

**Capinnova Investment Bank B.S.C. (c)**

**FINANCIAL STATEMENTS**

**31 DECEMBER 2010**

## **INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF CAPINNOVA INVESTMENT BANK B.S.C. (c)**

We have audited the accompanying statement of financial position of Capinnova Investment Bank B.S.C. (c) [the Bank] as of 31 December 2010, and the related statements of income, cash flows, changes in equity and sources and uses of zakah and charity fund for the year then ended. These financial statements and the Bank's undertaking to operate in accordance with Islamic Shari'a Rules and Principles are the responsibility of the Bank's Board of Directors. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Auditing Standards for Islamic Financial Institutions issued by the Accounting and Auditing Organisation for Islamic Financial Institutions [AAOIFI]. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinion.

### **Opinion**

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Bank as of 31 December 2010, the results of its operations, its cash flows, changes in equity and sources and uses of zakah and charity fund for the year then ended in accordance with the Financial Accounting Standards issued by AAOIFI.

**INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF  
CAPINNOVA INVESTMENT BANK B.S.C. (c) (continued)**

**Report on Other Requirements**

We confirm that, in our opinion, proper accounting records have been kept by the Bank and the financial statements, and the contents of the Report of the Board of Directors relating to these financial statements, are in agreement therewith. We further report, to the best of our knowledge and belief, that no violations of the Bahrain Commercial Companies Law, nor of the Central Bank of Bahrain and Financial Institutions Law, nor of the memorandum and articles of association of the Bank, have occurred during the year ended 31 December 2010 that might have had a material adverse effect on the business of the Bank or on its financial position and that the Bank has complied with the terms of its banking license and has also complied with the Islamic Shari'a Rules and Principles as determined by the Shari'a Supervisory Board of the Bank.

A handwritten signature in black ink that reads 'Ernst & Young' in a cursive script.

27 February 2011  
Manama, Kingdom of Bahrain

## Shari'a Supervisory Board's Report to the Shareholder

Assalam Alaikum Wa Rahmat Allah Wa Barakatuh,

In compliance with the letter of appointment and the Bank's Articles of Association, we are required to submit the following report:

We have reviewed the principle transactions done by Capinnova Investment Bank during the twelve months period ended 31<sup>st</sup> December 2010. We have also conducted our review to form an opinion as to whether the Bank has complied with Shari'a rules and principles.

The Bank's management is responsible for ensuring that the Bank conducts its business in accordance with Islamic Shari'a rules and principles. It is our responsibility to form an independent opinion, based on our review of the operations of the Bank, and to report to you.

We conducted our review, on a basis of type of transactions entered, the relevant documentation, and procedures adopted by the Bank. We planned and performed our review so as to obtain all the information and explanations which were considered necessary in order to provide us with sufficient evidence to give assurance that the Bank has not violated the rules and principles of Islamic Shari'a.

In our opinion;

- Transactions entered into by the Bank during the twelve months period ended 31<sup>st</sup> December 2010 are in compliance with the Islamic Shari'a rules and principles.
- All earning that has been realized from sources or by means prohibited by Islamic Shari'a rules and principles have been transferred to Charity account.
- The Bank's allocation of profit and charging of losses relating to investment accounts are in compliance with the rules and principles of the Islamic Shari'a.
- The Bank's calculation of Zakat is in compliance with the rules and principles of the Islamic Shari'a.

We beg Allah the Almighty to grant us all the success and straight forwardness

For Shari'a Supervisory Board



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**Shaikh Osama Bahar**  
Chairman & Executive Member  
of Shari'a Supervisory Board

### **The Board of Director's report to Shareholders**

In the name of Allah, the Beneficent, the Merciful, prayers and peace be upon the last apostle and messenger, our prophet, Mohammed.

On behalf of the Board of Directors, I am pleased to present to you the financial statements of Capinova Investment Bank for the period ending 31 December 2010.

### **Principal activity of the Bank**

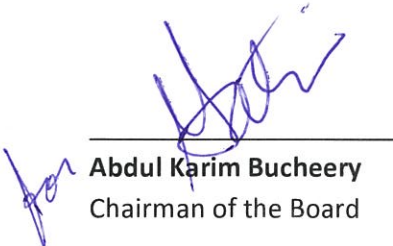
The principal activities of the Bank are investment banking services with three main lines of business i.e. Asset Management, Corporate Finance and Private Equity in conformity with Islamic Shari'a.

### **Results for the year**

During the year ended 31 December 2010, the Bank generated a total operating Income of US\$6,916,295 (2009: US\$ 2,999,565) and a net loss of US\$ 203,424 (2009: US\$ 4,465,407). Total operating expenses for the year amounted to US\$ 7,119,719 (2009: US\$ 7,464,972). Total assets at 31 December 2010 stood at US\$ 146,403,299 (2009: US\$ 118,235,189). During the year 2010 the total payment to Directors for Board, Audit & Excom sitting fees was US\$ 99,469 (2009: US\$ 123,242).

### **Acknowledgments**

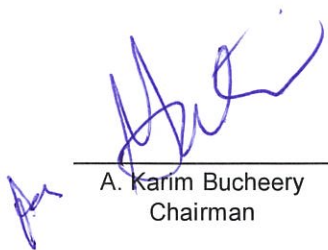
On behalf of the Board of Directors, I would like to thank the Central Bank of Bahrain and other agencies of the Kingdom of Bahrain for their support. I would also like to thank our shareholders for their continued confidence and support to Bank's management and staff for their contribution.

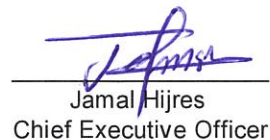


**Abdul Karim Bucheery**  
Chairman of the Board

Capinnova Investment Bank B.S.C. (c)  
 STATEMENT OF FINANCIAL POSITION  
 As at 31 December 2010

	Note	2010 US\$	2009 US\$
<b>ASSETS</b>			
Bank balances	3	966,486	5,998,355
Due from bank	4	10,016,041	-
Murabaha receivables	5	70,320,608	97,707,377
Istisna'a contract	6	16,497,685	8,192,868
Mudaraba investment		-	5,000,000
Investments in associate and joint venture	7	47,368,883	-
Equipment	8	796,308	1,115,913
Other assets	9	437,288	220,676
<b>TOTAL ASSETS</b>		<b>146,403,299</b>	<b>118,235,189</b>
<b>LIABILITIES AND EQUITY</b>			
<b>Liabilities</b>			
Other liabilities	10	1,594,308	213,640
<b>Total liabilities</b>		<b>1,594,308</b>	<b>213,640</b>
<b>Equity</b>			
Share capital	11	151,525,199	125,000,000
Statutory reserve	12	91,612	91,612
Accumulated losses		(7,273,487)	(7,070,063)
Foreign currency translation reserve	13	465,667	-
<b>Total equity</b>		<b>144,808,991</b>	<b>118,021,549</b>
<b>TOTAL LIABILITIES AND EQUITY</b>		<b>146,403,299</b>	<b>118,235,189</b>

