

SOLID GROWTH
ANNUAL REPORT 2007



**Khaleeji
Commercial
Bank**





بِسْمِ اللَّهِ الرَّحْمَنِ الرَّحِيمِ



**H.H. Shaikh Khalifa Bin
Salman Al Khalifa**

The Prime Minister



**H.M. King Hamad
Bin Isa Al Khalifa**

The King of Bahrain



**H.H. Shaikh Salman
Bin Hamad Al Khalifa**

The Crown Prince
and Deputy Supreme
Commander of Bahrain
Defence Force

SOLID GROWTH



Khaleeji
Commercial
Bank

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SOLID FOUNDATIONS

Established in November 2004 and with a paid-up capital of BD100 million, Khaleeji Commercial Bank (KHCB) is an Islamic private bank, headquartered in the Kingdom of Bahrain, and operating under a retail Islamic banking license granted by the Central Bank of Bahrain (CBB).

The Bank is majority owned by strategic GCC Financial Services Investors, with 40% held by the original parent company, Gulf Finance House, the leading regional Islamic finance house.

Khaleeji Commercial Bank offers a comprehensive range of innovative banking and investment products and services to high net worth individuals, corporate entities, and financial institutions. These include commercial and corporate banking, wealth management, structured investment products, and project financing facilities.

The Bank seeks to expand its network of strategic alliances with other financial institutions and business partners to source new and mutually beneficial investment and financing opportunities.



VISION To be a leading domestic and regional Islamic bank, providing unique, innovative and high quality Shari'a-compliant products, services and investment opportunities for our clients.

MISSION To participate in the economic development of Bahrain, GCC and the MENA region, maximising client and shareholder value in accordance with the principles of Shari'a, contributing towards the growth of Islamic banking, and providing a challenging environment to our employees to be innovative and realise their professional objectives.

VALUES The Bank will empower its clients, creating long-term relationships with them; provide the best service available; respond to clients' different needs and demands; provide superior products and services; and use market knowledge and investment prowess to achieve our clients' business objectives.

STRONG LEADERSHIP BOARD OF DIRECTORS



Dr. Fuad Abdulla Al-Omar
Chairman



Mr. Esam Yousif Janahi
Vice Chairman



Mr. Buti Khalifa Al-Flasi
Director



Mr. Yousif Mohammed Khayat, Director



Mr. Abdul Latif Abdulla Al-Meer, Director



Mr. Samir Yaqoob Al-Nafisi
Director



Mr. Waleed A. Rahman Al-Rowaih, Director



Mr. Abdulla Abdul Karim Showaiter, Director

SOLID ETHICS SHARI'A SUPERVISORY BOARD

Khaleeji Commercial Bank is guided by a Shari'a Supervisory Board consisting of three distinguished scholars. This Board reviews the Bank's activities to ensure that all products and investment transactions comply fully with the rules and principles of Islamic Shari'a.

Dr. Fareed Yaqoob Al Miftah Chairman

Member of the Supreme Council of Islamic Affairs, Undersecretary of the Ministry of Islamic Affairs, Kingdom of Bahrain; former Judge of the High Shari'a Court, Lecturer, University of Bahrain; PhD from the University of Edinburgh, United Kingdom.

Dr. Fareed Mohammed Hadi Executive Member

Assistant Professor at the College of Arts, Department of Arabic and Islamic Studies, University of Bahrain; PhD in Ibn Hazm's Methodology of Jahala, Edinburgh University, UK; PhD in Al-Bukhari's Methodology, University of Mohammed V, Morocco; member of Shari'a Supervisory Boards of a number of Islamic banks.

Shaikh Nizam Mohammed Saleh Yaqoobi

Executive Member

Executive Member of Shari'a Supervisory Board, Abu Dhabi Islamic Bank; member of Shari'a Supervisory Boards of Bahrain Islamic Bank and Shamil Bank; Board Member of Dow Jones Islamic Index; Member of Shari'a Supervisory Boards of a number of Islamic banks.

INVESTMENT VEHICLES

AL-HARETH FRENCH
PROPERTY FUND
EQARAT AL-KHALEEJ
GULF-GERMAN RESIDENCES
AMLAK II
SUROOH
SAFANA
HAJAR TOWER
JANAYEN
DANAT INDIA

PROJECT INVOLVEMENT

BAHRAIN FINANCIAL HARBOUR
BAHRAIN LAGOON
ORYX HILLS (AL AREEN, BAHRAIN)
ROYAL UNIVERSITY FOR WOMEN
(BAHRAIN)
EMIRATES HEALTHCARE
DEVELOPMENT COMPANY (UAE)

SOLID PERFORMANCE

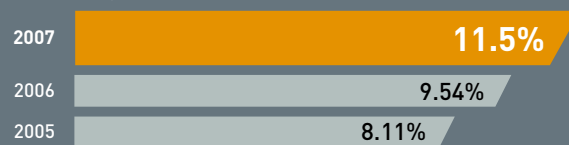
TOTAL INCOME

BD 000's



RETURN ON AVERAGE ASSETS

PERCENT



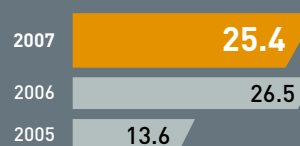
NET INCOME

BD 000's



EARNINGS PER SHARE

BAHRAIN FILS



TOTAL ASSETS

BD 000's



TOTAL SHAREHOLDERS' EQUITY

BD 000's



CHAIRMAN'S STATEMENT



Dr. Fuad Abdulla Al-Omar

**In the name of Allah, the Beneficent, the Merciful,
Prayers and Peace upon the Last Apostle and
Messenger, Our Prophet Muhammad.**

On behalf of the Board of Directors, it is my pleasure to present the annual report of Khaleeji Commercial Bank (KHCB) for the year ended 31 December 2007. I am delighted to report that this proved to be a most blessed third year of operations for Khaleeji Commercial Bank. Strong financial results, key business achievements, significant investment in our human resources and our operational capabilities highlight the continuing successful execution of our strategy .

Financial Performance

With the blessing of Allah the Almighty, this has truly been a year of exceptional growth for the business. KHCB delivered another set of excellent results, with significant gains when compared to 2006. Net income increased by 161% from BD8 million to BD20.8 million, generating a return on average equity of 23.4%. Total assets stood at BD269 million, an increase of 180% compared to the previous year. Total shareholders' equity grew by 217% to BD135 million following a capital increase from BD30 million to BD100 million during the year. Return on average assets also reached 11.5% against 9.54% in 2006. Following these outstanding results, the Board of Directors has recommended, for the first time, a cash dividend of 15%, subject to the necessary regulatory approvals.

