

**BOUBYAN BANK K.S.C.P. AND SUBSIDIARIES
STATE OF KUWAIT**



**CONSOLIDATED FINANCIAL STATEMENTS
AND INDEPENDENT AUDITORS' REPORT
FOR THE YEAR ENDED 31 DECEMBER 2013**

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INDEPENDENT AUDITORS' REPORT

**To the Shareholders of
Boubyan Bank K.S.C.P.
State of Kuwait**

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Boubyan Bank K.S.C.P. (the "Bank") and its subsidiaries (collectively the "Group"), which comprise the consolidated statement of financial position as at 31 December 2013, and the consolidated statement of profit or loss, consolidated statement of other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

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

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

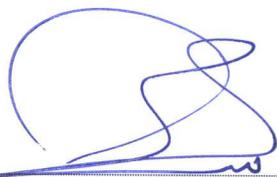
Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2013, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted for use by the State of Kuwait.

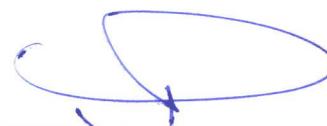
INDEPENDENT AUDITORS' REPORT (Continued)**Report on Other Legal and Regulatory Requirements**

Furthermore, in our opinion proper books of account have been kept by the Bank and the consolidated financial statements, together with the contents of the report of the Bank's Board of Directors relating to these consolidated financial statements, are in accordance therewith. We further report that we obtained all the information and explanations that we required for the purpose of our audit and that the consolidated financial statements incorporate all information that is required by the Capital Adequacy Regulations issued by the Central Bank of Kuwait ("CBK") as stipulated in CBK Circular No 2/RBA/44/2009 dated 15 June 2009, as amended, the Companies Law No. 25 of 2012, as amended, and by the Bank's Memorandum of Incorporation and Articles of Association, as amended, that an inventory was duly carried out and that, to the best of our knowledge and belief, no violations of the Capital Adequacy Regulations issued by the CBK as stipulated in CBK Circular No 2/RBA/44/2009 dated 15 June 2009, as amended, the Companies Law No. 25 of 2012, as amended, or of the Bank's Memorandum of Incorporation and Articles of Association have occurred during the year ended 31 December 2013 that might have had a material effect on the business of the Group or on its consolidated financial position.

We further report that, during the course of our audit, we have not become aware of any violations of the provisions of Law No. 32 of 1968, as amended, concerning currency, the CBK and the organisation of banking business, and its related regulations during the year ended 31 December 2013 that might have had a material effect on the business of the Group or on its consolidated financial position.



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7 January 2014
Kuwait

**BOUBYAN BANK K.S.C.P. AND SUBSIDIARIES
STATE OF KUWAIT**



CONSOLIDATED STATEMENT OF PROFIT OR LOSS
For the year ended 31 December 2013

	Notes	2013 KD'000	2012 KD'000
Income			
Murabaha and other Islamic financing income		70,969	64,670
Distribution to depositors	5	(8,527)	(10,176)
Murabaha cost		(1,700)	(2,023)
Net financing income		60,742	52,471
Net investment income/(loss)	6	962	(522)
Net fees and commission income	7	3,632	3,679
Share of results of associates	16	726	2,364
Net foreign exchange gain		1,010	887
Operating income		67,072	58,879
Staff costs		(18,767)	(17,249)
General and administrative expenses		(10,062)	(9,311)
Depreciation and amortization		(1,699)	(1,911)
Operating expenses		(30,528)	(28,471)
Operating profit before provision for impairment		36,544	30,408
Provision for impairment	8	(23,081)	(20,432)
Operating profit before deductions		13,463	9,976
Contribution to Kuwait Foundation for the Advancement of Sciences ("KFAS")		(127)	(94)
National Labour Support Tax ("NLST")		(348)	(209)
Zakat		(133)	(83)
Board of directors' remuneration		(135)	(54)
Net profit for the year		12,720	9,536
Attributable to:			
Equity holders of the Bank		13,408	10,050
Non-controlling interests		(688)	(514)
Net profit for the year		12,720	9,536
Basic and diluted earnings per share attributable to the equity holders of the Bank (fils)	9	7.29	5.47

The notes from 1 to 32 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF OTHER COMPREHENSIVE INCOME

For the year ended 31 December 2013

	<u>2013</u> <u>KD'000</u>	<u>2012</u> <u>KD'000</u>
Net profit for the year	12,720	9,536
Other comprehensive income		
Other comprehensive income to be reclassified to consolidated statement of profit or loss in subsequent periods:		
Change in fair value of available for sale investments	(2,230)	(2,190)
Net gains on available for sale investments transferred to consolidated statement of profit and loss	(449)	-
Impairment losses on available for sale Investments transferred to consolidated statement of profit and loss	2,115	3,976
Foreign currency translation adjustments	(2,873)	(2,509)
Other comprehensive loss for the year	(3,437)	(723)
Total comprehensive income for the year	9,283	8,813
Attributable to:		
Equity holders of the Bank	9,971	9,327
Non-controlling interests	(688)	(514)
Total comprehensive income for the year	9,283	8,813

The notes from 1 to 32 form an integral part of these consolidated financial statements.

**BOUBYAN BANK K.S.C.P. AND SUBSIDIARIES
STATE OF KUWAIT**



CONSOLIDATED STATEMENT OF FINANCIAL POSITION
As at 31 December 2013

	Notes	2013 KD'000	2012 KD'000
Assets			
Cash and cash equivalents	10	205,622	169,530
Due from banks	11	298,871	251,625
Islamic financing to customers	12	1,478,701	1,270,014
Financial assets at fair value through profit or loss	13	5,866	51,293
Available for sale investments	14	63,044	99,929
Investments in associates	16	85,691	9,082
Investment properties	17	30,245	17,904
Other assets	18	13,994	7,916
Property and equipment		9,952	7,363
Total assets		2,191,986	1,884,656
Liabilities and Equity			
Liabilities			
Due to banks		236,018	207,133
Depositors' accounts		1,657,398	1,396,962
Other liabilities	19	29,083	24,397
Total liabilities		1,922,499	1,628,492
Equity			
Share capital	20	183,645	174,824
Share premium	21	62,896	62,896
Proposed bonus shares	22	12,855	8,741
Treasury shares	23	(1,100)	(1,024)
Statutory reserve	24	3,306	1,891
Voluntary reserve	25	3,167	1,813
Share based payment reserve	26	860	537
Fair value reserve		2,857	3,421
Foreign currency translation reserve		(7,746)	(4,873)
Retained earnings		3,204	5,424
Equity attributable to equity holders of the Bank		263,944	253,650
Non-controlling interests		5,543	2,514
Total equity		269,487	256,164
Total liabilities and equity		2,191,986	1,884,656

Mahmoud Yousif Al-Fulaij
Chairman

Adel Abdul Wahab Al Majed
Vice Chairman & Chief Executive Officer

The notes from 1 to 32 form an integral part of these consolidated financial statements.

**BOUBYAN BANK K.S.C.P. AND SUBSIDIARIES
STATE OF KUWAIT**



CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
For the year ended 31 December 2013

	Share capital	Share premium	Proposed bonus shares	Treasury shares	Statutory reserve	Voluntary reserve	Share based payment reserve	Fair value reserve	Foreign currency translation reserve	Retained earnings	Equity attributable to equity holders of the Bank	Non-controlling interests	Total equity
	KD'000	KD'000	KD'000	KD'000	KD'000	KD'000	KD'000	KD'000	KD'000	KD'000	KD'000	KD'000	KD'000
Balance at 1 January 2013	174,824	62,896	8,741	(1,024)	1,891	1,813	537	3,421	(4,873)	5,424	253,650	2,514	256,164
Total comprehensive income for the year	-	-	-	-	-	-	-	(564)	(2,873)	13,408	9,971	(688)	9,283
Transfer to reserves	-	-	-	-	1,415	1,354	-	-	-	(2,769)	-	-	-
Issued of bonus shares (note 22)	8,745	-	(8,741)	-	-	-	-	-	-	(4)	-	-	-
Proposed bonus shares (note 22)	-	-	12,855	-	-	-	-	-	-	(12,855)	-	-	-
Issue of share capital	76	-	-	(76)	-	-	-	-	-	-	-	-	-
Share based payment (note 26)	-	-	-	-	-	-	323	-	-	-	323	-	323
Net movement in non-controlling interests	-	-	-	-	-	-	-	-	-	-	-	3,717	3,717
Balance at 31 December 2013	183,645	62,896	12,855	(1,100)	3,306	3,167	860	2,857	(7,746)	3,204	263,944	5,543	269,487
Balance at 1 January 2012	174,824	62,896	-	(1,024)	842	802	253	1,635	(2,364)	6,381	244,245	2,923	247,168
Total comprehensive income for the year	-	-	-	-	-	-	-	1,786	(2,509)	10,050	9,327	(514)	8,813
Transfer to reserves	-	-	-	-	1,049	1,011	-	-	-	(2,060)	-	-	-
Proposed bonus shares (note 22)	-	-	8,741	-	-	-	-	-	-	(8,741)	-	-	-
Acquisition of non-controlling interests	-	-	-	-	-	-	-	-	-	(206)	(206)	(888)	(1,094)
Share based payment (note 26)	-	-	-	-	-	-	284	-	-	-	284	-	284
Net movement in non-controlling interests	-	-	-	-	-	-	-	-	-	-	-	993	993
Balance at 31 December 2012	174,824	62,896	8,741	(1,024)	1,891	1,813	537	3,421	(4,873)	5,424	253,650	2,514	256,164

The notes from 1 to 32 form an integral part of these consolidated financial statements.

