ALUBAF Arab International Bank B.S.C. (c)

FINANCIAL STATEMENTS

31 DECEMBER 2013

alubaf
بنك اليوباف العربي الدولي ش.م.ب (م)
Alubaf Arab International Bank B.S.C(c)

Board of Directors' Report

On behalf of the Board of Directors of Alubaf Arab International Bank , I am delighted to present the annual report and audited financial statements for the year ended 31 December, 2013.

Year 2013 was a special year for Alubaf Bank in achieving a significant milestone in its growth path.

In 2013, there was change in composition of the Board members and its committees, strategic initiatives were taken to expand business, included investments activity, broadened income streams from Treasury and investment related products and strengthened its core business by launching new products and services.

In 2013, the Bank moved its operations to its own premises at Seef- Bahrain. Alubaf continued its growth momentum and achieved impressive financial results that reinforced its position in the Banking Industry.

Global economic scenario widely experienced negative growth in 2013 with advanced and emerging economies decelerated growth and most of MENA region countries grappling with political stability, which ended in a challenging environment for Banking industry.

Financial Highlights and Performance

In the midst of challenging business environment, Alubaf Arab International Bank's net profit for the year ended 2013 surged to $ 37 million, signifying an increase of 22% over last year's net profit of $ 30 million.

Net profit for Q4, 2013 was $ 7 million, an increase of 37% over last year same period. Fourth quarter 2013, however, reduced compared to third quarter, 2013, due to provision for credit losses amounting to $ 4 million.

Operating income for 2013 was $ 51 million, an increase of 31 % over previous year 2012, largely driven by interest income, which contributed to 67% of operating income. Net interest income increased by 38% compared to last year. Significant increase in interest income was from interest earnings from investment in fixed income securities, which increased by 340% in 2013 over previous year. This was achieved due to strategic initiatives taken in 2013.

Considerable increase in interest income from Trade finance and lending activity was also witnessed. However, taking a conservative stand, reasonable provision for credit losses was made at $ 4 million (increase of 73% over last year) during the year, thus, increasing the overall specific and general provision to $ 11 million. With the above increase in provisioning, the collective provision constitutes 1.5% of Loans Portfolio. Earnings from Fee and commission income increased by 18% over last year, due to widening income stream from Trade finance activity.

Gains from foreign exchange amounted to $823 thousand , which increased by 119% over last year. Overall, net operating income after provision for credit losses, amounted to $ 47 million an increase of 28% over last year.

On the expenses front, operating expenses increased by 54% , mainly on account of depreciation on building and due to increase in manpower during 2013. However, cost to income ratio increased moderately to 23% in 2013 from 19% in 2012, in order to align with the growth and expansion plans.

Investments grew by 290% over last year. Whilst, loans portfolio had a negative growth of 4% over last year, total assets was almost in line with last year. Investments to total assets stood at 14% and Loan to total assets was at 33%. Nonperforming assets to gross loans increased to 1%, however, is adequately provided.

Return on average equity grew by 1% over last year and stood at 12% for 2013. Capital adequacy ratio continued to be strong at 44%. Liquid assets to liabilities stood at 75%.

In summary, the results achieved in 2013 was well aligned to management's expectations due to timely and proper implementation of various strategic initiatives planned.

Proposed dividend

Alubaf continues to be committed to its valued shareholders by ensuring record profit levels and good return to its shareholders. The Board of Directors is pleased to propose a dividend of US$ 5 per share, at 10% of paid up share capital, i.e., US$ 25 Million for the year 2013, subject to regulatory and shareholders' approval.

Outlook for the year ahead

2014 is anticipated to bring in stability in MENA region and improved economic climate. Alubaf's clear strategic direction, right implementation of strategic initiatives , strong capital adequacy and sustained focus on achieving financial results is expected to bolster growth in 2014. Alubaf plans to augment its offering of core products and services , enhance internal control, compliance and operational efficiency to align with business expansion and industry practice.

Acknowledgement

Finally, I would like to thank all the members of the Board, the Shareholders, the Ministry of Industry and Commerce in the Kingdom of Bahrain , Central bank of Bahrain and all Correspondent Banks and our Customers for their continued support.
I also extend my appreciation and thanks to all the employees for their dedication and commitment in achieving remarkable results.

Chairman
Moraja G. Solaiman

Building a better working world

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INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF ALUBAF ARAB INTERNATIONAL BANK B.S.C. (c)

Report on the financial statements

We have audited the accompanying financial statements of the Alubaf Arab International Bank B.S.C. (c) ('the Bank'), which comprise the statement of financial position as at 31 December 2013 and the 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 financial statements

The Board of Directors is responsible for the preparation and fair presentation of these 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 the 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 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 financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgement, including the assessment of the risks of material misstatement of the 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 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 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 financial statements present fairly, in all material respects, the financial position of the Bank as of 31 December 2013, its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

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INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF ALUBAF ARAB INTERNATIONAL BANK B.S.C. (c) (continued)

Report on other regulatory matters

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

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

b) the financial information contained in the Report of the Board of Directors is consistent with the 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, or the terms of the Bank's memorandum and articles of association during the year ended 31 December 2013 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

16 February 2014
Manama, Kingdom of Bahrain

STATEMENT OF FINANCIAL POSITION

At 31 December 2013

	Note	**2013 US$ '000**	2012 US$ '000
ASSETS			
Cash and balances with banks	3	**150,345**	7,102
Deposits with banks and other financial institutions	3,4	**422,005**	664,904
Investments held for trading	5	**14,626**	24
Non-trading investments	6	**137,282**	38,890
Loans and advances	7	**362,998**	378,684
Property, equipment and software	8	**13,366**	13,966
Interest receivable		**5,916**	8,034
Other assets		**1,224**	495
TOTAL ASSETS		**1,107,762**	1,112,099
LIABILITIES AND EQUITY			
LIABILITIES			
Deposits from banks and other financial institutions	9	**501,186**	519,017
Due to banks and other financial institutions	9	**268,273**	267,063
Due to customers	10	**7,714**	21,083
Interest payable		**205**	169
Other liabilities	11	**14,283**	4,168
Total liabilities		**791,661**	811,500
EQUITY			
Share capital	12	**250,000**	250,000
Statutory reserve	12	**13,597**	9,933
Retained earnings		**28,642**	20,666
Proposed dividend	13	**25,000**	20,000
Fair value reserve		**(1,138)**	-
Total equity		**316,101**	300,599
TOTAL LIABILITIES AND EQUITY		**1,107,762**	1,112,099

Moraja G. Solaiman
Chairman

Sulieman Esa Al Azzabi
Deputy Chairman

Hasan Khalifa Abulhasan
Chief Executive Officer

The attached notes 1 to 24 form part of these financial statements.

STATEMENT OF INCOME

Year ended 31 December 2013

	Note	*2013* *US$ '000*	*2012* *US$ '000*
Interest and similar income	14	**34,627**	26,280
Interest expense	15	**(1,860)**	(2,472)
Net interest income		**32,767**	23,808
Fee and commission income	16	**17,874**	15,124
Trading and investment income - net	17	**(74)**	4
Foreign exchange gain		**823**	375
Other income		**18**	20
OPERATING INCOME		**51,408**	39,331
Provision for loan losses	7	**(4,017)**	(2,322)
NET OPERATING INCOME		**47,391**	37,009
Staff costs		**6,253**	4,518
Depreciation	8	**1,078**	354
Other operating expenses	18	**3,420**	2,120
OPERATING EXPENSES		**10,751**	6,992
NET PROFIT FOR THE YEAR		**36,640**	30,017

Moraje G. Solaiman
Chairman

Sulieman Esa Al Azzabi
Deputy Chairman

Hasan Khalifa Abulhasan
Chief Executive Officer

The attached notes 1 to 24 form part of these financial statements.