Strategic Progress

In our third successful year of operations, we stand on the threshold of a dynamic future. Our achievements of the past were built on execution of key strategies in targeted sectors and markets. Since our inception in November 2004, KHCB has sought to exploit the significant market opportunity which exists for creating innovative Islamic financial products and services to meet the needs of under-served and under-funded markets. By adopting a hybrid business model of investment and commercial banking, KHCB is able to harness the combined value of higher return investment banking services and the lower

volatility and diversified assets of its commercial banking activities. This we believe will ensure a revenue stream that will support KHCB's growth and superior returns for our shareholders in the long term. Through our strategic alliances and our range of structured financial products, KHCB is able to offer our clients a diverse product range, offering regular income to capital growth. We firmly believe that an important and enduring part of KHCB's role in the market place is to open up the significant growth opportunity of the GCC and MENA countries to the increasing numbers of affluent customers..

Increase in Capital and Strategic Partnerships

Whilst our strategy has delivered significant value for our shareholders and our clients, 2007 was an important year in KHCB's development. As the region's economies continued to grow, the requirement of capital has increased manifold, creating a valuable opportunity for KHCB. To fully harness this opportunity and succeed in a very competitive market, it was essential for the Bank to scale up significantly both in size and scope. Therefore, the paid up capital of the Bank was increased from BD30 to BD100 Million. Subsequently, several large and reputable regional institutions including Emirates Islamic Bank, Qatar Islamic Bank, Al Imtiaz Investment Co, Kuwait, Awqaf and Minor Affairs Directorate, UAE, Bahrain Islamic Bank, MENA Real Estate Company, Kuwait and Others became strategic shareholders in the Bank. We believe that, continued support of Gulf Finance House and the new shareholders, will increase our market reach and enhance our ability to capitalise on opportunities in the GCC countries and wider MENA.

We also expect to further widen and diversify our shareholder base by listing on regional stock exchanges, subject to regulatory approvals and favourable market conditions.

Operational Achievements

Our increased capital base and new shareholders presents us with new opportunities across our target markets. We launched four new restricted investment accounts (RIAs), enabling our clients to actively participate

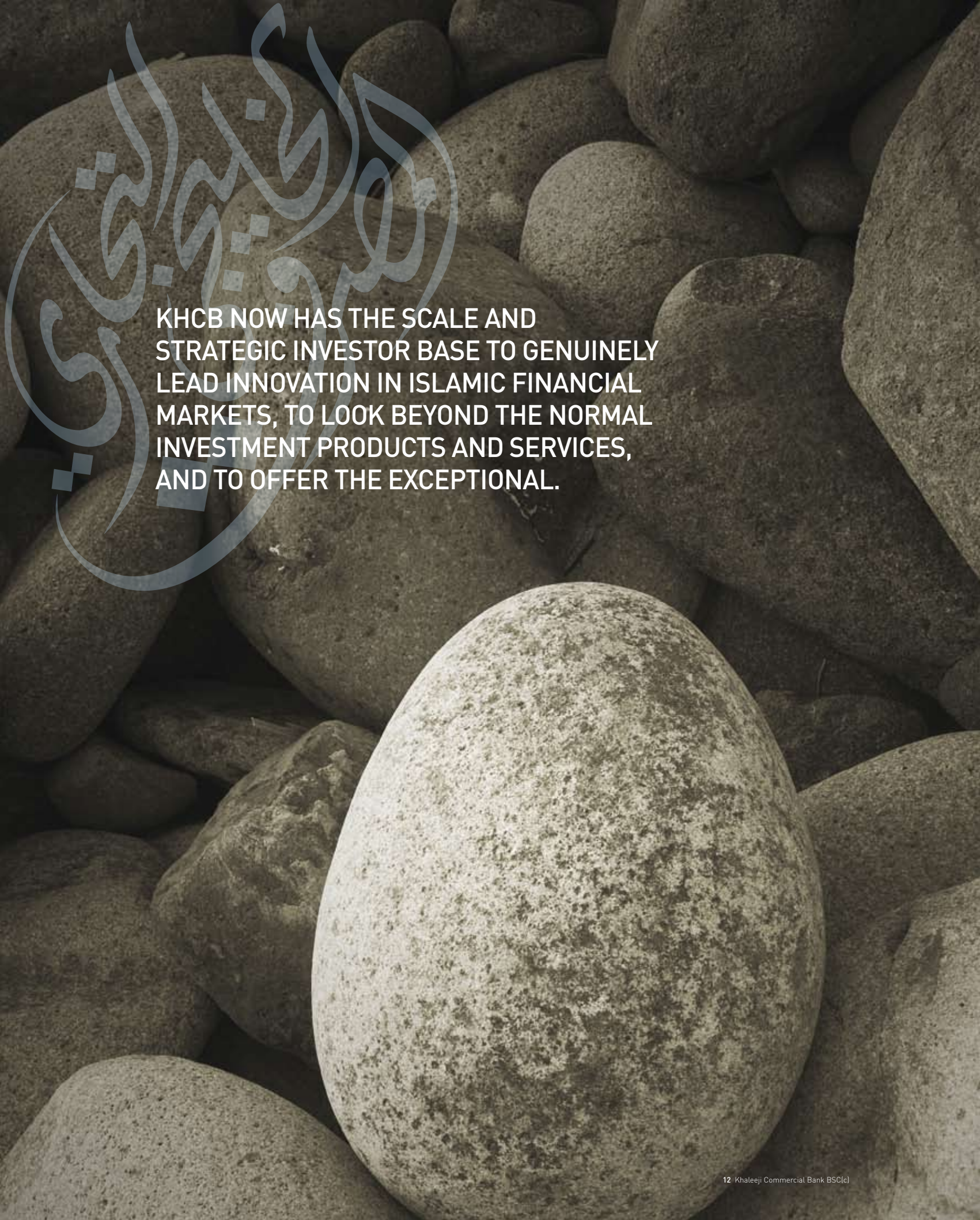
and benefit from rapid regional economic growth. We have seen exceptional demand from our clients for these innovative products. We also structured and arranged funding of \$163 Million for Danat India Investment Company, our largest and first fund outside of the GCC. We also continued to participate in regional investment opportunities in the form of sukuk and other products.

Our commercial banking activities also made considerable progress during the year. Number of customers increased by more than 200% and customer deposits increased by 188% to BD64.1 million. Islamic financing assets have grown from BD15.6m in 2006 to BD88.5 million in 2007. KHCB also invested in offering best in class services such as nationwide access to ATMs for KHCB card holders through the Benefit network. We plan additional access points for our customers in the form of new branches, ATMs and digital access in the form of e-banking and mobile banking in the near future. These initiatives will ensure our customers benefit from a high value commercial banking service.