**BOUBYAN BANK K.S.C.P. AND SUBSIDIARIES
STATE OF KUWAIT**



CONSOLIDATED STATEMENT OF CASH FLOWS
For the year ended 31 December 2013

		2013	2012
	Notes	KD'000	KD'000
OPERATING ACTIVITIES			
Net profit for the year		12,720	9,536
Adjustments for:			
Provision for impairment	8	23,081	20,432
Depreciation and amortization		1,699	1,911
Foreign currency translation adjustments		(1,270)	(2,468)
Net (gain)/loss from available for sale investments		(314)	97
Net losses from financial assets at fair value through profit or loss		876	14,510
Share of results of associates		(726)	(2,364)
Unrealised profit on interest retained subsequent to loss of significant influence		-	(18,087)
Realized profit from partial disposal of associate		-	(5,703)
Dividend income		(1,397)	(872)
Net unrealized loss from change in fair value of investment properties		1,712	5,026
Loss on sale of investment properties		34	7,433
Share based payment reserve		323	284
Operating profit before changes in operating assets and liabilities		36,738	29,735
Changes in operating assets and liabilities:			
Due from banks		(47,246)	(128,384)
Islamic financing to customers		(242,762)	(256,010)
Other assets		(5,683)	(757)
Due to banks		28,885	128,147
Depositors' accounts		260,609	194,535
Other liabilities		4,672	5,877
Dividend income received		1,397	872
Net cash generated from (used in) operating activities		36,610	(25,985)
INVESTING ACTIVITIES			
Purchase of financial assets at fair value through profit or loss		(966)	(1,990)
Proceeds from sale of financial assets at fair value through profit or loss		6,453	2,596
Purchase of available for sale investments		(7,660)	(6,754)
Proceeds from sale of available for sale investments		6,504	6,936
Dividends received from associates		286	290
Acquisition of associates	16	(3,436)	-
Proceeds from disposals of investment in associates		-	9,638
Purchase of investment properties		(3,155)	(3,961)
Proceeds from sale of investments properties		5,744	-
Purchase of property and equipment		(4,288)	(3,096)
Acquisition of non-controlling interests		-	(1,094)
Net cash (used in) generated from investing activities		(518)	2,565
FINANCING ACTIVITIES			
Movement in non-controlling interests		-	993
Net cash generated from financing activities		-	993
Net decrease in cash and cash equivalents		36,092	(22,427)
Cash and cash equivalents at the beginning of the year		169,530	191,957
Cash and cash equivalents at the end of the year	10	205,622	169,530

The notes from 1 to 32 form an integral part of these consolidated financial statements.

1. INCORPORATION AND ACTIVITIES

Boubyan Bank K.S.C.P (“the Bank”) is a Kuwaiti public shareholding company incorporated on 21 September 2004, in accordance with the Commercial Companies Law in the State of Kuwait, by Amiri Decree No. 88 and in accordance with the rules and regulations of the Central Bank of Kuwait (“CBK”) (Law No. 30 of 2003).

The Bank’s shares were listed on the Kuwait Stock Exchange on 15 May 2006.

The Bank was licensed by the CBK on 28 November 2004. The Bank is principally engaged in providing banking services, in accordance with Codes of the Islamic Sharia’a, as approved by the Bank’s Sharia’a Supervisory Board.

The Bank is a subsidiary of National Bank of Kuwait S.A.K.P (“the Parent Company”).

The total number of employees in the Group was **901** employees as at 31 December 2013 (807 employees as at 31 December 2012).

The address of the Bank’s registered office is P.O. Box 25507, Safat 13116, State of Kuwait.

The consolidated financial statements were authorised for issue by the Board of Directors on 7 January 2014 and the shareholders have the power to amend these consolidated financial statement at the annual assembly meeting.

2. BASIS OF PREPARATION

2.1 Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRSs”) promulgated by the International Accounting Standards Board (“IASB”) and interpretations issued by the International Financial Reporting Interpretations Committee of the IASB, as adopted for use by the State of Kuwait for financial services institutions regulated by the CBK. These regulations require adoption of all IFRSs except for the IAS 39 requirements for collective impairment provision, which has been replaced by the CBK requirements for a minimum general provision as described in accounting policy 3.10.1.

2.2 Basis of measurement

The consolidated financial statements have been prepared under the historical cost basis except for the measurement at fair value of investment securities other than held to maturity investments and investment properties.

2.3 Functional and presentation currency

These consolidated financial statements are presented in Kuwaiti Dinars, which is the Bank’s functional currency. All financial information presented in Kuwaiti Dinars (“KD”) has been rounded to the nearest thousands, except when otherwise indicated.

2.4 New standards, interpretations and amendments effective from 1 January 2013

New and revised IFRSs affecting amounts reported and/or disclosures in the financial statements

The accounting policies adopted are consistent with those of the previous financial year, except for the adoption of the following new standards and amendments to IFRS’s effective as of 1 January 2013:

2. BASIS OF PREPARATION (CONTINUED)

2.4 New standards, interpretations and amendments effective from 1 January 2013 (continued)

IFRS 10 - Consolidated Financial Statements:

IFRS 10, which is effective 1 January 2013, replaces the consolidation guidance in IAS 27 Consolidated and Separate Financial Statements and SIC-12 Consolidation - Special Purpose Entities by introducing a single consolidation model for all entities based on control, irrespective of the nature of the investee (i.e., whether an entity is controlled through voting rights of investors or through other contractual arrangements as is common in special purpose entities). Under IFRS 10, control is based on whether an investor has 1) power over the investee; 2) exposure or rights, to variable returns from its involvement with the investee; and 3) the ability to use its power over the investee to affect the amount of the returns. The adoption of this standard did not have material impact on the financial performance or financial position of the Group.

IFRS 12 - Disclosure of Interests in Other Entities:

IFRS 12, requires enhanced disclosures about both consolidated entities and unconsolidated entities in which an entity has involvement. The objective of IFRS 12 is to require information so that financial statement users may evaluate the basis of control, any restrictions on consolidated assets and liabilities, risk exposures arising from involvements with unconsolidated structured entities and non-controlling interest holders' involvement in the activities of consolidated entities. IFRS 12 disclosures are presented in the consolidated financial statements of the Group.

IFRS 13 - Fair Value Measurement

The Group has applied IFRS 13 for the first time in the current year. IFRS 13 establishes a single source of guidance for fair value measurements and disclosures about fair value measurements. The scope of IFRS 13 is broad; the fair value measurement requirements of IFRS 13 apply to both financial instrument items and non-financial instrument items for which other IFRSs require or permit fair value measurements and disclosures about fair value measurements. except for share-based payment transactions that are within the scope of IFRS 2 *Share-based Payment*, leasing transactions that are within the scope of IAS 17 *leases* and measurements that have some similarities to fair value but are not fair value (e.g. net realisable value for the purposes of measuring inventories or value in use for impairment assessment purposes).

IFRS 13 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions. Fair value under IFRS 13 is an exit price regardless of whether that price is directly observable or estimated using another valuation technique. Also, IFRS 13 includes extensive disclosure requirements.

IFRS 13 requires prospective application from 1 January 2013. In addition, specific transitional provisions were given to entities such that they need not apply the disclosure requirements set out in the Standard in comparative information provided for periods before the initial application of the Standard. (Please see notes 17 and 30.6 for the 2013 disclosures). Other than the additional disclosures, the application of IFRS 13 has not had any material impact on the amounts recognized in the consolidated financial statements.

Amendments to IAS 1 Presentation of Items of Other Comprehensive Income

The Group has applied the amendments to IAS 1 Presentation of Items of Other Comprehensive Income for the first time in the current year. The amendments introduce new terminology whose use is not mandatory, for the statement of comprehensive income and statement of profit or loss.

2. BASIS OF PREPARATION (CONTINUED)

2.4 New standards, interpretations and amendments effective from 1 January 2013 (continued)

Amendments to IAS 1 - Presentation of Items of Other Comprehensive Income (continued)

The amendments to IAS 1 retain the option to present profit or loss and other comprehensive income in either a single statement or in two separate but consecutive statements.

However, the amendments to IAS 1 require items of other comprehensive income to be grouped into two categories in the other comprehensive income section: (a) items that will not be reclassified subsequently to profit or loss and (b) items that may be reclassified subsequently to profit or loss when specific conditions are met. The amendments have been applied retrospectively, and hence the presentation of items of other comprehensive income has been modified to reflect the changes. Other than the above mentioned presentation changes, the application of the amendments to IAS 1 does not result in any impact on profit or loss, other comprehensive income and total comprehensive income.

IAS 28 - Investments in Associates and Joint Ventures (as revised in 2011)

As a consequence of the new IFRS 11 Joint Arrangements and IFRS 12 Disclosure of Interests in Other Entities, IAS 28 Investments in Associates, has been renamed IAS 28 Investments in Associates and Joint Ventures, and describes the application of the equity method to investments in joint ventures in addition to associates. The adoption of this standard did not have any impact on the financial performance, financial position or disclosures in the consolidated financial statements of the Group.

2.5 New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are effective for annual periods beginning after 1 January 2013, and have not been applied in preparing these consolidated financial statements. None of these are expected to have a significant effect on the consolidated financial statements of the Group, except for IFRS 9 - Financial Instruments,

IFRS 9 'Financial Instruments':

The standard was issued in November 2009, however at the IASB meeting in July 2013, the IASB tentatively decided to defer the mandatory effective date of IFRS 9 to be left open. However, IFRS 9 would still be available for early application. The extent of the impact has not yet been determined, classification categories, measurement and associated impairment methods. The application of IFRS 9 will result in amendments and additional disclosures relating to financial instruments and associated risks.

3. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements, and have been applied consistently by all of the Group's entities.

3.1 Basis of consolidation

The consolidated financial statements comprise the Bank and its subsidiaries (collectively "the Group")- Boubyan Takaful Insurance Company K.S.C. and Boubyan Capital Investment Company K.S.C., which are controlled by the Bank as set out in note 15.

3.1.1 Business combinations

Business combinations are accounted for using the acquisition method as at the acquisition date, which is the date on which control is transferred to the Group. The Group controls an investee if and only if the Group has:

- Power over the investee (i.e. existing rights that give it the current ability to direct the relevant activities of the investee)
- Exposure, or rights, to variable returns from its involvement with the investee, and
- The ability to use its power over the investee to affect its returns

When the Group has less than a majority of the voting or similar rights of an investee, the Group considers all relevant facts and circumstances in assessing whether it has power over an investee, including:

- The contractual arrangement with the other vote holders of the investee
- Rights arising from other contractual arrangements
- The Group's voting rights and potential voting rights

The Group measures goodwill at the acquisition date as:

- The fair value of the consideration transferred; plus
- The recognised amount of any non-controlling interests in the acquiree; plus
- If the business combination is achieved in stages, the fair value of the pre-existing equity interest in the acquiree; less
- The net recognised amount of the identifiable assets acquired and liabilities assumed.

When the excess is negative, a bargain purchase gain is recognised immediately in consolidated statement of profit or loss.

Transactions costs, other than those associated with the issue of debt or equity securities, that the Group incurs in connection with a business combination are expensed as incurred.

3.1.2 Non-controlling interests

Interest in the equity of subsidiaries not attributable to the Group is reported as non-controlling interest in the consolidated statement of financial position. Non-controlling interest in the acquiree is measured at the proportionate share in the recognized amount of the acquiree's identifiable net assets. Losses are allocated to the non-controlling interest even if they exceed the non-controlling interest's share of equity in the subsidiary. Transactions with non-controlling interests are treated as transactions with equity owners of the Group. Gains or losses on disposals of non-controlling interests without loss of control are recorded in equity.

