Statement of income

During 2012, the difficult trading environment of 2011 continued to prevail. The continued delay in government spending adversely impacted economic recovery prospects and the prevalent lower interest rate environment negatively impacted profitability within the local banking industry. Despite these challenging conditions our Bank still managed to sustain our operating profits at KD 80.4 million, marginally above 2011. However, our net profits were down at KD 30 million, mainly on account of precautionary provisions taken to protect against unexpected market events in these uncertain times. The Earnings per Share amounted to 20 fils, and the Return on Assets (ROA) and Return on Equity (ROE) were 1 per cent and 6 per cent respectively.

The Bank still achieved a net interest income of KD 84.3 million, marginally lower than 2011 net interest income of KD 84.8 million, by employing effective balance sheet and interest rate management strategies, and growing its lower cost customer deposit base to reduce cost of funds, a commendable performance considering the interest rate environment which prevailed during 2012. Additionally, fee, investment and foreign exchange incomes increased by 4.4 per cent to KD 32.13 million over 2011 in spite of limited trading activities.

Operating expenses were successfully contained at KD 36 million, even though we continued to invest in our infrastructure and resources to improve customer service capability and maintain our competitive position by improving our operational efficiencies. Consequently, our cost to income ratio at 31 per cent remained at 2011 levels and is comparable with the best in the industry.

Overall the Bank managed to maintain profitability even in these difficult market conditions. Further, with capital adequacy levels in excess of 25 per cent the Bank has a strong capital position and financial resilience to cope with any market contingencies.

Balance sheet

The total assets of the Bank at the end of 2012 remained relatively stable at KD 2.973 billon compared to KD 3.079 billion in 2011. Lending opportunities remained limited in 2012, and our net loans and advances declined to KD 1.987 billion in 2012 from KD 2.066 billion at the end of 2011. The non-performing loans portfolio at the end of 2012 amounted to KD 112.1 million, increasing from KD 91.4 million in 2011. Overall the non-performing loans remained stable given the market conditions and are adequately collateralised.

The Bank has been compliant with all Central Bank of Kuwait regulatory ratios during 2012.

Appropriations and distributions

The net profit is appropriated as follows:

1. KD 3.170 million transferred to statutory reserve as per Commercial Companies Law of Kuwait.
2. KD 3.170 million transferred to general reserve as per Articles of Association.
3. The balance of KD 23.687 million transferred to retained earnings.

The directors have recommended distribution of profit to shareholders, subject to the approval of the shareholders at the Annual General Meeting, to be distributed from retained earnings as follows:

1. KD 9.078 million as cash dividend of 6 fils per share.
2. KD 10.593 million by way of issue of 105,926,763 bonus shares with nominal value of 100 fils per share, equivalent to 7 per cent of the issued and paid up capital.

Ernst & Young
Al Aiban, Al Osaimi & Partners

Deloitte & Touche
Al-Fahad, Al Wazzan & Co.

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF AL AHLI BANK OF KUWAIT K.S.C.

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Al Ahli Bank of Kuwait K.S.C. (the Bank) and its Subsidiary (together "the Group"), which comprise the consolidated statement of financial position as at 31 December 2012 and the consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in shareholders' equity and consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2012, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted for use by the State of Kuwait.

Report on Other Legal and Regulatory Requirements

Furthermore, in our opinion proper books of account have been kept by the Bank and the consolidated financial statements, together with the contents of the report of the Bank's Board of Directors relating to these consolidated financial statements, are in accordance therewith. We further report that we obtained all the information and explanations that we required for the purpose of our audit and that the consolidated financial statements incorporate all information that is required by the Capital Adequacy Regulations issued by Central Bank of Kuwait ("CBK") as stipulated in CBK Circular No. 2/BS/184/2005 dated 21 December 2005, as amended, the Commercial Companies Law No. 25 of 2012, and by the Bank's Articles of Association; that an inventory was duly carried out and that, to the best of our knowledge and belief, no violations of Capital Adequacy Regulations issued by the CBK as stipulated in CBK Circular No. 2/BS/184/2005 dated 21 December 2005, as amended, the Commercial Companies Law No. 25 of 2012, nor of the Articles of Association have occurred during the year ended 31 December 2012 that might have had a material effect on the business of the Group or on its financial position.

We further report that, during the course of our audit, we have not become aware of any material violations of the provisions of Law No. 32 of 1968, as amended, concerning currency, the CBK and the organisation of banking business, and its related regulations during the year ended 31 December 2012.

WALEED A. AL OSAIMI
LICENCE NO. 68 A
OF ERNST & YOUNG

JASSIM AHMAD AL-FAHAD
LICENCE NO. 53 A
DELOITTE
AL-FAHAD, AL WAZZAN & CO.

15 January 2013
Kuwait

Consolidated Statement of Financial Position

As at 31 December 2012

	Notes	2012 (KD'000s)	2011 (KD'000s)
ASSETS			
Cash and balances with banks	3	**251,477**	317,728
Kuwait Government treasury bills and bonds	4	**211,775**	237,048
Central Bank of Kuwait bonds	4	**259,654**	199,828
Loans and advances	5, 22	**1,986,869**	2,066,379
Investment securities	6	**189,545**	191,658
Investment in an associate	7	**10,772**	-
Other assets	8	**33,734**	38,299
Premises and equipment	9	**29,193**	28,861
TOTAL ASSETS		**2,973,019**	3,079,801
LIABILITIES AND SHAREHOLDERS' EQUITY			
LIABILITIES			
Due to banks and other financial institutions		**557,740**	422,991
Customers' deposits		**1,838,673**	2,102,433
Other liabilities	10	**59,871**	63,434
TOTAL LIABILITIES		**2,456,284**	2,588,858
SHAREHOLDERS' EQUITY			
Share capital	11	**151,324**	144,118
Proposed bonus shares	11	**10,593**	7,206
Share premium	11	**108,897**	108,897
Treasury shares	11	**(118)**	(8,556)
Reserves	11	**236,961**	217,884
Proposed dividend	11	**9,078**	21,394
TOTAL SHAREHOLDERS' EQUITY		**516,735**	490,943
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		**2,973,019**	3,079,801

Ahmed Yousuf Behbehani
Chairman

Ali Hilal Al Mutairi
Deputy Chairman and Managing Director

Colin Plowman
Chief General Manager and
Chief Executive Officer

The attached notes 1 to 25 form part of these consolidated financial statements.

Consolidated Income Statement

Year ended 31 December 2012

	Notes	2012 (KD'000s)	2011 (KD'000s)
Interest income	12	117,607	121,381
Interest expense	13	(33,289)	(36,551)
NET INTEREST INCOME		84,318	84,830
Net fees and commission income	14	23,420	24,472
Net foreign exchange gain		3,397	3,289
Net gain (loss) on investment securities		1,612	(901)
Dividend income		1,891	3,045
Share of results from an associate	7	667	-
Other income		1,144	865
OPERATING INCOME		116,449	115,600
Staff expenses		(23,291)	(23,370)
Other operating expenses and depreciation		(12,745)	(12,628)
OPERATING EXPENSES		(36,036)	(35,998)
OPERATING PROFIT FOR THE YEAR BEFORE PROVISIONS / IMPAIRMENT LOSSES		80,413	79,602
Provision / impairment losses	15	(47,361)	(25,113)
PROFIT FOR THE YEAR AFTER PROVISIONS / IMPAIRMENT LOSSES		33,052	54,489
Directors' fees		(280)	(265)
Taxation	16	(2,745)	(3,888)
NET PROFIT FOR THE YEAR		30,027	50,336
BASIC AND DILUTED EARNINGS PER SHARE	17	20 fils	34 fils

The attached notes 1 to 25 form part of these consolidated financial statements.

Consolidated Statement of Comprehensive Income

Year ended 31 December 2012

	2012 (KD'000s)	2011 (KD'000s)
NET PROFIT FOR THE YEAR	30,027	50,336
Other comprehensive income		
Effect of changes in fair values of investments available for sale	5,902	(1,274)
Net gain on sale / impairment losses on investments available for sale	666	2,343
Revaluation of freehold land	499	(451)
Exchange difference on translation of foreign operations	62	27
Other comprehensive income for the year	7,129	645
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	37,156	50,981

The attached notes 1 to 25 form part of these consolidated financial statements.