Organisational Developments and Institutional Capacity

Increase in capital and expansion of our business presents us with new challenges in terms of our institutional capacity to deliver value to our clients and to keep ahead in an increasingly competitive market place. We continued to recruit qualified professionals and invest in our human capital. Past year saw our staff strength increase by 89% reaching 72. We are also enhancing our infrastructure by strengthening our communication and information technology systems.

During the year, the Board reviewed and approved the Bank's corporate governance framework in line with global best practices and regulatory requirements. Further, significant progress was achieved in enhancing the Bank's compliance and risk management framework. Policies and procedures for effectively managing bank's capital, credit and investment risk, profit rate risk as well as operational risk were reviewed and approved by the Board. The Board has also been monitoring the progress towards complying with requirements under Basel 2, as amended by Central Bank of Bahrain.



KHCB NOW HAS THE SCALE AND STRATEGIC INVESTOR BASE TO GENUINELY LEAD INNOVATION IN ISLAMIC FINANCIAL MARKETS, TO LOOK BEYOND THE NORMAL INVESTMENT PRODUCTS AND SERVICES, AND TO OFFER THE EXCEPTIONAL.

CHAIRMAN'S STATEMENT

CONTINUED

Corporate Social Responsibility

We are also aware that as a growing institution we have a responsibility to contribute to the communities within which we operate. We undertook to support a number of causes during the year and we will continue to increase this activity in the coming year through an on-going programme of social investment.

Looking Ahead

2007 has been an important year in the development and growth of the Bank. KHCB now has the scale and strategic investor base to genuinely lead innovation in Islamic financial markets, to look beyond the normal investment products and services, and to offer the exceptional. Our shareholders and strategic partners represent some of the most successful financial and corporate institutions in the region; which will help us to capitalise on new business opportunities and enhance our market reach.

Though the global economic performance has been strong over the past few years, as we look forward, we see that the financial markets are certainly more fragile, undermined by investor confidence in the growth prospects of the US economy and the repercussions of the credit crisis. However, we believe that the growth prospects of our target markets, the GCC and MENA, remain robust, driven by continuing massive investment backed by historically high oil revenues. KHCB's business model has delivered excellent returns within this environment and we expect it to continue to do so. The Board and the management will build upon the success to date to sustain profitability and growth in 2008 and beyond, and to maximise returns for our shareholders and clients.

2008 will also see the business move from its current location at Al Zamil Tower to Bahrain Financial Harbour, where KHCB has leased several floors in the landmark development. The move will enable the business to offer

an even greater level of service to its customers, as a new branch will also open in the Financial Mall within Bahrain Financial Harbour. It will also enable the business to make further investments in personnel and infrastructure to drive future growth and innovation.

Appreciations

On behalf of the Board of Directors, I would like to express my gratitude to His Majesty the King, His Highness the Prime Minister, and His Highness the Crown Prince and Deputy Commander of Bahrain Defence Force, for their wise and inspired leadership of the Kingdom of Bahrain, and for their encouragement for the growth of the private sector and the development of the banking and finance industry. I also extend my thanks to all Government ministries and the Central Bank of Bahrain for their continued guidance and support.

Special appreciation is due to our shareholders, clients and business partners for their ongoing confidence and loyalty; and to the Bank's management and staff for their hard work and dedication.

Allah the Almighty is the Purveyor of All Success.



Dr. Fuad Abdulla Al-Omar
Chairman

A STRONG YEAR MANAGEMENT REVIEW



Ebrahim Hussain Ebrahim

I am pleased to report that during 2007, KHCB continued to grow and expand its business operations in line with its stated business strategy of offering innovative Islamic financial products and services to the GCC and MENA markets. During the course of the year, we undertook two significant strategic steps that will ultimately help in transforming KHCB into a business that will play a leading role in the future development of Islamic financial products and services.

First, in April, we increased the paid up capital of the Bank from BD30 million to BD100 million. This move gave us the ability to scale up our operations in order to compete effectively across our target markets and thus enter larger transactions, offering our customers a greater selection of products and enhanced returns. Thereafter, Gulf Finance House (GFH), then the sole shareholder of the Bank, sold down 60% of its shareholding to a number of investors, institutions and individuals, including employees and directors. Among the new shareholders are some of the most reputable and largest financial institutions in the region. These shareholders have helped us to build strategic partnerships, which we believe will help us in gaining access to new markets and products in the near to medium term. The Bank also made significant progress in terms of its product and service development and deployment during 2007, offering its customers market leading innovation and service levels.

Organisational developments

During the course of 2007, we continued to strengthen our institutional capacity in line with the larger size and scope of our business. To keep pace with our growth, we doubled our employee numbers to 72, bringing in specialist expertise to support the business infrastructure as well as customer facing operations of the Bank. As we gain reputation as a forward thinking, team focused business, KHCB is increasingly becoming an employer of choice for graduates and industry professionals alike. We also built upon the progress made during 2006 in developing the Bank's corporate governance, risk management, and corporate policies, processes and procedures.

2008 WILL SEE THE BANK EXPANDING ITS PRESENCE ACROSS NEW MARKETS, AS IT UTILISES ITS FINANCIAL SCALE AND STRATEGIC PARTNERSHIPS.



Interior fit-out of the Bank's new branch at Bahrain Financial Harbour

WE ARE INCREASINGLY FOCUSING ON DELIVERING A COMPREHENSIVE RANGE OF SERVICES, BOTH PERSONAL AND BUSINESS, TO OUR HIGH NET WORTH CLIENTS



Khaleeji Commercial's banking operations at Zamil Tower on Government Avenue, Manama

MANAGEMENT REVIEW

CONTINUED

Commercial Banking

2007 saw the first full year of our commercial banking operations. Enhancements to our products and services, strengthening of branch operations as well as increasing customer referrals resulted in our customer base growing by more than 200%. Customer deposits including Unrestricted Investment Accounts (UIA) also grew by 188% to BD64.1 million by the end of the year. With the formation of a Wealth Management group, we are increasingly focusing on delivering a comprehensive range of services, both personal and business, to our high net worth clients.

With larger capital and an enhanced team, corporate banking business also grew significantly during the year. Islamic financing assets, which included Ijara, Murabaha, Musharaka etc., grew by 463% to BD88.5 million. We expect to maintain a steady rate of penetration in the local corporate and business banking markets, increasing our market share gradually.

