GULF FINANCE HOUSE BSC

CONSOLIDATED FINANCIAL STATEMENTS

31 DECEMBER 2010

Commercial registration	:	44136 (registered with Central Bank of Bahrain as a Islamic wholesale investment Bank)
Registered Office	:	Bahrain Financial Harbour PO Box 10006, Manama, Kingdom of Bahrain Telephone +973 17538538
Directors	:	Dr. Esam Yousif A. Janahi, *Chairman* Hamad A Aziz Al-Shaya, *Vice Chairman* Abdul Latif Abdullah Al-Meer Adel Dawood Al-Ohali Yousuf Mohammed Khayat Dr. Abdul Aziz Al – Hinai Anthony Travis Mosabah Saif Al Mutairy Abdullah Ali Al Hamli Mohammad Ebrahim Mohammed Bader Nasser Al Subaei (upto 15 June 2010)
Company Secretary	:	Dr. Haider Majali
Auditors	:	KPMG

GULF FINANCE HOUSE BSC

CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2010

CONTENTS **Page**

Chairman's report	1-2
Independent auditors' report to the shareholders	3-4
Consolidated financial statements	
Consolidated statement of financial position	5
Consolidated income statement	6
Consolidated statement of comprehensive income	7
Consolidated statement of changes in equity	8-9
Consolidated statement of cash flows	10
Consolidated statement of changes in restricted investment accounts	11-12
Consolidated statement of sources and uses of charity and zakah fund	13
Notes to the consolidated financial statements	14-70

CHAIRMAN'S REPORT
for the year ended 31 December 2010

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

Dear Shareholders,

On behalf of the Board of Directors, I am presenting to you the financial statements of Gulf Finance House (GFH) for the financial year ended 31st December 2010.

Regional Overview
2010 proved to be yet another challenging year for all financial institutions around the world, including GFH, as the effects of the global economic crisis continued to ripple through the international financial system. The MENA regional economy in 2010 experienced a slowdown in its recovery matching that of the global economy. The banking sector showed slow improvement in some GCC nations - mainly due to government sponsored projects. Some governments assigned higher spending budgets which will be focused on developing the social infrastructure in countries such as Saudi Arabia. Investor confidence and liquidity also improved through 2010; reflected in equity markets generally having a strong year with the Kuwait Stock Exchange reversing losses in January and gathering momentum to end the year 20% higher. The banking sector drove some of this increase, closing 45.4% higher for the year, while the real estate sector and investment sector ended 2010 down 2.7% and 11.3%, respectively.

Overcoming the Challenges
Despite these challenging market conditions both regionally and internationally, particularly during the first half of the year, the benefits of the actions we have taken to refocus the Bank on its core strengths are already bearing fruit. Similarly, I believe that our patience in not proceeding with exits and initiating certain projects has been and will continue to be rewarded.

Throughout the year, GFH made significant progress in executing upon its recovery plan, deleveraging the bank balance sheet, cutting costs and enhancing liquidity by selling non-core assets. In tandem, we successfully exited some of our non-core assets including its stake in the Bahrain Financial Harbour, Qinvest and Saudi Real Estate Company with cash and assets proceeds reaching in excess of US$ 300 million, with further asset sales targeted in order to improve the bank liquidity position in 2011.

GFH undertook various measures during the year to reduce operating expenses. These measures allowed us to reduce expenses by 20% from US$ 126 million in 2009 to US$ 101 million in 2010, including financing charges and costs. These expenses are expected to continue their declining trend in 2011 as the full effect of the measures taken in 2010 is realized.

GFH's balance sheet continued to be realigned as part of this strategy with total assets reduced to US$ 1 billion at the year-end compared to US$ 1.6 billion at 31 December 2009. Liabilities were reduced from US$ 1.2 billion at the end of 2009 to US$ 900 million at the year-end. It is worth noting that financing liabilities were reduced by an impressive 33% to US$ 440 million compared to US$ 653 million at 31 December 2009. Excluding the current convertible Murabaha of US$96 million, where all investors have converted, the financing liabilities have reduced by 47%.

During the year, GFH repaid nearly US$ 400 million of its debts. Foremost amongst them is US$ 200 million of a US$ 300 million murabaha financing facility. The repayment terms of the remaining US$ 100 million were renegotiated for a period of two years - with a further one year option until 2013. Thanks to this and other successful renegotiated debts, GFH drastically improved the maturity profile of the Bank's term debt.

We continue to take a prudent approach to assessing the value of the assets on our balance sheet and we decided to register an impairment provision of US$256 million for the year (2009: US$656 million). In light of this, and the drop in total income for the year, down 86% to US$8 million (2009: US$57 million), GFH registered a net loss of US$ 349 million for 2010, substantially lower compared to the US$728 million loss for 2009.

Roadmap to Recovery

We continued to forge ahead with our new business model which will focus on the creation, development and management of pioneering Islamic financial institutions offering a range of financial products and services to corporate and retail clients. This will create a more stable business model of recurring revenues for GFH which in turn creates a platform that can generate real, meaningful and recurring profitable returns for our clients and shareholders, both from operations in our home market and further afield.

Moreover, GFH has dedicated itself towards completing its existing projects while achieving the best possible returns for its clients. This strategy will continue in 2011, and announcements related to these exits will be made in due course. GFH has during 2009 and 2010 made high provisions on its assets because of market conditions, many of which have been fully provided for. In 2011, once the regional markets stabilize not only is GFH looking to generate liquidity from these assets, but also try to enhance its value and hence make returns for its shareholders.

In late 2010, GFH's plans to improve its capital structure, strengthen its balance sheet and raise funds to pursue its aforementioned growth strategy were presented and subsequent resolutions approved at the EGM held in November 2010. The resolutions covered a 4:1 share consolidation and other capital reduction measures and a capital increase of up to US$500 million through a convertible murabaha to strengthen GFH's capital base and fund its growth strategy. Following obtaining the relevant approvals, I am pleased to inform you that GFH has received subscriptions of over US$100 million towards its recapitalization plan from GCC investors, including sovereign funds. GFH is anticipating receiving additional participation during the course of 2011 which will further boost its business growth and strengthen its position in the market.

In addition, the shareholders at this EGM approved a swap arrangement with the Executive Chairman whereby the bank would swap its interest in the "Lost Paradise of Dilmun" Waterpark (a non-core asset) for the Executive Chairman's interest in 10% of the issued share capital of Khaleeji Commercial Bank B.S.C. – an asset which is more in line with the bank's core activities and future business objectives. It is expected that this swap arrangement will be finalised following the receipt of relevant regulatory approvals in the first half of 2011.

Moving Forward

In light of these decisions, our Board is optimistic that GFH will be well positioned to once again lead the region's Islamic banks as growth returns to the region. Looking forward, our strategy is predicated on taking the best parts of our heritage – our core Islamic finance segment – and building on this foundation by improving our balance sheet, concentrating on our core assets and transforming into a much more efficient operation in all facets of our business.

As part of this plan, there are plans for a GCC-wide tour aimed featuring myself and senior GFH management aimed at engaging our valued investors and shareholders in constructive dialogue and increasing transparency between the organization and its stakeholders. We will be announcing the details of this tour once arrangements are finalized.

Allow me before I conclude to take this opportunity to extend my heartfelt thanks and appreciation to the rulers and respective government of the Kingdom of Bahrain and the Central Bank of Bahrain for the role they played in strengthening the Kingdom's position as the financial hub of the region and their continuous support and assistance to the financial sector as a whole. We are also grateful to the leadership and respective governments of the Kingdom of Saudi Arabia, the State of Kuwait, Sultanate Oman, State of Qatar, the United Arab Emirates, the Republic of India, the Hashemite Kingdom of Jordan, the Great Socialist people's Libyan Arab Jamahiriya, the Kingdom of Morocco and the Tunisian Republic for their valued relationships and continued contribution to our achievements.

Finally, I would like extend my sincere thanks to all our valued shareholders and investors for their continued support over the years and to the Bank's management team for their appreciated hard effort. GFH remains an active and leading member of Bahrain's financial and business community and we sincerely look forward to 2011 to be a year of renewed achievement for GFH.

Best regards,



Esam Yousif Janahi

KPMG Fakhro
Audit
5th Floor
Chamber of Commerce Building
PO Box 710, Manama
Kingdom of Bahrain

CR No. 6220
Telephone +973 17 224807
Fax +973 17 227443
Internet www.kpmg.com.bh

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

7 April 2011

Report on the consolidated financial statements

We have audited the accompanying consolidated financial statements of Gulf Finance House BSC (the "Bank") and its subsidiaries (together, the "Group") which comprise the consolidated statement of financial position as at 31 December 2010, and the consolidated statements of income, comprehensive income, changes in equity, cash flows, changes in restricted investment accounts and sources and uses of charity and zakah fund for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Board of directors' responsibility for the consolidated financial statements
The board of directors of the Bank is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Financial Accounting Standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions and International Financial Reporting Standards, and for such internal control as the board of directors determine is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error. The board of directors is also responsible for the Group's undertaking to operate in accordance with Islamic Shari'a rules and principles.

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 both the Auditing Standards for Islamic Financial Institutions and International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether 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 our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we 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.

KPMG Fakhro, a registered partnership under Bahrain law,
is a member of KPMG International, a Swiss cooperative.

Independent auditors' report to the shareholders (continued)
7 April 2011

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the financial position of the Group as at 31 December 2010, and of the results of its operations, its cash flows, changes in equity, changes in restricted investment accounts and sources and uses of charity and zakah fund for the year then ended in accordance with Financial Accounting Standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions and the Shari'a rules and principles as determined by the Shari'a Supervisory Board of the Bank.

In addition, in our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at 31 December 2010, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards.

Emphasis of matter

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

Report on other regulatory requirements

As required by the Bahrain Commercial Companies Law and the Central Bank of Bahrain Law, we report that the Bank has maintained proper accounting records and the consolidated financial statements are in agreement therewith; the financial information contained in the chairman's report is consistent with the consolidated financial statements; we are not aware of any violations of the Bahrain Commercial Companies Law, the Central Bank of Bahrain Law, the terms of the Bank's license or the terms of the Bank's memorandum and articles of association having occurred during the year that might have had a material adverse effect on the business of the Bank or on its financial position; and satisfactory explanations and information have been provided to us by the management in response to all our requests.

KPMG

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

as at 31 December 2010 US$ 000's

	Note	31 December 2010	31 December 2009
ASSETS			
Cash and bank balances	4	3,770	10,174
Placements with financial and other institutions	5	56,868	454,966
Financing receivables	6	14,400	29,173
Investment in associates	7	224,847	376,424
Investment securities	8	248,794	349,399
Investment property	9	266,412	-
Receivable from investment banking services	10	-	85,270
Other assets	11	203,150	336,930
Total assets		**1,018,241**	1,642,336
LIABILITIES			
Investors' funds	14	138,798	246,193
Placements from financial and other institutions	15	126,241	210,842
Financing liabilities	16	439,504	652,520
Other liabilities	17	195,535	96,584
Total liabilities		**900,078**	1,206,139
Unrestricted investment accounts	18	**1,880**	2,875
EQUITY			
Share capital	19	145,780	604,079
Treasury shares		(24,674)	(52,371)
Share premium		206,203	202,316
Statutory reserve		88,298	106,700
Accumulated losses		(302,068)	(432,677)
Available-for-sale investments fair value reserve		975	975
Other reserves	20	1,769	4,300
Total equity (page 8)		**116,283**	433,322
Total liabilities, unrestricted investment accounts and equity		**1,018,241**	1,642,336
Off-balance sheet items			
Restricted investment accounts (page 11)		**48,227**	50,042

The consolidated financial statements consisting of pages 5 to 70 were approved by the Board of Directors on 7 April 2011and signed on its behalf by:

Esam Yousif A. Janahi
Chairman

Hamad A Aziz Al-Shaya
Vice-Chairman

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

CONSOLIDATED INCOME STATEMENT

for the year ended 31 December 2010 US$ 000's

	Note	2010	2009
Income from investment banking services		5,032	48,980
Management fees		7,085	2,580
Income from placements with financial and other institutions		1,148	3,752
Income from financing		651	1,353
Loss from investment in associates	21	(11,729)	(7,288)
Loss from investment securities, net	22	(1,380)	(4,027)
Other income, net		7,300	11,614
Total income		**8,107**	56,964
Staff cost	23	17,635	28,213
Investment advisory expenses		6,990	26,571
Finance expense	24	50,035	39,578
Other expenses	25	26,207	31,502
Total expenses		**100,867**	125,864
Loss before provision for impairment		**(92,760)**	(68,900)
Provision for impairment	26	(256,119)	(655,598)
Loss for the year from continuing operations		**(348,879)**	(724,498)
Discontinued operations			
Loss from discontinued operations	12	(522)	(3,881)
Loss for the year		**(349,401)**	(728,379)
Basic and Diluted Earnings per share (US cents)			
Continuing operations	29	**(76.84)**	(272.17)
Discontinued operations	29	**(0.11)**	(1.46)

