بنك الخليج المتحد ش.م.ب.

United Gulf Bank B.S.C.

A member of the KIPCO Group

Annual Report 2011

H. M. King Hamad Bin Isa Al Khalifa

King of the Kingdom of Bahrain

H. H. Sheikh Sabah Al Ahmed Al Jaber Al-Sabah

Amir of the State of Kuwait

Major Financial Subsidiaries and Affiliates

Company Profile

United Gulf Bank (UGB) is a leading asset management and investment banking group, with operations spanning the Middle East and North Africa (MENA) region. From its home base in the Kingdom of Bahrain, and through its regional network of affiliates, the Bank engages primarily in asset and fund management, investment banking, private equity, and corporate finance. Other financial business activities include proprietary investments, treasury, brokerage, commercial banking, and savings and pensions. Through its non-financial associate companies, the Bank holds substantial investments in the real estate, hospitality, communications and industrial sectors. Established in 1980, UGB operates under a conventional wholesale banking licence from the Central Bank of Bahrain, and is listed on the Bahrain Bourse and the Kuwait Stock Exchange. Over the past 31 years, the Bank has established a reputation for financial strength, sound governance, prudent management and depth of expertise. At the end of 2011, UGB reported total assets under management of over US$ 7 billion.

UGB's core subsidiaries, associates and joint venture include: Burgan Bank, KIPCO Asset Management Company (KAMCO), North Africa Holding Company, Al Sharq Financial Brokerage Company, Manafae Investment Company, Overland Real Estate Company, Royal Capital Company, Syria Gulf Bank, Takaud Savings & Pensions Company, United Gulf Financial Services - North Africa, United Industries Company, United Networks (formerly United Cable Company), United Capital Transport Company and United Real Estate Company.

UGB is a member of the KIPCO Group – one of the largest diversified holding companies in the Middle East and North Africa. KIPCO has significant ownership interests in a portfolio of over 60 companies operating across 26 countries. The Group's main business sectors are financial services and media. Through the subsidiaries and affiliates of its core companies, KIPCO also has interests in the real estate, industrial, education, and management and advisory sectors.

KIPCO's financial services interests include holdings in commercial and investment banking, asset management and insurance companies. The Group's core operating companies in this sector include Burgan Bank, United Gulf Bank and Gulf Insurance Company. In the media sector, KIPCO has a presence through Orbit Showtime Network, the leading pay-TV operator in the region.

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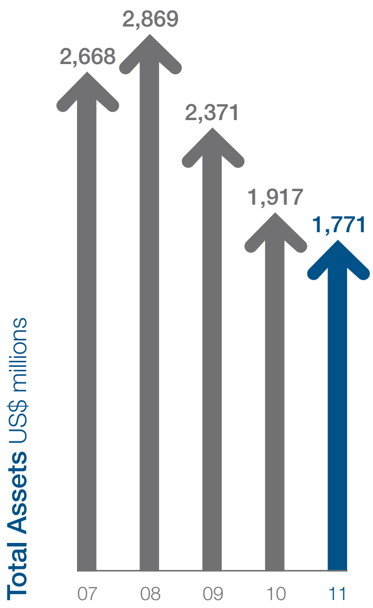
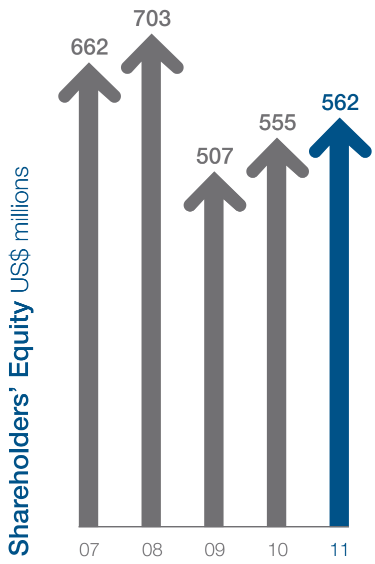
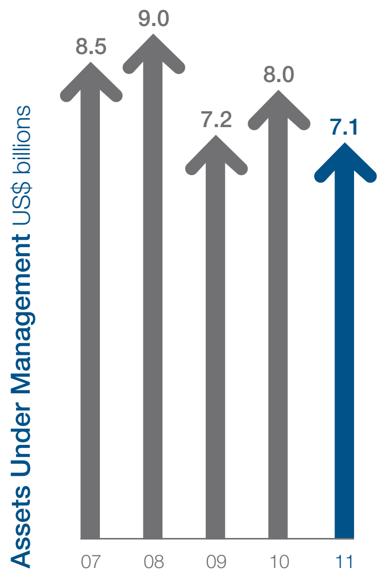
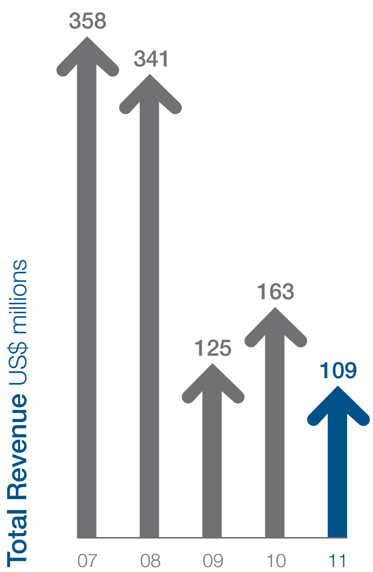
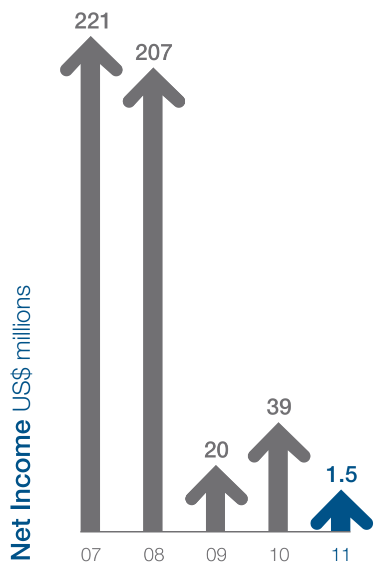
Financial Highlights

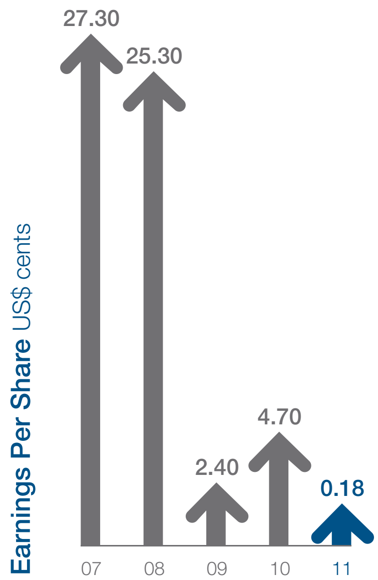












US$
7.1 billion

Assets under Management

18.21%

Capital Adequacy Ratio

Financial Summary

	2011	2010	2009	2008	2007 (Restated)
US$ million					
Total Income	108.5	163	125	341	358
Investment Income	53.6	109	94	281	194
Operating Income	55.0	114	73	274	290
Shareholders' Equity	561.8	555	507	703	662
Total Assets	1,770.5	1,917	2,371	2,869	2,668
Net Income	1.5	39	20	207	221
%					
Return on Average Equity	0.3	7.3	3.3	30.4	38.4
Return on Average Assets	0.1	1.8	0.7	7.5	8.8
Operating Expense/Operating Income	61.2	42.6	55.3	20.6	21.2
Average Equity to Average Assets	30.3	24.8	23.1	24.6	22.9
US$					
Book Value Per Share	0.682	0.675	0.619	0.864	0.813
Earnings Per Share	0.0018	0.047	0.020	0.253	0.273
Dividend Per Share	-	-	0.125	0.185	0.165

Comparative Average Balances (based on quarterly averages)

US$ million					
Assets	1,801.2	1,980.7	2,421.3	3,098.8	2,462.7
Liabilities	1,194.6	1,396.3	1,814.1	2,248.5	1,749.7
Minority Interest	44.0	50.0	92.9	139.5	125.8
Shareholders' Equity	562.6	534.3	514.4	710.8	587.2
Total Liabilities + Shareholders' Equity	1,801.2	1,980.7	2,421.3	3,098.8	2,462.7
Guarantees and Letters of Credit	55.9	36.8	45.5	210.4	122.5
Commitments	118.1	91.5	104.5	111.0	33.1
Assets Under Management (US$ billion)	7.3	7.6	7.6	11.5	7.3

Chairman's Statement

On behalf of the Board of Directors, I have the privilege to present the annual report and consolidated financial statements of United Gulf Bank (UGB) for the year ended 31 December 2011. In what proved to be a more challenging year than expected, I am pleased to report that UGB continued to weather the worst of the difficulties facing the regional investment banking industry.

Market background

Overall, 2011 was marked by unprecedented volatility in regional and international capital markets, dominated by concerns surrounding the weakened state of the global economy. In many ways, it was remarkably similar to 2008, but the year also contained a number of surprises. These included a downgrading of the sovereign ratings of the US and several European economies, along with Bahrain; the USA's near budget default; the Eurozone sovereign debt and currency crises; and the tragic earthquake and tsunami in Japan, along with other natural disasters across the world. Closer to home, the 'Arab Spring' enhanced geo-political tensions in the MENA region. Such factors combined to produce an underlying feeling of uncertainty and instability, with investor confidence remaining fragile. Either directly or indirectly, in varying degrees, these events had a serious impact on the regional investment banking sector, and affected UGB's business.

Financial performance

Against this challenging backdrop, UGB successfully maintained profitability, a strong capital base and high liquidity. Total income before interest and other expenses for the year was US$ 108.5 million compared with US$ 163.3 million in 2010. Net profit for the year was US$ 1.5 million versus US$ 38.6 million in 2010, with basic earnings per share of 0.18 cents against 4.71 cents the previous year. I would like to point out that 2011 was the Bank's 21st successive year of profitability and the 28th year of positive performance in our 32-year history. Contributing to these results were gains totalling US$ 30.5 million from the sale of certain available-for-sale investments. These were partially offset by an impairment loss of US$ 24 million against non-trading investments.

Total assets stood at US$ 1.78 billion at the end of 2011 compared with US$ 1.92 billion at the end of 2010, with the decrease mainly due to the exit from investments. Total equity at the end of the year increased to US$ 603.2 million from US$ 600.7 million at the end of 2010. The Bank retained a strong balance sheet with a consolidated capital adequacy ratio of 18%, well above the requirements of the Central Bank of Bahrain. UGB maintained a high level of liquidity, with total liquid assets of US$ 301 million, representing 17% of the balance sheet at the end of 2011. During the year, UGB made a full repayment of its three-year US$ 115 million syndicated loan facility and of a US$ 20 million bilateral loan on their maturity dates.

Investment income in 2011 dropped to US$ 53.7 million from US$ 108.6 million in 2010. Dividend income increased to US$ 11.8 million from US$ 9.7 million the previous year, while trading positions recorded a gain of US$ 4.8 million compared to a gain of US$ 11.9 million in 2010. Losses resulted mainly from investments on the Kuwait Stock Exchange (KSE), with the KSE Index recording a year-to-date return of negative 16.9% versus a positive YTD return of 0.5% the previous year. In 2010, the Bank had recorded net exceptional gains of US$ 82 million on the sale of Tunis International Bank, the acquisition of Burgan Bank, and the dilution of United Real Estate Company.

Given the challenging operating environment, we took a proactive approach during the year to substantially reduce expenses. Staff costs were reduced by US$ 3.8 million (14.1%) to US$ 23.1 million at the end of the year compared with US$ 26.9 million at the end of 2010. Due to cost control measures taken at UGB and KAMCO, general and administrative expenses decreased by US$ 11.1 million (51.3%) to US$ 10.5 million at the end of 2011 versus US$ 21.6 million at the end of the previous year.

Our policy to maintain a strong level of liquidity and equity base has enabled UGB to weather the challenges facing the regional investment banking industry. During 2011, we took steps to further bolster the maturity profile of our liabilities. The Bank was successful in arranging new three-year medium-term facilities totalling US$ 310 million. The Bank has a Ba1 deposit rating from Moody's Investor Services; and a BBB foreign currency long-term rating and an A3 short-term rating from Capital Intelligence. In order to strengthen the balance sheet and retain resources for future growth, the Board has decided not to recommend a dividend for the year ended 31 December 2011.

Subsidiaries and Associates

In a year when most investment companies were seriously affected, UGB's flagship subsidiary, KIPCO Asset Management Company (KAMCO), recorded a net loss of US$ 21.7 million in 2011 compared to a profit of US$ 6.4 million for 2010. The contributions from the Bank's associated companies in 2011 increased substantially to US$ 31.7 million compared with US$ 9.2 million in 2010. Key contributors during the year were Burgan Bank with US$ 33.8 million and United Real Estate Company with US$ 7.1 million.

Strategic review

In the light of increasingly volatile and uncertain market conditions, we commenced a comprehensive review of the Bank's strategy in 2011. This involved evaluating a number of options for redefining our business model and strategic direction. A number of initial steps were taken during the year. These include a restructuring of the management team due to a refocusing of the asset book, and taking steps to de-leverage the balance sheet. UGB transferred a number of assets to other Group companies; and liquidated certain assets in sectors where the Bank had been a passive investor, such as real estate and hospitality.

During the first half of the year, the Central Bank of Bahrain approved the establishment of Takaud Savings and Pension Company, a 50-50 joint venture between UGB and KIPCO. The first company of its kind in the MENA region, Takaud has started to build its senior management team with the appointment of a Chief Executive Officer and Chief Actuary. In January 2012, the Bank signed an agreement with the Bahrain Bourse to commence brokerage operations for its overseas corporate clients.

Corporate social responsibility

As a leading financial institution, we have long recognised UGB's responsibility to contribute to the social well-being and economic prosperity of the Kingdom of Bahrain, and to support the development of the regional banking and financial services sector. During 2011, we continued to implement our corporate responsibility programme in a number of different ways. These included financial and practical support for numerous charitable, cultural, social, medical, educational, and environmental organisations and initiatives; membership of professional and banking-related institutions; and active participation in regional financial sector conferences and seminars. In addition, we encouraged and supported our staff to engage in community activities, and participate in major annual events that raise funds for charity.

Governance

UGB views sound corporate governance as a critical factor in ensuring organisational integrity and efficiency, creating long-term value for shareholders, and protecting the interests of all stakeholders. During the year, we continued to take active steps to comply with the requirements of the Code of Corporate Governance for the Kingdom of Bahrain, and the Higher Levels Controls of the Rulebook of the Central Bank of Bahrain. These included familiarisation programmes for the Board of Directors, Executive Management and staff; seeking CBB approval for the appointment of two additional independent Board Directors; and Board approval of sixteen new policies and procedures pertaining to corporate governance. The Bank also formalised the establishment of an offsite disaster recovery centre, and conducted business continuity planning exercises.

As at 31 December 2011, the Directors owned 636,600 shares in UGB (2010: 636,600) and Executive Managers owned 436,116 shares (2010: 1,351,521) through the exercise of stock options.

Changes to the Board and Executive Management

The Board of Directors unanimously supports the principle of independent directors. Following the new definition of 'independent director' communicated by the Central Bank of Bahrain, the Board determined that Mr Mubarak Al Maskati, who has served as a Board Member since 1999, qualified to be an Independent director. In December, the CBB approved the change in his designation to an independent director. In addition, two prospective candidates were identified by the Board to be independent directors, and approval for their election was received from the CBB. They were elected at the Annual General Meeting that was held on 26 March 2012.

In February 2012, the Board reluctantly accepted Mr. Mohammed Haroon's request for retirement as Acting Chief Executive Officer after 30 years' sterling service with the Bank. On behalf of the Board of Directors, I would like to pay tribute to Mr. Haroon's major contribution to the business growth and strategic development of UGB. I am very pleased to report that he has agreed to stay on as Advisor to the Board, so the Bank will continue to benefit from his unique experience and expertise, and his invaluable advice and guidance. The Board welcomes Mr. Rabih Soukarieh as the new Acting Chief Executive Officer. Mr. Soukarieh has worked extensively, over the past twenty-one years, in Canada, Kuwait, Saudi Arabia, Dubai, Qatar and Bahrain. Prior to re-joining UGB in 2009, he held senior operating positions in various KIPCO Group Companies, including Chief Executive Officer, United Gulf Financial Services Company, Qatar; and Group Chief Financial Officer, Wataniya International.

Looking ahead

As an investment bank firmly focused on the MENA region, we are cautiously optimistic for UGB's prospects in 2012. The MENA region as an economic bloc has the fourth largest population in the world, and is the eighth largest global economy. The region's average nominal GDP growth rate between 2000 and 2010 was 11.4%, and it has one of the highest forecast real GDP growth rates of 4.9% for the period 2011-2015. While political events in the Arab world affected foreign direct investment into the MENA region in 2011, a recent report by the World Bank's Multilateral Investment Guarantee Agency noted that investors are cautiously optimistic about the region over the medium-term.

Looking ahead, we believe that the GCC will continue to deliver strong and sustainable growth. The GCC economies have illustrated their ability to weather the worst effects of the global financial crisis, and continued to grow at a faster rate than the global average. The recent rising trend in oil prices has strengthened the robust underlying macroeconomic fundamentals of the GCC, and the long-term economic outlook remains positive.

UGB is committed to creating a regional platform of long-term growth for our shareholders and investors. Supported by our unique heritage and tradition of financial strength, good governance, prudent management and depth of expertise, we will continue to leverage our long experience and deep market knowledge to ensure the Bank's continued growth and development. While cautiously optimistic about the outlook for UGB in 2012, we recognise that this could be another testing year.

Acknowledgements

On behalf of the Board of Directors, I would like to gratefully acknowledge the longstanding support and guidance that we receive from the Government of the Kingdom of Bahrain, and the constructive cooperation of the regulatory and supervisory authorities in the jurisdictions where UGB operates. I express my sincere thanks for the financial support and confidence of our shareholders; the trust and loyalty of our clients; and the positive collaboration of our business partners. Finally, I would like to pay tribute to the professionalism and dedication of the Bank's management and staff, and their positive contribution in yet another challenging year.

Masaud M J Hayat
Chairman

Board of Directors

Masaud M. J. Hayat

Chairman

Member of the Executive Committee

Chief Executive Officer, Banking Sector at Kuwait Projects Company (Holding), Kuwait
Chairman of Syria Gulf Bank, Syria
Chairman and Chairman of Investment Committee of Tunis International Bank, Tunisia
Deputy Chairman and Chairman of the Executive Committee of Gulf Bank Algeria, Algeria
Deputy Chairman of Bank of Baghdad, Iraq
Deputy Chairman and Chairman of the Executive Committee of North Africa Holding Company, Kuwait
Vice Chairman of Royal Capital PJSC, United Arab Emirates
Board Member of Jordan Kuwait Bank, Jordan
Board Member of KIPCO Asset Management Company (KAMCO), Kuwait
Degree with a major in Economics from Kuwait University; and High Diploma in Banking Studies from the Institute of Banking Studies, Kuwait

Sheikh Hamad Sabah Al Ahmad Al Sabah

Deputy Chairman

Member of the Executive Committee

Chairman of Kuwait Projects Company (Holding), Kuwait
Chairman of Saudia Dairy & Foodstuff Company (SADAFCO), Kingdom of Saudi Arabia
Chairman of Gulf Egypt Hotels & Tourism Company SAE, Egypt
Educated in Kuwait, Lebanon and the United States of America

Faisal Hamad M. Al-Ayyar

Executive Director

Member of the Executive Committee and Chairman of the Board Audit Committee

Vice Chairman of Kuwait Projects Company (Holding), Kuwait
Chairman of United Broadcasting Company Limited, Cayman Islands
Board Member of Orbit-ShowTime Network, United Arab Emirates
Chairman of Saudi Pearl Insurance, Kingdom of Saudi Arabia
Vice Chairman, Gulf Insurance Company, Kuwait
Vice Chairman, Jordan Kuwait Bank, Jordan
Board Member of Saudia Dairy & Foodstuff Company (SADAFCO), Kingdom of Saudi Arabia
Board Member of Gulf Egypt Hotels & Tourism Company, Egypt
Board Member of United Assets Management Company, Luxembourg
Board Member of Swiss Premium Food Company, Egypt
Trustee of American University of Kuwait, Kuwait
Honorary Chairman of the National Committee for Learning Difficulties, Kuwait
Recipient of Arab Bankers Association of North America (ABANA) Achievement Award in 2005. Award winner at Tunis Arab Economic Forum 2007, and Lifetime Achievement Award winner at Beirut Arab Economic Forum 2007. Award winner at the Kuwait Financial Forum 2009 for his contribution to the investment sector in Kuwait and his successes in the global financial market.

Samer Khanachet

Executive Director

Member of the Executive Committee and Member of the Board Audit Committee

Group Chief Operating Officer of Kuwait Projects Company (Holding), Kuwait
Chairman of Takaud Savings & Pensions Company, Kingdom of Bahrain
Board Member of Burgan Bank, Kuwait
Board Member of United Real Estate Company, Kuwait
Trustee of the American University of Kuwait, Kuwait
Member of the Corporation Development Committee and the Educational Council of MIT, United States of America
Past President of the Arab Bankers Association of North America
MBA from the Harvard Business School, United States of America
BSc in Chemical Engineering and BSc in Management Science from MIT, United States of America

Sheikh Abdullah Nasser Sabah Al Ahmad Al Sabah

Executive Director

Chairman of KIPCO Asset Management Company (KAMCO), Kuwait
Board Member of Kuwait Projects Company (Holding), Kuwait
Graduated from the Royal Military Academy, Sandhurst, United Kingdom
BSc in Business Administration from the New York Institute of Technology, United States of America

Mubarak Mohammed Al-Maskati

Independent Director

Member of the Board Audit Committee

Chairman of the Royal Aviation Company, Kuwait
Past Board Member of Kuwait Projects Company (Holding); and Kuwait Aviation Services, Kuwait
BSc in Political Studies and Economics from the University of Pennsylvania, United States of America

Mr Faick Al Saleh and Mr Bader Al Awadi were elected as independent members to the Board of Directors on 26 March 2012.

Executive Management

5 6 3 8 1 2 4 7

1 **Mohammad Haroon**
Acting Chief Executive Officer

2 **Rabih Soukarieh CFA**
Assistant General Manager, Head of Asset Management and Investment Banking

3 **Hussain A. Lalani ACA CISA**
Assistant General Manager, Chief Financial Officer

4 **Jawad Al Asfoor**
Senior Vice President, Head of Treasury

5 **Ghulam Ahmed Mohatarem**
Senior Vice President, Chief Operating Officer

6 **Mohammed Alqumaish CIA CISA**
Senior Vice President, Head of Internal Audit & Quality Assurance

7 **Deepa Chandrasekhar CAMS CFE MICA ACSI**
Senior Vice President, Chief Compliance Officer

8 **Syed Rehan Ashraf ACA**
Senior Vice President, Head of Credit & Risk Management

1 Mohammad Haroon

Acting Chief Executive Officer

Mr Haroon joined UGB in November 1981. He has more than 45 years' experience in investment and commercial banking, gained in Pakistan and Bahrain. He worked previously with National Bank of Pakistan (OBU) Bahrain as Head of Credit & Marketing, and in the same bank in Pakistan in senior management positions. Before that he worked with the Investment Corporation of Pakistan in management positions in Corporate Finance, Investment Advisory and Asset Management. He is also a Director of United Gulf Investments Ltd, Cayman Islands. Mr Haroon holds a BSc (Hons) from Peshawar University in Pakistan, and a Diploma in Banking.

2 Rabih Soukarieh CFA

Assistant General Manager, Head of Asset Management and Investment Banking

Mr Soukarieh rejoined UGB in Bahrain in early 2009, having relocated from Qatar where he held the post of Chief Executive Officer at UGB's subsidiary, United Gulf Financial Services Company from 2008. He was previously Head of Corporate Finance at UGB between 2003 and 2004, during which time he established the Investment Banking division of the Bank. In 2005 he joined Wataniya International as Group Chief Financial Officer, and co-led the expansion of Wataniya Telecom Group into Tunisia, Iraq, Algeria, Saudi Arabia, Maldives, and Palestine, as well as co-managing their activities in these countries. His career spans over 20 years in the areas of investment and corporate banking as well as mobile telecommunications. He has tenured many board directorships over the years. He is currently a director of North Africa Holdings Company, Kuwait; Gulf Bank Algeria, Algeria; Tunis International Bank, Tunisia; Syria Gulf Bank, Syria; Millennium Private Equity, UAE and Mobility Telecom International Holding Ltd, UAE. A Chartered Financial Analyst, Mr Soukarieh holds an MBA in General Management (Hons) from Northeastern University, Boston, USA; and a BSc in Finance (Hons) from Indiana University, Bloomington, USA.

3 Hussain A. Lalani ACA CISA

Assistant General Manager, Chief Financial Officer

Mr Lalani joined UGB in 2001. He has more than 14 years' experience in Public Accounting and Financial Control. He was previously employed by Ernst & Young, Bahrain, and PriceWaterhouseCoopers, Pakistan. He is a Board Member and Board Audit Committee Member of Takaud Savings & Pensions Company. A Chartered Accountant and a Certified Information Systems Auditor, Mr Lalani holds a Bachelor of Commerce degree from the University of Karachi.

4 Jawad Al Asfoor

Senior Vice President, Head of Treasury

Mr Al Asfoor joined UGB in October 2006. He has more than 30 years' experience in Treasury and Islamic Banking. He was previously Chief Dealer at Indosuez (Calyon) and BNP Paribas Islamic Banking; and Head of Sales and Marketing at Liquidity Management Centre (LMC), Bahrain. Mr Al Asfoor holds a Diploma Certificate in Accounting and Finance from the Association of Certified Chartered Accountants, and a Diploma Certificate in Islamic Banking & Finance.

5 Ghulam Ahmed Mohatarem

Senior Vice President, Chief Operating Officer

Mr Mohatarem joined UGB in October 2003. He previously worked with Citigroup for over 26 years, working at various Citibank branches and subsidiaries around the world. His last assignment was with Citibank in London as Deputy Head of Compliance for the CEEMEA Division covering Central and Eastern Europe and MENA. Prior to that, he was Head of Operations & Compliance for Samba Capital Management (SCMI), a London-based Citigroup affiliate in the UK. With SCMI he was involved in setting up a number of Luxembourg registered UCITS Funds including an Islamic Equity Fund. Mr Mohatarem also worked with Citibank in Pakistan as Head of Operations, and with Saudi American Bank, (now Samba Financial Group) in Jeddah as Regional Operations Head for the Western Province. He holds an MBA and BSc degree from Karachi University.

6 Mohammed Alqumaish CIA CISA

Senior Vice President, Head of Internal Audit & Quality Assurance

Mr Alqumaish joined UGB in September 2001. He has more than 15 years of commercial and investment banking experience in Internal Auditing, Risk Assessment, Compliance and Quality Assurance Services. He previously worked with Ahli United Bank and Shamil Bank in Bahrain. Mr Alqumaish is a Board member of Tunis International Bank, Tunisia. He is a member of the Board Audit Committees of KIPCO Asset Management Company (KAMCO), Kuwait; Tunis International Bank, Tunisia; Gulf Bank Algeria, Algeria; and Syria Gulf Bank, Syria. A Certified Internal Auditor and Certified Information Systems Auditor, he holds an MBA from the University of Strathclyde Business School, UK.

In March 2012 Mr Soukarieh took over the resposibilities of Acting Chief Executive Officer following Mr Haroon's appointment as Advisor and Secretary to the Board of Directors.

Executive Management

Continued

7 **Deepa Chandrasekhar CAMS, CFE, MICA, ACSI**

Senior Vice President, Chief Compliance Officer

Mrs Chandrasekhar joined UGB in 2008. She has over 23 years' experience in the areas of Risk Management, Treasury, Operations, Internal Audit and Compliance. She started her career with Citibank as a foreign exchange dealer, and since then has worked extensively in the Middle East – in Bahrain, Lebanon and the UAE. She was previously Head of Risk at RAKBANK, UAE where she was actively involved in implementing Basel II. Mrs Chandrasekhar holds an MBA degree from the University of Alberta, Canada as well as the professional certifications of CAMS, CFE, MICA and ACSI. She is a member of the Steering Committee of the Professional Risk Managers International Association (PRMIA), Bahrain Chapter and the Advisory Council of the Chartered Institute of Securities and Investment (CISI), Bahrain Chapter.

