par value at any time).

31 December 2010

1 INCORPORATION AND ACTIVITIES

Liquidity Management Centre B.S.C. (c) (the "Bank") is a closed joint stock company incorporated in the Kingdom of Bahrain on 31 July 2002 and registered with Ministry of Industry and Commerce under commercial registration (CR) number 49092. The Bank operates in the Kingdom of Bahrain (Bahrain) under wholesale banking license issued by the Central Bank of Bahrain (CBB). The Bank is engaged in the following activities:

- Facilitate creation of an Islamic inter-bank money market that will allow Islamic Financial Services Institutions ("IFSI") to effectively manage their assets and liabilities.
- Provide short-term liquid, tradable asset backed treasury instruments (Sukuk) based on Islamic Shari'a principles where IFSI can invest their surplus liquidity.
- Provide short-term investment opportunities based on Islamic Shari'a principles.

The activities of the Bank and its wholly owned subsidiary (together the "Group") are to carry out operations in accordance with the teachings of Islam (Shari'a). The Group's Shari'a Supervisory Board is entrusted to ensure the Group's adherence to Shari'a rules and principles in its transactions and activities.

The address of the Bank's registered office is Building 852, Road 3618, Block 436, Seef district, Kingdom of Bahrain.

The Bank operates only in Bahrain. As of 31 December 2010, the total number of employees employed by the Group was 35 (2009: 36).

The consolidated financial statements were approved by the Board of Directors on 22 February 2011.

2 SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies adopted in the preparation of the consolidated financial statements are set out below:

a. Basis of preparation

The consolidated financial statements have been prepared on a historical cost basis, except for certain available-for-sale investments and trading investments that have been measured at fair value. The consolidated financial statements have been presented in United States Dollars (US Dollar), being the principal currency of the Group's operations. All the values are rounded to the nearest US Dollar thousand unless otherwise stated.

b. Statement of compliance

The consolidated financial statements are prepared in accordance with the Financial Accounting Standards and interpretations issued by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), the Shari'a Rules and Principles as determined by the Shari'a Supervisory Board of the Bank, the Bahrain Commercial Companies Law, the Central Bank of Bahrain and Financial Institutions Law. For matters which are not covered by AAOIFI standards, the Group uses the relevant International Financial Reporting Standards (the "IFRS").

c. Basis of consolidation

The consolidated financial statements comprise the financial statements of the Bank and its wholly owned subsidiary "The Short Term Sukuk Centre B.S.C. (closed)" (STSC). A subsidiary is an entity over which the Bank has power to control, which is other than fiduciary in nature. The financial statements of the subsidiary are prepared for the same reporting year as the Bank, using consistent accounting policies.

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

31 December 2010

2 SIGNIFICANT ACCOUNTING POLICIES (continued)**c. Basis of consolidation (continued)**

Subsidiary is fully consolidated from the date of formation or acquisition, being the date on which the Group obtains control, and continue to be consolidated until the date that control ceases. Control is achieved where the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

	<i>Ownership for 2010</i>	<i>Ownership for 2009</i>	<i>Year of incor- poration</i>	<i>Country of incor- poration</i>
<i>Held directly by the Bank</i>				
The Short Term Sukuk Centre B.S.C. (c)	100%	100%	2003	Kingdom of Bahrain

d. Adoption of new and amended standards and interpretations

The accounting policies are consistent with those of the previous year except for the following new and amended AAOIFI standards:

Financial Accounting Standard No. 23 - Consolidation

FAS 23 sets out the principles for determining entities that are subject to be included in the consolidated financial statements of a parent and prescribes the accounting for investment in subsidiaries by parent.

Financial Accounting Standard No. 24 - Associates

FAS 24 sets out the accounting principles for recognising, measuring, presenting and disclosing the investments in associates.

The requirements of FAS 23 are largely in line with the current policies followed by the Group for accounting of subsidiaries and the adoption of the standard is not expected to have any material impact on the consolidated financial statements. As the Bank does not have any investment in associate FAS 24 is not applicable to the Group.

Standards issued but not yet effective***Financial Accounting Standard No. 25 - Investment in sukuk, shares and similar instruments***

FAS 25 sets out the principles for recognition, measurement, presentation and disclosure of investment in sukuk, shares and other investments that exhibit the characteristics of debt and equity instruments. This standard is effective for annual period beginning on or after 1 January 2011.

e. Cash and cash equivalents

Cash and cash equivalents as referred to in the consolidated statement of cash flows comprise cash on hand, balances with banks and due from banks with an original maturity of ninety days or less.

f. Murabaha receivables

Murabaha receivables consist mainly of murabaha and international commodities stated net of deferred profits and provisions for impairment. The Group considers the promise made in the murabaha to the purchase orderer as obligatory.

g. Ijarah receivable

Ijarah receivable is initially recognised at fair value of consideration given and less provision for impairment.

h. Mudaraba receivable

Mudaraba receivable is a partnership in which the Group contributes capital. These contracts are stated at the fair value of consideration given less provision for impairment.

31 December 2010

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

i. Financing receivable and Due from banks

The financing receivable represents wakala financing to projects and is initially stated at fair value of consideration given less provision for impairment.

j. Investments

The investments are classified either as trading, available-for-sale or held to maturity.

All investments, excluding Trading investments, are initially recognised at cost, being the fair value of the consideration given including acquisition costs.

Trading investments

These are initially recognised at cost, being the fair value of the consideration given excluding acquisition costs. These are subsequently re-measured at fair value. All related realised and unrealised gains or losses are included in the consolidated statement of income.

Available-for-sale investments through equity

Subsequent to initial recognition, these investments are re-measured at fair value with unrealised gains or loss recognised directly in equity in "investment fair value reserve", until the investment is derecognised or determined to be impaired at which time the cumulative gain or loss previously recorded in equity is recognised in the consolidated statement of income.