  
 A. Karim Bucheery  
 Chairman

  
 Jamal Hijres  
 Chief Executive Officer

The attached notes 1 to 22 form part of these financial statements

# Capinnova Investment Bank B.S.C. (c)

## STATEMENT OF INCOME

For the year ended 31 December 2010

	<i>Note</i>	<b>2010 US\$</b>	<b>2009 US\$</b>
Profit on Murabaha receivables		<b>2,380,653</b>	2,068,163
Profit from Istisna'a contract		<b>1,868,664</b>	471,611
Profit on Mudaraba investment		<b>122,188</b>	57,690
Profit on balance due from bank		<b>150,694</b>	-
Share of results of associate and joint venture	7	<b>506,079</b>	-
Gain on acquisition of joint venture	7	<b>1,638,011</b>	-
Other income		<b>3,256</b>	-
		<b>6,669,545</b>	2,597,464
Profit on Murabaha payables		-	(9,777)
		<b>6,669,545</b>	2,587,687
Fee and commission income		<b>246,750</b>	411,878
		<b>6,916,295</b>	2,999,565
Staff costs		<b>5,453,846</b>	5,164,869
General and administration expenses		<b>1,300,622</b>	1,999,366
Depreciation	8	<b>365,251</b>	300,737
		<b>7,119,719</b>	7,464,972
<b>LOSS FOR THE YEAR</b>		<b>(203,424)</b>	<b>(4,465,407)</b>

The attached notes 1 to 22 form part of these financial statements

Capinnova Investment Bank B.S.C. (c)

STATEMENT OF CASH FLOWS

For the year ended 31 December 2010

	Note	2010 US\$	2009 US\$
<b>OPERATING ACTIVITIES</b>			
Loss for the year		(203,424)	(4,465,407)
Adjustments:			
Depreciation	8	365,251	300,737
Share of results of associate and joint venture	7	(506,079)	-
Gain on acquisition of joint venture	7	(1,638,011)	-
		<u>(1,982,263)</u>	<u>(4,164,670)</u>
Changes in:			
Murabaha receivables with original maturity of more than 90 days		(17,499,691)	(4,180,278)
Istisna'a contract	6	(8,304,817)	(8,192,868)
Other assets		(216,612)	(25,918)
Murabaha payables		-	(441,667)
Other liabilities		1,380,668	(31,713)
		<u>(26,622,715)</u>	<u>(17,037,114)</u>
<b>INVESTING ACTIVITIES</b>			
Mudaraba investment		5,000,000	(3,911,312)
Purchase of equipment	8	(45,646)	(399,213)
Acquisition of associate		(20,122,353)	-
Dividend from an associate		1,888,426	-
		<u>(13,279,573)</u>	<u>(4,310,525)</u>
<b>FINANCING ACTIVITY</b>			
Proceed from issue of share capital	11	-	112,500,000
		<u>-</u>	<u>112,500,000</u>
<b>NET MOVEMENT IN CASH AND CASH EQUIVALENTS</b>		<b>(39,902,288)</b>	<b>91,152,361</b>
Cash and cash equivalents at 1 January		<u>99,525,454</u>	<u>8,373,093</u>
<b>CASH AND CASH EQUIVALENTS AT 31 DECEMBER</b>		<b><u>59,623,166</u></b>	<b><u>99,525,454</u></b>
Cash and cash equivalents comprise of the following amounts:			
Bank balances		966,486	5,998,355
Due from bank		10,016,041	-
Murabaha receivables with original maturity of 90 days or less		48,640,639	93,527,099
		<u>59,623,166</u>	<u>99,525,454</u>
<b>Non-cash financing activity</b>			
Acquisition of joint venture by issuing share capital		<u>26,525,199</u>	<u>-</u>

The attached notes 1 to 22 form part of these financial statements

Capinnova Investment Bank B.S.C. (c)

STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2010

	Share capital US\$	Statutory reserve US\$	Accumulated losses US\$	Foreign currency translation reserve US\$	Total US\$
At 1 January 2010	125,000,000	91,612	(7,070,063)	-	118,021,549
Issue of shares (note 11)	26,525,199	-	-	-	26,525,199
Foreign currency translation adjustment (note 13)	-	-	-	465,667	465,667
Net loss for the year	-	-	(203,424)	-	(203,424)
<b>At 31 December 2010</b>	<b>151,525,199</b>	<b>91,612</b>	<b>(7,273,487)</b>	<b>465,667</b>	<b>144,808,991</b>
At 1 January 2009	12,500,000	91,612	(2,604,656)	-	9,986,956
Issue of shares (note 11)	112,500,000	-	-	-	112,500,000
Net loss for the year	-	-	(4,465,407)	-	(4,465,407)
At 31 December 2009	125,000,000	91,612	(7,070,063)	-	118,021,549

The attached notes 1 to 22 form part of these financial statements

Capinnova Investment Bank B.S.C. (c)

STATEMENT OF SOURCES AND USES OF ZAKAH AND CHARITY FUNDS

For the year ended 31 December 2010

	<i>2010</i> <i>US\$</i>	<i>2009</i> <i>US\$</i>
<b>Sources of zakah and charity funds</b>		
Undistributed zakah and charity funds at the beginning of the year	77,137	75,956
Zakah due from the Bank for the year	2,361	-
Non-Islamic income	-	1,181
Total sources of funds during the year	<u>79,498</u>	<u>77,137</u>
<b>Uses of zakah and charity funds</b>		
Distribution to charities	<u>79,498</u>	-
Total uses of zakah and charity funds during the year	<u>79,498</u>	-
Undistributed zakah and charity funds at end of the year	<u>-</u>	<u>77,137</u>

As at 31 December 2010

## 1 INCORPORATION AND ACTIVITIES

Capinnova Investment Bank B.S.C. (c) [the Bank] started its operations effective 14 January 2009. The Bank took the commercial registration of Al Khaleej Islamic Investment Bank which was registered on 6 June 1999 in the Kingdom of Bahrain and registered with the Ministry of Industry and Commerce under commercial registration number 43137. The Bank operates under an Islamic wholesale banking license issued by the Central Bank of Bahrain [the CBB].

The Bank's registered office is Floor 38, West Tower, Bahrain Financial Harbour, P.O. Box 5507, Kingdom of Bahrain.