Esam Yousif A. Janahi
Chairman

Hamad A Aziz Al-Shaya
Vice-Chairman

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

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

for the year ended 31 December 2010 US$ 000's

	2010	2009
Loss for the year	**(349,401)**	(728,379)
Other comprehensive income		
Changes in fair value of available-for-sale investments	-	(157)
Total comprehensive income for the year	**(349,401)**	(728,536)

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

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
for the year ended 31 December 2010 US$ 000's

2010	**Share Capital**	**Treasury shares**	**Share premium**	**Statutory reserve**	**Accumulated losses**	**Available-for –sale investments fair value reserve**	**Other reserves** (note 20)	**Total**
At 1 January 2010	604,079	(52,371)	202,316	106,700	(432,677)	975	4,300	433,322
Comprehensive income for the year:								
Loss for the year	**-**	**-**	**-**	**-**	(349,401)	**-**	**-**	**(349,401)**
Total comprehensive income for the year	-	-	-	-	**(349,401)**	**-**	**-**	**(349,401)**
Conversion of Murabaha to share capital (note 16)	21,711	-	3,922	-	-	-	(633)	25,000
Adjustment of accumulated losses against share capital (note 19)	(480,010)	-	-	-	480,010	-	-	-
Share issue expenses	-		(35)	-	-	-	-	(35)
Share grants vesting expense, net of forfeitures (note 23)	-	-	-	-	-	-	(1,898)	(1,898)
Sale of treasury shares	-	27,697	-	-	-	-	-	27,697
Loss on sale of treasury shares	-	-	-	(18,402)	-	-	-	(18,402)
At 31 December 2010	**145,780**	**(24,674)**	**206,203**	**88,298**	**(302,068)**	**975**	**1,769**	**116,283**

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

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
for the year ended 31 December 2010 *(continued)* US$ 000's

2009	Share capital	Treasury shares	Share premium	Statutory reserve	Accumul-ated losses	Available-for-sale investments fair value reserve	Other reserves (note 20)	Total equity
At 1 January 2009	262,813	(17,364)	180,382	106,700	409,702	1,132	23,508	966,873
Comprehensive income for the year:								
Loss for the year	-	-	-	-	(728,379)	-	-	(728,379)
Changes in fair value of available-for-sale investments	-	-	-	-	-	(157)	-	(157)
Total comprehensive income for the year (page 7)	-	-	-	-	(728,379)	(157)	-	(728,536)
Increase in share capital	262,651	-	39,795	-	-	-	-	302,446
Issue of bonus shares	52,562	-	-	-	(52,562)	-	-	-
Share issue expenses	-	-	(21,808)	-	-	-	-	(21,808)
Equity component of convertible murabaha (note 16)	-	-	-	-	-	-	1,266	1,266
Convertible options exercised (note 16)	26,053	-	3,947	-	-	-	-	30,000
Share grants vesting expense, net of forfeitures (note 23)	-	-	-	-	-	-	(20,474)	(20,474)
Dividend declared for 2008	-	-	-	-	(52,563)	-	-	(52,563)
Charity contribution declared for 2008	-	-	-	-	(3,000)	-	-	(3,000)
Board remuneration declared for 2008	-	-	-	-	(3,000)	-	-	(3,000)
Zakah contribution declared for 2008	-	-	-	-	(2,875)	-	-	(2,875)
Purchase of treasury shares	-	(35,007)	-	-	-	-	-	(35,007)
At 31 December 2009	604,079	(52,371)	202,316	106,700	(432,677)	975	4,300	433,322

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

CONSOLIDATED STATEMENT OF CASH FLOWS
for the year ended 31 December 2010 US$ 000's

	2010	2009
OPERATING ACTIVITIES		
Cash receipts from investment banking services	5,032	102,462
Placements with / received from financial and other institutions, net	(22,643)	(867,451)
Cash receipts from water park operations	4,902	5,897
Disbursement for financing of projects, net	(12,424)	(13,142)
Investors' funds utilised, net	(40,726)	(292,799)
Management fees received	7,085	2,580
Income from placements and financing received	1,597	3,752
Payments for expenses and project costs	(63,917)	(86,370)
Cash used in operating activities	**(121,094)**	(1,145,071)
INVESTING ACTIVITIES		
Purchase of investment securities	(6,882)	(76,764)
Proceeds from sale of available-for-sale investments	35,647	-
Proceeds from sale of investment in associates	40,000	-
Dividends received	2,230	17,950
Proceeds from partial disposal of associate	-	51,502
Payment for development property	-	(19,310)
Net cash flows from disposal of a subsidiary (note 12)	(1,309)	-
(Payments for acquisition) / proceeds from disposal of equipment	(116)	365
Cash generated from / (used in) investing activities	**69,570**	(26,257)
FINANCING ACTIVITIES		
Financing liabilities, net	(180,449)	29,238
Proceeds from issue of ordinary shares	-	276,381
Finance expense paid	(40,350)	(38,019)
Proceeds from sale of treasury shares	9,295	-
Cash paid to charitable organisations	(631)	(360)
Board remuneration paid	-	(3,000)
Dividends paid	(262)	(57,644)
(Payments) to / receipts from unrestricted investment accounts, net	(993)	746
Cash (used in) / generated from financing activities	**(213,390)**	207,342
DECREASE IN CASH AND CASH EQUIVALENTS	**(264,914)**	(963,986)
Cash and cash equivalents at 1 January	325,552	1,289,538
CASH AND CASH EQUIVALENTS at 31 December	**60,638**	325,552
Cash and cash equivalents comprise:		
Cash and bank balances	3,770	10,174
Placements with financial and other institutions (note 5)	56,868	315,378
	60,638	325,552

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

CONSOLIDATED STATEMENT OF CHANGES IN RESTRICTED INVESTMENT ACCOUNTS
for the year ended 31 December 2010

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

Revaluation changes include loss of US$ 1,815 thousand (2009: gain of US$ 2,056 thousand) on account of foreign exchange translation differences and US$ Nil (2009: US$ 22,795 thousand) of impairment allowances for decline in value of investments

CONSOLIDATED STATEMENT OF CHANGES IN RESTRICTED INVESTMENT ACCOUNTS
for the year ended 31 December 2010 *(continued)*

2009	Balance at 1 January 2009			Movements during the year						Balance at 31 December 2009		
Company	No of units (000)	Average value per share US$	Total US$ 000's	Investment US$ 000's	Revaluation US$ 000's	Gross income US$ 000's	Dividends paid US$ 000's	Bank's fees as an agent US$ 000's	Administration expenses US$ 000's	No of units (000)	Average value per share US$	Total US$ 000's
Mena Real Estate Company KSCC	150	0.36	54	-	(2)	-	-	-	-	150	0.35	52
Kuwait National Real Estate Investment & Services Co. KSCC	250	0.36	90	-	(3)	-	-	-	-	250	0.35	87
Gulf Holding Company	10,000	0.36	3,624	-	(866)	-	(341)	-	-	10,000	0.24	2,417
Gulf North Africa Holding Company KSCC	11,500	0.36	4,168	-	(995)	-	(422)	-	-	11,500	0.24	2,751
Gulf Real Estate Development Company	936	13.32	12,472	-	(8)	-	(1,193)	-	-	936	12.05	11,271
Al Basha'er Fund	203	7.93	1,610	(764)	546	-	-	(721)	-	93	7.22	671
Pan European Fund	35.85	1,410.76	50,576	-	(19,411)	-	-	-	-	35.85	869.32	31,165
Oman Development Company	522.50	3.12	1,628	-	-	-	-	-	-	522.50	3.12	1,628
			74,222	(764)	(20,739)	-	(1,956)	(721)	-			50,042

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

CONSOLIDATED STATEMENT OF SOURCES AND USES OF CHARITY AND ZAKAH FUND
for the year ended 31 December 2010 US$ 000's

	2010	2009
Sources of charity and zakah fund		
Contributions by the Bank	-	5,875
Non-Islamic income (note 31)	6	23
Total sources	**6**	5,898
Uses of charity fund and zakah fund		
Contributions to charitable organisations	(631)	(360)
Total uses	**(631)**	(360)
Excess of sources over uses	**(625)**	5,538
Undistributed charity and zakah fund at 1 January	11,256	5,718
Undistributed charity and zakah fund at 31 December (note 17)	**10,631**	11,256
Represented by:		
Charity fund	7,830	7,824
Zakah payable	2,801	3,432
	10,631	11,256

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2010

US$ 000's

1 INCORPORATION AND PRINCIPAL ACTIVITY

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

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

Consolidated financial statements

The consolidated financial statements for the year comprise the financial statements of the Bank and its subsidiaries (together referred to as "the Group"). The significant subsidiaries of the Bank include GFH Sukuk Limited and Injazat Capital Limited, which are wholly owned. In its normal course of business, the bank also set up subsidiaries, that are special purpose entities with nominal capital to execute specific investing and financing transactions.

2 SIGNIFICANT ACCOUNTING POLICIES

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

(a) Statement of compliance

The consolidated financial statements have been prepared in accordance with both the Financial Accounting Standards ('FAS') issued by the Accounting and Auditing Organisation for Islamic Financial Institutions and International Financial Reporting Standards ('IFRS').

(b) Basis of preparation

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

Going concern

For the year ended 31 December 2010, the Group incurred a net loss of US$ 349,401 thousand and, as of that date, its current contractual liabilities exceeded its available liquid assets. As a result, the ability of the Group to meet its obligations when due depends on its ability to achieve a timely disposal of assets. Further, the regulatory capital adequacy ratio as at 31 December 2010 stood at to 10.60%, which restricts the Group's ability to absorb further losses or undertake additional exposures. These factors indicate the existence of material uncertainties which may cast doubt, about the Group's ability to continue as a going concern.

During 2010, the Group was able to repay a substantial amount of its debt obligations and managed to renegotiate the terms and extend tenure of its major obligations due in 2010. The Group has also restructured its balance sheet by writing off a substantial portion of its accumulated losses against share capital to enable issue of additional equity (note 19) at competitive terms. To improve its equity and liquidity positions, the Group is in the process of issuing additional capital through the issue of up to US$ 500 million convertible murabaha instruments (note 16). Till date, subscriptions amounting to US$ 102 million have been received and converted into equity in 2011 (note 16). Further, the Group is continuing its structured assets sale plan to generate the required liquidity to support its obligation when due. Currently, the Group has also commenced discussions with its lenders to renegotiate the tenor and other terms of its obligations due in 2011 and is confident that it will be able to successfully conclude these negotiations.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(b) Basis of preparation (continued)

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

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

(c) New standards, amendments and interpretations effective from 1 January 2010

The following standards, amendments and interpretations, which became effective in 2010 are relevant to the Group:

*(i) **International Financial Reporting Standards***

- **IFRS 3 (revised), 'Business combinations' (2008)**
  Revised IFRS 3 *Business Combinations* (2008) incorporates the following changes that are likely to be relevant to the Group's operations:

  - The definition of a business has been broadened, which may result in more acquisitions being treated as business combinations.
  - Contingent consideration will be measured at fair value, with subsequent changes in fair value recognised in profit or loss.
  - Transaction costs, other than share and debt issue costs, will be expensed as incurred.
  - Any pre-existing interest in an acquiree will be measured at fair value, with the related gain or loss recognised in profit or loss.
  - Any non-controlling (minority) interest will be measured at either fair value, or at its proportionate interest in the identifiable assets and liabilities of an acquiree, on a transaction-by-transaction basis.

  The revised standard is effective prospectively to business combinations for which the acquisition date is on or after the first annual reporting period beginning on or after 1 July 2009. The revised standard did not have any significant impact on the Group. However, in the future, this guidance will tend to produce higher volatility in equity and/or earnings in connection with the acquisition of interests by the Group.