Consolidated Statement of Changes in Shareholders' Equity

Year ended 31 December 2012

					Reserves							Reserves		
	Share capital (KD'000s)	Proposed bonus shares (KD'000s)	Share premium (KD'000s)	Treasury shares (KD'000s)	Statutory reserve (KD'000s)	General reserve (KD'000s)	Treasury shares reserve (KD'000s)	Cumulative changes in fair value (KD'000s)	Property revaluation surplus (KD'000s)	Foreign currency translation reserve (KD'000s)	Retained earnings (KD'000s)	Total reserves (KD'000s)	Proposed dividend (KD'000s)	Total (KD'000s)
Balance as at 1 January 2011	144,118	-	108,897	(8,410)	48,413	47,966	6,473	17,568	5,487	(67)	69,661	195,501	28,530	468,636
Net profit for the year	-	-	-	-	-	-	-	-	-	-	50,336	50,336	-	50,336
Other comprehensive income (expense) for the year	-	-	-	-	-	-	-	1,069	(451)	27	-	645	-	645
Total comprehensive income (expense) for the year	-	-	-	-	-	-	-	1,069	(451)	27	50,336	50,981	-	50,981
Dividend paid	-	-	-	-	-	-	-	-	-	-	-	-	(28,528)	(28,528)
Dividend on treasury shares	-	-	-	-	-	-	-	-	-	-	2	2	(2)	-
Treasury shares purchased	-	-	-	(146)	-	-	-	-	-	-	-	-	-	(146)
Transfers to reserves	-	-	-	-	5,293	5,293	-	-	-	-	(10,586)	-	-	-
Proposed bonus shares (Note 11)	-	7,206	-	-	-	-	-	-	-	-	(7,206)	(7,206)	-	-
Proposed dividend (Note 11)	-	-	-	-	-	-	-	-	-	-	(21,394)	(21,394)	21,394	-
Balance as at 31 December 2011	144,118	7,206	108,897	(8,556)	53,706	53,259	6,473	18,637	5,036	(40)	80,813	217,884	21,394	490,943
Net profit for the year	-	-	-	-	-	-	-	-	-	-	30,027	30,027	-	30,027
Other comprehensive income for the year	-	-	-	-	-	-	-	6,568	499	62	-	7,129	-	7,129
Total comprehensive income for the year	-	-	-	-	-	-	-	6,568	499	62	30,027	37,156	-	37,156
Issue of bonus shares (Note 11)	7,206	(7,206)	-	-	-	-	-	-	-	-	-	-	-	-
Dividend paid (Note 11)	-	-	-	-	-	-	-	-	-	-	-	-	(21,394)	(21,394)
Treasury shares purchased	-	-	-	(104)	-	-	-	-	-	-	-	-	-	(104)
Treasury shares sold (Note 11)	-	-	-	8,542	-	-	1,592	-	-	-	-	1,592	-	10,134
Transfers to reserves	-	-	-	-	3,170	3,170	-	-	-	-	(6,340)	-	-	-
Proposed bonus shares (Note 11)	-	10,593	-	-	-	-	-	-	-	-	(10,593)	(10,593)	-	-
Proposed dividend (Note 11)	-	-	-	-	-	-	-	-	-	-	(9,078)	(9,078)	9,078	-
Balance as at 31 December 2012	151,324	10,593	108,897	(118)	56,876	56,429	8,065	25,205	5,535	22	84,829	236,961	9,078	516,735

The attached notes 1 to 25 form part of these consolidated financial statements.

Consolidated Statement of Cashflows

Year ended 31 December 2012

	2012 (KD'000s)	2011 (KD'000s)
OPERATING ACTIVITIES		
Net profit for the year	30,027	50,336
Adjustments for:		
Net (gain) loss on sale of investments available for sale	(1,993)	250
Dividend income	(1,891)	(3,045)
Share of results from an associate	(667)	-
Depreciation	1,595	1,514
Provisions / impairment losses	43,629	25,113
Operating profit before changes in operating assets and liabilities	70,700	74,168
Changes in operating assets and liabilities:		
Deposits with banks	16,803	(18,695)
Kuwait Government treasury bills and bonds	25,273	21,952
Central Bank of Kuwait bonds	(59,826)	(69,910)
Loans and advances	36,567	(84,553)
Investments at fair value through profit or loss	777	630
Other assets	5,137	(5,677)
Due to banks and other financial institutions	134,749	25,657
Customers' deposits	(263,760)	80,381
Other liabilities	(1,590)	4,083
Net cash flows (used in) from operating activities	(35,170)	28,036
INVESTING ACTIVITIES		
Purchase of investments available for sale	(68,202)	(51,702)
Proceeds from sale of investments available for sale	64,763	37,415
Net purchase of premises and equipments	(1,428)	(1,366)
Dividend income received	1,891	3,045
Net cash flows used in investing activities	(2,976)	(12,608)
FINANCING ACTIVITIES		
Dividend paid	(21,394)	(28,528)
Purchase of treasury shares	(104)	(146)
Sale of treasury shares	10,134	-
Net cash flows used in financing activities	(11,364)	(28,674)
Foreign currency translation difference	62	27
Net decrease in cash and cash equivalents	(49,448)	(13,219)
Cash and cash equivalents at 1 January	216,506	229,725
Cash and cash equivalents at 31 December	167,058	216,506
Cash and cash equivalent comprise:		
Cash in hand and in current account with other banks	32,236	33,838
Balances with the Central Bank of Kuwait	73,181	104,585
Deposits with banks with original maturity of thirty days	61,641	78,083
	167,058	216,506

Interest received in 2012 was KD 120,788 thousand (2011: KD 114,598 thousand) and interest paid in 2012 was KD 34,458 thousand (2011: KD 35,370 thousand).

The attached notes 1 to 25 form part of these consolidated financial statements.

1 INCORPORATION AND REGISTRATION

Al Ahli Bank of Kuwait K.S.C. ("the Bank") is a public shareholding company incorporated in Kuwait on 23 May 1967 and is registered as a Bank with the Central Bank of Kuwait (CBK). Its registered office is at Al Safat Square, Ahmed Al Jaber Street, Kuwait City. It is engaged in banking, primarily in Kuwait, and in the United Arab Emirates.

The Bank has a wholly owned subsidiary, Ahli Capital Investment Company K.S.C. (Closed) ("the Subsidiary") and is engaged in investment management and advisory activities, regulated by the Capital Markets Authority, Kuwait (CMA).

These consolidated financial statements of the Bank and its Subsidiary (collectively "the Group") were approved for issue by the Bank's Board of Directors on 15 January 2013. The annual general assembly of the shareholders has the power to amend these consolidated financial statements after issuance.

2 SIGNIFICANT ACCOUNTING POLICIES

Basis of preparation

The consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board (IASB), as adopted for use by the State of Kuwait for financial services institutions regulated by CBK. These regulations require adoption of all IFRS except for the IAS 39 requirement for collective provision, which has been replaced by CBK's requirement for a minimum general provision as described under the accounting policy for impairment of financial assets.

The consolidated financial statements are prepared under the historical cost convention as modified by the revaluation of "investment securities", "freehold land" and "derivative financial instruments".

The consolidated financial statements have been presented in Kuwaiti Dinars, which is the Bank's functional currency, rounded to the nearest thousand except when otherwise stated.

Basis of consolidation

The consolidated financial statements comprise the financial statements of the Bank and its Subsidiary. The financial statement of the Subsidiary is prepared for the same reporting year as the Bank using consistent accounting policies.

Subsidiaries are entities that are controlled by the Group. Control exists when the Group has the power, directly or indirectly, to govern the financial and operating policies of the entity generally accompanying a shareholding of more than one half of the voting rights. Subsidiaries are consolidated from the date on which the Group obtains control and continues to be consolidated until the date that such control ceases.

All material intra-group balances and transactions, including material unrealised gains and losses arising on intra-group transactions are eliminated on consolidation.

Changes in accounting policies

The accounting policies are consistent with those used in the previous year except for the adoption of policy on investment in an associate.

Standards issued but not yet effective

The following IASB Standards have been issued but are not yet effective and have not been early adopted by the Group. This listing of standards and interpretations issued are those that the Group reasonably expects to have an impact on disclosures, financial position or performance when applied at a future date. The Group intends to adopt these standards when they become effective.

IAS 1 Financial Statement Presentation

The amendments to IAS 1 change the grouping of items presented in other comprehensive income. Items that could be reclassified (or 'recycled') to profit or loss at a future point in time (for example, upon derecognition or settlement) would be presented separately from items that will never be reclassified. The amendment is effective for annual periods beginning on or after 1 July 2012.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Standards issued but not yet effective (continued)

IFRS 9 'Financial Instruments'

The standard was issued in November 2009 and becomes effective for annual years beginning on or after 1 January 2015. IFRS 9 improves the ability of the users of the financial statement to assess the amount, timing and uncertainty of future cash flows of the entity by replacing many financial instrument classification categories, measurement and associated impairment methods. The application of IFRS 9 will result in amendments and additional disclosures relating to financial instruments and associated risks.