The principal activities of the Bank include providing investment banking services in conformity with Islamic Shari'a. The Bank is a wholly owned subsidiary of BBK B.S.C. [the Parent].

The financial statements were authorised for issue by a resolution of the Board of Directors on 27 February 2011.

## 2 SIGNIFICANT ACCOUNTING POLICIES

### **Basis of preparation**

These financial statements have been prepared in accordance with Financial Accounting Standards [FAS] issued by the Accounting and Auditing Organisation for Islamic Financial Institutions [AAOIFI], the Islamic Shari'a Rules and Principles as determined by the Shari'a Supervisory Board of the Bank, the Bahrain Commercial Companies Law and the Central Bank of Bahrain and Financial Institutions Law. In accordance with the requirement of AAOIFI, for matters for which no AAOIFI standards exists, the Bank uses the relevant International Financial Reporting Standards issued by the International Accounting Standards Board.

### **Accounting convention**

The financial statements are prepared under the historical cost convention and presented in United States Dollars [US\$], being the functional currency of the Bank's operations.

Following is the summary of significant accounting policies adopted in preparing the financial statements. These accounting policies are consistent with those used in the previous year, except as noted below:

### **New financial accounting standards**

#### *Financial Accounting Standard No. 23 - Consolidation*

During the year, the Bank has adopted FAS 23 issued by the AAOIFI which sets out the principles for determining entities that are subject to be included in the consolidated financial statements of a parent and prescribes the accounting for investment in subsidiaries by parent. The adoption of this standard is effective for financial periods commencing on or after 1 January 2010. Adoption of this standard did not have any material effect on the financial statements of the Bank.

#### *Financial Accounting Standard No. 24 - Associates*

During the year, the Bank has adopted FAS 24 issued by the AAOIFI which sets out the accounting principles for recognising, measuring, presenting and disclosing the investments in associate. The adoption of this standard is effective for financial periods commencing on or after 1 January 2010. Adoption of this standard did not have any material effect on the financial statements of the Bank.

As at 31 December 2010

## 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

### Standard issued but not effective

The Bank has not elected to early adopt the following IASB standard which have been issued but are not yet effective:

*Financial Accounting Standard No. 25 - Investment in Sukuk, shares and similar instruments*  
FAS 25 was issued on 22 July 2010 relating to the recognition, measurement, presentation and disclosure of investment in Sukuk, shares and other investments that exhibit characteristics of debt and equity instruments made by the Islamic financial institutions. The standard is effective for the financial period beginning 1 January 2011. The Bank is considering the implications of the standard, the impact on the Bank.

### Investments in associate and joint venture

#### *Associate*

The Bank's investment in its associate is accounted for using the equity method. An associate is an entity over which the Bank exercises significant influence but not control. Significant influence is presumed to exist if the Bank holds 20% or more of the voting rights in an entity. Conversely, the significant influence may also exist through agreements with the entity's other shareholders or the entity itself regardless of the level of shareholding that the Bank has in the said entity. Under the equity method, the investment in the associate is carried in the statement of financial position at cost plus post acquisition changes in the Bank's share of net assets of the associate, less any impairment in value.

The statement of income reflects the share of the results of operations of the associate. Where there has been a change recognised directly in the equity of the associate, the Bank recognises its share of any changes and discloses this, when applicable, in the statement of changes in equity. Unrealised gains and losses resulting from transactions between the Bank and the associate are eliminated to the extent of the interest in the associate.

The financial statements of the associate are prepared for the same reporting period as the Bank. Where necessary, adjustments are made to bring the accounting policies in line with those of the Bank.

After application of the equity method, the Bank determines whether it is necessary to recognise an additional impairment loss on the Bank's investment in its associate. The Bank determines at each reporting date whether there is any objective evidence that the investment in the associate is impaired. If this is the case the Bank calculates the amount of impairment as the difference between the recoverable amount of the associate and its carrying value and recognises the amount in the statement of income. Goodwill relating to the associate is included in the carrying amount of the investment and is neither amortised nor individually tested for impairment.

Upon loss of significant influence over the associate, the Bank 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 retaining investment and proceeds from disposal are recognised in profit or loss.

#### *Joint venture*

The Bank has an interest in a joint venture which is a jointly controlled entity, whereby the venturers have a contractual arrangement that establishes joint control over the economic activities of the entity. The Bank recognises its interest in the joint venture using the equity method. Under the equity method, the interest in joint venture is carried in the statement of financial position at cost plus post acquisition changes in the Bank's share of net assets of the joint venture, less any impairment in value. Goodwill relating to the joint venture is included in the carrying amount of the investment and is neither amortised nor individually tested for impairment.

The statement of income reflects the share of the results of operations of the joint venture. Where there has been a change recognised directly in the equity of the joint venture, the Bank recognises its share of any changes and discloses this, when applicable, in the statement of changes in equity. Unrealised gains and losses resulting from transactions between the Bank and the joint venture are eliminated to the extent of the interest in the joint venture.

## 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

### Investments in associate and joint venture (continued)

#### *Joint venture (continued)*

After application of the equity method, the Bank determines whether it is necessary to recognise an additional impairment loss on the Bank's investment in its joint venture. The Bank determines at each reporting date whether there is any objective evidence that the investment in the joint venture is impaired. If this is the case the Bank calculates the amount of impairment as the difference between the recoverable amount of the joint venture and its carrying value and recognises the amount in the statement of income.

Upon loss of joint control and provided the former joint control entity does not become a subsidiary or associate, the Bank measures and recognises its remaining investment at its fair value. Any difference between the carrying amount of the former joint controlled entity upon loss of joint control and the fair value of the remaining investment and proceeds from disposal are recognised in profit or loss. When the remaining investment constitutes significant influence, it is accounted for as investment in an associate.

#### **Goodwill**

Goodwill represents the excess of the cost of acquisition over the Bank's share of the fair value of the net identifiable assets of the acquired associate or joint venture at the date of the acquisition. Any excess, at the date of acquisition, of the Bank's share in the fair value of the net identifiable assets acquired over the cost of the acquisition is recognised as negative goodwill. Negative goodwill arising on an acquisition is recognised immediately in the statement of income.

#### **Cash and cash equivalents**

Cash and cash equivalents as referred to in the statement of cash flows comprise cash in hand, balances with banks, due from other banks and Murabaha receivables with original maturity of ninety days or less.

#### **Due from bank**

Due from bank comprise mainly Wakala receivables stated at cost less provision for impairment, if any.

#### **Murabaha receivables**

Murabaha receivables with banks comprise commodity Murabaha receivables stated net of deferred profits and provision for impairment.