3.1.3 Subsidiaries

Subsidiaries are entities controlled by the Group. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. Where necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies in line with those used by the Bank.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.1 Basis of consolidation (continued)

3.1.4 *Loss of control*

On loss of control, the Group derecognises the assets and liabilities of the subsidiary, any non-controlling interests and the other components of equity related to the subsidiary. Any surplus or deficit arising on loss of control is recognised in the consolidated statement of profit or loss. If the Group retains any interest in the previous subsidiary, then such interest is measured at fair value at the date that control is lost. Subsequently it is accounted for as an equity-accounted investee or as a financial asset depending on the level of influence retained.

3.1.5 *Investments in associates (equity-accounted investees)*

Associates are those entities in which the Group has significant influence, but not control, over the financial and operating policies. Significant influence is presumed to exist when the Group holds between 20% and 50% of the voting right.

Investments in associates are accounted for using the equity method and are recognised initially at cost. The cost of the investment includes transaction costs.

The Group recognises in the consolidated statement of profit or loss its share of the total recognised profit or loss of the associate from the date that influence effectively commences until the date that it effectively ceases. Distributions received from the associate reduce the carrying amount of the investments. Adjustments to the carrying amount may also be necessary for changes in Group's share in the associate arising from changes in the associate's equity and other comprehensive income. The Group's share of those changes is recognised directly in equity or in other comprehensive income as appropriate.

When the Group's share of losses exceeds its interest in an equity-accounted investee, the carrying amount of the investment, including any long-term interests that form part thereof, is reduced to zero, and the recognition of further losses is discontinued except to the extent that the Group has an obligation or has made payments on behalf of the investee.

Any excess of the cost of acquisition over the Group's share of the net fair value of the identifiable assets and liabilities of the associate at the date of acquisition is recognized as goodwill within the carrying amount of the associates.

Any excess of the Group's share of the net fair value of the identifiable assets and liabilities over the cost of acquisition, after reassessment, is recognized immediately in the consolidated statement of profit or loss.

Unrealised gains arising from transactions with associates are eliminated against the investment to the extent of the Group's interest in the associate. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

3.1.6 *Transactions eliminated on consolidation*

Intra-group balances and transactions, and any unrealised income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

3.2 Foreign currency

The individual financial statements of each group entity are presented in the currency of the primary economic environment in which the entity operates (its functional currency).

Foreign currency transactions are recorded in the functional currency at the rate of exchange prevailing at the date of the transaction.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.2 Foreign currency (continued)

Exchange differences arising on the settlement of monetary items, and on the translation of monetary items, are included in the consolidated statement of profit or loss for the year. Exchange differences arising on the translation of non-monetary items carried at fair value are included in the consolidated statement of profit or loss for the year, except for differences arising on the translation of non-monetary items in respect of which gains and losses are recognised directly in other comprehensive income. For such non-monetary items, any exchange component of that gain or loss is also recognised directly in other comprehensive income.

For the purpose of presenting consolidated financial statements, the assets and liabilities of the Group's foreign operations are expressed in KD using exchange rates prevailing on the reporting date. Income and expense items are translated at the average exchange rates for the year. Exchange differences arising, if any, are classified as other comprehensive income and transferred to the Group's foreign currency translation reserve. Such translation differences are recognised in the consolidated statement of profit or loss in the year in which the foreign operation is disposed off.

3.3 Revenue recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised.

- Income from Murabaha, Wakala, and Leased assets is recognized on a pattern reflecting a constant periodic return on the outstanding net investment.
- Dividend income is recognized when the right to receive payment is established.
- Fees and commission income is recognized at the time the related services are provided.
- Rental income from investment properties is recognised on a straight line basis over the lease period.

3.4 Financial instruments

3.4.1 Financial assets

Trade and settlement date accounting

All regular way purchase and sale of financial assets are recognized using settlement date accounting. Changes in the fair value between trade date and settlement date are recognized in the consolidated statement of profit or loss for financial assets at fair value through profit or loss and are recognized in other comprehensive income for available for sale investments. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulations or conventions in the market place.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.4 Financial instruments (continued)

3.4.1 Financial assets (continued)

Recognition and derecognition of financial assets

Financial assets are recognised when the Group becomes party to contractual provisions of the instrument and are initially measured at fair value. Transaction costs are included only for those financial instruments that are not measured at fair value through profit or loss.

The Group derecognises a financial asset only when the contractual rights to the cash flows from the asset expire; or it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. If the Group neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Group recognizes its retained interest in the asset and an associated liability for amounts it may have to pay. If the Group retains substantially all the risks and rewards of ownership of a transferred financial asset, the Group continues to recognize the financial asset and also recognizes a liability for the proceeds received.

Offsetting

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

Income and expenses are presented on a net basis only if it is so permitted by the accounting standards, or for gains and losses arising from a group of similar transactions.

The Group classifies financial assets into the following categories: cash and cash equivalents, due from banks, Islamic financing to customers, financial assets at fair value through profit or loss, available for sale investments and other assets.

Cash and cash equivalents

Cash and cash equivalents consist of cash in hand, current account with other banks and placements with banks maturing within seven days.

Due from banks and Islamic financing to customers

Due from banks and Islamic financing to customers are financial assets with fixed or determinable payments that are not quoted in an active market.

Murabaha

Murabaha is an agreement relating to the sale of commodities at cost plus an agreed upon profit margin, whereby the seller informs the buyer of the price at which the deal will be completed and also the amount of profit to be recognized. Murabaha is a financial asset originated by the Group and is stated at amortized cost net of provision for impairment.

Wakala

Wakala is an agreement involving Al-Muwakkil (the Principal) who wishes to appoint Al-Wakil (the Agent) to be his agent with respect to the investment of Al-Muwakkil's fund, in accordance with regulations of the Islamic Sharia'a. Wakala is a financial asset originated by the Group and is stated at amortized cost net of provision for impairment.

Leased assets - the Group as a lessor

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating lease. Leased assets are stated at amounts equal to the net investment outstanding in the leases less provision for impairment.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.4 Financial instruments (continued)

3.4.1 Financial assets (continued)

Renegotiated finance facilities

In the event of a default, the Group seeks to restructure facilities rather than take possession of collateral. This may involve extending the payment arrangements and the agreement of new facility conditions. When the terms and conditions of these finance facilities are renegotiated, the terms and conditions of the new contractual arrangement apply in determining whether these facilities remain past due. Management continually reviews renegotiated facilities to ensure that all criteria are met and that future payments are likely to occur. The facility continues to be subject to an individual or collective impairment assessment.

Financial assets at fair value through profit or loss

A financial asset is classified as at fair value through profit or loss if it is classified as held for trading or is designated as such on initial recognition. Financial assets are designated as at fair value through profit or loss if the Group manages such investments and makes purchase and sale decisions based on their fair value in accordance with the Group's strategy or such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise.

Attributable transaction costs are recognised in consolidated statement of profit or loss as incurred. Financial assets at fair value through profit or loss are measured at fair value and changes therein, which takes into account any dividend income, are recognised in consolidated statement of profit or loss.

Available-for-sale investment

Available-for-sale investment is non-derivative financial assets that are not classified in any of the above categories of financial assets.

Available-for-sale investment is recognised initially at fair value plus any directly attributable transaction costs.

Subsequent to initial recognition, they are measured at fair value and changes therein, other than impairment losses (see note 3.10.1) and foreign currency differences on available-for-sale debt instruments, are recognised in other comprehensive income and presented in the fair value reserve in equity. When an investment is derecognised or is determined to be impaired, the gain or loss accumulated in equity is reclassified to consolidated statement of profit or loss.

3.4.2 Financial liabilities

All financial liabilities are recognised initially on the settlement date at fair value less any directly attributable transaction costs. Subsequent to initial recognition, these financial liabilities are measured at amortised cost.

The Group derecognises a financial liability when its contractual obligations are discharged, cancelled or expire.

Financial liabilities comprise due to banks, depositors' accounts and other liabilities.

Due to banks and depositors' accounts

Depositors' accounts are deposits received from customers under current account, saving investment accounts and fixed term investments accounts. The depositors' accounts of the Bank comprise the following:

- i) Non-investment deposits in the form of current accounts. These deposits are not entitled to any profits nor do they bear any risk of loss as the Bank guarantees to pay the related balances on demand. Accordingly, these deposits are considered Qard Hassan from depositors to the Bank under Islamic Sharia'a principals. Investing such Qard Hassan is made at the discretion of the Group, the results of which are attributable to the equity shareholders of the Bank.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.4 Financial instruments (continued)

3.4.2 Financial liabilities (continued)

Due to banks and depositors' accounts (continued)

ii) Investment deposit accounts include savings accounts, fixed term deposit accounts, and open term deposit accounts.

Saving Investment Accounts

These are open-term deposits and the client is entitled to withdraw the balances of these accounts or portions thereof at any time.

Fixed-Term Deposit Investment Accounts

These are fixed-term deposits based on the deposit contract executed between the Bank and the depositor. These deposits mature monthly, quarterly, semi-annually, or annually.

Open –Term Deposit Investment Accounts

These are open-term deposits and are treated as annual deposits renewed automatically for a similar period, unless the depositor notifies the Bank in writing of his/her desire not to renew the deposit.

In all cases, investment accounts receive a proportion of profit, bear a share of loss and are carried at cost plus profit payable.

3.5 Fair values

For investments traded in organized financial markets, fair value is determined by reference to stock exchange quoted market bid prices on the reporting date.

For investments where there is no quoted market price, a reasonable estimate of the fair value is determined by reference to an earnings multiple, or an industry specific earnings multiple or a fair value based on a similar publicly traded company, or based on the expected cash flows of the investments.

Available for sale investments with no reliable measures of their fair values are carried at their initial cost less impairment losses, if any.

Information about the valuation techniques and inputs used in determining the fair value of various assets and liabilities are disclosed in note 30.

3.6 Derivative

Derivative instruments are initially recognised in the consolidated statement of financial position at cost (including transaction costs) and subsequently measured at their fair value.

The Group enters into foreign exchange forward contracts. Forward foreign exchange contracts are contractual agreements to buy or sell a specified financial instrument at a specific price and date in the future. Derivatives are stated at fair value. The fair value of a derivative includes unrealised gain or loss from marking to market the derivative using prevailing market rates or internal pricing models. Derivatives with positive market values (unrealised gains) are included in other assets and derivatives with negative market values (unrealised losses) are included in other liabilities in the consolidated statement of financial position.

The resultant gains and losses from derivatives are included in the consolidated statement of profit or loss.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.7 Investment properties

Investment properties are properties held either to earn rental income or for capital appreciation or for both, but not for sale in the ordinary course of business, use in the production or supply of goods or services or for administrative purposes. Investment property is measured at cost on initial recognition and subsequently at fair value with any change therein recognised in consolidated statement of profit or loss. Cost includes expenditure that is directly attributable to the acquisition of the investment property.

Fair values of investment properties are determined by appraisers having an appropriate recognised professional qualification and recent experience in the location and category of the property being valued.

