بنك بوبيان

Boubyan Bank

# Annual Report 2013

Towards perfection

In the Name of Allah, Most Gracious, Most Merciful

"Verily, Allah is the All-Provider,
Possessor of Power, The Mighty"

Allah the almighty spoke the truth

## Contents





H.H. Sheikh
**Sabah Al-Ahmad Al-Jaber Al-Sabah**
Emir of the State of Kuwait

H.H. Sheikh
**Nawaf Al-Ahmad Al-Jaber Al-Sabah**
Crown Prince

H.H. Sheikh
**Jaber Mubarak Al-Hamad Al-Sabah**
Prime Minister

## Board of Directors

Mahmoud Y. Al-Fulaij
Chairman

Adel Abdul Wahab Al-Majed
Vice-Chairman & CEO

Abdulaziz Abdullah Al-Shaya
Board Member

Ahmad K. Al-Humaidhi
Board Member

Ahmed Yousef Al-Saqer
Board Member

Farid Soud Al-Fowzan
Board Member

Hazim Ali Al-Mutairi
Board Member

Nasser Abdulaziz Al-Jallal
Board Member

Waleed Mishari Al-Hamad
Board Member

## Fatwa & Shari'a Supervisory Board

| | |
|---|---|
| **Sheikh Dr. Ajeel Jassim Al-Nashmi** | Chairman |
| **Sheikh Dr. Abdulaziz Khalifa Al-Qasar** | Member |
| **Sheikh Dr. Esame Khalaf Al-Enezi** | Member/Reporter |
| **Sheikh Dr. Mohammed Awad Al-Fuzaie** | Member |
| **Sheikh Dr. Ali Ibrahim Al-Rashid** | Member |

## Executive Management

| | |
|---|---|
| **Adel Abdul Wahab Al-Majed** | Vice-Chairman & CEO |
| **Abdulla Al-Najran Al-Tuwaijri** | Deputy Chief Executive Officer - Consumer Banking and Banking Operations Group |
| **Abdul-Salam Mohammed Al-Saleh** | Deputy Chief Executive Officer - Corporate Banking & Treasury Group, Financial Control and Legal Affairs |
| **Adel Abdullah Al-Hammad** | General Manager - Human Resources Group |
| **Waleed Khalid Al-Yaqout** | General Manager - Administration Group |
| **Dr. Waleed Eisa Al-Hasawi** | General Manager - Information Technology Group |
| **Leslie James Rice** | General Manager - Risk Management |
| **Abdul Rahman Hamza Mansour** | General Manager - Internal Audit |
| **Ashraf Abdallah Sewilam** | General Manager – Corporate Banking Group |
| **Fahad Ahmad Al-Fouzan** | General Manager - Banking Operation Group |
| **Mohamed Ibrahim Ismail** | Deputy General Manager - Financial Control Group |
| **Mukkulam Jamal Jaffar** | Deputy General Manager - Treasury Services |

## Chairman's Message

**Valued Shareholders,**
For myself and on behalf of Board members and executive team, I am delighted to present to you 2013 Annual Report, and would like to extend our deepest thanks for your enduring support throughout the past period to realize our targets in line with the bank strategy and reap the current year gains at record levels that reinforce the bank's financial position and capital bases and assure the continuously improved quality of its assets.

### The Five-Year Strategy

By the end of year 2013, we have completed the first 4 years of our Five-Year Strategy (2010-2014), which certainly realized many of its objectives, as mainly represented in setting up the foundations for a banking institution able to compete and expand in the markets it operates in and realize high rates of growth, thanks to Allah and then to you.

The realization of our strategic objectives is clearly attributed to a set of key factors mainly including the return to core banking activities, expansion in the local market by providing our corporate and individual products and services in a different and distinguished manner, which resulted in uplifting our market share and boosting our competitiveness.

On the other hand, based on figures and statistics, we have an optimistic outlook, as we managed during a short period to uplift our market share to decent ratios, considering the circumstances we faced and the ardent competition in the Kuwaiti market, especially Islamic financial services; as we managed, thanks be to Allah, to boost our market share of financing to 5% by the end of year 2013, compared to 2.3% in year 2009, and raise personal finance to 7% now, compared to 1.2% during the year 2012.

### Consumer Banking

Our Consumer Banking Group stepped up its transaction processing and service quality to produce a wide range of products and services that suit our clients' needs and convenience with the aim to distinguish itself from its peers.

The bank strives to increase its market share of national clients. To this end, the bank launched in 2013 a new package of products and services solely for the retired and working women and developed its "WAYAK" accounts and Platinum services. Moreover, the bank targeted the young Kuwaitis, being a strategic category of clients for future growth, by offering a new product that accommodate their expectations.

Among our products there is a variety of personal financing facilities that suit the consumer needs including car, construction, medical treatment and education finance in addition to our card promotion campaigns raising our market share of credit card spending.

In 2013, the bank achieved a hike in the bank deposit and saving account portfolio in 2013; the bank offered four new products targeting various segments of customers including products specifically tailored for non-individual customers with the aim to increase deposits.

On the other hand, the bank strives to effectively employ alternative channels to promote its strategic and innovative approach using the state-of-art technology. One of the most important initiatives was the planned expansion of ATM network and developing functionality thereof. In this regard, we are the first bank in Kuwait launching "Withdrawal without Card" service in the local market.

As far as local geographical expansion is concerned, we would say that our goals set has become within reach, as the number of our branches has already reached 25 by the end of year 2013, and in view of planning to open new 6 to 7 in year 2014, in line with the targeted number of branches (30 branches), in line with our current five years strategy and may exceed the same. All branches are in residential areas with high population, in order to always be closer to our customers. Our 95 ATMs spread all over the country to complement our distinctive service and our attention to all sections of society.

### Corporate Banking

Our strategy focused on mid- and large-size companies to render Boubyan the bank of choice for companies, as our Corporate Banking Group maintains strong relationships with many national companies operating in productive economic sectors and provide them with the best banking services.

Despite the hard economic circumstances, Boubyan Bank managed to realize excellent growth rates in the credit portfolio to 7% during year 2013 by soliciting many productive companies known for economic and financial solvency, whilst adhering to the highest standards of creditworthiness and risk study and diversification.

During 2013, Corporate Banking Group arranged and managed syndicated finance transactions with local and international banks for various companies, as for instance, the Bank managed and participated in a finance transaction valuing KD 90 million for construction of a new mall, and another syndicated finance transaction with NBK valuing US$ 300 million for a Kuwaiti telecommunication company.

### Our Social Responsibility

Since the early beginning of implementing the new strategy starting from 2010, we have taken into account that no success can be attained without relying on our human resources and our ability to solicit distinguished cadre in the local market, and develop the capabilities of all our staff, while focusing on Kuwaiti youth, as we were able to raise national labor ratio to above 68.4%, which is one of the highest ratios in the private sector in general and banks in specific.

Meanwhile, and in collaboration with specialized international consulting firms, the bank developed workshops and training and communication programs for the new recruits to be acquainted with the bank's business environment to motivate and encourage them to adopt the business values and principles within Boubyan.

In 2013, ITQAN Academy, launched by Boubyan Bank in cooperation with Gulf University for Science and Technology (GUST) to be the first of its kind amongst local and regional banks, continued its mission through an advanced and innovative model for training human resources and developing young Kuwaiti leaders.

## Chairman's Message

The Academy represents a qualitative leap in the area of professional training and development, not only on the level of local banks, but also regional banks, as it shifts training and development concepts from the traditional style to a more advanced one as seen in granting the renowned academic certificates (bachelor's and master's degrees) in cooperation with the most prestigious American and international universities.

Social responsibility and social service are considered the corner stone of the Bank's dealings with all sections of society, in order to contribute to development and building of a society that is able to confront all regional and international variables. Accordingly, Boubyan Bank had a pioneer role by launching many social responsibility initiatives and supporting various activities and events targeting the different sections of society, especially the youth.

### International Recognition and Awards

Boubyan Bank continued to receive local, regional and international recognition. Moody's Investors Service has upgraded Boubyan's standalone bank financial strength rating (BFSR) from D to D+, and the global foreign and local-currency deposit ratings to Baa1 from Baa2, with a stable outlook.

Moody's rating upgrade primarily reflects the strengthening of asset-quality and coverage metrics; and the coverage ratio which has also improved to be higher than the 89% local average and 93% median of global banks with ba1 baseline credit assessment (BCA). These strong asset-quality metrics also compare favorably with the 3.1% median for banks with similar rating.

Thanks to Allah and our human resources, we also received more than 10 regional and international awards, mainly including: "Best Up-and-Comer Islamic Bank" from "Global Finance" Magazine, the "Best Islamic Bank" in Kuwait for the fourth year in a row from "Arabian Business", the "Best Islamic Bank in Kuwait for Customer Service" for the third year in a row from "Service Hero", "Fastest Growing Bank" in Kuwait for the second year in a row from "The Banker Middle East Magazine", the "Best Kuwait Bank" for Social Responsibility from Tatweej Academy and the "Best Islamic Fund Award" from "The Banker Middle East Magazine".

### NBK Family

The acquisition by National Bank of Kuwait, with all its long-established expertise and well-known history, of a significant stake in the Bank's shares in August 2009 greatly contributed to the achievements made throughout the past period, and it is no wonder due to the long experiences it possesses, which played a major role in setting the Bank's new strategy, the new launch and expansion in the Kuwaiti market.

Going forward, we shall build upon our mutual cooperation to be more and more reflected on our performance during the coming period, while stressing the complete separation between us on the operational level.

### To Conclude..

On this occasion, for myself and on behalf of all Boubyan Bank's Board and Executive Management members, I would like to express deepest thanks, appreciation and gratitude to H.H., the Amir of Kuwait, Sheikh Sabah Al-Ahmad Al-Jaber Al-Sabah, may Allah protect him as well as to H.H., Crown Prince, Sheikh Nawaf Al-Ahmad Al-Jaber Al-Sabah, and His Highness Prime Minister, Sheikh Jaber Al-Mubarak Al-Hamad Al-Sabah, may Allah protect them all, supplicating to Allah, the Almighty, to guide them to the right path and grant them success towards the development and glory of this nation.

Moreover, I would like to express deepest thanks to the executives of the Central Bank of Kuwait, headed by H.E., the Governor, Dr. Mohammed Al-Hashel, who spared no effort to take the actions deemed appropriate to serve the best interests of the Kuwaiti economy, and always support the different sectors, basically the banking sector.

I would like also to express deepest thanks to all the Bank's esteemed shareholders and customers who have always been the key element behind its support and who enabled it to confront the challenges, as well as all members of the Bank's Fatwa and Shari'ah Supervisory Board headed by Sheikh Ajeel Jassem Al-Nashmi, for their great efforts representing the guidelines for all the Bank's activities, services and dealings.

Finally, I would like to extend deepest appreciation to all Boubyan Bank's executives and employees who work in one-team spirit to realize more success for our Bank, and express the hope of us all that the coming period will be a new stage driving it towards more giving, achievements and realization of objectives that place it among leading banks.

May Allah Grant us success!

**Mahmoud Y. Al-Fulaij**
Chairman

# Management Discussion and Analysis Report

Contents



## Introduction

Management Discussion and Analysis report provides an overview of the economic outlook, which directly influence the performance of banking sector in general, and then presents highlights on our strategy and financial performance.

## Economic Outlook

### Global Economy

After years of recession from 2008 economic crisis, the global economy witnessed in general a stabilization of the economy and a recovery in year 2013. The United States passed the obstacle of increasing its Expenditure Budget, and the contraction of EU economy was eased, where certain EU countries started growing again.

In its latest economic forecast, the World Bank expects growth in global economy to increase from 2.4% in year 2013 to 3.2 % in year 2014, and to maintain that level for the next two years. However, the global economy may continue to face challenges during year 2014. As highlights, the World Bank expects that the United States will grow, Europe will bottom-out, and Japan will revitalize; whereas, the emerging-giants China and India will witness a stronger growth in year 2014.

### Regional Economy

Unlike most of the other Arab countries, the GCC countries witnessed economic growth in year 2013 and are expected to continue in similar pace in year 2014 as driven by the stability in oil sector and political circumstances. Whereas, the economies of other countries in the MENA region, such as Egypt, Libya, Syria, Tunisia, Lebanon and Jordan, are suffering from the transitional consequences of the "Arabic Spring".

According to the World Economic Forum's (WEF), Qatar, UAE, and Saudi Arabia are ranked 13th, 19th, and 20th respectively among the top most competitive economies in the world. Also, Moody's says the outlook is stable for most GCC countries, driven by the expectation of high fiscal surpluses and increased public spending. In the contrast, most other countries in the MENA region has negative outlook, where Moody's expects negative rating pressures in year 2014.

### Kuwait Economy

Kuwait maintained its economic growth over the last two years, and it is expected to continue in its economic growth, supported by the global economic improvement, which will increase demand for crude oil, and the huge development plan as part of "Vision 2035" set by the Government.

### Banking Sector

The deposit portfolio of the local banks reached KD 37billion by end of year 2013 with a compounded annual growth rate of 6.5%% over the last five years. On the other side, the respective credit portfolio has reached KD 30 billion by end of year 2013 with a compounded annual growth rate of 3.2 % over the last five years.

The banking sector in Kuwait has potentials for growth; however, the local market is highly competitive driven by the available resources of the banks and the entry of foreign and regional banks into the market. Hence, some of the local banks have increased their investment aboard, and may continue looking for opportunities abroad for expansion.

# Management Discussion and Analysis Report

## Strategy Overview

### Current Strategy

Boubyan Bank developed its five year strategy in 2010 which emphasized on building Boubyan's franchise in Kuwait by focusing on specific consumer and corporate segments through providing superior customer services along with new and innovative products.

The strategy of the Bank has been fruitful. Boubyan managed to improve on many fronts, and the transformation has been recognized by many regional and international bodies.

Boubyan's success is highlighted through a number of achievements:

- Steady growth in profitability and financial position since the turnaround in year 2010. net financing income increased from 22 million in 2009 to KD 61 million in 2013
- Upgrade in Moody's credit rating from D to D+ for the Bank financial strength, and from Baa2 to Baa1 for long-term deposits
- Fastest growing bank in Kuwait with total assets compounded annual growth rate of 23% between 2009-2013
- Non-Performing Financing ratio dropped to 1.9% in 2013 compared to 5.4% in 2009, which is one of the lowest rates in the market
- Awards from reputable organizations such as Global Finance and Service Heroes on growth and services respectively
- Reaching 25 branches, with additional 5 branches in the pipeline for 2014

### Prospective Strategy

The Bank is currently finalizing its second five year strategy - "Boubyan 2020" - which will focus on additional growth in Kuwait while exploring regional and international markets with strong Islamic banking potential.

In Kuwait, the focus will be on introducing new products and targeting horizontal expansion in untapped banking and financing activities. Internationally, Boubyan is exploring markets with strong potential where the Bank is uniquely positioned.

## Financial Highlights

| | 2013 | 2012 | 2011 | 2010 |
|---|---|---|---|---|
| **Financial performance** | | | | |
| **Net financing income** | 60,742 | 52,471 | 39,609 | 30,280 |
| **Operating income** | 67,072 | 58,879 | 45,939 | 40,604 |
| **Net profit attributable to Equity holders of the Bank** | 13,408 | 10,050 | 8,025 | 6,109 |
| **Earnings per share – fils** | 7.3 | 5.5 | 4.6 | 3.6 |
| **Financial position** | | | | |
| **Total assets** | 2,191,986 | 1,884,656 | 1,547,103 | 1,312,738 |
| **Total depositors' accounts** | 1,657,398 | 1,396,962 | 1,202,428 | 941,028 |
| **Total equity** | 263,944 | 253,650 | 244,245 | 238,190 |
| **Key performance ratios** | | | | |
| **Return on average assets** | 0.7% | 0.6% | 0.6% | 0.5% |
| **Return on average equity** | 5.2% | 4.0% | 3.3% | 3.6% |
| **Non-performing financing ratio** | 1.9% | 1.9% | 0.6% | 0.6% |

For the year ended December 31, 2013, net profit attributable to Equity holders of the Bank increased by 33% to KD 13.4 million, or 7.3 fils per share, from KD 10.1 million, or 5.5 per share, in 2012.

Operating income increased by 14% from 2012 to reach KD 67.1 million compared to KD 58.9 million in the year 2012. This increase was mainly driven by the growth in the net financing income which represents the core businesses of the Bank. Net financing income rose by 16% to reach KD 60.7 million compared to KD 52.5 million in year 2012 . The improvement is resulting from strong balance sheet growth during 2013 which was driven by the successful implementation of Strategy.

Operating expenses increased by 7% to KD 30.5 million, compared to 28.5 million in 2012, driven primarily by the growth in business volumes. However, as the growth in operating income was higher than the corresponding increase in operating expenses, the operating expenses to operating income ratio, which is the primary measure of efficiency, has been decreased to 45.5% in 2013 from 48.4% in 2012.

Provision for impairment increased by 13% to KD 23.1 million as the Bank continued to adopt a conservative provisioning policy, which led to maintaining a non-performing financing ratio of 1.9%, which is one of the lowest rate in the market, along with higher provision coverage ratio.

# Corporate Governance Report

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### Corporate Governance Statement

As per the Corporate Governance guidelines set by the Central Bank of Kuwait (the "CBK"), all local banks in Kuwait were due to meet the Corporate Governance requirements of the CBK effectively from 1 July 2013.

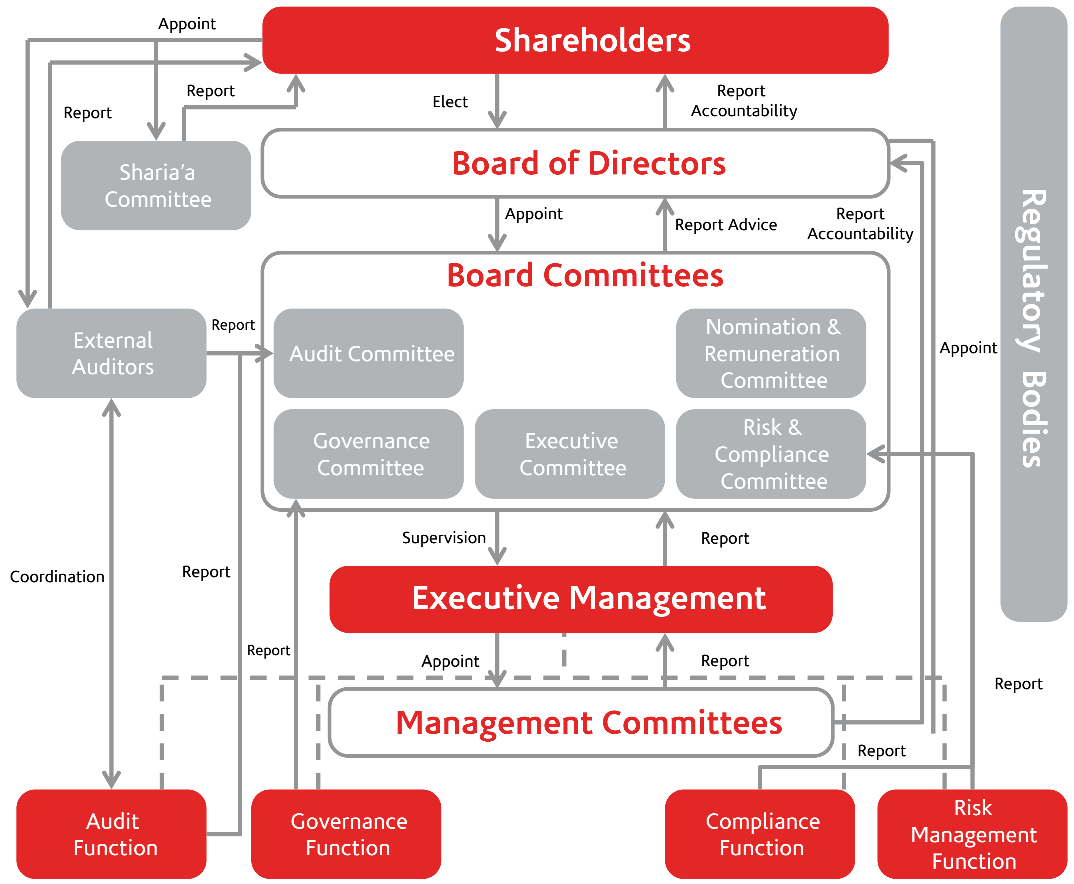
At Boubyan Bank, we have upgraded the Governance System in line with the guidelines of the CBK; this reflects our continuous endeavor for adopting professional practices in management and control under the prime objective of delivering the best to all our stakeholders. Accordingly, we have successfully achieved the full implementation of the Corporate Governance requirements of the CBK in line with our set timeframe and deadline of the CBK.

In summary, we have succeeded in upgrading the Governance System at Boubyan Bank on following aspects:

- Issuing a "Governance Manual" to guide and streamline the related Governance practices.
- Reviewing and developing the relevant policies, procedures, and practices in line with the Corporate Governance requirements of the CBK.
- Integrating and implementing the upgraded governance practices.
- Establishing the mechanism to monitor and follow-up on the adherence with the Corporate Governance requirements of the CBK.

We believe that the Corporate Governance is an ongoing journey which reaches milestones but continues to develop in line with the changes of control practices, business model, and markets. Hence, we reconfirm our commitment at the Bank, starting from the "Top of Pyramid", to adopt and implement a well developed and structured Corporate Governance system with high standards and professional practices

### Corporate Governance Framework



## Corporate Governance Report

### Board of Directors

Boubyan Bank is headed by a Board of Directors (the 'Board'), which consists of nine Directors elected by the shareholders under a mandate to deliver sustainable value to all stakeholders, including depositors / customers, shareholders, employees, and society.

The Board is granted the highest authorities and overall responsibilities by the shareholders to manage the Bank. The Board operates in line with the by-laws of the Bank and its charter; where its scope of work includes but is not limited to:

- Setting the strategies and risk appetite for the Bank.
- Approving capital and operating plans presented by management for the achievement of the Bank's strategic objectives.
- Ensuring efficient application of the resources for the achievement of the objectives.

### Directors

#### Mahmoud Yousef Al-Fulaij

Chairman (Non-Executive)
Year of joining: 2010

**Skills and Experience:**
Mr. Al-Fulaij is a well-known businessman in Kuwait with more than 30 years of experience; he manages two general trading and contracting companies in Kuwait. He graduated with a bachelor's degree in Business Administration from the United States of America in 1980.

**Other current posts:**
- Board Director – Arcadia Real Estate Company, KSCC (Kuwait)

#### Adel Abdul Wahab Al-Majed

Vice-Chairman & Chief Executive Officer (Executive)
Year of joining: 2010

**Skills and Experience:**
Mr. Al-Majed joined Boubyan Bank in August 2009 with more than 30 years of banking experience. In the course of his career, he worked for National Bank of Kuwait (NBK) where he held several positions including Deputy Chief Executive Officer and General Manager - Consumer Banking Group. Mr. Al-Majed graduated from the University of Alexandria with a bachelor's degree in Accounting, and has attended various management training programs at various universities, including Harvard, Wharton and Stanford.