The Bank continued to invest and participate in regional sukuk issues and syndication transactions with a total commitment of BD32.8 Million as at the end of the year. KHCB was one of the Mandated lead arrangers and underwriters for the \$300 Million syndicated financing of Energy City Qatar and was also one of the managers of the \$200 Million Sukuk issue of Gulf Finance House.

The Bank also invested in enhancing its customer service by making it easier for customers to access their accounts across Bahrain and the GCC through the Benefit network. Bank's customers can now access their accounts in any ATM in Bahrain at no charge. The coming year will see more initiatives to ensure that we are able to offer improved customer experience through all our Distribution Channels. We expect to provide e-banking and mobile banking services in 2008, which will offer our customers, easier access and reach to our products and services, at their convenience, wherever they are. We also will provide access to accounts worldwide by issuing Visa branded ATM services.

In 2008, we are planning to open our second branch in the Bahrain Financial Harbour, which we believe will provide another convenient point of contact for our customers and will enable us to optimally utilise infrastructure.

Investment Banking

Investment Banking business grew significantly during the year, with the introduction of Restricted Investment Accounts (RIA) as well as our first investment fund targeted for investment outside the GCC. RIAs are flexible in nature and may target both smaller investors as well the growing number of mass affluent and high net worth individuals in Bahrain and in the region, who have surplus capital to deploy and would like to benefit from the extraordinary growth in and outside the region. As such we believe that the RIAs will enable a new class of investor to access and benefit from the investment opportunity offered by developing economies in the region. In structuring our products, we seek to offer a range of investment products, so that customers may choose between different levels of risk, maturity periods and underlying assets. I am delighted to report that our customers received these products exceedingly well. We launched the following RIAs during the year:

RIA 1 - Safana: Launched on 1 May 2007, this BD9.5 million product offered investors the opportunity to buy into a potential 62% return over a 36 month term. The proceeds raised were used by the investment vehicle (established by a 3rd party) to acquire a land area in the Al-Seef District of Bahrain, the Kingdom's newest, fastest developing and most prestigious business venue. This land area will be reclaimed, sub-divided into plots and marketed. The Safana RIA was fully subscribed and closed at the end of May, following strong customer demand.

RIA 2 - Hajar Tower: This \$3 million RIA offered our customers the opportunity to generate a potential return of just over 16% over the course of 12 months. The underlying asset was a 28% interest in the leasehold of the 21st floor of the Hajar Tower located in the Holy City of Mecca. Investors could participate in this offer from as low as \$10,000. The offer was fully subscribed on the opening date.

RIA 3 - Aramis: Launched and closed in May 2007, this \$17.5 million enhanced murabaha product offered customers a rolling three month maturity from investment levels from \$10,000. The investment is guaranteed by a portfolio of investment assets rated BBB+ by S&P.

MANAGEMENT REVIEW

CONTINUED

RIA 4 - Janayen: Launched in June 2007, the underlying assets for this product are low income housing and modern worker accommodation, a first for the region. We are proud of the fact that KHCB lead the market with several other financial institutions following our lead and subsequently bringing similar classes of asset to market. The offering to the investors was of approximately \$55 million, with an investment term of 30 months and target total return on investment of just over 44%.

Danat India

KHCB also offered its largest investment product to date during 2007. Having offered a blend of RIA products during the course of the year, we launched the Danat India Investment Company, a \$163 million investment product targeting a return on investment of 83% over three years. The Company will invest in a property development targeted at providing an affordable housing alternative to the rapidly expanding middle class in India. The project is located in the fast growing National Capital Region, just north of New Delhi.

Existing Investment Funds

Eqarat Al Khaleej: This private equity investment company was established with the purpose of investing in income-generating properties across the GCC region. The private placement issued in late 2005 received an enthusiastic response, closing with investor subscriptions exceeding US\$51 million. During 2007, the overall portfolio continued to generate an annualised income yield of over 9% and KHCB also sold 30% of the underlying portfolio, generating a 40% capital gain over two years. The proceeds from the said disposal were used to redeem 30% of the company's capital in favour of investors.

Gulf-German Residences: This €154 million Investment Company was launched in February 2006 and closed in March 2006 in collaboration with Abu Dhabi Investment House, with the purpose of investing in a diversified portfolio of 100 income-producing residential properties in Germany. The anticipated annual cash yield of 10% is being distributed quarterly, with an overall internal rate of return (IRR) in excess of 14% over an expected tenor of five years.

Amlak II: This US\$39.35 million Investment Company was launched in November 2006 (and closed in early 2007). Amlak II offers investors the opportunity to invest in plots of land in the Kingdom of Bahrain. The targeted return on investment (ROI) is 13% per annum over an expected over an expected two-year investment tenor.

Surooh: Launched in November 2006 (and closed in early 2007), this BD14.2 million Investment Company has the purpose of investing solely in the Oryx Hills residential project and Bahrain Investment Wharf industrial development project in the Kingdom of Bahrain. The targeted internal rate of return (IRR) is 17% over an expected three-year investment period. The Oryx Hills gated residential community forms part of the broader US\$1.2 billion Al Areen development project. Covering an area of approximately 140,000 square metres, the prestigious Oryx Hills master-planned development comprises luxury villas set amidst breathtaking natural surroundings.

Al Hareth French Property Fund: Launched in 2005, this €25 million income-producing fund focuses on commercial and industrial real estate in the Isle de France, Paris and other regions of France. The Fund is performing to expectations, in line with the targeted cash yield of 9% with quarterly distributions, and an expected annual internal rate of return (IRR) in excess of 10% over a five-year tenor.



Social responsibility

The Bank takes very seriously its corporate social responsibility to contribute to the well being of the local community. During the year, we continued to provide financial assistance for a number of charitable, medical, educational and cultural organisations and other deserving causes. In partnership with Gulf Finance House, the Bank also sponsored national motor racing driver, Hamad Al Fardan, who races in the Toyota Racing Series. We will continue to increase activity in the social sector through an ongoing programme of social investment.

Looking Ahead

After an excellent year, we are now well geared towards pursuing our strategy and to delivering continuing value to our customers and shareholders. 2008 will see the Bank expanding its presence across new markets, as it utilises its financial scale and strategic partnerships. It will also see KHCB becoming increasingly visible, as we strive to deliver additional value to shareholders and a brand associated with high levels of customer service and innovative Islamic financial products and services.

Ebrahim Hussain Ebrahim
General Manager



Artist's impression of the Bank's new branch at Bahrain Financial Harbour

CORPORATE GOVERNANCE

As a Bahrain-based bank, Khaleeji Commercial Bank (KHCB) is subject to the corporate governance standards of the Central Bank of Bahrain (CBB) and other regulatory bodies.