Any gain or loss on disposal of an investment property (calculated as the difference between the net proceeds from disposal and the carrying amount of the item) is recognised in consolidated statement of profit or loss.

When the use of a property changes such that it is reclassified as property and equipment, its fair value at the date of reclassification becomes its cost for subsequent accounting.

3.8 Property and equipment

Items of property and equipment are measured at cost less accumulated depreciation and accumulated impairment losses. The initial cost of property and equipment comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use.

Subsequent expenditure is capitalised only when it is probable that the future economic benefits associated with the expenditure will flow to the Group. On-going repairs and maintenance is expensed as incurred.

Items of property and equipment are depreciated on a straight-line basis in consolidated statement of profit or loss over the estimated useful lives of each component

The estimated useful lives for the current and comparative years of significant items of property and equipment are as follows:

- Furniture and leasehold improvement 5 years
- Office equipment 3 years
- Building on leasehold land 20 years

Depreciation methods, useful lives and residual values are reviewed periodically and adjusted, if appropriate.

3.9 Intangible assets

Intangible assets acquired separately, which consist of software that have finite useful lives, are reported at cost less accumulated amortization and accumulated impairment losses. Software amortization is charged on a straight-line basis over its estimated useful life of 10 years. The estimated useful life and amortization method are reviewed at the end of each annual reporting period, with the effect of any changes in estimates being accounted for on a prospective basis.

3.10 Impairment

3.10.1 Financial assets

The Group assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred loss event) and that loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. If such evidence exists, any impairment loss is recognised in the consolidated statement of profit or loss.

Financial assets measured at amortised cost

The amount of impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective yield. Losses are recognised in the consolidated statement of profit or loss and reflected in an allowance account against Islamic financing to customers. When an event occurring after the impairment was recognised causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through the consolidated statement of profit or loss.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.10 Impairment (continued)

3.10.1 *Financial assets (continued)*

In addition, in accordance with CBK instructions, a minimum general provision of 1% for the cash facilities and 0.5% for the non-cash facilities, net of certain categories of collateral, to which CBK instructions are applicable and not subject to specific provisions is made. In March 2007, CBK issued a circular amending the basis of calculating general provisions on facilities changing the rate from 2% to 1% for cash facilities and from 1% to 0.5% for non-cash facilities. The required rates were to be applied effective from 1 January 2007 on the net increase in facilities, net of certain categories of collateral, during the reporting period. The general provision in excess of the present 1% for cash facilities and 0.5% for non-cash facilities as of 31 December 2006 would be retained as a general provision until a further directive from the CBK is issued.

Available for sale investment

Impairment losses on available for sale investment are recognised by reclassifying the losses accumulated in the fair value reserve in equity to consolidated statement of profit or loss. The cumulative loss that is reclassified from equity to consolidated statement of profit or loss is the difference between the acquisition cost, net of any principal repayment and amortisation, and the current fair value, less any impairment loss recognised previously in consolidated statement of profit or loss. If, in a subsequent period, the fair value of an impaired available-for-sale debt security increases and the increase can be related objectively to an event occurring after the impairment loss was recognised, then the impairment loss is reversed, with the amount of the reversal recognised in consolidated statement of profit or loss. However, any subsequent recovery in the fair value of an impaired available-for-sale equity security is recognised in other comprehensive income.

3.10.2 *Non-financial assets*

At each reporting date, the Group reviews the carrying amounts of its non-financial assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs. Where a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual cash-generating units, or otherwise they are allocated to the smallest group of cash-generating units for which a reasonable and consistent allocation basis can be identified.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a discount rate that reflects current market rates and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised immediately in consolidated statement of profit or loss, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

For non-financial assets excluding goodwill, an assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. Where an impairment loss is subsequently reversed, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount and is limited to the carrying amount that would have been determined had no impairment loss been recognized for the asset (cash-generating unit) in prior years. A reversal of impairment loss is recognized immediately in the consolidated statement of profit or loss, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.11 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. Provisions are reviewed at each financial reporting date and adjusted to reflect the current best estimate of the expenditure required to settle the obligation at the financial reporting date and are discounted to present value where the effect is material.

3.12 Contingent liabilities and contingent assets

Contingent liabilities are not recognized in the consolidated financial statements. They are disclosed in the notes of the consolidated financial statements, unless the possibility of an outflow of resources embodying economic benefits is remote.

Contingent assets are not recognized in the consolidated financial statements but are disclosed when an inflow of economic benefits is probable

3.13 Share based payment

The Bank operates an equity settled share based compensation plan. The fair value of the employee services received in exchange for the grant of options or shares is recognized as an expense, together with a corresponding increase in equity. The total amount to be expensed over the vesting period is determined by reference to the fair value of the options or shares on the date of grant using the Black Scholes model. At each reporting date, the Group revises its estimates of the number of options that are expected to become exercisable. It recognises the impact of the revision of original estimates, if any, in the consolidated statement of profit or loss, with a corresponding adjustment to equity.

3.14 Segment reporting

Operating segments are identified on the basis of internal reports that are regularly reviewed by the decision makers in order to allocate resources to the segments and to assess their performance. Such operating segments are classified as either business segments or geographical segments.

A business segment is a distinguishable component of the Group that is engaged in providing products or services, which is subject to risks and returns that are different from those of other segments.

A geographic segment is a distinguishable component of the Group that is engaged in providing products or services within a particular economic environment which is subject to risks and returns different from those of segments operating in other economic environments.

3.15 Treasury shares

Treasury shares consist of the Bank's own shares that have been issued, subsequently reacquired by the Bank and not yet reissued or cancelled. The treasury shares are accounted for using the cost method. Under the cost method, the weighted average cost of the shares reacquired is charged to a contra equity account. When the treasury shares are reissued, gains are credited to a separate account in equity (treasury shares reserve) which is not distributable. Any realised losses are charged to the same account to the extent of the credit balance on that account. Any excess losses are charged to retained earnings then reserves. Gains realised subsequently on the sale of treasury shares are first used to offset any previously recorded losses in the order of reserves, retained earnings and the gain on sale of treasury shares account.

No cash dividends are paid on these shares. The issue of bonus shares increases the number of treasury shares proportionately and reduces the average cost per share without affecting the total cost of treasury shares.

3.16 Kuwait Foundation for the Advancement of Sciences (KFAS)

The Bank calculates the contribution to KFAS at 1% in accordance with the calculation based on the Foundation's Board of Directors resolution.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.17 National Labour Support Tax (NLST)

The Bank calculates the NLST in accordance with Law No. 19 of 2000 and the Minister of Finance Resolutions No. 24 of 2006 at 2.5% of taxable profit for the year. Cash dividends from listed companies which are subjected to NLST are deducted from the profit for the year to determine the taxable profit.

3.18 Zakat

Effective from 10 December 2007, the Bank has provided for Zakat in accordance with the requirements of Law No. 46 of 2006. The Zakat charge calculated in accordance with these requirements is charged to the consolidated statement of profit and loss.

3.19 Financial guarantees

In the ordinary course of business, the Group gives financial guarantees, consisting of letters of credit, guarantees and acceptances. Financial guarantees are initially recognized as a liability at fair value, adjusted for transaction costs that are directly attributable to the issuance of the guarantee. Subsequently, the liability is measured at the higher of the best estimate of the expenditure required to settle the present obligation at the reporting date and the amount recognized less cumulative amortization.

3.20 Fiduciary assets

The Group provides trust and other fiduciary services that result in the holding or investing of assets on behalf of its customers. Assets held in trust or in a fiduciary capacity are not treated as assets of the Group and accordingly are not included in the consolidated statement of financial position. These are disclosed separately in the consolidated financial statements.

4. CRITICAL ACCOUNTING JUDGMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY

4.1 Critical judgments in applying the Group's accounting policies

In the process of applying the Group's accounting policies, management has made the following judgments, apart from those involving estimations, which have the most significant effect in the amounts recognized in the consolidated financial statements:

Classification of investments

Management decides on acquisition of an investment whether to classify it as held to maturity, available for sale or financial asset at fair value through profit or loss.

In designating financial assets at fair value through profit or loss, the Group determines if it meets one of the criteria for this designation set out in the significant accounting policies (see note 3).

Impairment of investments

The Group treats available for sale equity investments as impaired when there has been a significant or prolonged decline in the fair value below its cost or where other objective evidence of impairment exists. The determination of what is "significant" or "prolonged" requires considerable judgement. In addition, the Group evaluates other factors, including normal volatility in share price for quoted equities and the future cash flows and the discount factors for unquoted equities.

4. CRITICAL ACCOUNTING JUDGMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY (CONTINUED)

4.1 Critical judgments in applying the Group's accounting policies (continued)

Fair value hierarchy

As disclosed in note 30, the Group is required to determine and disclose the level in the fair value hierarchy into which the fair value measurements are categorized in their entirety, segregating fair value measurements in accordance with the levels defined in IFRS. Differentiating between Level 2 and Level 3 fair value measurements, i.e., assessing whether inputs are observable and whether the unobservable inputs are significant, may require judgement and a careful analysis of the inputs used to measure fair value, including consideration of factors specific to the asset or liability.

4.2 Key sources of estimation uncertainty

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

Impairment losses on finance facilities

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

Valuation of unquoted equity investments

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

- Recent arm's length market transactions;
- Current fair value of another instrument that has substantially the same characteristics; or
- Other valuation models.

The determination of the cash flows and discount factors for unquoted equity investments requires significant estimation.

5. DISTRIBUTION TO DEPOSITORS

The Bank determines and distributes the depositors' share of profit based on the Bank's results at the end of each month.