Impairment losses on equity investments are not reversed through the consolidated statement of income and increases in their fair value after impairment are recognised directly in equity.

Available-for-sale investments through statement of income

Subsequent to initial recognition, those investments are re-measured at fair value and the resultant gains or losses are included in the consolidated statement of income as "Fair value changes" provided that there are no investment account holders participating in such investments or to the extent of the portion related to owners' equity participating in the investments. Unrealised gains or losses are appropriated to "Investment fair value reserve" in consolidated statement of changes in equity in accordance with interpretation letter issued by AAOIFI. Upon realisation of these gains and losses, these are transferred to retained earnings.

Held-to-maturity investments

Investments which have fixed or determinable payments and where the Group has both the intent and ability to hold to maturity are classified as held to maturity. After initial measurement, these investments are carried at amortised cost less provision for impairment in value. Amortised cost is calculated by taking into account any premium or discount on acquisition. Any gain or loss on such investment is recognised in the consolidated statement of income, when the investment is de-recognised or impaired.

k. Fair value

Fair value is determined for each investment individually in accordance with the valuation policies set out below:

- (i) For investments that are traded in organised financial markets, fair value is determined by reference to the quoted market bid prices prevailing on the balance sheet date.
- (ii) For unquoted investments, fair value is determined by reference to recent significant buy or sell transactions with third parties that are either completed or are in progress. Where no recent significant transactions have been completed or are in progress, fair value is determined by reference to the current market value of similar investments. For others, the fair value is based on the net present value of estimated future cash flows, or other relevant valuation methods.
- (iii) For investments that have fixed or determinable cash flows, fair value is based on the net present value of estimated future cash flows determined by the Group using current profit rates for investments with similar terms and risk characteristics.
- (iv) Investments which cannot be remeasured to fair value using any of the above techniques are carried at cost, less provision for any impairment.

31 December 2010

2 SIGNIFICANT ACCOUNTING POLICIES (continued)**I. Investment in properties**

Properties held for rental, or for capital appreciation, or both, are classified as investment in properties. Investment in properties are initially recorded at cost, being the fair value of the consideration given and acquisition charges associated with the property. Subsequent to initial recognition, investment in properties are measured at fair value and changes in fair value are recognised in the consolidated statement of income.

In accordance with AAOIFI, such gains or losses are appropriated to investment fair value reserve at year end. Upon realisation, these gains/ losses are transferred to retained earnings from investment fair value reserve.

m. Property and equipment

Equipment are initially recognised at cost. The cost of additions and major improvements are capitalised; maintenance and repairs are charged to the consolidated statement of income as incurred. Gains or losses on disposal are reflected in other income. Depreciation is provided on the straight-line basis over the estimated useful lives of the assets.

The calculation of depreciation is on the following basis:

Building	25 years
Office furniture and equipment	3 years
Vehicles	5 years
Others	3-5 years

n. Offsetting

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

o. Derecognition of financial instruments*Financial assets*

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

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

Financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

p. Provisions

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

31 December 2010

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

q. Revenue recognition

Income from investments, Ijarah receivable, Murabaha and due from banks and Financing receivable

Income is recognised on a time-apportioned basis over the period of the investment. Income that is 90 days or more overdue is suspended until it is received in cash.

Dividend income

Dividends are recognised when the right to receive payment is established.

Ijarah income

Ijarah income is accounted for on a straight line basis over the ijarah terms.

Income from Mudaraba receivables

Income on mudaraba receivables is recognised when the right to receive payment is established or on distribution by the mudarib.

Investment Banking Fees

These comprise fee for structuring, arranging and underwriting deals. Structuring and arranging fee income is recognised by reference to percentage of completion method, measured by reference to the percentage of cost incurred to date to estimated total cost. Underwriting and other fees are recognised when earned.

Return to Short Term Sukuk - investors

Return to Short Term Sukuk - investors is recognised in accordance with the underlying contracts.

r. Foreign currencies

Transactions in foreign currencies are recorded at the rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated into US Dollars at the rate of exchange ruling at the balance sheet date. All differences are taken to the consolidated statement of income.

Translation gains or losses on non-monetary items are included in equity as part of the fair value adjustment.

s. Impairment of financial assets

An assessment is made at each financial position date to determine whether there is objective evidence that a specific financial asset or a group of financial assets may be impaired. If such evidence exists, the estimated recoverable amount of that asset is determined and any impairment loss, based on the assessment by the Group of the estimated cash equivalent value, is recognised in the consolidated statement of income. Specific provisions are created to reduce all impaired financial contracts to their realisable cash equivalent value. Financial assets are written off only in circumstances where effectively all possible means of recovery have been exhausted. Impairment is determined as follows:

- (i) For assets carried at fair value, impairment is the difference between cost and fair value, less any impairment loss previously recognised in the income statement.
- (ii) For assets carried at cost, impairment is the difference between carrying value and the present value of future cash flows discounted at the current market rate of return for a similar financial asset.
- (iii) For assets carried at amortised cost, impairment is the difference between carrying amount and the present value of future cash flows discounted at the original effective profit rate.

For available for sale equity investments impairment losses recognised in the statement of income for an investment equity instrument shall not be reversed through the statement of income and should be recorded as increases in cumulative changes in fair value through equity.

31 December 2010

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

t. Use of estimates in preparation of the consolidated financial statements

In the process of applying the Group's accounting policies, management has made estimates in determining the amounts recognised in the consolidated financial statements. The most significant use of judgments and estimates are as follows:

Impairment

The Group assesses at each consolidated balance sheet date whether there is objective evidence that a specific asset or a group of assets may be impaired. An asset or a group of assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (an incurred "loss event") and that loss event(s) have an impact on the estimated future cash flows of the asset or the group of the assets that can be reliably estimated.