Recently, in an effort to bring the corporate governance of Bahraini banks more into line with corporate governance standards in many other countries, the CBB has adopted a series of new corporate governance rules. Included among the rules that are currently effective is a requirement that the entire board of directors rather than a sub-committee be responsible for ensuring that the systems and controls framework of a bank is appropriate for the Bank's business and associated risks.

In assessing the systems and controls framework, each Bank's board will be required to demonstrate that the Bank's operations are measured, monitored and controlled by appropriate, effective and prudent risk management systems commensurate with the scope of the bank's activities and are supported by an appropriate control environment.

As part of the Bank's commitment to focus on stringent corporate governance guidelines as well as adhere to the corporate governance rules of the Central Bank of Bahrain, the Board of Directors approved a new corporate governance charter during the year

Corporate Governance Structure

As a subsidiary of Gulf Finance House (GFH), Khaleeji Commercial Bank (KHCB) was previously governed by the group's corporate governance framework. Following the reduced ownership of GFH during the year, the Bank's Board of Directors approved a new corporate governance charter which focuses on Board responsibility, oversight and management accountability vis-à-vis governing regulations and better practices.

The Bank's new corporate governance framework is in line with global best practices and regulatory requirements which seeks to balance entrepreneurship, control and transparency, while creating value for all stakeholders.

Corporate governance, the way the Board and Management is organized and how they operate in practice ultimately aims at leading the Bank towards

successfully meeting its strategic objectives. The Board of Directors is accountable to the Bank's shareholders for the creation and delivery of strong sustainable financial performance and long-term shareholder value. To achieve this, the Board approves and monitors the Bank's strategy and financial performance, within a framework of sound corporate governance and effective risk management. The structure of the Board and Management Committees is given below:

Board Committees Structure

The Board currently has two committees and has approved setting up two more committees, relating to Nominations, Governance & Remuneration and Risk Management, which will be constituted during 2008

- Board Audit Committee, which is responsible for internal and external audit, compliance, risk management and anti money laundering.
- Board Investment & Credit Committee (previously called Executive Committee), which is responsible for investment and credit approval, setting limits and investment policies, asset liability management and maintaining banking relationships as well as for the oversight of the off balance sheet vehicles.
- Board Nominations, Remunerations and Governance Committee (New), which is responsible for setting policies for compensation and incentives, human resources and administration. It will also be responsible for approval of annual budget, dividend policy, capital expenditure as well as for the corporate governance framework of the Bank.
- Board Risk Management Committee (New), which will ensure that the Bank's overall risk management framework is effective and that key risks are managed within parameters established by the Board. (Currently, the duties of this committee is being performed by the Board Audit Committee).

The new governance structure has been established in accordance with the envisaged internal requirements of the Bank, High Level Controls Module issued by the Central Bank of Bahrain; and best corporate practices. The structure of the Executive Management Committees and supporting management forums and structures which would undertake the detailed control, monitoring

and reporting on activities to the Board are also detailed here. For 2008 the Board of Directors will consist of ten members. The Chairman is responsible for leading the Board, ensuring its effectiveness, monitoring the performance of the General Manager (GM), and maintaining a dialogue with the Bank's stakeholders including shareholders. The Internal Audit function reports to the Board Audit Committee and also has access to the Chairman.

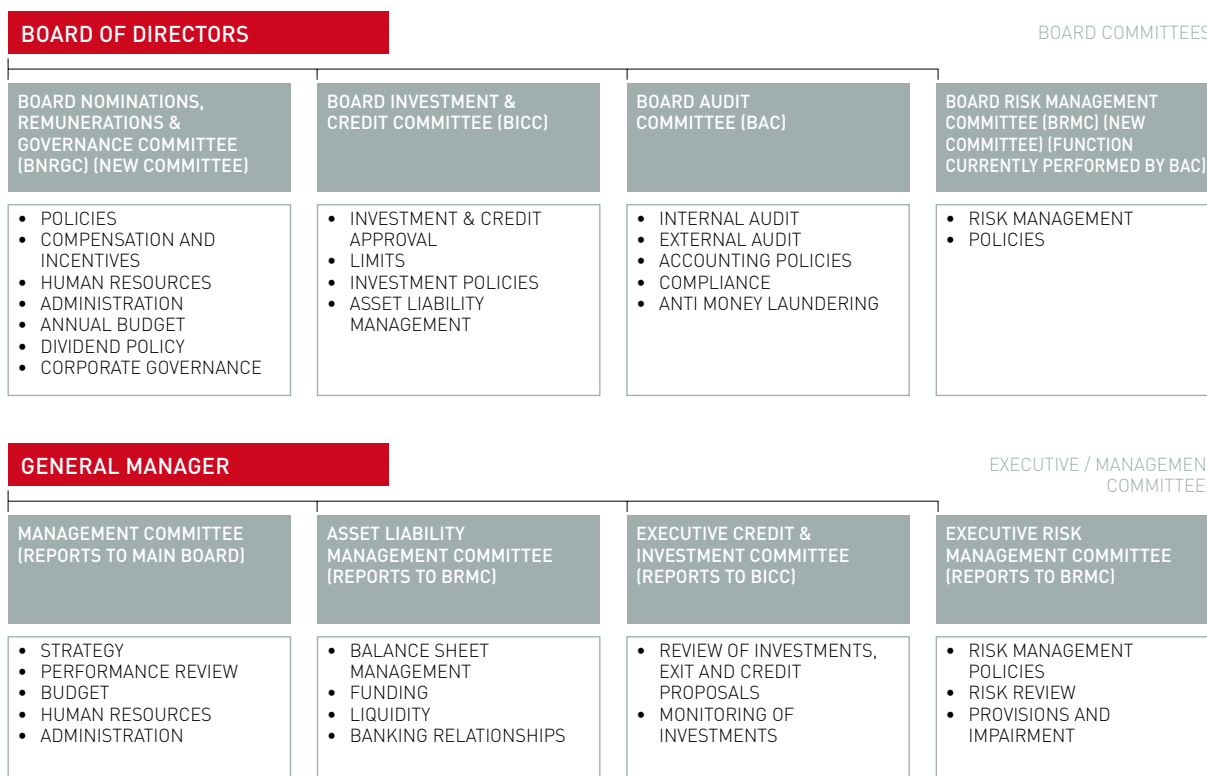
The Board of Directors and its committees receive regular reports on various aspects of the Bank's business from senior management as well as from internal audit, risk management, operations and finance departments.