**Other current posts:**
- Board Director – Visa APCEMEA – Senior Client Council
- Board Director – Bank London & Middle East (UK)
- Board Director – Hayat Investment Company, KSCC (Kuwait)
- Chairman – United Capital Bank (Sudan)

#### Abdulaziz Abdullah Al-Shaya

Director (Non-Executive)
Year of joining: 2009

**Skills and Experience:**
Mr. Al-Shaya is a well-known businessman with more than 35 years of experience; he manages a trading company in Kuwait. Mr. Al-Shaya holds a bachelor's degree in Economics from Kuwait University.

**Other current posts:**
- Vice Chairman – Awatad Real Estate Company, KSCC (Kuwait)
- Vice Chairman – Orient Investment Company, KSCC (Kuwait)
- Vice Chairman – Enmaa Real Estate Company (Oman)

#### Ahmad Khalid Al-Homaizi

Director (Non-Executive)
Year of joining: 2012

**Skills and Experience:**
Mr. Al-Homaizi has a well diversified experience in banking, investment and consultancy. He is General Manager of a consultancy company in Kuwait. Mr. Al-Homaizi obtained his bachelor's degree in Finance and Management Information System from Northeastern University in the United States of America, and his MBA from London Business School.

**Other current posts:**
- Board Director – Combined Group Contracting Company, KSCC (Kuwait)
- Board Director – Boubyan Capital Investment Company, KSCC (Kuwait)

#### Ahmed Yousef Al-Sager

Director (Non-Executive)
Year of joining: 2011

**Skills and Experience:**
Mr. Al-Sager is a well-known businessman in Kuwait with more than 27 years of experience. He is currently the managing partner of a well-known food trading company in Kuwait. Mr. Al-Sager graduated from the United States of America with a bachelor's degree in Economics.

**Other current posts:**
- Board Director – Al-Shall Investment Company, KSCC (Kuwait)
- Board Director – United Electronics Company – EXTRA (Saudi Arabia)
- Board Director – Göknur Foodstuff Company (Turkey)

#### Farid Soud Al-Fozan

Director (Non-Executive)
Year of joining: 2009

**Skills and Experience:**
Mr. Al-Fozan possesses more than 25 year of experience in various sectors including trading, real estate, and energy. He manages a holding company in Kuwait. Mr. Al-Fozan obtained his bachelor's degree in Finance and Banking from Kuwait University.

**Other current posts:**
- Vice Chairman – Gulf Group Holding Company, KSCC (Kuwait)
- Board Director – SAFCORP Holding Company, KSCC (Kuwait)
- Board Director – Innovest Company (Bahrain)
- Board Director – Gulf Real Estate Company (Saudi Arabia)

#### Hazim Ali Al-Mutairi

Director (Non-Executive)
Year of joining: 2010

**Skills and Experience:**
Mr. Al-Mutairi has a diversified experience in the fields of financing, investment, and treasury. He is the CEO of a holding company in Kuwait. He graduated from the United States of America with a bachelor's degree in Finance.

**Other current posts:**
- Board Director – Idafa Holding Company, KSCC (Kuwait)

#### Nasser Abdulaziz Al-Jallal

Director (Non-Executive)
Year of joining: 2013

**Skills and Experience:**
Mr. Al- Jallal is a well-known banker with more than 30 years of banking, investment, and business experience; he possessed several executive positions in banking including the General Manager-Corporate Banking and Treasury at Ahli United Bank in Kuwait. He is currently the CEO of a general trading company in Kuwait. He graduated from the United States of America with a degree in Economics.

**Other current posts:**
- Chairman – Perfetto Trading Company, KSCC (Kuwait)
- Vice Chairman – Future Investment Company, KSCC (Kuwait)
- Managing Director – Nasco Trading Company, KSCC (Kuwait)
- Board Director – American School of Kuwait (Kuwait)

In March 2013, Mr. Nasser Al-Jallal was elected as a Board Director instead of Mr. Yousef Al-Qatami.

## Corporate Governance Report

**Waleed Mishari Al-Hamad**
Director (Non-Executive)
Year of joining: 2010

**Skills and Experience:**
Mr. Al-Hamad has more than 20 years of experience, including 11 years in banking and the remaining in the investment sector; he is the Managing Director of a holding company in Kuwait. Mr. Al-Hamad possesses a bachelor's degree in Economics, and a master's degree in Finance from the United States of America.

**Other current posts:**
- Managing Director – Helvetia Arab Holding Company, KSCC (Kuwait)

### Structure and Independence
The Board possesses a collective experience from various industries and business sectors brought by all the Board Directors who are elected by the shareholders. Within the Board, only the Vice-Chairman & CEO is entrusted with executive roles. All other Board Directors are Non-Executive Directors, who are not acting as employees and do not participate in the day-to-day business management and activities of Boubyan.

Accordingly, the Non-Executive Directors bring an independent perspective, with constructive challenges to develop proposals on strategy, scrutinize the performance of management in meeting agreed goals and objectives, and monitor the risk profile and the reporting of performance, where the decisions of the Board are not dominated by certain individuals or groups.

Further, Non-Executive Directors are independent in post and judgment as supported by the Board "Code of Conduct" and "Conflict of Interest" policies. The Board has ensured that any potential incidence of conflict of interest that may jeopardize the independence and objectivity of any Board Directors will be managed and cleared as per the adopted policies. Hence, the Bank confirms the independency of its Board Directors on their judgments and decisions.

### Authorities
The Board is responsible for managing the business of Boubyan Bank and, in doing so, may exercise its full authorities, subject to any relevant laws and regulations and to the Articles of Association and By-laws of the Bank. In particular, the Board may exercise the authority to obtain financing and to mortgage or charge all or any part of the undertaking, property or assets (present or future) of Boubyan Bank, and may also exercise any of the authorities delegated by the shareholders in a General Assembly.

On the other hand, the Board is able to assign to Directors, Executives and/or Committees any of its powers, authorities and discretions (including the power to sub-delegate); accordingly, the Board delegated the management and day-to-day activities of the Bank to the Executive Management but retained certain authorities among of which:

1. The approval of critical matters including operating plans, risk appetite and performance targets, procedures for monitoring and controlling operations.
2. The authority or the delegation of authority to approve credit and market risk limits, acquisitions, disposals, investments, capital expenditure or realization or creation of a new venture.
3. Appointment of the Executive Management team.
4. Any changes on the accounting policies, which would have material impact on the financial position.

### Reporting of Information
The Board regularly reviews the progress financial and management reports compared to financial budgets and business plans. Also, the Board Committees report to the Board on a quarterly basis on their activities.

The Board has ensured the receipt of reliable, relevant, adequate, useful and timely information that enables them taking appropriate decisions; such information included:

- The agenda and supporting documents of Board and Committee meetings.
- Regular reports and presentations on strategy, budgets and developments in the businesses.
- Regular reports on the Group's risk appetite profile, top and emerging risks, risk management, credit exposures and the bank's finance portfolio, asset and liability management, liquidity, litigation, compliance and reputational issues.

Further, all Board Directors have full access to all relevant information, and may take independent professional advice if necessary; they are also free to contact management and employees at all levels.

### Board Assessment
The Board adopted a mechanism to conduct annual assessment for the Board, and its Directors and Committees. External consultants are engaged to conduct the Board assessment, and hence promote better independent assessment.

### Board Committees
The Board has established all the key Board Committees in line with the Corporate Governance requirements. The Chairperson of each Board Committee regularly reports to the Board on the performance of activities of the respective Board Committee.

### Committees

**Board of Directors**

| Board Executive Committee (BEC) | Board Nomination & Remuneration Committee (BNRC) | Board Corporate Governance Committee (BCGC) | Board Audit Committee (BAC) | Board Risk & Compliance Committee (BRCC) |
|---|---|---|---|---|
| • Comprises of Executive & Non-Executive Directors | • Comprises of Non-Executive Directors | • Comprises of Executive & Non-executive Directors. | • Comprises of Non-Executive Directors | • Comprises of Non-Executive Directors |
| • Meets at least 6 times a year | • Meets at least 4 times a year | • Meets at least 2 times a year | • Meets at least 4 times a year | • Meets at least 4 times a year |
| • Reviews, approves, and directs the Executive Management on financing / investment proposals within its authority limits | • Sets the principles of the Group's remuneration policy and remuneration of Executive Management, and administers the processes of assessing the performance of the Board and of identifying the nominees for the Board. | • Ensures that the Bank adopts high corporate governance standards, and periodically reviews the effectiveness and efficiency of governance practices and procedures. | • Ensures the effectiveness and efficiency of the internal and external audit functions, and advises the Board on matters related to financial reporting. | • Assists the Board in fulfilling its oversight responsibilities in respect of setting the overall risk management and risk appetites, along with advising the Board on matters related to risk, compliance, and anti-money laundering. |

## Corporate Governance Report

### Composites

The composites of the Board Committees are as follows:

| BEC | BNRC | BCGC | BAC | BRCC |
|---|---|---|---|---|
| Adel Abdul Wahab Al-Majed * | Nasser Abdulaziz Al-Jallal * | Mahmoud Yousef Al-Fulaij * | Farid Soud Al-Fozan * | Ahmed Yousef Al-Sager * |
| Abdulaziz Abdullah Al-Shaya | Abdulaziz Abdullah Al-Shaya | Adel Abdul Wahab Al-Majed | Ahmad Khalid Al-Homaizi | Ahmad Khalid Al-Homaizi |
| Hazim Ali Al-Mutairi | Ahmed Yousef Al-Sager | Farid Soud Al-Fozan | Waleed Mishari Al-Hamad | Waleed Mishari Al-Hamad |
| Nasser Abdulaziz Al-Jallal | | Hazim Ali Al-Mutairi | | |

* Chairperson

### Meetings of Board and Board Committees

| Attendance<br>Number of Meetings<br>Minimum Required Meetings | Board<br>8<br>6 | BEC<br>40<br>6 | BNRC<br>7<br>4 | BCGC<br>3<br>2 | BAC<br>5<br>4 | BRCC<br>4<br>4 |
|---|---|---|---|---|---|---|
| Mahmoud Yousef Al-Fulaij | 8 | | | 3 | | |
| Adel Abdul Wahab Al-Majed | 8 | 40 | | 3 | | |
| Abdulaziz Abdullah Al-Shaya | 8 | 31 | 7 | | | |
| Ahmad Khalid Al-Homaizi | 5 | | | | 3 | 3 |
| Ahmed Yousef Al-Sager | 5 | | 4 | | | 4 |
| Farid Soud Al-Fozan | 6 | | | 2 | 5 | |
| Hazim Ali Al-Mutairi | 6 | 32 | | 3 | | |
| Nasser Abdulaziz Al-Jallal * | 5 | 20 | 7 | | | |
| Waleed Mishari Al-Hamad | 7 | | | | 5 | 4 |

* Joined the Board subsequent to its first board meeting and the BEC subsequent to its 9th meeting.

### Executive Management

The Board of Directors delegated to the Executive Management, which is headed by the Vice-Chairman and Chief Executive Officer, the implementation of the adopted strategy and business plan.

### Management Team

#### Adel Abdul Wahab Al-Majed

Vice-Chairman & Chief Executive Officer

Mr. Al-Majed joined Boubyan Bank in August 2009, and has more than 31 years of banking experience. In the course of his career, he worked for National Bank of Kuwait (NBK) where he held several positions including Deputy Chief Executive Officer and General Manager - Consumer Banking Group. Mr. Al-Majed graduated from the University of Alexandria with a bachelor's degree in accounting, and attended various management training programs at various universities, including Harvard, Wharton and Stanford.

#### Abdulla Al-Najran Al-Tuwaijri

Deputy Chief Executive Officer

Mr. Al-Tuwaijri joined Boubyan Bank in December 2011 with more than 22 years of retail banking experience at NBK. During his time with NBK, he held different leadership roles in retail banking in Kuwait and London, where his last position was the Deputy General Manager - Consumer Banking Group. Mr. Al-Tuwaijri got his bachelor's degree in Finance from Kuwait University, and attended several executive development programs at Harvard Business School, INSEAD, and other reputable institutions.

#### Abdul-Salam Mohammed Al-Saleh

Deputy Chief Executive Officer

Mr. Al-Saleh joined Boubyan Bank in October 2012, and has more than 26 years of banking experience. He worked for 18 years at NBK, where he gained experience in Financial Control and Corporate Banking; and his last position was the Head of Domestic Corporate Banking. Prior to joining the Bank, he worked over 7 years for National Bank of Abu Dhabi (NBAD) as the Regional Manager of its branch in Kuwait. Mr. Al-Saleh got his bachelor's degree in Finance from Kuwait University, and attended various management and leadership training programs over the course of his career.

#### Adel Abdullah Al Hammad

General Manager - Human Resources Group

Mr. Al-Hammad joined Boubyan Bank in December 2006, and has more than 30 years of experience in Human Resources Management, out of which 23 years were at NBK, where he held several key positions, the last of which was the Head of Human Resources. Mr. Al-Hammad graduated with a bachelor's degree in Economics from Kuwait University, and attended several executive training programs at Harvard University and Stanford University.

#### Waleed Khalid Al-Yaqout

General Manager - Administration Group

Mr. Al-Yaqout joined Boubyan from NBK with more than 31 years of banking experience. His last position at NBK was General Manager – Administration and Human Resources Group. Mr. Al-Yaqout graduated with a bachelor's degree in Business Administration and Marketing from the University of Ashland in USA, and participated in various executive management programs at Harvard, Wharton, Stanford and Columbia.

# Corporate Governance Report

**Dr. Waleed Eisa Al-Hasawi**
General Manager - Information Technology Group

Dr. Al-Hasawi joined Boubyan Bank in February 2011, and has more than 36 years of experience. He held many positions in different institutions, the last of which was the Assistant General Manager for the IT Sector at Kuwait Finance House. Dr. Al-Hasawi studied at Worcester Polytechnic Institute in USA and continued his master's study at Lehigh University and got his PhD. from Loughborough University of Technology in UK; all studies were in the area of Electronics and Computer Engineering.

**Leslie James Rice**
General Manager - Risk Management

Mr. Rice joined Boubyan Bank in 2010 and has over 30 years banking experience, where he started his banking career with Grindlays Bank in London. Before joining Boubyan, Mr. Rice was Group Chief Risk and Compliance Officer at SHUAA Capital in UAE. His regional experience included senior positions with National Bank of Dubai and Riyad Bank. He is an Economics graduate and a Fellow of the Chartered Institute of Management Accountants.

**Abdul Rahman Hamza Mansour**
General Manager - Internal Audit

Mr. Hamza joined the Bank in year 2006 and has more than 32 years of professional experience with financial institutions. Prior to joining Boubyan, he held a position as Audit Manager at Kuwait Investment Authority, and worked before that at Al-Ahli Bank of Kuwait. Mr. Hamza holds a bachelor's degree in Accounting, and he is a Certified Public Accountant (CPA) , a Certified Internal Auditor (CIA) and a Certified Fraud Examiner (CFE).

**Ashraf Abdallah Sewilam**
General Manager – Corporate Banking Group

Mr. Sewilam joined Boubyan Bank in 2013, and has over 19 years experience in Banking sector. Before joining Boubyan, Mr. Sewilam was CEO of Al Rajhi bank-Kuwait Also, he worked for 10 years at NBK, where he progressed in several managerial positions, the last of which was the Executive Manager. Mr. Sewilam holds bachelors' degree in Economics from Cairo University.

**Fahad Ahmad Al-Fouzan**
General Manager - Banking Operation Group

Mr. Al-Fouzan joined Boubyan Bank in 2012 and has more than 28 years of banking experience in both Conventional and Islamic sectors. Before joining Boubyan, he held a position of Deputy General Manager - Operations Group at NBK. Mr. Al-Fouzan worked at Kuwait International Bank for 24 years, including 19 years in Corporate Banking and 5 years in Operations. Mr. Fouzan graduated with a bachelor's degree in Accounting from Kuwait University.

**Mohamed Ibrahim Ismail**
Deputy General Manager – Financial Control Group

Mr. Ismail joined Boubyan Bank in 2005 and has 17 years of banking and financial services experience. He started his career as an external auditor with Deloitte & Touche and then Ernst & Young. In the course of his career, he worked at Kuwait Finance House and Gulf Investment House. Mr. Ismail is a Certified Public Accountant (CPA) and a Certified Internal Auditor (CIA), and holds MBA in Finance from Manchester Business School.

**Mukkulam Jamal Jaffar**
Deputy General Manager - Treasury Services

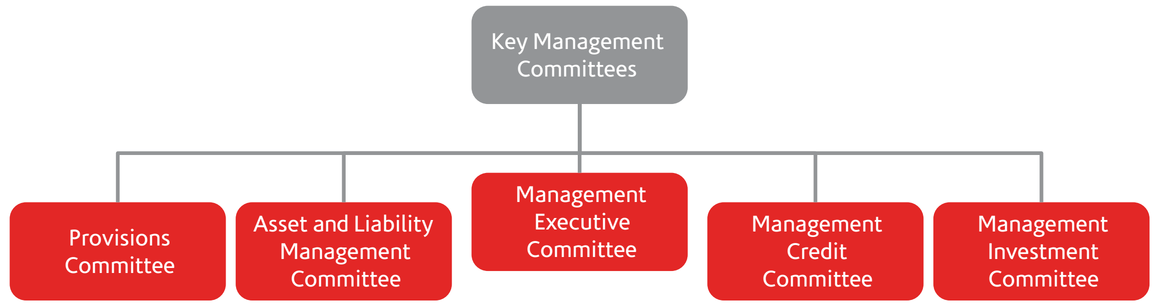
Mr. Jaffar joined the Bank in March 2005 and has over 35 years experience in Banking sector, mainly in treasury services. Prior to joining Boubyan, he held the position as the Assistant Treasurer at Burgan Bank. Mr. Jaffar holds a master's degree in Physics and a diploma in Bank Management.

## Management Committees

The Executive Management works in teamwork spirit, where collective efforts and decisions would be required for ensuring effective and efficient management of integrated functions and activities. Accordingly, Boubyan Bank has a set of Management Committees to assist in fulfilling the duties and responsibilities of the Executive Management. The Management Committees derive their authorities mainly from the Vice-Chairman & CEO, and based on authorities and limits delegated by the Board of Directors.

## Key Management Committees

The Key Management Committees are as follows:




**Management Executive Committee (MEC)**
This committee deals with all significant management level matters other than those handled by other management committees.

**Assets and Liability Management Committee (ALCO)**
The ALCO reviews the assets and liability composition of the bank, liquidity, market risks, trends and their impact on the Bank.

**Management Credit Committee (MCC)**
The main objective of MCC is to discuss and make decisions within its authorized limits on financing proposals submitted by the business groups.

**Management Investment Committee (MIC)**
The MIC discusses and makes decisions within its authorized limits on investment proposals submitted by the concerned business groups.

**Provisions Committee**
The Provisions Committee reviews and evaluates the outstanding investments and financing transactions for each customer, to determine any issues or difficulties relating to the customer position that require to classify such investments and financing transactions as irregular and hence determining the required provisions in accordance with CBK instructions and International Financial Reporting Standards.

## Internal Control

The Board is responsible for ensuring the adequacy of the Group's internal control framework. This includes, but is not restricted to, the approval and oversight of the implementation of the strategy via policies that reflect the prudent Sharia'a compliant approach to conducting its businesses. The internal control processes include controls and limits that are embedded in all processes; risk and control reports are integral parts of the Group's daily activities. Such procedures were designed to manage and mitigate risk of failure to achieve business objectives and can only provide reasonable and rather than absolute assurance against material misstatements, errors, losses, or fraud.

## Corporate Governance Report

In line with its duties and responsibilities toward ensuring adequate internal control systems, the Board provided all needed support and ensured fulfillment of the roles of the various entities involved in the internal control system, including:

• Sharia'a Board
• External Audit
• Independent Internal Control Review
• Internal Audit
• Risk Management
• Compliance
• Corporate Governance

### Internal Control Review

In year 2013, Boubyan Bank engaged an external auditor in line with the CBK regulation to conduct an independent internal control review for year 2012 activities. Based on the review of the external auditor, no exceptions pertaining to Corporate Governance aspects were noted. Also, the report of the external auditor conveyed that Boubyan Bank maintained in all material aspects, effective internal control system, where no high risk issues were even noted; the ICR report is attached in the following section.



# Internal Control Review Report

**RSM Albazie & Co.**
Public Accountants

50 Years of Service Since 1963

RSM Albazie & Co.
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T +965 22961000 F +965 22412761
E mail@albazie.com W www.albazie.com

## OPINION LETTER

The Board of Directors
Boubyan Bank K.S.C
State of Kuwait

In accordance with our engagement letter dated February 13, 2013, we have examined the accounting records and other records and internal control systems of the Boubyan Bank K.S.C. ("the Bank"), which were in existence during the year ended December 31, 2012. The areas examined were as follows:

a. Corporate Banking
b. Treasury Services Division
c. Consumer Banking Group
d. Financial Control Group
e. Banking Operations Group
f. Information Technology Group
g. Risk Management Division
h. Compliance Division
i. Anti Money Laundering Unit
j. Human Resources Group
k. Legal Affairs Division
l. Sharia Authority Division
m. Internal Audit Division
n. Corporate Communication Division
o. Administration Group
p. Complaint Unit

Our examination has been carried out with regard to the Central Bank of Kuwait's General Guidelines Manual dated November 14, 1996 , the guidelines relating to corporate governance issued by the CBK on May 3, 2004 and in accordance with International Auditing Standards. We have also examined the Bank's compliance on the following matters as per the instruction issued by CBK on January 10, 2013:

a. Section III and IV of the Principles of Good Corporate Governance in Financial Institutions relating to Internal Control Systems;
b. CBK instructions regarding anti money laundering and finance of terrorism;
c. Financial Securities activities of the Bank.

We would like to indicate that you as Directors of the Bank are responsible for establishing and maintaining adequate accounting systems, other records and internal control systems for your Bank, taking into account that the related cost of such systems should be commensurate with the benefits expected from implementation thereof. It shall be observed that the objective of this report

**RSM Albazie & Co.**
Public Accountants

50 Years of Service Since 1963

is to provide reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, that banking risks are properly monitored and evaluated, that transactions are executed in accordance with established authorization procedures and are recorded properly, and to enable you to conduct the business in a prudent manner, with care and caution.

Because of inherent limitations in any accounting and internal control system, errors or irregularities may nevertheless occur and not be detected or traced. Also projection of any evaluation of the systems to future periods is subject to the risk that management information and control procedures may become inadequate because of changes in conditions or that the degree of compliance with those procedures may deteriorate.