- **IAS 27 (revised), 'Presentation of financial statements'**
  The revised standard requires the effects of all transactions with non-controlling interests to be recorded in equity if there is no change in control and these transactions will no longer result in goodwill or gains and losses. The standard also specifies the accounting when control is lost; any remaining interest in the entity is re-measured to fair value, and a gain or loss is recognised in profit or loss. The Group will apply IAS 27 (revised) prospectively from 1 January 2010 to transactions with non-controlling interests and for transactions resulting in loss of control. The change in accounting policy was applied prospectively and had no material impact on the consolidated financial statements.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

- **Improvements to IFRSs (2009)**
  Improvements to IFRS issued in April 2009 contained numerous amendments to IFRS that the IASB considers non-urgent but necessary. 'Improvements to IFRS' comprise amendments that result in accounting changes to presentation, recognition or measurement purposes, as well as terminology or editorial amendments related to a variety of individual IFRSs. The amendments are effective for annual periods beginning on or after 1 January 2010 with earlier adoption permitted. There were no material changes to the current accounting policies of the Group as a result of these amendments.

(ii) ***Financial Accounting Standards issued by AAOIFI***

- FAS 23 Consolidation (effective for annual periods beginning on or after 1 January 2010); and
- FAS 24 Investment in Associates (effective for annual periods beginning on or after 1 January 2010).

The requirements of these standards are largely in line with the current policies followed by the Group for accounting of subsidiaries and associates and the adoption of these standards did not result in any material impact on the consolidated financial statements.

(d) Basis of consolidation

(i) Subsidiaries

Subsidiaries are those enterprises (including special purpose entities) controlled by the Group. Control exists when the Group has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Subsidiaries are consolidated from the date on which control is transferred to the Group and de-consolidated from the date that control ceases. Accounting for acquisition of subsidiaries is governed under IFRS 3 'Business combinations'. Accounting for business combinations under IFRS 3 only applies if it is considered that a business has been acquired. For acquisitions meeting the definition of a business, the acquisition method of accounting is used. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. Any goodwill arising from initial consolidation is tested for impairment at least once a year and whenever events or changes in circumstances indicate the need for an impairment. If the cost of acquisition is less than the fair value of the Group's share of the net assets acquired, the difference is recognised directly in the consolidated income statement. For acquisitions not meeting the definition of a business, the Group allocates the cost between the individual identifiable assets and liabilities. Financial assets and liabilities are recognised at their fair value at the acquisition date as measured in accordance with IAS 39 'Financial instruments: Recognition and measurement' and the remaining balance of the cost of purchasing the assets and liabilities is allocated to other individual non-financial assets and liabilities based on their relative fair values at the acquisition date.

(ii) Special purpose entities

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

The Group in its fiduciary capacity manages and administers assets held in trust and other investment vehicles on behalf of investors. The financial statements of these entities are usually not included in these consolidated financial statements. Information about the Group's fiduciary assets under management is set out in note 27.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(d) Basis of consolidation (continued)

(iii) Associates

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

The Group, being a venture capital organisation, designates certain of its investments in associates, as allowed by IAS 28 'Investments in Associates', as 'investments carried at fair value through profit or loss in accordance with IAS 39 [note 2 (g)]. These are managed, evaluated and reported on internally on a fair value basis.

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

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

(iv) Transactions eliminated on consolidation

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

(e) Foreign currency transactions

(i) Functional and presentation currency

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

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(e) Foreign currency translation (continued)

(ii) Transactions and balances

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

(iii) Group companies

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

(f) Financial assets and liabilities

Financial assets of the Group comprise bank balances, placements with financial and other institutions, available-for-sale investments, investments designated at fair value through profit or loss, financing receivables and other receivable balances. Financial liabilities of the Group comprise investors' funds, placements from financial and other institutions, financing liabilities and other payable balances.

(i) Recognition and de-recognition

All financial assets (except investment securities) and liabilities are recognised on the date at which they are originated. Investment securities are recognised at the trade date i.e. the date that the Group contracts to purchase or sell the asset, at which date the Group becomes party to the contractual provisions of the instrument.

A financial asset or liability is initially measured at fair value which is the value of the consideration given (in the case of an asset) or received (in the case of a liability).

The Group derecognises a financial asset when the rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all risk and rewards of ownership. The Group writes off certain financial assets when they are determined uncollectible. The Group derecognises a financial liability when its contractual obligations are discharged, cancelled or expire.

(ii) Offsetting

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

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

(iii) Classification of financial assets and liabilities

The Group allocates financial assets to the following IAS 39 categories: financial assets at fair value through profit or loss; loans and receivables; held-to-maturity investments; and available-for-sale financial assets. Except for investment securities (note 2 (g)), the Group classifies all other financial assets as loans and receivables. All of the financial liabilities of the Group are classified at amortised cost. Management determines the classification of its financial instruments at initial recognition.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(f) Financial assets and liabilities (continued)

(iv) Measurement principles

Financial assets and liabilities are measured either at fair value, amortised cost or in certain cases carried at cost.

Fair value measurement

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction on the measurement date.

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

Amortised cost measurement

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortisation using the effective profit method of any difference between the initial amount recognised and the maturity amount, minus any reduction for impairment. The calculation of the effective profit rate includes all fees and points paid or received that are an integral part of the effective profit rate, transaction cost and all other premiums and discounts.

(g) Investment securities

The Group classifies its investment securities, excluding investment in subsidiaries and equity accounted associates (note 2 (d)), in the following categories: investment at fair value through profits or loss; held-to-maturity investments and available-for-sale investments.

(i) Classification

Investments carried at fair value through profit or loss are financial assets that are held for trading or which upon initial recognition are designated by the Group as fair value through profit or loss.

An investment is classified as held for trading if it is acquired principally for the purpose of selling or repurchasing it in the near term or part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking. The Group currently does not hold trading investments.

The Group designates investment securities at fair value through profit or loss at inception only when it is managed, evaluated and reported on internally on a fair value basis. These include certain private equity investments and investments in certain quoted associates - note 2 (d)].

Held-to-maturity investments are financial assets with fixed or determinable payments and fixed maturity that the Group has the positive intention and ability to hold to maturity, and which are not designated as carried at fair value through profit or loss or as available-for-sale. The Group currently does not hold any held-to-maturity investments.

Available-for-sale investments are financial assets that are not investments carried at fair value through profit or loss or held-to-maturity or loans and receivables. These include investments in certain quoted and unquoted equity securities.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(g) Investment securities (continued)

(ii) Initial recognition

Investment securities are initially recognised at fair value, plus transaction costs for all financial assets not carried at fair value through profit or loss. Transaction costs on investments carried at fair value through profit or loss are expensed in the consolidated income statement when incurred.

(iii) Subsequent measurement

Subsequent to initial recognition, investments carried at fair value through profit or loss and available-for-sale investments are re-measured to fair value. Gains and losses arising from a change in the fair value of investments carried at fair value through profit or loss are recognised in the consolidated income statement in the period in which they arise. Gains and losses arising from a change in the fair value of available-for-sale investments are recognised in the comprehensive income and presented in a separate fair value reserve within equity. When the available-for-sale investments are sold, impaired, collected or otherwise disposed of, the cumulative gain or loss previously recognised in the consolidated statement of comprehensive income is transferred to the income statement.

Available-for-sale investments which do not have a quoted market price or other appropriate methods from which to derive reliable fair values, are carried at cost less impairment allowances.

(iv) Fair value measurement principles

Fair value for quoted investments is their market bid price. For unquoted investments, fair value is determined either by reference to the price of the most recent transactions in the shares, or based on recognised internal valuation models, or based on valuations undertaken by independent external valuers.

For certain investments, the Group uses proprietary models, which usually are developed from recognised valuation models for fair valuation. Some or all of the inputs into these models may not be market observable, but are estimated based on assumptions. Inputs to valuation techniques reasonably represent market expectations and measures of the risk-return factors inherent in the financial instrument. Valuation adjustments are recorded to allow for bid-ask spreads, liquidity risks, as well as other factors. Management believes that these valuation adjustments are necessary and appropriate to fairly state the values of these investments.

(h) Placements with and from financial and other institutions

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

(i) Financing receivables

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

(j) Cash and cash equivalents

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2010 US$ 000's

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(k) Investment property

Investment property is property held to earn rentals and/or for capital appreciation. Investment property is measured initially at cost, including transaction costs. Subsequent to initial recognition, investment property is carried at cost. Cost includes expenditure that is directly attributable to the acquisition of the investment property.

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

(l) Equipment

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

(m) Impairment of assets

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

Financial assets carried at amortised cost

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

Available-for-sale investments

In the case of available-for-sale equity securities carried at fair value, a significant or prolonged decline in the fair value of the security below its cost is objective evidence of impairment resulting in recognition of an impairment loss. In case of equity securities quoted in active markets, the Group considers a decline in value of 20% below cost or a decline in value that persists for more than 6 months as an indicator of impairment. If any such evidence exists for available-for-sale investments, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in the income statement. Impairment losses recognised in the income statement on equity instruments are not subsequently reversed through the consolidated income statement.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(m) Impairment of assets (continued)

For available-for-sale investments carried at cost, the Group makes an assessment of whether there is an objective evidence of impairment for each investment by assessment of financial and other operating and economic indicators. Impairment is recognised if the estimated recoverable amount is assessed to be below the cost of the investment.

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

(n) Risk management instruments
The Group enters into shari'a compliant foreign exchange risk management instruments on behalf of its customers/ projects on a back-to-back basis and does not retain significant open positions. These derivative-type risk management instruments are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at their fair value. The fair value of a instrument is the equivalent of the unrealised gain or loss from marking to market the instrument using prevailing market rates. Instruments with positive market values (unrealised gains) are disclosed under other assets and instruments with negative market values (unrealised losses) are disclosed under other liabilities in the statement of financial position. For risk management instruments that are not designated in a qualifying hedge relationship, all changes in its fair value are recognised immediately in the income statement.

(o) Financing liabilities
Financing liabilities comprise shari'a compliant financing facilities from financial institutions, financing raised through issue of Sukuk and the liability component of financing from convertible murabaha instrument. Financing liabilities are initially measured at fair value plus transaction costs, and subsequently measured at their amortised cost using the effective profit rate method. Financing cost, dividends, losses and gains relating to the financial liabilities are recognised in the income statement.

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

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

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(p) Financial guarantees

Financial guarantees are contracts that require the Group to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument. A financial guarantee contract is recognised from the date of its issue. The liability arising from a financial guarantee contract is recognised at the present value of any expected payment, when a payment under the guarantee has become probable. The Group has issued financial guarantees to support its development projects (note 38).

(q) Dividends and board remuneration

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

(r) Share capital and reserves

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

Treasury shares

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

Statutory reserve

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

(s) Restricted investment accounts

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

(t) Unrestricted investment accounts

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

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(u) Revenue recognition

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

Placement, **arrangement and management fees** are recognised as income when earned and the related services are performed.

Income from placements with financial and other institutions are recognised on a time-apportioned basis over the period of the related contract.

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

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

(v) Earnings prohibited by Shari'a

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

(w) Zakah

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

(x) Employees benefits

(i) Short-term benefits

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

(ii) Post employment benefits

Pensions and other social benefits for Bahraini employees are covered by the General Organisation for Social Insurance scheme, which is a "defined contribution scheme" in nature under IAS 19 'Employee Benefits', and to which employees and employers contribute monthly on a fixed-percentage-of-salaries basis. Contributions by the Bank are recognised as an expense in consolidated income statement when they are due.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(x) Post employment benefits (continued)

Expatriate employees on fixed contracts are entitled to leaving indemnities payable under the Bahraini Labour Law for the Private Sector of 1976, based on length of service and final remuneration. Provision for this unfunded commitment, has been made by calculating the notional liability had all employees left at the reporting date. These benefits are in the nature of a "defined benefit scheme" under IAS 19 and any increase or decrease in the benefit obligation is recognised in the income statement.

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

(iii) Share-based employee incentive scheme

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

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

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

(y) Provisions

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

3 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

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

Judgements

(i) Classification of investments

In the process of applying the Group's accounting policies, management decides on acquisition of an investment whether it should be classified as investments at fair value through profit or loss, held-to-maturity or available-for-sale investment securities. The classification of each investment reflects the management's intention in relation to each investment and is subject to different accounting treatments based on such classification [note 2 (f)].

(ii) Special purpose entities

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

Estimations

(i) Fair value of investments

The Group determines fair values of investment designated at fair value through profit or loss that are not quoted in active markets by using valuation techniques such as discounted cash flows and recent transaction prices. Fair value estimates are made at a specific point in time, based on market conditions and information about the investee companies. These estimates are subjective in nature and involve uncertainties and matters of significant judgement and therefore, cannot be determined with precision. There is no certainty about future events (such as continued operating profits and financial strengths). It is reasonably possible, based on existing knowledge, that outcomes within the next financial year that are different from assumptions could require a material adjustment to the carrying amount of the investments. In case where discounted cash flow models have been used to estimate fair values, the future cash flows have been estimated by the management based on information from and discussions with representatives of the management of the investee companies, and based on the latest available audited and un-audited financial statements. The basis of valuation have been reviewed by the Management in terms of the appropriateness of the methodology, soundness of assumptions and correctness of calculations and have been approved by the Board of Directors for inclusion in the consolidated financial statements. The potential effect of using reasonable possible alternative assumptions for valuing the investments would increase or decrease the fair values by US$ 3,899 thousand (2009: US$ 2,395 thousand).