IFRS 10 Consolidated Financial Statements

IFRS 10, which will be effective 1 January 2013, replaces the consolidation guidance in IAS 27 Consolidated and Separate Financial Statements and SIC-12 Consolidation - Special Purpose Entities by introducing a single consolidation model for all entities based on control, irrespective of the nature of the investee (i.e., whether an entity is controlled through voting rights of investors or through other contractual arrangements as is common in special purpose entities). Under IFRS 10, control is based on whether an investor has 1) power over the investee; 2) exposure or rights, to variable returns from its involvement with the investee; and 3) the ability to use its power over the investee to affect the amount of the returns. The Bank will assess and quantify the impact as on the date of adoption depending on the relationship between the Bank and other entities as on that date.

IFRS 12 Disclosure of Interests in Other Entities

IFRS 12, which will be effective 1 January 2013, requires enhanced disclosures about both consolidated entities and unconsolidated entities in which an entity has involvement. The objective of IFRS 12 is to require information so that financial statement users may evaluate the basis of control, any restrictions on consolidated assets and liabilities, risk exposures arising from involvements with unconsolidated structured entities and non-controlling interest holders' involvement in the activities of consolidated entities. The Bank will assess and quantify the impact as on the date of adoption depending on the relationship between the Bank and other entities as on that date.

IFRS 13 Fair Value Measurement

IFRS 13, which will be effective 1 January 2013, replaces the guidance on fair value measurement in existing IFRS with a single standard. IFRS 13 defines fair value, provides guidance on how to determine fair value and requires disclosures about fair value measurements. However, IFRS 13 does not change the requirements regarding which items should be measured or disclosed at fair value.

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 becomes effective for annual periods beginning on or after 1 January 2013.

The application of the above standards is not expected to have a material impact on the financial position or performance of the Group as and when they become effective or early adopted, except for IFRS 9 and IFRS 13 which will result in amendments and/or additional disclosures relating to classification, measurement and associated risks of financial instruments.

Financial Instruments

Classification of financial instruments

The Group classifies financial instruments as "loans and receivables", "investment securities", and "financial liabilities other than at fair value through profit or loss". Investment securities comprise of "investments at fair value through profit or loss" and "investments available-for-sale". Management determines the appropriate classification of each instrument at the time of acquisition.

Recognition

A financial asset or a financial liability is recognised when the Group becomes a party to the contractual provisions of the instrument. All regular way purchase and sale of financial assets are recognised using settlement date accounting i.e. the date the Group receives or delivers the assets. Changes in fair value between the trade date and settlement date are recognised in the consolidated income statement or in other comprehensive income in accordance with the policy applicable to the related instrument. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulations or conventions in the market place.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial Instruments (continued)

De-recognition

A financial asset (in whole or in part) is derecognised either when:

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

Where the Group has transferred its right 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.

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the bank would be required to repay.

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

Initial measurement

All financial assets or financial liabilities are initially measured at fair value. Transaction costs are added to the cost of all financial instruments except for financial assets classified as investments at fair value through profit or loss. Transaction costs on financial assets classified as investments at fair value through profit or loss are recognised in the consolidated income statement.

Subsequent measurement

Loans and receivables

These are non-derivative financial assets having fixed or determinable payments that are not quoted in an active market. These are subsequently measured at amortised cost using the effective interest method adjusted for effective fair value hedges less any provision for impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees and costs that are an integral part of the effective interest rate. The amortisation is included in "Interest income" in the consolidated income statement. The losses arising from impairment are recognised in the consolidated income statement under "Provisions/impairment losses".

Cash and balances with banks, Kuwait Government treasury bills and bonds, Central Bank of Kuwait bonds, loans and advances and certain other assets are classified as "loans and receivables".

Investments at fair value through profit or loss

This category has two sub-categories: investments held for trading and those designated at fair value through profit or loss at inception. An investment is classified as held for trading if it is acquired principally for the purpose of selling or repurchasing in the near term. Investments are designated at fair value through profit or loss in accordance with a documented investment strategy and reported to key management personnel on that basis. These are subsequently measured at fair value and any resultant gains or losses are recognised in the consolidated income statement. The Group has not designated any investments as 'those designated at fair value through profit or loss at inception' upon initial recognition.

Investments available for sale

These are non-derivative financial assets either designated as "available for sale" or are not classified as investments at fair value through profit or loss or loans and receivables. These are subsequently measured at fair value and any resultant gains or losses are recognised through other comprehensive income. When the asset is disposed of, or impaired, the related accumulated fair value adjustments are transferred to the consolidated income statement.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial Instruments (continued)

Subsequent measurement (continued)

Financial liabilities other than at fair value through profit or loss

These are subsequently measured at amortised cost using the effective interest method. Amortised cost is calculated by taking into account any discount or premium on the issue and costs that are an integral part of the effective interest rate. Due to banks and other financial institutions, customers' deposits and other liabilities are classified as "financial liabilities other than at fair value through profit or loss".

Derivative financial instruments and hedging

Derivatives include interest rate swaps and forward foreign exchange contracts. Such derivative financial instruments are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at fair value. 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. For hedges, which do not qualify for hedge accounting and for "held for trading" derivatives, any gains or losses arising from changes in the fair value of derivatives are taken directly to the consolidated income statement.

The Group makes use of derivative financial instruments to manage exposures to interest rate and foreign currency risks. Certain derivatives embedded in other financial instruments are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract and the host contract is not carried at fair value through profit or loss. These embedded derivatives are measured at fair value with the changes in fair value recognised in the consolidated income statement.

In order to manage particular risks, the Group applies hedge accounting for transactions, which meet the specified criteria. At inception of the hedge relationship, the Group formally documents the relationship between the hedged item and the hedging instrument, including the nature of the risk, the objective 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 hedge relationship, a formal assessment is undertaken to ensure that the hedging instrument is expected to be highly effective in offsetting the designated risk in the hedged item. Hedges are formally assessed at each reporting date. A hedge is regarded as highly effective if the changes in fair value or cash flows attributable to the hedged risk during the year for which the hedge is designated are expected to offset in a range of 80 per cent to 125 per cent.

For the purposes of hedge accounting, hedges are classified into two categories: (a) fair value hedges which hedge the exposure to changes in the fair value of a recognised asset or liability; and (b) cash flow hedges, which hedge exposure to variability in cash flows that is either attributable to a particular risk associated with a recognised asset or liability or a highly probable forecast transaction.

Fair value hedge

In relation to fair value hedges, which meet the conditions for hedge accounting, any unrealised gain or loss from re-measuring the hedging instrument to fair value is recognised in 'Other assets' or 'Other liabilities' and in the consolidated income statement. Any gain or loss on the hedged item attributable to the hedged risk is adjusted against the carrying value of the hedged item and recognised in the consolidated income statement.

If the hedging instrument expires or is sold, terminated or exercised, or where the hedge no longer meets the criteria for hedge accounting, the hedge relationship is terminated.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial Instruments (continued)

Subsequent measurement (continued)

Cash flow hedge

When a derivative is designated as the hedging instrument in a hedge of the variability in cash flows attributable to a particular risk associated with a recognised asset or liability or a highly probable forecast transaction that could affect profit or loss, the effective portion of changes in the fair value of the derivative is recognised directly in the consolidated statement of comprehensive income. The amount recognised in the consolidated statement of comprehensive income is removed and included in the consolidated income statement in the same year as the hedged cash flows affect profit or loss under the same income statement line item as the hedged item. Any ineffective portion of changes in the fair value of the derivative is recognised immediately in the consolidated income statement.

If the derivative expires or is sold, terminated, or exercised, or no longer meets the criteria for cash flow hedge accounting, or the designation is revoked, then hedge accounting is prospectively discontinued and the amount recognised in consolidated statement of comprehensive income remains in the consolidated statement of comprehensive income until the forecast transaction affects profit or loss. If the forecast transaction is no longer expected to occur, then the balance in the consolidated statement of comprehensive income is recognised immediately in the consolidated income statement.