In our opinion, having regard to the nature and scale of the business, during the year ended December 31, 2012, the accounting records and other records and internal control systems examined by us were established and maintained in all material respects in accordance with the requirements of the General Guideline Manual issued by the Central Bank of Kuwait on November 14, 1996. We have conducted a follow up review of the exceptions noted in our report dated June 17, 2013, and in our opinion, these exceptions were satisfactorily resolved by the management during the year 2013 and there are no material exceptions outstanding as of 31 December 2013 in respect of those exceptions.

Dr. Shuaib A. Shuaib
Licence No. 33-A
RSM Albazie & Co.

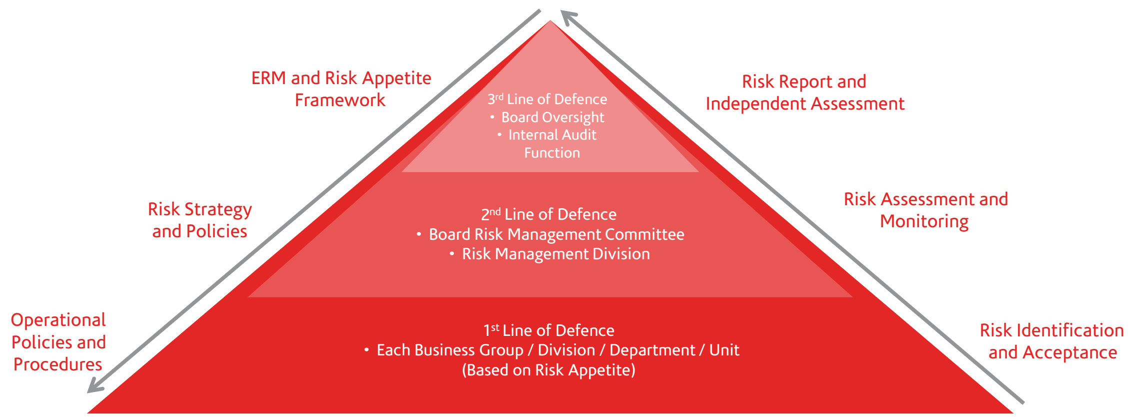
State of Kuwait
10 February 2014

## Risk Management

### Risk Management Framework

Risk Management is a core focus at Boubyan Bank. This is driven by the responsibility of the Board of Directors to ensure having a proper Risk Management function to protect the best interest of all stakeholders, especially the depositors/customers. Boubyan Bank perceives Risk Management as an integrated function with the business activities, which is guided by a well-balanced Risk Appetite model.

Boubyan Bank adopts the philosophy of “risk is everyone’s business”, and this is reflected under the following “Three-Lines of Defence” approach:




In line with the “Three-Lines of Defence” approach, Boubyan Bank is introducing its Enterprise Risk Management (ERM) framework through updating the Risk appetite and linking them to ERM measures.

### *Stress Testing*

In line with its risk management practices, Boubyan Bank conducts stress testing to measure the Bank’s vulnerability to exceptional but plausible events. The respective stress testing is conducted on a quarterly basis, where the results are discussed at management level and presented to the Board Risk Management and Compliance Committee. Further, the results of Stress Testing are reported on semi-annual basis to the Board.

### Board Risk Management & Compliance Committee

Boubyan Bank has a Board Risk Management and Compliance Committee (BRCC), which oversees the Risk Management function. The role of the BRCC includes but is not limited to the following:

- Assessing the ERM measures, Risk Appetite measures, Risk Strategy, and other risk related measures, and proposing recommendations to the Board.
- Reviewing and discussing the reports of the Risk Management Division, including the Capital Adequacy Ratio, Stress Testing, and Risk Assessment reports.
- Approving the appointment and/or resignation of the GM – Risk Management Division, and assessing his annual performance.
- Providing support to the Risk Management Division to ensure fulfilling its scope of work effectively and independently.

As per its charter, the BRCC meets at least four times a year, and reports on its activities to the Board on a periodic basis.

### Risk Management Division

The Risk Management Division (RMD) operates independently from the business, and is head by a General Manager, who reports to the Board Risk Management and Compliance Committee and the CEO. The RMD comprises of the following functional departments:

- Financial & Market Risk Department
- Operational Risk Department
- Technology Risk Department
- Credit Risk Departments (Corporate, Corporate Reporting, and Consumer)

## Remuneration Policy and Remuneration Package

### Remuneration Scheme

Boubyan Bank always considers adopting a balanced “Remuneration Scheme” to be competitive enough to attract and maintain qualified and skilled employees, who are key success factors in banking sector, and, at the same time, to be reasonably linked to sustainable progressive performance, and achievement of both short and long-term targets.

In year 2013, Boubyan Bank updated its “Employee Incentive Plan” taking into consideration:

- Both financial and risk measures
- Link to long term targets (Strategic Objectives)
- Sensitivity to time horizons of risks
- Claw back feature

### Board Remuneration

As per the by-laws and Article of Associations and in line with the Companies’ Laws of the State of Kuwait, the Board of Directors may propose annual remuneration up to 10% of annual Net Profit after deducting the following appropriations:

- 10% of Net Profit as Statutory Reserves
- 10% of Net Profit as Voluntary Reserves
- 1% of Net Profit as Contribution to KFAS
- 5% of capital as preliminary dividends to the Shareholders

In any case, Remuneration to the Board should be subject to the approval of the Shareholders in the Annual General Assembly.

As current practice, the Board Directors are not entitled to attendance fees for the Board and/or Board Committees meetings, and/or any material in-kind benefits. None of the Board Directors is entitled to any fixed salaries, except for the Vice-Chairman & CEO, who earns remunerations as employee for his executive role.

For year 2013, the Board has proposed annual remuneration of KD 135 thousands to be allocated equally among the Board Directors; this proposal is subject to the approval of the shareholders.

### Employee Remuneration

The employees of the Bank are entitled to two categories of remuneration, which are as follows:

- Fixed remuneration: such remuneration are defined in the employment agreements, and may include fixed salaries (i.e. basic salary , allowances and annual fixed pay as a percentage of basic salary) and other benefits (i.e. medical insurance, air-tickets, and schooling support),.

- Variable remuneration: such remuneration are driven mainly by performance and guided by the “Employee Incentive Plan”. This could be in the form of cash bonus and/or Employee Stock Options (ESOP). The variable remuneration are reviewed by the Board Nomination and Remuneration Committee and approved by the Board of Directors.

# Corporate Governance Report

The following table details the remuneration paid to certain employee categories for year ended 31 December 2013:

| Employees Categories | Number of Employees | Fixed Remuneration KD'000 | Variable Remuneration KD'000 | | Total KD'000 |
|---|---|---|---|---|---|
| | | | Cash | ESOP | |
| Senior Management | 26 | 2,746 | 561 | 347 | 3,654 |
| Material Risk Takers | 22 | 1,929 | 399 | 202 | 2,530 |
| Financial and Risk Control | 19 | 897 | 91 | 70 | 1,058 |

**Categories Definitions:**

- Senior Management includes all staff in the positions of Assistant General Manager and above and staff whose hiring are subject to approval of regulators.
- Material Risk Takers includes all staff whose activities and decisions have a material impact on the risk profile of the bank.
- Financial and Risk Control includes all head of divisions and head of groups in Financial Control, Risk Management, Compliance, Internal Audit and Anti-Money Laundering functions.

The five senior executives who received the highest remuneration packages, plus the heads of Financial Control, Internal Audit and Risk Management groups (i.e., eight executives in total) received together as a group remuneration package of KD1,850 thousand for the year ended 31 December 2013.

**Major Shareholders**

As of December 31, 2013, the major shareholders owning or controlling more than 5% of capital were as follows:

| Name of Shareholder | Percentage of Ownership |
|---|---|
| National Bank of Kuwait S.A.K | 58.3% |
| The Commercial Bank of Kuwait S.A.K | 19.9% |



# Boubyan Bank's Social Responsibility

**"Best Social Responsible Bank" Award**

In appreciation of its achievements in the area of social service and social responsibility over the past many years, Boubyan Bank was granted the Award of "Best Social Responsible Bank in Kuwait" from the Arab Social Responsibility Organization, which is the leading Arab organization is this field.

Social responsibility is the cornerstone of the Bank's dealings with all sections of society in contribution to development and building a society which is able to keep pace with all regional and international changes. Therefore, the Bank took the lead in launching a variety of social initiatives and sponsoring many activities and events directed to different sections of society.

Bank's social responsibility stems from the fact that it is a bank operating in compliance with the principles of Islamic Shari'ah, and based on the spirit of Islam that enjoins cooperation, selflessness and helping different sections of society, especially those in need or suffering from shortage in resources needed for daily life.

During the period extending from 2010 through the end of 2013, the Bank sponsored and participated in over 350 different activities targeting different sections including youth, children, people with special needs as well as all other sections of society.

**Boubyan's Social Responsibility Vision:**

The Bank's vision with regard to social responsibility is to have a remarkable impression in the different areas of society service by organizing initiatives that contribute to and impact development of society, and to make social responsibility a key interest for all the Bank's staff of all levels.

The Board of Directors is the highest authority which is in charge of approving this policy and ensuring compliance with the same by the executive management, which in its turn supervises the adoption of the same and directly assigns Corporate Communications Division to undertake social responsibility duties in the Bank.

Boubyan Bank pays care to different public utility and social responsibility activities, which are in line with Islamic principles and moral, humanistic values. The core areas of interest include youth, education, health, environment, sport and people with special needs.

**Boubyan's Key Awareness Campaigns in 2013**

- **"The Big Tree Society"**

In cooperation with UNESCO, Boubyan organized the environmental initiative "THE BIG TREE SOCIETY" among all the schools of Kuwait with the purpose of increasing awareness regarding environmental conservation in a practical manner by implementing environmental project inside the schools themselves.

## Boubyan Bank's Social Responsibility

**• "Movement for Health" Campaign**

For the second year in a row, and in cooperation with Kuwait Physical Therapy Association, Boubyan Bank launched an awareness campaign about the importance of physical activity and doing sports of all kinds and their positive impact on health. The Campaign was organized in celebration of the World Physical Therapy Day on the 8th of September.

**• Medical Emergencies Campaign**

Under the slogan "Save a Life", an awareness campaign on the importance of medical emergencies was organized at the Avenues Mall. The Campaign was part of the awareness activities organized by Boubyan Bank in cooperation with the Applied Medical Sciences Department - College of Health Sciences at the Public Authority of Applied Education and Training (PAAET), and in cooperation with the National Applied Education, Training and Emergency Management Fund at the Ministry of Health.

**• Ideal Driver Campaign**

In cooperation with the Ministry of Interior, Boubyan Bank launched an awareness campaign under the slogan "Ideal Driver Campaign". The Campaign that aimed at providing awareness about the importance of complying with traffic laws and rules witnessed selecting and honoring a number of ideal drivers.

**• Anti-Smoking Campaign**

In cooperation with Kuwait Society for Smoking and Cancer Prevention (Anti-Smoking Committee), Boubyan Bank organized a campaign under the slogan "My Health is My Wealth.. Anti-Smoking Generation". The Campaign aimed at spreading awareness about the dangers of smoking and its seriously negative effects on health and society.

**• Youth Projects Support Program**

The year 2013 witnessed the launch of Youth Projects Support Program by the Bank's promotion of their products and services and directly dealing with them as suppliers. The first launch of the Program witnessed remarkable success by drawing over 10 projects for Kuwaiti youth with whom the Bank directly established direct dealings and provided support to them by purchasing their products and services.



**Boubyan Bank K.S.C.P. and Subsidiaries**
**State of Kuwait**

بـنـك بـوبـيـان
Boubyan Bank

**Risk Managment**
**For the year ended 31 December 2013**

## 1. INTRODUCTION AND OVERVIEW

In 15 June 2009, the Central Bank of Kuwait ("CBK") issued directives on the adoption of the Capital Adequacy Standards under Basel II framework applicable to Islamic banks in Kuwait. These directives set out the new capital adequacy rules for calculating and maintaining the minimum capital required for credit, market and operational risk under the "Standardizes Approach". The CBK Basel II framework is intended to strengthen risk management and market discipline and to enhance the safety and soundness of the banking industry in Kuwait. Furthermore, and in compliance with aforementioned instructions, Boubyan Bank has developed an ICAAP and Stress Test framework along with underlying models, policies and procedures. Boubyan Bank continually enhances its ICAAP and Stress Test framework to maintain its capital commensurate with the overall risks to which the Bank is exposed

## 2. GROUP STRUCTURE

Boubyan Bank ("the Bank") is a public shareholding company incorporated on 21 September 2004, in accordance with the Commercial Companies Law in the State of Kuwait, by Amiri Decree No. 88 and in accordance with the rules and regulations of the Central Bank of Kuwait ("CBK") (Law No. 30 passed in 2003). The Bank's shares were listed in Kuwait Stock Exchange on 15 May 2006.

The Bank was licensed by the Central Bank of Kuwait on 28 November 2004. The Bank is principally engaged in providing banking services, in accordance with codes of the Islamic Shari'a, as approved by the Bank's Shari'a Supervisory Board.

**Principal operating subsidiaries are as follows:**

| Name of subsidiary | Country of incorporation | **2013 proportion of ownership interest and voting power %** | 2012 proportion of ownership interest and voting power % | Principal activity |
|---|---|---|---|---|
| Boubyan Takaful Insurance Company KSC (Closed) | Kuwait | **67.63** | 67.63 | Takaful insurance |
| Boubyan Capital Investment Company KSC (Closed) | Kuwait | **99.55** | 99.55 | Islamic investments |





## 3. CAPITAL STRUCTURE AND CAPITAL ADEQUACY RATIOS

The primary objectives of the Group's capital management are to ensure that the Group complies with externally imposed capital requirements and that the Group maintains strong and healthy capital ratios in order to support its business and to maximize shareholders' value.

The Group actively manages its capital base in order to cover risks inherent in the business. The adequacy of the Group's capital is monitored using, among other measures, the rules and ratios established by the Basel Committee on Banking Supervision (BIS rules/ratios) and adopted by the Central Bank of Kuwait in supervising the Group.

During the year, the Group has complied in full with all its externally imposed capital requirements.

The Group's regulatory capital and capital adequacy ratios are shown below:

| | **2013 KD'000** | 2012 KD'000 |
|---|---|---|
| **Tier 1 capital** | | |
| Share capital | **183,645** | 174,824 |
| Share premium | **62,896** | 62,896 |
| Proposed bonus shares | **12,855** | 8,741 |
| Treasury shares | **(1,100)** | (1,024) |
| Statutory reserve | **3,306** | 1,891 |
| Voluntary reserve | **3,167** | 1,813 |
| Share based payment reserve | **860** | 537 |
| Retained earnings | **3,204** | 5,424 |
| Non-controlling interest | **5,543** | 2,514 |
| Deductions from tier 1 capital | **(74,112)** | (3,246) |
| | **200,264** | 254,370 |
| **Tier 2 capital** | | |
| Fair value reserve & foreign currency translation reserve | **(4,889)** | (3,334) |
| General provision | **13,306** | 12,380 |
| Deductions from tier 2 capital | **(8,417)** | (3,246) |
| | **-** | 5,800 |

| | **2013 KD'000** | 2012 KD'000 |
|---|---|---|
| **Total regulatory capital** | **200,264** | 260,170 |
| Risk-weighted assets | **1,149,157** | 1,066,494 |
| **Capital ratios** | | |
| Total regulatory capital expressed as a percentage of total risk- weighted assets | **17.43%** | 24.39% |
| Total tier 1 capital expressed as a percentage of risk-weighted assets | **17.43%** | 23.85% |

## 4. PROFILE OF RISK-WEIGHTED ASSETS AND CAPITAL CHARGE

The Group's risk-weighted capital requirements for credit, market and operational risks were as follows:

### *4.1 Credit risk*

The capital charge in respect of credit risk as at 31 December 2013 was **KD 125,229 thousand** (2012: KD 116,889 thousand) as detailed below:

| **2013** | **Gross credit exposure KD'000** | **Risk-weighted assets KD'000** | **Capital charge KD'000** |
|---|---|---|---|
| Cash | **19,846** | **-** | **-** |
| Claims on sovereigns | **89,802** | **-** | **-** |
| Claims on banks | **406,025** | **63,112** | **7,573** |
| Claims on corporates | **682,562** | **344,856** | **41,383** |
| Regulatory retail exposure | **568,042** | **384,338** | **46,121** |
| Past due exposures | **27,488** | **12,540** | **1,505** |
| Investment property | **30,245** | **60,491** | **7,259** |
| Investment and financing with customers | **327,648** | **118,236** | **14,188** |
| Sukuk | **31,289** | **22,809** | **2,737** |
| Other exposures | **64,742** | **37,214** | **4,463** |
| | **2,247,689** | **1,043,596** | **125,229** |

| 2012 | Gross credit exposure KD'000 | Risk-weighted assets KD'000 | Capital charge KD'000 |
|---|---|---|---|
| Cash | 14,020 | - | - |
| Claims on sovereigns | 159,119 | - | - |
| Claims on banks | 258,029 | 46,342 | 5,561 |
| Claims on corporates | 678,561 | 347,804 | 41,736 |
| Regulatory retail exposure | 405,725 | 279,654 | 33,558 |
| Past due exposures | 21,978 | 12,989 | 1,559 |
| Investment property | 17,904 | 35,808 | 4,297 |
| Investment and financing with customers | 264,855 | 113,832 | 13,660 |
| Sukuk | 33,685 | 25,174 | 3,021 |
| Other exposures | 133,525 | 112,471 | 13,497 |
| | 1,987,401 | 974,074 | 116,889 |

Other exposures above includes an amount of **KD 19,783 thousand** (2012: KD 16,306 thousand) representing the amount of general provision in excess of the 1.25% allowed as a contribution towards Tier 2 capital.



BOUBYAN BANK K.S.C.P. AND SUBSIDIARIES
STATE OF KUWAIT

RISK MANAGEMENT

For the year ended 31 December 2013

بـنـك بـوبـيـان
Boubyan Bank

## 4. PROFILE OF RISK-WEIGHTED ASSETS AND CAPITAL CHARGE (CONTINUED)

### *4.2 Market risk*

The capital charge in respect of market risk arising from the self-financed exposures as at 31 December 2013 was **KD 3,621 thousand** (2012: KD 2,995 thousand) as detailed below:

| | **2013 KD'000** | 2012 KD'000 |
|---|---|---|
| Foreign exchange risk | **3,621** | 2,995 |
| Multiplier | **8.333** | 8.333 |
| Risk weighted assets | **30,170** | 24,955 |

### *4.3 Operational risk*

The capital charge in respect of operational risk as at 31 December 2013 was **KD 9,050 thousand** (2012: KD 8,096 thousand). This capital charge was computed using basic indicator approach.

The following table summarizes amount of operational risk exposure and related capital requirements:

| | **2013 KD'000** | 2012 KD'000 |
|---|---|---|
| Average gross income | **60,333** | 53,974 |
| Multiplier | **8.333** | 8.333 |
| | **502,755** | 449,765 |
| Eligible portion for the purpose of calculation | **15%** | 15% |
| Total operational risk exposure | **75,413** | 67,465 |

## 5. RISK MANAGEMENT

Risk is inherent in the Group's activities but is managed in a structured, systematic manner through a Group risk policy that embeds comprehensive risk management into organisational structure, risk measurement and monitoring processes. The overall risk management direction and oversight is provided by the Board of Directors and Board Risk Committee with the support of the Management Executive Committee and the Group's Risk Management functions.

The Group has implemented a comprehensive system for the measurement and management of risk. This methodology helps in reflecting both the expected loss likely to arise in normal circumstances and unexpected losses, which are an estimate of the ultimate actual loss based on statistical models. Information compiled from all internal business groups are closely examined and analysed to identify, manage and control risks.

Transactions and outstanding risk exposures are quantified and compared against authorised limits, whereas non-quantifiable risks are monitored against policy guidelines and key risk and control indicators. Any discrepancies, excesses or deviations are escalated to management for appropriate action.

The risk which the Group is exposed to includes:

- Credit risk
- Market risk
- Operational risk (includes IT risk)
- Liquidity risk

### *5.1 Credit risk*

Credit risk is the risk that counterparty will cause a financial loss to the Group by failing to discharge an obligation. Credit risk arises in the Group's normal course of business.

All policies relating to credit are reviewed and approved by the Board of Directors.

Credit limits are established for all customers after a careful assessment of their creditworthiness. Standing procedures, outlined in the Group's Credit Policy Manual, require that all credit proposals be subjected to detailed screening by the respective credit risk functions.

The credit risk function monitors and ensures that the collaterals and their concentrations are timely checked and reported to the management. It also ensures adherence to Group's collateral policy is monitored, reviewed and timely reported regularly for the changing dynamics of credit exposures. Financing portfolio risk report is timely prepared and all the aspects of the lending, their concentrations and collateral weightings are checked and reported.

#### *5.1.1 Group credit risk mitigation strategy*

Effective risk mitigation is fundamental to the strategy of the Group. In order to mitigate its credit risk, Group exclusively deals with counterparties with approved limits as specified by Group policy, based on the counter parties overall position for meeting the financial obligations backed by adequate collaterals.

The amount, type and valuation of collateral are based on guidelines specified in the risk management framework.

The main types of collateral accepted includes

- Real estate.
- Shares
- Sukuk
- Cash collateral and
- Bank guarantees.

The revaluation and custody of collaterals are performed independent of the business units. The Group may also obtain guarantees from parent companies for financing provided to their subsidiaries.