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

Estimations (continued)

(ii) Impairment on available-for-sale investments

Available-for-sale investments where fair values are not readily available and reliably measurable are carried at cost and the recoverable amount of such investment is estimated to test for impairment. A significant portion of the Group's available-for-sale investments comprise investments in long-term real estate and infrastructure development projects. In making a judgement of impairment, the Group evaluates among other factors, liquidity of the project, evidence of a deterioration in the financial health of the project, impacts of delays in execution, industry and sector performance, changes in technology, and operational and financing cash flows. The Bank has exposures to investments and projects that operate in countries and geographies where business and political environment are subject to rapid changes. The performance of the investments and recoverability of exposures is based on condition prevailing and information available with management as at the reporting date. It is the management's opinion that the current level of provisions are adequate and reflect prevailing conditions and available information. It is reasonably possible, based on existing knowledge, that the current assessment of impairment could require a material adjustment to the carrying amount of the investments within the next financial year due to significant changes in the assumptions underlying such assessments.

(iii)Impairment of financing receivables

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

(iv) Impairment of investment property

The Group conducts valuation of its investment property periodically using external independent valuers to assess for impairment. The fair value was determined based on the market value of the property through the comparable method, analysing the land rates in the vicinity for similar assumed zoning regulations. All of the Group's investment property is situated in Bahrain. Given the reduction in the frequency of property transactions, instability in the local real estate market and the larger global economic environment which continued to decline throughout 2010, it is reasonably possible, based on existing knowledge, that the current assessment of impairment could require a material adjustment to the carrying amount of these assets within the next financial year due to significant changes in assumptions underlying such assessments.

(v) Impairment of cash generating units

Cash generating includes the Group's investments in certain subsidiaries and investment in equity accounted associates that generate cash flows that are largely independent from other assets and activities of the Group. The basis of impairment assessment for such cash generating units is described in accounting policy 2 (m). For investments in associates with indicators of impairment, the recoverable amounts of have been determined based on value in use calculations. The forecasts use cash flow projections based on financial budgets covering 5 years and have been determined on the basis of management's expectation of the businesses, taking into account the prevailing global and MENA region economic conditions in general and the particular industry of the associate. In addition, a growth rate of 3 % has been applied from year 6 into perpetuity which is in line with the long term average growth rates of the businesses in which the cash generating units operate. The cash flows are discounted using a discount rate of 17.6%, which reflects market specific risks relating to the businesses. Management believes that reasonably possible changes in key assumptions used to determine the recoverable amounts will not result in impairment.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2010 US$ 000's

4 CASH AND BANK BALANCES

	31 December 2010	31 December 2009
Cash on hand	8	8
Bank balances	3,709	10,113
Deposit with Ministry of Industry and Commerce	53	53
	3,770	10,174

5 PLACEMENTS WITH FINANCIAL AND OTHER INSTITUTIONS

	31 December 2010	31 December 2009
Gross placements	56,870	455,066
Less: Deferred profits	(2)	(100)
Net placements	**56,868**	454,966

Placements with financial and other institutions include US$ Nil (31 December 2009: US$ 139,588 thousand) that is pledged against commitments and facilities of projects of the Group and are not available for the Group's day-to-day operations.

6 FINANCING RECEIVABLES

	31 December 2010	31 December 2009
Murabaha financing receivables	14,400	29,173
Wakala financing receivables	62,650	62,650
	77,050	91,823
Less: Provision for impairment	(62,650)	(62,650)
	14,400	29,173

Murabaha financing receivables are net of deferred profits of US$ 1,832 thousand (31 December 2009: US$ 236 thousand).

7 INVESTMENT IN ASSOCIATES

	2010	2009
At 1 January	376,424	409,779
Reclassification during the year	-	70,692
Acquisitions during the year	35,152	-
Share of losses from associates	(11,729)	(171)
Distributions received during the year	-	(14,710)
Disposals during the year, at carrying value (note 9)	(175,000)	(59,166)
Provision for impairment during the year (note 26)	-	(30,000)
At 31 December	**224,847**	376,424

7 Investment in associates (continued)

During the year, the Group acquired an additional 10% stake in Khaleeji Commercial Bank BSC, an existing associate of the Group in exchange for its fully owned subsidiary, Al Areen Leisure and Tourism Company –"The Lost Paradise of Dilmun SPC"("Waterpark") (note 12).

The fair value of investment in the associate for which there are published price quotations is US$ 93,457 thousand (31 December 2009: US$ 133,839 thousand). The carrying value of the investment is US$ 158,550 thousand (31 December 2009: US$ 131,565 thousand). The Group has conducted an independent external assessment of the value-in-use of the associate and has concluded that the investment is not impaired (note 3(v)).

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

	2010	2009
Total assets	1,417,983	2,100,539
Total liabilities	363,381	525,105
Total revenues	62,839	88,522
Total net profits	(66,466)	14,494

8 INVESTMENT SECURITIES

	31 December 2010	31 December 2009
Available-for-sale investments	222,934	315,423
Investments designated at fair value through profit or loss	25,860	33,976
	248,794	349,399

a) AVAILABLE-FOR-SALE INVESTMENTS

	2010	2009
At 1 January	315,423	406,892
Acquisitions during the year	155,265	77,480
Reclassification during the year, net	-	(70,692)
Disposals during the year, at carrying value	(103,233)	(50,625)
Fair value changes during the year	-	(157)
Provision for impairment during the year	(144,521)	(47,475)
At 31 December	**222,934**	315,423

Available-for-sale investments include private equity investments managed by external investment managers or investments in projects promoted by the Group. Available-for-sale investments of US$ 222,459 thousand (31 December 2009: US$ 311,133 thousand) are carried at cost less impairment in the absence of a reliable measure of fair value. The Group plans to exit these investments principally by means of strategic sell outs, sale of underlying assets or through initial public offerings. As at 31 December 2010, the Group provided for US$ 120 million against the investment in a project in Libya.

8 Investment securities (continued)

Available-for-sale investments are primarily in unlisted equities in various real estate and infrastructure development projects and the impairment allowances has been established based on the management's assessment of the current market conditions, the marketability of the investments and the assessment of recoverable amounts.

b) INVESTMENTS DESIGNATED AT FAIR VALUE THROUGH PROFIT OR LOSS

	2010	2009
At 1 January	33,976	41,245
Acquisitions during the year	1,617	-
Disposals during the year, at carrying value	(4,233)	-
Fair value changes during the year	(5,500)	(7,269)
At 31 December	**25,860**	33,976

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

	2010	2009
Total assets	112,969	99,708
Total liabilities	25,826	25,504
Total revenues	76,838	65,701
Total net profits	4,865	4,442

9 INVESTMENT PROPERTY

In August 2010, the Group received plots of land in exchange for the Group's investment in an associate and settlement of certain receivables. The Group has classified the plots of land as investment property and follows the cost model for measurement. The investment property is pledged against a Wakala facility (note 16) and any proceeds from the investment property would be first applied towards the repayment of the facility.

During the year, the Group recognised an impairment allowance of US$ 12 million against the investment property based on assessment of its recoverable amount (note 26). The fair value of the Group's investment property at 31 December 2010 was US$ 276,627 thousand based on a valuation carried out by independent external valuers.

10 RECEIVABLE FROM INVESTMENT BANKING SERVICES

During the year, the Bank has recognised an impairment allowance of US$ 60,540 thousand (2009: US$ 83,570 thousand) against the impaired receivable.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2010 US$ 000's

11 OTHER ASSETS

	31 December 2010	31 December 2009
Project costs recoverable	-	811
Financing to projects	73,716	186,758
Receivable from sale of investments	-	94,463
Operating property and equipment of water park (note 12)	-	28,625
Other equipment (note 13)	7,137	15,910
Reimbursement right (notes 17, 38)	121,111	-
Prepayment and other receivables	1,186	10,363
	203,150	336,930

Financing to projects represents working capital and funding facilities provided to projects promoted by the Group in the normal course of business. During the year, the Group exercised its right to a collateral provided against financing to one of the Group's projects and it has been classified under investment property. The financing is expected to be recovered from the operating cash flows of the underlying project assets. Financing to projects and other receivables are net of impairment allowance of US$ 135,907 thousand (31 December 2009: US$ 99,849 thousand).

12 DISPOSAL OF A SUBSIDIARY

In September 2010, the Group sold 100% of its stake in Al Areen Leisure and Tourism Company -"The Lost Paradise of Dilmun SPC ("Waterpark") for an incremental stake of 10% in Khaleeji Commercial Bank BSC, an existing associate of the Group (note 7). With effect from 30 September 2010, the subsidiary's financial statements have been de-consolidated from the consolidated financial statements of the Group.

The partial sale of the subsidiary has been presented in the cash flow statement in accordance with International Accounting Standard 7 "Cash Flow Statements" as follows:

	US$ 000's
Total assets de-consolidated on disposal	35,671
Total liabilities de-consolidated on disposal	(519)
Net carrying value of investments disposed/ Gross consideration received (note 7)	**35,152**
Cash and cash equivalents of the subsidiary on the date of de-consolidation	(1,309)
Net cash flows on partial sale of subsidiary	**(1,309)**

12 Disposal of a subsidiary (continued)

The results of the discontinued operations during the year till the date of de-consolidation is as follows:

	2010	2009
Gross revenues	4,734	6,057
Operating and other expenses	(3,593)	(6,204)
Depreciation	(1,663)	(3,734)
Loss for the year	**(522)**	(3,881)

The cash flows from / (used in) discontinued operation during the period till 30 September 2010 are as follows:

	2010	2009
Cash generated from waterpark operations	4,902	5,897
Payment for operating expenses	(3,593)	(6,204)

13 EQUIPMENT

	Furniture	**Fixtures and equipment**	**Motor vehicles**	**Computers**	**2010 Total**	2009 Total
Cost						
At 1 January	2,023	15,242	516	11,305	29,086	27,939
Additions	-	279	-	330	609	2,881
Disposals	-	(46)	(356)	(185)	(587)	(1,734)
At 31 December	**2,023**	**15,475**	**160**	**11,450**	**29,108**	29,086
Depreciation						
At 1 January	674	4,791	204	7,790	13,459	8,655
Charge for year	390	3,034	64	2,410	5,898	6,515
Disposals	-	(46)	(172)	(168)	(386)	(1,711)
At 31 December	**1,064**	**7,779**	**96**	**10,032**	**18,971**	13,459
Provision for impairment during the year	-	(3,000)	-	-	(3,000)	-
Net book value At 31 December	**959**	**4,696**	**64**	**1,418**	**7,137**	15,627
Capital work-in-progress	-	-	-	-	**-**	283
Total	**959**	**4,696**	**64**	**1,418**	**7,137**	15,910

During the year, the Group has given notice to vacate part of its office premises due to overall reduction in headcount and its activities. Office fixtures of US$ 3 million that may not be recovered or be of continuing use have been provided for (note 26).

14 INVESTORS' FUNDS

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2010 US$ 000's

15 PLACEMENTS FROM FINANCIAL AND OTHER INSTITUTIONS

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

16 FINANCING LIABILITIES

	31 December 2010	31 December 2009
Murabaha financing	101,796	301,620
Wakala financing facilities	66,288	150,907
Sukuk liability	152,123	152,640
Convertible murabaha (2009)	23,437	47,353
Advance received for convertible murabaha (2010)	95,860	-
	439,504	652,520

Murabaha financing

Murabaha financing comprise medium-term financing from a syndicate of banks of US$ 100 million (31 December 2009: US$ 301.62 million). During the year, the Group repaid US$ 200 million of the outstanding financing facility and renegotiated the terms of financing facility of US$ 100 million by extending the repayment terms initially for a period of 6 months at an agreed profit rate of 5% over the benchmark rate (LIBOR) and thereafter for a further period of 2 years (extendable by 1 year at the option of the Group) by reducing the profit rate to 2.50% over the benchmark rate (LIBOR) payable semi annually and an additional profit mark up of 1.25% per annum. The Murabaha financing facility has also been secured by a pledge over a portion of the Group's investment in an associate of carrying value of US$ 123 million.