STATEMENT OF COMPREHENSIVE INCOME

Year ended 31 December 2013

	2013	2012
	US$ '000	*US$ '000*
NET PROFIT FOR THE YEAR	**36,640**	30,017
Other comprehensive loss:		
Items that may be reclassified to the statement of income in subsequent periods:		
Unrealised fair value loss on available-for-sale investments - net	**(1,138)**	-
Other comprehensive loss for the year	**(1,138)**	-
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	**35,502**	30,017

STATEMENT OF CASH FLOWS

Year ended 31 December 2013

	Note	2013 US$ '000	2012 US$ '000
OPERATING ACTIVITIES			
Net profit for the year		**36,640**	30,017
Adjustments for:			
Provision for loan losses	7	**4,017**	2,322
Depreciation	8	**1,078**	354
Write off of property, equipment and software		**-**	9
Trading and investment income - net	17	**74**	(4)
Amortisation of assets reclassified as "loans and advances" from trading investments		**(554)**	(509)
Gain on disposal of property, equipment and software		**-**	(20)
Operating income before changes in operating assets and liabilities		**41,255**	32,169
Changes in operating assets and liabilities:			
Deposits with banks and other financial institutions		**(188,910)**	(10,000)
Loans and advances		**12,223**	(111,237)
Investments held for trading		**(15,629)**	2
Interest receivable		**2,118**	(2,920)
Other assets		**(729)**	371
Deposits from banks and other financial institutions		**(17,831)**	48,715
Due to banks and other financial institutions		**1,210**	(9,419)
Due to customers		**(13,369)**	12,716
Interest payable		**36**	(49)
Other liabilities		**10,115**	10
Net cash used in operating activities		**(169,511)**	(39,642)
INVESTING ACTIVITIES			
Purchase of non-trading investments		**(109,523)**	(29,773)
Proceeds from disposal of non-trading investments		**10,946**	4,702
Purchase of property, equipment and software	8	**(478)**	(2,737)
Proceeds from disposal of property, equipment and software		**-**	20
Net cash used in investing activities		**(99,055)**	(27,788)
FINANCING ACTIVITIES			
Issue of share capital	12	**-**	50,000
Dividend paid	13	**(20,000)**	(20,000)
Net cash (used in) from financing activities		**(20,000)**	30,000
DECREASE IN CASH AND CASH EQUIVALENTS		**(288,566)**	(37,430)
Cash and cash equivalents at 1 January		**662,006**	699,436
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	3	**373,440**	662,006

STATEMENT OF CHANGES IN EQUITY

Year ended 31 December 2013

	Note	*Share capital US$ '000*	*Statutory reserve US$ '000*	*Retained earnings US$ '000*	*Proposed dividend US$ '000*	*Fair value reserve US$'000*	*Total US$ '000*
Balance as of 1 January 2013		250,000	9,933	20,666	20,000	-	300,599
Net profit for the year		-	-	36,640	-	-	36,640
Other comprehensive loss		-	-	-	-	(1,138)	(1,138)
Total comprehensive income (loss) for the year		-	-	36,640	-	(1,138)	35,502
Dividends paid	13	-	-	-	(20,000)	-	(20,000)
Transfer to statutory reserve	12	-	3,664	(3,664)	-	-	-
Proposed dividend	13	-	-	(25,000)	25,000	-	-
Balance as of 31 December 2013		**250,000**	**13,597**	**28,642**	**25,000**	**(1,138)**	**316,101**
Balance as of 1 January 2012		200,000	6,888	13,694	20,000	-	240,582
Net profit for the year		-	-	30,017	-	-	30,017
Other comprehensive income		-	-	-	-	-	-
Total comprehensive income for the year		-	-	30,017	-	-	30,017
Issue of share capital	12	50,000	-	-	-	-	50,000
Dividends paid	13	-	-	-	(20,000)	-	(20,000)
Transfer to statutory reserve	12	-	3,045	(3,045)	-	-	-
Proposed dividend	13	-	-	(20,000)	20,000	-	-
Balance as of 31 December 2012		250,000	9,933	20,666	20,000	-	300,599

1 ACTIVITIES

ALUBAF Arab International Bank B.S.C. (c) (the "Bank") is a closed Bahraini joint stock company incorporated in the Kingdom of Bahrain and registered with the Ministry of Industry and Commerce under Commercial Registration (CR) number 12819. The Bank operates under a wholesale banking license issued by the Central Bank of Bahrain (the "CBB") under the new integrated licensing framework. The Bank's registered office is Building 854, Road 3618, Avenue 436, Alubaf Tower, Al-Seef District, PO Box 11529, Manama, Kingdom of Bahrain.

The Bank is majority owned by Libyan Foreign Bank, a bank registered in Libya (refer note 12 for more details).

The financial statements for the year ended 31 December 2013 were authorised for issue in accordance with a resolution of the Board of Directors on 16 February 2014.

2 ACCOUNTING POLICIES

2.1 Basis of preparation

Statement of compliance
The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and are in conformity with the Bahrain Commercial Companies Law ("BCCL") the Central Bank of Bahrain ("CBB") and Financial Institutions Law, the CBB Rule Book (Volume 1 and applicable provisions of Volume 6) and the relevant CBB directives.

Accounting convention
The financial statements have been prepared on a historical cost basis, as modified for investments held for trading, available-for-sale investments and derivative financial instruments which have been measured at fair value. The financial statements are presented in United States Dollars (US$) which is the Bank's functional and presentation currency. All values are rounded off to the nearest thousand (US$ '000) unless otherwise indicated.

2.2 Significant accounting judgements and estimates
In the process of applying the Bank's accounting policies, management has exercised judgement and estimates in determining the amounts recognised in the financial statements. The most significant uses of judgement and estimates are as follows:

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

(ii) Impairment and uncollectability of financial assets
Financial assets not carried at fair value are reviewed at each statement of financial position date to determine whether there is objective evidence that a specific financial asset may be impaired. If such evidence exists, any impairment loss is recognised in the statement of income. For assets carried at amortised cost, impairment is based on estimated future cash flows discounted at the original effective interest rate.

(iii) Classification of investments
Management decides on acquisition of a financial asset whether it should be classified as "fair value through profit or loss", "available-for-sale" or held to maturity. The classification of each investment reflects the management's intention in relation to each investment and is subject to different accounting treatments based on such classification.

2.3 Adoption of new and amended standards and interpretations
The accounting policies adopted are consistent with those of the previous financial year, except for the adoption of the following new and amended IFRS:

2 ACCOUNTING POLICIES (continued)

2.3 Adoption of new and amended standards and interpretations (continued)

IFRS 13 Fair Value Measurement
IFRS 13 establishes a single source of guidance under IFRS for all fair value measurements. IFRS 13 does not change when an entity is required to use fair value, but rather provides guidance on how to measure fair value under IFRS. IFRS 13 defines fair value as an exit price. IFRS 13 also requires additional disclosures.

Application of IFRS 13 has not materially impacted the fair value measurements of the Bank. Additional disclosures where required, are provided in the individual notes relating to the assets and liabilities whose fair values were determined. The disclosures relating to fair value hierarchy are provided in note 20.5.

IAS 1 Presentation of Items of Other Comprehensive Income – Amendments to IAS 1
The amendments to IAS 1 introduce a grouping of items presented in other comprehensive income. Items that will be reclassified ('recycled') to profit or loss at a future point in time (e.g., net loss or gain on available-for-sale investments) have to be presented separately from items that will not be reclassified. The amendments affect presentation only and have no impact on the Bank's financial position or performance.

IFRS 10 Consolidated Financial Statements and IAS 27 Separate Financial Statements
The standard became effective for annual periods beginning on or after 1 January 2013. It replaced the requirements of *IAS 27 Consolidated and Separate Financial Statements* that address the accounting for consolidated financial statements and *SIC 12 Consolidation – Special Purpose Entities. What remains in IAS 27* is limited to accounting for subsidiaries, jointly controlled entities, and associates in separate financial statements. The adoption of this standard did not have any impact on the financial position or performance of the Bank as the Bank has no subsidiaries and hence do not prepare consolidated financial statements.