6. NET INVESTMENT INCOME/(LOSS)

	<u>2013</u>	<u>2012</u>
	KD'000	KD'000
Sukuk coupon income	1,545	1,687
Dividend income	1,397	872
Net rental income from investment properties	328	195
Net losses from financial assets at fair value through profit or loss	(876)	(14,510)
Net gains/(loss) from available for sale investment	314	(97)
Losses on sale of investment properties	(34)	(7,433)
Unrealized loss from changes in fair value of investment properties	(1,712)	(5,026)
Unrealized profit on interest retained subsequent to loss of significant influence	-	18,087
Realized profit from partial disposal of associate	-	5,703
	<u>962</u>	<u>(522)</u>

7. NET FEES AND COMMISSION INCOME

	<u>2013</u>	<u>2012</u>
	KD'000	KD'000
Gross fees and commission income	5,271	4,825
Fees and commission expenses	<u>(1,639)</u>	<u>(1,146)</u>
	<u>3,632</u>	<u>3,679</u>

8. PROVISION FOR IMPAIRMENT

	<u>2013</u>	<u>2012</u>
	KD'000	KD'000
Provision for impairment of finance facilities	17,852	16,175
Provision for impairment of available for sale investment	2,115	3,976
Provision for impairment of other assets	<u>3,114</u>	<u>281</u>
	<u>23,081</u>	<u>20,432</u>

The analysis of provision for impairment of finance facilities based on specific and general provision is as follows:

	<u>Specific</u>	<u>General</u>	<u>Total</u>
	KD'000	KD'000	KD'000
Balance at 1 January 2012	2,673	33,368	36,041
Provided/(released) during the year	20,858	(4,683)	16,175
Recovery of written off balances	240	-	240
Written off balances during the year	(19,532)	-	(19,532)
Foreign currency movement	22	-	22
Balance at 31 December 2012	<u>4,261</u>	<u>28,685</u>	<u>32,946</u>
Provided during the year	<u>13,448</u>	<u>4,404</u>	<u>17,852</u>
Recovery of written off balances	<u>3,779</u>	-	<u>3,779</u>
Written off balances during the year	<u>(17,781)</u>	-	<u>(17,781)</u>
Balance at 31 December 2013	<u>3,707</u>	<u>33,089</u>	<u>36,796</u>

Further analysis of provision for impairment of finance facilities by category is as follows:

	<u>Due from</u>	<u>Islamic finance</u>	<u>Non-cash</u>	<u>Total</u>
	banks	to customers	facilities	KD'000
	KD'000	KD'000	KD'000	KD'000
Balance at 1 January 2012	-	34,803	1,238	36,041
Provided during the year	5,616	10,402	157	16,175
Recovery of written off balances	-	240	-	240
Written off balances during the year	(5,638)	(13,894)	-	(19,532)
Foreign currency movement	22	-	-	22
Balance at 31 December 2012	<u>-</u>	<u>31,551</u>	<u>1,395</u>	<u>32,946</u>
Provided/(released) during the year	-	<u>17,903</u>	<u>(51)</u>	<u>17,852</u>
Recovery of written off balances	-	<u>3,779</u>	-	<u>3,779</u>
Written off balances during the year	-	<u>(17,781)</u>	-	<u>(17,781)</u>
Balance at 31 December 2013	<u>-</u>	<u>35,452</u>	<u>1,344</u>	<u>36,796</u>

At 31 December 2013, non-performing finance facilities amounted to **KD 25,071 thousand**, net of provision of **KD 3,707 thousand** (31 December 2012: 20,566 thousand net of provision of KD 4,261 thousand). The analysis of specific and general provision stated above is based on CBK instructions.

9. BASIC AND DILUTED EARNING PER SHARE

Basic earnings per share are calculated by dividing the profit for the year by the weighted average number of shares outstanding during the year.

Diluted earnings per share is calculated by dividing the profit for the year by the weighted average number of shares outstanding during the year plus the weighted average number of share that would be issued on the conversion of all the dilutive potential shares into shares. The diluted earnings per share arising from the issue of employee share option does not result in any change from the reported basic earnings per share.

	<u>2013</u>	<u>2012</u>
Net profit for the year attributable to the equity holders of the Bank (KD'000)	13,408	10,050
Weighted average number of shares outstanding during the year (thousands of shares)	1,839,020	1,839,020
Basic and diluted earnings per share attributable to the equity holders of the Bank (fils)	7.29	5.47

Earnings per share for the year ended 31 December 2012 was 5.75 fils per share before retroactive adjustment to the number of shares following the bonus issue (see note 22).

10. CASH AND CASH EQUIVALENTS

	<u>2013</u> KD'000	<u>2012</u> KD'000
Cash on hand	19,846	14,020
Balances with CBK – current account	682	840
Balances with banks – current accounts	7,674	3,675
Placement with banks maturing within seven days	177,420	150,995
	205,622	169,530

The fair values of cash and cash equivalents do not differ from their respective carrying values.

11. DUE FROM BANKS

The geographical distribution of balances due from banks is as follows:

	<u>2013</u> KD'000	<u>2012</u> KD'000
Kuwait & Middle East	266,884	240,562
Europe	31,987	11,063
	298,871	251,625

12. ISLAMIC FINANCING TO CUSTOMERS

The geographical distribution of Islamic financing to customers is as follows:

	<u>Kuwait & Middle East</u> KD'000	<u>Europe</u> KD'000	<u>Asia</u> KD'000	<u>Total</u> KD'000
2013				
Corporate banking	930,151	4,550	3,099	937,800
Consumer banking	576,353	-	-	576,353
	1,506,504	4,550	3,099	1,514,153
Less: provision for impairment	(35,376)	(46)	(30)	(35,452)
	1,471,128	4,504	3,069	1,478,701

12. ISLAMIC FINANCING TO CUSTOMERS (CONTINUED)

2012

Corporate banking	880,691	4,064	3,520	888,275
Consumer banking	413,290	-	-	413,290
	<u>1,293,981</u>	<u>4,064</u>	<u>3,520</u>	<u>1,301,565</u>
Less: provision for impairment	(31,475)	(41)	(35)	(31,551)
	<u>1,262,506</u>	<u>4,023</u>	<u>3,485</u>	<u>1,270,014</u>

Provision for impairment of Islamic financing to customers is calculated and analysed based on CBK instructions on the outstanding balance net of deferred profits (if any) as follows:

	Specific		General		Total	
	2013	2012	2013	2012	2013	2012
	KD'000	KD'000	KD'000	KD'000	KD'000	KD'000
Balance at beginning of the year	4,261	2,673	27,290	32,130	31,551	34,803
Provided/(released) during the year	13,448	15,242	4,455	(4,840)	17,903	10,402
Recovery of written off balances	3,779	240	-	-	3,779	240
Written off balances	(17,781)	(13,894)	-	-	(17,781)	(13,894)
Balance at end of the year	3,707	4,261	31,745	27,290	35,452	31,551

Further analysis of specific provision based on class of financial assets is given below:

	Corporate banking		Consumer banking		Total	
	2013	2012	2013	2012	2013	2012
	KD'000	KD'000	KD'000	KD'000	KD'000	KD'000
Balance at beginning of the year	2,461	349	1,800	2,324	4,261	2,673
Provided/(released) during the year	12,638	15,766	810	(524)	13,448	15,242
Recovery of written off balances	3,619	240	160	-	3,779	240
Written off balances	(16,349)	(13,894)	(1,432)	-	(17,781)	(13,894)
Balance at end of the year	2,369	2,461	1,338	1,800	3,707	4,261

Whenever necessary, Islamic financing to customers is secured by acceptable forms of collateral to mitigate the related credit risks.

Non performing Islamic financing to customers and related specific provisions are as follows:

	2013	2012
	KD'000	KD'000
Islamic financing to customers	28,778	24,827
Specific provision for impairment	(3,707)	(4,261)
	<u>25,071</u>	<u>20,566</u>

At 31 December 2013 management estimates the fair value of collaterals held against individually impaired Islamic finance facilities to be **KD 23,280 thousand** (31 December 2012: KD 17,594 thousand).

13. FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

	2013	2012
	KD'000	KD'000
Investment in unquoted securities	3,932	32,781
Investment in quoted securities	-	1,181
Investment in unquoted funds	1,934	17,331
	<u>5,866</u>	<u>51,293</u>

14. AVAILABLE FOR SALE INVESTMENTS

	<u>2013</u>	<u>2012</u>
	KD'000	KD'000
Investment in Sukuk	31,289	33,685
Investment in unquoted funds	18,383	17,711
Investment in unquoted securities	11,159	44,968
Investment in quoted securities	<u>2,213</u>	<u>3,565</u>
	<u>63,044</u>	<u>99,929</u>

15. SUBSIDIARIES

Principal operating subsidiaries are as follows:

Name of subsidiary	Country of incorporation	2013 proportion of ownership interest and voting power %	2012 proportion of ownership interest and voting power %	Principal activity
Boubyan Takaful Insurance Company K.S.C. (Closed)	Kuwait	67.63	67.63	Takaful insurance
Boubyan Capital Investment Company K.S.C. (Closed)	Kuwait	99.55	99.55	Islamic investments

16. INVESTMENTS IN ASSOCIATES

Name of associate	Country of incorporation	2013 proportion of ownership interest and voting power %	2012 proportion of ownership interest and voting power %	Principal activity
United Capital Bank	Republic of Sudan	21.67	21.67	Islamic commercial banking
Ijarah Indonesia Finance Company	Indonesia	33.33	33.33	Islamic financing services
Saudi Projects Holding Group	Kuwait	25.00	20.00	Real Estate
Bank of London and the Middle East (a)	United Kingdom	25.62	-	Islamic commercial banking
Bank Syariah Muamalat Indonesia Tbk (b)	Indonesia	22.00	-	Islamic commercial banking

- a. The Bank held a 19.8% interest in Bank of London and the Middle East (“BLME”) with a carrying amount of **KD 29,688 thousand** and accounted for this investment as a financial asset at fair value through profit or loss. During the year the Group acquired additional **5.82%** interests in BLME for a consideration of **KD 8,128 thousand**. Hence the total ownership interest of the Group in BLME is now **25.62%** and is being accounted as an investment in associate from the effective date of 7 October 2013.
- b. The Bank held a 19.03% interest in Bank Syariah Muamalat Indonesia Tbk (“BSMI”) with a carrying amount of **KD 37,234 thousand** and accounted for this investment as an available for sale investment. Effective 3 December 2013 (“the effective date”), the Bank acquired an additional **2.97%** interest in BSMI for a consideration of **KD 3,436 thousand**. Hence the total ownership interest of the Bank in BSMI is now **22%** and is being accounted as an investment in associate from the effective date. On reclassification to investment in associate, the bank transferred **KD 449 thousand** accumulated in equity to consolidated statement of profit and loss.