Financial guarantees

In the ordinary course of business, the Group gives financial guarantees, consisting of letters of credit, guarantees and acceptances. Financial guarantees are initially recognised in the consolidated financial statements at fair value, being the premium received, in other liabilities. The premium received is amortised in the consolidated income statement in 'net fees and commission income' on a straight-line basis over the life of the guarantee. The guarantee liability is subsequently measured as a higher of the amount initially recognised less amortisation or the value of any financial obligation that may arise therefrom. Any increase in the liability relating to financial guarantees is recognised in consolidated financial statements.

Offsetting

Financial assets and liabilities are offset when the Group has a legally enforceable right to offset and intends to settle either on a net basis or to realise the asset and settle the liability simultaneously.

Fair values

Fair values for financial instruments traded in active markets are based on closing bid prices. For all other financial instruments including financial instruments for which the market has become inactive, the fair value is determined by using appropriate valuation techniques. Valuation techniques include the fair value derived from recent arm's length transaction, comparison to similar instruments for which market observable prices exist, discounted cash flow method or other relevant valuation techniques commonly used by market participants. For investments in equity instruments, where a reasonable estimate of fair value cannot be determined, the investment is carried at cost.

The fair value of financial instruments carried at amortised cost, other than short-term in nature is estimated by discounting the future contractual cash flows at the current market interest rates for similar financial instruments.

The fair value of a derivative financial instrument is the equivalent of the unrealised gain or loss from marking to market the derivative financial instrument, using relevant market rates or internal pricing models.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial Instruments (continued)

Impairment of assets

The Group assesses at each statement of financial position date whether there is any objective evidence that an individually significant financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets are impaired if and only if, there is objective evidence of impairment as a result of one or more loss events that has occurred after the initial recognition of the financial asset and that the loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets. For the purpose of assessing impairment, the financial assets are grouped at the lowest levels for which there are separately identifiable cash flows.

For loans and receivables, if there is objective evidence of impairment loss, the financial asset is written down to its recoverable amount. For loans and receivables with fixed interest rates, the recoverable amount is the present value of expected future cash flows discounted at the original effective interest rate and for loans and receivables with variable interest rates, the recoverable amount is discounted at the current effective interest rate as determined under the contract. Future cash flow includes amounts recoverable from guarantees and collateral. Financial guarantees are assessed and impairment loss is recorded in a similar manner as for loans and receivables. The carrying amount of the asset is reduced through the use of a provision account and the amount of impairment loss is recognised in the consolidated income statement. If in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reversed by adjusting the provision account. The amount of the increase or reversal is recognised in the consolidated income statement. Loans and receivables together with the associated provision account are written off when there is no realistic prospect of future recovery and all collateral have been realised or have been transferred to the Group. If a write off is later recovered, the recovery is recognised in the consolidated income statement.

Central Bank of Kuwait directives require the Group to maintain a minimum general provision of 1% on regular cash facilities and 0.5% on regular non cash credit facilities, net of certain categories of collateral.

For available for sale equity investments, the Group assess on each statement of financial position date whether there is objective evidence that an investment or a group of investments is impaired. When 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 consolidated income statement, is transferred from other comprehensive income and recognised in the consolidated income statement. Impairment losses on equity investments are not reversed through the consolidated income statement. Any increase in their fair value after impairment is taken directly to other comprehensive income.

For available for sale debt instruments, the Group assess the instruments at an individual level to determine whether any objective evidence for impairment exists. When there is objective evidence of impairment, the amount of loss is measured as the difference between the instrument's carrying value and the present value of the future cash flows. If in a subsequent year, the fair value of a debt instruments increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the consolidated income statement, the impairment loss is reversed through the consolidated income statement.

Other assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Impairment loss is recognised for the amount by which the carrying amount of the asset exceeds its recoverable amount. The recoverable amount is the higher of the asset's fair value less cost of sale and value in use.

Renegotiated loans

In the event of a default, the Group seeks to restructure loans rather than take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. When the terms and conditions of these loans are renegotiated, the terms and conditions of the new contractual arrangement apply in determining whether these loans remain past due. Management continually reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial Instruments (continued)

Investment in an associate

The Group's investment in its associate is accounted for using the equity method. An associate is an entity in which the Group has significant influence but not control, generally representing a shareholding of between 20% and 50% of the voting rights.

Under the equity method, the investment in the associate is carried in the consolidated statement of financial position at cost plus post acquisition changes in the Group's share of net assets of the associate. Unrealised gains and losses resulting from transactions between the Group and the associate are eliminated to the extent of the interest in the associate.

The Group's share of its associate's post-acquisition profits or losses is recognised in the consolidated income statement and its share of post-acquisition movements in other comprehensive income of associate is recognised in consolidated statement of changes in equity. Goodwill relating to the associate is included in the carrying amount of the investment and is neither amortised nor individually tested for impairment.

Where applicable, adjustments are made to bring the accounting policies of the associate in line with those of the Group. The difference in reporting date of the associate and the Group is not more than three months. Adjustments are made for the effects of significant transactions or events that occur between that date and the date of the Group's consolidated financial statements.

At each reporting date, the Group determines if there is any objective evidence that the investment in the associate is impaired, in which case the Group calculates the amount of impairment loss as the difference between the recoverable amount of the associate and its carrying value and recognises the amount in the consolidated income statement.

Upon loss of significant influence over the associate, the Group measures and recognises any retaining investment at its fair value. Any difference between the carrying amount of the associate upon loss of significant influence and the fair value of the retained investment and proceeds from disposal is recognised in the consolidated income statement.

Cash and cash equivalents

Cash and cash equivalents consists of cash on hand, balances and deposits with banks with original maturity not exceeding thirty days.

Premises and equipments

Premises and equipments other than freehold land are stated at cost less accumulated depreciation and impairment losses. Depreciation is provided on all premises and equipments, other than freehold land, at rates calculated to write off the cost of each asset on a straight line basis over its estimated useful life.

Freehold land is initially recognised at cost. After initial recognition freehold land is carried at its revalued amount which is the fair value at the date of revaluation based on valuations by external independent valuers. The resultant revaluation surplus or deficit is recognised, as a separate component under other comprehensive income to the extent the deficit does not exceed the previously recognised surplus. The portion of the revaluation deficit that exceeds a previously recognised surplus is recognised in the consolidated income statement. To the extent that a revaluation surplus reverses a revaluation loss previously recognised in the consolidated income statement, the increase is recognised in the consolidated income statement. Upon disposal the revaluation surplus relating to the freehold land sold is transferred directly to retained earnings.

The assets residual values, useful lives and methods of depreciation are reviewed, and adjusted if appropriate, at each financial year end. The estimated useful lives of the assets for the calculation of depreciation are as follows:

Buildings	20 years
Furniture and equipment	3 to 5 years

The carrying amounts of premises and equipments are reviewed at each statement of financial position date to determine whether there is any indication of impairment. If any such indication exists, the assets are written down to their recoverable amounts and the impairment loss is recognised in the consolidated income statement.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

End of service indemnity

Provision is made for amounts payable to employees under the Kuwait Labour Law, employee contracts and respective applicable laws in the countries where the branches operate.

Treasury shares

Treasury shares consist of the Bank's own issued shares that have been reacquired by the Bank and not yet reissued or cancelled. The treasury shares are accounted for using the cost method. Under this method, the weighted average cost of the shares reacquired is charged to a contra account in equity. When the treasury shares are reissued, gains are credited to the "treasury shares reserve", which is not distributable. Any realised losses are charged to the same account to the extent of the credit balance in that account. Any excess losses are charged to retained earnings then to the reserves. No cash dividends are paid on these shares. The issue of bonus shares increases the number of treasury shares proportionately and reduces the average cost per share without affecting the total cost of treasury shares.

Revenue recognition

Interest income and expenses are recognised on an effective interest basis. Once a financial instrument categorised as loans and receivables is impaired, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. Interest income and expenses for all interest bearing financial instruments including those classified as investments at fair value through profit or loss and investments available for sale, are recognised within interest income in the consolidated income statement.

Fees and commission that are an integral part of the effective interest rate of a financial instrument are treated as an adjustment to the effective interest rate. Other fees and commission are recognised over the period of service. Dividend income is recognised when the right to receive the payment is established.

Taxation

Taxation is provided for in accordance with the fiscal regulations in Kuwait and the United Arab Emirates where the foreign branches operate.

Foreign currencies

Foreign currency transactions are recorded at rates of exchange ruling at value date of the transaction. Monetary assets and liabilities in foreign currencies outstanding at the year end are translated into Kuwaiti Dinars at rates of exchange ruling at the statement of financial position date.