Wakala financing

Wakala financing facilities include financing of US$ 100 million obtained from financial institutions during 2008 and repayable equally in March 2010 and March 2011. During the year, the Group repaid a portion of the outstanding facility and renegotiated the balance amount to be repaid in 2010 and 2011 at an agreed profit rate of 8.5%. The Wakala financing facility is secured by a pledge over the Group's investment property (note 9). Subsequent to the year end, the Bank sold one of its investment property and utilised the proceeds of US$ 7 million towards partial repayment of the facility. The Group is currently negotiation the terms of the facility with its lenders.

Sukuk liability

In 2007, the Group announced a US$ 1 billion medium term Shari'a compliant Sukuk issuance programme (the 'Programme'). The Programme provides a facility for the issuance of Sukuk Certificates in series (each, a "Series"). Under the terms of the Programme, the Bank issued its first Series of Sukuk Certificates amounting to US$ 200 million in 2007. The Sukuk Certificates issued under the Programme have a tenure of 5 years maturing in 2012 and returns based on an agreed spread of 175 bps over the benchmark rate (LIBOR). The Sukuk Certificates issued are backed by a pool of assets of the Group and has a liquidity facility provided by the Bank to support timely payments of distributions under the Programme. The Sukuk Certificates issued have been admitted for trading on the London Stock Exchange's Gilt Edged and Fixed Interest Market.

The Sukuk Certificates are backed by the Group's investment securities with carrying values of US$ 183,923 thousand (31 December 2009: US$ 201,424 thousand).

During the year, the Group repurchased Sukuk Certificates of nominal value US$ 15 million (2009: US$ 37.8 million) resulting in a gain of Nil (2009: US$ 11.61 million). During the year, the Group sold Sukuk Certificates of nominal value of US$ 14.37 million in response to liquidity needs resulting in a loss of US$ 4.22 million on remeasurement of the liability to its amortised cost. The loss on buy back and sale of Sukuk is included under "Finance expense" (note 24).

16 Financing liabilities (continued)

Convertible murabaha facility 2009

During 2009, the Group issued a compound financial instrument ("Notes") in the form of unsecured convertible murabaha facility. The Notes have a tenure of 3 years maturing in October 2012 unless converted into ordinary shares of the Bank at the option of the holder, at an exchange price of US$ 0.38 per share. The Notes provide for returns of 8% p.a. payable quarterly to the holder. During the year, Note holders of face value US$ 25 million have exercised their option to convert their Notes into equity (note 19).

Advance received for convertible murabaha facility (2010)

During the year, the Group had planned to raise additional capital through the issue of a new series of convertible instruments. The shareholders have approved the issue of convertible murabaha of upto US$ 500 million in their Extraordinary General meeting held on 14 November 2010. Pending the approval from the regulator, advances of US$ 95.86 million received towards the proposed convertible murabaha have been included in 'Financing liabilities'. Subsequent to the year end, the Bank has received an additional subscription of US$ 9.14 million and pursuant to the approval of the regulatory authorities, the total of US$ 102 million has been converted into subscription for the facility and the counter parties exercised their option to convert the facility into 464,115 thousand number of equity shares.

17 OTHER LIABILITIES

	31 December 2010	31 December 2009
Employee related accruals	22,898	46,682
Unclaimed dividends	8,140	8,402
Provision for employees' leaving indemnities	472	772
Charity and zakah fund (page 13)	10,631	11,256
Provision against financial guarantees (note 11)	121,111	-
Accounts payable	3,053	7,577
Accrued expenses and other payables	29,230	21,895
	195,535	96,584

18 UNRESTRICTED INVESTMENT ACCOUNTS

Unrestricted investment accounts comprise Mudarabah deposits accepted by the Bank. The average gross rate of return in respect of unrestricted investment accounts was 0.67% for 2010 (2009: 0.76%). Approximately 0.67% / US$ 14 thousand (2009: 0.76% / US$ 20 thousand) was distributed to investors and the balance was either set aside for provisions and/or retained by the Bank as a Mudarib fee. Unrestricted investment accounts include profit equalisation reserve of US$ 4 thousand (2009: US$ 3 thousand) and investment risks reserve of US$ 2 thousand (2009: US$ 2 thousand). The funds received from unrestricted investment account holders have been commingled and jointly invested with the Group in placements with financial and other institutions.

19 SHARE CAPITAL

	31 December 2010	31 December 2009
Authorised:		
1,136,363,636 (2009: 4,545,454,545) shares of US$ 0.3075 each (2009: US$ 0.33 each)	349,431,818	1,500,000
Issued and fully paid up:		
474,083,141 shares of US$ 0.3075 each	**145,780**	-
1,830,543,093 shares of US$ 0.33 each	**-**	604,079

19 Share capital (continued)

The movement in the share capital during the year ended 31 December 2010 is as follows:

	2010
At 1 January	604,079
Conversion of murabaha to share capital (note 16)	21,711
Adjustment of accumulated losses for capital reduction	(480,010)
At 31 December	**145,780**

During the year, Note holders of convertible murabaha facility exercised their right to convert 65 million ordinary shares of US$ 21,711 thousand at a premium of US$ 0.05 per share (note 16).

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

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

The Bank is currently in the process of updating its regulatory and shareholders records to give affect to the above decisions.

At 31 December 2010, the Bank held 2,803,305 (31 December 2009: 102,254,809) treasury shares.

Subsequent to the year end, pursuant to the approval from the regulatory authorities, the Bank's issued and paid-up capital has further increased by US$ 102 million resulting in increase in the number of shares by 464,115 thousand as result of the note holders exercising their option to convert the murabaha facility to equity (note 15).

Additional information on shareholding pattern

(i) The Bank has only one class of equity shares and the holders of these shares have equal voting rights.

(ii) Distribution schedule of equity shares, setting out the number of holders and percentage in the following categories:

Categories*	Number of shares	Number of shareholders	% of total outstanding shares
Less than 1%	332,453,609	7,497	70.13
1% up to less than 5%	109,112,029	10	23.01
5% up to less than 10%	32,517,503	1	6.86
	474,083,141	**7,508**	**100**

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

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

Name	Nationality	No. of shares
Securities and Investment Company BSC (portfolio accounts)	Bahraini	32,517,503

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2010 US$ 000's

20 OTHER RESERVES

	2010			2009		
	Share grant reserve	**Equity component of convertible murabaha**	**Total**	Share grant reserve	Equity component of convertible murabaha	Total
At 1 January	3,034	1,266	4,300	23,508	-	23,508
Separation of equity component in a compound financial instrument (note 16)	-	(633)	(633)	-	1,266	1,266
Vesting expense, net of forfeiture (note 23)	(1,898)	-	(1,898)	(20,474)	-	(20,474)
At 31 December	**1,136**	**633**	**1,769**	3,034	1,266	4,300

21 LOSS FROM INVESTMENT IN ASSOCIATES

	2010	2009
Share of losses from associates, net (note 7)	(11,729)	(171)
Loss on partial disposal of associate	-	(7,117)
	(11,729)	(7,288)

22 LOSS FROM INVESTMENT SECURITIES

	2010	2009
Dividend income	2,230	3,242
Profit on disposal of available-for-sale investments	1,890	-
Changes in fair value of investments designated at fair value through profit or loss	(5,500)	(7,269)
	(1,380)	(4,027)

23 STAFF COST

	2010	2009
Salaries and benefits	16,904	25,377
Social insurance expenses	731	1,089
Other staff expenses	-	1,747
	17,635	28,213

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2010 US$ 000's

23 STAFF COST (continued)

The Bank operates a share incentive scheme for its employees. The share awards granted under the scheme have an initial lock-in period of 3 years and shall vest rateably over varied vesting periods of up to 10 years as per the terms of the scheme.

Of the cumulative 16.09 million shares (2009: 97.74 million) outstanding share awards granted under the terms of the scheme, 11.15 million were forfeited during the year due to failure to satisfy service conditions specified at grant date. At 31 December 2010, 4.94 million (31 December 2009: 16.09 million) share awards are outstanding to be exercised at a price of US$ 0.75 per share in future periods on satisfaction of the vesting conditions. A net reversal of vesting charge amounting to US$ 1,898 thousand (2009: US$ 20,474 thousand) was recognised during the year primarily due to the forfeitures of share awards on non-satisfaction of service conditions (note 20).

24 TOTAL FINANCE INCOME AND EXPENSE

	2010	2009
TOTAL FINANCE INCOME		
Income from placements with financial and other institutions	1,148	3,752
Income from financing receivables	651	1,353
	1,799	5,105
TOTAL FINANCE EXPENSE		
Investors' funds	5,585	118
Placements from financial and other institutions	10,753	9,809
Financing liabilities	29,460	29,631
Loss on disposal of sukuk (note 16)	4,223	-
Unrestricted investment accounts	14	20
	50,035	39,578
NET FINANCE EXPENSE	**(48,236)**	(34,473)

25 OTHER EXPENSES

	2010	2009
Rent	3,149	5,166
Professional and consultancy fee	7,025	6,609
Legal expenses	2,307	1,078
Depreciation	5,896	6,339
Foreign exchange loss, net	426	846
Other administrative expenses	7,404	11,464
	26,207	31,502

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2010 US$ 000's

26 PROVISION FOR IMPAIRMENT

	2010	2009
Financing receivables (note 6)	-	53,650
Assets held-for-sale	-	311,018
Investment in associates (note 7)	-	30,000
Investment securities (note 8)	144,521	47,475
Investment property (note 9)	12,000	-
Receivable from investment banking services (note 10)	60,540	83,570
Financing to projects	-	77,382
Goodwill	-	17,375
Other receivables (note 11)	36,058	22,467
Other equipment (note 13)	3,000	-
Operating property and equipment of a water park	-	12,661
	256,119	655,598

27 ASSETS UNDER MANAGEMENT

The Group provides corporate administration, investment management and advisory services to its project companies, which involve the Group making decisions on behalf of such entities. Assets that are held in such capacity are not included in these consolidated financial statements. At the reporting date, the Group had assets under management of US$ 2,282,415 thousand (31 December 2009: US$ 2,824,055 thousand). During the year, the Group has charged management fees amounting to US$ 7,085 thousand (2009: US$ 4,406 thousand) for the activities related to management of assets.

28 RELATED PARTY TRANSACTIONS

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

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2010 US$ 000's

28 RELATED PARTY TRANSACTIONS (continued)

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

2010	Associates	Key management personnel	Significant shareholders / entities in which directors are interested	Assets under management including special purpose entities	Total
Assets					
Cash and bank balances	583	-	-	-	583
Financing receivables	-	-	14,400	-	14,400
Investment in associates	224,847	-	-	-	224,847
Investment securities	25,860	-	55,897	121,314	203,071
Other assets	93	-	-	194,706	194,799
Liabilities					
Investors' funds	60,762	-	-	77,837	138,597
Placements from financial and other institutions	27	-	13,392	-	13,419
Financing liabilities	-	50,492	-	-	50,492
Other liabilities	-	-	-	121,111	121,111
Income					
Income from investment banking services	-	-	-	4,982	4,982
Management fees	-	-	-	7,085	7,085
Income from financing receivables	-	-	415	-	415
Loss from investment in associates	(11,729)	-	-	-	(11,729)
Loss from investment securities, net	(5,500)	-	-	6,811	1,313
Other Income	1,760	-	498	3,740	5,998
Expenses					
Finance expense	-	334	606	2,296	3,236
Provision for impairment	-	-	-	197,561	197,561
Commitments					
Commitment to extend finance	16,500	-	-	-	16,500

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2010 US$ 000's

28 RELATED PARTY TRANSACTIONS (continued)

2009	Associates	Key management personnel	Significant shareholders / entities in which directors are interested	Assets under management including special purpose entities	Total
Assets					
Cash and bank balances	1,387	-	3	-	1,390
Placements with financial and other institutions	28,357	-	64,358	-	92,715
Financing receivables	-	-	15,000	-	15,000
Investment in associates	376,424	-	-	-	376,424
Investment securities	33,976	-	111,554	157,456	302,986
Receivable from investment banking services	-	-	-	85,270	85,270
Other assets	35,639	-	36,005	159,230	230,874
Liabilities					
Investors' funds	-	-	-	246,193	246,193
Placements from financial and other institutions	497	-	85,909	-	86,406
Financing liabilities	-	-	52,108	-	52,108
Income					
Income from investment banking services	-	-	-	46,540	46,540
Management fees	-	-	-	2,580	2,580
Income from placements with financial and other institutions	122	-	440	-	562
Income from financing	-	-	-	-	-
Loss from investment in associates	(7,288)	-	-	-	(7,288)
(Loss) from investment securities, net	(7,279)	-	-	1,955	(5,324)
Expenses					
Provision for impairment	30,000	3,030	18,828	237,157	289,015
Finance expense	144	-	8,076	118	8,338
Commitments					
Commitment to extend finance	-	-	-	-	-
Commitment to invest	-	-	-	30,000	30,000
Equity transaction					
Transaction cost	-	-	14,300	-	14,300

Key management personnel

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

28 RELATED PARTY TRANSACTIONS (continued)

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

Categories*	**Number of Shares**	**Number of Directors**
Less than 1%	1,424,926	5

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

Details of material contracts involving directors' include:

	2010	2009
Directors' participation in investments promoted by the Group	7,160	21,235

During the year, the Group acquired an additional 10% stake in Khaleeji Commercial Bank BSC from its Chairman in exchange for its 100% stake in Al Areen Leisure and Tourism Company –"The Lost Paradise of Dilmun SPC" ("Waterpark") (note 12 and note 7). This transaction was approved by the shareholders in the Ordinary General Meeting held on 14 November 2010.