Murabaha receivables are sales on deferred terms. The Bank arranges a murabaha transaction by buying a commodity (which represents the object of the murabaha) and then resells this commodity to the client after computing a margin of profit over cost. The sale price (cost plus the profit margin) is repaid in instalments by the client over the agreed period.

#### **Istisna'a contract**

Istisna'a contract comprises of direct costs of constructing 'al-masnoo' and indirect costs relating to the contract allocated on an objective basis. Istisna'a costs incurred during the year are recognised as an asset.

#### **Mudaraba investments**

Mudaraba is a partnership between one party, which provides the capital (Rabulmal), and another, which possesses the necessary skills and expertise to manage such capital (Mudarib), for a pre-determined share of profit. These are stated at the fair value of consideration given less provision for impairment.

Capinnova Investment Bank B.S.C. (c)  
NOTES TO THE FINANCIAL STATEMENTS

As at 31 December 2010

**2 SIGNIFICANT ACCOUNTING POLICIES (continued)**

**Equipment and depreciation**

Equipment is stated at cost less accumulated depreciation. Cost includes all costs directly attributable to bringing the asset to working condition for its intended use. Depreciation is provided on a straight line basis on all equipment over its expected useful life.

The estimated useful lives of the assets for the calculation of depreciation are as follows:

Furniture	5 years
Office equipment	3 years
Vehicles	5 years

**Provisions**

Provisions are recognised when the Bank has a present obligation (legal or constructive) arising from a past event and the cost to settle the obligation are both probable and able to be reliably measured.

**Offsetting financial instruments**

Financial assets and financial liabilities are offset, and the net amount reported in the statement of financial position, if and only if, there is a legally enforceable or religious right to set off the recognised amounts and the Bank intends to settle on a net basis.

**Revenue recognition**

*Murabaha receivables*

Where income is quantifiable and contractually determined at the commencement of the contract, income is recognised on a time apportioned basis over the period of the contract, based on principal amounts outstanding. Income from a contract that is not contractually determined or quantifiable, is recognised when realised. Income that is 90 days or more overdue is not recognised until received in cash.

*Profit from Istisna'a*

Istisna'a income is recognised over the construction period using the percentage completion method.

*Mudaraba investments*

Income and losses on Mudaraba transactions are recognised when the right to receive is established or these are declared by the Mudarib, whichever is earlier. In case of losses in Mudaraba, the Bank's share of loss is recognized to the extent that such losses are being deducted from its share of the Mudaraba capital.

*Dividends*

Dividends revenue is recognised when the right to receive the dividend is established.

*Fee and commission income*

Fee and commission income is recognised when earned.

**Derecognition of financial assets and financial liabilities**

*Financial assets*

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

- the right to receive cash flows from the asset have expired; or
- the Bank has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to third party under a 'pass-through' arrangement; 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 assets, but has transferred control of the asset.

As at 31 December 2010

## 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

### Derecognition of financial assets and financial liabilities (continued)

#### *Financial liabilities*

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

#### **Foreign currencies**

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

Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the date of statement of financial position. All differences are taken to the consolidated statement of income.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial recognition. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value is determined. For items classified as equity investments such differences are taken to statement of equity. Any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition are treated as assets and liabilities of the foreign operations and translated at closing rate.

#### **Earnings prohibited by Shari'a**

The Bank is committed to avoid recognising any income generated from non-Islamic sources. Accordingly, all non-Islamic income is credited to a charity fund where the Bank uses these funds for social welfare activities.

#### **Impairment of financial assets**

An assessment is made at each reporting 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. Impairment is determined as follows:

- (a) For assets carried at fair value, impairment is the difference between cost and fair value, less any impairment loss previously recognised in the statement of income;
- (b) For assets carried at cost, impairment is the difference between carrying value and the present value of future cash flows discounted at the current market rate of return for a similar financial asset; and
- (c) For assets carried at amortised cost, impairment is the difference between carrying amount and the present value of future cash flows discounted at the original effective profit rate.

#### **Employees' end of service benefits**

Provision is made for amounts payable under the Bahrain Labour law applicable to non-Bahraini employees' accumulated periods of service at the date of the statement of financial position. Bahraini employees are covered under the Social Insurance Organisation.

#### **Significant assumptions, accounting judgement and estimates**

In the process of applying the Bank's accounting policies, management has used its judgements and made estimates in determining the amounts recognised in the financial statements. The most significant use of judgements and estimates are discussed below:

#### *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, management 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 the going concern basis.

Capinnova Investment Bank B.S.C. (c)  
**NOTES TO THE FINANCIAL STATEMENTS**

As at 31 December 2010

**2 SIGNIFICANT ACCOUNTING POLICIES (continued)**

**Significant assumptions, accounting judgement and estimates (continued)**

*Impairment and uncollectibility of financial assets*

An assessment is made at each reporting date to determine whether there is objective evidence that a specific financial asset or a group of financial assets may be impaired. If such evidence exists, the estimated recoverable amount of that asset is determined and any impairment loss, based on the assessment by the Bank of the value to it of anticipated future cash flows, is recognised in the statement of income. Specific provisions are created to reduce all impaired financial contracts to their realisable cash equivalent value. Such estimates are necessarily based on assumptions about several factors involving varying degrees of judgement and uncertainty, and actual results may differ resulting in future changes to such provisions.

**Zakah**

Zakah is calculated on the zakah base of the Bank in accordance with the Financial Accounting Standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions using the net assets method. Zakah is paid by the Bank based on statutory reserve, other reserves and retained earning balances at the beginning of the year. In accordance with the decision of the Board of Directors of the Bank and Parent the responsibility of payment of zakah on share capital of the Bank is on the shareholder of the Bank.

**Shari'a Supervisory Board**

The Bank's business activities are subject to the supervision of a Shari'a Supervisory Board consisting of three members appointed by the general assembly.

**3 BANK BALANCES**

	<b>2010</b>	<b>2009</b>
	<b>US\$</b>	<b>US\$</b>
Cash in hand	796	796
Balance with Parent	965,690	5,982,147
Balance with other bank	-	15,412
	<b>966,486</b>	<b>5,998,355</b>

**4 DUE FROM BANK**

The amount represents a Wakala deposit with an Islamic bank with an expected profit rate of 1.75% per annum maturing on 6 January 2011.

**5 MURABAHA RECEIVABLES**

	<b>2010</b>	<b>2009</b>
	<b>US\$</b>	<b>US\$</b>
Murabaha receivables*	72,573,448	98,253,104
Deferred profit	(2,252,840)	(545,727)
	<b>70,320,608</b>	<b>97,707,377</b>

\* Includes Murabaha receivables amounting to US\$ 52,130,607 (2009: US\$ 93,527,098) with the Parent (note 17).