16. INVESTMENTS IN ASSOCIATES (CONTINUED)

Summarized financial information in respect of Bank of London and the Middle East (“BLME”) is set out below:

	<u>2013</u> KD’000
Total assets	528,745
Total liabilities	<u>(418,620)</u>
Net assets	<u>110,125</u>
Group’s share of net assets	<u>28,214</u>
Group’s share of contingent liabilities	<u>-</u>
	<u>2013</u> KD’000
Total revenue	<u>11,762</u>
Net profit	<u>461</u>
Group’s share of results	<u>-</u>

Summarized financial information in respect of Bank Syariah Muamalat Indonesia Tbk (“BSMI”) is set out below:

	<u>2013</u> KD’000
Total assets	1,241,918
Total liabilities	<u>(1,140,734)</u>
Net assets	<u>101,184</u>
Group’s share of net assets	<u>22,260</u>
Group’s share of contingent liabilities	<u>6,305</u>
	<u>2013</u> KD’000
Total revenue	<u>56,590</u>
Net profit	<u>12,507</u>
Group’s share of results	<u>-</u>

Summarized financial information in respect of the Group’s other associates that are immaterial, are set out below:

	<u>2013</u> KD’000	2012 KD’000
Total assets	112,440	127,870
Total liabilities	<u>(77,878)</u>	(90,436)
Net assets	<u>34,562</u>	<u>37,434</u>
Group’s share of net assets	<u>7,631</u>	9,082
Group’s share of contingent liabilities	<u>14,984</u>	<u>16,078</u>
	<u>2013</u> KD’000	2012 KD’000
Total revenue	<u>1,608,273</u>	11,831
Net profit	<u>591,759</u>	1,744
Group’s share of results	<u>726</u>	<u>2,364</u>

17. INVESTMENT PROPERTIES

The movement in the investment properties is as follows:

	<u>2013</u> KD'000	<u>2012</u> KD'000
Balance at the beginning of the year	17,904	25,613
Additions during the year	21,808	3,961
Disposals during the year	(8,048)	(7,390)
Net unrealized loss from change in fair value of investment properties	(1,712)	(5,026)
Foreign currency translation adjustments	293	746
Balance at the ending of the year	<u>30,245</u>	<u>17,904</u>

The fair value of the Group's investment properties as at 31 December 2013 and 31 December 2012 has been arrived at on the basis of valuations carried out on the respective dates by independent appraisers who have appropriate qualifications and recent experience in the valuation of properties in the relevant locations. The fair values were determined based on market approach. In estimating the fair values of the properties, the highest and the best use of the properties is their current use. There has been no change to the valuation techniques during the year. All of the Group's investment properties are included in Level 2 of fair value hierarchy as at 31 December 2013.

18. OTHER ASSETS

	<u>2013</u> KD'000	<u>2012</u> KD'000
Accrued income	616	887
Prepayments	4,394	3,092
Software	2,478	1,837
Others	6,506	2,100
	<u>13,994</u>	<u>7,916</u>

19. OTHER LIABILITIES

	<u>2013</u> KD'000	<u>2012</u> KD'000
Creditors and accruals	6,223	5,146
Accrued staff benefits	6,434	5,147
Clearing accounts	7,642	7,974
General provision on non-cash facilities	1,344	1,395
Margin accounts	3,085	2,421
Others	4,355	2,314
	<u>29,083</u>	<u>24,397</u>

20. SHARE CAPITAL

	<u>2013</u>		<u>2012</u>	
	Shares	KD'000	Shares	KD'000
Shares authorised, issued and fully paid in cash of 100 fils each	<u>1,836,450,000</u>	<u>183,645</u>	<u>1,748,235,315</u>	<u>174,824</u>

21. SHARE PREMIUM

The share premium is not distributable except under specific circumstances as provided by the Companies Law.

22. PROPOSED DIVIDEND

The board of directors recommended distribution of bonus share of 7% on outstanding shares as at 31 December 2013 (2012: 5%). The proposed dividends, if approved by the shareholders' general assembly shall be payable to the shareholders registered in the bank's records as of the date of the general assembly meeting.

23. TREASURY SHARES

The Bank held the following treasury shares as at 31 December:

	<u>2013</u>	<u>2012</u>
Number of treasury shares	2,603,669	1,715,000
Treasury shares as a percentage of total issued shares - %	0.1418%	0.0981%
Cost of treasury shares – KD thousand	1,100	1,024
Market value of treasury shares – KD thousand	1,458	1,098

24. STATUTORY RESERVE

As required by the Companies Law and the Bank's Articles of Association 10% of profit for the year attributable to the shareholders of the Bank before KFAS, NLST, Zakat and Board of directors' remuneration is transferred to statutory reserve. The Bank may resolve to discontinue such annual transfers when the reserve equals 50% of the capital. This reserve is not available for distribution except in cases stipulated by law and the Bank's Articles of Association.

25. VOLUNTARY RESERVE

As required by the Bank's Articles of Association 10% of profit for the year attributable to the shareholders of the Bank is transferred to the voluntary reserve. Such annual transfers may be discontinued by a resolution of the shareholders' General Assembly upon a recommendation by the Board of Directors.

26. SHARED BASED PAYMENT RESERVE

The Bank operates an equity settled share based compensation plan and granted share options to its senior executives. These options will vest if the employees remain in service for a period of three years from the grant date and the employees can exercise the options within one year from the vesting date. If the exercise price is not paid within one year from date of vesting, the options vested will be cancelled. The exercise price of the granted options is equal to 100 fils per share.

The fair value of options granted during the year as determined using the Black-Scholes valuation model was **546 fils** (2012: 497 fils). The significant inputs into the model were a share price of **640 fils** (2012: 590 fils) at the grant date, an exercise price of 100 fils as shown above, a standard deviation of expected share price returns of **26%** (2012: 42%), option life disclosed above and annual risk free rate of 2%. The volatility measured at the standard deviation of expected share price returns is based on statistical analysis of daily share prices over the last three years. The weighted average remaining life of the share options was **575 days** (2012: 507 days) and the weighted average fair value of share options granted was **530 fils** (2012: 522 fils).

The following table shows the movement in number of share options during the year:

	<u>2013</u>	<u>2012</u>
	<u>Number of</u>	<u>Number of</u>
	<u>share options</u>	<u>share options</u>
Outstanding at 1 January	1,900,216	1,409,630
Granted during the year	897,233	810,280
Cancelled during the year	(428,293)	(319,694)
Outstanding at 31 December	<u>2,369,156</u>	<u>1,900,216</u>

The expense accrued on account of share based compensation plans for the year amounts to **KD 323 thousand** (31 December 2012: KD 284 thousand) and is included under staff cost.

27. RELATED PARTY TRANSACTIONS

Related parties comprise the major shareholders, board of directors, entities controlled by them or under their joint control, associates, key management personnel and their close family members and the Parent Company including their board members, key management personnel, branches, associates and subsidiaries. Balances with related parties arise from commercial transactions in the normal course of business on an arm's length basis and are included within the following financial information captions:

	Number of board member or executive officers		Number of related parties		2013	2012
	2013	2012	2013	2012	KD'000	KD'000
Islamic financing to customers	7	6	2	2	5,745	8,956
Depositors' accounts	11	12	9	7	29,465	33,711
Letters of guarantee and letters of credit	1	1	-	-	18	62
Revenues					202	194
Expenses					(173)	(335)
Proceed from disposal of an Investment					-	9,638
Parent Company						
Due from banks					92,401	80,028
Due to banks					87,612	53,254
Revenues					279	98
Expenses					(150)	(145)

The Group holds collaterals against Islamic finance facilities to related parties in the form of shares and real estate. An estimate of the fair value of collaterals held against Islamic finance facilities to related parties amounted to **KD 1,271 thousand** as at 31 December 2013 (31 December 2012: KD 1,236 thousand).

Compensation of key management personnel:

Details of compensation for key management comprise the following:

	2013	2012
	KD'000	KD'000
Short-term benefits	1,904	1,716
Post-employment benefits	299	257
Share based compensation	226	167
	2,429	2,140

Senior executive officers also participate in the Group's share based payment programme (see note 26)

28. CONTINGENCIES AND COMMITMENTS

At the financial reporting date there were outstanding contingencies and commitments entered in the ordinary course of business in respect of the following:

	2013	2012
	KD'000	KD'000
Guarantees	166,952	137,909
Acceptances and letters of credit	26,872	47,749
Capital commitments (projects under construction)	411	1,307
Credit commitments	34,428	8,437
	228,663	195,402

29. SEGMENT REPORTING

Operating segments are identified on the basis of internal reports that are regularly reviewed by the decision makers in order to allocate resources to the segments and to assess their performance. The operating segments are divided as either business segments or geographical segments.

Business Segments

For management purposes, the Bank is organized into the following four major business segments:

Consumer banking: Provides a diversified range of products and services to individuals and institutional customers. The range includes consumer finance, credit cards, deposits and other branch related services.

Corporate banking: Provides Murabaha, Ijarah, trade service and other related services to business and corporate customers.

Investment banking: Principally handling direct investments, investment in associates, local and international real estate investment and asset management.

Treasury: Principally handling local and international Murabaha and other Islamic financing, primarily with banks, as well as the management of the Bank's funding operations.

Group centre: Includes other group activities and residual in respect of transfer pricing and inter segment allocation.

	Consumer banking	Corporate banking	Investment banking	Treasury	Group centre	Total
	KD'000	KD'000	KD'000	KD'000	KD'000	KD'000
2013						
Net financing income/(loss)	30,347	23,642	(3,787)	8,076	2,464	60,742
Share of results of associates	-	-	726	-	-	726
Operating income	30,799	27,817	(1,585)	9,052	989	67,072
Depreciation and amortization	(987)	(44)	(47)	(15)	(606)	(1,699)
Net profit/ (loss) for the year	16,365	11,829	(9,341)	8,641	(14,774)	12,720
Total assets	584,980	987,148	156,757	477,174	(14,073)	2,191,986
Total liabilities	650,861	158,846	19,460	1,092,695	637	1,922,499
	Consumer banking	Corporate banking	Investment banking	Treasury	Group centre	Total
	KD'000	KD'000	KD'000	KD'000	KD'000	KD'000
2012						
Net financing income/(loss)	22,948	24,590	(4,122)	8,187	868	52,471
Share of results of associates	-	-	2,364	-	-	2,364
Operating income	23,794	28,699	(1,328)	9,073	(1,359)	58,879
Depreciation and amortization	(1,154)	(46)	(42)	(17)	(652)	(1,911)
Net profit/ (loss) for the year	10,667	11,706	(9,149)	8,658	(12,346)	9,536
Total assets	418,916	917,848	151,565	402,467	(6,140)	1,884,656
Total liabilities	543,912	156,591	4,264	911,053	12,672	1,628,492

Geographical segment

In presenting information on the basis of geographical areas, revenue is based on the geographical location of customers and assets are based on the geographical location of assets.

	Middle East & North Africa	North America	Europe	Asia	Other	Total
	KD'000	KD'000	KD'000	KD'000	KD'000	KD'000
2013						
Assets	2,041,687	1,253	88,907	43,524	16,615	2,191,986
Non-current assets (excluding financial instruments)	49,730	-	4,461	-	-	54,191
Liabilities and equity	2,188,007	30	3,803	146	-	2,191,986
Segment income/(expenses)	69,112	-	(2,157)	117	-	67,072
	Middle East & North Africa	North America	Europe	Asia	Other	Total
	KD'000	KD'000	KD'000	KD'000	KD'000	KD'000
2012						
Assets	1,775,037	476	69,582	35,198	4,363	1,884,656
Non-current assets (excluding financial instruments)	21,598	-	11,585	-	-	33,183
Liabilities and equity	1,875,899	2,558	4,557	-	1,642	1,884,656
Segment income/(expenses)	43,874	(816)	(8,913)	25,071	(337)	58,879

30. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

30.1 Introduction and overview

Risk is inherent in the Group's activities but is managed in a structured, systematic manner through a Group risk policy that embeds comprehensive risk management into organisational structure, risk measurement and monitoring processes. The overall risk management direction and oversight is provided by the Board of Directors and Board Risk Committee with the support of the Management Executive Committee and the Group's Risk Management functions.