8 **Syed Rehan Ashraf, ACA**

Senior Vice President, Head of Credit & Risk Management

Mr Ashraf joined UGB in 2005. He has 16 years of experience in the areas of Credit, Risk Management, Advisory, Compliance and Assurance Services with Islamic and conventional banks, and big four audit firms. He previously worked with Shamil Bank, Bahrain; Deloitte & Touche, Bahrain; Faysal Bank, Pakistan; and PriceWaterhouseCoopers, Pakistan. A Chartered Accountant (ACA) from the Institute of Chartered Accountants of Pakistan, he also holds an MBA from DePaul University of Chicago, USA.

Review of Operations

Business Overview and Strategy

Either directly or through its subsidiaries, associate companies and joint venture, UGB engages primarily in asset and fund management, investment banking, private equity, and corporate finance. Other business activities include brokerage, commercial banking, savings and pensions, proprietary investments and treasury.

Asset Management & Investment Banking

Asset Management

Asset and fund management activities – covering local, regional and international markets – comprise discretionary and non-discretionary portfolio management; securities trading; portfolio structuring and asset allocation advice; mutual funds; investments and structuring; and alternative/structured investments.

Investment Banking

Conventional and Islamic investment banking activities cover equity and debt underwriting, private placements, capital restructuring, and merger and acquisitions.

Private Equity

Private equity activity focuses on key growth or demand sectors such as telecoms, media, technology, and energy.

Corporate Banking

Corporate banking advisory services include IPO and private placement advisory and execution, business valuation, financial feasibility studies, project finance, and due diligence.

Other Business Activities

Commercial Banking

UGB has consolidated its commercial banking assets under Burgan Bank with the exception of Syria Gulf Bank, which is planned to be sold at a later date, once regulatory requirements have been met.

Proprietary Investments

UGB's proprietary investments are mainly in private and quoted equities, private equity funds, structured products, managed funds and debt securities. These are managed directly by the Bank or through its subsidiaries and associates, across a range of sectors including finance, real estate development, hospitality, media, healthcare and education.

Brokerage

UGB provides financial brokerage services for overseas clients within the MENA region.

Treasury

UGB's corporate treasury function manages the Bank's liquidity and funding requirements, and is responsible for developing conventional and Islamic counterparty relationships.

Non-financial Activities

Through its non-financial associate companies, the Bank carries out investments in the real estate, industry, hospitality and media sectors.

Strategy

UGB's strategic objective is to create the MENA region's premier asset management and investment bank. The Bank seeks to be the preferred gateway to the region for its clients and global partners through the delivery of both conventional and Islamic services backed by world-class standards of support, infrastructure and processes.

In 2010, the Bank completed a major realignment and consolidation of its business through the sale of its commercial banking assets to Burgan Bank, with the exception of Syria Gulf Bank, which will be sold at a later date once regulatory requirements have been met. This consolidation allows UGB to concentrate on its core expertise in asset management and investment banking, and develop its strategy to create a platform of long-term growth for shareholders and investors. UGB's 18% equity stake in Burgan Bank provides it with a stable and recurring revenue stream, and allows it the opportunity to access Burgan Bank's regional client base to cross-sell asset management and investment banking services. At the same time, UGB will leverage its own experience and relationships developed in markets across the MENA region, through its previous and current subsidiaries and associates in Kuwait, Jordan, Tunisia, Algeria, Iraq and Syria.

The combined experience of UGB and its subsidiary, KIPCO Asset Management Company (KAMCO) is expected to provide a true MENA-wide distribution platform for asset management, investment and financial solutions. UGB and KAMCO intend to adapt the same management philosophy that the Group has practiced in the past; namely to seek representation at board level, appoint strong management teams, and provide them with guidance and execution support to achieve targets and enhance performance. Realising the benefits of diversification, UGB has also made investments in the non-financial sector which include real estate, education, healthcare, hospitality and media.

In the light of increasingly volatile and uncertain market conditions, UGB commenced a comprehensive review of its strategy in 2011. This involved evaluating a number of options for refining the Bank's business model and strategic direction. A number of initial steps were taken during the year. These include a restructuring of the management team due to a refocusing of the asset book, and taking steps to de-leverage the balance sheet. UGB transferred a number of assets to other Group companies; and liquidated certain assets in sectors (such as real estate and hospitality) where the Bank had been a passive investor. The strategic review will continue during 2012.

Review of Operations

Continued

Review of Major Subsidiaries and Associates

UGB Network

بنك الخليج المتحد ش.م.ب.
United Gulf Bank B.S.C.

Asset Management & Investment Banking

- 86% KAMCO — Asset Management, Kuwait
- 31% Manafae Investment Company — Investment Company, Kuwait
- 45% North Africa Holding Company — Investment Company, Kuwait
- 45% Royal Capital PJSC — Investment Company, Abu Dhabi
- 77% UGFS North Africa — Investment Company, Tunisia

Savings & Pensions

- 50% Takaud Savings & Pensions Company — Pensions Company, Bahrain

Brokerage

- 19% Al Sharq Financial Brokerage Company — Brokerage House, Kuwait

Commercial Banking

- 18% Burgan Bank — Commercial Bank, Kuwait
- 31% Syria Gulf Bank — Commercial Bank, Syria

Non-Financial Operating Companies

- 20% United Real Estate Company — Real Estate, Kuwait
- 32% United Industries Company — Industrial Company, Kuwait
- 45% Overland Real Estate Company — Real Estate, Kuwait
- 40% United Capital Transport Company — Transport Company, Kuwait
- 28% United Networks — Media Company, Kuwait

Key Business Developments in 2011

Financial Highlights

- UGB's assets under management stood at US$ 7.1 billion at the end of 2011 compared with US$ 8 billion at the end of 2010.
- The contributions from the Bank's associated companies in 2011 increased substantially to US$ 31.7 million compared with US$ 9.2 million in 2010.
- Key contributors were Burgan Bank with US$ 33.8 million and United Real Estate Company with US$ 7.1 million.
- KAMCO recorded a net loss of US$ 21.7 million in 2011 compared with a profit of US$ 6.4 million in 2010.

Acquisitions

- In a secondary market transaction, UGB purchased a stake in Moelis Capital Partners Opportunity Fund I, which is a 2007 vintage fund, for US$ 34.8 million.
- KAMCO acquired a 40% equity stake in United Capital Transport Company.
- KAMCO acquired an additional equity interest of 16.38% in KAMCO Energy Services Fund.

Divestitures

- UGB completed its liquidation of United Gulf Bank Securities Company.
- UGB reduced its investments in the real estate and hospitality sectors, with exits from Al Dhiyafa Holding Company, Kuwait Hotels Company, and United Real Estate Company, Jordan.
- KAMCO sold its 29% stake in SSH DAR International.

New Initiatives

- UGB invested US$ 5 million, being the first capital tranche, for a 50% stake of Takaud Savings & Pensions Company, a first-of-its-kind regional savings and pensions company.
- UGB received approval from the Bahrain Bourse to provide brokerage services for its overseas clients.

Asset Management & Investment Banking

KIPCO Asset Management Company (KAMCO)

UGB Consolidated Subsidiary based in Kuwait

Established in 1998, KAMCO is a leading asset management and financial institution in Kuwait. Its three principal business lines are asset management, financial services, and investment advisory research services, which are offered to a diverse local, regional and international client base. During 2011, UGB acquired a 40% equity stake in United Capital Transport Company for KD 2 million (US$ 7.18 million) through its subsidiary KAMCO. The company liquidated its entire holdings in UGB Securities Company, SSH DAR International, and United Universal Real Estate Consultants, resulting in a loss of KD 40 thousand (US$ 143 thousand). In a year when most investment companies were seriously affected, KAMCO recorded a net loss of US$ 21.7 million in 2011 compared with a net income of US$ 6.5 million in 2010. At the end of the year, total assets under management stood at US$ 7.8 billion (2010: US$ 8.8 billion). UGB owns 86% of KAMCO, which is listed on the Kuwait Stock Exchange.

Financial Performance Summary

US$ million	31 Dec 11	31 Dec 10
Total Revenue	21.0	37.2
Net Income	(21.7)	6.5
Total Assets	527.5	581.4
Total Equity	290.3	313.7
ROE (%)	(7.5)	2.1
ROA (%)	(4.1)	1.1

Manafae Investment Company (Manafae)

UGB Associate Company based in Kuwait

An Islamic investment company established in 2005, Manafae offers a wide range of Sharia-compliant products and services including asset management, investment services, extension of financing and credit, and advisory services. The firm was one of the first to launch an Islamic mutual fund in 2007. The Manafae First Fund invests in listed and private companies, incorporated primarily in Kuwait and the GCC. Manafae reported a net loss of US$ 9.8 million in 2011 compared with a net loss of US$ 3.1 million in 2010. UGB owns 31% of the firm through its subsidiary KAMCO. Manafae was listed on the Kuwait Stock Exchange as of 2010.

Financial Performance Summary

US$ million	31 Dec 11	31 Dec 10
Total Revenue	(1.0)	2.4
Net Income	(9.8)	(3.1)
Total Assets	77.9	92.4
Total Equity	75.9	90.6
ROE (%)	(12.9)	(3.5)
ROA (%)	(12.6)	(3.4)

North Africa Holding Company (NorAH)

UGB Associate Company based in Kuwait

Established in 2006, NorAH focuses on acquiring significant stakes in companies based in Morocco, Algeria, Tunisia, Libya and Egypt, which have demonstrated the ability, or have the potential, to deliver real value. The company is regulated by the Ministry of Commerce and Industry, Kuwait. In 2011, NorAH acquired a 10% stake in Résidences Dar Saada via a capital increase. Established in 2001 by the Palmeraie Group, Résidences Dar Saada is a Moroccan-based company specialising in social housing development. UGB has a total consolidated interest of 45% in NorAH, whose shares are unlisted.

Royal Capital PJSC (RCP)

UGB Associate Company based in the UAE

RCP was established in 2007 and commenced business activities in 2009. Regulated by the Central Bank of the UAE, the company provides investment banking and asset management services and products. In January 2011, RCP launched its second investment fund, the Royal Capital MENA Multi-Market Strategy Fund, which is structured as an open-ended collective investment scheme registered in the Kingdom of Bahrain. It was shortlisted as the 'Best Balanced Fund 2011' by the MENA Fund Manager magazine. The company's first fund, the Royal Capital MENA Fixed Income Plus Fund, launched in March 2010, has been assigned an 'A' rating by Standard & Poor's, the first for a MENA fixed income fund. It also received several awards during 2011, including the 'Fixed Income Manager of the Year 2011' by the Global Investor publication, and 'Newcomer Fund of the Year' by the MENA Fund Manager magazine. Also during the year, RCP acted as Lead Manager for the IPO of Eshraq Properties, a UAE-based property developer, on the Abu Dhabi Stock Exchange. Taking into account the challenging investment environment and likely capital utilisation, the shareholders of RCP approved a reduction of the company's issued and paid up capital from AED 300 million to AED 150 million, of which AED 144.3 million was distributed to the shareholders on a pro-rata basis in cash in early 2012. UGB owns 45% of RCP on a consolidated basis. Its shares are unlisted.

Financial Performance Summary

	9 months ended	
US$ million	31 Dec 11	31 Dec 10
Total Revenue	2.3	3.8
Net Income	(2.0)	(1.2)
Total Assets	78.1	81.7
Total Equity	78.1	81.4
ROE (%)	(2.5)	(1.5)
ROA (%)	(2.5)	(1.5)

United Gulf Financial Services Company North Africa (UGFS-NA)

UGB Consolidated Subsidiary based in Tunisia

UGFS-NA was established in November 2008 as an asset management entity, and officially commenced operations in 2009. The company is regulated by the Conseil du Marché Financier (CMF) of Tunisia. UGFS-NA is primarily involved in three main activities: portfolio management services, fund services, and corporate finance.

The company was active in all three areas of its operations during 2011:

- Portfolio management services: UGFS-NA increased its business during the year to 29 clients in Tunisia (both institutional and individual) with total assets under management of TND 5.2 million (US$ 3.4 million) as at 31 December 2011.
- Fund services: UGFS-NA currently has two funds: Tunisian Equity Fund, a listed equity fund with total assets under management of TND 7.2 million (US$ 4.7 million); and Tunisian Development Fund, a private equity fund with total assets under management of TND 6.6 million (US$ 4.4 million), as at 31 December 2011. The company plans to launch three more funds in 2012.
- Corporate finance: UGFS-NA has built a healthy pipeline of financial advisory transactions, which are expected to be closed in 2012.

Despite the challenging market and political conditions in Tunisia during 2011, the long-term outlook for the country and its financial services industry remains positive, with particular developments expected in the areas of private equity funds, micro-financing and Islamic finance. UGB has a direct shareholding of 60% in UGFS-NA, whose shares are unlisted.

Brokerage

Al Sharq Financial Brokerage Company (Al Sharq)

UGB Associate Company based in Kuwait

Established in 1985, Al Sharq has grown to become one of the largest brokerage firms in Kuwait, as measured by the number of transactions conducted on the Kuwait Stock Exchange (KSE). In 2011, the firm was impacted by lower trading volumes and a lacklustre performance of the KSE. Al Sharq reported net income of US$ 0.8 million in 2011 compared with US$ 2.6 million the previous year. UGB owns 19% of Al Sharq on a consolidated basis. Its shares are unlisted.

Financial Performance Summary

US$ million	31 Dec 11	31 Dec 10
Total Revenue	4.5	8.7
Net Income	0.8	2.6
Total Assets	22.4	25.3
Total Equity	19.8	22.4
ROE (%)	4.1	11.4
ROA (%)	3.6	10.1

Commercial Banking

Burgan Bank (BB)

UGB Associate Company based in Kuwait

Established in 1975, Burgan Bank (BB) is a subsidiary of KIPCO. The Bank is listed on the Kuwait Stock Exchange and regulated by the Central Bank of Kuwait. Over the years it has acquired a leading role in the retail, corporate and investment banking sectors in the MENA region. Its achievements in product innovation, information technology, efficiency, quality and corporate governance have been recognised by numerous awards, with several of them being either first or unique in the region. BB is also the first bank in the GCC to achieve ISO 9001:2008 accreditation. In 2010, UGB completed the transfer of its commercial banking assets to Burgan Bank with the exception of Syria Gulf Bank, which will be sold at a later date once regulatory requirements have been met. In 2011, BB reported net income of US$ 181.5 million compared with US$ 16.6 million in 2010, with reduced provisions. UGB has an equity stake of 18% in Burgan Bank, which provides it with a stable and recurring revenue stream, and the opportunity to access BB's regional client base.

Financial Performance Summary

US$ million	31 Dec 11	31 Dec 10
Total Revenue	809.2	824.7
Net Income	181.5	16.6
Total Assets	16,341.0	14,762.0
Total Equity	2,031.0	1,917.0
ROE (%)	8.9	0.9
ROA (%)	1.1	0.1

Syria Gulf Bank (SGB)

UGB Associate Company based in Syria

SGB was licensed as a new commercial bank in Syria in 2006 when the country opened up its financial sector for foreign investment after years of relative isolation. The bank commenced operations in June 2007, and offers a range of retail and commercial banking services through 12 branches across the country. SGB was named 'Best Bank in Syria 2009' by The Banker magazine. The Bank witnessed significant growth in 2011, posting a net profit of US$ 4.6 million compared with a net loss of US$ 4.3 million in 2010. Total assets increased by US$ 118 million to US$ 401 million at the end of 2011, with total deposits growing by 21% to US$ 260 million. Loans increased by 70% to US$ 228 million, while provisions for loan losses were US$ 2.7 million. The successful implementation of focused strategies resulted in SGB becoming profitable from core banking operations for the first time since its establishment. The Bank is listed on the Damascus Securities Exchange.

Financial Performance Summary

US$ million	31 Dec 11	31 Dec 10
Total Revenue	22.5	14.6
Net Income	4.6	(4.3)
Total Assets	401.0	336.0
Total Equity	49.1	52.7
ROE (%)	9.5	(8.2)
ROA (%)	1.2	(1.3)

Non-Financial Associates

United Real Estate Company (URC)

UGB Associate Company based in Kuwait

Established in 1973, URC is involved in real estate activities that include the purchase, sale, leasing and renting of land and buildings. The company handles the construction of private and public buildings and projects, and manages third party properties in Kuwait, Egypt, Lebanon and Jordan. URC is the developer of the benchmark Marina Mall project in Kuwait. The company recorded a net profit of US$ 36.3 million in 2011 compared with US$ 19.8 million the previous year. UGB owns a 20% stake in URC. The company is listed on the Kuwait Stock Exchange.

Financial Performance Summary

US$ million	31 Dec 11	31 Dec 10
Total Revenue	106.4	60.7
Net Income	36.3	19.8
Total Assets	1,873.0	1,294.7
Total Equity	891.1	718.2
ROE (%)	4.1	2.4
ROA (%)	1.9	1.5

United Industries Company (UIC)

UGB Associate Company based in Kuwait

UIC was incorporated in 1979 with the aim of establishing and developing industrial projects, and providing technical consultancy services relating to industrial investments. It is also involved in the incorporation, marketing and management of investment funds specialised in the industrial and services sectors in Kuwait and the region. Investments include United Cement Company, United Industrial Gas Company, and United Gulf Industries Company. UIC posted a net profit of US$ 4.3 million in 2011 compared with a net profit of US$ 14.4 million in 2010. UGB owns 32% of UIC on a consolidated basis. The company is listed on the Kuwait Stock Exchange.

Review of Operations

Financial Performance Summary

US$ million	31 Dec 11	31 Dec 10
Total Revenue	29.3	34.5
Net Income	4.3	14.4
Total Assets	638.1	633.9
Total Equity	348.5	365.4
ROE (%)	1.2	3.9
ROA (%)	0.7	2.3

Overland Real Estate Company (Overland)

UGB Associate Company based in Kuwait

A limited liability company incorporated in Kuwait in 2010, Overland invests in equities and real estate as its principal activities. Its major investments include 36.8% focused on the healthcare sector and a 28.5% stake in the Islamic Investment Company. UGB owns 45% of Overland on a consolidated basis. The company's shares are not listed.

United Capital Transport Company (UCTC)

UGB Associate based in Kuwait

Established in 2011, the main activities of UCTC comprise land and marine transportation and related services; vehicle and equipment sales and leasing; and maintenance services. The company reported a net income of US$ 10.6 million in its first year of operations. UGB owns 40% of UCTC on a consolidated basis. The company's shares are not listed.

Financial Performance Summary

US$ million	31 Dec 11	31 Dec 10
Total Revenue	13.8	-
Net Income	10.6	-
Total Assets	41.9	-
Total Equity	28.6	-
ROE (%)	37.2	-
ROA (%)	25.4	-

United Networks Company (UNC)

UGB Associate Company based in Kuwait

Incorporated in 2001, United Networks is Kuwait's pioneering communications and media solutions provider. The company's innovative and progressive product and service range offers media and communications solutions. UNC is leveraging the convergence of voice, video and data to create new business opportunities. UGB owns 28% of UNC on a consolidated basis. The company's shares are not listed.

United Real Estate Company Syria (URCS)

UGB Associate Company based in Syria

Established in 2007, URCS is primarily engaged in the purchase, development, management and trade of real estate. The company's shares are not listed.

Operations and Support Services

Treasury

UGB's corporate treasury function manages the Bank's liquidity and funding requirements, and is responsible for developing conventional and counterparty relationships. In another challenging year, which was marked by the ongoing impact of the global financial crisis and unexpected political events in the Middle East, it proved difficult to attract deposits at favourable pricing. UGB was able to minimise the impact of such challenges by fostering the long-term relationships it has developed with counterparties, and by benefiting from the support it continues to receive from the KIPCO Group.

UGB retained a strong balance sheet with a consolidated capital adequacy ratio of 18%, well above the requirements of the Central Bank of Bahrain. The Bank also maintained a high level of liquidity, with total liquid assets of US$ 301 million, representing 17% of the balance sheet at the end of 2011. During the year, the Bank took steps to further bolster the maturity profile of its liabilities, and successfully arranged two new three-year medium-term facilities through bilateral and club deals totalling US$ 310 million. UGB also made a full repayment of its three-year US$ 115 million syndicated loan facility, and a US$ 20 million bilateral loan, on their respective maturity dates.

Operations

During 2011, the Bank conducted a comprehensive review of its operating processes and procedures in order to enhance efficiency and productivity. As the result of cost control measures taken at UGB and KAMCO, general and administrative expenses decreased by US$ 11.1 million (51.3%) to US$ 10.5 million at the end of 2011, compared with US$ 21.6 million at the end of the previous year.

Information Technology

Key IT developments in 2011 included the successful installation and testing of a new disaster recovery site to support UGB's business continuity planning process, and continued enhancement of the Bank's information security system. In addition, a detailed business impact analysis was conducted.

Human Resources

As a result of the reorganisation of the management team due to a refocusing of the asset book, plus a number of staff resignations during the year, the Bank's headcount decreased by 10% in 2011. Staff costs were reduced by US$ 3.8 million (14.1%) to US$ 23.1 million at the end of the year compared with US$ 26.9 million at the end of 2010. UGB continued to support staff with relevant training and development, including special in-house workshops covering anti-money laundering, code of conduct, corporate governance and operational risk management; and also sponsored staff to gain business-related graduate and postgraduate qualifications, and professional accreditations.

UGB's merit-based Mashare' Al Khair Scholarship Programme assists dependents of qualified Bank staff to obtain degrees from accredited colleges, universities or other academic institutions. With the enrollment of an additional two children in 2011, a total of four children are currently benefiting from this programme. During 2011, the UGB Staff Committee organised a number of events for Bank staff to enhance inter-departmental relationships, and also raise awareness of health-related issues such as breast cancer through support for the 'Think Pink Bahrain' campaign.

Financial Review

This review provides a detailed description of the financial performance of UGB for the period ended 31 December 2011. The Notes to the Consolidated Financial Statements provide additional relevant details, with some of these notes being cross-referenced here. Figures contained in the Financial Review are subject to rounding adjustments and, in certain instances, the sum of the numbers in a column or row may not conform exactly to the total figure given for that column or row.

Revenues

UGB's total revenues recorded a decrease of US$ 66.4 million in 2011 to US$ 108.5 million compared with US$ 174.9 million (including discontinued operations of US$ 11.7 million) in 2010. The decline in total revenues is attributable to exceptional gains recorded in 2010 of US$ 82 million on the acquisition of an associate and a gain on the sale of Tunis International Bank, partially offset by a loss on the dilution of United Real Estate Company. The following table indicates the contribution of revenues from UGB's activities and investments in various sectors. Each sector is also discussed in detail.

Total Revenues (US$ million)	2011	2010*
Financial Services associates	23.7	(0.8)
Real Estate associates	6.0	5.3
Other associates	2.0	7.3
Management fees from asset management	13.3	16.8
Credit related fees and commission	1.5	1.6
Advisory fees	2.2	13.7
Interest Income	7.4	16.1
Realised gain on non-trading investments	30.5	4.6
Gain on acquisition of an associate	-	69.7
Gain on trading investments	4.8	11.9
Dividend income	11.8	10.3
Other income	1.2	3.5
Foreign currency translation (losses) gains - net	(1.2)	2.4
Loss on dilution of investment in an associate	-	(31.4)
Gain on sale of associates and subsidaries	5.3	44.0
Total	108.5	174.9

* Includes revenues of discontinued operation US$ 11.7 million

Financial Services Associates

UGB's financial services related revenues are derived from its investment in associates involved in asset management and investment banking, commercial banking, and brokerage. Details of these entities are included in the Business Activities section of the Review of Operations in this annual report.

In 2011, results from financial associates recorded a 24-fold increase to US$ 23.7 million compared with a loss of US$ 0.8 million in 2010. The increase is mainly attributed to UGB's commercial banking associate Burgan Bank - Kuwait, and Syria Gulf Bank, recording a nine-fold increase in profit in 2011 compared with 2010.

The table below indicates the performance of UGB's financial associates:

Revenues - Financial Associates (US$ million)	2011	2010
Al Sharq Financial Brokerage Company	0.1	0.3
Burgan Bank SAK	33.8	4.5
Gulf Bank Algeria (discontinued operation)	-	2.6
Kuwait Private Equities Opportunity Fund	(2.5)	(1.2)
Manafae Investment Company	(2.4)	(0.6)
Millennium Private Equity Limited	-	(1.9)
North Africa Holding Company	(5.8)	(2.7)
Royal Capital PJSC	(1.0)	(0.8)
Syria Gulf Bank	1.6	(1.1)
	23.7	(0.8)

Real Estate Associates

UGB's real estate revenues are derived from United Real Estate Company - URC (also refer to Business Activities section of the Review of Operations) which contributed a net profit of US$ 7.1 million in 2011 compared with US$ 5.6 million in 2010.

Subsequent to the year-end, URC sold its stake in an investment property in Lebanon and realised a profit of US$ 72 million, which will be recorded in 2012. UGB owns a 20% equity stake in URC as at 31 December 2011.

Other Non-Financial Associates

UGB posted a net income of US$ 2 million from its non-financial associates in 2011 compared with US$ 7.3 million in 2010.

The table below indicates the performance of UGB's non-financial associates:

Revenues - Non-Financial Associates (US$ million)	2011	2010
Al-Dhiyafa Holding Company KSC (Closed)	(0.3)	(0.4)
KAMCO Energy Service Fund	(2.6)	-
Kuwait Education Fund	-	(0.2)
SSH Dar International WLL	(0.7)	1.3
United Networks Company	(0.3)	0.2
United Industries Company	1.5	6.4
United Capital Transport Company	4.5	-
	2.0	7.3

United Capital Transport Company is a new entity engaged in transportation activities in Kuwait, and contributed US$ 4.5 million in its first year of operations from vehicle lease contracts. United Industries Company (UIC) contributed US$ 1.5 million compared with US$ 6.4 million in 2010. In

2010, UIC posted an exceptional profit largely from the sale of its subsidiary SNZP by SADAFCO, and a gain arising from an additional acquisition of a 50% stake in Kuwait National Industrial Projects Company. However, such exceptional gains were not posted in 2011.

In 2011, the Bank sold its 32% ownership stake in Al Dhiyafa Holding Company (ADHC), and its 29% equity stake in SSH Dar International WLL, for US$ 45.3 million, and a realised profit of US$ 8 million.

Management Fees from Asset Management Activities

UGB's assets under management decreased to US$ 7.1 billion in 2011 compared with US$ 8 billion in 2010. Management fees were reduced by 20.6% to US$ 13.3 million in 2011 compared with US$ 16.8 million in 2010.

Credit Related Fees and Commissions

Credit related fees and commissions contributed US$ 1.5 million in 2011 compared with US$ 1.6 million in 2010.

Advisory Fees

Advisory fees for 2011 totalled US$ 2.2 million in 2011 compared with US$ 13.7 million in 2010, a decrease of US$ 11.5 million. In 2010, advisory fees of US$ 5.6 million were recorded from KIPCO, and US$ 4.5 million from Burgan Bank for managing the commercial banking associates. However, no such fees were recorded in 2011.

Interest Income

The main source of interest income for UGB is derived from its loan book and interbank placements. Interest income in 2011 was reduced by 41% to US$ 7.4 million compared with US$ 12.7 million in 2010, largely as a result of the redemption of Burgan Bank's subordinated debt in 2010. In 2010 the Bank also recorded interest income of US$ 3.4 million from discontinued operations.

Realised Gains on Non-Trading Investments

Realised gains on non-trading investments increased to US$ 30.5 million in 2011 compared with US$ 3.2 million in 2010. The gains in 2011 were mainly realised from the exit of private equity investments and other real estate assets.

Gain on Acquisition of an Associate

In 2010, the Bank recognised an exceptional gain of US$ 69.7 million on the acquisition of a 17% stake in Burgan Bank (BB). The Bank has acquired significant influence on BB through acquisitions of its share capital in stages. In 2010, at the date of significant influence achieved, previously held equity interest was fair valued and a resulting gain of US$ 69.7 million was recycled to the income statement from equity. However, no such gain was recorded in 2011.The Bank exercises its significant influence on BB through representation of two directors on the Board of Burgan Bank.

Gain on Trading Investments

Trading positions in 2011 recorded a mark-to-market gain of US$ 4.8 million (2010: trading gain of US$ 11.9 million). The mark-to-market gain declined due to the negative performance (-17%) of the Kuwait Stock Exchange (KSE) compared with a YTD negative return of -0.3% in 2010.