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**5 MURABAHA RECEIVABLES (continued)**

The composition of the Murabaha receivables portfolio geographically and by sector is as follows:

	<i>Europe</i> US\$	<i>Middle</i> <i>East</i> US\$	<i>Total</i> US\$
Bank	-	52,130,607	52,130,607
Commercial	-	1,740,000	1,740,000
Secured by real estate (note 15)	16,450,001	-	16,450,001
<b>At 31 December 2010</b>	<b>16,450,001</b>	<b>53,870,607</b>	<b>70,320,608</b>
Bank	-	93,527,098	93,527,098
Commercial	-	4,180,279	4,180,279
At 31 December 2009	-	97,707,377	97,707,377

**6 ISTISNA'A CONTRACT**

The Bank has entered into an Istisna'a financing agreement for the construction of a commercial project in the Kingdom of Bahrain.

	<i>2010</i> US\$	<i>2009</i> US\$
Receivable from Istisna'a contract	16,497,685	8,192,868
Cost of Istisna'a work in progress	(14,157,410)	(7,721,257)
Profit from Istisna'a contract	<b>2,340,275</b>	471,611

**7 INVESTMENTS IN ASSOCIATE AND JOINT VENTURE**

**Associate**

Effective 1 January 2010, the Bank acquired 36.36% equity stake in EBLA Computer Consultancy K.S.C.C. [EBLA], a company incorporated in Kuwait and engaged in computer consultancy and trading activities.

**Joint venture**

Effective 1 January 2010, the Bank acquired 50% equity stake in Sakana Holistic Housing Solutions B.S.C. (c) [Sakana] from its Parent by way of issuing its 26,525,199 shares of US\$ 1 each (note 11). Sakana is a jointly controlled company incorporated in the Kingdom of Bahrain and engaged in Islamic real estate financing. At the date of acquisition, excess of the Bank's share of the net fair value of the Sakana's identifiable assets and liabilities over the cost amounted to US\$ 1,638,011 was recognised in the statement of income.

The following tables illustrate summarised financial information of the Bank's interest in these entities:

	<i>2010</i> US\$
<i>Statement of financial position</i>	
Current and non-current assets	56,410,692
Current and non-current liabilities	18,983,711
Net assets	<b>37,426,981</b>

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**7 INVESTMENTS IN ASSOCIATE AND JOINT VENTURE (continued)**

	2010 US\$
<i>Statement of income</i>	
Revenue	6,786,425
Total expenses	6,280,346
<b>Net profit</b>	<b>506,079</b>
<i>Memorandum items</i>	
Commitments and contingent liabilities	6,825,611
	2010 US\$
<i>Carrying amount of investment in associate and joint venture</i>	
Net assets at fair value upon acquisition of associate and joint venture	48,285,563
Share of results of associate and joint venture	506,079
Dividend from an associate	(1,888,426)
Foreign currency translation adjustment	465,667
<b>At 31 December 2010</b>	<b>47,368,883</b>

**8 EQUIPMENT**

	2010			
	<i>Furniture</i> US\$	<i>Office equipment</i> US\$	<i>Vehicles</i> US\$	<i>Total</i> US\$
<b>Cost</b>				
As at 1 January	1,465,494	416,608	95,490	1,977,592
Additions	41,634	4,012	-	45,646
As at 31 December	1,507,128	420,620	95,490	2,023,238
<b>Depreciation</b>				
As at 1 January	708,113	136,143	17,423	861,679
Charged during the year	265,133	81,020	19,098	365,251
As at 31 December	973,246	217,163	36,521	1,226,930
As at 31 December	533,882	203,457	58,969	796,308
	2009			
	<i>Furniture</i> US\$	<i>Office equipment</i> US\$	<i>Vehicles</i> US\$	<i>Total</i> US\$
<b>Cost</b>				
As at 1 January	1,294,843	283,536	-	1,578,379
Additions	170,651	133,072	95,490	399,213
As at 31 December	1,465,494	416,608	95,490	1,977,592
<b>Depreciation</b>				
As at 1 January	500,953	59,989	-	560,942
Charged during the year	207,160	76,154	17,423	300,737
As at 31 December	708,113	136,143	17,423	861,679
Net book value as at 31 December	757,381	280,465	78,067	1,115,913

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**9 OTHER ASSETS**

	<b>2010</b>	<b>2009</b>
	<b>US\$</b>	<b>US\$</b>
Accrued profit	-	2,951
Deposit with the Central Bank of Bahrain	<b>53,050</b>	53,050
Prepayments	<b>384,238</b>	164,675
	<b>437,288</b>	220,676

**10 OTHER LIABILITIES**

	<b>2010</b>	<b>2009</b>
	<b>US\$</b>	<b>US\$</b>
Unearned revenue	<b>740,250</b>	-
Accrued expenses	<b>854,058</b>	136,503
Charity funds	-	77,137
	<b>1,594,308</b>	213,640

**11 SHARE CAPITAL**

	<b>2010</b>	<b>2009</b>
	<b>US\$</b>	<b>US\$</b>
<b>Authorised</b>		
Ordinary shares of US\$ 1 each (2009: US\$ 1 each)	<b>500,000,000</b>	500,000,000
<b>Issued and fully paid up</b>		
As at 1 January		
Ordinary shares of US\$ 1 each (2009: US\$ 1 each)	<b>125,000,000</b>	12,500,000
Issued during the year		
Ordinary shares of US\$ 1 each	<b>26,525,199</b>	112,500,000
As at 31 December		
Ordinary shares of US\$ 1 each (2009: US\$ 1 each)	<b>151,525,199</b>	125,000,000

During the year ended 31 December 2010, the Bank increased its issued and fully paid up share capital from US\$ 125,000,000 to US\$ 151,525,199 by issuing shares as a consideration to the Parent for the acquisition of investment in joint venture (note 7). The transaction was approved by the Central Bank of Bahrain on 6 January 2010.

**12 STATUTORY RESERVE**

The statutory reserve has been created in accordance with the Bahrain Commercial Companies Law. The Bank transfers 10% of its annual profits to its statutory reserve till such time as the reserve equals 50% of the issued share capital of the Bank. No transfer has been made for the current year as there was a net loss for the year (2009: nil). The reserve is not available for distribution, except in circumstances as stipulated in the Bahrain Commercial Companies Law and following the approval of the Central Bank of Bahrain.

**13 FOREIGN CURRENCY TRANSLATION RESERVE**

The foreign currency translation reserve represents the net foreign exchange gain (loss) arising from translating the financial statements of the Bank's foreign associate from its functional currency into United States Dollars.