The Group is exposed to credit risk, market risk, liquidity risk and operational risk.

In accordance with the Central Bank of Kuwait's directives, the Group has implemented a comprehensive system for the measurement and management of risk.

This methodology helps in reflecting both the expected loss likely to arise in normal circumstances and unexpected losses, which are an estimate of the ultimate actual loss based on statistical models. Information compiled from all internal business groups are closely examined and analysed to identify, manage and control risks.

Transactions and outstanding risk exposures are quantified and compared against authorised limits, whereas non-quantifiable risks are monitored against policy guidelines and key risk and control indicators. Any discrepancies, excesses or deviations are escalated to management for appropriate action.

As part of its overall risk management, the Group uses financial instruments to manage exposures resulting from changes in foreign exchange and equity risks. Collateral is used to reduce the Group's credit risk.

The Group's comprehensive risk management framework has specific guidelines that focus on maintaining a diversified portfolio to avoid excessive concentration of risks.

30.2 Credit risk

Credit risk is the risk that counterparty will cause a financial loss to the Group by failing to discharge an obligation. Credit risk arises in the Group's normal course of business.

All policies relating to credit are reviewed and approved by the Board of Directors.

Credit limits are established for all customers after a careful assessment of their creditworthiness. Standing procedures, outlined in the Group's Credit Policy Manual, require that all credit proposals be subjected to detailed screening by the respective credit risk functions. Whenever necessary, Islamic facilities are secured by acceptable forms of collateral to mitigate the related credit risks.

In accordance with the instructions of the Central Bank of Kuwait, setting out the rules and regulations regarding the classification of credit facilities, the Group has formed an internal committee comprising competent professional staff and having as its purpose the study and evaluation of the existing credit facilities of each customer of the Group. This committee, which meets regularly throughout the year, is required to identify any abnormal situations and difficulties associated with a customer's position which might cause the debt to be classified as irregular, and to determine an appropriate provisioning level.

The Group further limits risk through diversification of its assets by industry sector. In addition, all credit facilities are continually monitored based on a periodical review of the credit performance and account rating.

30.2.1 *Maximum exposure to credit risk (Net exposure after covered collateral)*

An analysis of Islamic financing to customers and contingent liabilities before and after taking account of collateral held or other credit enhancements is as follows:

	2013		2012	
	Gross exposure KD'000	Net exposure KD'000	Gross exposure KD'000	Net exposure KD'000
Islamic financing to customers	1,478,701	978,066	1,270,014	839,241
Contingent liabilities	228,663	220,558	195,402	169,415

Collateral and other credit enhancements

The amount, type and valuation of collateral are based on guidelines specified in the risk management framework. The main types of collateral accepted includes real estate, shares, cash collateral and bank guarantees. The revaluation and custody of collaterals are performed independent of the business units. The Group may also obtain guarantees from parent companies for financing provided to their subsidiaries.

30. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

30.2 Credit risk (continued)

30.2.2 Risk Concentration of the maximum exposure to credit risk

Concentrations of credit risk arise from exposure to customers having similar characteristics in terms of the geographic location in which they operate or the industry sector in which they are engaged, such that their ability to discharge contractual obligations may be similarly affected by changes in political, economic or other conditions.

Credit risk can also arise due to a significant concentration of Group's assets to any single counterparty. This risk is managed by diversification of the portfolio. The 20 largest facilities outstanding as a percentage of gross facilities as at 31 December 2013 are **25.6%** (2012: 27.3%).

The Group's financial assets and off-balance sheet items, before taking into account any collateral held or credit enhancements can be analysed by the following geographic regions:

	Middle East & North Africa	North America	Europe	Asia	Other	Total
	KD'000	KD'000	KD'000	KD'000	KD'000	KD'000
2013						
Cash and cash equivalents (excluding cash on hand)	176,301	1,206	8,022	247	-	185,776
Due from banks	266,883	-	31,988	-	-	298,871
Islamic financing to customers	1,471,227	-	4,446	3,028	-	1,478,701
Available for sale investments (Sukuk)	29,084	-	2,205	-	-	31,289
Other assets (excluding software)	11,515	-	-	-	-	11,515
	<u>1,955,010</u>	<u>1,206</u>	<u>46,661</u>	<u>3,275</u>	<u>-</u>	<u>2,006,152</u>
Contingent liabilities	185,487	-	313	8,024	-	193,824
Commitments	27,744	-	7,095	-	-	34,839
Total credit risk exposure	<u>2,168,241</u>	<u>1,206</u>	<u>54,069</u>	<u>11,299</u>	<u>-</u>	<u>2,234,815</u>

	Middle East & North Africa	North America	Europe	Asia	Other	Total
	KD'000	KD'000	KD'000	KD'000	KD'000	KD'000
2012						
Cash and cash equivalents (excluding cash on hand)	146,601	476	8,286	143	4	155,510
Due from banks	240,562	-	11,063	-	-	251,625
Islamic financing to customers	1,262,506	-	4,023	3,485	-	1,270,014
Available for sale investments (Sukuk)	29,319	-	4,366	-	-	33,685
Other assets (excluding software)	6,079	-	-	-	-	6,079
	<u>1,685,067</u>	<u>476</u>	<u>27,738</u>	<u>3,628</u>	<u>4</u>	<u>1,716,913</u>
Contingent liabilities	177,175	-	457	8,026	-	185,658
Commitments	8,153	-	-	-	1,591	9,744
Total credit risk exposure	<u>1,870,395</u>	<u>476</u>	<u>28,195</u>	<u>11,654</u>	<u>1,595</u>	<u>1,912,315</u>

The Group's financial assets before taking into account any collateral held or credit enhancements, can be analysed by the following industry sectors:

	2013 KD'000	2012 KD'000
Trading	134,362	126,359
Manufacturing	76,872	92,370
Banking and other financial institutions	520,150	415,736
Construction	40,525	37,390
Real Estate	394,106	322,045
Retail	557,084	410,064
Government	106,086	176,911
Others	176,967	136,038
	<u>2,006,152</u>	<u>1,716,913</u>

30. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

30.2 Credit risk (continued)

30.2.3 Credit quality per class of financial assets

In managing its portfolio, the Group utilises ratings and other measures and techniques which seek to take account of relevant aspects of perceived risk. Credit exposures classified as 'High' quality are those where the ultimate risk of financial loss from the obligor's failure to discharge its obligation is assessed to be low. These include facilities to corporate entities with financial condition, risk indicators and capacity to repay which are considered to be good to excellent. Credit exposures classified as 'Standard' quality comprise all other facilities whose payment performance is fully compliant with contractual conditions and which are not impaired. The ultimate risk of possible financial loss on 'Standard' quality is assessed to be higher than that for the exposures classified within the 'High' quality range.

The table below shows the credit quality by class of asset for statement of financial position lines, based on the Group's credit rating system.

	Neither past due nor impaired		Past due or impaired	Total
	High	Standard		
	KD'000	KD'000	KD'000	KD'000
2013				
Cash and cash equivalents (excluding cash on hand)	185,776	-	-	185,776
Due from banks	286,934	11,937	-	298,871
Islamic financing to customers	1,290,782	177,514	45,857	1,514,153
Available for sale investments (Sukuk)	31,289	-	-	31,289
Other assets (excluding software)	11,515	-	-	11,515
	1,806,296	189,451	45,857	2,041,604
2012				
Cash and cash equivalents (excluding cash on hand)	155,510	-	-	155,510
Due from banks	246,523	5,102	-	251,625
Islamic financing to customers	1,072,837	189,027	39,701	1,301,565
Available for sale investments (Sukuk)	33,685	-	-	33,685
Other assets (excluding software)	6,079	-	-	6,079
	1,514,634	194,129	39,701	1,748,464

Ageing analysis of past due or impaired financial assets:

	Corporate banking		Consumer banking		Total	
	Past due and not impaired	Past due and impaired	Past due and not impaired	Past due and impaired	Past due and not impaired	Past due and impaired
	KD'000	KD'000	KD'000	KD'000	KD'000	KD'000
2013						
Up to 30 days	5,151	-	8,260	-	13,411	-
31 – 60 days	6	-	2,239	-	2,245	-
61 – 90 days	163	-	1,260	-	1,423	-
91 – 180 days	-	-	-	1,475	-	1,475
More than 180 days	-	26,404	-	899	-	27,303
	5,320	26,404	11,759	2,374	17,079	28,778
2012						
Up to 30 days	4,643	-	5,293	-	9,936	-
31 – 60 days	2,001	-	1,916	-	3,917	-
61 – 90 days	27	-	994	-	1,021	-
91 – 180 days	-	-	-	804	-	804
More than 180 days	-	22,210	-	1,813	-	24,023
	6,671	22,210	8,203	2,617	14,874	24,827

At 31 December 2013 management estimates the fair value of collaterals held against individually past due or impaired Islamic finance facilities to **KD 24,411 thousand** (31 December 2012: KD 18,455 thousand).

30. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

30.3 Market risk

Market risk is the risk that the fair value of financial instruments will fluctuate due to changes in market prices. Market risks arise from open positions in currency and equity products, all of which are exposed to general and specific market movements and changes in the level of volatility of prices such as foreign exchange rates and equity prices.

The Group is not exposed to material risk in terms of the re-pricing of its liabilities since, in accordance with Islamic Sharia'a, the Group does not provide a guaranteed contractual rate of return to its depositors.

Foreign currency risk

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

Foreign exchange risks are controlled through limits pre-established by the Board of Directors on currency position exposures. Assets are typically funded in the same currency as that of the business being transacted to eliminate exchange exposures. Appropriate segregation of duties exists between the treasury front and back office functions, while compliance with position limits is independently monitored on an ongoing basis by an independent middle office function.

The table below analyses the effect on profit and equity of an assumed 5% strengthening in value of the currency rate against the Kuwaiti Dinar from levels applicable at the year end, with all other variables held constant. A negative amount in the table reflects a potential net reduction in profit or equity, whereas a positive amount reflects a net potential increase.

		2013		2012	
		Effect on profit KD'000	Effect on equity KD'000	Effect on profit KD'000	Effect on equity KD'000
US Dollar	+5	(132)	-	(8)	-
Sterling Pound	+5	2	-	(45)	-
Euro	+5	1	-	-	-
Indonesian Rupiah	+5	-	2,012	1,519	60
Sudanese Pound	+5	14	224	13	265
Japanese Yen	+5	-	-	2	-
Others	+5	9	-	9	-

A 5 percent decrease of the above currencies against the Kuwaiti Dinar would have had equal, but opposite, effect of the amounts shown above, on the basis that all other variables remain constant.