Dividend Income

The main contributors of dividend income were from listed and private equity investments. Dividend income increased by 15% to US$ 11.8 million in 2011 compared with US$ 9.7 million in 2010. During 2011 UGB received increased dividend distributions from US private equity funds.

Foreign Currency Translation Gain/(Loss) and Other Income

Other income consisted mainly of gains on foreign currencies and rental income on investment property. In 2011, the Bank recorded a foreign currency loss of US$ 1.2 million, mainly from Kuwait Dinar positions, compared with a gain of US$ 2.4 million in 2010.

Loss on Dilution of Investment in an Associate

In 2010, the Bank did not participate in rights shares issued by URC in December due to large exposure restrictions imposed by the CBB. As a result, the Bank's shareholding in URC was diluted to 20% in December 2010 from 30% in September 2010. A loss of US$ 31.4 million was recorded as dilution impact/deemed disposal in 2010.

Gain on Sale of Associates and Subsidiaries

The Bank recorded a gain of US$ 5.3 million from the exit of certain associated companies in 2011. UGB recorded a net gain of US$ 43.8 million from the transfer of its stake in Tunis International Bank to Burgan Bank in 2010.

Expenses

Interest Expense

Interest expense increased by US$ 4.3 million (8.7%) to US$ 53.6 million as at 31 December 2011, compared with US$ 49.3 million as at 31 December 2010. The increase is mainly due to the conversion of US$ 240 million short-term borrowings to medium-term tenors.

Operating Expenses

Operating expenses decreased by 30.6% to US$ 33.7 million in 2011 compared with US$ 48.6 million in 2010. Salaries and benefits decreased by 14.1% to US$ 23.1 million (2010: US$ 26.9 million) whereas general and administration expenses decreased by 51% to US$ 10.5 million (2010: US$ 21.6 million) mainly due to cost control measures.

The following table compares operating expenses for 2011 and 2010:

Operating Expenses (US$ million)	2011	2010
Salaries and benefits	23.1	26.9
General and administrative expenses	10.5	21.6
Total	33.7	48.6

Net Operating Income

UGB's net operating income decreased by 67.4% to US$ 21.3 million in 2011 compared with US$ 65.4 million in 2010.

Provisions

The erosion of asset prices continued in 2011. UGB recorded impairment losses on non-trading investments of US$ 24 million (2010: US$ 13.5 million) in 2011. An impairment loss of US$ 15.78 million was recorded against Millennium Private Equity Limited (MPEL) (joint venture) in 2010.

Net Income

UGB's net income in 2011 decreased by 96% to US$ 1.5 million in 2011 compared with US$ 38.6 million in 2010. Earnings per share were reduced to 0.18 US cents compared to 4.71 US cents in 2010.

Consolidated Balance Sheet

Consolidated Assets

UGB's consolidated assets stood at US$ 1.78 billion at the end of 2011 compared with US$ 1.92 billion at the end of 2010. The decrease was mainly due to the liquidation of investments and reduced placements with banks. A comparison of the two years is provided below:

Assets (US$ million)	2011	2010
Demand and call deposits with banks	17.9	27.9
Placements with banks	102.3	167.3
Investment carried at fair value through statements of income	73.2	126.7
Non-trading investments	435.0	385.8
Loans and receivables	27.9	57.9
Investment properties	16.1	21.2
Other assets	37.5	47.0
Investments in associates and joint venture accounted for under the equity method	1,002.9	1,026.1
Property and equipment	0.9	1.1
Goodwill	56.8	56.3
Total	1,770.5	1,917.1

Demand, Call and Placements with Banks

Demand, call and placements with banks were US$ 120.2 million in 2011 compared with US$ 195.2 million in 2010. Total liquid assets comprising cash, deposits, liquid securities and other assets represented 17% of the balance sheet as at end 2011 (2010: 24.6%).

Investments Carried at Fair Value through the Statement of Income

Investments carried at fair value through the statement of income were US$ 73.2 million in 2011 compared with US$ 126.7 million in 2010. This portfolio comprises securities held for trading and managed funds designated as held for trading. Securities held for trading decreased to US$ 24.2 million in 2011 from US$ 29.2 million the previous year. The securities held for trading portfolio is well diversified, and consists mainly of equities listed on the Bahrain, Kuwait and Saudi Arabia stock exchanges.

Managed funds designated held for trading reduced to US$ 48.9 million in 2011 compared to US$ 97.5 million in 2010, mainly due to liquidations.

As at year-end 2011, 43.6% of the outstanding portfolio of managed funds designated held for trading, aggregating US$ 21.3 million, was invested in Kuwait. The balance consisted of funds domiciled in the US, Europe and other GCC countries. In line with UGB's risk management policy, the whole portfolio is diversified in terms of products, asset class and industry risk.

Non-Trading Investments

Non-trading investments were US$ 435 million in 2011 compared with US$ 385.7 million in 2010. The portfolio mainly comprises listed equities of US$ 43.3 million (2010: US$ 45.1 million), unlisted equities of US$ 81.7 million (2010: US$ 132.5 million), real estate managed funds of US$ 16.5 million (2010: US$ 18.6 million), other managed funds of US$ 280.1 million (2010: US$ 179 million), and debt securities of US$ 13.2 million (2010: US$ 10.4 million). The increase in 'other managed funds' is primarily due to new investments in private equities of US$ 105 million, mainly in the US market.

The major investments under the non-trading investments portfolio as at 31 December 2011 were:

- **Advanced Technology Company KSC (Closed)** is a Kuwait shareholding company with the principal objectives of trading in healthcare products, installation and maintenance of equipment, civil construction of healthcare facilities, and investment of surplus funds in investment securities through a portfolio manager. The year-end value of this investment was US$ 21.4 million, representing an equity stake of 6.2%.

- **Burgan Equity Fund** is an open-ended fund managed by Burgan Bank and focused mainly on investing in shares of Kuwaiti companies listed on the KSE. The fund adopts a balanced investment policy, and its objective is to earn long-term capital gains with minimum possible risk. The year-end value of this investment was US$ 43.8 million (2010:

US$ 50.2 million) and represents an equity stake of 15.5% (2010: 16%).

- **Global Banking Corporation (GBCORP)** is an Islamic investment bank incorporated in Bahrain, with an issued and paid-up capital of US$ 250 million. GBCORP's business lines include private equity and venture capital, real estate and infrastructure development, asset management, advisory services in corporate finance and capital markets, and portfolio management services. The year-end value of this investment was US$ 20.9 million (2010: US$ 20.9 million) and represents an equity stake of 12.5% (2010: 12.5%).

- **Hauck & Aufhauser Bank (Hauck)** is a private investment bank established in Germany in 1796. Hauck focuses on asset fund management, and has a strong clientele base. UGB's investment as at year-end 2011 was US$ 17.2 million (2010: US$ 17.6 million) and represents an ownership stake of 7.88% (2010: 7.88%).

- **KAMCO Investment Fund** is an open-ended fund managed by KAMCO. The fund invests in securities of companies listed on the Kuwait Stock Exchange in primary issues, government bonds, and public issues that are expected to be listed, including securities of companies listed on the exchanges in the MENA region. The year-end value of this investment was US$ 14.3 million (2010: US$ 13.2 million) and represents an equity stake of 13.84% (2010: 13.4%).

- **Bond and High Yield Fund** is managed by KAMCO. The fund's objective is to achieve a return based on relatively high yield compared with short-term bank interest rates, by investing in corporate bonds and treasury bills in Kuwaiti and GCC markets. The Fund also invests surplus liquidity in certificate of deposits, bank deposits and local money market funds managed by other institutions. UGB's investment as at year-end 2011 was US$ 13.1 million (2010: US$ 13.2 million) and represents an ownership stake of 15.48% (2010: 9.49%).

- **MPE Energy Fund (MPE)** is managed by MPEL with the objective of acquiring a stake in companies operating in the energy sector. At year-end 2011, UGB's investment in the fund was US$ 16 million (2010: US$ 16 million).

- **Private Equity Fund of Funds PEH III & IV.** UGB's year-end value was US$ 63 million (2010: US$ 50 million) and is invested with 25 leading fund managers based in North America, with underlying investments well-diversified in numerous economic sectors. Many of UGB's private equity funds are coming out of the 'J-curve effect', and are starting to produce positive cash flows and returns. The portfolio value includes a positive fair value of US$ 9.8 million.

Loans and Advances

Loans and advances mainly consists of facilities extended to individuals and related parties. All loans and advances are secured, and adequate provisions have been made against possible future weakness.

Investment Properties

Investment properties in UGB's books include the Bank's head office building – UGB Tower – situated in the Diplomatic Area, Bahrain; as well as a plot of land in a prime location in Saudi Arabia. The CBB mandated the exclusion of booking unrealised gains derived from the revaluation of investment property in the income statement. UGB has an unrealised gain of US$ 8 million on the valuation of the property in Saudi Arabia, which has not been recorded as income.

Investments in Associated Companies

Investments in the Bank's associated companies and joint venture accounted for under the equity method reduced by US$ 23 million in 2011 to US$ 1,002 million, compared with US$ 1,026 million in 2010. The Bank sold its 32% equity stake in Al Dhiyafa Holding Company, a 47% equity stake in United Real Estate Company - Jordan, and a 29% equity stake in SSH Dar International through KAMCO, in 2011. These were partially offset by an investment of a 50% equity stake in Takaud Savings and Pensions Company, a 39.8% equity stake in United Capital Transport Company, and an additional 16% equity stake in the KAMCO Energy Services Fund.

The Bank's associated companies contributed a total profit of US$ 31.7 million in 2011 compared with a profit of US$ 9.2 million in 2010. Key contributors were Burgan Bank (US$ 33.8 million), United Real Estate Company (US$ 7.1 million), and United Capital Transport Company (US$ 4.5 million).

Consolidated Liabilities

UGB's consolidated liabilities reduced by 11.3% to US$ 1.2 billion in 2011 compared with US$ 1.3 billion in 2010. The decrease is mainly due to the repayment of KD bonds of US$ 71 million with KAMCO on the due date of 22 June 2011, and reduced short-term borrowings by UGB. Loans and Murabaha payables increased to US$ 731 million compared with US$ 501 million as at 31 December 2010, mainly due to new three-year medium-term facilities totalling US$ 310 million. These were partially offset by UGB's repayment of a US$ 115 million club loan and US$ 20 million bilateral loan. A comparison of the two years is provided below:

Liabilities (US$ million)	2011	2010
Due to banks and other financial institutions	211.8	435.6
Deposits from customers	80.3	139.6
Loans payable	731.2	501.4
Other liabilities	44.0	68.5
Bonds	-	71.2
Subordinated debt	100.0	100.0
Total	1,167.4	1,316.3

Equity

As at year-end 2011, total equity increased to US$ 603.2 million compared with US$ 600.8 million at the end of 2010 mainly due to a decrease in negative fair value reserves and movement in minority interests. Negative fair value reserves decreased by US$ 7.9 million to US$ 13.5 million from US$ 21.4 million mainly due to impairment losses against non-trading investments and maturing interest rate swaps. Minority interest decreased to US$ 41.3 million compared to US$ 46.2 million mainly due to losses at KAMCO (UGB subsidiary).

The following table reflects the composition of shareholders' equity and minority interest at year-end 2011 compared with 2010:

Equity (US$ million)	2011	2010
Share capital	208.6	208.2
Treasury shares	(12.7)	(12.7)
Share premium	11.5	10.6
Statutory reserve	95.5	95.4
General reserve	76.0	75.9
Treasury share reserve	14.3	14.3
Fair value reserve	(13.5)	(21.4)
Foreign currency translation reserve	40.1	43.5
Retained Earnings	142.0	140.9
Capital and reserves attributable to the shareholders of the parent	561.8	554.6
Non-controlling interests in equity	41.3	46.1
Total Equity	603.2	600.8
Total Liabilities and Equity	1,770.5	1,917.1

Off Balance Sheet Commitments

UGB's off balance sheet commitments comprise guarantees, letters of credit, credit commitments, undrawn investment commitments, bankers' acceptances, financial instruments to cover foreign exchange risks, forward purchase and sales contracts, and interest rate and currency swaps. The Bank's investments and credit related commitments aggregated to US$ 69.9 million as at year-end 2011 (2010: US$ 39.8 million). This increase is largely due to trade finance facilities of US$ 32 million to group companies by UGB. The Bank's contingent liabilities mainly include forward contracts and interest rate swaps that were undertaken to hedge existing balance sheet exposures. The Bank does not trade derivatives nor engages in proprietary foreign exchange trading. Further details regarding off balance sheet commitments are provided in Notes 29 & 30 to the Consolidated Financial Statements.

Capital Adequacy

UGB's capital adequacy ratio of 18% (2010: 19.5%) under the Basel II regulations is well above the minimum requirement of 12% with a buffer of an additional 0.5%, as mandated by the CBB.

The following table provides an analysis of the capital adequacy position of the Bank:

Capital Adequacy (US$ million)	2011	2010
Capital base:		
Tier 1 capital	422.80	414.50
Tier 2 capital	-	77.53
Total capital base (a)	422.80	492.03
Credit risk weighted exposure	2,103.95	2,186.78
Market risk weighted exposure	161.68	275.18
Operational risk weighted exposure	56.53	66.83
Total risk weighted exposure (b)	2,322.15	2,528.79
Capital adequacy (a/b * 100)	18.2%	19.5%
Minimum requirement	12.0%	12.0%

Risk Management

UGB's risk management framework is developed to provide comprehensive controls and ongoing management of the major risks inherent in the Bank's business model and operational activities.

Developments in 2011

- The key focus during the year was on liquidity management, portfolio management, and optimising the balance sheet.
- The Operational Risk framework was revamped and automated through the implementation of a robust Operational Risk system.
- Considerable work was undertaken on developing internal rating models for investment banking and asset management.
- A comprehensive review of risk management policies and processes was conducted.
- The Risk Management team was expanded and enhanced.

Risk Philosophy

The Bank's risk philosophy is based on the following four key principles:

- A sound knowledge base, and the experience and judgement of Senior Management and Risk Management staff, are the cornerstone of a successful risk mitigation programme.
- Vigilance, discipline and attention to detail are mandatory.
- Complete segregation of duties and reporting authorities must exist between business lines and support functions.
- Policies and procedures must be clear, properly documented, well communicated, understood, and implemented in letter and spirit.

Responsibilities

The Board of Directors of UGB has the ultimate authority for setting the overall risk appetite, risk tolerance, parameters and limits, within which the Bank operates. The Board approves the Bank's overall risk profile and significant risk exposures, as well as the policies, procedures and controls that have been extensively documented. The Board has delegated day-to-day decision making to the Executive Committee (EC) that comprises four Directors. The EC meets in between Board meetings to approve all proposals that exceed the threshold of the Investment Committee. The Investment Committee is responsible for approving or recommending approvals to the Executive Committee, limits for individual exposures, investments, and concentrations towards banks, countries, industries, risk rating classes or other special risk asset categories. Further information on the constitution and responsibilities of these committees is disclosed in the Corporate Governance Report on the Bank's website www.ugbbah.com.

The Risk Management Department of the Bank is staffed by a dedicated and well qualified team of five individuals. UGB's ability to properly identify, assess, manage, measure, monitor and report risk is critical to its financial strength and profitability. A comprehensive set of risk management policies, processes and limits, are in place to provide guidelines and parameters. These are continuously updated with the objective of incorporating best practice, changes in market factors, and changes in the regulatory environment in various jurisdictions where the Bank operates.

Risk Management Philosophy

The overall risk management strategy of UGB focuses on optimising the risk-return profile of the Bank's exposures (on a portfolio approach) as well as mitigating losses. The management philosophy of the Bank for managing the main types of risk is summarised below:

Risk Type	Risk Management Philosophy
Credit risk	To discipline its lending activities and ensure that credit facilities are granted on a sound basis, and that the Bank's funds are invested in a profitable manner.
Market risk	To minimise the loss of the value of financial instruments or a portfolio of financial instruments due to an adverse change in market prices or rates.
Interest Rate risk	To capture all material sources of interest rate risk, and assess the effect of interest rate changes on the income stream and equity of the Bank.
Liquidity risk	To identify, capture, monitor and manage the various dimensions of liquidity risk with the objective of protecting asset values and income streams such that the interests of the Bank's shareholders are safeguarded, while maximising returns to shareholders.
Operational risk	To mitigate or insure the risk of loss arising from a failure in the Bank's internal processes due to inadequate internal controls and procedures, human error, deliberate acts and/or business interruptions caused by technology, systems or external disasters beyond the Bank's control.

Types of Risk

In accordance with the Central Bank of Bahrain's guidelines and the Bank for International Settlements, UGB adopted Basel II standards effective 1 January 2008. This has been done with the view of determining capital adequacy, as well as adopting sound practices for the management of risk. The major types of risk to which UGB is primarily exposed, include credit, market,

Risk Management

operational, liquidity and funding, interest rate, concentration, reputational and legal risks. Details on each of these are provided in the Pillar III Risk Management and Capital Adequacy Disclosures that is available on the Bank's website: www.ugbbah.com.

The following section provides a brief synopsis of the different types of risk and the processes adopted to identify, assess and monitor them.

Credit Risk

Credit risk arises mainly from the extension of credit facilities in UGB's banking, investment and trading activities, where there is a possibility that a counterparty may fail to honour its commitments.

Credit risk is mitigated through:

- Establishing an appropriate credit risk environment;
- Operating under a sound credit and investment approval process;
- Ensuring adequate controls over the credit risk management process; and
- Maintaining appropriate credit administration, measurement and monitoring processes.

Well-documented policies and subsequent updates are approved by UGB's Board of Directors. These provide the guidelines for credit risk management. The Bank manages credit risk through its limit structure, which controls the amount of risk that it is willing to accept for individual counterparties, related parties and for geographical and industry concentrations. Exposures with respect to the adherence of these limits are monitored on a regular basis.

There is a two-tier committee structure to approve and review credit and investment risk. The Investment Committee (IC) includes the Acting Chief Executive Officer, the Chief Financial Officer and the Chief Operating Officer. The Head of Credit and Risk Management is a non-voting member on the Committee and acts as its secretary. Exposures beyond IC delegated limits are approved by the Board's Executive Committee or the full Board of Directors.

The credit risk inherent in trading activities is also actively managed, and in case of exposures to counterparties, is calculated daily as the sum of mark-to-market values. In certain cases, the Bank has entered into legally enforceable netting agreements covering its money market and foreign exchange trading activities, whereby only the net amount may be settled at maturity. In areas where the Bank acts as an agent for commodity trading on behalf of certain Islamic financial institutions, the risk is managed through simultaneous spot and forward trading in commodities, through well established financial and commodity trading institutions that have been subjected to a detailed credit review. The Bank seeks to procure third party guarantees wherever feasible to mitigate the inherent credit risk in it's off balance sheet exposures.

Continuous monitoring of the Bank's assets through various reports and reviews is key to early and timely identification of any impairment. A monthly risk asset review report is produced by the Credit and Risk Management Department, in which all investments are assessed based on rating, industry, and geographic exposure, in addition to a number of other parameters. The purpose of this report is also to ensure compliance with external regulatory requirements and internal risk policy guidelines. Additionally, a semi-annual review of all investments is conducted for monitoring performance and highlighting any recent developments that may have occurred. A quarterly review of loans is prepared for the purpose of identifying impairments and providing an update on the status of each facility. The risk asset review report is reviewed on a monthly basis by Management, and quarterly by the Risk and Compliance Committee of the Bank.

UGB has adopted the Standardized Approach for calculating the charge for credit risk. Non-performing loans for the Group stood at US$ 2.0 million as at 31 December 2011 (2010: US$ 2.0 million) against which a provision of US$ 1.7 million has been made (2010: US$ 1.7 million).

The Bank identifies and manages credit risk inherent in all products and activities, and ensures that such risks are assessed in depth and are well understood. These activities are then subject to adequate risk management procedures and controls, and approved by the Board of Directors before being introduced or undertaken. The Bank operates within sound, well-defined credit criteria. These criteria include a clear indication of the Bank's target market and a thorough understanding of the borrower or the counterparty, as well as the purpose and structure of the credit and its source of repayment. The Bank has established overall credit limits at the level of individual borrowers and counterparties, as well as groups of connected or comparable counterparties that are aggregated in a meaningful manner to indicate different types of exposures, both in the banking and trading book, and on and off the balance sheet. The credit limits recognise and reflect the risks associated with the near-term liquidation of positions in the event of counterparty default. Limits also factor in any unsecured exposure in a liquidation scenario.

All extensions of credit are made on an arm's length basis. Any credit extended to companies and individuals that are outside the approved policy parameters are avoided or are authorised on an exception basis by the appropriate authorities. A detailed review of connected party exposure is conducted on a monthly basis and reported to Central Bank of Bahrain.

Detailed information on the Bank's credit risk exposures, including geographical distribution, industry/sector allocation, details of the collaterals and other credit enhancements, and bifurcation based on internal ratings, has been provided in Note 31(b) to the Consolidated Financial Statements.

Market Risk

Market risk is defined as the risk of losses in the value of on or off balance sheet financial instruments caused by a change in market prices or rates (including changes in interest rates and foreign exchange rates). UGB's policy guidelines for market risk have been vetted by the Board of Directors in accordance with the rules and guidelines provided by the Central Bank of Bahrain.

UGB has adopted the Standardized Approach for the measurement of its market risk. This involves a 'building block' methodology that aggregates charges for interest rate exposure, equities, foreign exchange, commodities and options. The Bank has entered into forward contracts and interest rate swaps for hedging purposes, and does not trade commodities or derivatives. Thus UGB's market risk capital adequacy requirements cover the securities trading book and the foreign exchange book.

The minimum capital charge for interest rate exposure is expressed as the sum of two separately calculated charges: one relating to the specific risk of each position and the other to the interest rate risk in the portfolio (general market risk). For the general market risk capital charge, the Bank applies the maturity method with its respective rules. Information on the interest rate sensitivity in the Bank's asset and liability structure is detailed in Note 31(c) to the Consolidated Financial Statements.

The capital charge for equities held in the Bank's trading book is also an aggregate of two separate components. One applies to 'specific risk' of holding a long or short position in an individual equity, and the other pertains to 'general market risk' of holding that position in the market as a whole. In case of foreign exchange risk, the open currency position is taken both in the banking and the trading book. The currency exposures are detailed in Note 31(c) to the Consolidated Financial Statements. The capital charge under this approach is the arithmetical sum of the risk measures obtained from the measurement framework.

The Bank seeks to manage the market risks that it faces through diversification of exposures across dissimilar markets, industries and products. In addition to the exercise of business judgement and management experience, UGB utilises limit structures related to positions, portfolios, maturities and maximum allowable losses, to control the extent of such risk.

Operational Risk

The Bank has defined operational risk as the risk of losses arising from a failure in its internal processes due to inadequate internal controls and procedures, human error, deliberate acts and/or business interruptions caused by technology, systems or external disasters beyond the Bank's control. Internal control systems have been introduced that are based on the tenet of adequate segregation of duties. Exception and excess exposure reporting by the Credit and Risk Management Department, succession planning, business continuity planning, reliable management reporting and supervision of the Internal Audit and Quality Assurance Department and the Board Audit Committee, is also adhered to by the Bank. Anti-money laundering procedures and controls are also in place to mitigate any possible misuse of the Bank's services. These anti-money laundering procedures are reviewed by the external auditors on a yearly basis; their report is then sent to the Central Bank of Bahrain as mandated by local regulations.

In accordance with Basel II guidelines, UGB has developed a comprehensive operational risk framework, whereby all activities and processes of the Bank are analysed; and residual risks are identified, measured and reported as appropriate. The management of operational risk in the Bank is the responsibility of every employee. The operational risk framework is built around a detailed Risk Control Self Assessment (RCSA) that identifies all risks stemming from activities of each department of the Bank. The probability of occurrence and potential severity of the risks are assessed; existing controls against each probable risk event are plotted and reviewed in terms of their effectiveness; residual risks after taking into account the effectiveness of controls are documented; and action plans are developed to reduce or mitigate the residual risks. The results of the RCSA are periodically reviewed by the Risk and Compliance Committee. Heat maps are produced to alert Senior Management to areas that may be subject to an increased level of operational risk.

UGB uses Basel II's Basic Indicator Approach (BIA) to calculate the capital charge for operational risk. This is prescribed as 15% of the average annual gross income of the current year and the preceding two years. The detailed working for the capital charge on operational risk is provided in the Prudential Disclosures related to Basel II - Pillar III.

In 2011, UGB automated its operational risk framework through the implementation of a robust operational risk system. The system comprises three key modules: loss database, risk and control self assessment, and key risk indicators. It enables the Bank to monitor, mitigate and report its operational risk exposures on a real-time basis.

Liquidity Risk and Funding

Liquidity risk stems from the inability to procure sufficient cash flow to meet UGB's financial obligations as and when they fall due. The risk arises due to the timing differences between the maturity profile of the Bank's assets and liabilities.

In order to ensure that the Bank can meet its financial obligations as they fall due, the tenors of UGB's assets and liabilities are closely monitored across different maturity time bands. The Asset and Liability Committee evaluates the balance sheet from a structural, liquidity and sensitivity point of view. The whole process is aimed at ensuring availability of sufficient liquidity to fund the

Bank's ongoing business activities, effectively managing maturity mismatches between assets and liabilities, managing market sensitivities, and ensuring the Bank's ability to fund its obligations as they fall due. Daily and weekly reports are generated, which monitor deposits by counterparties to ensure maintenance of a diversified funding base in terms of individual depositors, their ratings, geographical concentration and maturities.

A diversified funding base has evolved around the deposits raised from the interbank market, Sharia-compliant market deposits received from customers, and medium-term funds raised through the syndicated borrowings. Access to available but uncommitted short-term funding from the Bank's established relationships, internationally and across the MENA region, provides additional comfort. As at year end 2011, UGB's solo liquidity ratio was 47.2% (2010: 35.3%). The Bank monitors this on a daily basis to ensure that the regulatory level of 25% is maintained at all times.

Liquidity risk is minimised by actively managing mismatches, and through diversification of assets and liabilities. The Bank uses a combination of limits to ensure that liquidity risk is managed and controlled from the asset and liability perspective:

- Maturity gap limits: assets and liabilities in the Bank's balance sheet are grouped in specific maturity time buckets. The maximum liquidity mismatch between assets and liabilities in each defined time bucket (e.g. one to seven days, eight days to one month, one to three months, three to six months, six to 12 months, one to three years, three to five years, and more than five years), is controlled by gap limits that have been set for each time bucket. The Risk Management team tracks these limits on a monthly basis.

- Liquidity ratio limits: the Bank has limits on a set of ratios which it uses proactively for monitoring liquidity risk. These include the current ratio, liquid assets as a percentage of total assets, liquid assets as a percentage of total liabilities, and short-term liabilities as a percentage of total liabilities.

Information on the liquidity risk and maturity profile of UGB's asset and liability structure as at the end of 2011 is detailed in the Note 31(d) to the Consolidated Financial Statements. As of this date, 17% of total assets and 51% of total liabilities were contracted to mature within one year (2010: 24.5% and 56.5% respectively). A significant portion of assets with longer-term maturities comprise readily realisable securities or listed assets with active markets.

Interest Rate Risk in the Banking Book

Interest rate risk in the banking book arises as a result of mismatches in the re-pricing or maturity of interest rate sensitive financial assets and liabilities. This is also known as re-pricing risk. Additionally, UGB is exposed to minimal basis risk which results from a change in the relationship between the yields/yield curves of long and short positions with the same maturity in different financial instruments. In effect, this means that the long and short positions no longer fully hedge each other.

UGB clearly identifies the sources of interest rate risk, and the interest rate risk-sensitive products and activities. It proactively measures and monitors the interest rate risk in the banking book. The Bank also periodically carries out stress tests to assess the effect of extreme movements in interest rates that could expose the Bank to high risks. A conscious effort is also made to match the amount of floating rate assets with floating rate liabilities in the banking book. All new products/transactions are evaluated with respect to the interest rate risk introduced by it and the identification of mitigating factors. UGB also enters into certain transactions in order to hedge exposures arising from day-to-day banking and investment activities. These hedge transactions may be instruments such as interest rate swaps (IRS) and floating rate notes (FRN), to convert a floating rate asset/liability into a fixed rate one or vice-versa. The Bank continuously monitors the effectiveness of the hedges.

Concentration Risk

Concentration of exposures in credit portfolios is an important aspect of credit risk that is monitored separately in UGB. This risk can be considered from either a micro (idiosyncratic) perspective or a macro (systemic) perspective. The first type – name concentration, relates to imperfect diversification of risk in the portfolio, either because of its small size or because of large exposures to specific individual obligors/investments. The second type – sector concentration, relates to imperfect diversification across systemic components of risk, namely industry sectoral factors.