## 5. RISK MANAGEMENT (CONTINUED)

### *5.1 Credit risk (continued)*

#### *5.1.1 Group credit risk mitigation strategy (continued)*

The Group's credit exposures were covered by the following Eligible collaterals:

| | | **Eligible collaterals** | | |
|---|---|---|---|---|
| | **Gross credit exposure** | **Financial collaterals** | **Other collaterals** | **Net credit exposure** |
| **2013** | **KD'000** | **KD'000** | **KD'000** | **KD'000** |
| Cash | **19,846** | **-** | **-** | **19,846** |
| Claims on sovereigns | **89,802** | **-** | **-** | **89,802** |
| Claims on banks | **406,025** | **-** | **-** | **406,025** |
| Claims on corporates | **682,562** | **57,670** | **154,027** | **470,865** |
| Regulatory retail exposure | **568,042** | **-** | **-** | **568,042** |
| Past due exposures | **27,488** | **8,949** | **-** | **18,539** |
| Investment property | **30,245** | **-** | **-** | **30,245** |
| Investment and financing with customers | **327,648** | **44,457** | **166,692** | **116,499** |
| Sukuk | **31,289** | **-** | **-** | **31,289** |
| Other exposures | **64,742** | **-** | **-** | **64,742** |
| | **2,247,689** | **111,076** | **320,719** | **1,815,894** |

| | | Eligible collaterals | | |
|---|---|---|---|---|
| | Gross credit exposure | Financial collaterals | Other collaterals | Net credit exposure |
| 2012 | KD'000 | KD'000 | KD'000 | KD'000 |
| Cash | 14,020 | - | - | 14,020 |
| Claims on sovereigns | 159,119 | - | - | 159,119 |
| Claims on banks | 258,029 | - | - | 258,029 |
| Claims on corporates | 678,561 | 75,554 | 126,691 | 476,316 |
| Regulatory retail exposure | 405,725 | - | - | 405,725 |
| Past due exposures | 21,978 | 3,125 | - | 18,853 |
| Investment property | 17,904 | - | - | 17,904 |
| Investment and financing with customers | 264,855 | 51,862 | 102,893 | 110,100 |
| Sukuk | 33,685 | - | - | 33,685 |
| Other exposures | 133,525 | - | - | 133,525 |
| | 1,987,401 | 130,541 | 229,584 | 1,627,276 |

## 5. RISK MANAGEMENT (CONTINUED)

### *5.1 Credit risk (continued)*

### *5.1.2 Gross credit exposures*

The Group's gross credit exposures are detailed below:

| **2013** | **Gross credit exposure** | **Self-funded exposure** | **Funded through investments accounts exposure** |
|---|---|---|---|
| | **KD'000** | **KD'000** | **KD'000** |
| Cash | **19,846** | **7,010** | **12,836** |
| Claims on sovereigns | **89,802** | **31,718** | **58,084** |
| Claims on banks | **406,025** | **149,185** | **256,840** |
| Claims on corporates | **682,562** | **304,174** | **378,388** |
| Regulatory retail exposure | **568,042** | **200,633** | **367,409** |
| Past due exposures | **27,488** | **9,709** | **17,779** |
| Investment property | **30,245** | **30,245** | **-** |
| Investment and financing with customers | **327,648** | **115,726** | **211,922** |
| Sukuk | **31,289** | **31,289** | **-** |
| Other exposures | **64,742** | **49,253** | **15,489** |
| | **2,247,689** | **928,942** | **1,318,747** |

| 2012 | Gross credit exposure | Self-funded exposure | Funded through investments accounts exposure |
|---|---|---|---|
| | KD'000 | KD'000 | KD'000 |
| Cash | 14,020 | 5,307 | 8,713 |
| Claims on sovereigns | 159,119 | 60,232 | 98,887 |
| Claims on banks | 258,029 | 103,337 | 154,692 |
| Claims on corporates | 678,561 | 303,296 | 375,265 |
| Regulatory retail exposure | 405,725 | 153,582 | 252,143 |
| Past due exposures | 21,978 | 8,320 | 13,658 |
| Investment property | 17,904 | 17,904 | - |
| Investment and financing with customers | 264,855 | 100,257 | 164,598 |
| Sukuk | 33,685 | 33,685 | - |
| Other exposures | 133,525 | 124,030 | 9,495 |
| | 1,987,401 | 909,950 | 1,077,451 |





## 5. RISK MANAGEMENT (CONTINUED)

### *5.1 Credit risk (continued)*

### *5.1.3 Average credit exposures*

The Group's quarter-based average credit exposure for the period ended 31 December 2013 comprises the following:

| **2013** | **Average credit exposure** | **Self-funded exposure** | **Funded through investments accounts exposure** |
|---|---|---|---|
| | **KD'000** | **KD'000** | **KD'000** |
| Cash | **17,903** | **6,295** | **11,608** |
| Claims on sovereigns | **147,350** | **53,262** | **94,088** |
| Claims on banks | **298,098** | **110,980** | **187,118** |
| Claims on corporates | **677,736** | **303,195** | **374,541** |
| Regulatory retail exposure | **461,873** | **163,560** | **298,313** |
| Past due exposures | **30,077** | **10,812** | **19,265** |
| Investment property | **23,797** | **23,797** | **-** |
| Investment and financing with customers | **301,229** | **106,697** | **194,532** |
| Sukuk | **32,596** | **32,596** | **-** |
| Other exposures | **112,743** | **100,308** | **12,435** |
| | **2,103,402** | **911,502** | **1,191,900** |

| **2012** | Average credit exposure | Self-funded exposure | Funded through investments accounts exposure |
|---|---|---|---|
| | KD'000 | KD'000 | KD'000 |
| Cash | 12,654 | 4,732 | 7,922 |
| Claims on sovereigns | 152,321 | 56,812 | 95,509 |
| Claims on banks | 213,323 | 80,124 | 133,199 |
| Claims on corporates | 610,069 | 228,696 | 381,373 |
| Regulatory retail exposure | 335,540 | 125,675 | 209,865 |
| Past due exposures | 18,271 | 6,825 | 11,446 |
| Investment property | 22,176 | 22,176 | - |
| Investment and financing with customers | 245,170 | 91,800 | 153,370 |
| Sukuk | 33,525 | 33,525 | - |
| Other exposures | 123,597 | 114,917 | 8,680 |
| | 1,766,646 | 765,282 | 1,001,364 |

## 5. RISK MANAGEMENT (CONTINUED)

### *5.1 Credit risk (continued)*

### *5.1.4 Geographical distribution of the gross credit exposures*

The geographical distribution of the gross credit exposure is as detailed below:

| **2013** | **Kuwait and The Middle East KD'000** | **North America KD'000** | **Western Europe KD'000** | **Other KD'000** | **Total KD'000** |
|---|---|---|---|---|---|
| Cash | **19,846** | **-** | **-** | **-** | **19,846** |
| Claims on sovereigns | **89,802** | **-** | **-** | **-** | **89,802** |
| Claims on banks | **360,394** | **1,206** | **40,167** | **4,259** | **406,026** |
| Claims on corporates | **679,463** | **-** | **-** | **3,099** | **682,562** |
| Regulatory retail exposure | **568,042** | **-** | **-** | **-** | **568,042** |
| Past due exposures | **23,836** | **-** | **900** | **2,752** | **27,488** |
| Investment property | **25,784** | **-** | **4,461** | **-** | **30,245** |
| Investment and financing with customers | **323,098** | **-** | **-** | **4,550** | **327,648** |
| Sukuk | **29,084** | **-** | **2,205** | **-** | **31,289** |
| Other exposures | **56,736** | **-** | **-** | **8,005** | **64,741** |
| | **2,176,085** | **1,206** | **47,733** | **22,665** | **2,247,689** |

| 2012 | Kuwait and The Middle East KD'000 | North America KD'000 | Western Europe KD'000 | Other KD'000 | Total KD'000 |
|---|---|---|---|---|---|
| Cash | 14,020 | - | - | - | 14,020 |
| Claims on sovereigns | 159,119 | - | - | - | 159,119 |
| Claims on banks | 235,165 | 476 | 18,232 | 4,156 | 258,029 |
| Claims on corporates | 675,041 | - | - | 3,520 | 678,561 |
| Regulatory retail exposure | 405,725 | - | - | - | 405,725 |
| Past due exposures | 20,628 | - | 1,350 | - | 21,978 |
| Investment property | 5,811 | - | 11,585 | 508 | 17,904 |
| Investment and financing with customers | 260,791 | - | 4,064 | - | 264,855 |
| Sukuk | 29,318 | - | 4,367 | - | 33,685 |
| Other exposures | 61,041 | 69 | 30,259 | 42,156 | 133,525 |
| | 1,866,659 | 545 | 69,857 | 50,340 | 1,987,401 |





## 5. RISK MANAGEMENT (CONTINUED)

### *5.1 Credit risk (continued)*

### *5.1.5 Maturity profile of gross credit exposures*

The Group's gross credit exposure by residual contractual maturity is as detailed below:

| **2013** | **Up to 3 months KD'000** | **3 – 6 months KD'000** | **6 – 12 months KD'000** | **Over 1 year KD'000** | **Total KD'000** |
|---|---|---|---|---|---|
| Cash | **19,846** | **-** | **-** | **-** | **19,846** |
| Claims on sovereigns | **42,287** | **47,515** | **-** | **-** | **89,802** |
| Claims on banks | **372,365** | **28,864** | **2,583** | **2,213** | **406,025** |
| Claims on corporates | **355,841** | **158,043** | **84,183** | **84,496** | **682,563** |
| Regulatory retail exposure | **4,185** | **386** | **2,208** | **561,263** | **568,042** |
| Past due exposures | **27,488** | **-** | **-** | **-** | **27,488** |
| Investment property | **-** | **-** | **-** | **30,245** | **30,245** |
| Investment and financing with customers | **227,283** | **100,313** | **-** | **52** | **327,648** |
| Sukuk | **27,450** | **-** | **-** | **3,839** | **31,289** |
| Other exposures | **6,505** | **-** | **5,010** | **53,226** | **64,741** |
| | **1,083,250** | **335,121** | **93,984** | **735,334** | **2,247,689** |

| 2012 | Up to 3 months KD'000 | 3 – 6 months KD'000 | 6 – 12 months KD'000 | Over 1 year KD'000 | Total KD'000 |
|---|---|---|---|---|---|
| Cash | 14,020 | - | - | - | 14,020 |
| Claims on sovereigns | 111,051 | 40,062 | 8,006 | - | 159,119 |
| Claims on banks | 217,052 | 32,338 | 10 | 8,629 | 258,029 |
| Claims on corporates | 405,451 | 161,291 | 85,892 | 25,927 | 678,561 |
| Regulatory retail exposure | 2,405 | 235 | 2,186 | 400,899 | 405,725 |
| Past due exposures | 21,978 | - | - | - | 21,978 |
| Investment property | - | - | - | 17,904 | 17,904 |
| Investment and financing with customers | 191,340 | 64,130 | 9,072 | 313 | 264,855 |
| Sukuk | - | - | 2,111 | 31,574 | 33,685 |
| Other exposures | 3,281 | - | 3,979 | 126,265 | 133,525 |
| | 966,578 | 298,056 | 111,256 | 611,511 | 1,987,401 |

## 5. RISK MANAGEMENT (CONTINUED)

### *5.1 Credit risk (continued)*

### *5.1.6 Past due and impairment provision*

Credit facilities are classified as "past due" when a payment has not been received on its contractual payment date**.**

A credit facility is considered as "impaired" if the profit or principal installment is past due for more than 90 days, or if the carrying amount of the facility is greater than its estimated recoverable value.

Past due and impaired facilities are managed and monitored as "irregular facilities" and classified into the following four categories, which are then used to guide the provisioning process:

| **Category** | **Criteria** |
|---|---|
| Watch list | Irregular for a period up to 90 days |
| Substandard | Irregular for a period between 91 and 180 days |
| Doubtful | Irregular for a period between 181 days and 365 days |
| Bad | Irregular for a period exceeding 365 days |

The Group may also include a credit facility in one of the above categories based on management's judgment of a customer's financial and/or non-financial circumstances.

The Group's impaired portfolio as at 31 December 2013 was **KD 28,778 thousand** (2012: KD 24,827 thousand) against which a specific provision of **KD 3,707 thousand** (2012: KD 4,261 thousand) has been made, as detailed below.

| | **Impaired finance facilities** | **Related specific provision** | **Net balance** |
|---|---|---|---|
| **2013** | **KD'000** | **KD'000** | **KD'000** |
| Claims on corporates | **26,404** | **2,370** | **24,034** |
| Regulatory retail exposure | **2,374** | **1,337** | **1,037** |
| | **28,778** | **3,707** | **25,071** |

| | Impaired finance facilities | Related specific provision | Net balance |
|---|---|---|---|
| 2012 | KD'000 | KD'000 | KD'000 |
| Claims on corporates | 22,210 | 2,461 | 19,749 |
| Regulatory retail exposure | 2,617 | 1,800 | 817 |
| | 24,827 | 4,261 | 20,566 |





## 5. RISK MANAGEMENT (CONTINUED)

### *5.1 Credit risk (continued)*

### *5.1.6 Past due and impairment provision (continued)*

The geographical distribution of impaired loans and the related specific provision is as follows:

| | **Impaired finance facilities** | **Related specific provision** | **Net balance** |
|---|---|---|---|
| **2013** | **KD'000** | **KD'000** | **KD'000** |
| Kuwait and The Middle East | **25,714** | **3,359** | **22,355** |
| Other | **3,064** | **348** | **2,716** |
| | **28,778** | **3,707** | **25,071** |

| | Impaired finance facilities | Related specific provision | Net balance |
|---|---|---|---|
| 2012 | KD'000 | KD'000 | KD'000 |
| Kuwait and The Middle East | 24,827 | 4,261 | 20,566 |
| | 24,827 | 4,261 | 20,566 |

In accordance with CBK regulations, a general provision of 1% for cash facilities and 0.5% for non-cash facilities is made on all applicable credit facilities (net of certain eligible categories of collateral) which are not subject to specific provisioning.

The adequacy of provisions are regularly evaluated and monitored by the Provisions Committee.

The Group's total provision as at 31 December 2013 was **KD 36,796 thousand** (2012: KD 32,946 thousand) inclusive of a general provision of **KD 33,089 thousand** (2011: KD 28,685 thousand) as detailed below:

| | **Provision balance 01/01/2013** | **Provided /(released) during the year** | **General provision balance 31/12/2013** |
|---|---|---|---|
| **2013** | **KD'000** | **KD'000** | **KD'000** |
| Claims on corporates | **10,420** | **1,244** | **11,664** |
| Regulatory retail exposure | **2,226** | **1,035** | **3,261** |
| Investment and financing with customers | **3,020** | **597** | **3,617** |
| Un-allocated general provision | **13,019** | **1,528** | **14,547** |
| | **28,685** | **4,404** | **33,089** |

## 5. RISK MANAGEMENT (CONTINUED)

### *5.1 Credit risk (continued)*

### *5.1.6 Past due and impairment provision (continued)*

| 2012 | Provision balance 01/01/2012 | Provided /(released) during the year | Provision balance 31/12/2012 |
|---|---|---|---|
| | KD'000 | KD'000 | KD'000 |
| Claims on corporates | 9,220 | 1,200 | 10,420 |
| Regulatory retail exposure | 1,509 | 717 | 2,226 |
| Investment and financing with customers | 2,551 | 469 | 3,020 |
| Un-allocated general provision | 20,088 | (7,069) | 13,019 |
| | 33,368 | (4,683) | 28,685 |

The geographical distribution of the general provision is as follows:

| | **2013** | 2012 |
|---|---|---|
| | **KD'000** | KD'000 |
| Kuwait and Middle East | **18,456** | 15,590 |
| Western Europe | **51** | 41 |
| Other | **35** | 35 |
| Un-allocated general provision | **14,547** | 13,019 |
| | **33,089** | 28,685 |

The total general provisions balance above includes **KD 1,344 thousand** (2012: KD 1,395 thousand) relating to non-cash facilities in accordance with CBK regulations.

The analysis of specific and general provisions is further detailed in note 7 of the Group's consolidated financial statement.

### *5.2 Market risk*

Market risk is the risk that the value of assets will fluctuate because of changes in market prices.

The Group has an approved Assets & Liability Management Committee (ALCO), comprising of members from the Group's executive management. The Market risk function has set in place various measures and controls to mitigate market risk such as continuous monitoring of the liquidity position of the Group, primarily ensuring its compliance with the regulatory and management requirements and reporting to the management.

Currently the Group has minimal trading book positions and hence its exposure to those risks is minimal.
The Market risk functions adopts a comprehensive approach for the middle management to measure, manage and effectively monitor risks , in particular consumer banking, corporate banking, investment banking and treasury.

Vetting of investment proposals and providing the senior management with due risk reviews is one of the key elements of market risk management. In addition, effectively monitoring and reporting on the various positions taken by the group in foreign currencies and especially with regards to the liquidity of the Group.





## 5. RISK MANAGEMENT (CONTINUED)

### *5.3 Operational risk*

Operational risk is the risk of loss arising from inadequate or failed internal processes, systems failure, human error, or from external events. When controls fail to perform, it can lead to legal or regulatory implications, or financial or reputational loss.

The Group has established policies and procedures, which are applied to identify, assess, monitor, control and mitigate operational risk in addition to other types of risks relating to the banking and financial activities of the Group as part of overall risk management activities.

The operational risk of the Group is managed in line with the CBK instructions concerning the general guidelines for internal controls and best practice for managing and supervising operational risks in banks.

It is a prime task of the Group to avoid and restrict any inadequacy relating to people, processes and technology. Business processes are regularly reviewed and monitored, especially processes relating to I.T. systems. A standard operational risk matrix has been developed to evaluate IT projects and implement the control measures.

The Group has in place its Business Continuity Plan (BCP) and Disaster Recovery Plan forming a part of BCP to meet any internal or external failures or eventualities enabling smooth functioning of the Group business processes.

The Group has fully established Disaster Recovery (DR) sites both local and offshore. And ensures that the operational risk do not affect all the banking business areas. Being an Islamic bank, the bank pays special attention to operational risk that may array from Shari'a non-compliance and the failure in fiduciary responsibilities.

The group emphasizes continuous risk monitoring and reporting with risk ownership and accountability. Risk reporting lines and authority are structured to play key role in addressing specific risks for the Groups' operations.

### *5.4 Liquidity risk*

Liquidity risk is the risk that the Group will be unable to meet its financial liabilities when they fall due.

Liquidity risk management is one of the vital parts of managing day-to-day banking business. In order to meet any eventuality, The group's liquidity strategy is to maintain healthy level of liquid assets in the form of cash, cash equivalents and readily marketable securities. Furthermore, the Group continuously monitors the maturity profile of its assets and liabilities and ensures that the liquidity position of the Group is within the manageable level.

### *5.5 Compliance with Shari'a Principles.*

Fatwa & Shari'a Supervisory Board of the Bank is responsible for monitoring the Bank's compliance with its issued fatwa and resolutions. The Shari'a Supervisory Board reviews and approves the contract and agreement forms after obtaining the necessary information to provide its opinion. Random samples of operations related to the Bank's transactions are reviewed through Shari'a supervision according to the annual Shari'a audit plan for all the departments and through the periodic reports provided by the Shari'a supervisory department about the audit processes, field visits, workflow and the validity of implementing the fatwa and resolutions issue by the Shari'a Supervisory Board. Accordingly, an annual report about the Bank's compliance with Shari'a fatwa and resolutions are issued according to those fatwa and resolutions and it is attached along with Bank's annual report and submitted to shareholders in the General Assembly. The external auditors have looked at the procedures adopted by the Shari'a Supervisory Board.

## Report of Fatwa & Shari'a Supervisory Board

Date: 04 Rabi' Al-Awwal 1435 AH
Corresponding to: 05 January 2014

**In the Name of Allah, The Merciful, The Compassionate**

**Report of Fatwa & Shari'a Supervisory Board**
**From 01.01.2013 to 31.12.2013**
**To the Shareholders of Boubyan Bank**

Praise be to Allah Almighty, and Peace and Blessings be upon our Prophet Muhammad, his Folk, Companions and Followers.

Fatwa & Shari'a Supervisory Board "The Shari'a Board" of Boubyan Bank, having reviewed all contracts and transactions of the Bank for the period from 01.01.2013 to 31.12.2013, amended the same in accordance with the rules and regulations of the Islamic Shari'a and approved them accordingly.

The said transactions and contracts include individual and international murabaha, ijara ending with ownership, investment wakala, sukuk, etc. In addition, standard forms and contracts have been approved for the Bank.

As for Shari'a supervision, it was assured that all of the Bank's operations and activities have been carried out in accordance with the Shari'a controls and resolutions issued by Fatwa & Shari'a Supervisory Board by examining the documentation and the followed procedures on a test basis for each type of operations and obtaining all information and explanations deemed necessary for the Shari'a Board to express its opinion on compliance with the Islamic Shari'a.

In our opinion, Boubyan Bank's operations and activities for the financial year ended 31.12.2013 presented to us are all in compliance with the Islamic Shari'a. implementation of Shari'a Board resolutions is entrusted to the bank's executive management.

We invoke the Almighty Allah to guide the Bank's management towards integrity and more success.
Peace be upon our Prophet Muhammad and his Folk and Companions All,

Sheikh Dr. Ajeel J. Al-Nashmi

Sheikh Dr. Abdul Aziz K. Al-Qassar

Sheikh Dr. Essam K. Al-Enezi

Sheikh Dr. Mohammed O. Al-Fazie

Sheikh Dr. Ibrahim A. Al-Rashed



BOUBYAN BANK K.S.C. AND SUBSIDIARIES

STATE OF KUWAIT

بنك بوبيان
Boubyan Bank

CONSOLIDATED FINANCIAL STATEMENTS
AND INDEPENDENT AUDITORS' REPORT
FOR THE YEAR ENDED 31 DECEMBER 2012

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## INDEPENDENT AUDITORS' REPORT

**To the Shareholders of**
**Boubyan Bank K.S.C.P.**
**State of Kuwait**

### Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Boubyan Bank K.S.C.P. (the "Bank") and its subsidiaries (collectively the "Group"), which comprise the consolidated statement of financial position as at 31 December 2013, and the consolidated statement of profit or loss, consolidated statement of other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows 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 control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

*Opinion*

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2013, 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.



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## INDEPENDENT AUDITORS' REPORT (Continued)

### 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 the Central Bank of Kuwait ("CBK") as stipulated in CBK Circular No 2/RBA/44/2009 dated 15 June 2009, as amended, the Companies Law No. 25 of 2012, as amended, and by the Bank's Memorandum of Incorporation and Articles of Association, as amended, that an inventory was duly carried out and that, to the best of our knowledge and belief, no violations of the Capital Adequacy Regulations issued by the CBK as stipulated in CBK Circular No 2/RBA/44/2009 dated 15 June 2009, as amended, the Companies Law No. 25 of 2012, as amended, or of the Bank's Memorandum of Incorporation and Articles of Association have occurred during the year ended 31 December 2013 that might have had a material effect on the business of the Group or on its consolidated financial position.

We further report that, during the course of our audit, we have not become aware of any 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 2013 that might have had a material effect on the business of the Group or on its consolidated financial position.

BADER A. AL-WAZZAN
LICENCE NO. 62 A
DELOITTE & TOUCHE
AL-WAZZAN & CO.