IFRS 11 Joint Agreements
The standard became effective for annual periods beginning on or after 1 January 2013. It replaced *IAS 31 Interests in Joint Ventures* and *SIC 13 Jointly Controlled Entities – Non-monetary Contributions by Venturers*. Because IFRS 11 uses the principle of control in IFRS 10 to define control, the determination of whether joint control exists may change. The adoption of this standard did not have any impact on the financial position or performance of the Bank as the Bank has no joint ventures.

IFRS 12 Disclosure of interest in other entities
The standard became effective for annual periods beginning on or after 1 January 2013. It includes all of the disclosures that were previously in IAS 27 related to consolidated financial statements, as well as all of the disclosures that were previously included in *IAS 31 Interests in Joint Ventures* and *IAS 28 Investment in Associates*. These disclosures relate to an entity's interests in subsidiaries, joint arrangements, associates and structured entities. A number of new disclosures are also required. One of the most significant changes introduced by IFRS 12 is that an entity is now required to disclose the judgements made to determine whether it controls another entity. Many of these changes were introduced by the IASB in response to the financial crisis. Now, even if the Bank concludes that it does not control an entity, the information used to make that judgement will be transparent to users of the financial statements to make their own assessment of the financial impact were the Bank to reach a different conclusion regarding consolidation. The adoption of this standard did not have any impact on the financial position or performance of the Bank as the Bank have no investments in subsidiaries, joint ventures or associates.

IAS 28 Investments in Associates and Joint Ventures (as revised in 2011)
As a consequence of the new IFRS 11 *Joint Arrangements* and IFRS 12 *Disclosure of Interests in Other Entities*, IAS 28 *Investments in Associates*, has been renamed IAS 28 *Investments in Associates and Joint Ventures*, and describes the application of the equity method to investments in joint ventures in addition to associates. The revised standard became effective for annual periods beginning on or after 1 January 2013. The adoption of this standard did not have any impact on the financial position or performance of the Bank as the Bank have no investments in joint ventures or associates.

2 ACCOUNTING POLICIES (continued)

2.4 Summary of significant accounting policies

(i) Foreign currencies
Transactions in foreign currencies are initially recorded in the relevant functional currency rate of exchange ruling at the date of the transaction.

Monetary assets and liabilities in foreign currencies are translated into United States Dollars at rates of exchange prevailing at the statement of financial position date. Any exchange gains and losses are taken to the statement of income.

Non-monetary items in a foreign currency that are measured in terms of historical cost are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items in a foreign currency measured at fair value are translated using the exchange rates at the date when the fair value was determined.

(ii) Financial assets and financial liabilities

Recognition and de-recognition
Financial assets of the Bank comprise cash and bank balances, deposits with banks and other financial institutions, investments held for trading, non-trading investments, loans and advances, interest receivable and other assets. Financial liabilities of the Bank comprise deposits from banks and other financial institutions, due to banks and other financial institutions, due to customers, interest payable and other liabilities.

All financial assets and liabilities are initially recognised on the trade date, i.e., the date that the Bank becomes a party to the contractual provisions of the instrument. This includes "regular way trades", purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place.

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

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

(i) the right to receive cash flows from the asset has expired;

(ii) the Bank 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

(iii) the Bank 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 Bank 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 Bank's continuing involvement in the asset.

The Bank derecognises a financial liability when its contractual obligations are discharged, cancelled or expires.

(iii) Investments
The Bank classifies its investments in the following categories: fair value through profit or loss, available-for-sale and held-to-maturity.

Initial measurement
All the investments are recognised initially at fair value plus, in the case of investments not recorded at fair value through profit or loss, transaction costs that are attributable to the acquisition of the investment.

2 ACCOUNTING POLICIES (continued)

2.4 Summary of significant accounting policies (continued)

(iii) Investments (continued)

Subsequent measurement

Investments at fair value through profit or loss
Investments at fair value through profit or loss include financial assets held for trading. Investments are classified as held for trading if they are acquired for the purpose of selling or repurchasing in the near term. These are subsequently measured at fair value with any realised and unrealised gains and losses arising from changes in fair values being included in the statement of income in the period in which they arise. Interest earned and dividends received are included in 'interest and similar income' and 'other income' respectively.

Available-for-sale investments
Available-for-sale investments include equity investments and debt securities. Equity investments classified are those that are neither classified as held for trading nor designated at fair value through profit or loss. Debt securities in this category are those that are intended to be held for an indefinite period of time and that may be sold in response to needs for liquidity or in response to changes in the market conditions.

Available-for-sale investments are subsequently measured at fair value with unrealised gains or losses recognised in statement of comprehensive income and credited in fair value reserve in equity until the investment is derecognised or impaired, at which time the cumulative gain or loss is recognised in the statement of income.

Held-to-maturity investments
Non-derivative financial assets with fixed or determinable payments and fixed maturities are classified as held to maturity when the Bank has the positive intention and ability to hold them to maturity. After initial measurement, held to maturity investments are measured at amortised cost using the effective interest rate, less impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the effective interest rate. The amortisation is included as 'interest and similar income' in the statement of income. The losses arising from impairment are recognised in the statement of income.

(iv) Fair value measurement principles
Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- In the principal market for the asset or liability, or
- In the absence of a principal market, in the most advantageous market for the asset or liability.

The principal or the most advantageous market must be accessible to the Bank.

The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

The fair value of financial instruments that are quoted in an active market is determined by reference to market bid prices for assets and offer prices for liabilities, at the close of business on the statement of financial position date, without deduction for transaction costs.

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.

2 ACCOUNTING POLICIES (continued)

2.4 Summary of significant accounting policies (continued)

(v) Loans and advances

Loans and advances are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial measurement, such financial assets are subsequently measured at amortised cost using the effective interest rate method, less impairment allowances. The losses arising from impairment are recognised in the statement of income as provision for loan losses.

(vi) Derivative financial instruments

The Bank makes use of derivative instruments, such as forward foreign exchange contracts.

Derivatives are initially recognised, and subsequently measured at fair value with transaction costs taken directly to the 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 statement of financial position.

(vii) Impairment of financial assets

The Bank assesses at each reporting date, whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that have 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; the probability that they will enter bankruptcy or other financial reorganisation; default or delinquency in interest or principal payments; 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.

Financial assets carried at amortised cost

For financial assets carried at amortised cost, the Bank first assesses individually whether objective evidence of impairment exists for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the statement of income. Interest income continues to be accrued on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Available-for-sale investments

For available-for-sale financial investments, the Bank assesses at each reporting date whether there is objective evidence that an investment is impaired.

In the case of debt instruments classified as available-for-sale, the Bank assesses individually whether there is objective evidence of impairment 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.

2 ACCOUNTING POLICIES (continued)

2.4 Summary of significant accounting policies (continued)

(viii) Offsetting
Financial assets and financial liabilities are only offset and the net amount reported in the statement of financial position when there is currently enforceable legal right to set off the recognised amounts and the Bank intends to settle on a net basis.

(ix) Cash and cash equivalents
Cash and cash equivalents comprise cash and balances with banks and deposits with banks and other financial institutions with original maturities of 90 days or less.

(x) Property, equipment and software
Property, equipment and software is stated at cost, net of accumulated depreciation and/or accumulated impairment losses, if any. Such cost includes the cost of replacing part of the equipment if the recognition criteria are met. All other repair and maintenance costs are recognised in the statement of income as incurred. Land is not depreciated. It is carried at cost less any impairment in value.

Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets as follows:

Asset	*Estimated useful life in years*
Building	15
Furniture, equipment and vehicles	3 to 5
Software	3 to 5

An item of property, equipment and software is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset is included in the statement of income in the year the asset is derecognised.

(xi) Capital work in progress
All costs and expenses, including payments to project asset suppliers and directly attributable expenses incurred in connection with the construction of the building and the related infrastructure costs are recognised as capital work in progress.

Upon completion of the project, capital work in progress is classified into relevant class of property, equipment and software.

(xii) Provisions
Provisions are recognised when the Bank has a present obligation (legal or constructive) as a result of a past event, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. The expense relating to any provision is presented in the statement of income.

(xiii) Contingent liabilities
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.

(xiv) Financial guarantees
In the ordinary course of business, the Bank gives financial guarantees, consisting of letters of credit and guarantees.