Non-monetary assets and liabilities 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. Non-monetary assets and liabilities in foreign currencies that are stated at fair value are translated to Kuwaiti Dinars at the foreign exchange rates ruling at the dates that the values were determined. In case of non-monetary assets whose changes in fair values are recognised directly in other comprehensive income, related foreign exchange differences are also recognised directly in other comprehensive income. For other non-monetary assets foreign exchange differences are recognised directly in the consolidated income statement.

Assets and liabilities, both monetary and non-monetary, of foreign operations are translated at the exchange rates prevailing at the statement of financial position date. Operating results of such operations are translated at average exchange rates for the year. The resulting exchange differences are accumulated in other comprehensive income until the disposal of the foreign operation.

Segment information

A segment is a distinguishable component of the Group that engages in business activities from which it earns revenues and incurs costs. The operating segments are used by the management of the Bank to allocate resources and assess performance. Operating segments exhibiting similar economic characteristics, product and services, class of customers where appropriate are aggregated and reported as reportable segments.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Fiduciary assets

Assets held in trust or in a fiduciary capacity are not treated as assets of the Group and accordingly are not included in the consolidated financial statements.

Use of estimates and assumptions

The Group based its assumptions and estimates on parameters available when the consolidated financial statements were prepared. Existing circumstances and assumptions about future developments, however, may change due to market changes or circumstances arising beyond the control of the Group.

The basis used by management in determining the carrying values of loans and receivables and investments available for sale and the underlying risks therein are discussed below:

Impairment losses on loans and advances

The Group reviews its loans and advances on a regular basis to assess whether an impairment loss should be recorded in the consolidated income statement. In particular, considerable judgement by management is required in the estimation of the amount and timing of future cash flows when determining the level of provisions required. Such estimates are necessarily based on assumptions about several factors involving varying degrees of judgment and uncertainty.

Valuation of unquoted investments available for sale

Available for sale financial assets valued using valuation techniques or pricing models primarily consist of unquoted equities and debt securities.

These assets are valued using models that use both observable and un-observable data. The un-observable inputs to the models include assumptions regarding the future financial performance of the investee, its risk profile, and economic assumptions regarding the industry and geographical jurisdiction in which the investee operates.

Any changes in these estimates and assumptions as well as the use of different, but equally reasonable estimates and assumptions may have an impact on carrying amounts of loans and receivables and investments available for sale.

Judgements

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

Classification of financial assets

On acquisition of financial assets, management decides whether it should be classified as investments at fair value through profit or loss or investments available for sale or loans and receivables. Further, determining whether or not the market for a quoted financial instrument is active requires judgement based on assessment of the volume/market conditions and availability of ready and regular quotes.

Impairment of investments available for sale

The Group treats investments available for sale as impaired when there has been a significant or prolonged decline in the fair value below its cost or where other objective evidence of impairment exists. The determination of what is "significant" or "prolonged" requires considerable judgement and involves evaluating factors including industry and market conditions, future cash flows and discount factors.

3 CASH AND BALANCES WITH BANKS

	2012 (KD'000s)	2011 (KD'000s)
Cash in hand and in current account with other banks	32,236	33,838
Balances and deposits with the Central Bank of Kuwait	73,181	104,585
Deposits with banks	146,060	179,305
	251,477	317,728

4 KUWAIT GOVERNMENT TREASURY BILLS AND BONDS AND CENTRAL BANK OF KUWAIT BONDS

These financial instruments are issued by the Central Bank of Kuwait on behalf of the Ministry of Finance or on its own behalf and are acquired from the primary market by the Group.

5 LOANS AND ADVANCES

A reconciliation of the provision for credit losses for loans and advances to customers is as follows:

	2012 (KD'000s)	2011 (KD'000s)
At 1 January	121,982	106,671
Exchange difference	49	(36)
Amounts written off during the year	(18,301)	(12,651)
Recoveries	1,370	4,039
Charge for the year (Note 15)	42,943	23,959
At 31 December	148,043	121,982
General Provision	122,418	107,997
Specific Provision	25,625	13,985

The Bank's policy for calculating the provision for impairment losses on loans and advances agrees in all material respects with the requirements of the Central Bank of Kuwait in respect of specific provision.

As at 31 December 2012, loans and advances to customers individually determined to be impaired amounted to KD 112,106 thousand (31 December 2011: KD 91,365 thousand) with a specific provision of KD 25,625 thousand (2011: KD 13,985 thousand). The fair value of collateral that the Group held for impaired loans and advances to customers, as at 31 December 2012 was KD 99,774 thousand (31 December 2011: KD 110,543 thousand).

The available provision on non-cash facilities is KD 13,078 thousand (2011: KD 15,048 thousand) and is included in other liabilities (Note 10).

For disclosures relating to credit risk management, credit concentration, credit quality by class and credit risk mitigants for loans and advances, refer to note 22A.

6 INVESTMENT SECURITIES

The Group uses the following hierarchy for determining and disclosing the fair value of investment securities

Level 1: Quoted securities traded in active markets.

Level 2: Unquoted securities where significant valuation inputs are based on observable market data.

Level 3: Unquoted securities where significant valuation inputs are not based on observable market data.

	Investments at fair value through profit or loss		Investments available for sale	
	2012 (KD'000s)	2011 (KD'000s)	**2012 (KD'000s)**	2011 (KD'000s)
Level 1:				
Equity	788	1,565	11,660	10,424
Debt securities	-	-	115,349	115,144
Level 2:				
Equity	-	-	23,881	35,113
Debt securities	-	-	6,700	-
Managed funds	-	-	4,182	3,907
Level 3:				
Equity	-	-	21,985	20,505
Debt securities	-	-	5,000	5,000
	788	1,565	188,757	190,093

An amount of KD 1,480 thousand (2011: KD 588 thousand) was recorded in the consolidated statement of comprehensive income representing increase in valuation in level 3 unquoted equity securities. The impact on the consolidated statement of financial position or the consolidated statement of shareholders' equity would be immaterial if the relevant risk variables used to fair value the unquoted securities were altered by 5 per cent.

7 INVESTMENT IN AN ASSOCIATE

During the year, Credit One Kuwait Holding Company K.S.C. ("Credit One"), an unquoted holding company incorporated in Kuwait engaged in providing credit facilities to customers on instalment sale of goods and services has become an associate of the Bank with 35% equity interest and is accounted for using the equity method of accounting.

Summarised financial information for the period ended 30 November 2012 is as follows:

	Total (KD'000s)
Assets	67,289
Liabilities	35,522
Equity	31,767
Revenue	8,312
Results	4,037

The Bank is in the process of completing the purchase price allocation of the identifiable net assets of the associate.

8 OTHER ASSETS

	2012 (KD'000s)	2011 (KD'000s)
Interest receivable	18,736	23,110
Others	14,998	15,189
	33,734	38,299

Others include KD 8,585 thousand (2011: KD 8,566 thousand) which represents assets acquired in settlement of debt carried at lower of cost or fair value based on valuation provided by independent valuers.

9 PREMISES AND EQUIPMENT

During the year, the Group revalued its freehold land at KD 22,134 thousand (2011: KD 21,629 thousand) resulting in a gain of KD 499 thousand (2011: loss of KD 451 thousand) which is included in the consolidated statement of comprehensive income.

If the freehold land was measured using the cost model, the net carrying amount as at 31 December 2012 would be KD 16,599 thousand (2011: KD 16,593 thousand).

10 OTHER LIABILITIES

	2012 (KD'000s)	2011 (KD'000s)
Interest payable	9,695	10,898
Interest received in advance	336	894
Staff related accruals	9,507	8,784
Provisions on non cash facilities (Note 5)	13,078	15,048
Others	27,255	27,810
	59,871	63,434

11 SHARE CAPITAL AND RESERVES

a) The authorised, issued and fully paid share capital comprises 1,513,239,471 shares (2011: 1,441,180,449 shares) of 100 fils each.

The shareholders at the Annual General Meeting held on 10 March 2012 approved the distribution of cash dividend of 15 per cent and bonus shares of 5 per cent for the year ended 31 December 2011 (cash dividend of 20 per cent for the year ended 31 December 2010). The issue of bonus shares resulted in an increase in the number of authorised and issued shares by 72,059,022 shares and share capital by KD 7,206 thousand. Treasury shares are not entitled to any cash dividends.

b) The balance in the share premium account is not available for distribution.

c) As required by the Commercial Companies Law, 10 per cent of the profit for the year before directors' fees, contribution to Kuwait Foundation for the Advancement of Sciences, National Labour Support tax and Zakat has been transferred to statutory reserve. The Bank may resolve to discontinue such annual transfers when the reserve totals 50 per cent of paid up share capital.