WALEED A. AL OSAIMI
LICENCE NO. 68 A
EY
AL AIBAN, AL OSAIMI & PARTNERS

7 January 2014
Kuwait

**BOUBYAN BANK K.S.C.P. AND SUBSIDIARIES**
**STATE OF KUWAIT**

CONSOLIDATED STATEMENT OF PROFIT OR LOSS
For the year ended 31 December 2013

| | Notes | 2013 KD'000 | 2012 KD'000 |
|---|---|---|---|
| **Income** | | | |
| Murabaha and other Islamic financing income | | **70,969** | 64,670 |
| Distribution to depositors | 5 | **(8,527)** | (10,176) |
| Murabaha cost | | **(1,700)** | (2,023) |
| **Net financing income** | | **60,742** | 52,471 |
| Net investment income/(loss) | 6 | **962** | (522) |
| Net fees and commission income | 7 | **3,632** | 3,679 |
| Share of results of associates | 16 | **726** | 2,364 |
| Net foreign exchange gain | | **1,010** | 887 |
| **Operating income** | | **67,072** | 58,879 |
| Staff costs | | **(18,767)** | (17,249) |
| General and administrative expenses | | **(10,062)** | (9,311) |
| Depreciation and amortization | | **(1,699)** | (1,911) |
| **Operating expenses** | | **(30,528)** | (28,471) |
| **Operating profit before provision for impairment** | | **36,544** | 30,408 |
| Provision for impairment | 8 | **(23,081)** | (20,432) |
| **Operating profit before deductions** | | **13,463** | 9,976 |
| Contribution to Kuwait Foundation for the Advancement of Sciences ("KFAS") | | **(127)** | (94) |
| National Labour Support Tax ("NLST") | | **(348)** | (209) |
| Zakat | | **(133)** | (83) |
| Board of directors' remuneration | | **(135)** | (54) |
| **Net profit for the year** | | **12,720** | 9,536 |
| **Attributable to:** | | | |
| Equity holders of the Bank | | **13,408** | 10,050 |
| Non-controlling interests | | **(688)** | (514) |
| **Net profit for the year** | | **12,720** | 9,536 |
| **Basic and diluted earnings per share attributable to the equity holders of the Bank (fils)** | 9 | **7.29** | 5.47 |

The notes from 1 to 32 form an integral part of these consolidated financial statements.



**BOUBYAN BANK K.S.C.P. AND SUBSIDIARIES**
**STATE OF KUWAIT**

CONSOLIDATED STATEMENT OF OTHER COMPREHENSIVE INCOME
For the year ended 31 December 2013

| | 2013 KD'000 | 2012 KD'000 |
|---|---|---|
| **Net profit for the year** | **12,720** | 9,536 |
| **Other comprehensive income** | | |
| **Other comprehensive income to be reclassified to consolidated statement of profit or loss in subsequent periods:** | | |
| Change in fair value of available for sale investments | **(2,230)** | (2,190) |
| Net gains on available for sale investments transferred to consolidated statement of profit and loss | **(449)** | - |
| Impairment losses on available for sale Investments transferred to consolidated statement of profit and loss | **2,115** | 3,976 |
| Foreign currency translation adjustments | **(2,873)** | (2,509) |
| **Other comprehensive loss for the year** | **(3,437)** | (723) |
| **Total comprehensive income for the year** | **9,283** | 8,813 |
| **Attributable to:** | | |
| Equity holders of the Bank | **9,971** | 9,327 |
| Non-controlling interests | **(688)** | (514) |
| **Total comprehensive income for the year** | **9,283** | 8,813 |

The notes from 1 to 32 form an integral part of these consolidated financial statements.

**BOUBYAN BANK K.S.C.P. AND SUBSIDIARIES**
**STATE OF KUWAIT**

Boubyan Bank بنك بوبيان

## CONSOLIDATED STATEMENT OF FINANCIAL POSITION
As at 31 December 2013

| | Notes | 2013 KD'000 | 2012 KD'000 |
|---|---|---|---|
| **Assets** | | | |
| Cash and cash equivalents | 10 | **205,622** | 169,530 |
| Due from banks | 11 | **298,871** | 251,625 |
| Islamic financing to customers | 12 | **1,478,701** | 1,270,014 |
| Financial assets at fair value through profit or loss | 13 | **5,866** | 51,293 |
| Available for sale investments | 14 | **63,044** | 99,929 |
| Investments in associates | 16 | **85,691** | 9,082 |
| Investment properties | 17 | **30,245** | 17,904 |
| Other assets | 18 | **13,994** | 7,916 |
| Property and equipment | | **9,952** | 7,363 |
| **Total assets** | | **2,191,986** | 1,884,656 |
| **Liabilities and Equity** | | | |
| **Liabilities** | | | |
| Due to banks | | **236,018** | 207,133 |
| Depositors' accounts | | **1,657,398** | 1,396,962 |
| Other liabilities | 19 | **29,083** | 24,397 |
| **Total liabilities** | | **1,922,499** | 1,628,492 |
| **Equity** | | | |
| Share capital | 20 | **183,645** | 174,824 |
| Share premium | 21 | **62,896** | 62,896 |
| Proposed bonus shares | 22 | **12,855** | 8,741 |
| Treasury shares | 23 | **(1,100)** | (1,024) |
| Statutory reserve | 24 | **3,306** | 1,891 |
| Voluntary reserve | 25 | **3,167** | 1,813 |
| Share based payment reserve | 26 | **860** | 537 |
| Fair value reserve | | **2,857** | 3,421 |
| Foreign currency translation reserve | | **(7,746)** | (4,873) |
| Retained earnings | | **3,204** | 5,424 |
| **Equity attributable to equity holders of the Bank** | | **263,944** | 253,650 |
| Non-controlling interests | | **5,543** | 2,514 |
| **Total equity** | | **269,487** | 256,164 |
| **Total liabilities and equity** | | **2,191,986** | 1,884,656 |

Mahmoud Yousif Al-Fulaij
Chairman

Adel Abdul Wahab Al Majed
Vice Chairman & Chief Executive Officer

The notes from 1 to 32 form an integral part of these consolidated financial statements.



**BOUBYAN BANK K.S.C.P. AND SUBSIDIARIES**
**STATE OF KUWAIT**

Boubyan Bank بنك بوبيان

## CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
For the year ended 31 December 2013

| | Share capital | Share premium | Proposed bonus shares | Treasury shares | Statutory reserve | Voluntary reserve | Share based payment reserve | Fair value reserve | Foreign currency translation reserve | Retained earnings | Equity attributable to equity holders of the Bank | Non-controlling interests | Total equity |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | KD'000 | KD'000 | KD'000 | KD'000 | KD'000 | KD'000 | KD'000 | KD'000 | KD'000 | KD'000 | KD'000 | KD'000 | KD'000 |
| **Balance at 1 January 2013** | **174,824** | **62,896** | **8,741** | **(1,024)** | **1,891** | **1,813** | **537** | **3,421** | **(4,873)** | **5,424** | **253,650** | **2,514** | **256,164** |
| Total comprehensive income for the year | - | - | - | - | - | - | - | **(564)** | **(2,873)** | **13,408** | **9,971** | **(688)** | **9,283** |
| Transfer to reserves | - | - | - | - | **1,415** | **1,354** | - | - | - | **(2,769)** | - | - | - |
| Issued of bonus shares (note 22) | **8,745** | - | **(8,741)** | - | - | - | - | - | - | **(4)** | - | - | - |
| Proposed bonus shares (note 22) | - | - | **12,855** | - | - | - | - | - | - | **(12,855)** | - | - | - |
| Issue of share capital | **76** | - | - | **(76)** | - | - | - | - | - | - | - | - | - |
| Share based payment (note 26) | - | - | - | - | - | - | **323** | - | - | - | **323** | - | **323** |
| Net movement in non-controlling interests | - | - | - | - | - | - | - | - | - | - | - | **3,717** | **3,717** |
| **Balance at 31 December 2013** | **183,645** | **62,896** | **12,855** | **(1,100)** | **3,306** | **3,167** | **860** | **2,857** | **(7,746)** | **3,204** | **263,944** | **5,543** | **269,487** |
| **Balance at 1 January 2012** | 174,824 | 62,896 | - | (1,024) | 842 | 802 | 253 | 1,635 | (2,364) | 6,381 | 244,245 | 2,923 | 247,168 |
| Total comprehensive income for the year | - | - | - | - | - | - | - | 1,786 | (2,509) | 10,050 | 9,327 | (514) | 8,813 |
| Transfer to reserves | - | - | - | - | 1,049 | 1,011 | - | - | - | (2,060) | - | - | - |
| Proposed bonus shares (note 22) | - | - | 8,741 | - | - | - | - | - | - | (8,741) | - | - | - |
| Acquisition of non-controlling interests | - | - | - | - | - | - | - | - | - | (206) | (206) | (888) | (1,094) |
| Share based payment (note 26) | - | - | - | - | - | - | 284 | - | - | - | 284 | - | 284 |
| Net movement in non-controlling interests | - | - | - | - | - | - | - | - | - | - | - | 993 | 993 |
| **Balance at 31 December 2012** | 174,824 | 62,896 | 8,741 | (1,024) | 1,891 | 1,813 | 537 | 3,421 | (4,873) | 5,424 | 253,650 | 2,514 | 256,164 |

The notes from 1 to 32 form an integral part of these consolidated financial statements.

**BOUBYAN BANK K.S.C.P. AND SUBSIDIARIES**
**STATE OF KUWAIT**

CONSOLIDATED STATEMENT OF CASH FLOWS
For the year ended 31 December 2013

| | Notes | 2013 KD'000 | 2012 KD'000 |
|---|---|---|---|
| **OPERATING ACTIVITIES** | | | |
| Net profit for the year | | **12,720** | 9,536 |
| **Adjustments for:** | | | |
| Provision for impairment | 8 | **23,081** | 20,432 |
| Depreciation and amortization | | **1,699** | 1,911 |
| Foreign currency translation adjustments | | **(1,270)** | (2,468) |
| Net (gain)/loss from available for sale investments | | **(314)** | 97 |
| Net losses from financial assets at fair value through profit or loss | | **876** | 14,510 |
| Share of results of associates | | **(726)** | (2,364) |
| Unrealised profit on interest retained subsequent to loss of significant influence | | **-** | (18,087) |
| Realized profit from partial disposal of associate | | **-** | (5,703) |
| Dividend income | | **(1,397)** | (872) |
| Net unrealized loss from change in fair value of investment properties | | **1,712** | 5,026 |
| Loss on sale of investment properties | | **34** | 7,433 |
| Share based payment reserve | | **323** | 284 |
| **Operating profit before changes in operating assets and liabilities** | | **36,738** | 29,735 |
| **Changes in operating assets and liabilities:** | | | |
| Due from banks | | **(47,246)** | (128,384) |
| Islamic financing to customers | | **(242,762)** | (256,010) |
| Other assets | | **(5,683)** | (757) |
| Due to banks | | **28,885** | 128,147 |
| Depositors' accounts | | **260,609** | 194,535 |
| Other liabilities | | **4,672** | 5,877 |
| Dividend income received | | **1,397** | 872 |
| **Net cash generated from (used in) operating activities** | | **36,610** | (25,985) |
| **INVESTING ACTIVITIES** | | | |
| Purchase of financial assets at fair value through profit or loss | | **(966)** | (1,990) |
| Proceeds from sale of financial assets at fair value through profit or loss | | **6,453** | 2,596 |
| Purchase of available for sale investments | | **(7,660)** | (6,754) |
| Proceeds from sale of available for sale investments | | **6,504** | 6,936 |
| Dividends received from associates | | **286** | 290 |
| Acquisition of associates | 16 | **(3,436)** | - |
| Proceeds from disposals of investment in associates | | **-** | 9,638 |
| Purchase of investment properties | | **(3,155)** | (3,961) |
| Proceeds from sale of investments properties | | **5,744** | - |
| Purchase of property and equipment | | **(4,288)** | (3,096) |
| Acquisition of non-controlling interests | | **-** | (1,094) |
| **Net cash (used in) generated from investing activities** | | **(518)** | 2,565 |
| **FINANCING ACTIVITIES** | | | |
| Movement in non-controlling interests | | **-** | 993 |
| **Net cash generated from financing activities** | | **-** | 993 |
| Net decrease in cash and cash equivalents | | **36,092** | (22,427) |
| Cash and cash equivalents at the beginning of the year | | **169,530** | 191,957 |
| **Cash and cash equivalents at the end of the year** | 10 | **205,622** | 169,530 |

The notes from 1 to 32 form an integral part of these consolidated financial statements.



**BOUBYAN BANK K.S.C.P AND SUBSIDIARIES**
**STATE OF KUWAIT**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
For the year ended 31 December 2013

## 1. INCORPORATION AND ACTIVITIES

Boubyan Bank K.S.C.P ("the Bank") is a Kuwaiti public shareholding company incorporated on 21 September 2004, in accordance with the Commercial Companies Law in the State of Kuwait, by Amiri Decree No. 88 and in accordance with the rules and regulations of the Central Bank of Kuwait ("CBK") (Law No. 30 of 2003).

The Bank's shares were listed on the Kuwait Stock Exchange on 15 May 2006.

The Bank was licensed by the CBK on 28 November 2004. The Bank is principally engaged in providing banking services, in accordance with Codes of the Islamic Sharia'a, as approved by the Bank's Sharia'a Supervisory Board.

The Bank is a subsidiary of National Bank of Kuwait S.A.K.P ("the Parent Company").

The total number of employees in the Group was **901** employees as at 31 December 2013 (807 employees as at 31 December 2012).

The address of the Bank's registered office is P.O. Box 25507, Safat 13116, State of Kuwait.

The consolidated financial statements were authorised for issue by the Board of Directors on 7 January 2014 and the shareholders have the power to amend these consolidated financial statement at the annual assembly meeting.

## 2. BASIS OF PREPARATION

### 2.1 Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs") promulgated by the International Accounting Standards Board ("IASB") and interpretations issued by the International Financial Reporting Interpretations Committee of the IASB, as adopted for use by the State of Kuwait for financial services institutions regulated by the CBK. These regulations require adoption of all IFRSs except for the IAS 39 requirements for collective impairment provision, which has been replaced by the CBK requirements for a minimum general provision as described in accounting policy 3.10.1.

### 2.2 Basis of measurement

The consolidated financial statements have been prepared under the historical cost basis except for the measurement at fair value of investment securities other than held to maturity investments and investment properties.

### 2.3 Functional and presentation currency

These consolidated financial statements are presented in Kuwaiti Dinars, which is the Bank's functional currency. All financial information presented in Kuwaiti Dinars ("KD") has been rounded to the nearest thousands, except when otherwise indicated.

### 2.4 New standards, interpretations and amendments effective from 1 January 2013

*New and revised IFRSs affecting amounts reported and/or disclosures in the financial statements*

The accounting policies adopted are consistent with those of the previous financial year, except for the adoption of the following new standards and amendments to IFRS's effective as of 1 January 2013:

**2. BASIS OF PREPARATION (CONTINUED)**

**2.4 New standards, interpretations and amendments effective from 1 January 2013 (continued)**

*IFRS 10 - Consolidated Financial Statements:*

IFRS 10, which is 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 adoption of this standard did not have material impact on the financial performance or financial position of the Group.

*IFRS 12 - Disclosure of Interests in Other Entities:*

IFRS 12, 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. IFRS 12 disclosures are presented in the consolidated financial statements of the Group.

*IFRS 13 - Fair Value Measurement*

The Group has applied IFRS 13 for the first time in the current year. IFRS 13 establishes a single source of guidance for fair value measurements and disclosures about fair value measurements. The scope of IFRS 13 is broad; the fair value measurement requirements of IFRS 13 apply to both financial instrument items and non-financial instrument items for which other IFRSs require or permit fair value measurements and disclosures about fair value measurements. except for share-based payment transactions that are within the scope of IFRS 2 *Share-based Payment*, leasing transactions that are within the scope of IAS 17 *leases* and measurements that have some similarities to fair value but are not fair value (e.g. net realisable value for the purposes of measuring inventories or value in use for impairment assessment purposes).

IFRS 13 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions. Fair value under IFRS 13 is an exit price regardless of whether that price is directly observable or estimated using another valuation technique. Also, IFRS 13 includes extensive disclosure requirements.

IFRS 13 requires prospective application from 1 January 2013. In addition, specific transitional provisions were given to entities such that they need not apply the disclosure requirements set out in the Standard in comparative information provided for periods before the initial application of the Standard. (Please see notes 17 and 30.6 for the 2013 disclosures). Other than the additional disclosures, the application of IFRS 13 has not had any material impact on the amounts recognized in the consolidated financial statements.

*Amendments to IAS 1 Presentation of Items of Other Comprehensive Income*

The Group has applied the amendments to IAS 1 Presentation of Items of Other Comprehensive Income for the first time in the current year. The amendments introduce new terminology whose use is not mandatory, for the statement of comprehensive income and statement of profit or loss.



BOUBYAN BANK K.S.C.P. AND SUBSIDIARIES
STATE OF KUWAIT

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
For the year ended 31 December 2013

**2. BASIS OF PREPARATION (CONTINUED)**

**2.4 New standards, interpretations and amendments effective from 1 January 2013 (continued)**

*Amendments to IAS 1 - Presentation of Items of Other Comprehensive Income (continued)*

The amendments to IAS 1 retain the option to present profit or loss and other comprehensive income in either a single statement or in two separate but consecutive statements.

However, the amendments to IAS 1 require items of other comprehensive income to be grouped into two categories in the other comprehensive income section: (a) items that will not be reclassified subsequently to profit or loss and (b) items that may be reclassified subsequently to profit or loss when specific conditions are met. The amendments have been applied retrospectively, and hence the presentation of items of other comprehensive income has been modified to reflect the changes. Other than the above mentioned presentation changes, the application of the amendments to IAS 1 does not result in any impact on profit or loss, other comprehensive income and total comprehensive income.

*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 adoption of this standard did not have any impact on the financial performance, financial position or disclosures in the consolidated financial statements of the Group.

**2.5 New standards and interpretations not yet adopted**

A number of new standards, amendments to standards and interpretations are effective for annual periods beginning after 1 January 2013, and have not been applied in preparing these consolidated financial statements. None of these are expected to have a significant effect on the consolidated financial statements of the Group, except for IFRS 9 - Financial Instruments,

*IFRS 9 'Financial Instruments':*

The standard was issued in November 2009, however at the IASB meeting in July 2013, the IASB tentatively decided to defer the mandatory effective date of IFRS 9 to be left open. However, IFRS 9 would still be available for early application. The extent of the impact has not yet been determined, 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.

**3. SIGNIFICANT ACCOUNTING POLICIES**

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements, and have been applied consistently by all of the Group's entities.

**3.1 Basis of consolidation**

The consolidated financial statements comprise the Bank and its subsidiaries (collectively "the Group")- Boubyan Takaful Insurance Company K.S.C. and Boubyan Capital Investment Company K.S.C., which are controlled by the Bank as set out in note 15.

***3.1.1 Business combinations***

Business combinations are accounted for using the acquisition method as at the acquisition date, which is the date on which control is transferred to the Group. The Group controls an investee if and only if the Group has:

- Power over the investee (i.e. existing rights that give it the current ability to direct the relevant activities of the investee)
- Exposure, or rights, to variable returns from its involvement with the investee, and
- The ability to use its power over the investee to affect its returns

When the Group has less than a majority of the voting or similar rights of an investee, the Group considers all relevant facts and circumstances in assessing whether it has power over an investee, including:

- The contractual arrangement with the other vote holders of the investee
- Rights arising from other contractual arrangements
- The Group's voting rights and potential voting rights

The Group measures goodwill at the acquisition date as:

- The fair value of the consideration transferred; plus
- The recognised amount of any non-controlling interests in the acquiree; plus
- If the business combination is achieved in stages, the fair value of the pre-existing equity interest in the acquiree; less
- The net recognised amount of the identifiable assets acquired and liabilities assumed.

When the excess is negative, a bargain purchase gain is recognised immediately in consolidated statement of profit or loss.

Transactions costs, other than those associated with the issue of debt or equity securities, that the Group incurs in connection with a business combination are expensed as incurred.

***3.1.2 Non-controlling interests***

Interest in the equity of subsidiaries not attributable to the Group is reported as non-controlling interest in the consolidated statement of financial position. Non-controlling interest in the acquiree is measured at the proportionate share in the recognized amount of the acquiree's identifiable net assets. Losses are allocated to the non-controlling interest even if they exceed the non-controlling interest's share of equity in the subsidiary. Transactions with non-controlling interests are treated as transactions with equity owners of the Group. Gains or losses on disposals of non-controlling interests without loss of control are recorded in equity.

***3.1.3 Subsidiaries***

Subsidiaries are entities controlled by the Group. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. Where necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies in line with those used by the Bank.





**3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**3.1 Basis of consolidation (continued)**

***3.1.4 Loss of control***

On loss of control, the Group derecognises the assets and liabilities of the subsidiary, any non-controlling interests and the other components of equity related to the subsidiary. Any surplus or deficit arising on loss of control is recognised in the consolidated statement of profit or loss. If the Group retains any interest in the previous subsidiary, then such interest is measured at fair value at the date that control is lost. Subsequently it is accounted for as an equity-accounted investee or as a financial asset depending on the level of influence retained.

***3.1.5 Investments in associates (equity-accounted investees)***

Associates are those entities in which the Group has significant influence, but not control, over the financial and operating policies. Significant influence is presumed to exist when the Group holds between 20% and 50% of the voting right.

Investments in associates are accounted for using the equity method and are recognised initially at cost. The cost of the investment includes transaction costs.

The Group recognises in the consolidated statement of profit or loss its share of the total recognised profit or loss of the associate from the date that influence effectively commences until the date that it effectively ceases. Distributions received from the associate reduce the carrying amount of the investments. Adjustments to the carrying amount may also be necessary for changes in Group's share in the associate arising from changes in the associate's equity and other comprehensive income. The Group's share of those changes is recognised directly in equity or in other comprehensive income as appropriate.

When the Group's share of losses exceeds its interest in an equity-accounted investee, the carrying amount of the investment, including any long-term interests that form part thereof, is reduced to zero, and the recognition of further losses is discontinued except to the extent that the Group has an obligation or has made payments on behalf of the investee.

Any excess of the cost of acquisition over the Group's share of the net fair value of the identifiable assets and liabilities of the associate at the date of acquisition is recognized as goodwill within the carrying amount of the associates.

Any excess of the Group's share of the net fair value of the identifiable assets and liabilities over the cost of acquisition, after reassessment, is recognized immediately in the consolidated statement of profit or loss.

Unrealised gains arising from transactions with associates are eliminated against the investment to the extent of the Group's interest in the associate. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

***3.1.6 Transactions eliminated on consolidation***

Intra-group balances and transactions, and any unrealised income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

**3.2 Foreign currency**

The individual financial statements of each group entity are presented in the currency of the primary economic environment in which the entity operates (its functional currency).

Foreign currency transactions are recorded in the functional currency at the rate of exchange prevailing at the date of the transaction.

**3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**3.2 Foreign currency (continued)**

Exchange differences arising on the settlement of monetary items, and on the translation of monetary items, are included in the consolidated statement of profit or loss for the year. Exchange differences arising on the translation of non-monetary items carried at fair value are included in the consolidated statement of profit or loss for the year, except for differences arising on the translation of non-monetary items in respect of which gains and losses are recognised directly in other comprehensive income. For such non-monetary items, any exchange component of that gain or loss is also recognised directly in other comprehensive income.