Concentration risk is captured in UGB's framework through the use of internal and external regulations that cap the maximum exposure to any single obligor/investment. There are established limits in place that set thresholds for aggregate industry, geography, and counterparty. The actual levels of exposure are monitored against approved limits and regularly reviewed by Senior Management and the Board of Directors.

The Bank pursues a set of internal policies and limits that ascertain to a large extent, that no defined exposure limits referred to in its various policies are exceeded. If any potential exposure is deemed to result in breach of regulatory and/or internal limits, the Bank obtains due approvals from the appropriate authority (Central Bank of Bahrain and/or the Bank's relevant approving authority) before executing the respective business transaction.

Legal Risk

Legal risk is defined as the loss that may arise as a result of the inability to enforce contracts and agreements entered into, the failure of these to adequately cover the risks, and liabilities the Bank may face, and their inability to protect the Bank's interests. In order to mitigate this risk, UGB uses industry standard master agreements whenever available. Expert legal advice is sought on all legal structures and arrangements to which the Bank is a party. A retainer agreement is maintained with a Bahrain law firm for the review of ordinary business agreements and, for special assignments documentation, the Bank involves local and international law firms. Proper execution and completion of all legal contracts is ensured prior to committing funds to the transactions. All legal documents are reviewed on a periodic basis to ensure their ongoing enforceability. These are also maintained under dual custody.

Monitoring and Reporting

The monitoring and reporting of risk is conducted on a daily basis for market and liquidity risk, on a monthly basis for credit risk, and on a quarterly basis for operational risk. The regular forums in which risk related issues are highlighted and discussed are the weekly Management meetings, the quarterly Risk and Compliance Committee meetings, and the Executive Committee meetings. The Board of Directors is also regularly apprised of pertinent risk issues including the semi-annual investment reviews and the proposed corrective action.

Basel II

UGB's Management continuously strives to meet or exceed industry compliance and regulatory standards. The introduction of the New Capital Accord and its adoption by the Central Bank of Bahrain at the beginning of January 2008, is viewed by the Board and Management as an opportunity to reassess and further improve upon UGB's risk identification, assessment, measurement, monitoring and reporting procedures, thus providing assurance to all the stakeholders on managing and controlling risks inherent in the Bank's business.

The Basel II guidelines aim at allowing qualifying banks to determine capital levels consistent with the manner in which they measure, manage and mitigate risks. The framework provides a spectrum of methodologies, from simple to advanced, for the measurement of both credit and operational risks. More advanced measurement of risks should result in regulatory and economic capital being more closely aligned.

Basel III

The Basel Committee on Banking Supervision issued its final guidelines on Basel III in December 2010. The document provides a comprehensive set of reform measures, developed by the Basel Committee on Banking Supervision, to strengthen the regulation, supervision and risk management of the banking sector, and builds on the International Convergence of Capital Measurement and Capital Standards document (Basel II) issued in 2006.

Accordingly, the Central Bank of Bahrain requested all locally incorporated banks to conduct a detailed Quantitative Impact Assessment in which UGB participated. Although Basel III provides a transition period of up to 2018 for full implementation, the Bank is currently studying the probable impact on its capital, and will be proposing appropriate measures to the Board once the Central Bank of Bahrain issues its directives with respect to Basel III implementation.

The Risk and Compliance Committee of UGB supervises the adoption of best practices in the areas of risk and compliance, and acts as the steering committee for risk and compliance initiatives, with responsibility for monitoring the progress and facilitating a smooth transition towards complete compliance with provisions of the New Capital Accord. During the year, the Committee met three times and resolved important matters. UGB is carefully monitoring the changes/enhancements recommended by the Basel Committee in the Capital Framework and its potential impact on Bank's capital adequacy ratio. Although it is unclear how and when the CBB will adopt these guidelines, UGB shall continue performing the required quantitative impact analysis, and shall keep the Board apprised to better prepare itself for the eventual adoption of the proposed enhancements.

Internal Capital Adequacy Assessment Process

The Internal Capital Adequacy Assessment Process (ICAAP) is a requirement of Pillar II norms of Basel II, and involves appropriate identification and measurement of risks, and maintenance of an appropriate level of internal capital in alignment with the Bank's overall risk profile and business plan. The objective of the Bank's ICAAP is to ensure that adequate capital is retained at all times to support the risks the Bank undertakes in the course of its business.

The Bank recognises that its earnings are the first line of defence against losses arising from business risks, and that capital is one of the tools to address such risks. Also important, are establishing and implementing documented procedures; defining and monitoring internal limits on the Bank's activities/exposures; strong risk management, compliance and internal control processes; as well as adequate provisions for credit, market and operational losses. However, since capital is vital to ensure continued solvency, the Bank's objective is to maintain sufficient capital such that a buffer above regulatory capital adequacy requirement is available to meet risks arising from fluctuations in asset values, revenue streams, business cycles, and expansion and future requirements. The Bank's ICAAP identifies risks that are material to the Bank's business and the capital that is required to be set aside for such risks.

The Bank seeks to achieve the following goals by implementing an effective capital management framework:

- Meet the regulatory capital adequacy requirement and maintain a prudent buffer;
- Generate sufficient capital to support overall business strategy;
- Integrate capital allocation decisions with the strategic and financial planning process;

Risk Management

Continued

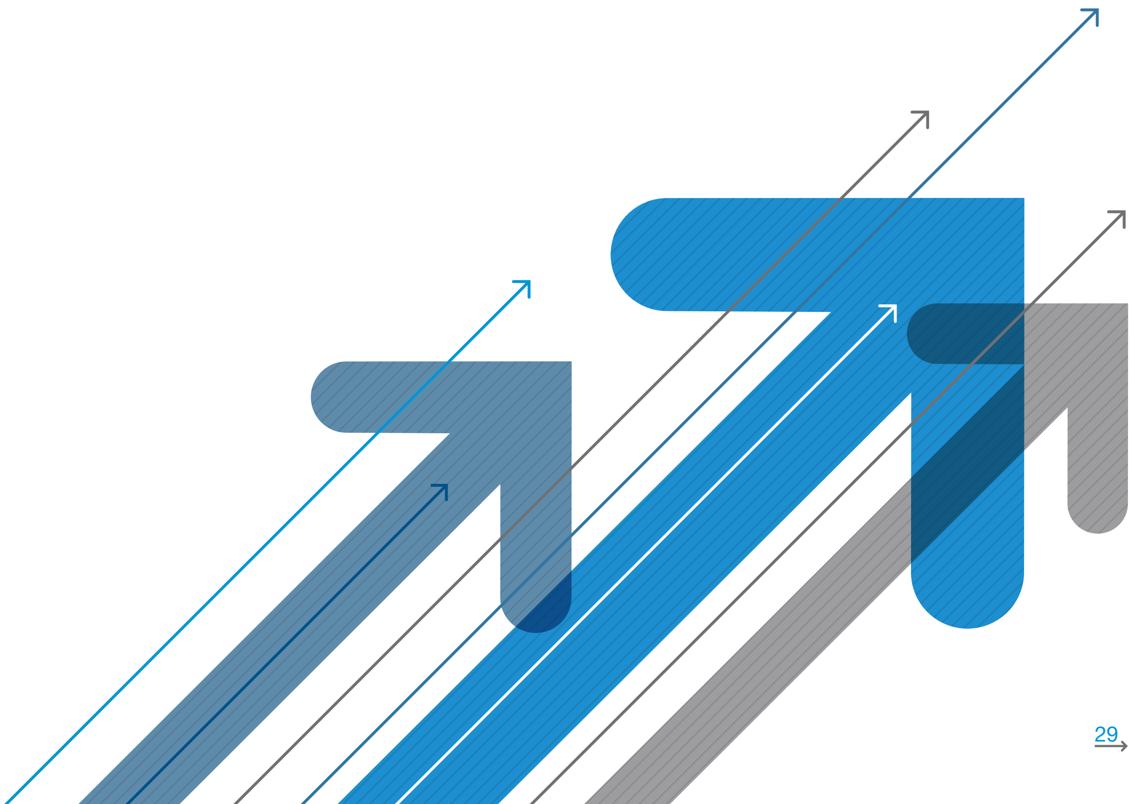
- Enhance Board and Senior Management's ability to understand the extent of capital flexibility required to support the overall business strategy;
- Enhance the Bank's understanding on capital requirements under different economic and stress scenarios; and
- Build and support the link between risks and capital and tie performance to both of them.

Capital Sources

UGB's capital is primarily derived from common shareholders' equity and retained earnings. Tier 2 sources of capital include subordinated long-term debt.

Capital Management

The Board of Directors of the Bank is responsible for ensuring that adequate levels of capital are maintained at all times. The Board also approves and oversees capital policy and processes adopted for capital management by the Bank.



Corporate Governance

United Gulf Bank's Board of Directors believe that sound ethical practices, transparency in operations and timely disclosures, go a long way in enhancing shareholder value, while safeguarding the interests of all the shareholders. During the last year, the Bank has taken several steps to comply with the new Code of Corporate Governance, which became effective from 1 January 2011.

The Bank held familiarisation sessions for its Directors, Executive Management and staff, regarding the tenets of the Code. It also conducted a gap analysis with respect to the status of compliance with the Code and submitted this to the CBB. The Board of Directors reviewed the gap analysis and unanimously supported the idea of having independent directors. Consequently, details of two identified candidates were submitted to the CBB for its prior approval; this was obtained in December 2011. The two proposed independent directors were formally elected to the Board of Directors in March 2012. The Nominating & Remunerations Committee (NRC) will soon be constituted as the Bank now has the independent members as required by the Code.

At Board Meeting # 4/2011 (held on 9 October 2011), the Board of Directors approved new policies and procedures pertaining to Corporate Governance. This includes the evaluation of the performance of the Board of Directors, the Board Executive Committee and the Board Audit Committee. These have been completed and the results are satisfactory. All members of the Board of Directors and staff have also signed their affirmation to abide by the Code of Conduct.

A detailed review of the Corporate Governance Report is available on UGB's website www.ugbbah.com.

Internal Audit

UGB has a functional Internal Audit Department reporting directly to the Board Audit Committee, with a dotted reporting line to the Acting Chief Executive Officer. The Department is staffed by experienced and qualified employees, and is governed by a detailed Board-approved Audit Charter. Its responsibilities are documented in a Board-approved policies and procedures manual. The Internal Audit Department has a close and direct working relationship with the Bank's Executive Management and Committees, in addition to having unrestricted access to information, records, systems and personnel within the Bank.

The Department develops a three-year strategic audit plan, designed to implement a systematic, disciplined audit review approach by utilising the available audit resources in the most efficient and effective manner. It examines the adequacy and effectiveness of internal control systems and procedures, and provides recommendations to enhance their quality. On a periodic basis, the Department performs follow-ups on raised internal control recommendations/corrective actions, and reports their updated status to the Board Audit Committee.

Compliance

In accordance with CBB guidelines, the Bank has a designated Chief Compliance Officer, who acts as the central coordinator for all matters relating to CBB regulatory reporting and other requirements. A framework of relevant policies and processes covering the areas of adherence to external regulations, code of conduct and conflict of interest, are encapsulated in the Compliance Charter and the Code of Conduct. These documents have been approved by the Board of Directors and help define, clarify, assert and enforce the role of governance within UGB. The Bank uses a Compliance Checklist which is linked to the relevant section of the CBB's rulebook. This enables it to adhere to impending deadlines for statutory reporting. A Compliance Report is presented every quarter by the Chief Compliance Officer to members of the Board Audit Committee and the Risk and Compliance Committee. Forthcoming deadlines, as well as feedback on ongoing consultations, are highlighted at quarterly Risk and Compliance Committee meetings. Compliance is also responsible for ensuring that all ad-hoc requests for information from regulatory authorities are met immediately, and that corrective action is taken if warranted. The function has a dotted reporting line to the Board's Audit Committee, in line with policy dictated by best practices.

UGB shares a strong rapport with its local regulators – the Central Bank of Bahrain (CBB), the Ministry of Industry & Commerce, the Bahrain Bourse and the Kuwait Stock Exchange. There is proactive dialogue as and when warranted. In addition, the CBB calls for a Prudential Meeting with Senior Management once a year. This forum involves the regulators receiving an overview of the Bank's performance, business model, strategic plan, market outlook, corporate governance, and the risk management and capital adequacy framework.

In 2011, a Risk Control Self Assessment exercise was conducted for the Compliance Department. Every activity was analysed to determine underlying risks and controls. Based on this exercise, certain Key Risk Indicators were designed and populated commencing December 2011.

Code of Conduct

The Board of Directors has established corporate standards for all its Directors and employees. These are emphasised in the Bank's Code of Conduct that reiterates the policies of upholding sensitive and confidential information; avoiding and disclosing (wherever applicable) conflicts of interest; personal accountability; honesty; harmonious relationships with its clients, subsidiaries, affiliates and regulators; non-solicitation of gifts; transparent and accurate external communication; expected standards of professionalism, fairness, behaviour and language; and accounting, audit and book keeping.

The Board and Senior Management of the Bank view the Code of Conduct as an integral part of the way they exercise their responsibilities and conduct themselves with customers, shareholders, staff, and the wider community. Familiarisation sessions on the requirements of the Code of Conduct are conducted on an annual basis by the Chief Compliance Officer. Board Members and staff submit a written affirmation that they will abide by the tenets of the Code and disclose any conflicts of interest that they might have. Any incidents of non-compliance with the Code, or the lack of affirmation by any member of UGB is escalated to the Board Audit Committee and the Board of Directors. A copy of the Code of Conduct is posted on the Bank's website.

Anti-Money Laundering

The Bank has a designated Money Laundering Reporting Officer (MLRO) and a Deputy MLRO. It has implemented an anti-money laundering (AML) and counter terrorism financing (CFT) policy, and annually trains its staff with the objective of raising awareness of identifying and reporting suspicious transactions. It follows prudent practices related to 'Customer Due Diligence' and 'Beneficial Ownership' using the Thomson Reuters screening tool and the 'Know Your Customer' principles. In accordance with regulatory requirements, the MLRO reviews the effectiveness of its AML/CFT procedures, systems and controls, at least once each calendar year. The review covers UGB and its main subsidiaries. The Bank's anti-money laundering measures are annually audited by independent external auditors to provide a separate assurance to the Compliance Directorate of the CBB.

Transparency and Disclosure

UGB is transparent and open with its regulators, shareholders, lenders and other stakeholders. The Board of Directors has approved a Disclosure and Transparency Policy, which lays down the set disclosure standards for UGB. The objective of this policy is to facilitate understanding and compliance with the disclosure and transparency requirements for all material and non-material information with regard to the affairs of the Bank. Adequate consideration has been given to regulatory requirements to which UGB is subject. The policy was also introduced to enable stakeholders to monitor the transparency adopted, and to enhance the Bank's image through accurate and timely disclosure of information.

As part of its communication strategy, UGB's website (www.ugbbah.com) is the repository of financial information, together with Board of Directors' reports and financial commentary, the financial statements, relevant information on the Group/Bank, key products and services, and press releases that are issued periodically to the media. As mandated by the Central Bank of Bahrain, the detailed risk management and capital adequacy calculations that relate to Basel II have also been uploaded under the 'Reports and Financials' section of the website. The Corporate Governance Report is available under the Corporate Governance section.

Corporate Social Responsibility

UGB plays its role as a responsible corporate citizen by contributing to the social well-being and economic prosperity of the Kingdom of Bahrain. During 2011, the Bank continued to implement its corporate social responsibility (CSR) programme, which places special emphasis on charitable and community-based activities; education and career development opportunities for young Bahrainis; and development of the regional banking sector. In addition, UGB encourages and supports its staff to personally participate in a variety of community activities and fundraising events for charity. Some examples of the Bank's diversified CSR activities over recent years are listed below.

Charitable and community-based activities

The Bank has provided financial and practical support for numerous charitable, cultural, social, medical, educational, and environmental organisations and initiatives, including:

- Support for mentally-retarded, psychiatrically sick, handicapped and visually-impaired people
- Al Manar Parents Care, UCO Parents Care Centre, Royal Charity Organization, Al Sanabel, Orphans Care, Hope Institute, Bahrain Disabled Sports Federation, and Friendship Society for the Blind
- Bait Al Qur'an, Red Crescent Society and Drug Rehabilitation Centre
- Ministry of Social Affairs for welfare of the elderly, orphans, children and mothers
- Over 80 approved charity funds across the Kingdom of Bahrain
- Bahrain Society for Children with Behavioural and Communication Difficulties
- Bahrain Society for Child Development
- Protection of Marine Resources, Environmental & Wildlife
- AMH Island Classic Golf Tournament – major annual fundraising event to upgrade medical facilities of the American Mission Hospital
- Bahrain Down's Syndrome Society
- Bahrain Association for Mental Retardation
- Bahrain Marathon Relay and American Women's Association Cherry Tree Trot

In recent years, the Bank has also supported the Cardiac Centre at the Bahrain Defence Force Hospital, and the Bahrain Centre for Studies & Research; and was a major donor to the University of Bahrain for the establishment of its Analytical Laboratory.

Education and career development for young Bahrainis

UGB is a firm believer in promoting education. The Bank's Mashare' Al Khair Scholarship Programme assists qualified UGB employees' dependents to study at accredited colleges, universities and other academic institutions. Currently, four children are benefitting from this programme. The Bank also extends financial support to its staff to upgrade their academic and professional qualifications, and enhance their skills. UGB also provides education and career development opportunities for young Bahraini students through the following activities:

- The Crown Prince's International Scholarship Program (CPISP): UGB has been an annual Silver Sponsor of this major educational initiative since its inception in 2006. The Bank became a Friends Sponsor in 2011, which carries a five-year commitment.
- CPISP Mentoring Program: UGB staff help to prepare and assess potential scholarship candidates in leadership skills for final selection.
- TradeQuest - The Investment Trading Competition: UGB is a sponsor of this annual stock market simulation competition, and also provides administrative support.
- University of Bahrain/Bahrain Association of Banks Mentoring Program: UGB is a founding member of this program, which provides students with summer work experience and the opportunity of placement. To date, the Bank has hired four students from this program.
- Summer Internships: UGB provides summer internships for its employees' children and other students to gain work experience.

Development of the regional banking sector

UGB contributes to the growth and development of the regional banking and financial services sector in a number of different ways:

- Bank support for a wide range of banking-related organisations including: Bahrain Association of Banks; Union of Arab Banks; Arab Bankers Association; Financial Markets Association; International Institute of Finance; International Islamic Financial Market of Bahrain; Arab Bankers Association of North America; Chartered Institute of Securities and Investment (CISI) Bahrain Chapter; and Professional Risk Managers International Association (PRMIA) Bahrain Chapter.
- UGB staff membership of professional institutions and associations.
- Support for the CFA Bahrain Society in promoting and maintaining the highest standards of professional excellence and integrity in the financial and investment community.
- Gold Sponsor of the 2011 CFA Middle East Investment Conference.

Staff participation in community and fund-raising activities

UGB encourages and supports its staff to personally participate in a variety of community activities and fundraising events for charity, including the following:

- The Bahrain Marathon Relay – one of Bahrain's oldest and largest annual fund-raising events in aid of various Bahrain charities.
- American Women's Association Cherry Tree Trot – an annual fun day for the handicapped.
- Think Pink - breast cancer awareness campaign.

Independent Auditors' Report to the Shareholders of United Gulf Bank B.S.C.

At 31 December 2011

Report on the consolidated financial statements

We have audited the accompanying consolidated financial statements of United Gulf Bank B.S.C. [the Bank] and its subsidiaries [together "the Group"], which comprise the consolidated statement of financial position as at 31 December 2011 and the consolidated statements of income, comprehensive income, cash flows and changes in equity for the year then ended, and a summary of significant accounting policies and other explanatory information.

Board of Directors' responsibility for the consolidated financial statements

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

Auditors' responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgement, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers 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 the Board of Directors, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 31 December 2011, its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Report on other regulatory requirements

As required by the Bahrain Commercial Companies Law and the Central Bank of Bahrain (CBB) Rule Book (Volume 1), we report that:

a) the Bank has maintained proper accounting records and the consolidated financial statements are in agreement therewith; and

b) the financial information contained in the Report of the Board of Directors is consistent with the consolidated financial statements.

We are not aware of any violations of the Bahrain Commercial Companies Law, the Central Bank of Bahrain and Financial Institutions Law, the CBB Rule Book (Volume 1 and applicable provisions of Volume 6) and CBB directives, regulations and associated resolutions, rules and procedures of the Bahrain Bourse or the terms of the Bank's memorandum and articles of association during the year ended 31 December 2011 that might have had a material adverse effect on the business of the Bank or on its financial position. Satisfactory explanations and information have been provided to us by management in response to all our requests.

Ernst & Young

28 February 2012
Manama, Kingdom of Bahrain

Consolidated Statement of Financial Position

At 31 December 2011

	Note	2011 US$ 000	2010 US$ 000
ASSETS			
Demand and call deposits with banks		17,857	27,914
Placements with banks		102,282	167,257
Investments carried at fair value through statement of income	5	73,183	126,661
Non-trading investments	6	435,028	385,770
Loans and receivables	7	27,942	57,920
Other assets	8	37,490	46,950
Investments in associates and joint ventures accounted for under the equity method	9	1,002,940	1,026,065
Investment properties	10	16,054	21,178
Property and equipment		946	1,074
Goodwill	11	56,782	56,296
TOTAL ASSETS		1,770,504	1,917,085
LIABILITIES AND EQUITY			
LIABILITIES			
Due to banks and other financial institutions		211,795	435,624
Deposits from customers		80,349	139,568
Loans payable	12	731,185	501,432
Bonds	13	-	71,187
Subordinated debt	14	100,000	100,000
Other liabilities	15	44,021	68,500
TOTAL LIABILITIES		1,167,350	1,316,311
EQUITY			
Share capital	16	208,640	208,234
Treasury shares	16	(12,725)	(12,725)
Share premium	16	11,459	10,631
Statutory reserve	16	95,518	95,371
General reserve	16	76,003	75,856
Treasury shares reserve	16	14,308	14,308
Fair value reserve	17	(13,532)	(21,374)
Foreign currency translation reserve	16	40,134	43,465
Retained earnings		142,037	140,860
CAPITAL AND RESERVES ATTRIBUTABLE TO THE SHAREHOLDERS OF THE PARENT		561,842	554,626
Non-controlling interests in equity		41,312	46,148
TOTAL EQUITY		603,154	600,774
TOTAL LIABILITIES AND EQUITY		1,770,504	1,917,085

Masaud Hayat
Chairman

Faisal Al Ayyar
Director

Mohammad Haroon
Acting Chief Executive Officer

The attached notes 1 to 33 form part of these consolidated financial statements.

Consolidated Statement of Income

Year ended 31 December 2011

	Note	2011 US$ 000	2010 US$ 000
Continuing operations			
Investment income - net	18	53,607	108,502
Interest income	19	7,365	12,699
		60,972	121,201
Fees and commissions	20	17,019	30,493
Foreign currency translation (losses) gains - net		(1,151)	2,372
Share of results of associates and joint ventures accounted for under the equity method - net	21	31,705	9,182
Total income		108,545	163,248
Interest expense	22	(53,570)	(49,262)
Operating income before expenses and provisions		54,975	113,986
Salaries and benefits		(23,133)	(26,916)
General and administrative expenses		(10,517)	(21,637)
Operating income before provisions		21,325	65,433
Impairment loss on investments	6,9	(23,961)	(29,280)
(Provision for) write-back of doubtful loans, guarantees and other assets - net		(398)	149
Net (loss) profit for the year from continuing operations		(3,034)	36,302
Discontinued operations			
Net profit for the year from discontinued operations	23	-	6,086
NET (LOSS) PROFIT FOR THE YEAR		(3,034)	42,388
Loss (profit) attributable to non-controlling interests			
from continuing operations		4,505	(832)
from discontinued operations		-	(2,899)
		4,505	(3,731)
PROFIT ATTRIBUTABLE TO SHAREHOLDERS OF THE PARENT			
from continuing operations		1,471	35,470
from discontinued operations		-	3,187
		1,471	38,657
Earnings per share			
Basic earnings per share (US cents)	24	0.18	4.71
Diluted earnings per share (US cents)	24	0.18	4.70

The attached notes 1 to 33 form part of these consolidated financial statements.

Consolidated Statement of Comprehensive Income

Year ended 31 December 2011

	2011 US$ 000	2010 US$ 000
NET (LOSS) PROFIT	(3,034)	42,388
Other comprehensive income (loss):		
Foreign currency translation reserve	(2,832)	7,914
Fair value reserve	(4,819)	9,993
Share of other comprehensive income (loss) of associates and joint ventures accounted for under the equity method	5,085	(3,138)
Cash flow hedges	7,010	3,096
Other comprehensive income	4,444	17,865
TOTAL COMPREHENSIVE INCOME	1,410	60,253
Attributable to:		
Shareholders of the parent		
from continuing operations	5,982	50,352
from discontinued operations	-	5,182
	5,982	55,534
Non-controlling interests		
from continuing operations	(4,572)	1,820
from discontinued operations	-	2,899
	(4,572)	4,719
	1,410	60,253

The attached notes 1 to 33 form part of these consolidated financial statements.

Consolidated Statement of Cash Flows

Year ended 31 December 2011

	Note	2011 US$ 000	2010 US$ 000
OPERATING ACTIVITIES			
Net (loss) profit including profit attributable to non-controlling interests		(3,034)	42,388
Adjustments for non-cash items:			
Depreciation		586	591
Gain on sale of disposal group	18	-	(43,850)
Share of results of associates and joint ventures accounted for under the equity method - net	21	(31,705)	(9,182)
Gain on sale of associated companies	18	(5,344)	(117)
Share of results of disposal group	23	-	(6,086)
Impairment loss on investments		23,961	29,280
Provision for (write-back of) doubtful loans, guarantees and other assets - net		398	(149)
Interest income		(7,365)	(12,699)
Interest expense		53,570	49,262
Dividend income	18	(11,785)	(9,702)
Other non-cash items		(486)	1,484
Change in fair value of investment properties	10	-	(56)
Gain on investments carried at fair value through statement of income	18	(4,814)	(11,945)
(Gain) loss on sale of investment properties	18	(117)	35
Operating profit before working capital changes		13,865	29,254
Changes in operating assets and liabilities:			
Placements with banks with maturities of more than ninety days at original acquisition		(266)	13,318
Investments carried at fair value through statement of income		58,292	40,599
Non-trading investments		(77,472)	256,024
Loans and receivables		29,580	(5,176)
Other assets		16,572	(821)
Due to banks and other financial institutions		(223,829)	(22,723)
Deposits from customers		(59,219)	(87,615)
Other liabilities		(23,996)	2,630
Net assets of disposal group classified as held for sale		-	32,904
Interest received		7,263	12,774
Interest paid		(53,353)	(51,599)
Dividends received	18	11,785	9,702
Donations		(300)	(300)
Directors' remuneration		(400)	(400)
Net cash (used in) from operating activities		(301,478)	228,571
INVESTING ACTIVITIES			
Investments in associates and joint ventures accounted for under the equity method - net		65,259	(318,169)
Proceeds from sale of disposal group	23	-	120,000
Investment properties - net	10	5,241	5,637
Property and equipment - net		(458)	(682)
Net cash from (used in) investing activities		70,042	(193,214)
FINANCING ACTIVITIES			
Loans raised - net		229,753	446
Bonds repaid		(71,187)	-
Proceeds from issue of shares		1,234	1,559
Dividends paid		-	(10,249)
Net cash from (used in) financing activities		159,800	(8,244)
Foreign currency translation adjustments		(3,331)	7,285
Movement in non-controlling interests		(331)	(22,440)
NET CHANGE IN CASH AND CASH EQUIVALENTS		(75,298)	11,958
Cash and cash equivalents at 1 January		195,118	183,160
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	26	119,820	195,118

The attached notes 1 to 33 form part of these consolidated financial statements.