Financial guarantees are initially recognised in the financial statements at fair value, being the commission received. Subsequent to initial recognition, the Bank's liability under each guarantee is measured at the higher of the un-amortised commission and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee.

2 ACCOUNTING POLICIES (continued)

2.4 Summary of significant accounting policies (continued)

(xv) Renegotiated loans

The Bank 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, any impairment is measured using the original effective interest rate as calculated before the modification of terms and the loan is no longer considered past due. Management continually reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original effective interest rate.

(xvi) Share capital and statutory reserve

Share capital

Ordinary shares issued by the Bank are classified as equity. The Bank classifies capital instruments as financial liabilities or equity instruments in accordance with the substance of the contractual terms of the instruments. Incremental costs directly attributable to the issue of an equity instrument are deducted from the initial measurement of the equity instruments.

Statutory reserve

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

(xvii) Revenue recognition

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

Interest income

Interest income and fees which are considered an integral part of the effective yield of a financial asset, are recognised using the effective yield method, unless collectability is in doubt. The recognition of interest income is suspended when the loans become impaired, such as when overdue by more than 90 days.

Fee and commission income

Fee and commission income are recognised when earned.

Dividend income

Dividend income is recognised when the right to receive payment is established.

2.5 New standards and amendments issued but not yet effective

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

2 ACCOUNTING POLICIES (continued)

2.5 New standards and amendments issued but not yet effective (continued)

IFRS 9 Financial Instruments
IFRS 9, as issued, reflects the first phase of the IASB's work though the adoption date is subject to the recently issued Exposure Draft on the replacement of IAS 39 and applies to classification and measurement of financial assets and liabilities as defined in IAS 39. The standard was initially effective for annual periods beginning on or after 1 January 2015, but amendments to IFRS 9 issued in November 2013, removed the mandatory effective date of 1 January 2015 for IFRS 9. A new mandatory date for IFRS 9 will be determined by the IASB when IFRS 9 is closer to completion. The Bank will quantify the effect of this standard in conjunction with the other phases, when the final standard including all phases is issued.

IAS 32 Offsetting Financial Assets and Financial Liabilities - Amendments to IAS 32
These amendments clarify the meaning of "currently has a legally enforceable right to set-off". It will be necessary to assess the impact to the Bank by reviewing settlement procedures and legal documentation to ensure that offsetting is still possible in cases where it has been achieved in the past. In certain cases, offsetting may no longer be achieved. In other cases, contracts may have to be renegotiated. The requirement that the right of set-off be available for all counterparties to the netting agreement may prove to be a challenge for contracts where only one party has the right to offset in the event of default.

The amendments also clarify the application of the IAS 32 offsetting criteria to settlement systems (such as central clearing house systems) which apply gross settlement mechanisms that are not simultaneous. Offsetting on the grounds of simultaneous settlement is particularly relevant for the Bank as to where it engages in large numbers of sale and repurchase transactions. Currently, transactions settled through clearing systems are, in most cases, deemed to achieve simultaneous settlement. While many settlement systems are expected to meet the new criteria, some may not. Any changes in offsetting are expected to impact leverage ratios, regulatory capital requirements, etc. As the impact of the adoption depends on the Bank's examination of the operational procedures applied by the central clearing houses and settlement systems it deals with to determine if they meet the new criteria, it is not practical to quantify the effects.

These amendments become effective for annual periods beginning on or after 1 January 2014.

3 CASH AND BALANCES WITH BANKS

	2013	*2012*
	US$ '000	*US$ '000*
Cash	**4**	7
Money at call and short notice	**150,341**	6,983
Balances with other banks	**-**	112
Cash and balances with banks	**150,345**	7,102
Deposits with banks and other financial institutions with original maturities of 90 days or less (note 4)	**223,095**	654,904
Cash and cash equivalents	**373,440**	662,006

4 DEPOSITS WITH BANKS AND OTHER FINANCIAL INSTITUTIONS

Deposits with banks and other financial institutions represent interest bearing money market deposits held with banks and other financial institutions as at the statement of financial position date. Except for US$ 199 million (2012: US$ 10 million) of deposits maturing in six months, all deposits have original maturities of 90 days or less (note 3).

5 INVESTMENTS HELD FOR TRADING

	2013 US$ '000	2012 US$ '000
Quoted:		
Debt securities	**11,715**	-
Equity securities	**2,911**	24
	14,626	24

6 NON TRADING INVESTMENTS

	2013 US$ '000	2012 US$ '000
Held-to-maturity:		
Debt securities:		
- Sovereign	**47,446**	23,897
- Corporate	**71,553**	11,993
Wakala units	**3,000**	3,000
Total held-to-maturity	**121,999**	38,890
Available-for-sale:		
Debt securities:		
- Sovereign	**7,194**	-
- Corporate	**8,089**	-
Total available-for-sale	**15,283**	-
Total non trading investments	**137,282**	38,890

7 LOANS AND ADVANCES

Loans and advances are stated net of provisions for loan losses and interest in suspense.

	2013 US$ 000	2012 US$ 000
Sovereign loans	**61,536**	42,085
Commercial loans	**106,464**	37,031
Letters of credit - financing	**206,334**	306,864
	374,334	385,980
Provision for loan losses and interest in suspense	**(11,336)**	(7,296)
	362,998	378,684

Movement in provision for loan losses and interest in suspense in relation to loans and advances were as follows:

	2013 US$ '000	2012 US$ '000
At 1 January	**7,296**	4,951
Provided during the year	**4,017**	2,322
Movement in interest in suspense	**23**	23
At 31 December	**11,336**	7,296

7 LOANS AND ADVANCES (continued)

The breakup of provision for loan losses and interest in suspense in relation to loans and advances is as follows:

	2013	*2012*
	US$ '000	*US$ '000*
Specific provision	**5,384**	3,867
Interest in suspense	**252**	229
Collective provision	**5,700**	3,200
At 31 December	**11,336**	7,296
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	**12,847**	11,529

Renegotiated facilities

	2013	*2012*
	US$ '000	*US$ '000*
Loans and advances		
Commercial loans	**8,828**	5,078

Reclassification of financial assets:

In October 2008, the IASB issued amendments to IAS 39 "Financial Instruments: Recognition and Measurement" and IFRS 7 "Financial Instruments: Disclosures" titled "Reclassification of Financial Assets". The amendments to IAS 39 permit reclassification of financial assets from the "trading investment" category to "loans and advances" 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 are effective retrospectively from 1 July 2008.

In accordance with the amendments to IAS 39 and IFRS 7, "Reclassification of Financial Assets" the Bank reclassified investments in Iraq Notes with a carrying value of US $ 40.2 million, effective 1 July 2008 from 'trading investment' to 'loans and advances' pursuant to the amendment to IAS 39 and IFRS 7 issued by IASB in October 2008 and considering the global financial crisis as a rare circumstance in the financial sector.

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

	2013	*2012*
	US$ '000	*US$ '000*
Carrying value	**42,639**	42,085
Fair value	**46,687**	52,317

Additional fair value loss that would have been recognised in the statement of income for the year ended 31 December 2013 had the trading investment not been reclassified amounts to US$ 6.1 million (2012: fair value gain of US$ 6.6 million).

The Bank earns an effective interest rate of 8.89% (2012: 8.89%) and expects to recover US $43 million (2012: US $ 42 million) on Iraq notes which were reclassified in 2008.

8 PROPERTY, EQUIPMENT AND SOFTWARE

	Land & Building US$ '000	*Furniture, equipment and motor vehicles* US$ '000	*Software* US$ '000	*Capital work in progress* US$ '000	*Total* US$ '000
Cost:					
At 1 January 2013	4,232	901	770	9,166	15,069
Additions during the year	35	422	21	-	478
Transfers in (out)	7,587	1,579	-	(9,166)	-
At 31 December 2013	11,854	2,902	791	-	15,547
Depreciation:					
At 1 January 2013	-	713	390	-	1,103
Charge for the year	465	446	167	-	1,078
At 31 December 2013	465	1,159	557	-	2,181
Net book value:					
At 31 December 2013	**11,389**	**1,743**	**234**	**-**	**13,366**
At 31 December 2012	4,232	188	380	9,166	13,966

The capital work in progress as of 31 December 2012 related to the Bank's head office premises, which was completed in January 2013.