For the purpose of presenting consolidated financial statements, the assets and liabilities of the Group's foreign operations are expressed in KD using exchange rates prevailing on the reporting date. Income and expense items are translated at the average exchange rates for the year. Exchange differences arising, if any, are classified as other comprehensive income and transferred to the Group's foreign currency translation reserve. Such translation differences are recognised in the consolidated statement of profit or loss in the year in which the foreign operation is disposed off.

**3.3 Revenue recognition**

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

- Income from Murabaha, Wakala, and Leased assets is recognized on a pattern reflecting a constant periodic return on the outstanding net investment.
- Dividend income is recognized when the right to receive payment is established.
- Fees and commission income is recognized at the time the related services are provided.
- Rental income from investment properties is recognised on a straight line basis over the lease period.

**3.4 Financial instruments**

***3.4.1 Financial assets***

*Trade and settlement date accounting*

All regular way purchase and sale of financial assets are recognized using settlement date accounting. Changes in the fair value between trade date and settlement date are recognized in the consolidated statement of profit or loss for financial assets at fair value through profit or loss and are recognized in other comprehensive income for available for sale investments. 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.





**3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**3.4 Financial instruments (continued)**

***3.4.1 Financial assets (continued)***

*Recognition and derecognition of financial assets*

Financial assets are recognised when the Group becomes party to contractual provisions of the instrument and are initially measured at fair value. Transaction costs are included only for those financial instruments that are not measured at fair value through profit or loss.

The Group derecognises a financial asset only when the contractual rights to the cash flows from the asset expire; or it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. If the Group neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Group recognizes its retained interest in the asset and an associated liability for amounts it may have to pay. If the Group retains substantially all the risks and rewards of ownership of a transferred financial asset, the Group continues to recognize the financial asset and also recognizes a liability for the proceeds received.

*Offsetting*

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

Income and expenses are presented on a net basis only if it is so permitted by the accounting standards, or for gains and losses arising from a group of similar transactions.

The Group classifies financial assets into the following categories: cash and cash equivalents, due from banks, Islamic financing to customers, financial assets at fair value through profit or loss, available for sale investments and other assets.

***Cash and cash equivalents***

Cash and cash equivalents consist of cash in hand, current account with other banks and placements with banks maturing within seven days.

***Due from banks and Islamic financing to customers***

Due from banks and Islamic financing to customers are financial assets with fixed or determinable payments that are not quoted in an active market.

***Murabaha***

Murabaha is an agreement relating to the sale of commodities at cost plus an agreed upon profit margin, whereby the seller informs the buyer of the price at which the deal will be completed and also the amount of profit to be recognized. Murabaha is a financial asset originated by the Group and is stated at amortized cost net of provision for impairment.

***Wakala***

Wakala is an agreement involving Al-Muwakkil (the Principal) who wishes to appoint Al-Wakil (the Agent) to be his agent with respect to the investment of Al-Muwakkil's fund, in accordance with regulations of the Islamic Sharia'a. Wakala is a financial asset originated by the Group and is stated at amortized cost net of provision for impairment.

***Leased assets - the Group as a lessor***

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating lease. Leased assets are stated at amounts equal to the net investment outstanding in the leases less provision for impairment.

**3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**3.4 Financial instruments (continued)**

***3.4.1 Financial assets (continued)***

***Renegotiated finance facilities***

In the event of a default, the Group seeks to restructure facilities rather than take possession of collateral. This may involve extending the payment arrangements and the agreement of new facility conditions. When the terms and conditions of these finance facilities are renegotiated, the terms and conditions of the new contractual arrangement apply in determining whether these facilities remain past due. Management continually reviews renegotiated facilities to ensure that all criteria are met and that future payments are likely to occur. The facility continues to be subject to an individual or collective impairment assessment.

***Financial assets at fair value through profit or loss***

A financial asset is classified as at fair value through profit or loss if it is classified as held for trading or is designated as such on initial recognition. Financial assets are designated as at fair value through profit or loss if the Group manages such investments and makes purchase and sale decisions based on their fair value in accordance with the Group's strategy or such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise.

Attributable transaction costs are recognised in consolidated statement of profit or loss as incurred. Financial assets at fair value through profit or loss are measured at fair value and changes therein, which takes into account any dividend income, are recognised in consolidated statement of profit or loss.

***Available-for-sale investment***

Available-for-sale investment is non-derivative financial assets that are not classified in any of the above categories of financial assets.

Available-for-sale investment is recognised initially at fair value plus any directly attributable transaction costs.

Subsequent to initial recognition, they are measured at fair value and changes therein, other than impairment losses (see note 3.10.1) and foreign currency differences on available-for-sale debt instruments, are recognised in other comprehensive income and presented in the fair value reserve in equity. When an investment is derecognised or is determined to be impaired, the gain or loss accumulated in equity is reclassified to consolidated statement of profit or loss.

***3.4.2 Financial liabilities***

All financial liabilities are recognised initially on the settlement date at fair value less any directly attributable transaction costs. Subsequent to initial recognition, these financial liabilities are measured at amortised cost.

The Group derecognises a financial liability when its contractual obligations are discharged, cancelled or expire.

Financial liabilities comprise due to banks, depositors' accounts and other liabilities.

***Due to banks and depositors' accounts***

Depositors' accounts are deposits received from customers under current account, saving investment accounts and fixed term investments accounts. The depositors' accounts of the Bank comprise the following:

i) Non-investment deposits in the form of current accounts. These deposits are not entitled to any profits nor do they bear any risk of loss as the Bank guarantees to pay the related balances on demand. Accordingly, these deposits are considered Qard Hassan from depositors to the Bank under Islamic Sharia'a principals. Investing such Qard Hassan is made at the discretion of the Group, the results of which are attributable to the equity shareholders of the Bank.





**3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**3.4 Financial instruments (continued)**

***3.4.2 Financial liabilities (continued)***

***Due to banks and depositors' accounts (continued)***

ii) Investment deposit accounts include savings accounts, fixed term deposit accounts, and open term deposit accounts.

*Saving Investment Accounts*

These are open-term deposits and the client is entitled to withdraw the balances of these accounts or portions thereof at any time.

*Fixed-Term Deposit Investment Accounts*

These are fixed-term deposits based on the deposit contract executed between the Bank and the depositor. These deposits mature monthly, quarterly, semi-annually, or annually.

*Open –Term Deposit Investment Accounts*

These are open-term deposits and are treated as annual deposits renewed automatically for a similar period, unless the depositor notifies the Bank in writing of his/her desire not to renew the deposit.
In all cases, investment accounts receive a proportion of profit, bear a share of loss and are carried at cost plus profit payable.

**3.5 Fair values**

For investments traded in organized financial markets, fair value is determined by reference to stock exchange quoted market bid prices on the reporting date.

For investments where there is no quoted market price, a reasonable estimate of the fair value is determined by reference to an earnings multiple, or an industry specific earnings multiple or a fair value based on a similar publicly traded company, or based on the expected cash flows of the investments.

Available for sale investments with no reliable measures of their fair values are carried at their initial cost less impairment losses, if any.

Information about the valuation techniques and inputs used in determining the fair value of various assets and liabilities are disclosed in note 30.

**3.6 Derivative**

Derivative instruments are initially recognised in the consolidated statement of financial position at cost (including transaction costs) and subsequently measured at their fair value.

The Group enters into foreign exchange forward contracts. Forward foreign exchange contracts are contractual agreements to buy or sell a specified financial instrument at a specific price and date in the future. Derivatives are stated at fair value. The fair value of a derivative includes unrealised gain or loss from marking to market the derivative using prevailing market rates or internal pricing models. Derivatives with positive market values (unrealised gains) are included in other assets and derivatives with negative market values (unrealised losses) are included in other liabilities in the consolidated statement of financial position.

The resultant gains and losses from derivatives are included in the consolidated statement of profit or loss.

## 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### 3.7 Investment properties

Investment properties are properties held either to earn rental income or for capital appreciation or for both, but not for sale in the ordinary course of business, use in the production or supply of goods or services or for administrative purposes. Investment property is measured at cost on initial recognition and subsequently at fair value with any change therein recognised in consolidated statement of profit or loss. Cost includes expenditure that is directly attributable to the acquisition of the investment property.

Fair values of investment properties are determined by appraisers having an appropriate recognised professional qualification and recent experience in the location and category of the property being valued.

Any gain or loss on disposal of an investment property (calculated as the difference between the net proceeds from disposal and the carrying amount of the item) is recognised in consolidated statement of profit or loss.

When the use of a property changes such that it is reclassified as property and equipment, its fair value at the date of reclassification becomes its cost for subsequent accounting.

### 3.8 Property and equipment

Items of property and equipment are measured at cost less accumulated depreciation and accumulated impairment losses. The initial cost of property and equipment comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use.

Subsequent expenditure is capitalised only when it is probable that the future economic benefits associated with the expenditure will flow to the Group. On-going repairs and maintenance is expensed as incurred.

Items of property and equipment are depreciated on a straight-line basis in consolidated statement of profit or loss over the estimated useful lives of each component

The estimated useful lives for the current and comparative years of significant items of property and equipment are as follows:

| | |
|---|---|
| • Furniture and leasehold improvement | 5 years |
| • Office equipment | 3 years |
| • Building on leasehold land | 20 years |

Depreciation methods, useful lives and residual values are reviewed periodically and adjusted, if appropriate.

### 3.9 Intangible assets

Intangible assets acquired separately, which consist of software that have finite useful lives, are reported at cost less accumulated amortization and accumulated impairment losses. Software amortization is charged on a straight-line basis over its estimated useful life of 10 years. The estimated useful life and amortization method are reviewed at the end of each annual reporting period, with the effect of any changes in estimates being accounted for on a prospective basis.

### 3.10 Impairment

#### 3.10.1 *Financial assets*

The Group assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred loss event) and that loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. If such evidence exists, any impairment loss is recognised in the consolidated statement of profit or loss.

*Financial assets measured at amortised cost*

The amount of impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective yield. Losses are recognised in the consolidated statement of profit or loss and reflected in an allowance account against Islamic financing to customers. When an event occurring after the impairment was recognised causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through the consolidated statement of profit or loss.





## 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### 3.10 Impairment (continued)

#### 3.10.1 *Financial assets (continued)*

In addition, in accordance with CBK instructions, a minimum general provision of 1% for the cash facilities and 0.5% for the non-cash facilities, net of certain categories of collateral, to which CBK instructions are applicable and not subject to specific provisions is made. In March 2007, CBK issued a circular amending the basis of calculating general provisions on facilities changing the rate from 2% to 1% for cash facilities and from 1% to 0.5% for non-cash facilities. The required rates were to be applied effective from 1 January 2007 on the net increase in facilities, net of certain categories of collateral, during the reporting period. The general provision in excess of the present 1% for cash facilities and 0.5% for non-cash facilities as of 31 December 2006 would be retained as a general provision until a further directive from the CBK is issued.

*Available for sale investment*

Impairment losses on available for sale investment are recognised by reclassifying the losses accumulated in the fair value reserve in equity to consolidated statement of profit or loss. The cumulative loss that is reclassified from equity to consolidated statement of profit or loss is the difference between the acquisition cost, net of any principal repayment and amortisation, and the current fair value, less any impairment loss recognised previously in consolidated statement of profit or loss. If, in a subsequent period, the fair value of an impaired available-for-sale debt security increases and the increase can be related objectively to an event occurring after the impairment loss was recognised, then the impairment loss is reversed, with the amount of the reversal recognised in consolidated statement of profit or loss. However, any subsequent recovery in the fair value of an impaired available-for-sale equity security is recognised in other comprehensive income.

#### 3.10.2 *Non-financial assets*

At each reporting date, the Group reviews the carrying amounts of its non-financial assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs. Where a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual cash-generating units, or otherwise they are allocated to the smallest group of cash-generating units for which a reasonable and consistent allocation basis can be identified.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a discount rate that reflects current market rates and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised immediately in consolidated statement of profit or loss, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

For non-financial assets excluding goodwill, an assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. Where an impairment loss is subsequently reversed, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount and is limited to the carrying amount that would have been determined had no impairment loss been recognized for the asset (cash-generating unit) in prior years. A reversal of impairment loss is recognized immediately in the consolidated statement of profit or loss, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

## 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### 3.11 Provisions

A provision is recognised if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are reviewed at each financial reporting date and adjusted to reflect the current best estimate of the expenditure required to settle the obligation at the financial reporting date and are discounted to present value where the effect is material.

### 3.12 Contingent liabilities and contingent assets

Contingent liabilities are not recognized in the consolidated financial statements. They are disclosed in the notes of the consolidated financial statements, unless the possibility of an outflow of resources embodying economic benefits is remote.

Contingent assets are not recognized in the consolidated financial statements but are disclosed when an inflow of economic benefits is probable

### 3.13 Share based payment

The Bank operates an equity settled share based compensation plan. The fair value of the employee services received in exchange for the grant of options or shares is recognized as an expense, together with a corresponding increase in equity. The total amount to be expensed over the vesting period is determined by reference to the fair value of the options or shares on the date of grant using the Black Scholes model. At each reporting date, the Group revises its estimates of the number of options that are expected to become exercisable. It recognises the impact of the revision of original estimates, if any, in the consolidated statement of profit or loss, with a corresponding adjustment to equity.

### 3.14 Segment reporting

Operating segments are identified on the basis of internal reports that are regularly reviewed by the decision makers in order to allocate resources to the segments and to assess their performance. Such operating segments are classified as either business segments or geographical segments.

A business segment is a distinguishable component of the Group that is engaged in providing products or services, which is subject to risks and returns that are different from those of other segments.

A geographic segment is a distinguishable component of the Group that is engaged in providing products or services within a particular economic environment which is subject to risks and returns different from those of segments operating in other economic environments.

### 3.15 Treasury shares

Treasury shares consist of the Bank's own shares that have been issued, subsequently reacquired by the Bank and not yet reissued or cancelled. The treasury shares are accounted for using the cost method. Under the cost method, the weighted average cost of the shares reacquired is charged to a contra equity account. When the treasury shares are reissued, gains are credited to a separate account in equity (treasury shares reserve) which is not distributable. Any realised losses are charged to the same account to the extent of the credit balance on that account. Any excess losses are charged to retained earnings then reserves. Gains realised subsequently on the sale of treasury shares are first used to offset any previously recorded losses in the order of reserves, retained earnings and the gain on sale of treasury shares account.

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.

### 3.16 Kuwait Foundation for the Advancement of Sciences (KFAS)

The Bank calculates the contribution to KFAS at 1% in accordance with the calculation based on the Foundation's Board of Directors resolution.





## 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### 3.17 National Labour Support Tax (NLST)

The Bank calculates the NLST in accordance with Law No. 19 of 2000 and the Minister of Finance Resolutions No. 24 of 2006 at 2.5% of taxable profit for the year. Cash dividends from listed companies which are subjected to NLST are deducted from the profit for the year to determine the taxable profit.

### 3.18 Zakat

Effective from 10 December 2007, the Bank has provided for Zakat in accordance with the requirements of Law No. 46 of 2006. The Zakat charge calculated in accordance with these requirements is charged to the consolidated statement of profit and loss.

### 3.19 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 recognized as a liability at fair value, adjusted for transaction costs that are directly attributable to the issuance of the guarantee. Subsequently, the liability is measured at the higher of the best estimate of the expenditure required to settle the present obligation at the reporting date and the amount recognized less cumulative amortization.

### 3.20 Fiduciary assets

The Group provides trust and other fiduciary services that result in the holding or investing of assets on behalf of its customers. 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 statement of financial position. These are disclosed separately in the consolidated financial statements.

## 4. CRITICAL ACCOUNTING JUDGMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY

### 4.1 Critical judgments in applying the Group's accounting policies

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

*Classification of investments*

Management decides on acquisition of an investment whether to classify it as held to maturity, available for sale or financial asset at fair value through profit or loss.

In designating financial assets at fair value through profit or loss, the Group determines if it meets one of the criteria for this designation set out in the significant accounting policies (see note 3).

*Impairment of investments*

The Group treats available for sale equity investments as impaired when there has been a significant or prolonged decline in the fair value below its cost or where other objective evidence of impairment exists. The determination of what is "significant" or "prolonged" requires considerable judgement. In addition, the Group evaluates other factors, including normal volatility in share price for quoted equities and the future cash flows and the discount factors for unquoted equities.

## 4. CRITICAL ACCOUNTING JUDGMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY (CONTINUED)

### 4.1 Critical judgments in applying the Group's accounting policies (continued)

*Fair value hierarchy*

As disclosed in note 30, the Group is required to determine and disclose the level in the fair value hierarchy into which the fair value measurements are categorized in their entirety, segregating fair value measurements in accordance with the levels defined in IFRS. Differentiating between Level 2 and Level 3 fair value measurements, i.e., assessing whether inputs are observable and whether the unobservable inputs are significant, may require judgement and a careful analysis of the inputs used to measure fair value, including consideration of factors specific to the asset or liability.

### 4.2 Key sources of estimation uncertainty

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

*Impairment losses on finance facilities*

The Group reviews its irregular finance facilities on a quarterly basis to assess whether a provision for impairment should be recorded in the consolidated statement of profit or loss. 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, and actual results may differ resulting in future changes to such provisions.

*Valuation of unquoted equity investments*

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

- Recent arm's length market transactions;
- Current fair value of another instrument that has substantially the same characteristics; or
- Other valuation models.

The determination of the cash flows and discount factors for unquoted equity investments requires significant estimation.

## 5. DISTRIBUTION TO DEPOSITORS

The Bank determines and distributes the depositors' share of profit based on the Bank's results at the end of each month.

## 6. NET INVESTMENT INCOME/(LOSS)

| | **2013** | 2012 |
|---|---|---|
| | **KD'000** | KD'000 |
| Sukuk coupon income | **1,545** | 1,687 |
| Dividend income | **1,397** | 872 |
| Net rental income from investment properties | **328** | 195 |
| Net losses from financial assets at fair value through profit or loss | **(876)** | (14,510) |
| Net gains/(loss) from available for sale investment | **314** | (97) |
| Losses on sale of investment properties | **(34)** | (7,433) |
| Unrealized loss from changes in fair value of investment properties | **(1,712)** | (5,026) |
| Unrealized profit on interest retained subsequent to loss of significant influence | **-** | 18,087 |
| Realized profit from partial disposal of associate | **-** | 5,703 |
| | **962** | (522) |





## 7. NET FEES AND COMMISSION INCOME

| | **2013** | 2012 |
|---|---|---|
| | **KD'000** | KD'000 |
| Gross fees and commission income | **5,271** | 4,825 |
| Fees and commission expenses | **(1,639)** | (1,146) |
| | **3,632** | 3,679 |

## 8. PROVISION FOR IMPAIRMENT

| | **2013** | 2012 |
|---|---|---|
| | **KD'000** | KD'000 |
| Provision for impairment of finance facilities | **17,852** | 16,175 |
| Provision for impairment of available for sale investment | **2,115** | 3,976 |
| Provision for impairment of other assets | **3,114** | 281 |
| | **23,081** | 20,432 |

The analysis of provision for impairment of finance facilities based on specific and general provision is as follows:

| | Specific | General | Total |
|---|---|---|---|
| | KD'000 | KD'000 | KD'000 |
| Balance at 1 January 2012 | 2,673 | 33,368 | 36,041 |
| Provided/(released) during the year | 20,858 | (4,683) | 16,175 |
| Recovery of written off balances | 240 | - | 240 |
| Written off balances during the year | (19,532) | - | (19,532) |
| Foreign currency movement | 22 | - | 22 |
| Balance at 31 December 2012 | 4,261 | 28,685 | 32,946 |
| Provided during the year | **13,448** | **4,404** | **17,852** |
| Recovery of written off balances | **3,779** | **-** | **3,779** |
| Written off balances during the year | **(17,781)** | **-** | **(17,781)** |
| Balance at 31 December 2013 | **3,707** | **33,089** | **36,796** |

Further analysis of provision for impairment of finance facilities by category is as follows:

| | Due from banks | Islamic finance to customers | Non-cash facilities | Total |
|---|---|---|---|---|
| | KD'000 | KD'000 | KD'000 | KD'000 |
| Balance at 1 January 2012 | - | 34,803 | 1,238 | 36,041 |
| Provided during the year | 5,616 | 10,402 | 157 | 16,175 |
| Recovery of written off balances | - | 240 | - | 240 |
| Written off balances during the year | (5,638) | (13,894) | - | (19,532) |
| Foreign currency movement | 22 | - | - | 22 |
| Balance at 31 December 2012 | - | 31,551 | 1,395 | 32,946 |
| Provided/(released) during the year | **-** | **17,903** | **(51)** | **17,852** |
| Recovery of written off balances | **-** | **3,779** | **-** | **3,779** |
| Written off balances during the year | **-** | **(17,781)** | **-** | **(17,781)** |
| Balance at 31 December 2013 | **-** | **35,452** | **1,344** | **36,796** |

At 31 December 2013, non-performing finance facilities amounted to **KD 25,071 thousand**, net of provision of **KD 3,707 thousand** (31 December 2012: 20,566 thousand net of provision of KD 4,261 thousand). The analysis of specific and general provision stated above is based on CBK instructions.

## 9. BASIC AND DILUTED EARNING PER SHARE

Basic earnings per share are calculated by dividing the profit for the year by the weighted average number of shares outstanding during the year.

Diluted earnings per share is calculated by dividing the profit for the year by the weighted average number of shares outstanding during the year plus the weighted average number of share that would be issued on the conversion of all the dilutive potential shares into shares. The diluted earnings per share arising from the issue of employee share option does not result in any change from the reported basic earnings per share.

| | **2013** | 2012 |
|---|---|---|
| Net profit for the year attributable to the equity holders of the Bank (KD'000) | **13,408** | 10,050 |
| Weighted average number of shares outstanding during the year (thousands of shares) | **1,839,020** | 1,839,020 |
| Basic and diluted earnings per share attributable to the equity holders of the Bank (fils) | **7.29** | 5.47 |

Earnings per share for the year ended 31 December 2012 was 5.75 fils per share before retroactive adjustment to the number of shares following the bonus issue (see note 22).

## 10. CASH AND CASH EQUIVALENTS

| | **2013**<br>**KD'000** | 2012<br>KD'000 |
|---|---|---|
| Cash on hand | **19,846** | 14,020 |
| Balances with CBK – current account | **682** | 840 |
| Balances with banks – current accounts | **7,674** | 3,675 |
| Placement with banks maturing within seven days | **177,420** | 150,995 |
| | **205,622** | 169,530 |

The fair values of cash and cash equivalents do not differ from their respective carrying values.