Consolidated Statement of Changes in Equity

Year ended 31 December 2011

	Attributable to shareholders of the parent											
	Share capital US$ 000	Treasury shares US$ 000	Share premium US$ 000	Statutory reserve US$ 000	General reserve US$ 000	Treasury share reserve US$ 000	Fair value reserve US$ 000	Foreign currency translation reserve US$ 000	Retained earnings US$ 000	Total before non-controlling interests US$ 000	Non-controlling interests US$ 000	Total equity US$ 000
Balance at 1 January 2011	208,234	(12,725)	10,631	95,371	75,856	14,308	(21,374)	43,465	140,860	554,626	46,148	600,774
Profit for the year	-	-	-	-	-	-	-	-	1,471	1,471	(4,505)	(3,034)
Other comprehensive income	-	-	-	-	-	-	7,842	(3,331)	-	4,511	(67)	4,444
Total comprehensive income for the year	-	-	-	-	-	-	7,842	(3,331)	1,471	5,982	(4,572)	1,410
Shares issued	406	-	828	-	-	-	-	-	-	1,234	-	1,234
Transfers during the year	-	-	-	147	147	-	-	-	(294)	-	-	-
Other movements in non-controlling interests	-	-	-	-	-	-	-	-	-	-	(264)	(264)
Balance at 31 December 2011	208,640	(12,725)	11,459	95,518	76,003	14,308	(13,532)	40,134	142,037	561,842	41,312	603,154
Balance at 1 January 2010	207,694	(12,725)	9,612	91,505	71,990	14,308	(30,966)	36,180	119,870	507,468	64,857	572,325
Profit for the year	-	-	-	-	-	-	-	-	38,657	38,657	3,731	42,388
Other comprehensive income	-	-	-	-	-	-	9,592	7,285	-	16,877	988	17,865
Total comprehensive income for the year	-	-	-	-	-	-	9,592	7,285	38,657	55,534	4,719	60,253
Shares issued	540	-	1,019	-	-	-	-	-	-	1,559	-	1,559
Transfers during the year	-	-	-	3,866	3,866	-	-	-	(7,732)	-	-	-
Dividends (note 16)	-	-	-	-	-	-	-	-	(10,249)	(10,249)	-	(10,249)
Dividends of subsidiaries	-	-	-	-	-	-	-	-	-	-	(2,580)	(2,580)
Employee share option plan	-	-	-	-	-	-	-	-	314	314	-	314
Other movements in non-controlling interests	-	-	-	-	-	-	-	-	-	-	(20,848)	(20,848)
Balance at 31 December 2010	208,234	(12,725)	10,631	95,371	75,856	14,308	(21,374)	43,465	140,860	554,626	46,148	600,774

The attached notes 1 to 33 form part of these consolidated financial statements.

1 INCORPORATION AND PRINCIPAL ACTIVITIES

Incorporation

United Gulf Bank B.S.C. [the Bank] is a joint stock company incorporated in the Kingdom of Bahrain in 1980, under Commercial Registration number 10550 and listed on the Bahrain and Kuwait Stock Exchanges. The address of the Bank's registered office is UGB Tower, Diplomatic Area, P.O. Box 5964, Manama, Kingdom of Bahrain.

The Bank operates in the Kingdom of Bahrain under a Wholesale Banking License issued by the Central Bank of Bahrain [the CBB].

Activities

The principal activities of the Bank and its subsidiaries [the Group] comprise asset management, investment banking and commercial banking. Investment banking includes asset portfolio management, corporate finance, advisory, investment in quoted and private equity funds, real estate, capital markets, international banking and treasury functions. Commercial banking includes extending loans and other credit facilities, accepting deposits and current accounts from corporate and institutional customers.

The Bank's parent and ultimate holding company is Kuwait Projects Company (Holding) K.S.C. (closed) [KIPCO], a company incorporated in the State of Kuwait and listed on the Kuwait Stock Exchange. As at 31 December 2011 KIPCO owned 95.93% of the Bank's outstanding shares (31 December 2010: 95.83%).

These consolidated financial statements were authorised for issue by the Board of Directors on 28 February 2012.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES

Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board (IASB) and the relevant provisions of the Central Bank of Bahrain and Financial Institutions Law and the Bahrain Commercial Companies Law, and the CBB Rulebook (Volume I and applicable provisions of Volume 6), relevant CBB directives and regulations and associated resolutions, rules and procedures of the Bahrain Bourse.

Basis of preparation

The consolidated financial statements have been prepared under the historical cost convention as modified by the remeasurement at fair value of investments carried at fair value through statement of income, non-trading investments, investment properties and derivative financial instruments.

Presentation and functional currency

The consolidated financial statements have been presented in US Dollars (US$) being the functional currency of the Group and are rounded to the nearest US$ thousands except when otherwise indicated.

New and amended standards and interpretations effective as of 1 January 2011

The accounting policies used in the preparation of these consolidated financial statements are consistent with those used in the previous year except that the Group has adopted the following new and amended IASB Standards and International Financial Reporting Interpretations Committee (IFRIC) Interpretations which became effective in 2011:

IAS 24 Related Party Disclosures (Amendment)
The IASB has issued an amendment to IAS 24 that clarifies the identification of related party relationships, particularly in relation to significant influence or joint controls. The new definitions emphasise a symmetrical view on related party relationships as well as clarifying in which circumstances persons and key management personnel affect related party relationships of an entity. Secondly, the amendment introduces an exemption from the general related party disclosure requirements for transactions with a government and entities that are controlled, jointly controlled or significantly influenced by the same government as the reporting entity. The adoption of the amendment did not have any impact on the financial position or performance of the Group.

IAS 32 Financial instruments: presentation (amendment)
The amendment alters the definition of a financial liability in IAS 32 to enable entities to classify rights issues and certain options or warrants as equity instruments. The amendment is applicable if the rights are given pro-rata to all of the existing owners of the same class of an entity's non-derivative equity instruments, to acquire a fixed number of the entity's own equity instruments for a fixed amount in any currency. The amendment has had no effect on the financial position or performance of the Group as the Group has not issued these type of instruments.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

New and amended standards and interpretations effective as of 1 January 2011 (continued)

IFRS 7 Financial instruments: Disclosures (amendment)
These amendments introduced new disclosure requirements for transfers of financial assets, including disclosures for:

- financial assets that are not derecognised in their entirety; and
- financial assets that are derecognised in their entirety but for which the entity retains continuing involvement.

Adoption of this amendment did not have any impact on the Group's consolidated financial statements.

Improvements to IFRSs
In May 2010 the IASB issued its third omnibus amendments to its standards, primarily with a view to removing inconsistencies and clarifying wording. There are separate transitional provisions for each standard. The adoption of the following amendments resulted in changes to accounting policies, but did not have any impact on the financial position or performance of the Group.

- IFRS 3 *Business Combinations*: The measurement options available for non-controlling interest (NCI) have been amended. Only components of NCI that constitute a present ownership interest that entitles their holder to a proportionate share of the entity's net assets in the event of liquidation must be measured at either fair value or at the present ownership instruments' proportionate share of the acquiree's identifiable net assets. All other components are to be measured at their acquisition date fair value.

- IFRS 7 *Financial Instruments – Disclosures*: The amendment was intended to simplify the disclosures provided, by reducing the volume of disclosures around collateral held and improving disclosures by requiring qualitative information to put the quantitative information in context. Other amendments added an explicit statement that qualitative disclosure should be made in the context of the quantitative disclosures to better enable users to evaluate an entity's exposure to risks arising from financial instruments.

- IAS 1 *Presentation of Financial Statements*: The amendment clarifies that an analysis of each component of other comprehensive income may be presented either in the statement of changes in equity or in the notes to the financial statements.

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

- IFRS 3 Business Combinations (Contingent consideration arising from business combination prior to adoption of IRS 3 (as revised in 2008);
- IFRS 3 Business Combinations (Un-replaced and voluntarily replaced share-based payment award);
- IAS 27 Consolidated and Separate Financial Statements;
  IAS 34 Interim Financial Reporting; and
- IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments.

Significant accounting policies are set out below:

Principles of consolidation

The consolidated financial statements include the financial statements of the Bank and its subsidiaries [the Group]. Subsidiaries are those entities controlled by the Bank, other than in a fiduciary capacity. The reporting dates of the subsidiaries and the Bank are identical and the subsidiaries' accounting policies conform to those used by the Bank for like transactions and events in similar circumstances.

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

Subsidiaries are fully consolidated from the date on which control is transferred to the Group. Control is achieved where the Group holds the majority of the voting rights and has the power to govern the financial and operating policies of an entity so as to obtain the benefits from its activities. The results of subsidiaries acquired or disposed of during the year are included in the consolidated statement of income from the date of acquisition or up to the date of disposal, as appropriate.

Losses within a subsidiary are attributed to the non-controlling interest even if that results in a deficit balance. A change in the ownership interest of a subsidiary, without a loss of control, is accounted for as an equity transaction. If the Group loses control over a subsidiary, it:

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Principles of consolidation (continued)

a) Derecognises the assets (including goodwill) and liabilities of the subsidiary;
b) Derecognises the carrying amount of any non-controlling interest;
c) Derecognises the cumulative transaction differences, recorded in equity;
d) Recognises the fair value of consideration received;
e) Recognises the fair value of any investment retained;
f) Recognises any surplus or deficit in the consolidated statement of income; and
g) Reclassifies the parent's share of a component previously recognised in other comprehensive income to consolidated statement of income.

The principal subsidiaries of the Bank are as follows:

		Effective ownership as at		
Name of the subsidiary	Country of incorporation	31 December 2011	31 December 2010	Year of incorporation
Held directly				
KIPCO Asset Management Company [KAMCO]	Kuwait	86%	86%	1998
United Gulf Bank Securities Company *	Bahrain	-	96%	1998
Hatoon Real Estate Company	Kuwait	98%	98%	2008
Syria Gulf Investment Company	Syria	99%	99%	2007
United Gulf Financial Services Company-North Africa	Tunisia	77%	77%	2008
Held through KAMCO				
Al-Nuzoul Holding Company K.S.C. (Closed)	Kuwait	60%	60%	2005
Al-Janah Holding Company K.S.C. (Closed)	Kuwait	60%	60%	2005
KAMCO Real Estate Company S.P.C.	Bahrain	100%	100%	2005
Al Zad Real Estate W.L.L.	Kuwait	100%	100%	2007
Al Dhiyafa United Real Estate Company W.L.L.	Kuwait	100%	100%	2007
First North Africa Real Estate Company W.L.L.	Kuwait	100%	100%	2007
Al Raya Real Estate Projects Company W.L.L.	Kuwait	100%	100%	2007
Orange Real Estate Company W.L.L.	Kuwait	100%	100%	2005
Al Rawabi International Real Estate Company W.L.L.	Kuwait	96%	99%	2009
First Homes Real Estate Company W.L.L.	Kuwait	99%	99%	2009

* Liquidated during 2011.

Business combinations

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred, measured at acquisition date fair value and the amount of any non-controlling interest in the acquiree. For each business combination, the acquirer measures the non controlling interest in the acquiree either at fair value or at the proportionate share of the acquiree's identifiable net assets. Acquisition costs incurred are expensed and included in administrative expenses.

When the Group acquires a business, it assesses the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date. This includes the separation of embedded derivatives in host contracts by the acquiree.

If the business combination is achieved in stages, the acquisition date fair value of the acquirer's previously held equity interest in the acquiree is remeasured to fair value at the acquisition date through the consolidated statement of income.

Any contingent consideration to be transferred by the acquirer will be recognised at fair value at the acquisition date. Subsequent changes to the fair value of the contingent consideration which is deemed to be an asset or liability, will be recognised in accordance with IAS 39 either in the consolidated statement of income or as a change to other comprehensive income. If the contingent consideration is classified as equity, it should not be remeasured until it is finally settled within equity.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Investments in associates and joint ventures accounted for under the equity method

Associated companies

An associated company (or associate) is one in which the Group exercises significant influence (but not control) over its operations, generally accompanying, directly or indirectly, a holding between 20% and 50% of the voting power of the investee and is accounted for under the equity method.

Under the equity method, the investment in the associate is initially recognised at cost and adjusted thereafter for the post-acquisition change in the Group's share of net assets of the investee. The Group recognises, in the consolidated statement of income, its share of the total recognised profit or loss of the associate from the date that influence or ownership effectively commences until the date that it effectively ceases. Distributions received from an associate reduce the carrying amount of the investment. Adjustments to the carrying amount may also be necessary for changes in the Group's share in the associate arising from changes in its comprehensive income that have not been recognised in the associate's statement of income. The Group's share of those changes is recognised directly in the statement of comprehensive income.

If the significant influence over an associate is achieved in stages, the acquisition date fair value of the acquirer's previously held equity interest in the acquiree is remeasured to fair value at the acquisition date through the consolidated statement of income.

Unrealised gains and losses resulting from transactions with an associate are eliminated to the extent of the Group's share in the associate.

Joint ventures

A joint venture is a contractual arrangement whereby the Group undertakes an economic activity with another entity that is subject to joint control. The joint venture is accounted for using the equity method of accounting. Under the equity method, the joint venture is carried in the statement of financial position at cost plus post-acquisition changes in the Group's share of net assets of the joint venture. The statement of income reflects the Group's share of the results of operations of the joint venture. Where there has been a change recognised directly in the other comprehensive income of the joint venture, the Group recognises its share of any changes and discloses this, when applicable, in the statement of comprehensive income. Unrealised gains and losses resulting from transactions between the Group and the joint venture are eliminated to the extent of the Group's interest in joint venture.

The reporting dates of the associates, joint ventures and the Group are identical and the associates' and joint ventures' accounting policies conform to those used by the Group for like transactions and events in similar circumstances.

Investments in associates and joint ventures are reviewed for impairment when there is an indication that the investments have been impaired, or that impairment losses recognised in prior years no longer exist. Whenever the impairment requirements of IAS 36 indicate that investments in associates or joint ventures may be impaired, the entire carrying amount of the investments is tested by comparing recoverable amounts with carrying values. The recoverable amount of an asset or a cash-generating unit is the higher of its fair value less costs to sell, and its value in use. Goodwill is included in the carrying amount of investment in an associate or a joint venture and, therefore, is not separately tested for impairment.

Goodwill

Goodwill represents the excess of the cost of acquisition over the Group's share of the fair value of the net identifiable assets of the acquired subsidiary, associate or joint venture at the date of the acquisition. Goodwill arising on the acquisition of an associate or a joint venture is included in the carrying amount of the respective associate or joint venture and, therefore, is not separately tested for impairment. Goodwill arising on the acquisition of a subsidiary is recognised as a separate asset in the consolidated statement of financial position. Any excess, at the date of acquisition, of the Group's share in the fair value of the net identifiable assets acquired over the cost of the acquisition is recognised as negative goodwill. Negative goodwill arising on an acquisition is recognised immediately in the consolidated statement of income.

Goodwill acquired in a business combination is initially measured at cost, being the excess of the cost of the business combination over the Bank's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities acquired.

Goodwill is stated at cost less impairment losses. Goodwill of subsidiaries is allocated to cash-generating units and is tested annually for impairment. If the recoverable amount of the cash generating unit is less than the carrying amount of the unit, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit and then to the other assets of the unit pro-rata on the basis of the carrying amount of each asset in the unit. The recoverable amount of a cash-generating unit is the higher of the cash-generating unit's fair value less costs to sell, and its value in use. Any impairment loss recognised for goodwill is not reversed in a subsequent period.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Goodwill (continued)

On disposal of a part of a subsidiary, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

Non-current assets held for sale and discontinued operations

When non-current assets and disposal group are classified as held for sale, these are measured at the lower of carrying amount and fair value less costs to sell. Non current assets and disposal groups are classified as held for sale if their carrying amounts will be recovered through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the assets or disposal group is available for immediate sale in its present condition. Management must be committed to the sale, which should be expected to qualify for recognition as a completed sale within one year from the date of classification. At 31 December 2011, there were no discontinued operations or non-current assets classified as held for sale (31 December 2010: same).

In the consolidated statement of income of the reporting period, and of the comparable period of the previous year, income and expenses from the discontinued operations are reported separately from income and expenses relating to continuing operations down to the level of profit after taxes, even when the Group retains a non-controlling interest in the subsidiary after the sale. The resulting profit or loss (after taxes) is reported separately in the consolidated statement of income.

Investments carried at fair value through statement of income

Investments classified as carried at fair value through the statement of income comprise of two categories 'investments held for trading' and 'investments designated at fair value through statement of income'.

An investment is classified as 'held for trading' if it is acquired or incurred principally for the purpose of selling in the near term or if on initial recognition is part of a portfolio of identifiable financial investments that are managed together and for which there is evidence of a recent actual pattern of short-term profit taking. Derivatives which are not used as hedge are also categorised as held for trading.

Investments designated at fair value through statement of income are investments that are not classified as held for trading but are managed, and their performance is evaluated on a fair value basis in accordance with the Group's investment strategy.

These investments are initially recognised at fair value. Transaction costs are immediately expensed in the consolidated statement of income. Subsequent to initial recognition, investments designated at fair value through statement of income are remeasured at fair value and gains and losses arising from such remeasurement are included in the consolidated statement of income.

Non-trading investments

These are classified as follows:

- Held to maturity
- Available-for-sale

Held to maturity
Investments with fixed or determinable payments and fixed maturities are classified as held to maturity when the Group has the positive intention and ability to hold these investments to maturity. These investments are initially recognised at fair value, including directly attributable transaction costs.

After initial recognition investments held to maturity are carried at amortised cost using the effective interest rate method. Any gain or loss on such investments is recognised in the consolidated statement of income when the investement is derecognised or impaired. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate. The amortisation is included in 'interest income' in the consolidated statement of income. The losses, if any, arising from impairment of such investments are recognised in the consolidated statement of income.

Investments available-for-sale
Investments available-for-sale are those non-derivative financial assets that are designated as available-for-sale or are not classified as investment at fair value through statement of income, investments held to maturity or loans and receivables.

These investments are initially recognised at fair value, including directly attributable transaction costs.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Non-trading investments (continued)

Investments available-for-sale (continued)

After initial recognition, available-for-sale investments are measured at fair value with gains and losses being recognised in the consolidated statement of comprehensive income until the investment is derecognised or determined to be impaired at which time the cumulative gains or losses previously reported in the consolidated statement of comprehensive income are recognised in the consolidated statement of income. Investments whose fair value cannot be reliably measured are carried at cost less impairment losses, if any.

Dividends are included in 'dividend income'. Interest income on available-for-sale investments is recorded in 'interest income' in the consolidated statement of income, using the effective interest yield method.

Loans and receivables

Loans and receivables include non-derivative financial assets with fixed or determinable payments that are not quoted in an active market other than;

a) those that the Group intends to sell immediately or in the near term and those that the Group upon initial recognition designates as at fair value through statement of income;
b) those that the Group, upon initial recognition, designates as available for sale; or
c) those for which the Group may not recover substantially all of its initial investment, other than because of credit deterioration.

Loans and receivables are initially recognised at fair value which is the cash consideration to originate or purchase the loan including any transaction costs. Subsequently loans and receivables are carried at amortised cost, less any amount written off, and net of any provision for impairment.

Derivatives and hedge accounting

The Group makes use of derivative instruments to manage exposure to foreign currency risk and interest rate risk. In order to manage a particular risk, the Group applies hedge accounting to transactions which meet the specified criteria. The Group enters into derivative instruments, mainly forward foreign exchange contracts, interest rate and forward currency swaps in the foreign exchange markets.

Derivatives are initially recognised, and subsequently measured at fair value with transaction costs taken directly to the consolidated statement of income. The fair value of a derivative is the equivalent of the unrealised gain or loss from marking to market the derivative. Derivatives with positive fair values (unrealised gains) are included in other assets and derivatives with negative fair values (unrealised losses) are included in other liabilities in the consolidated statement of financial position.

Derivatives embedded in other financial instruments are treated as separate derivatives and recorded at fair value, when their economic characteristics and risks are not closely related to those of the host contract and the host contract is not carried as held for trading. The embedded derivatives are, where material, separated from the host contract and carried at fair value with the changes in fair value recognised in the consolidated statement of income.

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

Also, at the inception of the hedging relationship, a formal assessment is undertaken to ensure the hedging instrument is expected to be highly effective in offsetting the designated risk in the hedged item. Hedges are formally assessed at the end of each quarter. A hedge is regarded as highly effective if the changes in the fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated are expected to offset in a range of 80% to 125%.

For the purpose of hedge accounting, hedges are classified into three categories: (a) fair value hedges which hedge the exposure to changes in the fair value of a recognised asset or liability; (b) cash flow hedges which hedge exposure to variability in cash flows of a recognised asset or liability or a forecasted transaction; and (c) hedge of net investment in a foreign operation.

Fair value hedges

In relation to fair value hedges, that qualify for hedge accounting, any gain or loss from remeasuring the hedging instrument to fair value, as well as related changes in fair value of the item being hedged, are recognised immediately in the consolidated statement of income. At 31 December 2011, there were no hedges classified as fair value hedges.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Derivatives and hedge accounting (continued)

Cash flow hedge
In relation to cash flow hedges the effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognised directly in the fair value reserve in the consolidated statement of comprehensive income. The gain or loss relating to the ineffective portion is recognised in the consolidated statement of income.

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

Hedge of net investments in foreign operations
Hedges of a net investment in a foreign operation are accounted for in a way similar to cash flow hedges. On the disposal of the foreign operation, the cumulative value of any such gains or losses recognised in equity through other comprehensive income is transferred to the consolidated statement of income.

Derivatives are stated at fair values and carried as assets when their fair value is positive and as liabilities when their fair value is negative. For hedges which do not qualify for hedge accounting and held for trading derivatives, any gains or losses arising from changes in the fair value of the hedging instrument are taken directly to the consolidated statement of income for the year.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. For discontinued fair value hedges of financial instruments with fixed maturities any adjustment arising from hedge accounting is amortised over the remaining term to maturity. For discontinued cash flow hedges, any cumulative gain or loss on the hedging instrument recognised in equity remains in equity until the hedged transaction occurs. If the hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the consolidated statement of income.

Investment properties

All properties held for rental or for capital appreciation purposes, or both, are classified as investment properties. Where a property is partially occupied by the Group and the portions could be sold separately, the Group accounts for the portions separately either as an investment property or property and equipment, as appropriate. If the portions cannot be sold separately, the property is classified as an investment property only if an insignificant portion is held for own use.

The Group applies the fair value model of accounting for investment properties. All investment properties are initially recorded at cost, including acquisition expenses associated with the property.

Subsequent to initial recognition, all investment properties are remeasured at fair value and changes in fair value are recognised in the consolidated statement of income. The Group engages independent valuation specialists to determine the fair value of investment properties.

Property and equipment

Property and equipment are stated at cost less accumulated depreciation and impairment losses. When assets are sold or retired, their cost and accumulated depreciation are eliminated from the statement of financial position and any gain or loss resulting from disposal is included in the consolidated statement of income.

Depreciation is computed on a straight-line basis over estimated useful lives of 3 to 20 years on all property and equipment other than freehold land which is deemed to have an indefinite life. Expenditure for maintenance and repairs is expensed as incurred.

Financial liabilities

Financial liabilities comprise of due to banks and other financial institutions, deposits from customers, loans, bonds and subordinated debt and other liabilities. These are stated at amortised cost. Transaction costs are amortised over the period of the debt using the effective yield method. Deposits from customers include deposits from both external customers and other group companies.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Treasury shares and treasury share reserve

Treasury shares are own equity instruments of the Bank which are reacquired by the Bank or any of its subsidiaries. These are stated at cost and deducted from equity. Any gain or loss arising on reissuance of treasury shares is taken directly to treasury share reserve in the consolidated statement of changes in equity.

Cash and cash equivalents

Cash and cash equivalents include cash, demand and call deposits, highly liquid investments that are readily convertible into cash and placements (excluding escrow balances) with original maturities up to ninety days from the date of acquisition.

Fiduciary assets

Assets held in a fiduciary capacity are not treated as assets of the Group in the consolidated statement of financial position.

Dividends on ordinary shares

Dividends on ordinary shares are recognised as a liability and deducted from equity when they are approved by the Bank's shareholders. Dividends for the year that are approved after the statement of financial position date are disclosed as an event after the statement of financial position date.

Taxes

There is no tax on corporate income in the Kingdom of Bahrain. Taxation on foreign operations is provided in accordance with the fiscal regulations of the respective countries in which the Group operates.

Derecognition

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

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

When the Group has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Group's continuing involvement in the asset.

A financial liability is derecognised when the obligation specified in the contract is discharged, cancelled or expired.

Offsetting

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

Trade and settlement date accounting

All "regular way" purchases and sales of financial assets are recognised on the settlement date, i.e. the date the asset is delivered to the counterparty.

Employees benefits

The Group provides for end of service benefits to all its employees. Entitlement to these benefits is usually based upon the employees' length of service and the completion of a minimum service period. The expected costs of these benefits are accrued over the period of employment. National employees of the Bank are also covered by the Social Insurance Organisation scheme and the Bank's obligations are limited to the amount contributed to the scheme.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Employees benefits (continued)

The Group operates an equity-settled, share-based Employee Stock Option Plan (ESOP or the plan). Under the terms of the plan, share options are granted to permanent employees, which are exercisable in a future period. The fair value of the options is recognised as an expense over the vesting period with a corresponding credit to equity. The fair value of the options is determined using the Black-Scholes option pricing model.

The proceeds received are credited to share capital (nominal value) and share premium when the options are exercised.

Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) arising from a past event and the costs to settle the obligation are both probable and reliably measurable.

Impairment of financial assets

An assessment is made at each statement of financial position date to determine whether there is objective evidence that a specific financial asset may be impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation and where observable data indicates that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults. If such evidence exists, an impairment loss, is recognised in the consolidated statement of income.

Financial assets carried at amortised cost

A financial asset is considered impaired when there is an objective evidence of credit-related impairment as a result of one or more loss event(s) that occurred after the initial recognition of the asset and those loss events have an impact on the estimated future cash flows of the financial asset or group of financial assets and can be reliably estimated.

A specific provision for credit losses, due to impairment of a loan or any other financial asset held at amortised cost, is established if there is objective evidence that the Group will not be able to collect all amounts due. The amount of the specific provision is the difference between the carrying amount and the estimated recoverable amount. The estimated recoverable amount is the present value of expected cash flows, including amounts estimated to be recoverable from guarantees and collateral, discounted based on the original effective yield basis.

In addition to a specific provision for credit losses, a provision for collective impairment is made on a portfolio basis for credit losses where there is an objective evidence that unidentified losses exist at the reporting date. These are based on any deterioration in the risk rating (i.e. downward migration of risk ratings) of the financial asset since it was originally granted. This provision is estimated based on various factors including credit ratings allocated to a borrower or group of borrowers, the current economic conditions, the experience the Group has had in dealing with a borrower or group of borrowers and available historical default information.

The carrying amount of the asset is adjusted through the use of a provision for impairment account and the amount of the adjustment is included in the consolidated statement of income.

Investments available-for-sale

For available-for-sale financial assets, the Group assesses at each reporting date whether there is objective evidence that an investment or a group of investments is impaired.

In the case of equity investments classified as available-for-sale, objective evidence would include a significant or prolonged decline in the fair value of the investment below its cost. 'Significant' is to be evaluated against the original cost of the investment and 'prolonged' against the period in which the fair value has been below its original cost. Where there is evidence of impairment, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognised in the statement of income – is removed from other comprehensive income and recognised in the consolidated statement of income. Impairment losses on equity investments are not reversed through the consolidated statement of income; increases in their fair value after impairment are recognised directly in other comprehensive income.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Impairment of financial assets (continued)

Investments available-for-sale (continued)
In the case of debt instruments classified as available-for-sale, impairment is assessed based on the same criteria as financial assets carried at amortised cost. However, the amount recorded for impairment is the cumulative loss measured as the difference between the amortised cost and the current fair value, less any impairment loss on that investment previously recognised in the statement of income. If, in a subsequent year, the fair value of a debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the consolidated statement of income, the impairment loss is reversed through the consolidated statement of income.

Impairment of non-financial assets

Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised in the consolidated statement of income for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell, and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash inflows (cash-generating units). The impairment test also can be performed on a single asset when the fair value less costs to sell or the value in use can be determined reliably. Non-financial assets other than goodwill that suffer impairment are reviewed for possible reversal of the impairment at each reporting date.

Fair values

For financial instruments traded in an active market, fair value is determined by reference to quoted market bid prices for assets and quoted market offer prices for liabilities, without deduction for transaction costs. The fair value of investments in managed funds or similar investment vehicles, where available, are based on last published bid price.

A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. If the above criteria are not met, the market is regarded as being inactive. Indications that a market is inactive are when there is a wide bid-offer spread or significant increase in the bid-offer spread or there are few recent transactions.

For financial instruments where there is no active market, fair value is determined using appropriate valuation techniques. Such techniques may include the following:

- brokers' quotes
- recent transactions
- the expected cash flows discounted at current rates applicable for items with similar terms and risk characteristics
- option pricing models

The estimated fair value of deposits with no stated maturity, which includes non-interest bearing deposits, is the amount payable on demand.