**14 CAPITAL MANAGEMENT**

The main objective of the capital management is to improve financial position and strengthen balance sheet of the Bank to support the growth in business and enhances shareholders' value. In this context, the Bank continued the process of following a strategic based approach in its implementation of Basel II as well further enhancing the Bank's risk management infrastructure in terms of skills, policies and processes.

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

**Regulatory capital**

	Note	2010 US\$	2009 US\$
Tier 1 capital	14 (i)	<u>118,814,294</u>	<u>117,157,143</u>
Total capital base (a)		<u>118,814,294</u>	<u>117,157,143</u>
Risk weighted assets (b)	14 (iii)	<u>110,576,766</u>	<u>43,445,496</u>
Capital ratio (a/b x 100)		<u>107.5%</u>	<u>269.7%</u>
Minimum requirement		<u>12%</u>	<u>12%</u>

**(i) Tier 1 capital**

Tier I Capital comprises of share capital, statutory reserve, foreign currency translation reserve and accumulated losses.

	2010 US\$	2009 US\$
Share capital	151,525,199	125,000,000
Statutory reserve	91,612	91,612
Foreign currency translation reserve	465,667	-
Accumulated losses	(7,273,487)	(7,070,063)
Core Tier 1 before deductions	<u>144,808,991</u>	<u>118,021,549</u>
Deductions	<u>(25,994,697)</u>	<u>(864,406)</u>
Tier 1 capital	<u>118,814,294</u>	<u>117,157,143</u>

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**14 CAPITAL MANAGEMENT (continued)**

*(ii) Tier 2 capital*

Only unaudited net income for the year is classified under Tier II. Once the financial statements are audited these balances are classified as Tier I and, as a result, at financial year end the Bank will not have any Tier II capital.

*(iii) Risk weighted assets*

Risk weighted assets are calculated in accordance with the rules laid down by the CBB.

	<b>2010</b>	<b>2009</b>
	<b>US\$</b>	<b>US\$</b>
Credit risk weight assets	<b>82,757,887</b>	42,409,466
Market risk weight assets	<b>21,374,186</b>	-
Operational risk weight assets	<b>6,444,693</b>	1,036,030
	<b>110,576,766</b>	<b>43,445,496</b>

**Credit risk weighted assets**

The Bank uses the standardised approach, which requires banks to use external credit ratings to combine them into categories to which standardised risk weightings are applied. For regulatory purposes, credit risk-weighted assets include total assets and off statement of financial position items.

**Market risk weighted assets**

The Bank does not maintain a trading book and, as a result, market risk-weighted assets result from the net foreign currency positions of the Bank.

**Operational risk weighted assets**

In calculating operational risk-weighted assets, the Bank uses the basic indicator approach which calculates operational risk-weighted assets as a proportion of the average of three years' revenues.

**15 SEGMENTAL INFORMATION**

The activities of the Bank are all related to investment banking activities.

The Bank's assets are distributed into two geographical segments which are the Middle East and Europe.

**Segment assets**

	<b>Europe*</b>	<b>Middle East</b>	<b>Total</b>
	<b>US\$</b>	<b>US\$</b>	<b>US\$</b>
<b>31 December 2010</b>			
Bank balances	-	966,486	966,486
Due from bank	-	10,016,041	10,016,041
Murabaha receivables	16,450,001	53,870,607	70,320,608
Istisna'a contract	-	16,497,685	16,497,685
Investments in associate and joint venture	-	47,368,883	47,368,883
Equipment	-	796,308	796,308
Other assets	-	437,288	437,288
	<b>16,450,001</b>	<b>129,953,298</b>	<b>146,403,299</b>

\* Represents an exposure to Cayman Islands company collateralised by a real estate investment in Makkah, Kingdom of Saudi Arabia.

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**15 SEGMENTAL INFORMATION (continued)**

	<i>Europe</i>	<i>Middle</i>	
	<i>US\$</i>	<i>East</i>	<i>Total</i>
31 December 2009		<i>US\$</i>	<i>US\$</i>
Bank balances	-	5,998,355	5,998,355
Murabaha receivables	-	97,707,377	97,707,377
Istisna'a contract	-	8,192,868	8,192,868
Mudaraba investment	-	5,000,000	5,000,000
Equipment	-	1,115,913	1,115,913
Other assets	-	220,676	220,676
	<u>-</u>	<u>118,235,189</u>	<u>118,235,189</u>

**Segment revenue**

	<i>Europe</i>	<i>Middle</i>	
	<i>US\$</i>	<i>East</i>	<i>Total</i>
31 December 2010		<i>US\$</i>	<i>US\$</i>
Profit on Murabaha receivables	773,352	1,607,301	2,380,653
Profit from Istisna'a contract	-	1,868,664	1,868,664
Profit on Mudaraba investment	-	122,188	122,188
Profit on due from bank	-	150,694	150,694
Share of results of associate and joint venture	-	506,079	506,079
Gain on acquisition of joint venture	-	1,638,011	1,638,011
Other income	-	3,256	3,256
Fee and commission income	246,750	-	246,750
	<u>1,020,102</u>	<u>5,896,193</u>	<u>6,916,295</u>

	<i>Europe</i>	<i>Middle</i>	
	<i>US\$</i>	<i>East</i>	<i>Total</i>
31 December 2009		<i>US\$</i>	<i>US\$</i>
Profit on Murabaha receivables	79,576	1,988,587	2,068,163
Profit from Istisna'a contract	-	471,611	471,611
Profit on Mudaraba investment	-	57,690	57,690
Fee and commission income	-	411,878	411,878
	<u>79,576</u>	<u>2,929,766</u>	<u>3,009,342</u>

**16 COMMITMENTS**

The Bank has entered into an operating Ijara for office space. There are no restrictions placed upon the Ijara. The future minimum rentals are due as follows:

	<b>2010</b>	<b>2009</b>
	<b>US\$</b>	<b>US\$</b>
Within one year	<b>259,545</b>	259,545
After one year but not more than five years	<b>172,557</b>	432,102
	<u><b>432,102</b></u>	<u>691,647</u>
Credit related commitment	<u><b>4,410,229</b></u>	<u>10,846,382</u>

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**17 RELATED PARTY TRANSACTIONS**

Related parties comprise shareholder (the Parent), directors of the Bank, Shari'a Supervisory Board, entities owned or controlled, jointly controlled or significantly influenced by them and companies affiliated by virtue of shareholding in common with that of the Bank.