The key management personnel compensation is as follows:

	2010	2009
Board remuneration	-	3,000
Board member fees	2,477	2,477
Share-based payments (net of forfeitures)	-	(19,285)
Salaries and other short-term benefits	2,625	2,390
Post employment benefits	54	212

29 EARNINGS PER SHARE

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

	2010	2009
Loss for the year from continuing operations (US$ 000's)	**(348,879)**	(724,498)
Loss for the year from discontinued operations (US$ 000's)	**(522)**	(3,881)
Weighted average number of ordinary equity shares (Nos. in 000's)	**454,021**	266,189
Basic and diluted earnings per share from continuing operations (in US cents)	**(76.84)**	(272.17)
Basic and diluted earnings per share from discontinued operations (in US cents)	**(0.11)**	(1.46)

In accordance with IAS 33 'Earnings per share', the weighted average number of ordinary equity shares for the comparative periods presented are adjusted for the issue of shares during the period without corresponding change in resources.

29 Earnings per share (continued)

Diluted earnings per share

Diluted earnings per share is calculated by adjusting the weighted average number of ordinary shares outstanding to assume conversion of all dilutive potential ordinary shares. Potential ordinary shares are considered to be dilutive when, and only when, their conversion to ordinary shares would decrease earnings per share or increase the loss per share. The Bank has two categories of dilutive potential ordinary shares: convertible murabaha notes (note 16) and share awards granted to employees (note 23).

As the Bank has reported a loss during the period, the conversion of the murabaha facility to ordinary shares would not result in dilution i.e. increase the loss per share. Further, in case of the share awards granted to employees, as the average market value of shares during the current period was lower than the assumed issue price of shares under the scheme, the share awards are not considered to be dilutive as at 31 December 2010. Accordingly, no adjustment for dilution has been made for the purposes of computation of diluted earnings per share.

30 ZAKAH

Based on the computation approved by the Shari'a Supervisory Board, the Bank has appropriated US$ Nil (31 December 2009: US$ 2,875 thousand) from retained earnings towards payment of Zakah which is included in other liabilities.

Zakah is directly borne by the shareholders on distributed profits and investors in restricted investment accounts. The Bank does not collect or pay Zakah on behalf of its shareholders and investors in restricted investment accounts. Zakah payable by the shareholders is computed by the Bank on the basis of the method prescribed by the Bank's Shari'a Supervisory Board and notified to shareholders annually.No Zakah is payable by the shareholders for the year ended 31 December 2010 as the Bank has incurred losses during the year (2009: US$ Nil).

31 EARNINGS PROHIBITED BY SHARI'A

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

The Group receives interest from deposits placed with the Central Bank of Bahrain and other incidental or required deposits. These earnings are utilised exclusively for charitable purposes and amounts to US$ 6 thousand (2009: US$ 23 thousand).

32 SHARI'A SUPERVISORY BOARD

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

33 SOCIAL RESPONSIBILITY

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

34 MATURITY PROFILE

The table below shows the maturity profile of the Group's assets and liabilities and unrecognised commitments on the basis of their expected realisation/ payment and the Group's contractual maturity and amount of cash flows on these instruments may vary significantly from this analysis. For contractual maturity of financial liabilities refer note 39 (b).

31 December 2010	Up to 3 months	3 to 6 months	6 months-1 year	1 to 3 years	Over 3 years	Total
Assets						
Bank balances	3,709	-	-	-	-	3,709
Placements with financial and other institutions	56,868	-	-	-	-	56,868
Financing receivables	2,000	-	4,000	8,400	-	14,400
Investment in associates	-	-	-	-	224,847	224,847
Investment securities	20,220	-	-	228,574	-	248,794
Investment property	18,000	-	-	248,412	-	266,412
Other financial assets	-	4,944	-	189,825	1,244	196,013
Total assets	**100,797**	**4,944**	**4,000**	**675,211**	**226,091**	**1,011,043**

31 December 2010	Up to 3 months	3 to 6 months	6 months - 1 year	1 to 3 years	Over 3 years	Total
Financial liabilities						
Investors' funds	21,063	17,197	6,514	94,024	-	138,798
Placements from financial and other institutions	9,949	946	104,861	10,485	-	126,241
Financing liabilities	32,179	-	20,000	291,466	95,859	439,504
Other financial liabilities	71,911	-	-	123,624	-	195,535
Total liabilities	**135,102**	**18,143**	**131,375**	**519,599**	**95,859**	**900,078**
Unrestricted investment accounts	1,880	-	-	-	-	**1,880**
Off-balance sheet items						
Restricted investment accounts	**-**	**-**	**-**	48,227	**-**	48,227
Commitments	16,500	6,000	-	613	-	23,113

31 December 2009	Up to 3 months	3 to 6 months	6 months-1 year	1 to 3 years	Over 3 years	Total
Assets						
Bank balances	10,166	-	-	-	-	10,166
Placements with financial and other institutions	454,966	-	-	-	-	454,966
Financing receivables	14,173	15,000	-	-	-	29,173
Investment in associates	-	131,566		244,858	-	376,424
Investment securities	117,881	9,523	25,000	196,995	-	349,399
Receivable from investment banking services	40,540	44,730	-	-	-	85,270
Other financial assets	33,004	8,854	55,000	190,684	-	287,542
Total assets	670,730	209,673	80,000	632,537	-	1,592,940

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2010 US$ 000's

34 MATURITY PROFILE (continued)

31 December 2009	Up to 3 months	3 to 6 months	6 months - 1 year	1 to 3 years	Over 3 years	Total
Financial liabilities						
Investors' funds	94,831	59,820	41,014	50,528	-	246,193
Placements from financial and other institutions	210,842	-	-	-	-	210,842
Financing liabilities	127,346	223,674	-	301,500	-	652,520
Other financial liabilities	51,382	34,254	-	10,176	-	95,812
Total liabilities	484,401	317,748	41,014	362,204	-	1,205,367
Unrestricted investment accounts	2,875	-	-	-	-	2,875
Off-balance sheet items						
Restricted investment accounts	-	-	-	50,042	-	50,042
Commitments	8,737	30,000	16,500	613	-	55,850

35 CONCENTRATION OF ASSETS, LIABILITIES, UNRESTRCITED AND RESTRICTED INVESTMENT ACCOUNTS

Industry sector

31 December 2010	Trading and manufacturing	Banks and financial institutions	Development Infrastructure	Technology	Others	Total
Assets						
Cash and bank balances	-	3,770	-	-	-	3,770
Placements with financial and other institutions	-	56,868	-	-	-	56,868
Financing receivables	-	14,400	-	-	-	14,400
Investment in associates	66,297	158,550	-	-	-	224,847
Investment securities	23,370	13,548	200,190	2,500	9,186	248,794
Investment property	-	-	266,412	-	-	266,412
Other assets	17	95	192,073	-	10,965	203,150
Total assets	**89,684**	**247,231**	**658,675**	**2,500**	**20,151**	**1,018,241**
Liabilities						
Investors' funds	63,106		75,692	-	-	138,798
Placements from financial and other institutions	-	112,088	10,484	-	3,669	126,241
Financing liabilities	-	439,504	-	-	-	439,504
Other liabilities	-	413	-	-	195,122	195,535
Total liabilities	**63,106**	**552,005**	**86,176**	**-**	**198,791**	**900,078**
Unrestricted investment accounts	-	-	-	-	1,880	1,880
Off-Balance sheet items						
Restricted investment accounts	-	-	48,227	-	-	48,227
Commitments	-	16,500	613	-	6,000	23,113

35 Concentration of assets, liabilities, unrestricted and restricted investment accounts (continued)

(a) Industry sector (continued)

31 December 2009	Trading and manufacturing	Banks and financial institutions	Development Infrastructure	Technology	Others	Total
Assets						
Cash and bank balances	-	10,174	-	-	-	10,174
Placements with financial and other institutions	-	454,966	-	-	-	454,966
Financing receivables	-	15,000	14,173	-	-	29,173
Investment in associates	69,450	131,974	175,000	-	-	376,424
Investment securities	24,452	94,576	140,421	5,000	84,950	349,399
Receivable from investment banking services	-	-	85,270	-	-	85,270
Other assets	-	639	154,539	-	181,752	336,930
Total assets	93,902	707,329	569,403	5,000	266,702	1,642,336
Liabilities						
Investors' funds	85,656	24,350	133,959	-	2,228	246,193
Placements from financial and other institutions	-	93,869	-	-	116,973	210,842
Financing liabilities	-	652,520	-	-	-	652,520
Other liabilities	-	-	-	-	96,584	96,584
Total liabilities	85,656	770,739	133,959	-	215,785	1,206,139
Unrestricted investment accounts	-	-	-	-	2,875	2,875
Off-Balance sheet items						
Restricted investment accounts	-	-	50,042	-	-	50,042
Commitments	-	-	55,850	-	-	55,850

35 Concentration of assets, liabilities, unrestricted and restricted investment accounts (continued)

(b) Geographic region

31 December 2010	GCC countries	Other MENA	Other Asia	UK	Europe (excluding UK)	USA	Total
Assets							
Cash and bank balances	3,105	7	1	205	5	447	3,770
Placements with financial and other institutions	31,868	-	-	-	25,000	-	56,868
Financing receivables	14,400	-	-	-	-	-	14,400
Investment in associates	224,847	-	-	-	-	-	224,847
Investment securities	154,851	52,590	36,572	-	1,631	3,150	248,794
Investment property	266,412	-	-	-	-	-	266,412
Other assets	141,207	25,157	36,786	-	-	-	203,150
Total assets	**836,690**	**77,754**	**73,359**	**205**	**26,636**	**3,597**	**1,018,241**
Liabilities							
Investors' funds	96,863	33,319	8,417	-	199	-	138,798
Placements from financial and other institutions	35,018	91,223	-	-	-	-	126,241
Financing liabilities	314,270	-	-	125,234	-	-	439,504
Other liabilities	195,535	-	-	-	-	-	195,535
Total liabilities	**641,686**	**124,542**	**8,417**	**125,234**	**199**	**-**	**900,078**
Unrestricted investment accounts	1,880	-	-	**-**	**-**	**-**	1,880
Off-Balance sheet items							
Restricted investment accounts	48,227	-	-	-	-	-	48,227
Commitments	22,500	613	-	-	-	-	23,113

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

35 Concentration of assets, liabilities, unrestricted and restricted investment accounts (continued)

(b) Geographic region (continued)

31 December 2009	GCC countries	Other MENA	Other Asia	UK	Europe (excluding UK)	USA	Total
Assets							
Cash and bank balances	8,693	319	-	933	-	229	10,174
Placements with financial and other institutions	454,966	-	-	-	-	-	454,966
Financing receivables	29,173	-	-	-	-	-	29,173
Investment in associates	376,424	-	-	-	-	-	376,424
Investment securities	253,387	43,808	47,572	-	1,632	3,000	349,399
Receivable from investment banking services	-	65,270	20,000	-	-	-	85,270
Other assets	246,734	53,739	36,457	-	-	-	336,930
Total assets	1,369,377	163,136	104,029	933	1,632	3,229	1,642,336
Liabilities							
Investors' funds	141,606	93,004	8,450	-	3,133	-	246,193
Placements from financial and other institutions	210,842	-	-	-	-	-	210,842
Financing liabilities	303,549	-	-	348,971	-	-	652,520
Other liabilities	96,584	-	-	-	-	-	96,584
Total liabilities	752,581	93,004	8,450	348,971	3,133	-	1,206,139
Unrestricted investment accounts	2,875	-	-	-	-	-	2,875
Off-Balance sheet items							
Restricted investment accounts	18,877	-	-	-	31,165	-	50,042
Commitments	25,237	30,613	-	-	-	-	55,850

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2010 US$ 000's

36 OPERATING SEGMENTS

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

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

- **Development infrastructure:** This business unit primarily is involved in origination and management of large scale economic infrastructure projects. The business unit also covers the Group's investment in real estate and related assets.