Collective impairment provision

Impairment is assessed collectively for losses on Islamic financing facilities that are not individually significant and for individually significant facilities where there is not yet objective evidence of individual impairment. Collective impairment is evaluated on each reporting date with each portfolio receiving a separate review.

Fair valuation of investments

The determination of fair values of unquoted investments requires management to make estimates and assumptions that may affect the reported amount of assets at the date of the consolidated financial statements. The valuation of such investments is based on the fair value criteria explained above.

Nonetheless, the actual amount that is realised in a future transaction may differ from the current estimate of fair value and may still be outside management estimates, given the inherent uncertainty surrounding valuation of unquoted investments.

u. Judgments

In the process of applying the Group's accounting policies, management has made the following judgments, apart from those involving estimations, which effects the amounts recognised in the financial statements:

Classification of investments

Management decides on acquisition of a financial asset whether it should be classified as "trading investments", "available for sale" or "held to maturity".

v. Zakah

In accordance with its Articles of Association, the Group is not required to pay Zakah on behalf of its shareholders.

w. Fiduciary assets

Assets held in a fiduciary capacity are not treated as assets of the Group.

x. Employees' end of service benefits

Provision is made for leaving indemnity payable under the Bahraini Labour Law applicable to non-Bahraini employees' accumulated period of service at the balance sheet date. In addition, provision for indemnity is also made for Bahraini employees in accordance with the above guidelines.

Bahraini employees of the Bank are covered by contributions made to the Social Insurance Organisation of Bahrain (SIO) as a percentage of the employees' salaries. The Bank's obligations are limited to these contributions, which are expensed when due.

y. Shari'a Supervisory Board

The Group's Shari'a Supervisory Board consists of four members appointed by the general assembly. They 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 December 2010

2 SIGNIFICANT ACCOUNTING POLICIES (continued)**z. Earnings prohibited by Shari'a**

The Group is committed to avoid recognising any income generated from non-Islamic source. Accordingly, all non-Islamic income is credited to a charity account where the Group uses these funds for various social welfare activities.

a.a. Dividend

Dividend to shareholders is recognised as liability when it is approved by the shareholders.

a.b. Trade and settlement date accounting

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

3 MUDARABA RECEIVABLES

Mudaraba receivables is a short term receivables from a financial institution with an expected profit rate ranged between 3% to 4.5% per annum (2009: 3%) and matures within 90 days from date of transaction.

4 IJARAH RECEIVABLES

Ijarah receivable from two parties, which are current, whose terms are as follow:

- 1- US\$ 3.8 million with a profit rate of 8% per annum and maturing on 26 August 2013.
- 2- US\$ 4 million with a profit rate of 7% per annum and maturing on 27 July 2014.

5 FINANCING RECEIVABLE

This is a syndicated financing transaction based on investment agency (wakala) agreement to finance a project in the Kingdom of Bahrain. The facility is collateralised by an ownership in the underlying companies and guaranteed by a bank incorporated in the Kingdom of Bahrain. The anticipated profit rate of the facility is 8.5% per annum and maturing partly in 2011 and remaining in March 2012.

6 INVESTMENTS

	2010 US\$ 000	2009 US\$ 000
Investments held-to-maturity	154,666	187,073
Available-for-sale investments through statement of income	11,445	12,275
Available-for-sale investments through equity	31,866	39,371
Trading investments	1,129	541
Impairment provision (note 7)	(15,570)	(7,864)
Total	183,536	231,396

31 December 2010

6 INVESTMENTS (continued)

Available-for-sale investments through equity include an amount of US\$ 16.3 million (2009: US\$ 13.7 million) which are considered to be impaired. In total an amount of US\$ 2.7 million (2009: US\$ 4.4 million) of investments in funds held as available for sale through equity which are carried at cost as their fair value is not significantly different from their book values.

Held to maturity investments include an amount of US\$ 6.8 million (2009: US\$ nil) which is considered to be impaired.

Investments include an amount of US\$ 159.2 million, net of provision, (2009: US\$ 201.2 million) representing the underlying assets of the secured Short Term Sukuk Program (STS Program) of The Short Term Sukuk Centre B.S.C. (c) managed by the Bank. The maturities of these investments range from 1 to 6 years and the effective profit rate on these investments ranged between 0.6% to 9.5% per annum (2009: 0.5% to 9.5% per annum).

During 2009 the Group entered into a long term financing arrangement with a third party international financial institution for which the Group's investments amounting to US\$ 74 million (2009: US\$ 83 million) have been provided as collateral.

7 PROVISIONS

	2010				2009			
	Available-for-sale investments			Total US\$ 000	Available-for-sale investments			Total US\$ 000
Investments held-to-maturity US\$ 000	investments through equity US\$ 000	Other receivables US\$ 000	Investments held-to-maturity US\$ 000		through equity US\$ 000	Other receivables US\$ 000		
Specific provision								
At 1 January	-	6,854	-	6,854	-	5,167	-	5,167
Charge for the year	1,020	2,511	143	3,674	-	1,687	120	1,807
Write offs	-	(1,525)	(42)	(1,567)	-	-	(120)	(120)
	1,020	7,840	101	8,961	-	6,854	-	6,854
Collective provision								
At 1 January	1,010	-	-	1,010	700	-	-	700
Charge for the year	5,700	-	-	5,700	310	-	-	310
Write offs	-	-	-	-	-	-	-	-
	6,710	-	-	6,710	1,010	-	-	1,010
TOTAL	7,730	7,840	101	15,671	1,010	6,854	-	7,864

8 INVESTMENT IN PROPERTIES

The Bank has obtained seven parcel of lands in Kuwait as a security for a fee income receivable of US\$ 2.8 million outstanding as of 31 December 2009. The agreement with the other party stated that If the amount is not yet paid post a specified date, the Bank can exercise their rights on the seven parcel of lands without any obligation from any party. The amount receivable was not paid to the Bank as of the specified date and the Bank has booked the lands as investment properties in exchange for the amount receivable.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2010

9 OTHER ASSETS

	2010	2009
	US\$ 000	US\$ 000
Accrued profit	1,776	1,907
Fee income receivable*	140	2,873
Prepaid expenses	172	121
Others	148	879
Provision (note 7)	(101)	-
	2,135	5,780

* US\$ 2.8 million was received in exchange for seven parcel of lands in Kuwait (note 8).