During 2007, the Board of Directors held 6 meetings, the Executive Committee held 3 meetings, and the Audit Committee held 2 meetings.

Executive / Management Committee Structure

The Board of Directors delegates the authority for day-to-day management of the business to the General Manager who uses a highly consultative approach through several general and specific cross functional committees. Details of the committees are given below.

The Bank is committed to continuously reviewing and developing its corporate governance standards to ensure compliance with the requirements of the revised corporate governance framework being implemented by the Central Bank of Bahrain and other regulatory bodies, and also to keep abreast with international best practice.



RISK MANAGEMENT

Risk is inherent in the Bank's business and effective management of that risk is seen as a core requirement to create shareholder value. The Board of Directors of the Bank has overall responsibility for establishing the Bank's risk culture and ensuring that an effective risk management framework is in place. The Board approves and periodically reviews the risk management policies and strategies of the Bank.

The assumption of risks by the Bank are guided by certain fundamental principles such as protection of investor and shareholder funds by adoption of sound credit and investment culture and prudent practices, adoption of effective 'risk reward' strategy to optimize stakeholders' returns, adherence to prudent levels of total risk exposure and concentration while focusing on the target market segments such as High Net worth Individuals, corporate and public sector clients and products which generate high profitability and growth.

The Board has established an Executive Risk Management Committee (ERMC), which is responsible for developing and monitoring Bank risk management policies in the specified areas. The committee consists of heads of business and other functional units in the Bank and will report regularly to the Risk Management Committee of the Board. The Risk Management department, together with the Internal Audit and Compliance departments, provides independent assurance that all types of risk are being measured and managed in accordance with the policies and guidelines set by the Board.

Basel II

In June 2004, the Basel Committee on Banking Supervision of the Bank for International Settlements, or Basel Committee, approved significant changes to existing international banking capital adequacy standards and endorsed the publication of "International Convergence of Capital Measurement and Capital Standards, a revised Framework", the new capital adequacy framework commonly referred to as Basel II.

In accordance with the regulations of the Central Bank of Bahrain, KHCB is subject to the application of the Basel II capital adequacy framework effective January 2008. The

most significant implications of the new framework relate to capital adequacy and capital management, credit risk, operational risk, disclosure policies and governance.

The Bank engaged external consultants to undertake a gap analysis exercise to determine the gaps in its processes relative to Basel II requirements. Based on the recommendations of the consultants, the Bank has implemented a program to comply with these requirements. These include an operational risk assessment currently being undertaken in all departments and development and refinement of several policies and implementation of a software based operational risk management system. KHCB has progressed well in complying with the requirements under Basel II.

Risk Policies

The Bank's risk management policies are established to identify and analyze the risks faced by the Bank, to set appropriate risk limits and controls, and to monitor adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered. The Bank, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment, in which all employees understand their roles and obligations.

The Bank's risk policies identify approval authorities, reporting requirements, and the procedures for referring risk related issues to executive management, ERMC and the Board, as appropriate. Policies are in place to address the categories of reputation, liquidity, investment and credit, currency, operational, legal and regulatory risk, together with capital adequacy requirements.

Reputational Risk

Reputational risk is the risk that negative perception regarding the bank's business practices or internal controls, whether true or not, will cause a decline in the Bank's investor base, lead to costly litigation that could have an adverse impact on liquidity or capital of the Bank. The senior management through the relevant committees examines issues that are considered to have reputational repercussions for the Bank and issues guidelines to address these.



KHCB Executive Management: (from right to left)
Mahdi A. Nabi Mohammed, Assistant General Manager, Operations & Administration
Silvan Varghese, Deputy General Manager and Chief Operating Officer;
Fuad Ali Taqi, Assistant General Manager, Commercial Banking;
Dimitry Blasi, Assistant General Manager, Investments;

RISK MANAGEMENT

CONTINUED

Liquidity Risk

Liquidity Risk is defined as the risk that funds will not be available to meet liabilities as they fall due. The Asset and Liability Management Committee (ALCO), which is chaired by the GM and comprises senior executives of the Bank, has overall responsibility for managing the balance sheet and liquidity of the Bank. ALCO provides broad guidelines with regard to minimum liquid assets to be maintained and uses a maturity ladder approach for managing and monitoring the liquidity risk. The Bank's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Bank's reputation.

Capital Adequacy

The Bank's capital adequacy ratio is calculated in accordance with the guidelines issued by the CBB and has policies in place for calculation, maintenance and monitoring of regulatory capital. In implementing current capital requirements CBB requires the Bank to maintain a prescribed ratio of total capital to total risk-weighted assets. Effective January 2008, the Bank is subject to a new capital adequacy framework in compliance with Basel II requirements. The Bank's risk capital ratio under the new framework will continue to be significantly in excess of the minimum required by the Central Bank of Bahrain. The Board of Directors of the Bank has approved a capital management policy, which seeks to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The allocation of capital between specific operations and activities is primarily driven by regulatory requirements.

Credit and Investment Risk

The Bank has well defined policies for managing credit and investment risks. These include delegated approval authority limits, concentration limits, maximum exposure limits, counterparty limits etc. Credit and Investment limits are approved after thorough assessment of credit and investment risks.

The Board of Directors has delegated responsibility for the management of credit and investment risk to its Executive Risk Management Committee (ERMC). A separate Bank Risk and Credit Management department independent of the business units is responsible for oversight of the Bank's credit and investment risk.

Fair valuation of the investments take place periodically as per the Bank's policy on Valuation of Investments, with inputs from investment and risk management departments followed by a review by the external auditors.

It is the Bank's policy to ensure that adequate provisions are made for expected credit or investment losses. The Bank's policy on Impairment & provisioning lays down guidelines creation of adequate allowance for impairment losses that represents the estimated future loss on its portfolio.. As on date the Bank has not made any allowances for impairment.

Market Risks

Market risk is the risk that changes in market prices, such as profit rate, equity prices, foreign exchange rates and credit spreads (not relating to changes in the obligor's / issuer's credit standing) will affect the Bank's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return on risk.

The Bank does not have an active trading book. All equity and debt investments are either available for sale or held to maturity and are marked to market at periodic intervals not exceeding one year..

Profit Rate Risk

The principal risk to which non-trading portfolios are exposed is the risk of loss from fluctuations in the future cash flows or fair values of financial instrument because of a change in market Profit rates. The Bank's policy on Profit Rate Risk management aims to assist in the identification, measurement, monitoring, control and reporting of profit rate risks in a timely manner. Profit rate risk is managed principally through monitoring Profit rate gaps and by having pre-approved limits for repricing

bands. The management of Profit rate risk against Profit rate gap limits is supplemented by monitoring the sensitivity of the Bank's financial assets and liabilities to various standard and non-standard Profit rate scenarios.