The fair value of forward foreign exchange contracts is determined using forward exchange rates at the statement of financial position date with the resulting value discounted back to present value.

The fair value of interest rate swaps is determined by discounting estimated future cash flows based on the terms and maturity of each contract and using market interest rates for a similar instrument at the measurement date.

Foreign currencies

The consolidated financial statements have been presented in US Dollars being the functional and presentational currency of the Bank. Each entity in the Group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency.

Transactions in foreign currencies are initially recorded in the functional currency rate of exchange ruling at the date of transaction.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Foreign currencies (continued)

Translation of foreign currency transactions and balances

Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the reporting date. Exchange differences arising on the retranslation of monetary items, are included in consolidated statement of income for the year. Non-monetary items measured at fair value in a foreign currency are retranslated using the exchange rates at the date when the fair value was determined. Exchange differences arising on the retranslation of non-monetary investments carried at fair value through the statement of income are included in the consolidated statement of income for the year. Exchange differences arising on the retranslation of available for sale equity investments, other than those which are carried at cost, are recognised directly in a fair value reserve in the consolidated statement of comprehensive income. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions.

Translation of financial statements of foreign operations

Assets (including goodwill) and liabilities of foreign operations are translated at the exchange rates prevailing at the statement of financial position date. Income and expense items are translated at average exchange rates for the relevant period. All resulting exchange differences are taken directly to a foreign currency translation reserve in equity through other comprehensive income.

On disposal of a foreign operation, the component of other comprehensive income relating to that particular foreign operation is recognised in the consolidated statement of income.

Recognition of income and expenses

Interest income and related fees are recognised using the effective yield method, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the effective interest rate, but not future credit losses. The carrying amount of the financial asset or financial liability is adjusted if the Group revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest income or expense.

Recognition of interest income is suspended when the related financial asset becomes impaired. Notional interest is recognised on impaired financial assets based on the rate used to discount future cash flows to their net present value.

Commission income and other fees are recognised when earned.

Rental income on investment properties is recognised on a straight line basis.

Dividend income is recognised when the Group's right to receive the dividend is established.

Contingent liabilities and contingent assets

Contingent liabilities are not recognised in the financial statements, but are disclosed unless the possibility of an outflow of resources embodying economic benefits is remote.

Contingent assets are not recognised in the financial statements, but are disclosed when an inflow of economic benefits is probable.

Segment information

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker is the person or group that allocates resources to and assesses the performance of the operating segments of an entity. The Group has determined the Acting Chief Executive Officer of the Bank as its chief operating decision-maker.

All transactions between business segments are conducted on an arm´s length basis, with intra-segment revenue and expenses being eliminated at Group level. Income and expenses directly associated with each segment are included in determining business segment performance.

Significant assumptions, accounting judgements and estimates

In the process of applying the Group's accounting policies, management has made the following assumptions, judgements and estimates in determining the amounts recognised in the consolidated financial statements:

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Significant assumptions, accounting judgements and estimates (continued)

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

Classification of investments
Management decides on acquisition of an investment whether it should be classified as carried at fair value through statement of income, held to maturity or available-for-sale.

The Group classifies investments as held for trading if they are acquired primarily for the purpose of making short term profit. Classification of investments designated as fair value through statement of income depends on how management monitors the performance of these investments.

Securities which are eligible for reclassification in accordance with IAS 39 and the Group has an intention and ability to hold for the foreseeable future are reclassified as non-trading investments. An analysis of reclassified assets is disclosed in note 6.

For those deemed to be held to maturity, management ensures that the requirements of IAS 39 are met and in particular the Group has the intention and ability to hold these to maturity.

All other investments are classified as available-for-sale.

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

Impairment of investments
The Group treats available-for-sale equity investments as impaired when there has been a significant or prolonged decline in the fair value below its cost or where other objective evidence of impairment exists. The determination of what is 'significant' or 'prolonged' requires considerable judgment.

Impairment of goodwill
The Group determines whether goodwill is impaired at each reporting date. This requires an estimation of the value in use of the cash generating units to which the goodwill is allocated. Estimating the value in use requires the Group to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows.

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

Collective impairment provisions on loans and receivables
In addition to specific provisions against individually significant loans and receivables, the Group also makes a collective impairment provision against loans and receivables, which although not specifically identified against a loan, have a greater risk of default than when originally granted. This collective provision is based on any deterioration in the internal grade of the loan since it was granted. The amount of the provision is based on the historical loss pattern for loans within each grade and is adjusted to reflect current economic changes.

These internal gradings take into consideration factors such as any deterioration in country risk, industry, technological obsolescence as well as identified structural weaknesses or deterioration in cash flows.

2 BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Significant assumptions, accounting judgements and estimates (continued)

Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded in the statement of financial position cannot be derived from active markets, they are determined using valuation techniques including discounted cash flow models. The inputs to these models are taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. The judgments include considerations of inputs such as liquidity risk, credit risk and volatility. Changes in assumptions about these factors could affect the reported fair value of financial instruments.

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

- recent arm's length market transactions;
- current fair value of another instrument that is substantially the same; and
- other valuation methods (note 32).

Reclassification of financial assets

Effective from 1 July 2008, the Group may reclassify, in certain circumstances, non-derivative financial assets out of the 'held-for-trading' category and into the 'available-for-sale', 'loans and receivables', or 'held-to-maturity' categories. From this date it may also reclassify, in certain circumstances, financial instruments out of the 'available-for-sale' category and into the 'loans and receivables' category. Reclassifications are recorded at fair value at the date of reclassification, which becomes the new amortised cost.

The Group may reclassify a non-derivative trading asset out of the 'held-for-trading' category and into the 'loans and receivables' category if it meets the definition of loans and receivables and the Group has the intention and ability to hold the financial asset for the foreseeable future or until maturity. If a financial asset is reclassified, and if the Group subsequently increases its estimates of future cash receipts as a result of increased recoverability of those cash receipts, the effect of that increase is recognised as an adjustment to the effective interest rate from the date of the change in estimate.

For a financial asset reclassified out of the 'available-for-sale' category, any previous gain or loss on that asset that has been recognised in other comprehensive income is amortised to profit or loss over the remaining life of the investment using the effective interest rate. Any difference between the new amortised cost and the expected cash flows is also amortised over the remaining life of the asset using the effective interest rate. If the asset is subsequently determined to be impaired then the amount recorded in other comprehensive income is recycled to the statement of income.

Reclassification is at the election of management, and is determined on an instrument by instrument basis. The Group does not reclassify any financial instrument into the fair value through statement of income category after initial recognition. An analysis of reclassified assets is disclosed in note 6.

3 PROSPECTIVE CHANGES IN ACCOUNTING POLICIES

Standards issued but not yet effective up to the date of issuance of the Group's consolidated financial statements are listed below. This listing is of standards and interpretations issued, which the Group reasonably expects to be applicable at a future date. The Group intends to adopt those standards (where applicable) when they become effective:

IAS 1 *Financial Statement Presentation*

The amendments becomes effective for annual periods beginning on or after 1 July 2012 and require that an entity present separately, the items of other comprehensive income that would be reclassified (or recycled) to profit or loss in the future if certain conditions are met (for example, upon derecognition or settlement), from those that would never be reclassified to profit or loss. The amendment affects presentation only and, therefore, will have no impact on the Group's financial position or performance.

IFRS 9 *Financial Instruments*

IFRS 9 as issued reflects the first phase of the IASB's work on the replacement of IAS 39 and applies to classification and measurement of financial assets and financial liabilities as defined in IAS 39.

3 PROSPECTIVE CHANGES IN ACCOUNTING POLICIES (continued)

IFRS 9 *Financial Instruments (continued)*

It replaces the parts of IAS 39 that relate to the classification and measurement of financial instruments. IFRS 9 requires financial assets to be classified into two measurement categories: those measured as at fair value and those measured at amortised cost. The determination is made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument.

For financial liabilities, the standard retains most of the IAS 39 requirements. The main change is that, in cases where the fair value option is taken for financial liabilities, the part of a fair value change due to an entity's own credit risk is recorded in other comprehensive income rather than the income statement, unless this creates an accounting mismatch.

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 standard is currently effective for annual periods beginning on or after 1 January 2013. The IASB issued an exposure draft (ED) "Mandatory effective date of IFRS 9" - that proposes the meaning of the mandatory effective date to periods beginning on or after 1 January 2015 with early application continuing to be permitted. In subsequent phases, the IASB will address hedge accounting and impairment of financial assets.

The Group will quantify the effect of adoption of this Standard, in conjunction with the other phases, when issued, to present a comprehensive picture.

IAS 19 *Employee benefits*

The IASB has issued numerous amendments to IAS 19, which are effective for annual periods beginning on or after 1 January 2013. These include the elimination of the corridor approach and recognising all actuarial gains and losses in the other comprehensive income as they occur; immediate recognition of all past service costs; and replacement of interest cost and expected return on plan assets with a net interest amount that is calculated by applying the discount rate to the net defined benefit liability (asset); and certain clarifications and re-wording. The Group is currently assessing the full impact of these amendments.

IFRS 10 *Consolidated financial statements*

IFRS 10 introduces a new approach to determining which investees should be consolidated and provides a single consolidation model that identifies control as the basis for consolidation for all types of entities.

An investor controls an investee when:

- it is exposed or has rights to variable returns from its involvement with that investee;
- it has the ability to affect those returns through its power over that investee; and
- there is a link between power and returns.

Control is re-assessed as facts and circumstances change.

IFRS 10 replaces IAS 27 *Consolidated and Separate Financial Statements* and SIC-12 *Consolidation - Special Purpose Entities*. IFRS 10 is effective for annual periods beginning on or after 1 January 2013 and earlier application is permitted. The Group is currently assessing the full impact of this new standard.

IFRS 11 *Joint arrangements*

IFRS 11 establishes principles for the financial reporting by parties to a joint arrangement and improves on IAS 31 by establishing principles that are applicable to the accounting for all joint arrangements.

IFRS 11 classifies joint arrangements into two types – joint operations and joint ventures; and defines joint control as the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities (i.e. activities that significantly affect the returns of the arrangement) require the unanimous consent of the parties sharing control.

IFRS 11 supersedes IAS 31 *Interests in Joint Ventures* and SIC-13 *Jointly Controlled Entities – Non-monetary Contributions by Venturers*. IFRS 11 is effective for annual periods beginning on or after 1 January 2013 and earlier application is permitted. The Group is currently assessing the full impact of this new standard.

3 PROSPECTIVE CHANGES IN ACCOUNTING POLICIES (continued)

IFRS 12 *Disclosure of interests in other entities*

IFRS 12 combines, enhances and replaces the disclosure requirements for subsidiaries, joint arrangements, associates and unconsolidated structured entities. As a consequence of these new IFRSs, the IASB also issued amended and retitled IAS 27 *Separate Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures*.

IFRS 12 aims to provide information to enable users to evaluate:

- the nature of, and risks associated with, an entity's interests in other entities; and
- the effect of those interests on the entity's financial position, financial performance and cash flows.

IFRS 12 is effective for annual periods beginning on or after 1 January 2013 and earlier application is permitted. The Group is currently assessing the full impact of this new standard.

IFRS 13 *Fair value measurement*

IFRS 13 replaces the fair value measurement guidance contained in individual IFRSs with a single source of fair value measurement guidance. It defines fair value, establishes a framework for measuring fair value and sets out disclosure requirements for fair value measurements. It explains how to measure fair value when it is required or permitted by other IFRSs. IFRS 13 does not extend the use of fair value accounting but provides guidance on how it should be applied where its use is already required or permitted by other standards within IFRSs.

IFRS 13 is effective for annual periods beginning on or after 1 January 2013 and earlier application is permitted. The Group is currently assessing the full impact of this new standard.

IAS 27 *Separate Financial Statements (as revised in 2011)*

IAS 27 (2011) supersedes IAS 27 (2008). As a consequence of the new IFRS 10 and IFRS 12 aforementioned, IAS 27 (2011) carries forward the existing accounting and disclosure requirements for separate financial statements, with some minor clarifications.

IAS 27 (2011) is effective for annual periods beginning on or after 1 January 2013 and earlier application is permitted. The Bank does not present separate financial statements.

IAS 28 *Investments in Associates and Joint Ventures Separate Financial Statements (as revised in 2011)*

IAS 28 (2011) supersedes IAS 28 (2008). As a consequence of the new IFRS 11 and IFRS 12 (refer above), IAS 28 has been renamed IAS 28 *Investments in Associates and Joint Ventures*, and describes the application of the equity method to investments in joint ventures in addition to associates.

IAS 28 (2011) is effective for annual periods beginning on or after 1 January 2013 and earlier application is permitted. The Group is currently assessing the full impact of this revised standard.

4 FINANCIAL ASSETS AND LIABILITIES

The table below summarises the accounting classification of the Group's financial assets and financial liabilities:

31 December 2011	Held for trading US$ 000	Designated at fair value through statement of income US$ 000	Available-for-sale US$ 000	Amortised cost / Loans and receivables US$ 000	Total US$ 000
Demand and call deposits with banks	-	-	-	17,857	17,857
Placements with banks	-	-	-	102,282	102,282
Investments carried at fair value through statement of income	24,232	48,951	-	-	73,183
Non-trading investments	-	-	435,028	-	435,028
Loans and receivables	-	-	-	27,942	27,942
Other assets	-	-	-	31,949	31,949
Total financial assets	24,232	48,951	435,028	180,030	688,241
Due to banks and other financial institutions	-	-	-	211,795	211,795
Deposits from customers	-	-	-	80,349	80,349
Loans	-	-	-	731,185	731,185
Bonds	-	-	-	-	-
Subordinated debt	-	-	-	100,000	100,000
Other liabilities	-	-	-	44,021	44,021
Total financial liabilities	-	-	-	1,167,350	1,167,350

31 December 2010	Held for trading US$ 000	Designated at fair value through statement of income US$ 000	Available-for-sale US$ 000	Amortised cost / Loans and receivables US$ 000	Total US$ 000
Demand and call deposits with banks	-	-	-	27,914	27,914
Placements with banks	-	-	-	167,257	167,257
Investments carried at fair value through statement of income	29,196	97,465	-	-	126,661
Non-trading investments	-	-	385,770	-	385,770
Loans and receivables	-	-	-	57,920	57,920
Other assets	-	-	-	43,538	43,538
Total financial assets	29,196	97,465	385,770	296,629	809,060
Due to banks and other financial institutions	-	-	-	435,624	435,624
Deposits from customers	-	-	-	139,568	139,568
Loans	-	-	-	501,432	501,432
Bonds	-	-	-	71,187	71,187
Subordinated debt	-	-	-	100,000	100,000
Other liabilities	-	-	-	40,140	40,140
Total financial liabilities	-	-	-	1,287,951	1,287,951

5 INVESTMENTS CARRIED AT FAIR VALUE THROUGH STATEMENT OF INCOME

	2011 US$ 000	2010 US$ 000
Investments held for trading		
Quoted equities	24,232	29,196
Investments designated at fair value through statement of income		
Managed funds	48,951	97,465
	73,183	126,661

Managed funds primarily represent private equity funds invested through unlisted companies and limited partnership interests. The fund managers have created these legal structures for tax efficiency and to meet other investors' requirements. The underlying investments in these funds are primarily in quoted debt and equity instruments in Kuwait and other international markets.

6 NON-TRADING INVESTMENTS

Non-trading investments comprise of available-for-sale investments as follows:

	2011 US$ 000	2010 US$ 000
Quoted		
Equities	43,395	45,102
Unquoted		
Equities	81,705	132,558
Real estate managed funds	16,560	18,636
Other managed funds	280,160	179,025
Debt securities	13,208	10,449
Total unquoted	391,633	340,668
Total non-trading investments	435,028	385,770

In October 2008, the International Accounting Standards Board [IASB] issued amendments to IAS 39 "Financial Instruments: Recognition and Measurement" and IFRS 7 "Financial Instruments: Disclosures" entitled "Reclassification of Financial Assets". The amendments to IAS 39 permit reclassification of financial assets from the "held for trading" category to the "available-for-sale" category in certain circumstances.

The amendments to IFRS 7 introduce additional disclosure requirements if an entity has reclassified financial assets in accordance with the IAS 39 amendments. The amendments were effective retrospectively from 1 July 2008.

As per the amendments, the Group reclassified certain financial assets from the "held for trading" category to the "available-for-sale" category. The assets were reclassified with retrospective effect as on 1 July 2008. The carrying value of these financial assets, as at date of reclassification, was US$ 19,082 thousand.

The carrying values and fair values of the financial assets reclassified are as follows:

	2011 US$ 000	2010 US$ 000
Carrying value and fair value as at 31 December	9,323	11,768

The fair value loss that would have been recognised in the consolidated statement of income for the period from the date of reclassification to 31 December 2011 had the financial assets not been reclassified amounts to US$ nil (31 December 2010: US$ 1,709 thousand).

Included under non-trading investments are unquoted available-for-sale investments, primarily representing nominal equity stakes up to 13% (31 December 2010: 13%) in various geographically and sectorally dispersed companies, amounting to US$ 87,943 thousand (31 December 2010: US$ 116,040 thousand) for which fair value cannot be determined with sufficient accuracy, as future cash flows are not determinable. Accordingly, these investments are carried at cost less provisions for impairment.

6 NON-TRADING INVESTMENTS (continued)

During the year an impairment loss of US$ 23,961 thousand (31 December 2010: US$ 13,499 thousand) has been recognised and adjusted against the gross amount of non-trading investments of US$ 141,304 thousand (31 December 2010: US$ 131,759 thousand).

The movement in provision for non-trading investments was as follows:

	2011 US$ 000	2010 US$ 000
At 1 January	55,395	32,802
Charge for the year	23,961	13,499
Written off	(9,514)	(427)
Other movements	(3,868)	9,521
Net charge during the year	10,579	22,593
At 31 December	65,974	55,395
Gross amount of individually impaired investments	141,304	131,759

7 LOANS AND RECEIVABLES

	2011 US$ 000	2010 US$ 000
Commercial loans	27,365	57,376
Overdrafts	-	488
Staff loans	3,306	2,762
	30,671	60,626
Less: Provision for impairment	(2,729)	(2,706)
	27,942	57,920

The movements in the provision for impairment are as follows:

	2011 US$ 000	2010 US$ 000
At 1 January	2,706	5,158
Written off during the year	-	(2,394)
Charge for the year	8	3
Other adjustments	15	(61)
At 31 December	2,729	2,706

Provision for impairment mainly relates to commercial loans.

	2011 US$ 000	2010 US$ 000
Individual impairment	1,711	1,697
Collective impairment	1,018	1,009
	2,729	2,706
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	1,995	2,016

8 OTHER ASSETS

	2011 US$ 000	2010 US$ 000
Due from customers	26,584	34,524
Accounts receivable	5,027	4,900
Prepayments	5,541	3,412
Interest receivable	338	236
Others	-	3,878
	37,490	46,950

Due from customers is stated net of provision of US$ 9,039 thousand (31 December 2010: US$ 8,497 thousand). The net provision for impairment of other assets charged for the year amounted to US$ 468 thousand (31 December 2010: US$ 169 thousand).

9 INVESTMENTS IN ASSOCIATES AND JOINT VENTURES ACCOUNTED FOR UNDER THE EQUITY METHOD

Investments in associates and joint ventures

	Activity	Carrying value 2011 US$ 000	Ownership % 2011	Carrying value 2010 US$ 000	Ownership % 2010
a) Al Dhiyafa Holding Company K.S.C. (closed)	Hotel and tourism	-	-	54,984	32
b) Al Sharq Financial Brokerage Company	Brokerage and investment business	19,685	19	19,572	20
c) Dhow Development Company	Real estate	-	20	27	20
d) Burgan Bank S.A.K.	Commercial banking	463,782	18	424,099	17
e) KAMCO Energy Services Fund	Fund	8,173	36	-	-
f) Kuwait Private Equity Opportunities Fund	Private equity fund	12,411	45	14,184	45
g) Manafae Investment Company	Islamic investment	25,312	31	28,221	30
h) Millennium Private Equity Limited	Asset management	-	50	-	50
i) North Africa Holding Company	Investments	75,470	45	80,440	44
j) Overland Real Estate Company	Real estate	47,042	45	46,503	44
k) Royal Capital Company P.S.C.	Asset management and financial services	35,701	45	35,426	43
l) SSH Dar International W.L.L.	Architectural consulting services	-	-	2,955	29
m) Syria Gulf Bank	Commercial banking	18,182	31	19,634	31
n) Takaud Savings and Pensions B.S.C. (c)	Offering of personal pension and saving products	5,000	50	-	-
o) United Capital Transport Company K.S.C.C.	Transport	11,413	40	-	-
p) United Industries Company	Industrial and manufacturing	113,162	32	110,525	32
q) United Network Company	Telecommunication	13,050	28	13,277	28
r) United Real Estate Company	Real estate	154,473	20	145,579	19
s) United Real Estate Company - Syria	Real estate	84	20	2,918	40
t) United Real Estate Company - Jordan	Real estate	-	-	27,037	47
u) United Universal Real Estate Company	Real estate	-	-	684	20
		1,002,940		1,026,065	

9 INVESTMENTS IN ASSOCIATES AND JOINT VENTURES ACCOUNTED FOR UNDER THE EQUITY METHOD (continued)

Investments in associates and joint ventures (continued)

Summarised financial information of the Group's investments in associates and joint ventures is set out below:

	2011 US$ 000	2010 US$ 000
Total assets	20,014,573	18,309,489
Total liabilities	(16,206,946)	(14,411,447)
Net assets	3,807,627	3,898,042
Revenue	1,104,576	1,013,826
Profit for the year	244,345	68,276

The Group has no share of any contingent liabilities or capital commitments, as at 31 December 2011 and 31 December 2010 related to its joint ventures and associates.

a) Al-Dhiyafa Holding Company K.S.C. (closed) is a company incorporated in the State of Kuwait during 2005. During the year, the Group sold its 32% (31 December 2010: 32%) ownership to a related party.

b) Al Sharq Financial Brokerage Company is a closed company incorporated in the State of Kuwait during 2005. At 31 December 2011, the Bank indirectly owns a 19% interest in the associate through its subsidiary KAMCO (31 December 2010: directly owned 15% and indirectly owned 5% through KAMCO). The Group has the ability to exercise significant influence on Al Sharq through representation on the board of directors of Al Sharq.

c) Dhow Development Company is held through the Bank's subsidiary KAMCO and is incorporated in the State of Kuwait. The investment has been fully provided for.

d) Burgan Bank S.A.K. is a listed commercial bank incorporated in the State of Kuwait. The Bank directly owns an 18% (31 December 2010: 17%) equity interest in Burgan Bank. The Group has the ability to exercise significant influence on Burgan Bank through representation of 2 directors on the board of directors of Burgan Bank.

e) During the year, the Bank acquired a 36% equity stake in KAMCO Energy Service Fund through its subsidiary KAMCO. KAMCO Energy Service Fund was incorporated in the State of Kuwait in 2007.

f) Kuwait Private Equity Opportunities Fund is a closed ended fund incorporated in the State of Kuwait in 2004. At 31 December 2011, the Bank indirectly owns a 45% interest in the associate through its subsidiary KAMCO (31 December 2010: directly owned 15% and indirectly owned 30% through KAMCO).

g) The Bank indirectly owns 31% (31 December 2010: 30%) of Manafae Investment Company through its subsidiary KAMCO.

h) During 2009 the Group acquired a 50% stake in Millennium Private Equity Limited (MPE) through a share swap of Millennium Finance Corporation Limited (MFC) a jointly controlled company incorporated in the United Arab Emirates. MPE is engaged in managing private equity funds. In 2010, an impairment loss of US$ 15,781 thousand has been recognised against MPE.

i) The Bank directly owns 35% (31 December 2010: 34%) of North Africa Holding Company (NAHC), a closed company incorporated in the State of Kuwait in 2006, and indirectly owns an additional 10% (31 December 2010: 10%) through its subsidiary KAMCO.

j) The Bank indirectly owns 45% (31 December 2010: 44%) of Overland Real Estate Company through its subsidiary KAMCO.

k) The Bank directly owns 19% (31 December 2010: 18%) of Royal Capital, a closed company incorporated in the United Arab Emirates in 2007, and indirectly owns an additional 26% (31 December 2010: 25%) through its subsidiary KAMCO.

l) SSH Dar International W.L.L. was owned through the Bank's subsidiary KAMCO. During the current year, the Group disposed of its interest in the entity to a third party.

9 INVESTMENTS IN ASSOCIATES AND JOINT VENTURES ACCOUNTED FOR UNDER THE EQUITY METHOD (continued)

Investments in associates and joint ventures (continued)

m) Syria Gulf Bank (SGB) is a commercial bank incorporated in the Syrian Arab Republic. SGB commenced commercial operations in 2007. The Bank directly owns a 31% (31 December 2010: 31%) equity stake of SGB.

n) During 2011, the Bank and KIPCO (Parent) established a joint venture (with an equal 50% equity interest) named Takaud Savings and Pensions B.S.C. (c) (Takaud) in Bahrain with a total paid up capital of US$ 10 million. Takaud has not commenced its operations at the date of statement of financial position. Takaud aims to offer wide range of personal pension and saving products to its customers.

o) United Capital Transport Company K.S.C.C. (UniCap) was incorporated in State of Kuwait in 2011. The Bank owns a 40% equity stake through its subsidiary KAMCO. UniCap is a dedicated leasing solutions provider to governments, international oil companies and varied construction, mining and industrial services businesses.

p) The Bank indirectly owns 32% (31 December 2010: 32%) of United Industries Company K.S.C. (closed) ("UIC"), a company incorporated in the State of Kuwait in 1979 and listed on the Kuwait Stock Exchange, through its subsidiary KAMCO. UIC is in litigation with Al Atoun Steel Industries S.S.C. (Closed) ("AL Atoun Steel") (and the sponsors of Al Atoun Steel) for the recovery of its investment in Al Atoun Steel amounting to US$ 44,813 thousand (KD 12,483 thousand). The management of UIC is confident that the investment in Al Atoun Steel will be recovered in full.

q) The Bank directly owns 20% (31 December 2010: 20%) of United Network Company, a closed company incorporated in the State of Kuwait in 2001, and indirectly owns an additional 8% (31 December 2010: 8%) through its subsidiary KAMCO.

r) United Real Estate Company (URC), is a company listed on the Kuwait Stock Exchange. At 31 December 2011, the Bank directly owns 20% (31 December 2010: 19%) of URC. The Group has the ability to exercise significant influence on URC through representation on the board of directors of URC.

s) United Real Estate Company - Syria is a closed company incorporated in the Syrian Arab Republic in 2008. At 31 December 2011, the Bank directly owns 20% of the associate through its subsidiary KAMCO (31 December 2010: directly owned 20% and indirectly owned 20% through KAMCO).

t) United Real Estate Company - Jordan is a company incorporated in the Kingdom of Jordan during 2007. During the year, the group sold its 47% (31 December 2010: 47%) ownership to a related party.

u) United Universal Real Estate Company was owned through the Bank's subsidiary KAMCO. During the current year, the Group disposed of its interest in the entity to a third party.

Investments in associates include quoted associates with a carrying value of US$ 774,906 thousand (31 December 2010: US$ 728,058 thousand) which have a total quoted market price of US$ 596,525 thousand at 31 December 2011 (31 December 2010: US$ 641,572 thousand). In accordance with IAS 36, 'Impairment of Assets', the group's recoverable amount of these associates (higher of fair value less costs to sell, and value in use) was in excess of their carrying values and accordingly no impairment was recognised during the year ended 31 December 2011.

10 INVESTMENT PROPERTIES

	2011 US$ 000	2010 US$ 000
Cost	21,178	21,122
Disposals	(5,124)	-
Cumulative fair value adjustments	-	56
	16,054	21,178

10 INVESTMENT PROPERTIES (continued)

The movement in investment properties is as follows:

	2011 US$ 000	2010 US$ 000
At 1 January	21,178	26,794
Disposals	(5,124)	(5,616)
At 31 December	16,054	21,178

Investment properties consist of the following:

	2011 US$ 000	2010 US$ 000
Buildings	14,707	19,831
Land	1,347	1,347
	16,054	21,178

Investment properties are stated at fair values, determined based on independent valuations performed by external professional valuers at the year end.