## 11. DUE FROM BANKS

The geographical distribution of balances due from banks is as follows:

| | **2013**<br>**KD'000** | 2012<br>KD'000 |
|---|---|---|
| Kuwait & Middle East | **266,884** | 240,562 |
| Europe | **31,987** | 11,063 |
| | **298,871** | 251,625 |

## 12. ISLAMIC FINANCING TO CUSTOMERS

The geographical distribution of Islamic financing to customers is as follows:

| | Kuwait & Middle East<br>KD'000 | Europe<br>KD'000 | Asia<br>KD'000 | **Total**<br>**KD'000** |
|---|---|---|---|---|
| **2013** | | | | |
| Corporate banking | **930,151** | **4,550** | **3,099** | **937,800** |
| Consumer banking | **576,353** | **-** | **-** | **576,353** |
| | **1,506,504** | **4,550** | **3,099** | **1,514,153** |
| Less: provision for impairment | **(35,376)** | **(46)** | **(30)** | **(35,452)** |
| | **1,471,128** | **4,504** | **3,069** | **1,478,701** |





## 12. ISLAMIC FINANCING TO CUSTOMERS (CONTINUED)

| | | | | |
|---|---|---|---|---|
| **2012** | | | | |
| Corporate banking | 880,691 | 4,064 | 3,520 | 888,275 |
| Consumer banking | 413,290 | - | - | 413,290 |
| | 1,293,981 | 4,064 | 3,520 | 1,301,565 |
| Less: provision for impairment | (31,475) | (41) | (35) | (31,551) |
| | 1,262,506 | 4,023 | 3,485 | 1,270,014 |

Provision for impairment of Islamic financing to customers is calculated and analysed based on CBK instructions on the outstanding balance net of deferred profits (if any) as follows:

| | Specific | | General | | Total | |
|---|---|---|---|---|---|---|
| | **2013**<br>**KD'000** | 2012<br>KD'000 | **2013**<br>**KD'000** | 2012<br>KD'000 | **2013**<br>**KD'000** | 2012<br>KD'000 |
| Balance at beginning of the year | **4,261** | 2,673 | **27,290** | 32,130 | **31,551** | 34,803 |
| Provided/(released) during the year | **13,448** | 15,242 | **4,455** | (4,840) | **17,903** | 10,402 |
| Recovery of written off balances | **3,779** | 240 | **-** | - | **3,779** | 240 |
| Written off balances | **(17,781)** | (13,894) | **-** | - | **(17,781)** | (13,894) |
| **Balance at end of the year** | **3,707** | 4,261 | **31,745** | 27,290 | **35,452** | 31,551 |

Further analysis of specific provision based on class of financial assets is given below:

| | Corporate banking | | Consumer banking | | Total | |
|---|---|---|---|---|---|---|
| | **2013**<br>**KD'000** | 2012<br>KD'000 | **2013**<br>**KD'000** | 2012<br>KD'000 | **2013**<br>**KD'000** | 2012<br>KD'000 |
| Balance at beginning of the year | **2,461** | 349 | **1,800** | 2,324 | **4,261** | 2,673 |
| Provided/(released) during the year | **12,638** | 15,766 | **810** | (524) | **13,448** | 15,242 |
| Recovery of written off balances | **3,619** | 240 | **160** | - | **3,779** | 240 |
| Written off balances | **(16,349)** | (13,894) | **(1,432)** | - | **(17,781)** | (13,894) |
| **Balance at end of the year** | **2,369** | 2,461 | **1,338** | 1,800 | **3,707** | 4,261 |

Whenever necessary, Islamic financing to customers is secured by acceptable forms of collateral to mitigate the related credit risks.

Non performing Islamic financing to customers and related specific provisions are as follows:

| | **2013**<br>**KD'000** | 2012<br>KD'000 |
|---|---|---|
| Islamic financing to customers | **28,778** | 24,827 |
| Specific provision for impairment | **(3,707)** | (4,261) |
| | **25,071** | 20,566 |

At 31 December 2013 management estimates the fair value of collaterals held against individually impaired Islamic finance facilities to be **KD 23,280 thousand** (31 December 2012: KD 17,594 thousand).

## 13. FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

| | **2013**<br>**KD'000** | 2012<br>KD'000 |
|---|---|---|
| Investment in unquoted securities | **3,932** | 32,781 |
| Investment in quoted securities | **-** | 1,181 |
| Investment in unquoted funds | **1,934** | 17,331 |
| | **5,866** | 51,293 |

## 14. AVAILABLE FOR SALE INVESTMENTS

| | **2013** | 2012 |
|---|---|---|
| | **KD'000** | KD'000 |
| Investment in Sukuk | **31,289** | 33,685 |
| Investment in unquoted funds | **18,383** | 17,711 |
| Investment in unquoted securities | **11,159** | 44,968 |
| Investment in quoted securities | **2,213** | 3,565 |
| | **63,044** | 99,929 |

## 15. SUBSIDIARIES

Principal operating subsidiaries are as follows:

| Name of subsidiary | Country of incorporation | **2013 proportion of ownership interest and voting power %** | 2012 proportion of ownership interest and voting power % | Principal activity |
|---|---|---|---|---|
| Boubyan Takaful Insurance Company K.S.C. (Closed) | Kuwait | **67.63** | 67.63 | Takaful insurance |
| Boubyan Capital Investment Company K.S.C. (Closed) | Kuwait | **99.55** | 99.55 | Islamic investments |

## 16. INVESTMENTS IN ASSOCIATES

| Name of associate | Country of incorporation | **2013 proportion of ownership interest and voting power %** | 2012 proportion of ownership interest and voting power % | Principal activity |
|---|---|---|---|---|
| United Capital Bank | Republic of Sudan | **21.67** | 21.67 | Islamic commercial banking |
| Ijarah Indonesia Finance Company | Indonesia | **33.33** | 33.33 | Islamic financing services |
| Saudi Projects Holding Group | Kuwait | **25.00** | 20.00 | Real Estate |
| Bank of London and the Middle East (a) | United Kingdom | **25.62** | - | Islamic commercial banking |
| Bank Syariah Muamalat Indonesia Tbk (b) | Indonesia | **22.00** | - | Islamic commercial banking |

a. The Bank held a 19.8% interest in Bank of London and the Middle East ("BLME") with a carrying amount of **KD 29,688 thousand** and accounted for this investment as a financial asset at fair value through profit or loss. During the year the Group acquired additional **5.82%** interests in BLME for a consideration of **KD 8,128 thousand**. Hence the total ownership interest of the Group in BLME is now **25.62%** and is being accounted as an investment in associate from the effective date of 7 October 2013.

b. The Bank held a 19.03% interest in Bank Syariah Muamalat Indonesia Tbk ("BSMI") with a carrying amount of **KD 37,234 thousand** and accounted for this investment as an available for sale investment. Effective 3 December 2013 ("the effective date"), the Bank acquired an additional **2.97%** interest in BSMI for a consideration of **KD 3,436 thousand**. Hence the total ownership interest of the Bank in BSMI is now **22%** and is being accounted as an investment in associate from the effective date. On reclassification to investment in associate, the bank transferred **KD 449 thousand** accumulated in equity to consolidated statement of profit and loss.



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## 16. INVESTMENTS IN ASSOCIATES (CONTINUED)

Summarized financial information in respect of Bank of London and the Middle East ("BLME") is set out below:

| | **2013** |
|---|---|
| | **KD'000** |
| Total assets | **528,745** |
| Total liabilities | **(418,620)** |
| Net assets | **110,125** |
| Group's share of net assets | **28,214** |
| Group's share of contingent liabilities | **-** |

| | **2013** |
|---|---|
| | **KD'000** |
| Total revenue | **11,762** |
| Net profit | **461** |
| Group's share of results | **-** |

Summarized financial information in respect of Bank Syariah Muamalat Indonesia Tbk ("BSMI") is set out below:

| | **2013** |
|---|---|
| | **KD'000** |
| Total assets | **1,241,918** |
| Total liabilities | **(1,140,734)** |
| Net assets | **101,184** |
| Group's share of net assets | **22,260** |
| Group's share of contingent liabilities | **6,305** |

| | **2013** |
|---|---|
| | **KD'000** |
| Total revenue | **56,590** |
| Net profit | **12,507** |
| Group's share of results | **-** |

Summarized financial information in respect of the Group's other associates that are immaterial, are set out below:

| | **2013** | 2012 |
|---|---|---|
| | **KD'000** | KD'000 |
| Total assets | **112,440** | 127,870 |
| Total liabilities | **(77,878)** | (90,436) |
| Net assets | **34,562** | 37,434 |
| Group's share of net assets | **7,631** | 9,082 |
| Group's share of contingent liabilities | **14,984** | 16,078 |

| | **2013** | 2012 |
|---|---|---|
| | **KD'000** | KD'000 |
| Total revenue | **1,608,273** | 11,831 |
| Net profit | **591,759** | 1,744 |
| Group's share of results | **726** | 2,364 |

## 17. INVESTMENT PROPERTIES

The movement in the investment properties is as follows:

| | **2013** | 2012 |
|---|---|---|
| | **KD'000** | KD'000 |
| Balance at the beginning of the year | **17,904** | 25,613 |
| Additions during the year | **21,808** | 3,961 |
| Disposals during the year | **(8,048)** | (7,390) |
| Net unrealized loss from change in fair value of investment properties | **(1,712)** | (5,026) |
| Foreign currency translation adjustments | **293** | 746 |
| Balance at the ending of the year | **30,245** | 17,904 |

The fair value of the Group's investment properties as at 31 December 2013 and 31 December 2012 has been arrived at on the basis of valuations carried out on the respective dates by independent appraisers who have appropriate qualifications and recent experience in the valuation of properties in the relevant locations. The fair values were determined based on market approach. In estimating the fair values of the properties, the highest and the best use of the properties is their current use. There has been no change to the valuation techniques during the year. All of the Group's investment properties are included in Level 2 of fair value hierarchy as at 31 December 2013.

## 18. OTHER ASSETS

| | **2013** | 2012 |
|---|---|---|
| | **KD'000** | KD'000 |
| Accrued income | **616** | 887 |
| Prepayments | **4,394** | 3,092 |
| Software | **2,478** | 1,837 |
| Others | **6,506** | 2,100 |
| | **13,994** | 7,916 |

## 19. OTHER LIABILITIES

| | **2013** | 2012 |
|---|---|---|
| | **KD'000** | KD'000 |
| Creditors and accruals | **6,223** | 5,146 |
| Accrued staff benefits | **6,434** | 5,147 |
| Clearing accounts | **7,642** | 7,974 |
| General provision on non-cash facilities | **1,344** | 1,395 |
| Margin accounts | **3,085** | 2,421 |
| Others | **4,355** | 2,314 |
| | **29,083** | 24,397 |

## 20. SHARE CAPITAL

| | **2013** | | 2012 | |
|---|---|---|---|---|
| | **Shares** | **KD'000** | Shares | KD'000 |
| Shares authorised, issued and fully paid in cash of 100 fils each | **1,836,450,000** | **183,645** | 1,748,235,315 | 174,824 |

## 21. SHARE PREMIUM

The share premium is not distributable except under specific circumstances as provided by the Companies Law.

## 22. PROPOSED DIVIDEND

The board of directors recommended distribution of bonus share of 7% on outstanding shares as at 31 December 2013 (2012: 5%). The proposed dividends, if approved by the shareholders' general assembly shall be payable to the shareholders registered in the bank's records as of the date of the general assembly meeting.



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## 23. TREASURY SHARES

The Bank held the following treasury shares as at 31 December:

| | **2013** | 2012 |
|---|---|---|
| Number of treasury shares | **2,603,669** | 1,715,000 |
| Treasury shares as a percentage of total issued shares - % | **0.1418%** | 0.0981% |
| Cost of treasury shares – KD thousand | **1,100** | 1,024 |
| Market value of treasury shares – KD thousand | **1,458** | 1,098 |

## 24. STATUTORY RESERVE

As required by the Companies Law and the Bank's Articles of Association 10% of profit for the year attributable to the shareholders of the Bank before KFAS, NLST, Zakat and Board of directors' remuneration is transferred to statutory reserve. The Bank may resolve to discontinue such annual transfers when the reserve equals 50% of the capital. This reserve is not available for distribution except in cases stipulated by law and the Bank's Articles of Association.

## 25. VOLUNTARY RESERVE

As required by the Bank's Articles of Association 10% of profit for the year attributable to the shareholders of the Bank is transferred to the voluntary reserve. Such annual transfers may be discontinued by a resolution of the shareholders' General Assembly upon a recommendation by the Board of Directors.

## 26. SHARED BASED PAYMENT RESERVE

The Bank operates an equity settled share based compensation plan and granted share options to its senior executives. These options will vest if the employees remain in service for a period of three years from the grant date and the employees can exercise the options within one year from the vesting date. If the exercise price is not paid within one year from date of vesting, the options vested will be cancelled. The exercise price of the granted options is equal to 100 fils per share.

The fair value of options granted during the year as determined using the Black-Scholes valuation model was **546 fils** (2012: 497 fils). The significant inputs into the model were a share price of **640 fils** (2012: 590 fils) at the grant date, an exercise price of 100 fils as shown above, a standard deviation of expected share price returns of **26%** (2012: 42%), option life disclosed above and annual risk free rate of 2%. The volatility measured at the standard deviation of expected share price returns is based on statistical analysis of daily share prices over the last three years. The weighted average remaining life of the share options was **575 days** (2012: 507 days) and the weighted average fair value of share options granted was **530 fils** (2012: 522 fils).

The following table shows the movement in number of share options during the year:

| | **2013** | 2012 |
|---|---|---|
| | **Number of share options** | Number of share options |
| Outstanding at 1 January | **1,900,216** | 1,409,630 |
| Granted during the year | **897,233** | 810,280 |
| Cancelled during the year | **(428,293)** | (319,694) |
| **Outstanding at 31 December** | **2,369,156** | 1,900,216 |

The expense accrued on account of share based compensation plans for the year amounts to **KD 323 thousand** (31 December 2012: KD 284 thousand) and is included under staff cost.

## 27. RELATED PARTY TRANSACTIONS

Related parties comprise the major shareholders, board of directors, entities controlled by them or under their joint control, associates, key management personnel and their close family members and the Parent Company including their board members, key management personnel, branches, associates and subsidiaries. Balances with related parties arise from commercial transactions in the normal course of business on an arm's length basis and are included within the following financial information captions:

| | Number of board member or executive officers | | Number of related parties | | | |
|---|---|---|---|---|---|---|
| | **2013** | 2012 | **2013** | 2012 | **2013** | 2012 |
| | | | | | KD'000 | KD'000 |
| Islamic financing to customers | **7** | 6 | **2** | 2 | **5,745** | 8,956 |
| Depositors' accounts | **11** | 12 | **9** | 7 | **29,465** | 33,711 |
| Letters of guarantee and letters of credit | **1** | 1 | **-** | - | **18** | 62 |
| Revenues | | | | | **202** | 194 |
| Expenses | | | | | **(173)** | (335) |
| Proceed from disposal of an Investment | | | | | **-** | 9,638 |
| **Parent Company** | | | | | | |
| Due from banks | | | | | **92,401** | 80,028 |
| Due to banks | | | | | **87,612** | 53,254 |
| Revenues | | | | | **279** | 98 |
| Expenses | | | | | **(150)** | (145) |

The Group holds collaterals against Islamic finance facilities to related parties in the form of shares and real estate. An estimate of the fair value of collaterals held against Islamic finance facilities to related parties amounted to **KD 1,271 thousand** as at 31 December 2013 (31 December 2012: KD 1,236 thousand).

**Compensation of key management personnel:**

Details of compensation for key management comprise the following:

| | **2013** | 2012 |
|---|---|---|
| | **KD'000** | KD'000 |
| Short-term benefits | **1,904** | 1,716 |
| Post-employment benefits | **299** | 257 |
| Share based compensation | **226** | 167 |
| | **2,429** | 2,140 |

Senior executive officers also participate in the Group's share based payment programme (see note 26)

## 28. CONTINGENCIES AND COMMITMENTS

At the financial reporting date there were outstanding contingencies and commitments entered in the ordinary course of business in respect of the following:

| | **2013** | 2012 |
|---|---|---|
| | **KD'000** | KD'000 |
| Guarantees | **166,952** | 137,909 |
| Acceptances and letters of credit | **26,872** | 47,749 |
| Capital commitments (projects under construction) | **411** | 1,307 |
| Credit commitments | **34,428** | 8,437 |
| | **228,663** | 195,402 |





## 29. SEGMENT REPORTING

Operating segments are identified on the basis of internal reports that are regularly reviewed by the decision makers in order to allocate resources to the segments and to assess their performance. The operating segments are divided as either business segments or geographical segments.

*Business Segments*

For management purposes, the Bank is organized into the following four major business segments:

***Consumer banking***: Provides a diversified range of products and services to individuals and institutional customers. The range includes consumer finance, credit cards, deposits and other branch related services.

***Corporate banking:*** Provides Murabaha, Ijarah, trade service and other related services to business and corporate customers.

***Investment banking:*** Principally handling direct investments, investment in associates, local and international real estate investment and asset management.

***Treasury:*** Principally handling local and international Murabaha and other Islamic financing, primarily with banks, as well as the management of the Bank's funding operations.

***Group centre:*** Includes other group activities and residual in respect of transfer pricing and inter segment allocation.

| | Consumer banking | Corporate banking | Investment banking | Treasury | Group centre | **Total** |
|---|---|---|---|---|---|---|
| **2013** | KD'000 | KD'000 | KD'000 | KD'000 | KD'000 | **KD'000** |
| Net financing income/(loss) | **30,347** | **23,642** | **(3,787)** | **8,076** | **2,464** | **60,742** |
| Share of results of associates | **-** | **-** | **726** | **-** | **-** | **726** |
| Operating income | **30,799** | **27,817** | **(1,585)** | **9,052** | **989** | **67,072** |
| Depreciation and amortization | **(987)** | **(44)** | **(47)** | **(15)** | **(606)** | **(1,699)** |
| Net profit/ (loss) for the year | **16,365** | **11,829** | **(9,341)** | **8,641** | **(14,774)** | **12,720** |
| Total assets | **584,980** | **987,148** | **156,757** | **477,174** | **(14,073)** | **2,191,986** |
| Total liabilities | **650,861** | **158,846** | **19,460** | **1,092,695** | **637** | **1,922,499** |

| 2012 | Consumer banking KD'000 | Corporate banking KD'000 | Investment banking KD'000 | Treasury KD'000 | Group centre KD'000 | Total KD'000 |
|---|---|---|---|---|---|---|
| Net financing income/(loss) | 22,948 | 24,590 | (4,122) | 8,187 | 868 | 52,471 |
| Share of results of associates | - | - | 2,364 | - | - | 2,364 |
| Operating income | 23,794 | 28,699 | (1,328) | 9,073 | (1,359) | 58,879 |
| Depreciation and amortization | (1,154) | (46) | (42) | (17) | (652) | (1,911) |
| Net profit/ (loss) for the year | 10,667 | 11,706 | (9,149) | 8,658 | (12,346) | 9,536 |
| Total assets | 418,916 | 917,848 | 151,565 | 402,467 | (6,140) | 1,884,656 |
| Total liabilities | 543,912 | 156,591 | 4,264 | 911,053 | 12,672 | 1,628,492 |

*Geographical segment*

In presenting information on the basis of geographical areas, revenue is based on the geographical location of customers and assets are based on the geographical location of assets.

| **2013** | Middle East & North Africa KD'000 | North America KD'000 | Europe KD'000 | Asia KD'000 | Other KD'000 | **Total KD'000** |
|---|---|---|---|---|---|---|
| Assets | **2,041,687** | **1,253** | **88,907** | **43,524** | **16,615** | **2,191,986** |
| Non-current assets (excluding financial instruments) | **49,730** | **-** | **4,461** | **-** | **-** | **54,191** |
| Liabilities and equity | **2,188,007** | **30** | **3,803** | **146** | **-** | **2,191,986** |
| Segment income/(expenses) | **69,112** | **-** | **(2,157)** | **117** | **-** | **67,072** |

| 2012 | Middle East & North Africa KD'000 | North America KD'000 | Europe KD'000 | Asia KD'000 | Other KD'000 | Total KD'000 |
|---|---|---|---|---|---|---|
| Assets | 1,775,037 | 476 | 69,582 | 35,198 | 4,363 | 1,884,656 |
| Non-current assets (excluding financial instruments) | 21,598 | - | 11,585 | - | - | 33,183 |
| Liabilities and equity | 1,875,899 | 2,558 | 4,557 | - | 1,642 | 1,884,656 |
| Segment income/(expenses) | 43,874 | (816) | (8,913) | 25,071 | (337) | 58,879 |

## 30. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

### 30.1 Introduction and overview

Risk is inherent in the Group's activities but is managed in a structured, systematic manner through a Group risk policy that embeds comprehensive risk management into organisational structure, risk measurement and monitoring processes. The overall risk management direction and oversight is provided by the Board of Directors and Board Risk Committee with the support of the Management Executive Committee and the Group's Risk Management functions.

The Group is exposed to credit risk, market risk, liquidity risk and operational risk.

In accordance with the Central Bank of Kuwait's directives, the Group has implemented a comprehensive system for the measurement and management of risk.

This methodology helps in reflecting both the expected loss likely to arise in normal circumstances and unexpected losses, which are an estimate of the ultimate actual loss based on statistical models. Information compiled from all internal business groups are closely examined and analysed to identify, manage and control risks.

Transactions and outstanding risk exposures are quantified and compared against authorised limits, whereas non- quantifiable risks are monitored against policy guidelines and key risk and control indicators. Any discrepancies, excesses or deviations are escalated to management for appropriate action.

As part of its overall risk management, the Group uses financial instruments to manage exposures resulting from changes in foreign exchange and equity risks. Collateral is used to reduce the Group's credit risk.

The Group's comprehensive risk management framework has specific guidelines that focus on maintaining a diversified portfolio to avoid excessive concentration of risks.

### 30.2 Credit risk

Credit risk is the risk that counterparty will cause a financial loss to the Group by failing to discharge an obligation. Credit risk arises in the Group's normal course of business.

All policies relating to credit are reviewed and approved by the Board of Directors.

Credit limits are established for all customers after a careful assessment of their creditworthiness. Standing procedures, outlined in the Group's Credit Policy Manual, require that all credit proposals be subjected to detailed screening by the respective credit risk functions. Whenever necessary, Islamic facilities are secured by acceptable forms of collateral to mitigate the related credit risks.

In accordance with the instructions of the Central Bank of Kuwait, setting out the rules and regulations regarding the classification of credit facilities, the Group has formed an internal committee comprising competent professional staff and having as its purpose the study and evaluation of the existing credit facilities of each customer of the Group. This committee, which meets regularly throughout the year, 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.