Currency Risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Bank's currency risk is managed on the basis of limits on net open position set by the Board of Directors and a continuous assessment of current and expected exchange rate movements. The management of foreign exchange risk against net exposure limits is supplemented by monitoring the sensitivity of the Bank's financial assets and liabilities to various foreign exchange scenarios. The Bank does not engage in foreign exchange trading and, where necessary, matches currency exposures inherent in certain assets with liabilities in the same or correlated currency.

Operational Risk

Operational risk is the risk of loss arising from systems and control failures, fraud and human errors, which can result in financial and reputation loss, and legal and regulatory consequences. The Bank manages operational risk through appropriate controls including a framework of policies and procedures to identify, control and manage these risks, instituting segregation of duties as well as through internal checks and balances,

including internal audit and compliance. The Bank is currently undertaking an operational risk assessment in all divisions as part of internal risk assessment process and implementing an operational risk management software in order to comply with requirements of the Central Bank of Bahrain.

Legal and Regulatory risk

Legal risk includes the risk of unexpected loss from transactions and/or contracts not being enforceable under applicable law or from unsound documentation. The Bank manages the legal risk through effective use of internal and external legal advisers.

Regulatory risk includes the risk of non-compliance with regulatory and legal requirements. The Bank has established a compliance function, to act as the coordinating department in respect of matters relating to the regulator i.e. CBB. The compliance department is also responsible for the Bank's anti money laundering initiatives.





Oryx Hills Villas: A project promoted by KHCB for the benefit of its clients through one of its investment vehicles, namely Surooh Investment Company.

REPORT OF THE SHARI'A SUPERVISORY BOARD

**In the name of Allah, the Beneficent, the Merciful,
Prayers and Peace upon the Last Apostle and
Messenger, Our Prophet Mohammed, His Comrades and
Relatives.**

The Shari'a Supervisory Board of Khaleeji Commercial Bank BSC (c) has reviewed the Bank's activities and compared them with the previously issued fatwas and rulings during the financial year ended 31 December 2007 and found them compatible with the already issued fatwas and rulings.

The Board believes that it has expressed its opinion in respect of the activities carried out by the Bank and it is the responsibility of the management to ensure the implementation of such decisions. It is the duty of the Board to express an independent opinion on the basis of its control and review of the Bank's operations and to prepare a report about them.

A representative of the Bank's management explained and clarified the contents of the Balance Sheet, attached notes and Income Statement for the financial year ended 31 December 2007 to our satisfaction. The report of the Board has been prepared based on the contents provided by the Bank.

The Board is further satisfied that any income which is not in compliance with the Glorious Islamic Shari'a has been dispersed to charitable organisations and that the responsibility of the payment of the Zakat lies with the shareholders in their shares.

The Board is satisfied that the activities and services of the Bank are in compliance with the Glorious Islamic Shari'a.

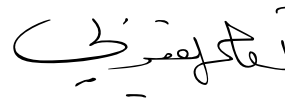
**Peace be to Allah, Lord of the Worlds.
Prayers be upon Prophet Mohammed (Peace Be Upon
Him), all His Family and Companions.**



Dr. Fareed Yaqoob Al Miftah
Chairman



Dr. Fareed Mohammed Hadi
Executive Member



Shaikh Nizam Mohammed Saleh
Yaquby
Executive Member

AUDITORS' REPORT

REPORT OF THE AUDITORS TO THE SHAREHOLDERS

KHALEEJI COMMERCIAL BANK BSC (c)

28 JANUARY 2008

MANAMA, KINGDOM OF BAHRAIN

Report on the financial statements

We have audited the accompanying financial statements of Khaleeji Commercial Bank B.S.C. (c) ("the Bank") as at, and for the year ended, 31 December 2007 as set out on pages 29 to 66.

Respective responsibilities of directors and auditors

These financial statements and the Bank's undertaking to operate in accordance with Islamic Shari'a rules and principles are the responsibility of the directors of the Bank. Our responsibility is to express an opinion on these financial statements based on our audit.

Basis of opinion

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2007, the results of its operations, the changes in its cash flows, equity, restricted investment accounts and sources and uses of charity fund for the year then ended, in accordance with Financial Accounting

Standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions and the Shari'a rules and principles as determined by the Shari'a Supervisory Board of the Bank.

Other regulatory matters

In addition, in our opinion, the Bank has maintained proper accounting records and the financial statements are in agreement therewith. We have reviewed the accompanying report of the chairman and confirm that the information contained therein is consistent with the financial statements. We are not aware of any violations of the Bahrain Commercial Companies Law 2001, the Central Bank of Bahrain and Financial Institutions Law 2006, terms of the Bank's license or its memorandum and articles of association having occurred during the year that might have had a material effect on the business of the Bank or on its financial position. Satisfactory explanations and information have been provided to us by the management in response to all our requests.



KPMG
28 January 2008

SOLID GROWTH
FINANCIAL STATEMENTS 2007



**Khaleeji
Commercial
Bank**

BALANCE SHEET

AS AT 31 DECEMBER 2007

	Note	31 December 2007	BD 000's 31 December 2006
ASSETS			
Cash and bank balances	3	6,169	3,284
Placements with financial institutions	4	79,065	32,838
Investment in properties	5	621	5,072
Islamic financing assets	6	75,462	11,699
Available-for-sale investments	7	38,227	14,262
Assets acquired for leasing	8	12,986	-
Investment in associates	9	6,683	-
Held-to-maturity investment – sukuks	10	32,812	14,515
Other assets	11	16,107	13,720
Equipment	12	1,379	860
Total assets		269,511	96,250
LIABILITIES			
Investors' funds	13	11,953	5,217
Placements from financial institutions and others		41,561	22,251
Customers' current accounts		10,724	2,751
Other liabilities	14	6,183	1,245
Total liabilities		70,421	31,464
Unrestricted investment accounts	15	64,100	22,213
EQUITY			
Share capital	16	100,000	30,154
Statutory reserve		3,258	1,174
Retained earnings		29,102	10,565
Share grants	19	2,630	680
Total equity (page 32)		134,990	42,573
Total liabilities, unrestricted investment accounts and equity		269,511	96,250
Off-balance sheet items			
Restricted investment accounts (page 34)		42,965	12,177

The financial statements, which consist of pages 30 to 66, were approved by the Board of directors on 28 January 2008 and signed on its behalf by:



Fuad Abdulla Al-Omar
Chairman



Esam Yousif A. Janahi
Vice-Chairman



Ebrahim Hussain Ebrahim
General Manager

The accompanying notes 1 to 34 form an integral part of these financial statements.