10 DUE TO SHORT TERM SUKUK - INVESTORS

Due to Sukukholders represent STS program Sukuk owned by the investors in the secured Short Term Sukuk Program (STS Program) of The Short Term Sukuk Centre B.S.C. (c) managed by the Bank. The investors are the legal owners of the underlying investments of US\$ 159.2 million (2009: US\$ 201.2 million) of the STS program as disclosed in note 6. Returns paid to the Sukukholders during the year on average at 2.04% per annum (2009: 2.25% per annum).

11 OTHER LIABILITIES

	2010	2009
	US\$ 000	US\$ 000
Staff related payables	2,046	1,854
Payable to financial institutions	1,233	916
Others	779	868
	4,058	3,638

12 EQUITY**(i) Share capital**

	2010	2009
	US\$ 000	US\$ 000
Authorised:		
200,000,000 ordinary shares of US\$ 1 each	200,000	200,000
Issued, subscribed and fully paid:		
51,000,000 ordinary shares of US\$ 1 each	51,000	51,000

(ii) Statutory reserve

In accordance with the requirements of the Bahrain Commercial Companies Law, 10% of the net profit is transferred to a statutory reserve. The Bank may resolve to discontinue such annual transfers when the reserve total 50% of the paid up share capital. No transfer has been made for the current year as there was a net loss for the year. The reserve is not distributable but can be utilised for the purpose of a distribution in such circumstances as stipulated in the Bahrain Commercial Companies Law and with the prior approval of the CBB.

(iii) General reserve

In accordance with the Bank's articles of association, the Group may transfer any amount, as approved by the directors, out of net income for the year to the general reserve after appropriating statutory reserve. The general reserve is distributable, subject to the approval of CBB.

31 December 2010

12 EQUITY (continued)**(iv) Investment fair value reserve**

Investment fair value reserve represents unrealised gains and losses resulting from re-measurement of available-for-sale investments. This reserve is distributable upon value realisation, which takes place at the time of actual exit or derecognition of investments.

13 INVESTMENT BANKING FEES

	<i>2010</i> <i>US\$ 000</i>	<i>2009</i> <i>US\$ 000</i>
Sukuk and islamic financing fees and commission income	1,338	5,029
Others	71	658
	<u>1,409</u>	<u>5,687</u>

14 IJARAH INCOME / (EXPENSE) - NET

	<i>2010</i> <i>US\$ 000</i>	<i>2009</i> <i>US\$ 000</i>
Rental income	1,387	784
Ijarah expense	(1,299)	(1,700)
	<u>88</u>	<u>(916)</u>

15 GENERAL AND ADMINISTRATIVE EXPENSES

	<i>2010</i> <i>US\$ 000</i>	<i>2009</i> <i>US\$ 000</i>
Directors' remuneration and related expenses (15.1)	270	196
Legal and professional fees	311	396
Advertising and marketing	44	56
Premises expenses	308	298
Others	943	590
	<u>1,876</u>	<u>1,536</u>

15.1 DIRECTORS' REMUNERATION AND RELATED EXPENSES

	<i>2010</i> <i>US\$ 000</i>	<i>2009</i> <i>US\$ 000</i>
Board of Directors' remuneration - 2009 / 2008	140	100
Board of Directors' meeting related expenses	130	96
	<u>270</u>	<u>196</u>

16 SPECIFIC IMPAIRMENT PROVISION

	<i>2010</i> <i>US\$ 000</i>	<i>2009</i> <i>US\$ 000</i>
Available-for-sale investments through equity	2,511	1,687
Held to maturity investments	1,020	-
Impairment provision on receivables	143	120
	<u>3,674</u>	<u>1,807</u>

31 December 2010

17 RELATED PARTY TRANSACTIONS

Related parties comprise shareholders, directors of the Group, close members of their families, entities owned or controlled by them and companies affiliated by virtue of common ownership or directors with that of the Group. All the financing transactions with related parties are performing and no provisions are required.

The balances of major transactions with related parties as follows:

	<i>Shari'a Board 2010 US\$ 000</i>	<i>Shari'a Board 2009 US\$ 000</i>	<i>Directors 2010 US\$ 000</i>	<i>Directors 2009 US\$ 000</i>	<i>Share- holders 2010 US\$ 000</i>	<i>Share- holders 2009 US\$ 000</i>
Cash and balances with banks	-	-	-	-	423	459
Due from banks	-	-	-	-	1,500	18,200
Investments	-	-	-	-	34,390	40,005
Other assets	-	-	-	-	325	296
Due to Short Term Sukuk - investors	-	-	-	-	90,054	95,096
Due to banks	-	-	-	-	42,368	72,474
Other liabilities	60	120	-	45	-	916

Key management personnel are those who possess significant decision making and direction setting responsibilities and includes personnel manager level and above. Compensation of these key management personnel is as follows:

Other liabilities	1,507	1,294
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The income and expenses arising from dealing with related parties included in the consolidated statement of income are as follows:

	<i>Shari'a Board 2010 US\$ 000</i>	<i>Shari'a Board 2009 US\$ 000</i>	<i>Directors 2010 US\$ 000</i>	<i>Directors 2009 US\$ 000</i>	<i>Share- holders 2010 US\$ 000</i>	<i>Share- holders 2009 US\$ 000</i>
Income from investments	-	-	-	-	1,129	1,155
Income from Murabaha and						
Due from bank	-	-	-	-	124	29
Return to Short Term Sukuk - investors	-	-	-	-	1,979	2,526
Return to banks	-	-	-	-	1,156	996
General and administrative expenses	60	64	270	196	-	20

Compensation of these key management personnel, consisting solely of short-term benefits, is as follows:

Staff costs	2,427	2,519
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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2010

18 MATURITY ANALYSIS OF ASSETS, LIABILITIES AND EQUITY

The table below shows an analysis of assets, liabilities and equity analysed according to when they are expected to be recovered or settled.