	<b>2010</b>	<b>2009</b>
	<b>US\$</b>	<b>US\$</b>
<b><i>Statement of financial position</i></b>		
Murabaha receivables with the Parent	<b>52,130,607</b>	93,527,098
Bank balance with the Parent	<b>965,690</b>	5,982,147
	<b><u>53,096,297</u></b>	<u>99,509,245</u>
	<b>2010</b>	<b>2009</b>
	<b>US\$</b>	<b>US\$</b>
<b><i>Statement of income</i></b>		
Profit on Murabaha receivables with the Parent	<b>1,125,069</b>	287,774
General and administration expenses	<b>99,469</b>	123,342
	<b><u>99,469</u></b>	<u>123,342</u>
<b>Compensation of the key management personnel</b>		
	<b>2010</b>	<b>2009</b>
	<b>US\$</b>	<b>US\$</b>
Short term employee benefits	<b>1,463,225</b>	1,009,301
	<b><u>1,463,225</u></b>	<u>1,009,301</u>

**18 RISK MANAGEMENT**

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

Risk management is an integral part of the business activities of the Bank. Our integrated risk management framework is aimed at setting the best course of action under uncertainty by identifying, measuring, prioritizing, monitoring and managing idiosyncratic and systemic risks. The Bank manages the risks through a framework of risk management policies and procedures, organizational structure and risk measurement and monitoring mechanism that are closely aligned with the overall operations of the Bank.

Risk management activities at the Bank broadly take place at different hierarchy levels. The overall authority for risk management at the Bank vests with the Board of Directors, while the management of the Bank actively ensures that the risks are adequately identified, measured and managed. An independent and dedicated Risk Management department guided by a prudent and a robust framework of risk management policies and guidelines is in place. The Board has constituted the Executive and Audit Committees, comprising of the Board members, for effective management of risks. The Board has also delegated the authority to monitor and manage different risks to the specialized committees at management level (Risk Management Committee, Asset Liability Management Committee and Investment & Credit Committee). These committees are comprised of senior management team members with relevant experience and expertise, who meet regularly to deliberate on the matters pertaining to various risk exposures under their respective supervision.

**Credit risk**

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and will cause the other party to incur a financial loss. Currently, credit risk is the single largest risk bucket in the statement of financial position of the Bank. The magnitude of credit exposure and the significant components thereof are provided in the notes to the financial statements.

The Bank has a well-defined credit structure duly approved by the Board of Directors under which the Bank has not only well defined policies and processes, but also a system in place to periodically review these policies and processes against market and regulatory requirements. The organisational structure for this function is based on a highly refined target market and comprehensive counterparty screening process, supported by ongoing client monitoring, industry analysis and comprehensive portfolio management techniques.

The Bank continually assesses and monitors credit exposures to ensure timely identification of potential problem credits. The Bank follows both objective and subjective criteria of loan classification wherein the objective criteria is primarily time driven whereas the subjective assessment process is typically based on management's judgment with respect to borrower's character, activity, cash flow, capital structure, security, quality of management and delinquency.

NOTES TO THE FINANCIAL STATEMENTS

As at 31 December 2010

18 RISK MANAGEMENT (continued)

**Credit risk (continued)**

The table below shows the maximum exposure to credit risk for the components of the statement of financial position.

	<i>Gross maximum exposure 2010 US\$</i>	<i>Gross maximum exposure 2009 US\$</i>
Bank balances	965,690	5,997,559
Due from bank	10,016,041	-
Murabaha receivables	70,320,608	97,707,377
Istisna'a contract	16,497,685	8,192,868
Mudaraba investments	-	5,000,000
Accrued profit	-	2,951
	<b>97,800,024</b>	<b>116,900,755</b>

The main types of collaterals held in relation to the above include commercial real estate and a guarantee from the Parent.

*Concentration of credit risk*

Concentration of credit risk is managed according to counterparty. The maximum exposure to a single counterparty as of 31 December 2010 was US\$ 52,130,607 (2009: US\$ 93,527,098).

*Past due but not impaired financial assets*

The Bank has an exposure of US\$ 1,746 thousand (2009: nil) as past due but not impaired. As at 31 December 2010 the exposure was past due by less than 30 days.

*Analysis of exposure to credit risk by external credit ratings*

The table below analyses the Bank's maximum credit exposure where the credit quality is reflected by Fitch credit ratings of the counterparties where relevant:

	<i>2010 US\$</i>	<i>2009 US\$</i>
A+ to A-	53,096,297	99,509,245
Not rated	44,703,727	17,391,510
	<b>97,800,024</b>	<b>116,900,755</b>

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## NOTES TO THE FINANCIAL STATEMENTS

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### 18 RISK MANAGEMENT (continued)

#### Liquidity risk

Liquidity risk is the risk that the Bank either does not have sufficient financial resources available to meet its obligations and commitments as they fall due or can fulfill them only at excessive cost that may affect the Bank's income and equity. The Bank seeks to ensure that it has access to funds at reasonable cost even under adverse conditions, by managing its liquidity risk across all class of assets and liabilities in accordance with regulatory guidelines and to take advantage of any lending and investment opportunities as they arise.

ALCO is responsible for reviewing and recommending liquidity risk policies and ensuring that sound risk measurement systems are established and comply with internal and regulatory requirements. Contingency Funding Plan for managing liquidity crisis is in place. Liquidity management is done through cash flow matching and investment in commodity Murabaha.

The table below summarises the maturity profile of the Bank's assets and liabilities on contractual repayment arrangements as at 31 December 2010:

	Up to 1 month US\$	1 month to 3 months US\$	3 months to 6 months US\$	6 months to 1 year US\$	Less than 1 year US\$	Over 1 year US\$	No fixed maturity US\$	Total US\$
<b>ASSETS</b>								
Bank balances	966,486	-	-	-	966,486	-	-	966,486
Due from Banks	-	10,016,041	-	-	10,016,041	-	-	10,016,041
Murabaha receivables	36,126,270	17,744,337	-	16,450,001	70,320,608	-	-	70,320,608
Istisna'a contract	-	-	-	93,162	93,162	16,404,523	-	16,497,685
Investment in Associate and Joint Venture	-	-	-	-	-	-	47,368,883	47,368,883
Equipment	-	-	-	-	-	-	796,308	796,308
Other assets	83,058	31,225	184,765	6,626	305,674	78,564	53,050	437,288
	<u>37,175,814</u>	<u>27,791,603</u>	<u>184,765</u>	<u>16,549,789</u>	<u>81,701,971</u>	<u>16,483,087</u>	<u>48,218,241</u>	<u>146,403,299</u>
<b>LIABILITIES</b>								
Other liabilities	190,571	910,237	246,750	246,750	1,594,308	-	-	1,594,308
	<u>190,571</u>	<u>910,237</u>	<u>246,750</u>	<u>246,750</u>	<u>1,594,308</u>	<u>-</u>	<u>-</u>	<u>1,594,308</u>
Net gap	36,985,243	26,881,366	(61,985)	16,303,039	80,107,663	16,483,087	48,218,241	144,808,991
Credit related commitment	-	-	-	4,410,229	4,410,229	-	-	4,410,229
Cumulative net gap	<u>36,985,243</u>	<u>63,866,609</u>	<u>63,804,624</u>	<u>75,697,434</u>	<u>92,180,521</u>	<u>140,398,762</u>	<u>-</u>	<u>-</u>