9 DEPOSITS FROM AND DUE TO BANKS AND OTHER FINANCIAL INSTITUTIONS

Deposits from banks and other financial institutions represent interest bearing money market deposits held with the Bank as at the statement of financial position date.

Due to banks and other financial institutions represent current account balances and cash collateral held with the Bank in relation to the letters of credit as at the statement of financial position date.

10 DUE TO CUSTOMERS

Due to customers represent current account balances and cash collateral of corporate customers held with the Bank in relation to the letters of credit as at the statement of financial position date.

11 OTHER LIABILITIES

	2013 **US$ '000**	*2012* US$ '000
Accrued expenses	**2,204**	1,543
Unearned fee income	**9,865**	2,184
Retention money	**130**	168
Other	**2,084**	273
	14,283	4,168

12 SHARE CAPITAL

	2013 US$ '000	2012 US$ '000
Authorised:		
10,000,000 (2012: 10,000,000) ordinary shares of US$ 50 each	**500,000**	500,000

	2013 US$ '000	2012 US$ '000
Issued and fully paid up :		
At beginning of the year :		
5,000,000 (2012: 4,000,000) ordinary shares of US$ 50 each	**250,000**	200,000
Issued during the year		
Nil (2012: 1,000,000) ordinary shares of US$ 50 each	**-**	50,000
At end of the year :		
5,000,000 (2012: 5,000,000) ordinary shares of US$ 50 each	**250,000**	250,000

Shareholders

	2013		2012	
	Percentage holding (%)	US$ '000	Percentage holding (%)	US$ '000
Libyan Foreign Bank	**99.50**	**248,751**	99.50	248,751
Yemen Bank for Reconstruction and Development	**0.22**	**561**	0.22	561
National Bank of Yemen	**0.28**	**688**	0.28	688
	100.00	**250,000**	100.00	250,000

Statutory reserve

As required by the Bahrain Commercial Companies Law (BCCL) and the Bank's articles of association, a statutory reserve has been created by transfer of 10% of its annual profit. The Bank may resolve to discontinue such transfers when the reserve totals 50% of the paid up capital. The reserve is not distributable except in such circumstances as stipulated in the BCCL and following approval of the Central Bank of Bahrain.

13 DIVIDENDS PAID AND PROPOSED

The Bank has proposed a dividend of US$ 25 million (US$ 5 per share) for the year ended 31 December 2013 (2012: US$ 20 million; US$ 4 per share), which will be submitted for approval of the Bank's shareholders at the next Annual General Meeting subject to necessary regulatory approvals.

During the year, the dividend for the year ended 31 December 2012 amounting to US$ 20 million (US$ 4 per share) was paid following regulatory approvals and the approval of the shareholders in the Annual General Meeting held on 21 April 2013.

14 INTEREST INCOME

	2013 US$ '000	2012 US$ '000
Loans and advances	**23,967**	18,720
Deposits with banks and other financial institutions	**3,676**	5,972
Investments held for trading	**737**	-
Non-trading investments	**6,247**	1,588
	34,627	26,280

15 INTEREST EXPENSE

	2013 US$ '000	2012 US$ '000
Deposits from and due to banks and other financial institutions	**1,845**	2,454
Due to customers	**15**	18
	1,860	2,472

16 FEE AND COMMISSION INCOME

	2013 US$ '000	2012 US$ '000
Commission income from letters of credit	**17,257**	15,105
Commission income from letters of guarantee	**160**	19
Other	**457**	-
	17,874	15,124

17 TRADING AND INVESTMENT INCOME

	2013 US$ '000	2012 US$ '000
Changes in fair value of investments held for trading	**(540)**	4
Trading loss - net	**(487)**	-
Investment income	**953**	-
	(74)	4

18 OTHER OPERATING EXPNESES

	2013 US$ '000	2012 US$ '000
Administrative and marketing expenses	**1,777**	1,118
Board of Directors' expenses	**921**	577
Professional services	**406**	179
Fees and other charges	**316**	182
Other	**-**	64
	3,420	2,120

19 COMMITMENTS AND CONTINGENT LIABILITIES

	2013 *US$ '000*	*2012* *US$ '000*
Letters of credit	**163,393**	250,045
Letters of guarantee	**6,347**	1,845
Foreign exchange contracts	**2,521**	22,110
Undrawn loan commitments	**1,102**	-
	173,363	274,000

20 RISK MANAGEMENT

20.1 Introduction

Risk is inherent in the Bank's activities and is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Bank's continuing profitability and each individual within the Bank is accountable for the risk exposures relating to his or her responsibilities. The main risks to which the Bank is exposed are credit risk, liquidity risk, market risk and operational risk.

a) Risk management structure

Board of Directors

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

Audit Risk and Compliance Committee

The Audit Risk and Compliance Committee (ARCC) of the Board is responsible for assessing the quality and integrity of financial reporting, effectiveness of systems monitoring financial and disclosure compliance with legal and regulatory requirements, supervision of compliance function and soundness of internal controls. The ARCC also obtains regular updates from management and the Bank's compliance officer regarding compliance matters, which may have a material impact on the Bank's financial statements and reviews the findings of any examinations by regulatory agencies.

Management Risk Committee

The Management Risk Committee has the overall responsibility for establishing the risk strategy and implementing principles, frameworks, policies and limits. It is responsible for the fundamental risk issues and manages and monitors relevant risk decisions.

Asset Liability Management Committee

The Asset Liability Management Committee's (ALCO) objective is to prudently direct and manage asset and liability allocation to achieve the Bank's strategic goals. The ALCO monitors the Bank's liquidity risks by ensuring that the Bank's activities are in line with the risk/reward guidelines approved by the Board.

Internal Audit

Internal control processes throughout the Bank are audited at least annually by the Internal Audit Department, based on the risk-based audit plan approved by the ARCC. Audit staff examine both the adequacy of the procedures and the Bank's compliance with the procedures. Internal Audit discusses the results of all assessments with management and reports its findings and recommendations to the ARCC.

20 RISK MANAGEMENT (continued)

20.1 Introduction (continued)

b) Risk measurement and reporting systems

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

c) Credit concentration risk

Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographical 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 Bank's performance to developments affecting a particular industry or geographical location.

In order to manage credit concentration risk, the Bank's policies and procedures include guidelines to maintain a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly.

20.2 Credit risk

Credit risk is the risk that a customer or counterparty will fail to meet a commitment, resulting in financial loss to the Bank. Such risk arises from lending, treasury and other activities undertaken by the Bank. Credit risk is actively monitored in accordance with the credit policies which clearly define delegated lending authorities, and procedures. The Bank manages its credit risk by monitoring concentration of exposures by geographic location and adhering to approved limits formulated. The Bank limits its risk on off balance sheet items with adequate collateral.

a. Maximum exposure to credit risk without taking account of any collateral and other credit enhancements

The table below shows the maximum exposure to credit risk for the components of the statement of financial position. The maximum exposure is shown gross, before the effect of mitigation through the use of master netting and collateral agreements. The net exposure represents gross exposure net of cash collateral against LC's.

	Gross maximum exposure 2013 US$ '000	***Net maximum exposure 2013 US$ '000***	*Gross maximum exposure 2012 US$ '000*	*Net maximum exposure 2012 US$ '000*
Balances with banks	**150,341**	**150,341**	7,095	7,095
Deposits with banks and other financial institutions	**422,005**	**422,005**	664,904	664,904
Investments held for trading	**11,715**	**11,715**	-	-
Non-trading investments	**137,282**	**137,282**	38,890	38,890
Loans and advances	**362,998**	**341,937**	378,684	316,455
Interest receivable	**5,916**	**5,916**	8,034	8,034
Other assets	**928**	**928**	263	263
Total funded credit risk exposure	**1,091,185**	**1,070,124**	1,097,870	1,035,641
Unfunded exposure on credit related contingencies	**170,842**	**48,681**	251,890	110,161
Total funded and unfunded credit risk exposures	**1,262,027**	**1,118,805**	1,349,760	1,145,802

The amount, type and valuation of collateral are based on guidelines specified in the risk management framework. The main types of collaterals accepted include cash collateral, residential and commercial real estate and securities.