31 December 2010	<i>Up to 1 month US\$ 000</i>	<i>1 to 3 months US\$ 000</i>	<i>3 to 6 months US\$ 000</i>	<i>6 months to 1 year US\$ 000</i>	<i>1 to 3 years US\$ 000</i>	<i>Over 3 years US\$ 000</i>	<i>No fixed maturity US\$ 000</i>	<i>Total US\$ 000</i>
ASSETS								
Cash and balances with banks	4,241	-	-	-	-	-	-	4,241
Due from banks	8,200	-	-	-	-	-	-	8,200
Mudaraba receivables	9,234	2,155	-	-	-	-	-	11,389
Ijarah receivables	107	218	329	1,679	4,438	1,000	-	7,771
Financing receivable	1,125	3,000	-	3,000	3,000	-	-	10,125
Investments	-	5,489	2,616	40,533	98,493	33,457	2,948	183,536
Investment in properties	-	-	-	-	-	-	2,800	2,800
Property and equipment	-	-	-	-	-	-	5,799	5,799
Other assets	386	1,070	410	7	-	-	262	2,135
Total assets	23,293	11,932	3,355	45,219	105,931	34,457	11,809	235,996
LIABILITIES AND EQUITY								
Due to Short Term Sukuk - investors	95,115	-	-	-	-	-	-	95,115
Due to banks	53,829	-	1,600	18,102	9,069	-	-	82,600
Other liabilities	1,262	916	261	75	-	1,270	274	4,058
Equity	-	-	-	-	-	-	54,223	54,223
Total liabilities and equity	150,206	916	1,861	18,177	9,069	1,270	54,497	235,996
Liquidity gap	(126,913)	11,016	1,494	27,042	96,862	33,187	(42,688)	
Cumulative liquidity gap	(126,913)	(115,897)	(114,403)	(87,361)	9,501	42,688	-	

The net funding requirement with respect to cumulative liquidity gap is managed through lines, amounting to US\$ 130 million as at 31 December 2010, provided by the shareholders (US\$97.8 million is utilised).

The Group expects that most of the short-term liabilities will be rolled over upon maturity. Also, as set out in note 6, the Group has other financing arrangements in place to manage the liquidity gap.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2010

18 MATURITY ANALYSIS OF ASSETS, LIABILITIES AND EQUITY (continued)

31 December 2009	<i>Up to 1 month US\$ 000's</i>	<i>1 to 3 months US\$ 000's</i>	<i>3 to 6 months US\$ 000's</i>	<i>6 months to 1 year US\$ 000's</i>	<i>1 to 3 years US\$ 000's</i>	<i>Over 3 years US\$ 000's</i>	<i>No fixed maturity US\$ 000's</i>	<i>Total US\$ 000's</i>
ASSETS								
Cash and balances with banks	3,676	-	-	-	-	-	-	3,676
Due from banks	23,200	-	-	-	-	-	-	23,200
Mudaraba receivable	8,000	-	-	-	-	-	-	8,000
Ijarah receivables	-	-	-	-	-	10,000	-	10,000
Financing receivable	-	7,500	-	-	7,500	-	-	15,000
Investments	16,640	6,610	17,433	27,141	129,562	28,499	5,511	231,396
Property and equipment	-	-	-	-	-	-	1,351	1,351
Other assets	372	1,076	459	-	-	-	3,873	5,780
Total assets	51,888	15,186	17,892	27,141	137,062	38,499	10,735	298,403
LIABILITIES AND EQUITY								
Due to Short Term Sukuk - investors	111,053	12,531	-	-	-	-	-	123,584
Due to banks	67,360	13,021	1,654	-	27,170	-	-	109,205
Other liabilities	1,348	77	234	971	-	1,008	-	3,638
Equity	-	-	-	-	-	-	61,976	61,976
Total liabilities and equity	179,761	25,629	1,888	971	27,170	1,008	61,976	298,403
Liquidity gap	(127,873)	(10,443)	16,004	26,170	109,892	37,491	(51,241)	
Cumulative liquidity gap	(127,873)	(138,316)	(122,312)	(96,142)	13,750	51,241	-	

The net funding requirement with respect to cumulative liquidity gap is managed through lines, amounting to US\$ 115 million, provided by the shareholders (US\$ 115 million is utilised).

31 December 2010

19 RISK MANAGEMENT

Introduction

Risk is inherent in the Group's activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Group's continuing profitability and each individual within the Group is accountable for the risk exposures relating to his or her responsibilities. These risks and the processes to mitigate these risks have not significantly altered from the previous year.

The Group is exposed to credit risk, liquidity risk and market risk, the latter being divided into trading and non-trading risks. It is also subject to operating risks.

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

Risk management structure

The Board of Directors is ultimately responsible for identifying and controlling risks; however, there are separate independent bodies responsible for managing and monitoring risks.

Board of Directors

The Board of Directors' is responsible for the overall risk management approach and for approving the risk strategies and principles.

The Board has delegated the oversight responsibilities of risk management to the Risk Management Committee and senior management (comprising the Chief Executive Officer and Senior Managers). They are responsible to carry out the policies laid down by the Board by ensuring that there are adequate and effective operational procedures, internal controls and systems for measuring, monitoring and controlling risks.