11 GOODWILL

	2011 US$ 000	2010 US$ 000
At 1 January	56,296	55,168
Foreign currency translation adjustments	486	1,128
At 31 December	56,782	56,296

The goodwill is related to KAMCO (a subsidiary) and is allocated to the asset management and investment banking operating segment, a cash generating unit (a CGU). The recoverable amount of the CGU is determined based on a value in use calculation using cash flow projections from financial budgets approved by the Group's senior management covering a five year period. The key assumptions used in the value in use calculation include a perpetuity growth rate of 3% (2010: 3%) and discount factor of 11% (2010: 8.7%). There was no impairment identified in 2011 or 2010 as the recoverable amount of the CGU was higher than its net book value.

The calculation of value in use for the CGU is sensitive primarily to market risk premium, growth risk rate, risk free rate and country risk premium.

12 LOANS PAYABLE

31 December 2011	Currency*	Parent US$ 000	Subsidiary US$ 000	Total US$ 000
Floating rate loans				
Maturing within one year				
Loan due on 15 January 2012	KWD	-	8,077	8,077
Loan due on 28 February 2012	KWD	-	3,590	3,590
Loan due on 26 April 2012	KWD	-	10,770	10,770
Loan due on 31 May 2012	KWD	-	39,490	39,490
Loan due on 30 June 2012	KWD	-	1,795	1,795
Loan due on 2 July 2012	US$	200,000	-	200,000
Loan due on 31 December 2012	KWD	-	4,487	4,487
Loan due on 31 December 2012	KWD	-	1,795	1,795
Loan due on 31 December 2012	KWD	-	3,590	3,590
		200,000	73,594	273,594

12 LOANS PAYABLE (continued)

	Currency*	Parent US$ 000	Subsidiary US$ 000	Total US$ 000
Maturing after one year				
Loan due on 28 February 2013	KWD	-	3,590	3,590
Loan due on 30 June 2013	KWD	-	1,795	1,795
Loan due on 31 December 2013	KWD	-	4,488	4,488
Loan due on 31 December 2013	KWD	-	3,590	3,590
Loan due on 31 December 2013	KWD	-	1,795	1,795
Loan due on 28 February 2014	KWD	-	10,771	10,771
Loan due on 11 May 2014	US$	239,500	-	239,500
Loan due on 17 June 2014	KWD	-	71,800	71,800
Loan due on 20 June 2014	KWD	70,000	-	70,000
Loan due on 30 June 2014	KWD	-	1,795	1,795
Loan due on 31 December 2014	KWD	-	4,488	4,488
Loan due on 31 December 2014	KWD	-	1,795	1,795
Loan due on 31 December 2014	KWD	-	7,180	7,180
Loan due on 30 June 2015	KWD	-	1,795	1,795
Loan due on 31 December 2015	KWD	-	4,488	4,488
Loan due on 31 December 2015	KWD	-	1,795	1,795
Loan due on 30 June 2016	KWD	-	8,976	8,976
Loan due on 31 December 2016	KWD	-	17,950	17,950
		309,500	148,091	457,591
		509,500	221,685	731,185

* KWD represents Kuwaiti Dinar.

31 December 2010	Currency*	Parent US$ 000	Subsidiary US$ 000	Total US$ 000
Floating rate loans				
Maturing within one year				
Loan due on 5 January 2011	KWD	-	3,559	3,559
Loan due on 7 January 2011	KWD	-	3,559	3,559
Loan due on 31 January 2011	KWD	-	7,118	7,118
Loan due on 31 January 2011	KWD	-	32,924	32,924
Loan due on 2 April 2011	KWD	-	44,492	44,492
Loan due on 31 May 2011	KWD	-	17,797	17,797
Loan due on 17 June 2011	KWD	-	26,696	26,696
Loan due on 30 June 2011	US$	115,000	-	115,000
Loan due on 20 December 2011	KWD	-	28,476	28,476
Loan due on 31 December 2011	KWD	-	3,559	3,559
		115,000	168,180	283,180
Maturing after one year				
Loan due on 2 July 2012	US$	200,000	-	200,000
Loan due on 31 December 2012	KWD	-	3,559	3,559
Loan due on 1 June 2013	SYP	-	4,014	4,014
Loan due on 31 December 2013	KWD	-	3,559	3,559
Loan due on 31 December 2014	KWD	-	7,120	7,120
		200,000	18,252	218,252
		315,000	186,432	501,432

* KWD represents Kuwaiti Dinar and SYP represents Syrian Pound.

13 BONDS

	2011 US$ 000	2010 US$ 000
Bonds - issued by a subsidiary	-	71,187

In June 2004, the Bank's subsidiary KAMCO issued floating rate bonds of Kuwaiti Dinar (KWD) 10,000 thousand (US$ 35,900 thousand) at a rate of Central Bank of Kuwait discount rate plus 2.75% per annum and fixed rate bonds of KWD 10,000 thousand (US$ 35,900 thousand) at a rate of 7.5% per annum each. These bonds matured and were repaid on 21 June 2011 at their principal amounts.

14 SUBORDINATED DEBT

On 13 October 2006, the Bank issued floating rate notes amounting to US$ 100 million for a term of 10 years maturing on 12 October 2016. For the first five years the notes carried interest at the rate of 1.8% per annum above LIBOR for 3 month US dollar deposits after which the notes now carry interest at the rate of 2.7% per annum above LIBOR for 3 month US dollar deposits. The notes carried a call option to repurchase the notes at par value exercisable by the Bank at its 5th anniversary on 13 October 2011, which the Bank did not exercise.

15 OTHER LIABILITIES

	2011 US$ 000	2010 US$ 000
Due to customers and other payables	8,903	18,113
Accrued expenses	8,533	20,807
Staff related payables	18,625	21,798
Interest payable	5,827	5,610
Dividends payable	2,133	2,172
	44,021	68,500

16 EQUITY

Share capital
The Bank's authorised share capital as of 31 December 2011 comprised 1 billion shares of US$ 0.25 each (31 December 2010: 1 billion shares of US$ 0.25 each).

The issued and fully paid up share capital as of 31 December 2011 comprised 834,560,885 shares of US$ 0.25 each (31 December 2010: 832,935,594 shares of US$ 0.25 each). The increase is due to exercise of share options by employees under the Employee Share Option Plan.

Treasury shares and treasury shares reserve
At 31 December 2011, the Bank held 11,056,255 treasury shares (31 December 2010: 11,056,255 shares). These treasury shares do not carry any voting rights and are not entitled to dividends. The net gain or loss on reissuance of treasury shares is taken to treasury share reserve in the consolidated statement of changes in equity and is not available for distribution. The value of treasury shares based on the last bid price as of 31 December 2011 was US$ 8.2 million (31 December 2010: US$ 14.7 million).

Share premium
Share premium represents a non-distributable reserve arising from the exercise of the Bank's Employee Share Option Plan. The reserve is credited with the difference between the proceeds from the exercise of share options and the par value of the shares issued under the plan.

Statutory reserve
In accordance with the Bahrain Commercial Companies Law and the Bank's articles of association, 10% of the profit for the year is transferred to a statutory reserve until such time as the reserve reaches 50% of the Bank's paid-up share capital. The reserve is not available for distribution, except in circumstances as stipulated in the Bahrain Commercial Companies Law and following the approval of the Central Bank of Bahrain.

16 EQUITY (continued)

General reserve
The Directors have approved a transfer of 10% (31 December 2010: 10%) of the profit of the Group for the year to general reserve in accordance with the Bank's Articles of Association. The transfer is subject to shareholders' approval at the forthcoming Annual General Meeting. The general reserve is distributable subject to the approval of the Central Bank of Bahrain.

Dividend paid
In 2010, the Bank paid a final dividend for 2009 of US cents 1.25 per issued share for a total amount of US$ 10,249 thousand. No dividend was proposed for 2010.

Foreign currency translation reserve
The foreign currency translation reserve represents the net foreign exchange gain (loss) arising from translating the financial statements of the Bank's foreign subsidiaries and associated companies from their functional currencies into United States Dollars.

17 FAIR VALUE RESERVE

	2011 US$ 000	2010 US$ 000
Non-trading investments		
Balance at 1 January	(11,522)	(18,018)
Transferred to consolidated statement of income upon:		
• sale related to continuing operations (note 18)	(30,478)	(3,239)
• sale related to the disposal group	-	(802)
• impairment (note 6)	23,961	13,499
Net movement in unrealised fair value during the year	7,349	(2,962)
Balance at 31 December	(10,690)	(11,522)
Cash flow hedges		
Balance at 1 January	(9,852)	(12,948)
Net movement in the fair values during the year	7,010	3,096
Balance at 31 December	(2,842)	(9,852)
	(13,532)	(21,374)

18 INVESTMENT INCOME

	2011 US$ 000	2010 US$ 000
Gain on acquisition of an associate	-	69,661
Loss on dilution of investment in an associate	-	(31,421)
Gain on investments carried at fair value through statement of income	4,814	11,945
Dividend income	11,785	9,702
Gain on sale of disposal group	-	43,850
Gain on sale of an associate	5,344	117
Gain on sale of available-for-sale investments (note 17)	30,478	3,239
Rental income from investment properties	307	612
Gain (loss) on sale of investment properties	117	(35)
Others	762	832
	53,607	108,502

Gain on sale of available-for-sale investments includes a loss of US$ 1.1 million (31 December 2010: gain of US$ 1.06 million) on the sale of securities with a carrying value of US$ 76.3 million (31 December 2010: US$ 0.5 million) that were carried at cost.

Notes to the Consolidated Financial Statements

At 31 December 2011

19 INTEREST INCOME

	2011 US$ 000	2010 US$ 000
Placements with banks	555	1,254
Loans and receivables	6,785	4,466
Non-trading investments	5	6,845
Demand and call deposits with banks	20	134
	7,365	12,699

20 FEES AND COMMISSIONS

	2011 US$ 000	2010 US$ 000
Management fees from fiduciary activities	13,316	26,913
Advisory fees	2,179	3,564
Credit related fees, commissions and other income	1,524	16
	17,019	30,493

21 SHARE OF RESULTS OF ASSOCIATES AND JOINT VENTURES ACCOUNTED FOR UNDER THE EQUITY METHOD - NET

	2011 US$ 000	2010 US$ 000
Al-Dhiyafa Holding Company K.S.C. (closed)	(300)	(352)
Al Sharq Financial Brokerage Company	69	345
Dhow Development Company	-	-
Burgan Bank	33,771	4,539
KAMCO Energy Service Fund	(2,628)	-
Kuwait Private Equity Opportunities Fund	(2,524)	(1,202)
Manafae Investment Company	(2,419)	(642)
Millennium Private Equity Limited	-	(1,906)
North Africa Holding Company	(5,774)	(2,651)
Overland Real Estate Company	(1,091)	-
Royal Capital Company P.S.C.	(987)	(764)
SSH Dar International W.L.L.	(708)	1,284
Syria Gulf Bank	1,560	(1,129)
Takaud Savings and Pensions B.S.C. (c)	-	-
United Capital Transport Company	4,492	-
United Industries Company	1,495	6,372
United Network Company	(317)	179
United Real Estate Company	7,117	5,602
United Real Estate Company - Syria	-	-
United Real Estate Company - Jordan	(51)	(333)
United Universal Real Estate Company	-	50
Kuwait Education Fund	-	(210)
	31,705	9,182

22 INTEREST EXPENSE

	2011 US$ 000	2010 US$ 000
Loans payable	38,269	23,446
Due to banks and other financial institutions	5,641	10,032
Subordinated debt	2,209	1,941
Deposits from customers	5,306	9,326
Bonds	2,145	4,517
	53,570	49,262

23 PROFIT FROM DISCONTINUED OPERATIONS

Pursuant to a master transfer agreement [MTA] with Burgan Bank, a related party, the Group had, at 31 December 2008, classified two subsidiaries Gulf Bank Algeria [GBA] and Tunis International Bank [TIB] and an associated company, Bank of Baghdad [BOB] as assets held for sale (disposal group) in accordance with IFRS 5. Subsequently, the transfers of GBA and BOB were completed in March 2009.

On 29 June 2010, the Bank transferred the ownership of TIB to Burgan Bank for a total consideration of US$ 120,000 thousand to conclude the transfer of disposal group to Burgan Bank as per the MTA.

The results of disposal group are as follows:

	Period from 1 January 2010 to 29 June 2010 US$ 000
Investment income	1,983
Interest income	3,412
Fees and commissions	1,574
Foreign currency translation gains - net	2,109
Share of results of associates forming part of discontinued operations	
Gulf Bank Algeria	2,585
Bank of Baghdad	-
Total income	11,663
Interest expense	(959)
Operating income before expenses and provisions	10,704
Salaries and benefits	(1,812)
General and administrative expenses	(2,331)
Operating income before provisions	6,561
Provision for doubtful loans, guarantees and other assets - net	(475)
Net profit from discontinued operations	6,086
Earnings per share from discontinued operations	
Basic earnings per share (US cents)	0.39
Diluted earnings per share (US cents)	0.39

Notes to the Consolidated Financial Statements

24 EARNINGS PER SHARE

Basic

Basic earnings per share is calculated by dividing the profit attributable to the equity shareholders of the Bank by the weighted average number of shares outstanding during the year as follows:

	2011 US$ 000	2010 US$ 000
Profit attributable to equity shareholders of the Bank	1,471	38,657
Weighted average number of shares outstanding during the year (in thousands)	822,873	821,106
Basic earnings per share (US cents)	0.18	4.71

Diluted

Diluted earnings per share is calculated by dividing the income attributable to the equity shareholders of the Bank, adjusted for the effect of conversion of employees' share options, by the weighted average number of ordinary shares outstanding during the year plus the weighted average number of ordinary shares that would be issued on the conversion of all employees' share options. The Bank has outstanding share options, issued under the Employee Stock Options Plan, which have a dilutive effect on earnings.

	2011 US$ 000	2010 US$ 000
Profit attributable to equity shareholders of the Bank	1,471	38,657
Weighted average number of shares outstanding during the year (in thousands)	822,873	821,106
Effect of dilutive potential ordinary shares:		
Share options (in thousands)	304	736
	823,177	821,842
Diluted earnings per share (US cents)	0.18	4.70

25 FUNDS UNDER MANAGEMENT

At 31 December 2011, the Group holds assets amounting to US$ 7,070 million (31 December 2010: US$ 8,006 million) under its management on behalf of third parties. As these are third party funds managed in a fiduciary capacity, without risk or recourse to the Group, these are not included in assets in the consolidated statement of financial position.

26 CASH AND CASH EQUIVALENTS

	2011 US$ 000	2010 US$ 000
Demand and call deposits with banks	17,857	27,914
Placements with original maturities of ninety days or less	101,963	167,204
	119,820	195,118

27 SEGMENTAL INFORMATION

Following the management approach of IFRS 8, operating segments are reported in accordance with the internal reporting provided to the Acting Chief Executive Officer (the chief operating decision-maker), who is responsible for allocating resources to the reportable segments and assessing their performance. All operating segments reported by the Group meet the definition of a reportable segment under IFRS 8.

For management purposes, the Group is organised into business units based on the nature of their operations and services. The Group has two reportable operating segments being 'asset management and investment banking' and 'commercial banking'.

Asset management and investment banking	Undertaking asset portfolio management, corporate finance, advisory, investments in quoted and private equity/funds, real estate, capital markets, international banking and treasury activities.
Commercial banking	Loans and other credit facilities, deposit and current accounts from corporate and institutional customers.

27 SEGMENTAL INFORMATION (continued)

Management monitors the operating results of its business units separately for the purpose of making decisions about resource allocation and performance assessment. Transactions between segments are generally recorded at estimated market rates.

Segmental information relating to the Group's continuing and discontinued operations for the year ended 31 December 2011 was as follows:

Statement of income	Asset management and investment banking US$ 000	Commercial banking US$ 000	Eliminations US$ 000	Total US$ 000
Income from external customers	76,840	-	-	76,840
Share of results of associates and joint ventures accounted for using the equity method	(3,626)	35,331	-	31,705
Total income	73,214	35,331	-	108,545
Operating income before provisions	21,325	-	-	21,325
Impairment loss on investments	(23,961)	-	-	(23,961)
Write-back of (provision for) doubtful loans, guarantees and other assets - net	(398)	-	-	(398)
Profit for the year	(3,034)	-	-	(3,034)
Income attributable to equity shareholders of the parent				1,471
Loss attributable to non-controlling interests				(4,505)
				(3,034)
Statement of financial position				
Investments in associates and joint ventures accounted for under equity method	539,158	463,782	-	1,002,940
Segment assets	1,306,722	463,782	-	1,770,504
Segment liabilities	1,167,350	-	-	1,167,350

Segmental information for the year ended 31 December 2010 was as follows:

Statement of income	Asset management and investment banking US$ 000	Commercial banking* US$ 000	Eliminations US$ 000	Total US$ 000
Income from external customers	154,066	9,078	-	163,144
Share of results of associates and joint ventures accounted for using equity method	5,772	5,995	-	11,767
Total income	159,838	15,073	-	174,911
Operating income before provisions	65,433	6,561	-	71,994
Impairment loss on investments	(29,280)	-	-	(29,280)
Write back of (provision for doubtful), loans, guarantees and other assets - net	149	(475)	-	(326)
Profit for the year	36,302	6,086	-	42,388
Income attributable to equity shareholders of the parent				38,657
Profit attributable to non-controlling interests				3,731
				42,388

27 SEGMENTAL INFORMATION (continued)

Statement of financial position	Asset management and investment banking US$ 000	Commercial banking* US$ 000	Eliminations US$ 000	Total US$ 000
Investments in associates and joint venture accounted for under equity method	582,332	443,733	-	1,026,065
Segment assets	1,473,352	443,733	-	1,917,085
Segment liabilities	1,316,311	-	-	1,316,311

* Includes income (loss) on assets held as disposal group.

Geographical segments

The Group operates in five geographic markets: Domestic region (G.C.C.*), Middle East and North Africa, Europe, North America and others. The following table shows the distribution of the Group's total income and non-current assets by geographical segment, allocated based on the location of the customers and assets for the years ended 31 December 2011 and 2010:

31 December 2011	G.C.C. US$ 000	Middle East and North Africa US$ 000	Europe US$ 000	North America US$ 000	Others US$ 000	Total US$ 000
Total income (loss)	73,192	(1,187)	7,282	29,258	-	108,545
Non-current assets	1,240,722	21,369	27,831	179,511	-	1,469,433
31 December 2010						
Total income	110,057	54,902	4,323	5,548	81	174,911
Non-current assets	1,239,146	108,311	29,528	69,366	-	1,446,351

* The Gulf Co-operation Council (G.C.C.) countries are Kingdom of Bahrain, State of Kuwait, Kingdom of Saudi Arabia, State of Qatar, the United Arab Emirates and the Sultanate of Oman.

28 RELATED PARTY TRANSACTIONS

Related parties represent the parent, associates and joint ventures, directors and key management personnel and entities which are controlled, jointly controlled or significantly influenced by any of the above mentioned parties.

The income and expenses in respect of related parties transactions during the year and included in the consolidated financial statements are as follows:

28 RELATED PARTY TRANSACTIONS (continued)

	2011			
	Parent US$ 000	Associates and joint ventures US$ 000	Other related parties US$ 000	Total US$ 000
Loss on investments carried at fair value through statement of income, net	-	(81)	(83)	(164)
Gain on sale of non-trading investments	-	-	23,136	23,136
Gain on sale of an associate	-	4,757	-	4,757
Fees and commissions	2,604	359	8,222	11,185
Dividend income	5	-	3	8
Interest income	1	971	842	1,814
Interest expense	(3,795)	(8,688)	(2,229)	(14,712)
Others	-	-	759	759
Sales transactions				
Investments carried at fair value through statement of income	-	14,655	-	14,655
Non-trading investments	-	83,240	45,000	128,240
Investments in associated companies	-	63,811	-	63,811
Purchase transactions				
Non-trading investments	88,021	-	45,000	133,021
Investments in associated companies	-	1,157	4,111	5,268

	2010			
	Parent US$ 000	Associates and joint ventures US$ 000	Other related parties US$ 000	Total US$ 000
Gain on investments carried at fair value through statement of income, net	148	2,610	949	3,707
Gain on acquisition of an associate	-	-	69,661	69,661
Loss on sale of non-trading investments	(1)	-	(1,490)	(1,491)
Gain on sale of disposal group	-	-	43,850	43,850
Gain on sale of an associate	109	8	-	117
Fees and commissions	8,061	7,238	7,910	23,209
Dividend income	8	227	1,634	1,869
Interest income	-	8,444	1,157	9,601
Interest expense	(8,637)	(10,350)	(1,413)	(20,400)
Others	-	477	642	1,119
Sales transactions				
Investments in associated companies	-	-	38,453	38,453
Disposal group	-	120,000	-	120,000
Purchase transactions				
Non-trading investments	-	-	18,904	18,904
Investments in associated companies	220,978	-	-	220,978

28 RELATED PARTY TRANSACTIONS (continued)

The year-end balances in respect of related parties included in the consolidated financial statements are as follows:

	2011			
	Parent US$ 000	Associates and joint ventures US$ 000	Other related parties US$ 000	Total US$ 000
Demand and call deposits with banks	-	9,446	536	9,982
Placements with banks	-	1,077	9,827	10,904
Investments, carried at fair value through statement of income	1,752	2,046	2,536	6,334
Investments, carried at fair value through statement of income, in funds managed by related party	-	-	12,036	12,036
Non-trading investments	-	-	12,378	12,378
Loans and receivables	-	2,741	8,849	11,590
Other assets	995	19,812	7,771	28,578
Due to banks and other financial institutions	-	(130,687)	(20,105)	(150,792)
Deposits from customers	(183)	(12)	(61,824)	(62,019)
Loans	-	(355,629)	-	(355,629)
Other liabilities	-	(4,886)	(3,652)	(8,538)
Off statement of financial position items:				
Letters of credit	-	500	18,485	18,985
Letters of guarantee	-	18,309	32,642	50,951
Funds managed or advised by the Group (including funds under management)	-	-	74,155	74,155

	2010			
	Parent US$ 000	Associates and joint ventures US$ 000	Other related parties US$ 000	Total US$ 000
Demand and call deposits with banks	-	12,310	111	12,421
Placements with banks	-	7,119	4,889	12,008
Investments, carried at fair value through statement of income	1,592	-	16,712	18,304
Investments, carried at fair value through statement of income, in funds managed by related party	-	-	11,967	11,967
Non-trading investments	-	-	63,148	63,148
Loans and receivables	-	31,822	2,755	34,577
Other assets	895	21,075	11,776	33,746
Due to banks and other financial institutions	-	(227,400)	(25,331)	(252,731)
Deposits from customers	(40,708)	(71,201)	(19,672)	(131,581)
Loans	-	(114,556)	-	(114,556)
Other liabilities	(229)	(1,002)	(2,007)	(3,238)
Off statement of financial position items:				
Letters of credit	-	500	20,275	20,775
Letters of guarantee	-	356	18,733	19,089
Funds managed or advised by the Group (including funds under management)	-	-	81,546	- 81,546

28 RELATED PARTY TRANSACTIONS (continued)

Compensation of key management personnel was as follows:

	2011 US$ 000	2010 US$ 000
Short term employee benefits	8,792	11,502
Share based payments	33	1,176
Total compensation	8,825	12,678

29 COMMITMENTS AND CONTINGENCIES

Credit-related commitments

Credit-related commitments include commitments to extend credit, standby letters of credit, guarantees and acceptances which are designed to meet the requirements of the Group's customers.

Letters of credit, guarantees (including standby letters of credit) and acceptances commit the Group to make payments on behalf of customers if certain conditions are met under the terms of the contract.

The Group has the following credit and investment related commitments:

	2011 US$ 000	2010 US$ 000
Credit related		
Letters of credit	18,984	20,775
Letters of guarantee	50,951	19,089
	69,935	39,864
Investment related *	122,182	86,349
	192,117	126,213

* Investment related commitments represent commitments for capital calls of fund structures. These commitments can be called during the investment period of the fund which is normally 1 to 5 years.

30 DERIVATIVES

In the ordinary course of business the Group enters into various types of transactions that involve derivative financial instruments.

				Notional amounts by term to maturity		
31 December 2011	Positive fair value US$ 000	Negative fair value US$ 000	Notional amount Total US$ 000	Within 3 months US$ 000	3 - 12 months US$ 000	1 - 5 years US$ 000
Derivatives held for trading *						
Forward foreign exchange contracts	3,454	(3,104)	300,534	131,444	82,882	86,208
Derivatives used as hedge of net investments in foreign operations						
Forward foreign exchange contracts	1,887	(120)	847,225	656,944	46,796	143,485
Cross currency swaps	-	(6,412)	406,411	-	406,411	-
Derivatives used as cash flow hedges						
Interest rate swap	-	(2,842)	200,000	100,000	100,000	-

30 DERIVATIVES (continued)

31 December 2010	Positive fair value US$ 000	Negative fair value US$ 000	Notional amount Total US$ 000	Notional amounts by term to maturity: Within 3 months US$ 000	3 - 12 months US$ 000	1 - 5 years US$ 000
Derivatives held for trading *						
Forward foreign exchange contracts	2,213	(2,085)	334,184	210,326	123,858	-
Derivatives used as hedge of net investments in foreign operations						
Forward foreign exchange contracts	47	(1,060)	801,344	770,109	31,235	-
Cross currency swaps	-	(4,648)	404,648	-	-	404,648
Derivatives used as cash flow hedges						
Interest rate swap	-	(9,852)	300,000	-	-	300,000

Forward foreign exchange contracts are contractual agreements to either buy or sell a specified currency, at a specific price and date in the future, and are customised contracts transacted in the over-the-counter market.

* The Group uses foreign currency denominated borrowings and forward currency contracts to manage some of its transaction exposures. These currency forward contracts are not designated as cash flow, fair value or net investment in foreign operations hedges and are entered into for periods consistent with currency transaction exposures.

Swaps are contractual agreements between two parties to exchange interest or foreign currency differentials based on a specific notional amount. For interest rate swaps, counterparties generally exchange fixed and floating rate interest payments based on a notional value in a single currency.

Hedge of net investments in foreign operations

The Bank has designated certain forward foreign exchange contracts and cross currency swaps to hedge against changes in the value of investments in associated companies for an amount of US$ 658.8 million (KWD 183.5 million) [2010: US$ 621 million (KWD 174.5 million)]. Gains or losses on the retranslation of these forward foreign exchange contracts are transferred to equity through other comprehensive income to offset any gains or losses on the translation of the net investments in associates.

Cash flow hedges

The Group is exposed to variability in interest cash flows on liabilities which bear interest at a variable rate. The Group uses interest rate swaps as cash flow hedges of these interest rate risks. A schedule indicating as at 31 December 2011 the periods when the net cash flows are expected to occur and when they are expected to affect the consolidated statement of income is as follows:

	2011 Within 1 year US$ 000	2011 1-5 years US$ 000	2010 Within 1 year US$ 000	2010 1-5 years US$ 000
Net cash outflows (Liabilities)	1,926	-	7,545	9,980
Statement of income	(2,842)	-	-	(9,852)

31 RISK MANAGEMENT

a) Introduction

Risk is inherent in the Group's activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is considered critical to the Group's continuing profitability.

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

The major risks to which the Group is exposed while conducting its business and operations, and the means and organisational structure it employs to manage them strategically for building shareholder value, are outlined below.

31 RISK MANAGEMENT (continued)

a) Introduction (continued)

Risk management structure

Each subsidiary within the Group is responsible for managing its own risks and has its own Board Committees, including Audit and Executive Committees in addition to other management committees such as Credit/ Investment Committee and (in the case of major subsidiaries) Asset and Liability Committees (ALCO), or equivalent, with responsibilities generally the same as the Bank's committees.

The Board's role is to approve investment strategies of the Bank. However, it has delegated authority for the day-to-day decision making to the Executive Committee so that risk can be effectively managed within the Bank.

The Board of Directors has delegated the Executive Management of the Bank to the Acting Chief Executive Officer (who is not a Director) and has appointed several Board Committees to work with him and to form and define policies and approve procedures for all of the Bank's activities.

The Executive Management of the Bank is headed by the Acting Chief Executive Officer who is broadly responsible for the day to day conduct of the Bank's business in line with the Board's approved policies and procedures and complements and facilitates the Board in meeting its responsibility towards all stakeholders. He is assisted by the seven members of the Bank's management team, each of whom is responsible for his or her respective department. Several management committees have been formed which are chaired by the Acting Chief Executive Officer.