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**NOTES TO THE FINANCIAL STATEMENTS**

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**18 RISK MANAGEMENT (continued)**

**Liquidity risk (continued)**

The maturity profile of assets and liabilities as of 31 December 2009 was as follows:

	Up to 1 month US\$	1 month to 3 months US\$	3 months to 6 months US\$	6 months to 1 year US\$	Less than 1 year US\$	Over 1 year US\$	No fixed maturity US\$	Total US\$
<b>ASSETS</b>								
Bank balances	5,982,943	15,412	-	-	5,998,355	-	-	5,998,355
Murabaha receivables	93,527,099	198,832	1,328,926	2,652,520	97,707,377	-	-	97,707,377
Istisna'a contract	-	-	-	-	-	8,192,868	-	8,192,868
Mudaraba investment	5,000,000	-	-	-	5,000,000	-	-	5,000,000
Equipment	-	-	-	-	-	-	1,115,913	1,115,913
Other assets	6,574	71,986	9,368	74,486	162,414	5,212	53,050	220,676
	104,516,616	286,230	1,338,294	2,727,006	108,868,146	8,198,080	1,168,963	118,235,189
<b>LIABILITIES</b>								
Other liabilities	136,503	77,137	-	-	213,640	-	-	213,640
	136,503	77,137	-	-	213,640	-	-	213,640
Net gap	104,380,113	209,093	1,338,294	2,727,006	108,654,506	8,198,080	1,168,963	118,021,549
Credit related commitment	526,286	1,964,053	2,670,130	1,275,684	6,436,153	4,410,229	-	10,846,382
Cumulative net gap	103,853,827	102,098,867	100,767,031	102,218,353		106,006,204	107,175,167	

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NOTES TO THE FINANCIAL STATEMENTS

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As at 31 December 2010

**18 RISK MANAGEMENT (continued)**

**Market Risk**

The Bank's risk management philosophy is to maximize the risk bearing capacity available to support its business activities. One way to achieve this is to minimize exposure to market sources of risk such as profit rate risk and currency, commodity risk. The objectives of market risk management are twofold: a) examine the Bank's policies and guidelines for managing market risk and assess their effectiveness; and b) evaluate the impact of other policy changes on the way the Bank manages market risk.

*Profit rate risk*

Profit rate risk arises from the possibility that changes in the market profit rate will adversely affect the future profitability or the fair value of financial assets and liabilities. The Bank has clear objectives, strategies, and risk tolerance level in order to protect it from profit rate risk. To achieve this objective, the Bank matches the profit rate sensitivity of its assets and liabilities by placing them into various time buckets according to the earlier of contractual reprising or maturity dates. The Bank is exposed to profit rate risk as a result of mismatches or gaps in the amounts of assets and liabilities and off-balance sheet instruments that mature or re-price in a given period. The Bank manages this risk by matching the re-pricing of assets and liabilities through risk management strategies. The Bank also has a system in place to monitor the effectiveness of its policies and limits.

The Bank is exposed to profit rate risk on its Murabaha receivables.

The sensitivity of the Bank's statement of income for every 100 basis points increase (decrease) in profit rates, with all other variables held constant, would be an increase (decrease) of profit by US\$ 519,593 (2009: US\$ 984,370).

*Currency risk*

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Bank has adopted a comprehensive system for the measurement and management of foreign exchange risk. Part of this risk management process involves managing the Bank's exposure to fluctuations in foreign exchange rates in order to minimize its exposure to currency and risk to acceptable levels as determined by the management. The Board of Directors sets limits on the level of exposure by currency and in total overnight positions. Positions are monitored and management strategies are used to ensure positions are maintained within established limits. The Bank's financial instruments are mainly denominated in Bahraini Dinars and in United States Dollars. As the Bahraini Dinar is pegged to the United States Dollar, the Bank's exposure to currency risk is minimal.

**Operational risk**

The Bank has prepared itself against operational risk by devising well defined policies and procedures, a strong operational risk and internal controls culture (including among other things, clear lines of responsibilities and segregation of duties), effective internal reporting, and contingency planning. Over the last year, the Bank has introduced wide ranging reforms intended not only to improve efficiency with which the Bank executes its mandate, but also to strengthen the overall internal control environment.

**Other risks**

*Legal / Compliance*

The Bank defines Legal and Compliance risk as the risk of sanctions and / or financial losses due to the failure to comply with laws, regulations, or guidelines for the regions that it operates in. To manage and mitigate legal / compliance risk, the Bank makes available to all staff a compliance manual. It also maintains a comprehensive compliance plan.

As at 31 December 2010

**18 RISK MANAGEMENT (continued)**

**Other risks (continued)**

*Strategic Risk*

The Bank defines strategic risk as the risk of losses due to inappropriate anticipation of market / competitor / technology development and inefficient implementation of its strategic plans. To minimize Strategic Risk, the Bank actively tracks and manages its major initiatives to ensure successful execution. The Bank creates a strategic plan with budgets that are tied to the plans target. The ALCO within the Bank monitor the plan and review them with the individual business units. This review happens at least monthly and possibly more depending on the risk associated with the initiative.

*Shari'a Compliance Risk*

It is specific to financial institutions licensed as Islamic Banks and arises from the possibility of a financial product or investment not being in compliance with established Shari'a principles and guidelines. This risk can arise in any type of transaction based on its structure and is managed by ensuring that all transactions, including those which are Treasury-related, have the necessary Shari'a approvals prior to execution as well as Shari'a Supervisory Board's ongoing involvement.

**19 FAIR VALUES**

The fair values of financial assets and liabilities are not materially different from their carrying values at the reporting date.

**20 EARNINGS AND EXPENSES PROHIBITED BY SHARI'A**

The Bank receives interest on deposits placed with the Central Bank of Bahrain. This earning is not reflected as part of the income of the Bank. This earning is utilised exclusively for charitable purposes and have been disclosed in the statement of sources and uses of charity funds.

**21 SOCIAL RESPONSIBILITY**

The Bank discharges its responsibilities by paying out donations to charitable causes and organisations.

**22 ZAKAH**

Zakah due and payable by the shareholders of the Bank as at 31 December 2010 was 2.13 US\$ cents (2009: 0.19 US\$ cents) per share.