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

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

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

The Bank has primary operations in Bahrain and the Bank does not have any significant overseas branches/divisions. The geographic concentration of assets and liabilities is disclosed in note 35(b) to the consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2010 US$ 000's

36 OPERATING SEGMENTS (continued)

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

2010	**Development infrastructure**	**Banking**	**Unallocated**	**Total**
Segment revenue	10,056	(4,325)	2,376	**8,107**
Segment expenses	286,218	56,826	14,464	**357,508**
Segment result	(276,162)	(61,151)	(12,088)	**(349,901)**
Segment assets	656,282	349,815	12,144	**1,018,241**
Segment liabilities	580,418	236,986	82,674	**900,078**
Other material items:				
Finance income	-	-	1,631	**1,631**
Finance expense	32,638	17,397	-	**50,035**
Loss from investment in associates	-	(11,729)	-	**(11,729)**
Depreciation	-	-	5,718	**5,718**
Provision for impairment	250,619	2,500	3,000	**256,119**
Capital expenditure	-	-	-	**-**
Investment in associates (equity accounted)	-	224,847	-	**224,847**
Commitments	16,500	6,613	-	**23,113**
Restricted investment accounts	47,523	704	-	**48,227**

2009	Development infrastructure	Banking	Unallocated	Total
Segment revenue	54,056	(13,981)	16,889	56,964
Segment expenses	557,349	220,770	7,224	785,343
Segment result	(503,293)	(234,751)	9,665	(728,379)
Segment assets	755,201	831,516	55,619	1,642,336
Segment liabilities	547,013	569,451	89,675	1,206,139
Other material items:				
Finance income	-	-	5,265	5,265
Finance expense	23,351	16,227	-	39,578
Loss from investment in associates	-	(171)	-	(171)
Depreciation	-	-	6,339	6,339
Provision for impairment	507,795	147,803	-	655,598
Capital expenditure	-	-	3,559	3,559
Investment in associates (equity accounted)	175,000	201,424	-	376,424
Commitments	55,850	-	-	55,850
Restricted investment accounts	49,371	671	-	50,042

37 FINANCIAL INSTRUMENTS

a) ACCOUNTING CLASSIFICATION OF FINANCIAL INSTRUMENTS

The classification of the financial instruments of the Group as per IAS 39 is as given below:

31 December 2010	Designated at fair value through profit or loss	Available-for-sale	Loans and receivables	Other amortised cost	Total carrying value
Assets					
Cash and bank balances	-	-	3,770	-	3,770
Placements with financial and other institutions	-	-	56,868	-	56,868
Financing receivables	-	-	14,400	-	14,400
Investment securities	25,860	222,934	-	-	248,794
Other financial assets	-	-	196,013	-	196,013
Total financial assets	**25,860**	**222,934**	**271,051**	**-**	**519,845**
Liabilities					
Investors' funds	-	-	-	138,798	138,798
Placements from financial and other institutions	-	-	-	126,241	126,241
Financing liabilities	-	-	-	439,504	439,504
Other financial liabilities	-	-	-	73,952	73,952
Total financial liabilities	**-**	**-**	**-**	**778,495**	**778,495**
Unrestricted investment accounts	**-**	**-**	**-**	1,880	**1,880**

37 FINANCIAL INSTRUMENTS (continued)

a) CLASSIFICATION OF FINANCIAL INSTRUMENTS (continued)

31 December 2009	Designated at fair value through profit or loss	Available-for-sale	Loans and receivables	Other amortised cost	Total carrying value
Assets					
Cash and bank balances	-	-	10,174	-	10,174
Placements with financial and other institutions	-	-	454,966	-	454,966
Financing receivables	-	-	29,173	-	29,173
Investment securities	33,976	315,423	-	-	349,399
Receivable from investment banking services	-	-	85,270	-	85,270
Other financial assets	-	-	287,542	-	287,542
Total financial assets	33,976	315,423	867,125	-	1,216,524
Liabilities					
Investors' funds	-	-	-	246,193	246,193
Placements from financial and other institutions	-	-	-	210,842	210,842
Financing liabilities	-	-	-	652,520	652,520
Other financial liabilities	-	-	-	95,812	95,812
Total financial liabilities	-	-	-	1,205,367	1,205,367
Unrestricted investment accounts	-	-	-	2,875	2,875

37 FINANCIAL INSTRUMENTS (continued)

b) FAIR VALUES OF FINANCIAL INSTRUMENTS

Fair value is an amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Other than certain available-for-sale investments of US$ 222,459 thousand (31 December 2009: US$ 311,133 thousand) (note 9) and financing liabilities of US$ 152,123 thousand (31 December 2009: US$ 152,640 thousand), the estimated fair values of the Group's other financial instruments are not significantly different from their book values as at 31 December 2010.

Available-for-sale investments

Investments amounting to US$ 222,459 thousand (31 December 2009: US$ 311,133 thousand) in unquoted equity securities are carried at cost less impairment in the absence of a reliable measure of fair value. Such investments are either private equity investments managed by external investment managers or represent investments in projects promoted by the Group for which a reliable estimate of fair value cannot be determined. The Group intends to exit these investments principally by means of strategic sell outs, sale of underlying assets or through initial public offerings.

Financing liabilities

	31 December 2010		31 December 2009	
	Carrying value	**Fair value**	Carrying value	Fair value
Sukuk	152,123	79,300	152,640	108,062

The fair value of the Sukuk has been determined based on quoted prices.

c) FAIR VALUE HIERARCHY

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

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

31 December 2010	**Level 1**	**Level 2**	**Level 3**	**Total**
Investment securities				
- Investments designated at fair value through profit or loss			25,860	25,860
- Available-for-sale investments	475	-	-	475
	475	**-**	**25,860**	**26,335**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2010 US$ 000's

37 FINANCIAL INSTRUMENTS (continued)

c) FAIR VALUE HIERARCHY (continued)

31 December 2009	Level 1	Level 2	Level 3	Total
Investment securities				
- Investments designated at fair value through profit or loss	-	-	33,976	33,976
- Available-for-sale investments	4,290	-	-	4,290
	4,290	-	33,976	38,266

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

	2010	2009
At 1 January	33,976	41,245
Total gains or losses		
- In profit or loss	(5,500)	(7,269)
Purchases	1,617	-
Settlements	(4,233)	-
At 31 December	**25,860**	33,976

38 COMMITMENTS AND CONTINGENCIES

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

	31 December 2010	31 December 2009
Commitments to invest	6,613	30,613
Commitments to extend finance	16,500	24,954
Capital commitments	-	283

The Group potentially has a commitment under a constructive obligation to extend finance to one of its projects of up to US$ 150 million (31 December 2009: US$ 150 million).

During the year, the Group's credit enhancement issued to financial institutions against outstanding credit facility arrangements amounting to US$ 86.11 million for a project managed by the Group were enforced by the lenders due to contractual defaults by the project company. Further, based on the Group's assessment of the likelihood that another project will not be able to meet the financing obligation when they fall due, the Group has estimated that its financial guarantee of US$ 35 million may be enforced. In accordance with the requirements of IAS 37, Provisions, Contingent Liabilities and Contingent Assets, the Group has recognised a provision of US$ 121.11 million (31 December 2009: US$ Nil) towards these liabilities until revised / renegotiated terms are agreed with the lenders of the project companies and included in other liabilities and recognised an equivalent amount of 'reimbursement right' receivable included in 'other assets' (note 11).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2010 US$ 000's

38 COMMITMENTS AND CONTINGENCIES (continued)

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

Performance obligations
During the ordinary course of business, the Group may enter into performance obligations in respect of its infrastructure development projects. It is the usual practice of the Group to pass these performance obligations, wherever possible, on to the companies that own the projects. In the opinion of the management, no liabilities are expected to materialise on the Group at 31 December 2010 due to the performance of any of its projects.

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

39 FINANCIAL RISK MANAGEMENT

Overview
Financial assets of the Group comprise bank balances, placements with financial and other institutions, investment securities, financing receivables, receivable from investment banking services and other receivable balances accounted for under IAS 39. Financial liabilities of the Group comprise investors' funds, placements from financial and other institutions, financing liabilities and other payable balances accounted for under IAS 39. Accounting policies for financial assets and liabilities are set out in note 2.

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

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

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

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

The Board of Directors has overall responsibility for establishing our risk culture and ensuring that an effective risk management framework is in place. The Board has established an Executive Risk Management Committee, which is responsible for developing and monitoring the Group's risk management policies in the specified areas. The committee also continuously monitors consistent implementation of the Board approved policies in the Group and reports deviations if any to the Risk Management Committee of the Board. The committee consists of heads of business and other functional units in the Group and reports to the Risk Management Committee of the Board. The Board of Directors approves and periodically reviews our risk management policies and strategies. The Board Risk Management Committee is responsible for implementing risk management policies,

39 FINANCIAL RISK MANAGEMENT (continued)

guidelines and limits and ensuring that monitoring processes are in place. The RMD, together with the Internal Audit and Compliance Departments, provide independent assurance that all types of risk are being measured and managed in accordance with the policies and guidelines set by the Board of Directors.

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

a) Credit risk

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

Management of investment and credit risk

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

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

- Ensuring that the Group has in place investment and credit policies, covering credit assessment, risk reporting, documentary and legal procedures, whilst the Compliance Department is responsible for ensuring compliance with regulatory and statutory requirements.
- Overseeing the establishment of the authorisation structure for the approval and renewal of investment and credit facilities. Authorisation limits are also allocated to the Management Investment and Credit Committee. Larger facilities require approval by BIC and the Board of Directors based on the authority limits structure of the Group.
- Reviewing and assessing credit risk. Risk Management department assesses all investment and credit exposures in excess of designated limits, prior to investments / facilities being committed. Renewals and reviews of investments / facilities are subject to the same review process.
- Monitoring concentrations of exposure to counterparties, geographies and industries.
- Ongoing review of credit exposures. The risk assessment approach is used in determining where impairment provisions may be required against specific investment / credit exposures. The current risk assessment process classifies credit exposures into two broad categories "Unimpaired" and "Impaired", reflecting risk of default and the availability of collateral or other credit risk mitigation. Risk is assessed on an individual basis for each investment / receivable and is reviewed at least once a year. The Group does not perform a collective assessment of impairment for its credit exposures as the credit characteristics of each exposure is considered to be different. Risk profile of exposures are subject to regular reviews.

39 FINANCIAL RISK MANAGEMENT (continued)

- Reviewing compliance of business units with agreed exposure limits, including those for selected industries, country risk and product types. Regular reports are provided to BIC on the exposure limits. Providing advice, guidance and specialist skills to business units to promote best practice throughout the Group in the management of investment / credit risk.

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

39 FINANCIAL RISK MANAGEMENT (continued)

The Group's maximum exposure to risk at 31 December 2010 is as follows:

Exposure to credit risk

31 December 2010	Bank balances	Placement with financial and other institutions	Financing receivables	Other financial assets
Neither past due nor impaired				
Carrying amount	3,709	56,868	12,400	184,013
Past due but not impaired				
Past due comprises				
30 – 60 days	-	-	2,000	-
60 – 90 days	-	-	-	-
90 – 180 days	-	-	-	-
Above 180 days	-	-	-	-
Carrying amount – Past due but not impaired	-	-	2,000	**-**
Individually impaired				
Gross amount	-	-	-	41,292
Allowance for impairment	-	-	-	29,292
Carrying amount – Individually impaired	**-**	-	**-**	**12,000**
Carrying amount	**3,709**	**56,868**	**14,400**	**196,013**

39 FINANCIAL RISK MANAGEMENT (continued)

Exposure to credit risk (continued)

31 December 2009	Bank balances	Placement with financial and other institutions	Financing receivables	Receivable from investment banking services	Other financial assets
Neither past due nor impaired					
Carrying amount	10,166	454,966	29,173	-	187,460
Past due but not impaired					
Past due comprises					
30 – 60 days	-	-	-	-	-
60 – 90 days	-	-	-	-	-
90 – 180 days	-	-	-	-	-
Above 180 days	-	-	-	40,540	-
Carrying amount – Past due but not impaired	-	-	-	40,540	-
Individually impaired					
Gross amount	-	-	62,650	131,376	483,164
Allowance for impairment	-	-	62,650	86,646	383,082
Carrying amount – Individually impaired	-	-	-	44,730	100,082
Carrying amount	10,166	454,966	29,173	85,270	287,542

39 FINANCIAL RISK MANAGEMENT (continued)

a) Credit risk (continued)

Impaired receivables

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

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

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

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

2009	Financing receivables	Financing to projects	Receivable from investment banking services	Other receivables	Total
At 1 January	16,500	-	3,076	15,786	35,362
Provision for impairment during the year	53,650	77,382	83,570	22,467	237,069
At 31 December	70,150	77,382	86,646	38,253	272,431

Receivables with renegotiated terms

During the year, the Group has renegotiated certain financing receivables and financing to projects due to changes in the financial position of the borrower. The financing receivables were renegotiated for terms and condition similar to original terms. Financing to projects of US$ 70.22 million (31 December 2009: US$ 147 million) were renegotiated for an extended period and do not have specified terms of repayment. The Group assesses the recoverability and timing of collection based on underlying stream of cash flows that will be generated by its projects.