20 RISK MANAGEMENT (continued)

20.2 Credit risk (continued)

b. Credit quality per class of financial assets

The table below presents an analysis of the financial assets exposed to credit risk and external rating designation at 31 December 2013 and 2012. The credit quality is graded based on external credit rating agencies- Standard & Poor, Fitch and Moody's and internal ratings are categorised as follows:

(i) High standard - Where external credit rating agency ratings are A and above.
(ii) Standard - Where external credit rating agency ratings are below A.
(iii) Watch list - Where the recoverability of loan is doubtful.
(iv) Past due and impaired - Where interest or principal sum of loan is due for more than 90 days.

	Neither past due nor impaired				
	High standard grade US$ '000	*Standard grade US$ '000*	*Past due and individually impaired (including interest in suspense)* US$ '000*	*Provision for losses and interest in suspense US$ '000*	*Total US$ '000*
At 31 December 2013					
Balances with banks	131,250	19,091	-	-	150,341
Deposits with banks and other financial institutions	-	422,005	-	-	422,005
Investments held for trading	497	11,218	-	-	11,715
Non-trading investments	13,019	124,263	-	-	137,282
Loans and advances	-	370,315	4,019	(11,336)	362,998
Interest receivable	185	5,731	-	-	5,916
Other assets	-	928	-	-	928
Funded exposures	144,951	953,551	4,019	(11,336)	1,091,185
Credit related contingencies	-	170,842	-	-	170,842
Gross unfunded exposures	-	170,842	-	-	170,842
Net funded and unfunded exposures	144,951	1,124,393	4,019	(11,336)	1,262,027

* Excludes loans of US$ 8,828 thousand (2012: US$ 5,078 thousand) which have been restructured and therefore classified under "Standard grade".

20 RISK MANAGEMENT (continued)

20.2 Credit risk (continued)

b. Credit quality per class of financial assets (continued)

	Neither past due nor impaired				
	High standard grade US$ '000	*Standard grade US$ '000*	*Past due and individually impaired (including interest in suspense)* US$ '000*	*Provision for losses and interest in suspense US$ '000*	*Total US$ '000*
At 31 December 2012					
Balances with banks	3,634	3,461	-	-	7,095
Deposits with banks and other financial institutions	119,297	545,607	-	-	664,904
Non-trading investments	11,992	26,898	-	-	38,890
Loans and advances	-	379,529	6,451	(7,296)	378,684
Interest receivable	173	7,861	-	-	8,034
Other assets	-	263	-	-	263
Funded exposure	135,096	963,619	6,451	(7,296)	1,097,870
Credit related contingencies	-	251,890	-	-	251,890
Gross unfunded exposures	-	251,890	-	-	251,890
Net funded and unfunded exposures	135,096	1,215,509	6,451	(7,296)	1,349,760

The Bank had no financial assets that are past due but not impaired as of 31 December 2013 or 31 December 2012.

c. Concentration of maximum exposure to credit risk

The geographical distribution of gross credit exposures (net of provision for impairment) is presented below:

At 31 December 2013

	Bahrain US$ '000	***Other GCC countries US$ '000***	***Other Middle-east and African countries US$ '000***	***Europe US$ '000***	***Rest of the world US$ '000***	***Total US$ '000***
ASSETS						
Balances with banks	**2,597**	**14,030**	**167**	**14,706**	**118,841**	**150,341**
Deposits with banks and other financial institutions	**166,052**	**80,000**	**70,000**	**75,953**	**30,000**	**422,005**
Investments held for trading	**623**		**958**	**5,892**	**4,242**	**11,715**
Non-trading investments	**29,430**	**37,928**	**14,127**	**51,026**	**4,771**	**137,282**
Loans and advances	**-**	**3,914**	**288,073**	**52,113**	**18,898**	**362,998**
Interest receivable	**548**	**526**	**3,784**	**810**	**248**	**5,916**
Other assets	**928**	**-**	**-**	**-**	**-**	**928**
Gross funded exposures	**200,178**	**136,398**	**377,109**	**200,500**	**177,000**	**1,091,185**
Credit related contingencies	**-**	**11,536**	**157,162**	**110**	**2,034**	**170,842**
Gross unfunded exposures	**-**	**11,536**	**157,162**	**110**	**2,034**	**170,842**
Gross funded and unfunded exposures	**200,178**	**147,934**	**534,271**	**200,610**	**179,034**	**1,262,027**

20 RISK MANAGEMENT (continued)

20.2 Credit risk (continued)

c. Concentration of maximum exposure to credit risk (continued)

At 31 December 2012

	Bahrain	Other GCC countries	Other Middle-east and African countries	Europe	Rest of the world	Total
	US$ '000	US$ '000	US$ '000	US$ '000	US$ '000	US$ '000
ASSETS						
Balances with banks	615	932	322	3,409	1,817	7,095
Deposits with banks and other financial institutions	235,354	174,765	97,200	157,585	-	664,904
Non-trading investments	18,296	11,993	8,601	-	-	38,890
Loans and advances	-	3,828	357,152	17,704	-	378,684
Interest receivable	366	201	7,384	83	-	8,034
Other assets	263	-	-	-	-	263
Gross funded exposures	254,894	191,719	470,659	178,781	1,817	1,097,870
Credit related contingencies	-	511	250,827	552	-	251,890
Gross unfunded exposures	-	511	250,827	552	-	251,890
Gross funded and unfunded exposures	254,894	192,230	721,486	179,333	1,817	1,349,760

Sectoral classification of gross credit exposures is presented below:

At 31 December 2013

	Sovereign	**Banks and financial institutions**	**Commercial, business and others**	**Total**
	US$ '000	**US$ '000**	**US$ '000**	**US$ '000**
ASSETS				
Balances with banks	-	**150,341**	-	**150,341**
Deposits with banks and other financial institutions	-	**422,005**	-	**422,005**
Investments held for trading	**1,581**	**5,395**	**4,739**	**11,715**
Non-trading investments	**54,640**	**41,936**	**40,706**	**137,282**
Loans and advances	**61,537**	**286,170**	**15,291**	**362,998**
Interest receivable	**2,102**	**3,111**	**703**	**5,916**
Other assets	-	**7**	**921**	**928**
Gross funded exposures	**119,860**	**908,965**	**62,360**	**1,091,185**
Credit related contingencies	**1,102**	**156,911**	**12,829**	**170,842**
Gross unfunded exposures	**1,102**	**156,911**	**12,829**	**170,842**
Gross funded and unfunded exposures	**120,962**	**1,065,876**	**75,189**	**1,262,027**

20 RISK MANAGEMENT (continued)

20.2 Credit risk (continued)

c. Concentration of maximum exposure to credit risk (continued)

At 31 December 2012

	Sovereign US$ '000	*Banks and financial institutions US$ '000*	*Commercial, business and others US$ '000*	*Total US$ '000*
ASSETS				
Balances with banks	-	7,095	-	7,095
Deposits with banks and other financial institutions	-	664,904	-	664,904
Non-trading investments	23,897	9,986	5,007	38,890
Loans and advances	42,085	329,067	7,532	378,684
Interest receivable	1,653	6,375	6	8,034
Other assets	-	37	226	263
Gross funded exposures	67,635	1,017,464	12,771	1,097,870
Credit related contingencies	-	248,288	3,602	251,890
Gross unfunded exposures	-	248,288	3,602	251,890
Gross of funded and unfunded exposures	67,635	1,265,752	16,373	1,349,760

20.3 Market risk

Market risk is the risk of potential financial loss that may arise from adverse changes in the value of a financial instrument or portfolio of financial instruments due to movements in interest rates, foreign exchange rates and equity. This risk arises from asset - liability mismatches, changes that occur in the yield curve and foreign exchange rates. Given the Bank's low risk strategy, aggregate market risk levels are considered very low.