Risk Management Committee

In line with the Group's expansion and growth plans, the Board established a Risk Management Committee (RMC) to further strengthen the Group's risk management process. The RMC has the overall responsibility for the development of the risk strategy and implementing principles, frameworks, policies and limits. It is responsible for the fundamental risk issues, managing and monitoring relevant risk decisions. All the members of this Committee are from the Board. The RMC meets quarterly with the objective of assisting the Board in carrying out its responsibilities in relation to managing the Group's range of inter-related risks in an integrated manner. The Committee is supported by the Group's risk management function which assists with the establishment of policies on credit, liquidity, market and operational risk, reviews compliance with and set risk limits approved by the Board and identifies emerging risk issues. The RMC is responsible to provide oversight and management of all risks in the Group and to ensure that there is an ongoing process to continuously manage the Group's risks proactively.

The following are management committees that support the risk management of the Group.

Risk Management Unit

The Risk Management Unit (RMU) is responsible for implementing and maintaining risk related procedures to ensure an independent control process. The RMU is a management committee set up to centralise the management of risks and to assist senior management and the risk committees in the controlling, monitoring and reporting of risks.

31 December 2010

19 RISK MANAGEMENT (continued)

Risk Management Unit (continued)

Asset/liability management committee

The Asset/Liability Management Committee is responsible for the Group's asset and liability management, pricing and funding strategies, management of market and liquidity risks, as well as ensuring that investments are made in accordance with the policies approved by the Board of Directors.

Credit and Investment Risk Committee

The Credit and Investment Risk Committee is responsible for the management of credit risk. Overseeing the management of operational risk is the Internal Audit Department which regularly reports to the Audit Committee to provide independent assurance that risks have been identified and there are sufficient and effective controls on all aspects of the Group's operations.

Internal Audit

Risk management processes throughout the Group are audited annually by the internal audit function that examines both the adequacy of the procedures and the Group's compliance with the procedures. Internal Audit discusses the results of all assessments with management, and reports its findings and recommendations to the Audit Committee.

Risk measurement and reporting systems

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

Credit Risk

Credit risk is the risk that any counterparty, to a financial instrument, will fail to fulfill an obligation and cause the other party to incur a financial loss. The Group attempts to control credit risk by monitoring credit exposures, limiting transactions with specific counterparties, and assessing the creditworthiness of counterparties. In addition to monitoring credit limits, the Group manages the credit exposure by entering into collateral arrangements with counterparties in appropriate circumstances, and limiting the duration of exposure. According to the terms of the STS program, the Sukukholders bear the credit risk arising from investments on account of default. However, the Bank bears the risk of a rating downgrade of its holding in sukuk assets.

The Group has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular collateral reviews. Counterparty limits are established by the use of a credit risk classification system, which assigns each counterparty a perceived risk rating. Risk ratings are subject to regular revision. The credit quality review process allows the Group to assess the potential loss as a result of the risks to which it is exposed and take corrective action.

31 December 2010

19 RISK MANAGEMENT (continued)**Credit Risk (continued)****Maximum exposure to credit risk without taking account of any collateral and other credit enhancements**

The table below shows the maximum exposure to credit risk for the Group's financial assets. The maximum exposure is shown gross, before the effect of migration through the use of master netting and collateral agreements. These balances are presented gross of impairment provision.

	<i>Gross maximum exposure 2010 US\$ '000</i>	<i>Gross maximum exposure 2009 US\$ '000</i>
Cash and balances with banks	4,241	3,676
Due from banks	8,200	23,200
Mudaraba receivables	11,389	8,000
Ijarah receivables	7,771	10,000
Financing receivable	10,125	15,000
Investments	173,736	208,963
Other assets	2,111	5,606
Total	217,573	274,445

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

The concentrations of assets analysed by geographic regions and industry sectors are as below:

	<i>2010 Assets US\$ '000</i>	<i>2009 Assets US\$ '000</i>
Geographic region:		
Bahrain	96,767	147,367
GCC countries	116,606	129,859
Others	22,623	21,177
Total	235,996	298,403
Industry sector:		
Banks and financial institutions	60,831	63,658
Government	26,581	26,593
Real estate	106,075	161,892
Construction and building materials	18,935	26,337
Others	23,574	19,923
Total	235,996	298,403

As at 31 December 2010, exposures to banks and non banks which exceed 15% of the Group's consolidated capital base amounted to US\$ 129 million (2009: US\$ 189 million).

31 December 2010

19 RISK MANAGEMENT (continued)**Credit Risk (continued)**

The Group's credit risk are managed due to the nature of its financial assets which are asset backed and/or asset based. It is the Group's policy to maintain consistent perceived risk ratings across the investment portfolio. This facilitates management focus on the applicable risks and the comparison of investment exposures across all lines of business, geographic regions and products. The rating system is supported by a variety of financial analytics, combined with processed market information to provide the main inputs for the measurement of counterparty risk. All internal risk ratings are tailored to the various categories and are derived in accordance with the Group's rating policy. The attributable risk ratings are assessed and updated regularly. The Group's holdings are perceived to be rated investment grade or better.

These risk ratings used by the Group are defined as follows:

High investment grade: These borrowers are internally rated between AAA and A-. These are of high credit quality and considered as low risk.

Investment grade: These borrowers are rated internally between BBB+ and BBB-. These are of good credit quality and considered higher risk than the high grade borrowers.

Unrated: These borrowers are not rated internally. They are higher risk than investment grade but full repayments are expected.

Past due or individually impaired: These borrowers are expected to be total loss.

The table below shows the credit quality by class of financial asset, based on the Group's internal credit rating system. The amount presented are gross of impairment provision.