Distribution of this reserve is limited to the amount required to enable the payment of a dividend of 5 per cent of share capital in years when accumulated profits are not sufficient for the payment of a dividend of that amount.

11 SHARE CAPITAL AND RESERVES (continued)

d) The articles of association of the Bank require that an amount of not less than 10 per cent of the profit for the year be transferred annually to a general reserve. The transfer is before directors' fees, contribution to Kuwait Foundation for the Advancement of Sciences, National Labour Support tax and Zakat. There is no restriction on distribution of this reserve.

e) As at 31 December 2012, the Bank held 202,743 (2011: 14,890,431) of its own shares equivalent to 0.01 per cent (2011: 1.03 per cent) of the total issued share capital at the statement of financial position date. The market value of these shares at 31 December 2012 amounted to KD 114 thousand (31 December 2011 KD 9,679 thousand).

f) The directors have proposed a cash dividend of 6 per cent and bonus shares of 7 per cent for the year ended 31 December 2012, (2011: 15 per cent cash dividend and bonus shares of 5 per cent) subject to the approval of the shareholders at the annual general meeting.

12 INTEREST INCOME

	2012 (KD'000s)	2011 (KD'000s)
Balances with banks	**2,267**	2,134
Loans and advances	**103,627**	107,749
Bills, bonds and debt securities	**11,713**	11,498
	117,607	121,381

13 INTEREST EXPENSE

	2012 (KD'000s)	2011 (KD'000s)
Due to banks and other financial institutions	**5,300**	6,490
Customers' deposits:		
- Sight deposits	**2,259**	1,661
- Time deposits	**25,730**	28,400
	33,289	36,551

14 NET FEES AND COMMISSION INCOME

	2012 (KD'000s)	2011 (KD'000s)
Fees and commission income	**24,567**	25,353
Fees and commission expense	**(1,147)**	(881)
	23,420	24,472

Fees and commission income includes KD 932 thousand (2011: KD 898 thousand) from fiduciary activities.

15 PROVISIONS / IMPAIRMENT LOSSES

	2012 (KD'000s)	2011 (KD'000s)
Cash facilities – general	17,976	18,094
Cash facilities – specific	24,967	5,865
Non cash facilities	(1,973)	(1,725)
Investments available for sale	2,659	2,093
Others	3,732	786
	47,361	25,113

Others include KD 3,732 thousand (2011: Nil) representing amount paid in settlement of a customer legal claim.

16 TAXATION

	2012 (KD'000s)	2011 (KD'000s)
Kuwait Foundation for the Advancement of Sciences	285	476
National Labour Support Tax	793	1,323
Zakat	317	529
Tax on overseas branches	1,350	1,560
	2,745	3,888

17 BASIC AND DILUTED EARNINGS PER SHARE

Basic and diluted earnings per share are computed by dividing the net profit for the year by the weighted average number of shares outstanding during the year.

	2012	2011
Net profit for the year (KD '000s)	30,027	50,336
Weighted average number of the Bank's issued and paid-up shares	1,513,239,471	1,513,239,471
Less: Weighted average number of treasury shares	(9,045,893)	(15,559,686)
Weighted average number of shares outstanding during the year	1,504,193,578	1,497,679,785
Basic and diluted earnings per share (fils)	20	34

The prior year comparative has been restated for the effect of bonus shares issued during the current year.

18 RELATED PARTY TRANSACTIONS

These represent transactions with certain related parties (major shareholders, directors and senior management of the Group, close members of their families and entities of which they are principal owners or over which they are able to exercise significant influence, managed funds and an associate entity) who were customers of the Group during the period. The terms of these transactions are approved by the Group's management.

In the normal course of business, these related parties have deposits with the Bank and credit facilities granted to them by the Bank. The balances included in the consolidated financial statements are as follows:

	Number		Number of parties related to directors		Amount	
	2012	2011	**2012**	2011	**2012 (KD'000s)**	2011 (KD'000s)
Directors						
Loans and advances	4	4	1	1	2,643	195
Deposits	7	7	6	5	23,335	11,685
Commitments and contingent Liabilities	-	-	2	2	346	904

Loans and advances are fully collateralised.

	Number		Amount	
	2012	2011	**2012 (KD'000s)**	2011 (KD'000s)
Senior management				
Loans and advances	9	9	147	205
Deposits	9	9	956	626
Commitments and contingent Liabilities	1	1	1	1

	2012 (KD'000s)
Associate	
Loans and advances	12,500
Deposits	754

Interest income and interest expense includes KD 709 thousand (2011: KD 27 thousand) and KD 218 thousand (2011: KD 195 thousand) respectively, on transactions with related parties.

The details of compensation for senior management officials are as follows:

	2012 (KD'000s)	2011 (KD'000s)
Salaries and other benefits	2,653	2,504
Post employment benefits	205	289
	2,858	2,793

19 COMMITMENTS AND CONTINGENT LIABILITIES

	2012 (KD'000s)	2011 (KD'000s)
Acceptances	61,965	50,656
Letters of credit	198,768	213,445
Guarantees	660,575	635,524
	921,308	899,625

The above balances represent the irrevocable contractual amounts of the Group's off balance sheet financial instruments that commit the Bank to make payments on behalf of the customers in the event of a specific act. The contractual amounts represent the credit risk, assuming that the amounts are fully advanced and that any collateral or other security is of no value. The total contractual amount of commitments to extend credit does not necessarily represent future cash requirements, since many of these commitments may expire or terminate without being funded. Total commitments to extend credit at the statement of financial position date amounted to KD 210,071 thousand (2011: KD 232,567 thousand).

20 DERIVATIVE FINANCIAL INSTRUMENTS

In the normal course of its business the Group utilises derivative financial instruments to manage its exposure to fluctuations in interest and foreign exchange rates. Derivative transactions result, to varying degrees, in credit as well as market risks.

The Group's measure of derivative related credit risk is the cost of replacing contracts at current market rates should the counter party default on or prior to the settlement date and is limited to the positive fair value of instruments that are favourable to the Group.

Market risk arises as interest and foreign exchange rates fluctuate affecting the value of a contract. For risk management purposes and to control these activities, the Group has established appropriate procedures and limits approved by the Board of Directors.

The table below shows the fair values of derivative financial instruments, recorded as assets or liabilities, together with their contractual amounts. The contractual amount, recorded gross, is the amount of a derivative's underlying asset, reference rate or index and is the basis upon which changes in the value of derivatives are measured. The contractual amounts represent the volume of transactions outstanding at the year end and are not indicative of the credit or market risk.

	2012			2011		
	Assets (KD'000s)	Liabilities (KD'000s)	Contractual amounts (KD'000s)	Assets (KD'000s)	Liabilities (KD'000s)	Contractual amounts (KD'000s)
Held for hedging:						
Fair value hedges						
Interest rate swaps	-	683	16,875	11	373	16,713
Held for trading:						
Forward foreign exchange contracts	4,054	1,171	189,007	2,895	733	101,942
Interest rate swaps	-	439	88,883	687	-	100,000
	4,054	2,293	294,765	3,593	1,106	218,655

20 DERIVATIVE FINANCIAL INSTRUMENTS (continued)

All derivative contracts are fair valued based on observable market inputs.

Forward foreign exchange contracts are contractual agreements to buy, sell or exchange a specified financial instrument at a specific price and date in the future. Forwards are customised contracts transacted on the over the counter market and are settled on a gross basis.

Interest rate swaps are contractual agreements between two parties and may involve exchange of interest or exchange of both principal and interest for a fixed period of time based on contractual terms.

21 SEGMENTAL INFORMATION

The Group is organised into segments that engage in business activities which earns revenue and incurs expenses. These segments are regularly reviewed by the chief operating decision maker for resource allocation and performance assessment. For the purposes of segment reporting the management has grouped the products and services into the following operating segments:

Commercial Banking - Comprising a full range of credit, deposit and related banking services provided to its commercial customers.

Treasury and Investment - Comprising money market, foreign exchange, treasury bonds, asset and surplus fund management, investment securities and investment in an associate.

Operating income includes operating revenue directly attributable to a segment. Segment results include revenue and expenses directly attributable to a segment. Segment assets comprise those operating assets that are directly attributable to the segment.