39 FINANCIAL RISK MANAGEMENT (continued)

a) Credit risk (continued)

Past due but not impaired exposures

Write-off policy

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

Concentration risk

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

The geographical and industry wise distribution of assets and liabilities are set out in note 35 (b).

b) Liquidity risk

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

Management of liquidity risk

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

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

39 FINANCIAL RISK MANAGEMENT (continued)

b) Liquidity risk (continued)

The daily liquidity position is monitored and regular liquidity stress testing is conducted under a variety of scenarios covering both normal and more severe market conditions. All liquidity policies and procedures are subject to review and approval by ALCO. Daily reports cover the liquidity position of the Bank. A summary report, including any exceptions and remedial action taken, is submitted regularly to ALCO. Moreover, periodic reports are submitted to the Board of Directors on the liquidity position.

The table below shows the undiscounted cash flows on the Group's financial liabilities, including issued financial guarantee contracts, and unrecognised financing commitments on the basis of their earliest possible contractual maturity. For issued financial guarantee contracts, the maximum amount of the guarantee is allocated to the earliest period in which the guarantee could be called. The Group's expected cash flows on these instruments vary significantly from this analysis. Refer note 34 for the expected maturity profile of assets and liabilities.

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

To manage the liquidity risk arising from financial liabilities, the Group aims to hold liquid assets comprising cash and cash equivalents, placements with financial and other institutions and treasury shares for which there is an active and liquid market. These assets can be readily sold to meet liquidity requirements. At 31 December 2010, the Group's current contractual liabilities exceeded its liquid assets.

The Group has focussed on strengthening its liquidity position in 2010 by undertaking an asset sale programme; restructuring of its financing liabilities and raising additional capital through the convertible murabaha (note 16). The Group plans to further strengthen its liquidity in 2011 by undertaking a wider asset sale program and additional capital raising that will target to provide the necessary additional liquidity needed to support the Group's funding requirements. These initiatives will help to improve the liquidity profile of the Group. The Group is confident of its ability to meet its future contractual liabilities when due.

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2010 US$ 000's

39 FINANCIAL RISK MANAGEMENT (continued)

b) Liquidity risk (continued)

	Gross undiscounted cash flows						
31 December 2009	Up to 3 months	3 to 6 months	6 months-1 year	1 to 3 years	Over 3 years	Total	Carrying amount
Financial liabilities							
Investors' funds	247,916	-	-	-	-	247,916	246,193
Placements from financial and other institutions	211,173	-	-	-	-	211,173	210,842
Financing liabilities	355,083	2,680	5,243	348,599	-	711,605	652,520
Other financial liabilities	95,812	-	-	-	-	95,812	95,812
Total financial liabilities	909,984	2,680	5,243	348,599	-	1,266,506	1,205,367
Unrestricted investment accounts	2,875	-	-	-	-	2,875	2,875
Off-balance sheet items							
Commitments	8,737	30,000	16,500	613	-	55,850	

Measures of liquidity

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

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

Liquidity coverage ratio	**2010**	2009
30 days	0.45	0.54
60 days	0.42	0.51
90 days	0.35	0.49

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

	2010	2009
Net stable funding ratio	0.56	0.83

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

	Liquid asset / Total asset	
	2010	2009
At 31 December	6.15%	29.18%
Average for the period	3.22%	25.98%
Maximum for the period	6.15%	29.18%
Minimum for the period	1.99%	20.05%

39 FINANCIAL RISK MANAGEMENT (continued)

c) Market risks

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

Management of market risks

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

Exposure to profit rate risk

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

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

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2010 US$ 000's

39 FINANCIAL RISK MANAGEMENT (continued)

c) Market risks (continued)

31 December 2009	Up to 3 months	3 to 6 months	6 months-1 year	1 to 3 years	Over 3 years	Total
Assets						
Placements with financial and other institutions	454,966	-	-	-	-	454,966
Financing receivables	14,173	15,000	-	-	-	29,173
Total assets	469,139	15,000	-	-	-	484,139
Liabilities						
Investors' funds	246,193	-	-	-	-	246,193
Placements from financial and other institutions	210,842	-	-	-	-	210,842
Financing liabilities	351,020	-	-	301,500	-	652,520
Total liabilities	808,055	-	-	301,500	-	1,109,555
Unrestricted investment accounts	2,875	-	-	-	-	2,875
Profit rate sensitivity gap	(341,791)	15,000	-	(301,500)	-	(628,291)

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

100 bps parallel increase / (decrease)	**2010**	2009
At 31 December	± 6,351	± 6,283
Average for the year	± 6,092	± 8,258
Maximum for the year	± 6,351	± 9,677
Minimum for the year	± 5,937	± 6,283

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2010 US$ 000's

39 FINANCIAL RISK MANAGEMENT (continued)

c) Market risks (continued)

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

	2010	2009
Placements with financial and other institutions	0.68%	0.83%
Financing receivables	2.88%	5.38%
Investors' funds	0.72%	0.70%
Placements from financial and other institutions	4.72%	2.13%
Financing liabilities	6.84%	4.38%
Unrestricted investment accounts	0.67%	0.76%

Exposure to foreign exchange risk

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

	2010 US$ Equivalent	2009 US$ Equivalent
Sterling Pounds	-	2,489
Euros	(69,645)	348
Jordanian Dinar	17,438	4,905
Kuwaiti Dinars	16,778	58,968
Other GCC Currencies (*)	(247,871)	523,831

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

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

	2010 US$ Equivalent	2009 US$ Equivalent
Sterling Pounds	-	± 124
Euros	±3,482	± 17
Jordanian Dinar	±872	± 245
Kuwaiti Dinars	±839	± 2,948

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2010 US$ 000's

39 FINANCIAL RISK MANAGEMENT (continued)

Exposure to foreign exchange risk (continued)

Exposure to other market risks

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

d) Operational risk

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

40 CAPITAL MANAGEMENT

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

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

The Group is required to comply with the provisions of the Capital Adequacy Module of the CBB (which is based on the Basel II and IFSB framework) in respect of regulatory capital. The Group has adopted the standardised approach to credit risk and market risk and basic indicator approach for operational risk management under the revised framework. During 2010, the Group's capital adequacy ratio has been deteriorating and the Group is in constant communication with its regulator in relation to its capital adequacy plan.

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

40 CAPITAL MANAGEMENT (continued)

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

	2010	2009
Total risk weighted assets	**1,931,686**	2,955,068
Tier 1 capital	204,746	381,528
Tier 2 capital	6	-
Total regulatory capital base	**204,752**	381,528
Total regulatory capital expressed as a percentage of total risk weighted assets	**10.60%**	12.91%

The capital adequacy ratio as at 31 December 2010 was below the minimum regulatory capital requirement of 12%. Based on the planned asset sales program and operating cash flow projections coupled with the ongoing convertible murabaha programme (note 16), the Group expects to improve its risk weighted assets profile and capital adequacy ratio.

41 NEW STANDARDS, AMENDMENTS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE

The following standards and interpretations have been issued by standard setters during 2010 and are mandatory for the Group's accounting for annual periods beginning on or after 1 July 2009 or later periods and are expected to be relevant to the Group:

a) International Financial Reporting Standards and interpretations issued by the IASB

The following standards and interpretations have been issued and are expected to be relevant to the Group but not yet effective for the year ended 31 December 2010.

- **IFRS 9 'Financial Instruments'**

  Standard issued November 2009 (IFRS 9 (2009))

  IFRS 9 (2009) "Financial Instruments" is the first standard issued as part of a wider project to replace IAS 39 "Financial instruments: recognition and measurement". IFRS 9 (2009) retains and simplifies the mixed measurement model and establishes two primary measurement categories for financial assets: amortised cost and fair value. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset. The guidance in IAS 39 on impairment and hedge accounting continues to apply. The 2009 standard did not address financial liabilities.

  Standard issued October 2010 (IFRS 9 (2010)

  IFRS 9 (2010) adds the requirements related to the classification and measurement of financial liabilities, and de-recognition of financial assets and liabilities to the version issued in November 2009. It also includes those paragraphs of IAS 39 dealing with how to measure fair value and accounting for derivatives embedded in a contract that contains a host that is not a financial asset, as well as the requirements of IFRIC 9 *"reassessment of Embedded Derivatives*".

  The Group is yet to assess IFRS 9's full impact. Given the nature of the Group's operations, this standard is expected to have a pervasive impact on the Group's financial statements.

41 NEW INTERNATIONAL FINANCIAL REPORTING STANDARDS AND INTERPRETATIONS NOT YET EFFECTIVE FOR ADOPTION (continued)

a) International Financial Reporting Standards and interpretations issued by the IASB (continued)

While adoption of IFRS 9 is mandatory from 1 January 2013, earlier adoption is permitted. Prior periods need not be restated if an entity adopts the standard for reporting periods beginning before 1 January 2012.

- **IAS 24(Revised) "related party disclosures"**
  It was issued in November 2009 and is mandatory for periods beginning on or after 1 January 2011. The revised standard clarifies and simplifies the definition of a related party and removes the requirement for government-related entities to disclose details of all transactions with the government and other government-related entities. When the revised standard will be applied, the Group and the parent will need to disclose transactions between its subsidiaries and its associates. The Group is currently putting systems in place to capture the necessary information.

- **IFRIC 19 'Extinguishing Financial Liabilities with Equity Instruments'**
  IFRIC 19 was issued in November 2009 and effective 1 July 2010. The interpretation addresses the issues in respect of the accounting by the debtor in a debt for equity swap transaction. An entity should measure equity instruments issued to a creditor to extinguish all or part of a financial liability at the fair value of those equity instruments, unless that fair value cannot be reliably measured, in which case the equity instruments should be measured to reflect the fair value of the financial liability extinguished. The equity instruments are initially measured when the financial liability (or part of that liability) is extinguished. The difference between the carrying amount of the financial liability (or part of the financial liability) extinguished and the initial measurement amount of the equity instruments issued should be recognised in profit or loss. The application of IFRIC 19 has no impact on the financial statements of the Group.

- **Improvements to IFRSs (2010)**
  Improvements to IFRS issued in 2010 contained numerous amendments to IFRS that the IASB considers non-urgent but necessary. 'Improvements to IFRS' comprise amendments that result in accounting changes to presentation, recognition or measurement purposes, as well as terminology or editorial amendments related to a variety of individual IFRS standards. The amendments are effective for the Company's/ Group's 2011 annual financial statements with earlier adoption permitted. No material changes to accounting policies are expected as a result of these amendments.

b) Financial Accounting Standards issued by AAOIFI

The following accounting standards and interpretations have been issued by AAOIFI during 2010 and are mandatory for the Group's accounting for annual periods beginning on or after 1 January 2011 and are expected to be relevant to the Group:

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

41 NEW INTERNATIONAL FINANCIAL REPORTING STANDARDS AND INTERPRETATIONS NOT YET EFFECTIVE FOR ADOPTION (continued)

b) Financial Accounting Standards issued by AAOIFI (continued)

The Group is currently in the process of evaluating the potential effect of this standard. Given the nature of the Group's operations, this standard is expected to have a pervasive impact on the Group's financial statements.

c) Early adoption of amendments or standards in 2010

The Group did not early-adopt new or amended standards in 2010.

42 COMPARATIVES

Certain prior year amounts have been regrouped to conform to the current year's presentation. Such regrouping did not affect previously reported loss, comprehensive income or equity.