	<i>Neither past due nor impaired</i>			
	<i>High Investment grade 2010 US\$ '000</i>	<i>Investment grade 2010 US\$ '000</i>	<i>Unrated 2010 US\$ '000</i>	<i>Total 2010 US\$ '000</i>
Cash and balances with banks	2,020	423	1,798	4,241
Due from banks	2,700	1,500	4,000	8,200
Mudaraba receivables	-	-	11,389	11,389
Ijarah receivables	4,000	3,771	-	7,771
Financing receivable	-	-	-	-
Investments	15,439	121,650	11,500	148,589
Other assets	160	1,242	196	1,598
	24,319	128,586	28,883	181,788
	<i>Neither past due nor impaired</i>			
	<i>High Investment grade 2009 US\$ '000</i>	<i>Investment grade 2009 US\$ '000</i>	<i>Unrated 2009 US\$ '000</i>	<i>Total 2009 US\$ '000</i>
Cash and balances with banks	1,046	1,778	852	3,676
Due from banks	5,000	18,200	-	23,200
Mudaraba receivable	-	-	8,000	8,000
Ijarah receivable	-	-	10,000	10,000
Financing receivable	-	-	15,000	15,000
Investments	111,610	68,821	21,732	202,163
Other assets	617	4,412	577	5,606
	118,273	93,211	56,161	267,645

31 December 2010

19 RISK MANAGEMENT (continued)**Credit Risk (continued)****Past due but not impaired financial assets**

The following is aging analysis of past due but not impaired assets per class of financial assets, The amount presented are gross of impairment provision;

	<i>Past due but not impaired</i>				<i>Individually impaired assets</i>	<i>Total</i>
	<i>Less than 30 days</i>	<i>31 to 60 days</i>	<i>61 to 90 days</i>	<i>More than 91 days</i>		
	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>		
31 December 2010						
Financing receivable	9,000	-	1,125	-	-	10,125
Investments	11,547	-	-	-	13,600	25,147
Other assets	400	-	-	-	113	513
Total	20,947	-	1,125	-	13,713	35,785
	<i>Past due but not impaired</i>				<i>Individually impaired assets</i>	<i>Total</i>
	<i>Less than 30 days</i>	<i>31 to 60 days</i>	<i>61 to 90 days</i>	<i>More than 91 days</i>		
	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>		
31 December 2009						
Investments	-	-	-	-	6,800	6,800
Total	-	-	-	-	6,800	6,800

Financial assets whose terms have been renegotiated

The financial asset whose terms were renegotiated during the year amounted to US\$ 57.6 million (2009: US\$ 11.55 million).

Collateral and other credit enhancements

The amount and type of collateral depends on an assessment of the credit risk of the counterparty. The types of collateral mainly include charges over real estate properties.

Management monitors the market value of collateral during its review of the adequacy of the allowance for impairment losses.

Liquidity Risk

Liquidity risk is the risk that an institution will be unable to meet its net funding requirements. Liquidity risk can be caused by market disruptions or credit downgrades which may cause certain sources of funding to cease immediately. For STS Program the Bank manages liquidity risk by entering into liquidity support agreements with the shareholders. Also refer note 6 for additional liquidity lines entered into by the Group.

The table below summarises the maturity profile of the Group's financial liabilities based on contractual undiscounted repayment obligations.

	<i>Less than 3</i>		<i>3 to 12</i>	<i>1 to 5 years</i>	<i>Over</i>	<i>Total</i>
	<i>On demand</i>	<i>months</i>	<i>months</i>		<i>5 years</i>	
	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>
31 December 2010						
Due to Short Term						
Sukuk - investors	-	95,222	-	-	-	95,222
Due to banks	-	53,872	20,055	9,375	-	83,302
Investment related						
commitment	580	-	-	-	-	580
Ijara commitment	-	-	5,663	19,800	-	25,463
Total undiscounted financial liabilities	580	149,094	25,718	29,175	-	204,567

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2010

19 RISK MANAGEMENT (continued)

Liquidity Risk (continued)

	<i>On demand</i>	<i>Less than</i>	<i>3 to 12</i>		<i>Over</i>	<i>Total</i>
	<i>US\$ 000</i>	<i>3 months</i>	<i>months</i>	<i>1 to 5 years</i>	<i>5 years</i>	<i>US\$ 000's</i>
		<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>	
<i>31 December 2009</i>						
Due to Short Term						
Sukuk - investors	-	123,674	-	-	-	123,674
Due to banks	-	80,475	1,645	27,173	-	109,293
Investment related						
commitment	580	-	-	-	-	580
Ijara commitment	-	-	5,667	22,668	5,667	34,002
Total undiscounted						
financial liabilities	580	204,149	7,312	49,841	5,667	267,549

Market risk

Market risk is the risk of loss arising from the adverse movement in the level of market prices or rates. The market risk components are foreign exchange risk, profit rate risk and equity risk. The Group's policy guidelines for market risk have been vetted by the Board of Directors in compliance with the rules and guidelines provided by the Central Bank of Bahrain.

The Group's principal investments activity focuses on the GCC countries, a region whose dynamics the Group comprehends well and where the Group has a better understanding of the inherent risks. Investments are made after rigorous qualitative and quantitative analysis, and where the desired risk-return objectives are met. A healthy diversification across industry sectors is maintained within the investments.

i. Foreign exchange risk

This risk refers to the adverse exchange rate movements on foreign currency positions taken by the Group. Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Group considers United States Dollar as its functional currency.

The Group had the following significant net exposures denominated in foreign currencies as of 31 December:

	<i>Equivalent</i>	<i>Equivalent</i>
	<i>Long</i>	<i>Long</i>
	<i>(short)</i>	<i>(short)</i>
	<i>2010</i>	<i>2009</i>
	<i>USD '000</i>	<i>USD '000</i>
Currency		
Pound Sterling	(451)	(448)

As the Bahraini Dinar, Emirates Dirham, Omani Riyals, Saudi Riyals and Qatari riyals is pegged to the US Dollar, positions in those currencies are not considered to represent significant currency risk.