Segmental information for the year ended 31 December is as follows:

	Commercial banking		Treasury and Investment		Total	
	2012 (KD'000s)	2011 (KD'000s)	**2012 (KD'000s)**	2011 (KD'000s)	**2012 (KD'000s)**	2011 (KD'000s)
Operating income	**102,029**	101,189	**14,420**	14,411	**116,449**	115,600
Segment result	**38,750**	62,060	**10,999**	9,572	**49,749**	71,632
Unallocated expense					**(16,697)**	(17,143)
Profit before tax and directors'fees					**33,052**	54,489
Segment assets	**2,091,814**	2,206,388	**818,278**	806,253	**2,910,092**	3,012,641
Unallocated assets					**62,927**	67,160
Total assets					**2,973,019**	3,079,801
Segment liabilities	**1,739,506**	1,905,049	**656,907**	620,375	**2,396,413**	2,525,424
Unallocated liabilities					**59,871**	63,434
Total Liabilities					**2,456,284**	2,588,858

The commercial banking segment includes operating income of KD 9,562 thousand (2011: KD 9,790 thousand) and segment assets of KD 248,463 thousand (2011: KD 212,153 thousand) relating to overseas branches.

22 RISK MANAGEMENT

A. CREDIT RISK

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. The financial instruments exposed to these risks, the objectives, policies and procedures for managing and measuring these risks is explained in the Risk Management section of the annual report.

The maximum exposure to credit risk as at the statement of financial position date is represented by the carrying amount of each financial asset in the consolidated statement of financial position.

Concentrations of credit risk arise when a number of counter parties are engaged in similar business activities or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations of credit risk indicate the relative sensitivity of the Group's performance to developments affecting a particular industry or geographic location. Maximum concentration of credit risk to a single or group of related counterparties is limited to 15 per cent of the Group's comprehensive capital as determined by the regulatory guidelines.

In accordance with the instructions of the Central Bank of Kuwait dated 18 December 1996, setting out the rules and regulations regarding the classification of credit facilities, the Group has formed an internal committee which is composed of competent professional staff and which has as its purpose the study and evaluation of the existing credit facilities of each customer of the Group. This Committee is required to identify any abnormal situations and difficulties associated with a customer's position, which might cause the debt to be classified as irregular, and to determine an appropriate provisioning level.

Derivative financial instruments

Credit risk arising from derivative financial instruments is limited to those with positive fair values, as recorded in the consolidated statement of financial position.

Credit-related commitments risks

The Group makes available to its customers, financial guarantees which may require that the Group makes payments on their behalf. Such payments are collected from customers based on the terms of the financial guarantees. They expose the Group to similar risks to loans and advances and these are mitigated by the same control processes and policies.

Credit concentration risks

Geographical and industry sector concentrations of financial assets and contingent liabilities with credit risk are as follows:

	2012		2011	
	Assets (KD'000s)	Contingent liabilities (KD'000s)	Assets (KD'000s)	Contingent liabilities (KD'000s)
Geographic region:				
Domestic (Kuwait)	2,355,268	422,385	2,493,760	466,868
Other Middle East	360,816	135,940	341,395	104,885
Europe	86,954	96,381	88,937	90,474
United States of America	2,949	375	3,094	1,037
Rest of the world	46,075	266,227	31,712	236,361
	2,852,062	921,308	2,958,898	899,625
Industry sector:				
Trading and manufacturing	292,139	185,903	335,465	176,056
Banks and other financial institutions	559,877	377,979	609,851	353,077
Construction and real estate	729,011	246,003	718,013	232,823
Others including government	1,271,035	111,423	1,295,569	137,669
	2,852,062	921,308	2,958,898	899,625

22 RISK MANAGEMENT (continued)

A. CREDIT RISK (continued)

Gross maximum exposures and credit quality of financial instruments

The table below shows the maximum exposure to credit risk for the components of the consolidated statement of financial position, without taking account of any collateral and other credit enhancements. The maximum exposure is shown gross, before the effect of mitigation through the use of master netting and collateral agreements.

The table also shows the credit risk exposure by credit quality of financial assets by class, grade and status:

	Neither Past due nor Impaired				
	High grade (KD'000s)	Standard grade (KD'000s)	Acceptable grade (KD'000s)	Past due including individually impaired (KD'000s)	Gross Maximum exposures (KD'000s)
31 December 2012					
Balances with banks	242,792	12	-	-	242,804
Kuwait Government treasury bills and bonds (Note 4)	211,775	-	-	-	211,775
Central Bank of Kuwait bonds (Note 4)	259,654	-	-	-	259,654
Loans and advances					
- Loans to customers	1,423,674	235,959	136,467	108,960	1,905,060
- Loans to banks	81,809	-	-	-	81,809
Debt securities available for sale (Note 6)	122,049	5,000	-	-	127,049
Other assets	21,171	1,646	932	162	23,911
Total	2,362,924	242,617	137,399	109,122	2,852,062
31 December 2011					
Balances with banks	306,808	6	-	-	306,814
Kuwait Government treasury bills and bonds (Note 4)	237,048	-	-	-	237,048
Central Bank of Kuwait bonds (Note 4)	199,828	-	-	-	199,828
Loans and advances					
- Loans to customers	1,550,411	290,222	80,382	104,367	2,025,382
- Loans to banks	40,997	-	-	-	40,997
Debt securities available for sale (Note 6)	115,144	5,000	-	-	120,144
Other assets	25,416	2,393	652	224	28,685
Total	2,475,652	297,621	81,034	104,591	2,958,898

The gross maximum credit risk exposure relating to contingencies amounts to KD 921,308 thousand (2011: KD 899,625 thousand).

The high, standard and acceptable grades of classification of loans to customers above is based on inherent credit quality of the counterparties, the assessed risk profile, acceptability and availability of collateral in accordance with Group's internal rating model. Grading of balances with banks, loans to banks and debt investments available for sale are based on the external rating of the counterparties.

Past due including individually impaired loans and advances above include KD 23,697 thousand (2011: KD 27,614 thousand) which are past due for less than 90 days and are not considered as impaired.

22 RISK MANAGEMENT (continued)

A. CREDIT RISK (continued)

The fair value of collateral that the Group held for past due including individually impaired loans and advances to customers, as at 31 December 2012 was KD 139,631 thousand (31 December 2011: KD 129,720 thousand). The Group has taken adequate legal measures to secure recovery of collateral when needed. Impairment loss on loans and advances is disclosed in Note 5.

Where financial instruments are recorded at fair value the amounts shown above represent the current credit risk exposure but not the maximum risk exposure that could arise in the future as a result of changes in values.

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 are cash, securities, and charges over real estate properties and counter-guarantees.

Management monitors the market value of collateral on an ongoing basis and requests additional collateral, if required, in accordance with the underlying agreement. At 31 December 2012, the Group held collateral with a fair value of KD 1,834,563 thousand (31 December 2011: KD 1,879,700 thousand).

It is the Group's policy to repossess collaterals mortgaged and reduce or repay the outstanding claims. The repossessed assets are disposed depending upon the market conditions and regulatory directives. In general, the Group does not use repossessed assets for business.

At 31 December 2012, 52.40 per cent (31 December 2011: 53.14 per cent) of the total outstanding loans to customers were secured with a collateral coverage of 1.52 times (2011: 1.50 times) the underlying loans.

B. LIQUIDITY RISK

Liquidity is the ongoing ability to accommodate maturing liabilities and deposit withdrawals; fund asset growth and business operations; and meet contractual obligations through unconstrained access to funding at reasonable market rates.

Liquidity risk is the risk that the Group will encounter difficulty in raising funds to meet commitments associated with financial instruments. Liquidity risk may also result from an inability to sell a financial asset quickly at close to its fair value. The financial instruments exposed to these risks, the objectives, policies and procedures for managing and measuring these risks are explained in the Risk Management section of the annual report.

22 RISK MANAGEMENT (continued)

B. LIQUIDITY RISK (continued)

The table below summarises the maturity profile of the Group's financial liabilities based on contractual undiscounted repayment obligations. Repayments, which are subject to notice, are treated as if notice were to be given immediately.

Financial liabilities	Less than one month (KD'000s)	One month to one year (KD'000s)	One year to five years (KD'000s)	Over five years (KD'000s)	Total (KD'000s)
31 December 2012					
Due to banks and other financial institutions	163,014	344,438	55,907	-	563,359
Customers' deposits	1,010,598	728,187	144,539	-	1,883,324
Other liabilities	-	50,176	-	-	50,176
	1,173,612	1,122,801	200,446	-	2,496,859
31 December 2011					
Due to banks and other financial institutions	107,595	321,384	-	-	428,979
Customers' deposits	1,180,955	778,098	142,071	47,592	2,148,716
Other liabilities	-	52,536	-	-	52,536
	1,288,550	1,152,018	142,071	47,592	2,630,231

Contractual amounts for gross settled derivative positions total to KD 277,890 thousand (2011: KD 201,942 thousand), of which KD 118,779 thousand (2011: KD 78,011 thousand) expires within three months.