20.3.1 Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect the value of financial instruments. The Bank is exposed to interest rate risk as a result of mismatches or gaps in the amounts of assets and liabilities that mature or reprise in a given period. The Bank manages this risk by matching the repricing of assets and liabilities through a number of means. The Bank's interest rate sensitivity position as of 31 December, is as follows:

Sensitivity analysis - interest rate risk

	Impact on statement of income	
	2013 US$ '000	*2012 US$ '000*
25 bps increase/decrease		
US Dollar	**(+)(-)291**	(+)(-)70
Euro	**(+)(-)5**	(+)(-)193

20 RISK MANAGEMENT (continued)

20.3 Market risk (continued)

20.3.2 Currency risk

Currency risk arise from the movement of the rate of exchange over a period of time. The Bank's currency risk is limited to assets and liabilities denominated in GBP and Euro. The following table demonstrates the sensitivity to a reasonable possible change in foreign exchange rates, with all other variables held constant, on the Bank's statement of comprehensive income:

	Change in rate	*Effect on net income for the year*	
		2013	*2012*
		US$ '000	*US$ '000*
Euro	(+)(-)5%	**(+)(-)94**	(+)(-)8
GBP	(+)(-)5%	**(+)(-)4**	(+)(-)3

As other currencies exposure is insignificant and GCC currencies to which the Bank is exposed are pegged to the US Dollar, their balances are not considered to represent significant currency risk.

20.3.3 Equity price risk

Equity price risk is the risk that the fair value of equities decreases as a result of changes in the value of individual companies' shares. The effect on profit and equity, as a result of a change in fair value of trading equity instruments, due to a reasonably possible change in equity prices, with all other variables held constant, is as follows:

	Change in equity prices	*Effect on net income and equity for the year*	
		2013	*2012*
		US$ '000	*US$ '000*
Investments held for trading	(+)(-)10%	**(+)(-)291**	(+)(-)2

20.4 Liquidity risk

Liquidity risk is the risk that the Bank will be unable to meet its funding requirements. Liquidity risk can be caused by market disruptions or a credit downgrade which may cause certain sources of funding to dry up immediately. To limit this risk, management has arranged diversified funding sources, manages assets with liquidity in mind, and monitors liquidity on a daily basis. This incorporates an assessment of expected cash flow and the availability of high grade collateral which would be used to secure additional funding if required.

20 RISK MANAGEMENT (continued)

20.4 Liquidity risk (continued)

The maturity profile of the assets and liabilities at **31 December 2013** given below reflects the management's best estimates of the maturities of assets and liabilities that have been determined on the basis of the remaining period at the balance sheet date.

	Up to 1 year						
At 31 December 2013	***Up to 1 month US$ '000***	***1 to 3 months US$ '000***	***3 to 12 months US$ '000***	***Total US$ '000***	***More than 1 year US$ '000***	***No specific maturity US$ '000***	***Total US$ '000***
ASSETS							
Cash and balances with banks	**150,345**	**-**	**-**	**150,345**	**-**	**-**	**150,345**
Deposits with banks and other financial institutions	**159,595**	**262,410**	**-**	**422,005**	**-**	**-**	**422,005**
Investments held for trading	**14,626**	**-**	**-**	**14,626**	**-**	**-**	**14,626**
Non-trading investments	**-**	**2,220**	**4,315**	**6,535**	**130,747**	**-**	**137,282**
Loans and advances	**37,209**	**29,218**	**194,547**	**260,974**	**102,024**	**-**	**362,998**
Property, equipment and software	**-**	**-**	**-**	**-**	**-**	**13,366**	**13,366**
Interest receivable	**2,359**	**1,582**	**1,975**	**5,916**	**-**	**-**	**5,916**
Other assets	**2**	**311**	**28**	**341**	**883**	**-**	**1,224**
Total assets	**364,136**	**295,741**	**200,865**	**860,742**	**233,654**	**13,366**	**1,107,762**
LIABILITIES							
Deposits from banks and other financial institutions	**257,736**	**243,450**	**-**	**501,186**	**-**	**-**	**501,186**
Due to banks and other financial institutions	**137,368**	**36,315**	**87,465**	**261,148**	**7,125**	**-**	**268,273**
Due to customers	**7,714**	**-**	**-**	**7,714**	**-**	**-**	**7,714**
Interest payable	**67**	**138**	**-**	**205**	**-**	**-**	**205**
Other liabilities	**593**	**142**	**11,439**	**12,174**	**1,678**	**431**	**14,283**
Total liabilities	**403,478**	**280,045**	**98,904**	**782,427**	**8,803**	**431**	**791,661**
Net liquidity gap	**(39,342)**	**15,696**	**101,961**	**78,315**	**224,851**	**12,935**	**316,101**
Cumulative liquidity gap	**(39,342)**	**(23,646)**	**78,315**	**-**	**303,166**	**316,101**	**-**

20 RISK MANAGEMENT (continued)

20.4 Liquidity risk (continued)

At 31 December 2012	*Up to 1 year*						
	Up to 1 month US$ '000	*1 to 3 months US$ '000*	*3 to 12 months US$ '000*	*Total US$ '000*	*More than 1 year US$ '000*	*No specific maturity US$ '000*	*Total US$ '000*
ASSETS							
Cash and balances with banks	7,102	-	-	7,102	-	-	7,102
Deposits with banks and other financial institutions	473,572	181,332	10,000	664,904	-	-	664,904
Investments held for trading	-	-	-	-	-	24	24
Non-trading investments	-	-	-	-	38,890	-	38,890
Loans and advances	42,725	62,874	226,736	332,335	46,349	-	378,684
Property, equipment and software	-	-	-	-	-	13,966	13,966
Interest receivable	2,939	1,147	3,948	8,034	-	-	8,034
Other assets	6	88	197	291	204	-	495
Total assets	526,344	245,441	240,881	1,012,666	85,443	13,990	1,112,099
LIABILITIES							
Deposits from banks and other financial institutions	305,546	81,471	132,000	519,017	-	-	519,017
Due to banks and other financial institutions	75,643	157,593	33,827	267,063	-	-	267,063
Due to customers	21,083	-	-	21,083	-	-	21,083
Interest payable	109	18	42	169	-	-	169
Other liabilities	147	-	3,725	3,872	42	254	4,168
Total liabilities	402,528	239,082	169,594	811,204	42	254	811,500
Net liquidity gap	123,816	6,359	71,287	201,462	85,401	13,736	300,599
Cumulative liquidity gap	123,816	130,175	201,462	-	286,863	300,599	-

20 RISK MANAGEMENT (continued)

20.4 Liquidity risk (continued)

The maturity profile of the financial and contingent liabilities as at **31 December 2013** based on contractual undiscounted repayment amounts is as follows:

At 31 December 2013	*Up to 1 year*						
	Up to 1 month US$ '000	*1 to 3 months US$ '000*	*3 to 12 months US$ '000*	*Total US$ '000*	*More than 1 year US$ '000*	*No specific maturity US$ '000*	*Total US$ '000*
Liabilities							
Deposits from banks and financial institutions	257,775	243,568	-	501,343	-	-	501,343
Due to banks and other financial institutions	137,389	36,331	87,544	261,264	7,138	-	268,401
Due to customers	7,715	-	-	7,715	-	-	7,715
Interest payable	67	138	-	205	-	-	205
Other liabilities	593	142	11,439	12,174	1,678	431	14,283
Total undiscounted liabilities	403,539	280,179	98,983	782,701	8,816	431	791,948
Derivatives:							
Foreign exchange contracts	2,521	-	-	2,521	-	-	2,521
Commitments and contingent liabilities							
Letters of credit	32,487	36,317	87,464	156,268	7,125	-	163,393
Letters of guarantee	-	1,355	4,973	6,328	19	-	6,347
Undrawn loan commitments	1,102	-	-	1,102	-	-	1,102
	33,589	37,672	92,437	163,698	7,144	-	170,842