31 December 2010

19 RISK MANAGEMENT (continued)**Market risk (continued)***ii. Profit rate risk*

Profit rate risk refers to the potential impact on the Group's net income or net income margin of equity caused by unexpected changes in rate of returns. Profit rate risk is mitigated by adopting the floating-profit rate approach through close monitoring of the secondary market trading of sukuks and prevailing market expectations on profit rates and yields. The Group's policy is to measure and manage its profit rate sensitivity positions to ensure that the Group's profit rates are optimised and its long-run earning power sustained. The Group reviews the volatility of its assets and liabilities portfolio using appropriate tools and techniques.

The effect on income solely due to reasonably possible immediate and sustained changes in profit return rates, affecting both floating rate assets and liabilities and fixed rate assets and liabilities are as follows:

	2010	2009
	US\$ '000	US\$ '000
<i>Change in rate</i>	<i>Effect on net profit</i>	<i>Effect on net profit</i>
1%	(672)	(286)
(1%)	672	286

iii. Equity risk

Equity risk refers to the adverse movements in the price of equities on equity positions. Equity position is marked to the market prices and monitored by the Risk Management Unit and reported to the Risk Management Committee. Risks arising from dealing and investment activities are managed by the establishment of limits that include trading limits, counterparty limits, as well as product and sub-product limits, i.e. permissible acquisition of BBB rated sukuk and above.

Equity price risk arises from the change in fair values of equity investments. The Bank has investments of US\$ 2.9 million (2009: US\$ 5.5 million) whose fair values are determined through equity indices.

The effect on net income/loss and equity (as a result of a change in the fair value of equity instruments held for trading at 31 December 2010 and 31 December 2009) due to a reasonably possible change in equity indices, with all other variables held constant, is as follows:

Market indices

	<i>Change in equity price</i>	<i>Effect on net income</i>	<i>Effect on equity</i>	<i>Change in equity price</i>	<i>Effect on net income</i>	<i>Effect on equity</i>
	%	US \$ '000	US \$ '000	%	US \$ '000	US \$ '000
		2010	2010		2009	2009
Dubai International						
Financial Exchange	(20)	(64)	(245)	(20)	(66)	(191)
Kuwait Stock Exchange	(20)	(75)	-	(20)	-	-
Doha Stock Exchange	(20)	(22)	-	(20)	-	-
Muscat Securities Market	(20)	(38)	-	(20)	-	-
Saudi Stock Exchange						
(TADAWUL)	(20)	-	-	(20)	(108)	-
Bahrain Stock Exchange	(20)	(147)	-	(20)	(737)	-

31 December 2010

19 RISK MANAGEMENT (continued)

Market risk (continued)

iii. Equity risk (continued)

The Group has US\$ 2.7 million (2009: US\$ 4.4 million) of investments in funds held as available for sale through equity which are carried at cost as their fair value is not significantly different from their book values.

Operational Risk

This risk is defined as the risk of loss arising from inadequate or failed internal processes, people and systems and external events. In managing this risk, a dedicated team has been established within the Bank to undertake the identification, assessment and measurement, establishing a control framework, monitoring and reporting of operational risks.

20 SEGMENTAL INFORMATION

The activities of the Group are performed on an integrated basis. Therefore, any segmentation of operating income, expenses, assets and liabilities is not relevant. As such, operating income, expenses, assets and liabilities are not segmented.

The Group operates solely in the Kingdom of Bahrain and, as such, no geographical segment information is presented.

21 FAIR VALUE OF FINANCIAL INSTRUMENTS

Financial instruments

Financial assets and financial liabilities carried on the consolidated balance sheet include cash and balances with bank, murabaha receivables, ijarah receivable, mudaraba receivable, due from banks, financing receivable, investments, investment in properties, a portion of other assets, due to short term sukuk - investors, due to banks, due to non banks and a portion of other liabilities.

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

The estimated fair value of the Group financial instruments are not significantly different from the carrying value as of 31 December 2010 and 31 December 2009.

22 CAPITAL ADEQUACY

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

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2010

22 CAPITAL ADEQUACY (continued)

The classification of the Group's capital in accordance to the regulatory requirements is as follows:

	2010 <i>US\$ '000</i>	2009 <i>US\$ '000</i>
Tier 1 Capital	50,712	58,140
Tier 2 Capital	247	86
Total Deductions	-	-
Total Eligible Capital	50,959	58,226

The Bank obtained exemption from the Central Bank of Bahrain for certain large exposures which are otherwise required to be deducted from the total eligible capital for capital adequacy purposes.

To assess its capital adequacy requirements in accordance to the CBB requirements, the Group adopts the standardized approach for its Credit Risk, Basic Indicator Approach for its Operational Risk and Standardized Measurement Approach for its Market Risk.

Total Credit Risk Weighted Assets	182,834	200,024
Total Market Risk Weighted Assets	1,550	1,600
Total Operational Risk Weighted Assets	19,298	24,459
Total Regulatory Risk Weighted Assets	203,682	226,083
Capital Adequacy Ratio	25.02%	25.75%

23 EARNINGS AND EXPENSES PROHIBITED BY SHARI'A

During the year there were no earnings realised by the Group from transactions which were not permitted by Shari'a.

24 COMMITMENTS**Investment related commitments**

Investment related commitments represent contractual commitments to fund certain deals. These commitments may expire without being drawn upon and do not necessarily represent future cash flow. As of 31 December 2010 the Group has US\$ 580 thousand (2009: US\$ 580 thousand) of investment related commitment.

Ijarah commitments

The Group has entered into an ijara agreement with a financial institution for the Group's Headquarter. There are no restrictions placed upon the Group. The future ijara rentals are due as follows:

	2010 <i>US\$ '000</i>	2009 <i>US\$ '000</i>
Within one year	4,421	4,421
After one year but not more than five years	17,683	17,683
More than five years	-	4,421
Total	22,104	26,525

31 December 2010

25 SOCIAL RESPONSIBILITY

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

26 COMPARATIVES

Certain prior year amounts have been reclassified to conform to the presentation in the current year. Such reclassifications do not affect previously reported net income or equity.