The Group further limits risk through diversification of its assets by industry sector. In addition, all credit facilities are continually monitored based on a periodical review of the credit performance and account rating.

#### 30.2.1 *Maximum exposure to credit risk (Net exposure after covered collateral)*

An analysis of Islamic financing to customers and contingent liabilities before and after taking account of collateral held or other credit enhancements is as follows:

| | **2013** | | 2012 | |
|---|---|---|---|---|
| | **Gross exposure** | **Net exposure** | Gross exposure | Net exposure |
| | **KD'000** | **KD'000** | KD'000 | KD'000 |
| Islamic financing to customers | **1,478,701** | **978,066** | 1,270,014 | 839,241 |
| Contingent liabilities | **228,663** | **220,558** | 195,402 | 169,415 |

**Collateral and other credit enhancements**

The amount, type and valuation of collateral are based on guidelines specified in the risk management framework. The main types of collateral accepted includes real estate, shares, cash collateral and bank guarantees. The revaluation and custody of collaterals are performed independent of the business units. The Group may also obtain guarantees from parent companies for financing provided to their subsidiaries.





## 30. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

### 30.2 Credit risk (continued)

#### 30.2.2 *Risk Concentration of the maximum exposure to credit risk*

Concentrations of credit risk arise from exposure to customers having similar characteristics in terms of the geographic location in which they operate or the industry sector in which they are engaged, such that their ability to discharge contractual obligations may be similarly affected by changes in political, economic or other conditions.

Credit risk can also arise due to a significant concentration of Group's assets to any single counterparty. This risk is managed by diversification of the portfolio. The 20 largest facilities outstanding as a percentage of gross facilities as at 31 December 2013 are **25.6%** (2012: 27.3%).

The Group's financial assets and off-balance sheet items, before taking into account any collateral held or credit enhancements can be analysed by the following geographic regions:

| | Middle East & North Africa | North America | Europe | Asia | Other | **Total** |
|---|---|---|---|---|---|---|
| **2013** | KD'000 | KD'000 | KD'000 | KD'000 | KD'000 | **KD'000** |
| Cash and cash equivalents (excluding cash on hand) | **176,301** | **1,206** | **8,022** | **247** | **-** | **185,776** |
| Due from banks | **266,883** | **-** | **31,988** | **-** | **-** | **298,871** |
| Islamic financing to customers | **1,471,227** | **-** | **4,446** | **3,028** | **-** | **1,478,701** |
| Available for sale investments (Sukuk) | **29,084** | **-** | **2,205** | **-** | **-** | **31,289** |
| Other assets (excluding software) | **11,515** | **-** | **-** | **-** | **-** | **11,515** |
| | **1,955,010** | **1,206** | **46,661** | **3,275** | **-** | **2,006,152** |
| Contingent liabilities | **185,487** | **-** | **313** | **8,024** | **-** | **193,824** |
| Commitments | **27,744** | **-** | **7,095** | **-** | **-** | **34,839** |
| **Total credit risk exposure** | **2,168,241** | **1,206** | **54,069** | **11,299** | **-** | **2,234,815** |

| | Middle East & North Africa | North America | Europe | Asia | Other | Total |
|---|---|---|---|---|---|---|
| 2012 | KD'000 | KD'000 | KD'000 | KD'000 | KD'000 | KD'000 |
| Cash and cash equivalents (excluding cash on hand) | 146,601 | 476 | 8,286 | 143 | 4 | 155,510 |
| Due from banks | 240,562 | - | 11,063 | - | - | 251,625 |
| Islamic financing to customers | 1,262,506 | - | 4,023 | 3,485 | - | 1,270,014 |
| Available for sale investments (Sukuk) | 29,319 | - | 4,366 | - | - | 33,685 |
| Other assets (excluding software) | 6,079 | - | - | - | - | 6,079 |
| | 1,685,067 | 476 | 27,738 | 3,628 | 4 | 1,716,913 |
| Contingent liabilities | 177,175 | - | 457 | 8,026 | - | 185,658 |
| Commitments | 8,153 | - | - | - | 1,591 | 9,744 |
| Total credit risk exposure | 1,870,395 | 476 | 28,195 | 11,654 | 1,595 | 1,912,315 |

The Group's financial assets before taking into account any collateral held or credit enhancements, can be analysed by the following industry sectors:

| | **2013** | 2012 |
|---|---|---|
| | **KD'000** | KD'000 |
| Trading | **134,362** | 126,359 |
| Manufacturing | **76,872** | 92,370 |
| Banking and other financial institutions | **520,150** | 415,736 |
| Construction | **40,525** | 37,390 |
| Real Estate | **394,106** | 322,045 |
| Retail | **557,084** | 410,064 |
| Government | **106,086** | 176,911 |
| Others | **176,967** | 136,038 |
| | **2,006,152** | 1,716,913 |

**30. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)**

**30.2 Credit risk (continued)**

**30.2.3 *Credit quality per class of financial assets***

In managing its portfolio, the Group utilises ratings and other measures and techniques which seek to take account of relevant aspects of perceived risk. Credit exposures classified as 'High' quality are those where the ultimate risk of financial loss from the obligor's failure to discharge its obligation is assessed to be low. These include facilities to corporate entities with financial condition, risk indicators and capacity to repay which are considered to be good to excellent. Credit exposures classified as 'Standard' quality comprise all other facilities whose payment performance is fully compliant with contractual conditions and which are not impaired. The ultimate risk of possible financial loss on 'Standard' quality is assessed to be higher than that for the exposures classified within the 'High' quality range.

The table below shows the credit quality by class of asset for statement of financial position lines, based on the Group's credit rating system.

| | Neither past due nor impaired | | Past due or | |
|---|---|---|---|---|
| | High | Standard | impaired | **Total** |
| | KD'000 | KD'000 | KD'000 | **KD'000** |
| **2013** | | | | |
| Cash and cash equivalents (excluding cash on hand) | **185,776** | **-** | **-** | **185,776** |
| Due from banks | **286,934** | **11,937** | **-** | **298,871** |
| Islamic financing to customers | **1,290,782** | **177,514** | **45,857** | **1,514,153** |
| Available for sale investments (Sukuk) | **31,289** | **-** | **-** | **31,289** |
| Other assets (excluding software) | **11,515** | **-** | **-** | **11,515** |
| | **1,806,296** | **189,451** | **45,857** | **2,041,604** |
| 2012 | | | | |
| Cash and cash equivalents (excluding cash on hand) | 155,510 | - | - | 155,510 |
| Due from banks | 246,523 | 5,102 | - | 251,625 |
| Islamic financing to customers | 1,072,837 | 189,027 | 39,701 | 1,301,565 |
| Available for sale investments (Sukuk) | 33,685 | - | - | 33,685 |
| Other assets (excluding software) | 6,079 | - | - | 6,079 |
| | 1,514,634 | 194,129 | 39,701 | 1,748,464 |

Ageing analysis of past due or impaired financial assets:

| | Corporate banking | | Consumer banking | | **Total** | |
|---|---|---|---|---|---|---|
| | Past due and not impaired | Past due and impaired | Past due and not impaired | Past due and impaired | **Past due and not impaired** | **Past due and impaired** |
| | KD'000 | KD'000 | KD'000 | KD'000 | **KD'000** | **KD'000** |
| **2013** | | | | | | |
| Up to 30 days | **5,151** | **-** | **8,260** | **-** | **13,411** | **-** |
| 31 – 60 days | **6** | **-** | **2,239** | **-** | **2,245** | **-** |
| 61 – 90 days | **163** | **-** | **1,260** | **-** | **1,423** | **-** |
| 91 – 180 days | **-** | **-** | **-** | **1,475** | **-** | **1,475** |
| More than 180 days | **-** | **26,404** | **-** | **899** | **-** | **27,303** |
| | **5,320** | **26,404** | **11,759** | **2,374** | **17,079** | **28,778** |
| 2012 | | | | | | |
| Up to 30 days | 4,643 | - | 5,293 | - | 9,936 | - |
| 31 – 60 days | 2,001 | - | 1,916 | - | 3,917 | - |
| 61 – 90 days | 27 | - | 994 | - | 1,021 | - |
| 91 – 180 days | - | - | - | 804 | - | 804 |
| More than 180 days | - | 22,210 | - | 1,813 | - | 24,023 |
| | 6,671 | 22,210 | 8,203 | 2,617 | 14,874 | 24,827 |

At 31 December 2013 management estimates the fair value of collaterals held against individually past due or impaired Islamic finance facilities to **KD 24,411 thousand** (31 December 2012: KD 18,455 thousand).





**30. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)**

**30.3 Market risk**

Market risk is the risk that the fair value of financial instruments will fluctuate due to changes in market prices. Market risks arise from open positions in currency and equity products, all of which are exposed to general and specific market movements and changes in the level of volatility of prices such as foreign exchange rates and equity prices.

The Group is not exposed to material risk in terms of the re-pricing of its liabilities since, in accordance with Islamic Sharia'a, the Group does not provide a guaranteed contractual rate of return to its depositors.

*Foreign currency risk*

Foreign currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign currency exchange rates.

Foreign exchange risks are controlled through limits pre-established by the Board of Directors on currency position exposures. Assets are typically funded in the same currency as that of the business being transacted to eliminate exchange exposures. Appropriate segregation of duties exists between the treasury front and back office functions, while compliance with position limits is independently monitored on an ongoing basis by an independent middle office function.

The table below analyses the effect on profit and equity of an assumed 5% strengthening in value of the currency rate against the Kuwaiti Dinar from levels applicable at the year end, with all other variables held constant. A negative amount in the table reflects a potential net reduction in profit or equity, whereas a positive amount reflects a net potential increase.

| | | **2013** | | 2012 | |
|---|---|---|---|---|---|
| | | **Effect on profit** | **Effect on equity** | Effect on profit | Effect on equity |
| | | **KD'000** | **KD'000** | KD'000 | KD'000 |
| US Dollar | +5 | **(132)** | **-** | (8) | - |
| Sterling Pound | +5 | **2** | **-** | (45) | - |
| Euro | +5 | **1** | **-** | - | - |
| Indonesian Rupiah | +5 | **-** | **2,012** | 1,519 | 60 |
| Sudanese Pound | +5 | **14** | **224** | 13 | 265 |
| Japanese Yen | +5 | **-** | **-** | 2 | - |
| Others | +5 | **9** | **-** | 9 | - |

A 5 percent decrease of the above currencies against the Kuwaiti Dinar would have had equal, but opposite, effect of the amounts shown above, on the basis that all other variables remain constant.

*Equity price risk*

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

For such investments classified as available for sale, a five percent increase in stock prices as at 31 December 2013 would have increased equity by **KD 669 thousand** (31 December 2012: an increase of KD 2,427 thousand). For such investments classified as at fair value through profit or loss, the impact on profit or loss would have been an increase of **KD 197 thousand** (31 December 2012: an increase of KD 1,698 thousand). An equal change in the opposite direction would have had equal, but opposite effect to the amounts shown above, on the basis that all other variables remain constant.

## 30. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

### 30.4 Liquidity risk

Liquidity risk is the risk that the Group will be unable to meet its financial liabilities when they fall due. To limit this risk, management has arranged diversified funding sources, manages assets with liquidity in mind and monitors liquidity on a daily basis.

The Group has established an Asset and Liabilities Management Committee to manage the assets and liabilities of the Group comprehensively and strategically. The committee meets regularly to determine and review policies for managing liquidity risk, as well as to set risk limits.

The table below summarises the maturity profile of Group's assets, liabilities and equity based on contractual cash flows and maturity dates. This does not necessarily take account of the effective maturities.

| | Up to three months KD'000 | 3 to 6 months KD'000 | 6 to 12 months KD'000 | Over 1 year KD'000 | **Total KD'000** |
|---|---|---|---|---|---|
| **2013** | | | | | |
| **Assets** | | | | | |
| Cash and cash equivalents | **205,622** | **-** | **-** | **-** | **205,622** |
| Due from banks | **222,492** | **72,865** | **3,514** | **-** | **298,871** |
| Islamic financing to customers | **587,699** | **236,008** | **80,650** | **574,344** | **1,478,701** |
| Financial assets at fair value through profit or loss | **-** | **-** | **-** | **5,866** | **5,866** |
| Available for sale investments | **27,450** | **-** | **-** | **35,594** | **63,044** |
| Investments in associates | **-** | **-** | **-** | **85,691** | **85,691** |
| Investment properties | **-** | **-** | **-** | **30,245** | **30,245** |
| Other assets | **6,506** | **-** | **5,010** | **2,478** | **13,994** |
| Property and equipment | **-** | **-** | **-** | **9,952** | **9,952** |
| **Total assets** | **1,049,769** | **308,873** | **89,174** | **744,170** | **2,191,986** |
| **Liabilities and Equity** | | | | | |
| Due to banks | **202,437** | **7,730** | **-** | **25,851** | **236,018** |
| Depositors' accounts | **1,010,366** | **329,081** | **293,427** | **24,524** | **1,657,398** |
| Other liabilities | **11,992** | **-** | **9,309** | **7,782** | **29,083** |
| Equity | **-** | **-** | **-** | **269,487** | **269,487** |
| **Total liabilities and equity** | **1,224,795** | **336,811** | **302,736** | **327,644** | **2,191,986** |

| | Up to three months KD'000 | 3 to 6 months KD'000 | 6 to 12 months KD'000 | Over 1 year KD'000 | **Total KD'000** |
|---|---|---|---|---|---|
| 2012 | | | | | |
| Assets | | | | | |
| Cash and cash equivalents | 169,530 | - | - | - | 169,530 |
| Due from banks | 171,271 | 72,348 | 8,006 | - | 251,625 |
| Islamic financing to customers | 548,906 | 213,996 | 96,296 | 410,816 | 1,270,014 |
| Financial assets at fair value through profit or loss | 1,181 | - | - | 50,112 | 51,293 |
| Available for sale investments | - | - | 2,111 | 97,818 | 99,929 |
| Investments in associates | - | - | - | 9,082 | 9,082 |
| Investment properties | - | - | - | 17,904 | 17,904 |
| Other assets | 2,100 | - | 3,979 | 1,837 | 7,916 |
| Property and equipment | - | - | - | 7,363 | 7,363 |
| Total assets | 892,988 | 286,344 | 110,392 | 594,932 | 1,884,656 |
| Liabilities and Equity | | | | | |
| Due to banks | 158,594 | 7,772 | 2,117 | 38,650 | 207,133 |
| Depositors' accounts | 935,043 | 196,004 | 263,423 | 2,492 | 1,396,962 |
| Other liabilities | 10,289 | - | 7,568 | 6,540 | 24,397 |
| Equity | - | - | - | 256,164 | 256,164 |
| Total liabilities and equity | 1,103,926 | 203,776 | 273,108 | 303,846 | 1,884,656 |





## 30. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

### 30.4 Liquidity risk (continued)

The liquidity profile of financial liabilities of the Group summarised below reflects the projected cash flows including future profit payments over the life of these financial liabilities based on contractual repayment arrangements.

| | Up to three months KD'000 | 3 to 6 months KD'000 | 6 to 12 months KD'000 | Over 1 year KD'000 | **Total KD'000** |
|---|---|---|---|---|---|
| **2013** | | | | | |
| **Financial Liabilities** | | | | | |
| Due to banks | **202,479** | **8,634** | **-** | **28,024** | **239,137** |
| Depositors' accounts | **1,011,095** | **329,621** | **295,428** | **24,927** | **1,661,071** |
| | **1,213,574** | **338,255** | **295,428** | **52,951** | **1,900,208** |
| 2012 | | | | | |
| Financial Liabilities | | | | | |
| Due to banks | 158,636 | 7,798 | 2,135 | 40,844 | 209,413 |
| Depositors' accounts | 935,592 | 196,760 | 265,533 | 2,569 | 1,400,454 |
| | 1,094,228 | 204,558 | 267,668 | 43,413 | 1,609,867 |

### 30.5 Operational risk

Operational risk is the risk of loss arising from inadequate or failed internal processes, systems failure, human error, or from external events. When controls fail to perform, it can lead to legal or regulatory implications, or financial /reputational loss.

The Group has established policies and procedures, which are applied to identify, assess, monitor, control and mitigate operational risk in addition to other types of risks relating to the banking and financial activities of the Group as part of overall risk management activities.

The operational risk of the Group is managed in line with the CBK instructions concerning the general guidelines for internal controls and best practice for managing and supervising operational risks in banks.

### 30.6 Fair value of financial instruments

Fair values are obtained from quoted market prices, discounted cash flow models and other models as appropriate. The carrying values of financial instruments, excluding Islamic financing to customers, are approximate to their fair values at 31 December due to the relatively short-term maturity of the instruments.

*Fair value of the Group's financial assets that are measured at fair value on a recurring basis.*

Some of the Group's financial assets are measured at fair value at the end of each reporting period. The following table gives information about how the fair values of these financial assets are determined ( in particular, the valuation techniques(s) and inputs used).

## 30. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

### 30.6 Fair value of financial instruments (continued)

| Financial assets | Fair value as at 31 December 2013 | 31 December 2012 | Fair value Hierarchy 2013 | sector |
|---|---|---|---|---|
| Financial assets at fair value through profit or loss - *Unquoted securities* | **1,026** | 1,026 | Level 2 | Financial Institution |
| Financial assets at fair value through profit or loss - *Quoted securities* | **-** | 155 | Level 2 | Service |
| Financial assets at fair value through profit or loss - *Unquoted funds* | **1,934** | 7,305 | Level 2 | Financial Institution |
| | **-** | 10,028 | Level 2 | Financial Institution |
| Financial assets at fair value through profit or loss - *Unquoted securities* | **2,906** | 2,521 | Level 2 | Real Estate |
| | **-** | 30,259 | Level 2 | Islamic Banking |
| Available for sale investments - *Sukuk* | **16,967** | 17,211 | Level 2 | Government |
| | **14,322** | 16,474 | Level 2 | Financial Institution |
| Available for sale investments - *Unquoted funds* | **9,232** | 9,976 | Level 2 | Financial Institution |
| | **3,852** | 3,876 | Level 2 | Real Estate |
| | **5,300** | 3,859 | Level 2 | Service |
| Available for sale investments - *Unquoted securities* | **6,364** | 6,569 | Level 2 | Financial Institution |
| | **3,169** | 2,701 | Level 2 | Real Estate |
| | **346** | 679 | Level 2 | Construction |
| | **1,280** | 4,645 | Level 2 | Service |
| | **-** | 30,374 | Level 2 | Islamic Banking |
| Available for sale investments - *Quoted securities* | **1,643** | 2,648 | Level 1 | Real Estate |
| | **570** | 917 | Level 1 | Financial Institution |

**Fair value hierarchy**

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

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

| **2013** | **Level 1 KD'000** | **Level 2 KD'000** | **Total KD'000** |
|---|---|---|---|
| Financial assets at fair value through profit or loss | **-** | **5,866** | **5,866** |
| Available for sale investments | **2,213** | **60,831** | **63,044** |
| | **2,213** | **66,697** | **68,910** |

| 2012 | Level 1 KD'000 | Level 2 KD'000 | Total KD'000 |
|---|---|---|---|
| Financial assets held for trading | 155 | - | 155 |
| Financial assets at fair value through profit or loss | 1,026 | 50,112 | 51,138 |
| Available for sale investments | 489 | 99,440 | 99,929 |
| | 1,670 | 149,552 | 151,222 |





## 30. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

### 30.7 Capital management

The primary objectives of the Group's capital management are to ensure that the Group complies with externally imposed capital requirements and that the Group maintains strong and healthy capital ratios in order to support its business and to maximize shareholders' value.

The Group actively manages its capital base in order to cover risks inherent in the business. The adequacy of the Group's capital is monitored using, among other measures, the rules and ratios established by the Basel Committee on Banking Supervision (BIS rules/ratios) and adopted by the Central Bank of Kuwait in supervising the Group.

During the year, the Group has complied in full with all its externally imposed capital requirements.

The Group's regulatory capital and capital adequacy ratios are shown below:

| | **2013 KD'000** | 2012 KD'000 |
|---|---|---|
| **Tier 1 capital** | | |
| Share capital | **183,645** | 174,824 |
| Share premium | **62,896** | 62,896 |
| Proposed bonus shares | **12,855** | 8,741 |
| Treasury shares | **(1,100)** | (1,024) |
| Statutory reserve | **3,306** | 1,891 |
| Voluntary reserve | **3,167** | 1,813 |
| Share based payment reserve | **860** | 537 |
| Retained earnings | **3,204** | 5,424 |
| Non-controlling interests | **5,543** | 2,514 |
| Deductions from tier 1 capital | **(74,112)** | (3,246) |
| | **200,264** | 254,370 |
| **Tier 2 capital** | | |
| Fair value and foreign currency translation reserves | **(4,889)** | (3,334) |
| General provision | **13,306** | 12,380 |
| Deductions from tier 2 capital | **(8,417)** | (3,246) |
| | **-** | 5,800 |

| | **2013 KD'000** | 2012 KD'000 |
|---|---|---|
| **Total regulatory capital** | **200,264** | 260,170 |
| Risk-weighted assets | **1,149,157** | 1,066,494 |
| **Capital ratios** | | |
| Total regulatory capital expressed as a percentage of total risk-weighted assets | **17.43%** | 24.39% |
| Total tier 1 capital expressed as a percentage of risk - weighted assets | **17.43%** | 23.85% |

The disclosures relating to the capital adequacy regulations issued by Central Bank of Kuwait as stipulated in Central Bank of Kuwait circular number 2/RBA/44/2009 dated 15 June 2009 are included under the 'Risk Management' section of the annual report.

## 31. DERIVATIVES

In the ordinary course of business, the Bank enters into various types of transactions that involve Sharia'a approved derivative financial instruments to mitigate foreign currency risk. A derivative financial instrument is a financial contract between two parties where payments are dependent upon movements in price of one or more underlying financial instruments, reference rate or index.

The notional amount, disclosed gross, is the amount of a derivative's underlying asset and is the basis upon which changes in the value of derivatives are measured.

The notional amounts indicate the volume of transactions outstanding at the year-end and are neither indicative of the market risk nor credit risk.

The positive fair value of forward foreign exchange contracts outstanding as of 31 December 2013 is **KD 10 thousand** (2012: Nil) and their notional amounts outstanding as of 31 December 2013 are **KD 365 thousand** (2012: Nil)

The Group's derivative trading activities mainly related to deals with customers, which are normally matched by entering into reciprocal spot deals with counterparties.

## 32. FIDUCIARY ASSETS

The aggregate value of assets held in a trust or fiduciary capacity by the Group amounted to **KD 78,905 thousand** (31 December 2012: KD 70,246 thousand) and the related income from these assets amounted to **KD 294 thousand** (31 December 2012: KD 241 thousand).