20 RISK MANAGEMENT (continued)

20.4 Liquidity risk (continued)

At 31 December 2012	*Up to 1 year*						
	Up to 1 month US$ '000	*1 to 3 months US$ '000*	*3 to 12 months US$ '000*	*Total US$ '000*	*More than 1 year US$ '000*	*No specific maturity US$ '000*	*Total US$ '000*
Liabilities							
Deposits from banks and financial institutions	305,633	81,540	132,449	519,622	-	-	519,622
Due to banks and other financial institutions	75,664	157,727	33,942	267,333	-	-	267,333
Due to customers	21,089	-	-	21,089	-	-	21,089
Other liabilities	256	18	3,767	4,041	42	254	4,337
Total undiscounted liabilities	402,642	239,285	170,158	812,085	42	254	812,381
Derivatives:							
Foreign exchange contracts	22,110	-	-	22,110	-	-	22,110
Commitments and contingent liabilities							
Letters of credit	19,278	90,650	138,341	248,269	1,776	-	250,045
Letters of guarantee	45	416	364	825	1,020	-	1,845
	19,323	91,066	138,705	249,094	2,796	-	251,890

20 RISK MANAGEMENT (continued)

20.5 Fair value of financial instruments

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- In the principal market for the asset or liability, or
- In the absence of a principal market, in the most advantageous market for the asset or liability.

Fair value hierarchy
The Bank 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.

Fair value hierarchy - financial instruments measured at fair value
The following table provides the fair value measurement hierarchy of the Bank's financial instruments measured at fair value:

At 31 December 2013

	Level 1 ***US$ '000***	***Level 2*** ***US$ '000***	***Level 3*** ***US$ '000***	***Total*** ***US$ '000***
Investments held for trading	**14,626**	-	-	**14,626**
Available-for-sale investments	**15,283**	-	-	**15,283**
Derivative financial instruments	-	**7**	-	**7**
	29,909	**7**	-	**29,916**

At 31 December 2012

	Level 1 *US$ '000*	*Level 2* *US$ '000*	*Level 3* *US$ '000*	*Total* *US$ '000*
Investments held for trading	24	-	-	24
Available-for-sale investments	-	-	-	-
Derivative financial instruments	-	-	-	-
	24	-	-	24

None of the financial assets were transferred into or out of level 1 during the year ended 31 December 2013.

20 RISK MANAGEMENT (continued)

20.5 Fair value of financial instruments (continued)

Fair value hierarchy - financial instruments not measured at fair value
The following table provides the fair value measurement hierarchy of the Bank's financial instruments not measured at fair value:

At 31 December 2013

	Level 1 US$ '000	***Level 2 US$ '000***	***Level 3 US$ '000***	***Total fair value US$ '000***	***Carrying value US$ '000***
Held-to-maturity investments	**106,012**	**-**	**9,630**	**115,642**	**121,999**
Loans and advances	**46,687**	**-**	**316,750**	**363,437**	**362,998**
	152,699	**-**	**326,380**	**479,079**	**484,997**

At 31 December 2012

	Level 1 US$ '000	*Level 2 US$ '000*	*Level 3 US$ '000*	*Total fair values US$ '000*	*Carrying values US$ '000*
Held-to-maturity investments	33,626	-	6,630	40,256	38,890
Loans and advances	52,317	-	336,223	388,540	378,684
	85,943	-	342,853	428,796	417,574

- Fair values of held-to-maturity investments are determined based on quoted prices in the active markets.

- Fair values of loans and advances falling under Level 1 are determined based on quoted prices in active markets. Fair values of loans and advances falling under Level 3 are determined using discounted cash flows.

Balances with banks, deposits with banks and other financial institutions, deposits from banks and other financial institutions, due to banks and other financial institutions and due to customers are generally short term in nature. Management has assessed that the fair values of these approximate their carrying values as of 31 December 2013.

21 DERIVATIVE FINANCIAL INSTRUMENTS

In the ordinary course of business, the Bank enters into various types of transactions that involve derivative financial instruments. A derivative financial instrument is a financial contract between two parties where payments are dependent upon movements in price in one or more underlying financial instruments, reference rates or indices.

These include forward exchange contracts which create rights and obligation that have the effect of transferring between the parties of the instrument one or more of the financial risks inherent in an underlying primary financial instrument. On inception, a derivative financial instrument gives one party a contractual right to exchange financial assets or financial liabilities with another party under conditions that are potentially favourable, or a contractual obligation to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavourable. However, they generally do not result in a transfer of the underlying primary financial instrument on inception of the contract, nor does such a transfer necessarily take place on maturity of the contract. Some instruments embody both a right and an obligation to make an exchange. Because the terms of the exchange are determined on inception of the derivative instruments, as prices in financial markets change those terms may become either favourable or unfavourable.

The table below shows the net fair values of derivative financial instruments together with the notional amount. These contracts are settled on a net basis. Depending on currency movements, the contracts may result in either a net asset or a net liability. The following table shows the material outstanding contracts as at 31 December:

	2013		*2012*	
	Notional amount US$ '000	***Gain / (loss) US$ '000***	*Notional amount US$ '000*	*Gain / (loss) US$ '000*
Forward exchange contracts	**2,521**	**7**	22,110	(4)

22 TRANSACTIONS WITH RELATED PARTIES

Related parties represent associated companies, shareholders, directors and key management personnel of the Bank, and entities controlled, jointly controlled or significantly influenced by such parties. Pricing policies and terms of these transactions are approved by the Bank's management.

Transactions with related parties included in the statement of income and statement of financial position are as follows:

	2013 US$ '000	*2012 US$ '000*
Statement of comprehensive income		
Interest income	**278**	447
Interest expense	**921**	703
Fee and commission income	**615**	1,172
Statement of financial position		
Assets		
Cash and balances with banks	**10,772**	2,055
Deposit with banks and financial institutions	**77,500**	100,700
Loans and advances	**7,874**	-
Interest receivable	**119**	50
Other assets	**38**	41

22 TRANSACTIONS WITH RELATED PARTIES (continued)

	2013 US$ '000	2012 US$ '000
Statement of financial position (continued)		
Liabilities		
Deposits from banks and other financial institutions	**243,935**	249,673
Due to banks and other financial institutions	**15,536**	15,144
Interest payable	**128**	99
Other liabilities	**3,014**	164
Assets under management (note 23)	**26,517**	-
Contingent liabilities- Letters of credit (fully secured by deposits)	**21,542**	13,625

Compensation paid to the Board of Directors and key management personnel:

	2013 US$ 000	2012 US$ 000
Short term benefits*	**3,469**	2,413
End of term benefits	**132**	134
Total compensation	**3,601**	2,547

* Includes accrual for sitting fee and bonus of US$ 680 thousand (2012: US$ 436 thousand) and the reimbursement of travel, accommodation and other expenses paid to Board of Directors amounting to US$ 197 thousand (2012: US$ 141 thousand). The accrual is subject to approval by the Bank's shareholders in the next Annual General Meeting.

23 ASSETS UNDER MANAGEMENT

The Bank provides trade finance services to certain customers on behalf of its Parent, which involve the Bank acting as the custodian of the assets on behalf of its Parent in a fiduciary capacity. Assets that are held in such capacity are not included in these financial statements. At 31 December 2013, the Bank had fiduciary assets under management of US$ 26,517 thousand (2012: nil).

24 CAPITAL ADEQUACY

The primary objectives of the Bank's capital management are to ensure that the Bank complies with externally imposed capital requirements and that the Bank 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, return capital to shareholders or issue capital securities.

The risk asset ratio, calculated in accordance with the capital adequacy guidelines, under Basel II, approved by the Central Bank of Bahrain.

	2013 US$ 000	2012 US$ 000
Capital base:		
Tier 1 capital	**311,206**	300,599
Tier 2 capital	**805**	-
Total capital base (a)	**312,011**	300,599
Risk weighted assets (b)	**712,166**	599,925
Capital adequacy (a/b * 100)	**43.81%**	50.11%
Minimum requirement	**12.00%**	12.00%