Substantially all acceptances and letters of credit commitments expire within a year, while 63 per cent (2011: 62 per cent) of the guarantees expire within one year, while the remaining portion expires within a period not exceeding five years.

The table below summarises the maturity profile of the Group's assets and liabilities. The maturities of assets and liabilities have been determined on the basis of the remaining period at the statement of financial position date to the contractual maturity date, except for equity investments at fair value through profit or loss, investments available for sale, investment in an associate and premises and equipment. The maturity profile for investments at fair value through profit or loss, investments available for sale, investment in an associate and premises and equipment is determined based on management's estimate of liquidation of those investments.

The actual maturities may differ from the maturities shown below since the borrower may have the right to prepay obligations with or without prepayment penalties, and customers' deposits might have to be repaid on demand.

22 RISK MANAGEMENT (continued)

B. LIQUIDITY RISK (continued)

The maturity profile as at 31 December 2012 was as follows:

	Less than one month (KD'000s)	One month to one year (KD'000s)	One year to five years (KD'000s)	Over five years (KD'000s)	Total (KD'000s)
ASSETS					
Cash and balances with banks	223,950	27,527	-	-	251,477
Kuwait Government treasury bills and bonds	10,762	121,419	74,594	5,000	211,775
Central Bank of Kuwait bonds	94,969	164,685	-	-	259,654
Loans and advances	426,321	1,002,172	385,273	173,103	1,986,869
Investment securities	-	68,941	107,786	12,818	189,545
Investment in an associate	-	-	10,772	-	10,772
Other assets	-	25,149	8,585	-	33,734
Premises and equipment	-	-	-	29,193	29,193
Total assets	756,002	1,409,893	587,010	220,114	2,973,019
LIABILITIES					
Due to banks and other financial institutions	162,903	339,619	55,218	-	557,740
Customers' deposits	1,002,610	709,219	126,844	-	1,838,673
Other liabilities	-	59,871	-	-	59,871
Total liabilities	1,165,513	1,108,709	182,062	-	2,456,284

The maturity profile as at 31 December 2011 was as follows:

	Less than one month (KD'000s)	One month to one year (KD'000s)	One year to five years (KD'000s)	Over five years (KD'000s)	Total (KD'000s)
ASSETS					
Cash and balances with banks	263,170	54,558	-	-	317,728
Kuwait Government treasury bills and bonds	59,961	157,007	20,080	-	237,048
Central Bank of Kuwait bonds	139,940	59,888	-	-	199,828
Loans and advances	360,914	1,017,324	539,037	149,104	2,066,379
Investment securities	-	80,330	99,062	12,266	191,658
Other assets	-	29,733	8,566	-	38,299
Premises and equipment	-	-	-	28,861	28,861
Total assets	823,985	1,398,840	666,745	190,231	3,079,801
LIABILITIES					
Due to banks and other financial institutions	107,386	315,605	-	-	422,991
Customers' deposits	1,171,537	758,462	130,651	41,783	2,102,433
Other liabilities	-	63,434	-	-	63,434
Total liabilities	1,278,923	1,137,501	130,651	41,783	2,588,858

22 RISK MANAGEMENT (continued)

C. MARKET RISK

C.1 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. The Board has established limits on the interest rate gaps for stipulated years. Positions are monitored on a daily basis and hedging strategies are used to ensure positions are maintained within the established limits. The financial instruments exposed to these risks, the objectives, policies and procedures for managing and measuring these risks are explained in the Risk Management section of the annual report.

The sensitivity of interest rate variability on the Group's consolidated income statement 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 2012 including the effect of hedging instruments. The sensitivity of interest rate variability on the Equity is calculated by revaluing fixed rate investments available for sale, including the effect of any associated hedges as at 31 December 2012 for the effects of the assumed changes in interest rates and is analysed by maturity of the asset or swap.

The following table reflects the effect of 25 basis points change in interest rates, with all other variables held constant.

	Effect			
	2012		2011	
	Net profit (KD'000s)	**Equity (KD'000s)**	Net profit (KD'000s)	Equity (KD'000s)
Kuwaiti Dinar	1,666	-	1,616	-
US Dollars	103	764	125	760

C.2 CURRENCY RISK

Currency risk is the risk that the value of financial instruments will fluctuate due to changes in foreign exchange rates. The Board of Directors has set limits on positions by currency. Positions are monitored on a daily basis and hedging strategies are used to ensure positions are maintained within established limits. The financial instruments exposed to these risks. The objectives, policies and procedures for managing and measuring these risks are explained in the Risk Management section of the annual report.

The effect on net profit for the year, as a result of 5 per cent change in currency rate due to the changes in fair value of monetary assets and liabilities, with all other variables held constant is shown below:

	Effect	
	2012 (KD'000s)	2011 (KD'000s)
Currency		
US Dollars	18	5
Euro	1	2
Others	22	7

22 RISK MANAGEMENT (continued)

C. MARKET RISK (continued)

C.3 EQUITY PRICE RISK

Equity price risk is the risk that the fair values of equities decrease as the result of changes in the levels of equity indices and the value of individual stocks. The equity price risk exposure arises from the Bank's investment portfolio. The financial instruments exposed to these risks, the objectives, policies and procedures for managing and measuring these risks are explained in the Risk Management section of the annual report.

The effect on consolidated income statement (as a result of equity price risk on investments at fair value through profit and loss and further impairment on impaired available for sale equity investments) and on Equity (as a result of a change in the fair value of available for sale equity investments), as at 31 December, due to a 5 per cent change in equity indices, with all other variables held constant is as follows:

	Effect			
	2012		2011	
	Net profit (KD'000s)	**Equity (KD'000s)**	Net profit (KD'000s)	Equity (KD'000s)
GCC Stock Exchanges	272	782	527	570

C.4 PREPAYMENT RISK

Prepayment risk is the risk that the Group will incur a financial loss because its customers and counterparties repay or request repayment earlier or later than expected, such as fixed rate loans and advances when interest rates fall. Majority of the Group's interests bearing financial assets are at floating rates. Also, majority of the interest bearing financial liabilities have a maturity of less than 1 year and accordingly, the Group is not exposed to significant prepayment risk. The financial instruments exposed to these risks, the objectives, policies and procedures for managing and measuring these risks are explained in the Risk Management section of the annual report.

D OPERATIONAL RISK

Operational risk is the risk of loss arising from systems failure, human error, fraud or external events. When controls fail to perform, operational risks 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. The financial instruments exposed to these risks, the objectives, policies and procedures for managing and measuring these risks are explained in the Risk Management section of the annual report.

The Risk Management Division manages operational risks in line with the Central Bank of Kuwait instructions dated 14 November 1996, concerning the general guidelines for internal controls and the instructions dated 13 December 2003, regarding the sound practices for managing and supervising operational risks in banks.

23 CAPITAL MANAGEMENT

The Group's regulatory capital and capital adequacy ratios are as follows:

	2012 (KD'000s)	2011 (KD'000s)
Risk Weighted Assets	**1,816,694**	1,910,975
Capital required	**218,003**	229,317
Capital available:		
Tier 1 capital	**471,530**	445,652
Tier 2 capital	**30,820**	34,020
Total capital	**502,350**	479,672
Tier 1 capital adequacy ratio	**25.96%**	23.32%
Total capital adequacy ratio	**27.65%**	25.10%

The disclosures relating to the Capital Adequacy Regulations issued by Central Bank of Kuwait as stipulated in CBK Circular number 2/BS/184/2005 dated 21 December 2005, as amended, are included under the Risk Management section of the annual report.

24 FAIR VALUE OF FINANCIAL INSTRUMENTS

Financial instruments comprise of financial assets and financial liabilities.

Financial assets consist of cash and balances with banks, Kuwait Government treasury bills and bonds, Central Bank of Kuwait Bonds, loans and advances, investment securities and certain other assets.

Financial liabilities consist of due to banks and other financial institutions, customer deposits and certain other liabilities.

Fair values of all financial instruments are not materially different from their carrying values.

25 FIDUCIARY ASSETS

The fiduciary assets managed by the Group as at 31 December 2012 amounted to KD 155,033 thousand (2011: KD 186,389 thousand).