Executive Committee
The Executive Committee comprises of four directors including the Chairman, Vice Chairman and two other directors. Board meetings are held through circulation to approve all proposals not within the Investment Committee's risk authority, as well as to act on all matters within the Board's remit.

Investment Committee
The Investment Committee is mainly responsible for approving or recommending approval to the Executive Committee limits for individual exposures, investments and concentrations towards banks, countries, industries, risk rating classes, or other special risk asset categories. In addition, the Committee also monitors the overall risk profile of the Bank and recommends provision levels to the Executive Committee. The Investment Committee is constituted by a majority motion passed in the Executive Committee. Currently the Committee consists of four members.

Audit Committee
The Audit Committee is appointed by the Board and consists of three members who are Directors, including one non-executive Director. The Board Audit Committee assists the Board in carrying out its responsibilities with respect to assessing (a) the quality and integrity of financial reporting, (b) the audit thereof, (c) the soundness of the internal controls of the Bank, (d) the risk assessment of the Bank's activities, and (e) the methods for monitoring compliance with laws, regulations and supervisory and internal policies.

Risk and Compliance Committee
The Risk and Compliance Committee is responsible for the monitoring and assessment of risks facing the Bank, the review of compliance with internal and external guidelines, the review and recommendation of provisioning requirements, the assessment of the impact on the Bank from new regulatory requirements, and review of Investment Committee decisions. The Committee comprises of eight senior executives of the Bank including the Acting Chief Executive Officer. Additionally, the Head of Internal Audit and Quality Assurance participates in the Committee meetings in the capacity of an observer.

Asset and Liability Committee
The Asset and Liability Committee establishes policies and objectives for the asset and liability management of the Bank's statement of financial position in terms of structure, distribution, risk and return and its impact on profitability. It also monitors the cash flow, tenor and cost/yield profiles of assets and liabilities and evaluates the Bank's financial position both from interest rate sensitivity and liquidity points of view, making corrective adjustments based upon perceived trends and market conditions, monitoring liquidity, monitoring foreign exchange exposures and positions. The Committee comprises of seven senior executives of the Bank including the Acting Chief Executive Officer.

31 RISK MANAGEMENT (continued)

a) Introduction (continued)

Risk management structure (continued)

Management Committee

The Management Committee acts as the steering committee of the Bank as well as a management forum to discuss any relevant issues. It meets on a weekly basis and consists of the Acting Chief Executive Officer and all Department Heads as well as Internal Audit and Quality Assurance. It also serves to follow up on a weekly basis on the daily conduct of the Bank's business activities. The Committee is headed by the Acting Chief Executive Officer.

Insider Trading Committee

The Insider Trading Committee comprises three members constituted from the Board of Directors and the Acting Chief Executive Officer as the alternate member. The Committee is mainly responsible for the supervision of adequacy of compliance with the Central Bank of Bahrain guidelines on insider trading.

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

On 15 March 2011, the Ministry of Commerce and Industry of the Kingdom of Bahrain introduced a Corporate Governance Code (the Code) applicable to the Group. The Code is based upon nine core Principles of Corporate Governance that adhere to international best practices. The Code includes recommendations to apply the Principles, as well as recommendations which support the implementation of good corporate governance. The Code is issued in a "comply or explain" framework, which means companies should comply with the recommendations, or give an explanation in the case of non-compliance.

The Central Bank of Bahrain also adopted the Code and incorporated the principles in its rulebook for all locally incorporated banks. The effective date of implementation of the Code is 31 December 2011. Accordingly, during the year, significant efforts were made by the Group to further enhance its Corporate Governance practices; an additional 16 policies and procedures pertaining to Corporate Governance were approved. The overall Committee structure was also reviewed. The Directors endorsed the creation of the Nominating & Remunerations Committee, which will be a permanent committee of the Board. The CBB's approval to appoint independent Directors was received in December 2011. Consequently, this committee will be constituted after the election of independent Directors, at the next Annual General Meeting. The Board Audit Committee's scope has been expanded to include the implementation and subsequent review of the Corporate Governance requirements.

Risk mitigation

As part of its overall risk management, the Group uses derivatives and other instruments to manage exposures resulting from changes in interest rates and foreign currency transactions.

The risk profile is assessed before entering into hedge transactions, which are authorised by the appropriate level of seniority within the Group.

Where warranted, the Group enters into legally enforceable netting arrangements covering its money market and foreign exchange trading activities whereby the only net amounts may be settled at maturity. With regard to the credit risk in the off statement of financial statement exposures, third party guarantees are obtained wherever possible as a risk mitigation measure.

Concentration risk

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

In order to avoid excessive concentrations of risk, the Group's policies and procedures include specific guidelines to focus on country and counterparty limits and maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly. Robust limit structures put in place by the Board ensures effective monitoring and control of concentration risk and any limit breaches are immediately rectified and reported to the Board.

31 RISK MANAGEMENT (continued)

b) Credit risk

Credit risk arises from the extension of credit facilities in the Group's banking and trading activities as well as in investment activities where there is a possibility that a counterparty may fail to honour its commitment whenever an investment may fail.

Credit risk is mitigated through:

(i) Establishing an appropriate credit risk environment;
(ii) Operating under a sound credit and investment approval process;
(iii) Maintaining appropriate credit administration, measurement and monitoring processes; and
(iv) Ensuring adequate controls over the credit risk management process.

The Group has well defined policies approved at the individual board level. These provide carefully documented guidelines for credit risk management. There is a two tier committee structure to approve and review credit and investment risk. The Investment Committee (IC) comprises of the Acting Chief Executive Officer, Head of Investment Banking and Asset Management and the Chief Financial Officer. The Head of Credit and Risk Management acts as a non-voting member to the Committee. Exposures beyond IC limits are approved by the Board's Executive Committee or by the full Board.

Maximum exposure to credit risk without taking account of any collateral or other credit enhancements

The table below shows the Group's maximum exposure to credit risk for the components of on and off statement of financial position exposure. The maximum exposure shown is gross before the effect of mitigation through the use of master netting and collateral arrangements, but after any provision for impairment.

	2011 US$ 000	2010 US$ 000
Demand and call deposits with banks	17,857	27,914
Placements with banks	102,282	167,257
Non-trading investments	13,153	10,449
Loans and receivables	27,942	57,920
Other assets	31,948	43,538
Letters of credit	18,984	20,775
Letters of guarantee	50,951	19,089
Derivative financial assets	5,341	2,260
	268,458	349,202

Risk concentrations of the maximum exposure to credit risk

Concentration of risk is managed by client/counterparty, by geographical region and by industry sector. The maximum credit exposure to any single client or counterparty as of 31 December 2011 was US$ 52.5 million (31 December 2010: US$ 50 million) before taking account of collateral or other credit enhancements.

An analysis of the Group's financial assets by geographical region, before taking into account collateral held or other credit enhancements, is as follows:

31 RISK MANAGEMENT (continued)

b) Credit risk (continued)

Risk concentrations of the maximum exposure to credit risk (continued)

	G.C.C. US$ 000	Middle East and North Africa US$ 000	Europe US$ 000	North America US$ 000	Others US$ 000	Total US$ 000
Demand and call deposits with banks	14,471	529	277	2,261	319	17,857
Placements with banks	92,406	9,876	-		-	102,282
Non-trading investments	13,153	-	-	-	-	13,153
Loans and receivables	4,678	2,742	16,514	4,008	-	27,942
Other assets	27,341	4,303	14	288	2	31,948
Letters of credit	18,484	500	-	-	-	18,984
Letters of guarantee	50,951	-	-	-	-	50,951
Derivative financial assets	1,393	-	3,948	-	-	5,341
31 December 2011	222,877	17,950	20,753	6,557	321	268,458
Demand and call deposits with banks	22,345	4,026	349	990	204	27,914
Placements with banks	132,367	-	30,000	4,890	-	167,257
Non-trading investments	10,449	-	-	-	-	10,449
Loans and receivables	31,934	-	23,268	2,718	-	57,920
Other assets	40,421	39	34	3,041	3	43,538
Letters of credit	20,275	500	-	-	-	20,775
Letters of guarantee	19,089	-	-	-	-	19,089
Derivative financial assets	-	102	2,158	-	-	2,260
31 December 2010	276,880	4,667	55,809	11,639	207	349,202

An industry sector analysis of the Group's financial assets, before taking into account collateral held or other credit enhancements, is as follows:

At 31 December 2011	Trading and manufacturing US$ 000	Banks and other financial institutions US$ 000	Construction and real estate US$ 000	Individuals US$ 000	Others US$ 000	Total US$ 000
Demand and call deposits with banks	-	17,857	-	-	-	17,857
Placements with banks	-	102,282	-	-	-	102,282
Non-trading investments	-	13,153	-	-	-	13,153
Loans and receivables	-	3,008	2,740	19,019	3,175	27,942
Other assets	-	5,898	-	18	26,032	31,948
Letters of credit	-	500	-	-	18,484	18,984
Letters of guarantee	-	18,309	-	-	32,642	50,951
Derivative financial assets	-	5,341	-	-	-	5,341
	-	166,348	2,740	19,037	80,333	268,458

31 RISK MANAGEMENT (continued)

b) Credit risk (continued)

Risk concentrations of the maximum exposure to credit risk (continued)

At 31 December 2010	Trading and manufacturing US$ 000	Banks and other financial institutions US$ 000	Construction and real estate US$ 000	Individuals US$ 000	Others US$ 000	Total US$ 000
Demand and call deposits with banks	-	27,914	-	-	-	27,914
Placements with banks	-	167,257	-	-	-	167,257
Non-trading investments	-	10,449	-	-	-	10,449
Loans and receivables	-	-	30,822	25,100	1,998	57,920
Other assets	5,676	7,651	20,410	4,619	5,182	43,538
Letters of credit	-	500	-	-	20,275	20,775
Letters of guarantee	-	356	-	-	18,733	19,089
Derivative financial assets	-	2,260	-	-	-	2,260
	5,676	216,387	51,232	29,719	46,188	349,202

Collateral and other credit enhancements

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are implemented regarding the acceptability of types of collateral and valuation parameters.

The main types of collateral obtained for commercial lending include charges over real estate properties, inventory, trade receivables, trading securities and bank guarantees.

The Group also obtains guarantees from parent companies for loans to their subsidiaries.

Management monitors the market value of collateral and requests additional collateral in accordance with the underlying agreement, during its review of the adequacy of the allowance for impairment losses.

An industry sector analysis of the Group's gross loans and advances, before and after taking into account collateral held or other credit enhancements, is as follows:

	Gross maximum exposure 2011 US$ 000	Net maximum exposure 2011 US$ 000	Gross maximum exposure 2010 US$ 000	Net maximum exposure 2010 US$ 000
Commercial loans	27,365	10,851	57,376	34,596
Overdrafts	-	-	488	488
Staff loans	3,306	-	2,762	-
	30,671	10,851	60,626	35,084

31 RISK MANAGEMENT (continued)

b) Credit risk (continued)

Credit risk exposure for each credit rating

	Investment grade US$ 000	Non-investment grade US$ 000	Unrated US$ 000	Total US$ 000
At 31 December 2011				
Demand and call deposits with banks	16,929	388	540	17,857
Placements with banks	92,405	5,000	4,877	102,282
Non-trading investments	-	-	13,153	13,153
Loans and receivables	-	-	27,942	27,942
Other assets	-	-	31,948	31,948
Letters of credit	-	-	18,984	18,984
Letters of guarantee	359	-	50,592	50,951
Derivative financial assets	5,341	-	-	5,341
	115,034	5,388	148,036	268,458
At 31 December 2010				
Demand and call deposits with banks	27,651	177	86	27,914
Placements with banks	162,367	-	4,890	167,257
Non-trading investments	872	9,577	-	10,449
Loans and receivables	-	-	57,920	57,920
Other assets	2,968	1,525	39,045	43,538
Letters of credit	-	-	20,775	20,775
Letters of guarantee	-	-	19,089	19,089
Derivative financial assets	2,260	-	-	2,260
	196,118	11,279	141,805	349,202

It is the Group's policy to maintain accurate and consistent risk ratings across the credit portfolio. This facilitates focused management of the applicable risk and the comparison of credit exposures across all business lines, geographic regions and products. All externally rated credit risk exposures are rated by the relevant External Credit Assessment Institutions ("ECAIs").

Additionally, the internal risk ratings of the Group's externally unrated credit risk exposures which are largely subjective, are tailored to the various categories and are derived in accordance with the internal rating policy and practices. The attributable internal risk ratings are assessed and updated on a regular basis.

The table above reflects the risk ratings of the credit risk exposures rated by the relevant ECAIs. All of the externally unrated credit risk exposures have been classified under "Unrated" category.

Renegotiated loans

Where possible, the Group seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, the loan is no longer considered past due. The Group had no renegotiated loans as of 31 December 2011 or 31 December 2010.

c) Market risk

Market risk is defined as the risk of losses in the value of on-or-off statement of financial position financial instruments caused by a change in market prices or rates, (including changes in interest rates and foreign exchange rates). The Group's policy guidelines for market risk have been vetted by the Board of Directors in compliance with the rules and guidelines provided by the Central Bank of Bahrain. The Central Bank of Bahrain guidelines introduced a risk measurement framework whereby all locally incorporated banks in Bahrain are required to measure and apply capital charges in respect of their market risk in addition to capital requirements for credit risk and operational risk.

31 RISK MANAGEMENT (continued)

c) Market risk (continued)

The market risk subject to capital charge normally arises from changes in value due to market forces in the following exposures:

- Interest rate instruments and securities in the trading book; and
- Foreign exchange throughout the banking book.

The Group has entered into interest rate swaps and forward foreign exchange contracts for hedging purposes and does not actively trade in derivatives.

Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments. Positions are monitored on a daily basis and hedging strategies are used to ensure positions are maintained within the established limits.

The following table demonstrates the sensitivity to a reasonably possible change in interest rates, with all other variables held constant, of the Group's consolidated statement of income based on the consolidated statement of financial position as of 31 December:

Currency	Increase in basis points 2011	Sensitivity of net interest income 2011 US$ 000	Increase in basis points 2010	Sensitivity of net interest income 2010 US$ 000
Kuwaiti Dinar	+ 25	(954)	+ 25	(1,165)
United States Dollar	+ 25	(830)	+ 25	(442)
Euro	+ 25	(13)	+ 25	(46)
Pound Sterling	+ 25	1	+ 25	(1)
Others	+ 25	(114)	+ 25	(44)

The decrease in the basis points will have an opposite impact on the net interest income.

The sensitivity of the consolidated statement of income is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate financial assets and financial liabilities held at 31 December 2011, including the effect of hedging instruments.

Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Group considers the United States Dollar as its functional currency. Positions are monitored on a daily basis and hedging strategies used to ensure positions are maintained within established limits.

The table below indicates the effect on profit before tax for the positions as at statement of financial position date as a result of change in the currency rate with all other variables held constant.

Currency	Change in currency rate in % 2011	Effect on profit before tax 2011 US$ 000	Effect on equity 2011 US$ 000	Change in currency rate in % 2010	Effect on profit before tax 2010 US$ 000	Effect on equity 2010 US$ 000
Kuwaiti Dinar	+2	(15,871)	2,719	+1	(10,431)	1,903
	-2	15,871	(2,719)	-1	10,431	(1,903)
Euro	+2	(303)	-	+1	(279)	223
	-2	303	-	-1	279	(223)
Jordanian Dinar	+2	-	-	+1	-	6
	-2	-	-	-1	-	(6)

31 RISK MANAGEMENT (continued)

c) Market risk (continued)

Equity price risk

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

The geographical distribution of the Group's equity investments is as follows:

Geographical distribution

At 31 December 2011	Middle East/ North Africa US$ 000	Europe US$ 000	North America US$ 000	Total US$ 000
Investments carried at fair value through statement of income				
Quoted equities	24,130	-	102	24,232
Managed funds	25,958	16,596	6,397	48,951
	50,088	16,596	6,499	73,183
Non-trading investments				
Quoted equities	43,395	-	-	43,395
Unquoted equities	51,952	22,973	6,780	81,705
Managed funds	119,365	4,859	172,496	296,720
	214,712	27,832	179,276	421,820
Total	264,800	44,428	185,775	495,003

At 31 December 2010	Middle East/ North Africa US$ 000	Europe US$ 000	North America US$ 000	Total US$ 000
Investments carried at fair value through statement of income				
Quoted equities	29,137	-	59	29,196
Managed funds	62,406	19,466	15,593	97,465
	91,543	19,466	15,652	126,661
Non trading investments				
Quoted equities	45,102	-	-	45,102
Unquoted equities	100,956	25,280	6,376	132,612
Managed funds	130,396	4,221	62,990	197,607
	276,454	29,501	69,366	375,321
Total	367,997	48,967	85,018	501,982

Any change in equity price index or the net asset values of the above financial instruments will have a direct impact on income or equity. The majority of the equities in the Middle East/North Africa region are quoted on the Kuwait Stock Exchange.

For unquoted investments carried at cost the impact of the changes in the equity prices will only be reflected in the consolidated statement of income when the investment is sold or deemed to be impaired.

31 RISK MANAGEMENT (continued)

d) Liquidity risk

Analysis of financial liabilities by remaining contractual maturities

The table below summarises the maturity profile of the Group's financial liabilities at 31 December 2011 based on contractual undiscounted repayment obligations. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Group expects that many customers will not request repayment on the earliest date the Group could be required to pay and the table does not reflect the expected cash flows indicated by the Group's deposit retention history.

At 31 December 2011	On demand US$ 000	1 - 6 months US$ 000	6 - 12 months US$ 000	1 - 5 years US$ 000	5 - 10 years US$ 000	Total US$ 000
Financial liabilities						
Due to banks and other financial institutions	197,614	15,063	251	-	-	212,928
Deposits from customers	22,556	56,783	1,411	-	-	80,750
Loans payable	8,094	56,688	211,621	525,614	-	802,017
Subordinated debt	-	-	-	114,834		114,834
Other liabilities	5,827	-	27,158	11,036	-	44,021
Total non-derivative undiscounted financial liabilities	234,091	128,534	240,441	651,484	-	1,254,550

	1 - 6 months US$ 000	6 - 12 months US$ 000	1 - 5 years US$ 000	Total US$ 000
Off statement of financial position items				
Net cash outflows on interest rate swaps	2,844	-	-	2,844
Gross settled foreign currency derivatives	918,065	406,412	229,693	1,554,170
Letters of credit	-	18,984	-	18,984
Letters of guarantee	-	50,951	-	50,951

31 RISK MANAGEMENT (continued)

d) Liquidity risk (continued)

At 31 December 2010	On demand US$ 000	1 - 6 months US$ 000	6 - 12 months US$ 000	1 - 5 years US$ 000	5 - 10 years US$ 000	Total US$ 000
Financial liabilities						
Due to banks and other financial institutions	193,066	209,582	35,757	-	-	438,405
Deposits from customers	128,557	5,938	-	10,937	-	145,432
Loans payable	47,337	206,478	33,611	227,224	-	514,650
Bonds	-	73,326	-	-	-	73,326
Subordinated debt	-	1,050	1,068	10,602	99,542	112,262
Other liabilities	5,610	25,826	-	8,704	-	40,140
Total non-derivative undiscounted financial liabilities	374,570	522,200	70,436	257,467	99,542	1,324,215

	1 - 6 months US$ 000	6 - 12 months US$ 000	1 - 5 years US$ 000	Total US$ 000
Off statement of financial position items				
Net cash outflows on interest rate swaps	-	7,545	9,980	17,525
Gross settled foreign currency derivatives	1,066,338	69,191	404,647	1,540,176
Letters of credit	-	20,775	-	20,775
Letters of guarantee	-	-	19,089	19,089

The Group expects that not all of contingent items or commitments will be drawn before expiry of the commitments.

31 RISK MANAGEMENT (continued)

d) Liquidity risk (continued)

In order to ensure that the Group can meet its financial obligations as they fall due, there is a close monitoring of its assets / liabilities position. Besides other functions, the Asset-Liability Committee evaluates the statement of financial position both from a liquidity and an interest rate sensitivity point of view. The whole process is aimed at ensuring sufficient liquidity to fund its ongoing business activities and to meet its obligations as they fall due. A diversified funding base has evolved in deposits raised from the interbank market, deposits received from customers and medium term funds raised through syndicated and commodity based murabaha transactions. These, together with the strength of its equity and the asset quality, ensure that funds are made available on competitive rates.

The maturity analysis of assets and liabilities analysed according to when they are expected to be recovered or settled are as follows:

At 31 December 2011	Less than 12 months US$ 000	Over 12 months US$ 000	Total US$ 000
Demand and call deposits with banks	17,539	318	17,857
Placements with banks	102,282	-	102,282
Investments carried at fair value through statement of income	73,183	-	73,183
Non-trading investments	43,395	391,633	435,028
Loans and receivables	27,181	761	27,942
Other assets	37,490	-	37,490
Investments in associates and joint ventures	-	1,002,940	1,002,940
Investment properties	-	16,054	16,054
Property and equipment	-	946	946
Goodwill	-	56,782	56,782
Total assets	301,070	1,469,434	1,770,504
Due to banks and other financial institutions	211,795	-	211,795
Deposits from customers	80,349	-	80,349
Loans payable	273,596	457,589	731,185
Subordinated debt	-	100,000	100,000
Other liabilities	32,985	11,036	44,021
Total liabilities	598,725	568,625	1,167,350
Net	(297,655)	900,809	603,154

31 RISK MANAGEMENT (continued)

d) Liquidity risk (continued)

At 31 December 2010	Less than 12 months US$ 000	Over 12 months US$ 000	Total US$ 000
Demand and call deposits with banks	27,861	53	27,914
Placements with banks	167,257	-	167,257
Investments carried at fair value through statement of income	126,661	-	126,661
Non-trading investments	45,102	340,668	385,770
Loans and receivables	56,922	998	57,920
Other assets	46,930	20	46,950
Investments in associates and joint venture	-	1,026,065	1,026,065
Investment properties	-	21,178	21,178
Property and equipment	-	1,074	1,074
Goodwill	-	56,296	56,296
Total assets	470,733	1,446,352	1,917,085
Due to banks and other financial institutions	200,624	235,000	435,624
Deposits from customers	128,889	10,679	139,568
Loans payable	283,180	218,252	501,432
Bonds	71,187	-	71,187
Subordinated debt	-	100,000	100,000
Other liabilities	59,796	8,704	68,500
Total liabilities	743,676	572,635	1,316,311
Net	(272,943)	873,717	600,774

e) Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. When controls fail to perform operational risk can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Group cannot expect to eliminate all operational risks, but through a control framework and by monitoring and responding to potential risks, the Group is able to manage the risks. Controls include effective segregation of duties, access, authorisation and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

32 FAIR VALUE OF FINANCIAL INSTRUMENTS

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

Fair values of quoted securities are derived from quoted market prices in active markets, if available. For unquoted securities, fair value is estimated using appropriate valuation techniques. Such techniques may include using recent arm's length market transactions; reference to the current fair value of another instrument that is substantially the same; discounted cash flow analysis or other valuation models.

The fair values of the funds that are listed on active markets are determined by reference to their quoted bid prices. The fair values of unlisted funds are based on net asset values which are determined by the fund manager using the quoted market prices of the underlying assets, if available, or other acceptable methods such as a recent price paid by another investor or the market value of a comparable company.

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

Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;

Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly; and

Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

32 FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

The following table shows an analysis of financial instruments recorded at fair value by level of the fair value hierarchy at 31 December 2011:

	Level 1 US$ 000	Level 2 US$ 000	Level 3 US$ 000	Total US$ 000
Investments carried at fair value through statement of income				
Quoted equities	24,232	-	-	24,232
Quoted managed funds	19,076	-	-	19,076
Unquoted managed funds	-	29,875	-	29,875
	43,308	29,875	-	73,183
Non-trading investments				
Quoted securities				
Equities	43,395	-	-	43,395
Unquoted securities				
Equities	-	13,831	1,560	15,391
Real estate managed funds	-	8,537	8,023	16,560
Other managed funds	-	249,580	8,952	258,532
Debt securities	-	-	13,207	13,207
	43,395	271,948	31,742	347,085
	86,703	301,823	31,742	420,268

The following table shows an analysis of financial instruments recorded at fair value by level of the fair value hierarchy at 31 December 2010:

	Level 1 US$ 000	Level 2 US$ 000	Level 3 US$ 000	Total US$ 000
Investments carried at fair value through statement of income				
Quoted equities	29,196	-	-	29,196
Quoted managed funds	51,116	-	-	51,116
Unquoted managed funds	-	46,349	-	46,349
	80,312	46,349	-	126,661
Non-trading investments				
Quoted securities				
Equities	44,690	-	412	45,102
Unquoted securities				
Equities	-	28,437	2,309	30,746
Real estate managed funds	-	9,223	9,411	18,634
Other managed funds	-	157,234	7,565	164,799
Debt securities	-	-	10,449	10,449
	44,690	194,894	30,146	269,730
	125,002	241,243	30,146	396,391

Transfers between Level 1, Level 2 and Level 3

During the year ended 31 December 2011 there were no transfers between Level 1 and Level 2 fair value measurements and no transfers into or out of Level 3 fair value measurement.

The fair values of other on statement of financial position financial instruments are not significantly different from the carrying values included in the consolidated financial statements except for non-trading investments carried at cost (note 6) and the following:

32 FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

Transfers between Level 1, Level 2 and Level 3 (continued)

The table below sets out the carrying value and the fair value of the financial instruments where fair values are materially different from their carrying values:

	2011		2010	
	Carrying value US$ 000	Fair value US$ 000	Carrying value US$ 000	Fair value US$ 000
Subordinated debt	100,000	72,125	100,000	49,000

33 CAPITAL ADEQUACY

The Bank maintains an actively managed capital base to cover risks inherent in the business. The adequacy of the Bank's capital is monitored using, among other measures, the rules and ratios established by the Basel Committee on Banking Supervision ("BIS rules/ratios") as adopted by the Central Bank of Bahrain.

Capital management

The primary objectives of the Group's capital management are to ensure that the Group complies with capital requirements of the Central Bank of Bahrain and that the Group maintains strong credit ratings and healthy capital ratios in order to support its business and to maximise shareholders' value. In order to maintain or adjust the capital structure, the Bank may adjust the amount of dividend payment to shareholders, or issue equity securities. No changes were made in the capital management objectives, policies and processes from previous years.

The risk asset ratio calculated in accordance with the capital adequacy guidelines issued by the Central Bank of Bahrain, for the Group is as follows:

	2011 US$ 000	2010 US$ 000
Capital base:		
Tier 1 capital	422,795	414,502
Tier 2 capital	-	77,525
Total capital base (a)	422,795	492,027
Credit risk weighted exposure	2,103,951	2,186,779
Market risk weighted exposure	161,675	275,175
Operational risk weighted exposure	56,526	66,834
Total risk weighted exposure (b)	2,322,152	2,528,788
Capital adequacy (a/b * 100)	18.21%	19.46%
Minimum requirement	12.0%	12.0%

Regulatory capital consists of Tier 1 capital, which comprises share capital, share premium, statutory reserve, general reserve, treasury share reserve, foreign currency reserve, retained earnings and non-controlling interests less goodwill. The other component of regulatory capital is Tier 2 capital, which includes subordinated long term debt and fair value reserves.

Group Directory

United Gulf Bank, the asset management and investment banking arm of the KIPCO Group.

United Gulf Bank is a member of the KIPCO Group - one of the largest diversified holding companies in the Middle East and North Africa. KIPCO has significant ownership interests in a portfolio over 60 companies operating across 26 countries. The company's main business sectors are financial services and media. Through the subsidiaries and affiliates of its core companies, KIPCO also has interests in the real estate, industrial, education and the management and advisory sectors.

KIPCO's financial services interests include holdings in commercial and investment banking, asset management and insurance companies. The Group's core operating companies in this sector include Burgan Bank, United Gulf Bank and Gulf Insurance Company. In the media sector, the Group has a presence through the Orbit Showtime Network, the leading pay-TV operator in the region.

United Gulf Bank B.S.C

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Fax: +973 1753 0285

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Commercial Banking

Burgan Bank

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Syria Gulf Bank

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Fax: +963 (11) 232 6112
Email: info@sgbsy.com
Website: www.sgbsy.com

Major Non-Financial Operating Companies

Overland Real Estate Company

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Tel: +965 2233 6600

United Capital Transport Company

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Email: info@unicapco.com
Website: www.unicapco.com

United Industries Company

P O Box 25821, Safat 13119, Kuwait
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Fax: +965 2242 3486
Email: uic@uickw.com
Website: www.uickw.com

United Networks

(Formerly known as United Cable Company)

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