Equity price risk

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

For such investments classified as available for sale, a five percent increase in stock prices as at 31 December 2013 would have increased equity by **KD 669 thousand** (31 December 2012: an increase of KD 2,427 thousand). For such investments classified as at fair value through profit or loss, the impact on profit or loss would have been an increase of **KD 197 thousand** (31 December 2012: an increase of KD 1,698 thousand). An equal change in the opposite direction would have had equal, but opposite effect to the amounts shown above, on the basis that all other variables remain constant.

30. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

30.4 Liquidity risk

Liquidity risk is the risk that the Group will be unable to meet its financial liabilities when they fall due. To limit this risk, management has arranged diversified funding sources, manages assets with liquidity in mind and monitors liquidity on a daily basis.

The Group has established an Asset and Liabilities Management Committee to manage the assets and liabilities of the Group comprehensively and strategically. The committee meets regularly to determine and review policies for managing liquidity risk, as well as to set risk limits.

The table below summarises the maturity profile of Group's assets, liabilities and equity based on contractual cash flows and maturity dates. This does not necessarily take account of the effective maturities.

	Up to three months	3 to 6 months	6 to 12 months	Over 1 year	Total
	KD'000	KD'000	KD'000	KD'000	KD'000
2013					
Assets					
Cash and cash equivalents	205,622	-	-	-	205,622
Due from banks	222,492	72,865	3,514	-	298,871
Islamic financing to customers	587,699	236,008	80,650	574,344	1,478,701
Financial assets at fair value through profit or loss	-	-	-	5,866	5,866
Available for sale investments	27,450	-	-	35,594	63,044
Investments in associates	-	-	-	85,691	85,691
Investment properties	-	-	-	30,245	30,245
Other assets	6,506	-	5,010	2,478	13,994
Property and equipment	-	-	-	9,952	9,952
Total assets	1,049,769	308,873	89,174	744,170	2,191,986
Liabilities and Equity					
Due to banks	202,437	7,730	-	25,851	236,018
Depositors' accounts	1,010,366	329,081	293,427	24,524	1,657,398
Other liabilities	11,992	-	9,309	7,782	29,083
Equity	-	-	-	269,487	269,487
Total liabilities and equity	1,224,795	336,811	302,736	327,644	2,191,986
2012					
Assets					
Cash and cash equivalents	169,530	-	-	-	169,530
Due from banks	171,271	72,348	8,006	-	251,625
Islamic financing to customers	548,906	213,996	96,296	410,816	1,270,014
Financial assets at fair value through profit or loss	1,181	-	-	50,112	51,293
Available for sale investments	-	-	2,111	97,818	99,929
Investments in associates	-	-	-	9,082	9,082
Investment properties	-	-	-	17,904	17,904
Other assets	2,100	-	3,979	1,837	7,916
Property and equipment	-	-	-	7,363	7,363
Total assets	892,988	286,344	110,392	594,932	1,884,656
Liabilities and Equity					
Due to banks	158,594	7,772	2,117	38,650	207,133
Depositors' accounts	935,043	196,004	263,423	2,492	1,396,962
Other liabilities	10,289	-	7,568	6,540	24,397
Equity	-	-	-	256,164	256,164
Total liabilities and equity	1,103,926	203,776	273,108	303,846	1,884,656

30. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

30.4 Liquidity risk (continued)

The liquidity profile of financial liabilities of the Group summarised below reflects the projected cash flows including future profit payments over the life of these financial liabilities based on contractual repayment arrangements.

	Up to three months	3 to 6 months	6 to 12 months	Over 1 year	Total
	KD'000	KD'000	KD'000	KD'000	KD'000
2013					
Financial Liabilities					
Due to banks	202,479	8,634	-	28,024	239,137
Depositors' accounts	1,011,095	329,621	295,428	24,927	1,661,071
	<u>1,213,574</u>	<u>338,255</u>	<u>295,428</u>	<u>52,951</u>	<u>1,900,208</u>
2012					
Financial Liabilities					
Due to banks	158,636	7,798	2,135	40,844	209,413
Depositors' accounts	935,592	196,760	265,533	2,569	1,400,454
	<u>1,094,228</u>	<u>204,558</u>	<u>267,668</u>	<u>43,413</u>	<u>1,609,867</u>

30.5 Operational risk

Operational risk is the risk of loss arising from inadequate or failed internal processes, systems failure, human error, or from external events. When controls fail to perform, it can lead to legal or regulatory implications, or financial /reputational loss.

The Group has established policies and procedures, which are applied to identify, assess, monitor, control and mitigate operational risk in addition to other types of risks relating to the banking and financial activities of the Group as part of overall risk management activities.

The operational risk of the Group is managed in line with the CBK instructions concerning the general guidelines for internal controls and best practice for managing and supervising operational risks in banks.

30.6 Fair value of financial instruments

Fair values are obtained from quoted market prices, discounted cash flow models and other models as appropriate. The carrying values of financial instruments, excluding Islamic financing to customers, are approximate to their fair values at 31 December due to the relatively short-term maturity of the instruments.

Fair value of the Group's financial assets that are measured at fair value on a recurring basis.

Some of the Group's financial assets are measured at fair value at the end of each reporting period. The following table gives information about how the fair values of these financial assets are determined (in particular, the valuation techniques(s) and inputs used).

30. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

30.6 Fair value of financial instruments (continued)

Financial assets	Fair value as at		Fair value Hierarchy 2013	sector
	31 December 2013	31 December 2012		
Financial assets at fair value through profit or loss - <i>Unquoted securities</i>	1,026	1,026	Level 2	Financial Institution
Financial assets at fair value through profit or loss - <i>Quoted securities</i>	-	155	Level 2	Service
Financial assets at fair value through profit or loss - <i>Unquoted funds</i>	1,934	7,305	Level 2	Financial Institution
	-	10,028	Level 2	Financial Institution
Financial assets at fair value through profit or loss - <i>Unquoted securities</i>	2,906	2,521	Level 2	Real Estate
	-	30,259	Level 2	Islamic Banking
Available for sale investments - <i>Sukuk</i>	16,967	17,211	Level 2	Government
	14,322	16,474	Level 2	Financial Institution
Available for sale investments - <i>Unquoted funds</i>	9,232	9,976	Level 2	Financial Institution
	3,852	3,876	Level 2	Real Estate
	5,300	3,859	Level 2	Service
Available for sale investments - <i>Unquoted securities</i>	6,364	6,569	Level 2	Financial Institution
	3,169	2,701	Level 2	Real Estate
	346	679	Level 2	Construction
	1,280	4,645	Level 2	Service
	-	30,374	Level 2	Islamic Banking
Available for sale investments - <i>Quoted securities</i>	1,643	2,648	Level 1	Real Estate
	570	917	Level 1	Financial Institution

Fair value hierarchy

The table below analyses 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 or liabilities;
- Level 2: inputs other than quoted prices included within level 1 that are observable, either directly (i.e. as prices) or indirectly (i.e. derived from prices);
- Level 3: inputs that are not based on observable market data (unobservable inputs).

	<u>Level 1</u> KD'000	<u>Level 2</u> KD'000	<u>Total</u> KD'000
2013			
Financial assets at fair value through profit or loss	-	5,866	5,866
Available for sale investments	2,213	60,831	63,044
	2,213	66,697	68,910
	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
2012	KD'000	KD'000	KD'000
Financial assets held for trading	155	-	155
Financial assets at fair value through profit or loss	1,026	50,112	51,138
Available for sale investments	489	99,440	99,929
	<u>1,670</u>	<u>149,552</u>	<u>151,222</u>

30. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

30.7 Capital management

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 and healthy capital ratios in order to support its business and to maximize shareholders' value.

The Group actively manages its capital base in order to cover risks inherent in the business. The adequacy of the Group's capital is monitored using, among other measures, the rules and ratios established by the Basel Committee on Banking Supervision (BIS rules/ratios) and adopted by the Central Bank of Kuwait in supervising the Group.

During the year, the Group has complied in full with all its externally imposed capital requirements.

The Group's regulatory capital and capital adequacy ratios are shown below:

	2013	2012
	KD'000	KD'000
Tier 1 capital		
Share capital	183,645	174,824
Share premium	62,896	62,896
Proposed bonus shares	12,855	8,741
Treasury shares	(1,100)	(1,024)
Statutory reserve	3,306	1,891
Voluntary reserve	3,167	1,813
Share based payment reserve	860	537
Retained earnings	3,204	5,424
Non-controlling interests	5,543	2,514
Deductions from tier 1 capital	(74,112)	(3,246)
	200,264	254,370
Tier 2 capital		
Fair value and foreign currency translation reserves	(4,889)	(3,334)
General provision	13,306	12,380
Deductions from tier 2 capital	(8,417)	(3,246)
	-	5,800
	2013	2012
	KD'000	KD'000
Total regulatory capital	200,264	260,170
Risk-weighted assets	1,149,157	1,066,494
Capital ratios		
Total regulatory capital expressed as a percentage of total risk-weighted assets	17.43%	24.39%
Total tier 1 capital expressed as a percentage of risk-weighted assets	17.43%	23.85%

The disclosures relating to the capital adequacy regulations issued by Central Bank of Kuwait as stipulated in Central Bank of Kuwait circular number 2/RBA/44/2009 dated 15 June 2009 are included under the 'Risk Management' section of the annual report.

31. DERIVATIVES

In the ordinary course of business, the Bank enters into various types of transactions that involve Sharia'a approved derivative financial instruments to mitigate foreign currency risk. A derivative financial instrument is a financial contract between two parties where payments are dependent upon movements in price of one or more underlying financial instruments, reference rate or index.

The notional amount, disclosed gross, is the amount of a derivative's underlying asset and is the basis upon which changes in the value of derivatives are measured.

The notional amounts indicate the volume of transactions outstanding at the year-end and are neither indicative of the market risk nor credit risk.

The positive fair value of forward foreign exchange contracts outstanding as of 31 December 2013 is **KD 10 thousand** (2012: Nil) and their notional amounts outstanding as of 31 December 2013 are **KD 365 thousand** (2012: Nil)

The Group's derivative trading activities mainly related to deals with customers, which are normally matched by entering into reciprocal spot deals with counterparties.

32. FIDUCIARY ASSETS

The aggregate value of assets held in a trust or fiduciary capacity by the Group amounted to **KD 78,905 thousand** (31 December 2012: KD 70,246 thousand) and the related income from these assets amounted to **KD 294 thousand** (31 December 2012: KD 241 thousand).