INCOME STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2007

	Note	2007	BD 000's 2006
Income from investment banking services		13,803	8,844
Placement, management and arrangement fees		2,301	312
Income from placements with financial institutions		4,197	1,560
Income from Islamic financing assets and assets acquired for leasing		3,508	483
Income from available-for-sale investments		4,305	-
Income from investment in sukuks		1,706	653
Income from investment in properties		2,484	1,575
Share of profits from an associate company	9	105	-
Other income		-	222
Total income before return on unrestricted investment accounts and investors funds		32,409	13,649
Less: Return on unrestricted investment accounts	15	(2,446)	(628)
Total income		29,963	13,021
Staff cost	17	5,907	2,330
Murabaha expenses		1,653	785
Investments related expenses		488	670
Other expenses	18	1,079	1,250
Total expenses		9,127	5,035
PROFIT FOR THE YEAR		20,836	7,986
Basic earnings per share (fils)	23	25.47	26.48
Diluted earnings per share (fils)	23	25.31	26.48

The accompanying notes 1 to 34 form an integral part of these financial statements.

STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31 DECEMBER 2007

	BD 000's				
2007	Share capital	Statutory reserve	Retained earnings	Share grants	Total
Balance at 1 January 2007	30,154	1,174	10,565	680	42,573
Profit for the year	-	-	20,836	-	20,836
Total recognised income and expense	-	-	20,836	-	20,836
Issue of ordinary of shares during the year	69,846	-	-	-	69,846
Transfer to statutory reserve	-	2,084	(2,084)	-	-
Fair value of share grants issued during the year (note 19)	-	-	-	2,403	2,403
Unvested share grants	-	-	-	(453)	(453)
Transfer to charity fund for 2006	-	-	(150)	-	(150)
Directors fees for 2006	-	-	(65)	-	(65)
Balance as at 31 December 2007	100,000	3,258	29,102	2,630	134,990
2006	Share capital	Statutory reserve	Retained earnings	Share grants	Total
Balance at 1 January 2006	30,154	375	3,378	-	33,907
Profit for the year	-	-	7,986	-	7,986
Total recognised income and expense	-	-	7,986	-	7,986
Transfer to statutory reserve	-	799	(799)	-	-
Fair value of share grants issued (note 19)	-	-	-	775	775
Unvested share grants	-	-	-	(95)	(95)
Balance as at 31 December 2006	30,154	1,174	10,565	680	42,573

The accompanying notes 1 to 34 form an integral part of these financial statements.

STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED 31 DECEMBER 2007

	Note	2007	BD 000's 2006
OPERATING ACTIVITIES			
Cash receipts from investment banking services		1,590	7,996
Islamic financing assets, net		(60,260)	(4,282)
Placement, management and arrangement fees received		1,170	204
Income from placements received		4,197	1,921
Investors' funds received, net		6,736	(16,384)
Profits allocated to unrestricted investment accounts paid		(2,092)	(1,413)
Payment for expenses		(3,914)	(2,084)
Net increase in customers' current accounts		7,973	832
Receipts from unrestricted investment account holders, net		41,887	8,754
Disbursements for assets acquired for leasing		(12,984)	-
Cash flows from operating activities		(15,697)	(4,456)
INVESTING ACTIVITIES			
Purchase of available-for-sale investments	7	(34,214)	(10,236)
Proceeds from sale of available-for-sale investments		14,432	1,149
Purchase of investment in associates		(6,578)	-
Purchase of investments in properties		-	(7,702)
Proceeds from sale of investments in properties		21,746	-
Purchase of sukuks		(20,483)	(8,770)
Proceeds from redemption of sukuks		1,658	-
Sukuk profits received		1,477	364
Purchase of equipment and payments towards capital advances		(732)	(758)
Cash flows from investing activities		(22,694)	(25,953)
FINANCING ACTIVITIES			
Proceeds from issue of ordinary share capital		69,846	-
Placements from financial institutions and other, net		19,310	13,752
Finance expenses paid		(1,653)	(300)
Cash flows from financing activities		87,503	13,452
Net increase (decrease) in cash and cash equivalents		49,112	(16,957)
Cash and cash equivalents at 1 January		36,122	53,079
Cash and cash equivalents at 31 December		85,234	36,122
Cash and cash equivalent comprise:			
Cash and bank balances	3	6,169	3,284
Placements with financial institutions	4	79,065	32,838
		85,234	36,122

The accompanying notes 1 to 34 form an integral part of these financial statements.

STATEMENT OF CHANGES IN RESTRICTED INVESTMENT ACCOUNTS

FOR THE YEAR ENDED 31 DECEMBER 2007

31 December 2007	Balance at 1 January 2007			Movements during the year							Balance at 31 December 2007			
	No of units (000)	Average value per share BD	Total BD 000's	Investment (withdrawals) BD 000's	Revaluation* BD 000's	Gross income BD 000's	Dividends paid BD 000's	Bank's fees as an agent BD 000's	Administ-ration expenses BD 000's	No of units (000)	Average value per share BD	Total BD 000's	% ownership	
Al Hareth French Property Fund	24.65	494.02	12,177	(4,480)	1,525	1,449	(1,148)	(34)	-	17.05	556.51	9,489	100.00	
Safana Investment WLL (RIA 1)	-	-	-	9,563	-	-	-	-	-	9,563	1.00	9,563	10.97	
Hajer Tower, Mecca (RIA 2)	-	-	-	1,139	-	-	-	-	-	3,021	0.377	1,139	28.00	
Aramis (RIA 3)	-	-	-	2,912	-	272	(222)	(50)	-	7,685	0.377	2,912	-	
Janayen Holding Limited (RIA 4)	-	-	-	19,862	-	-	-	-	-	52,684	0.377	19,862	96.00	
			12,177	28,996	1,525	1,721	(1,370)	(84)	-			42,965		

31 December 2006	Balance at 1 January 2006			Movements during the year							Balance at 31 December 2006			
	No of units (000)	Average value per share BD	Total BD 000's	Investment BD 000's	Revaluation* BD 000's	Gross income BD 000's	Dividends paid BD 000's	Bank's fees as an agent BD 000's	Administ-ration expenses BD 000's	No of units (000)	Average value per share BD	Total BD 000's	Total % ownership	
Al Hareth French Property Fund	24.65	447.22	11,024	-	1,200	1,222	(1,222)	(46)	-	24.65	494.02	12,177	100	
			11,024	-	1,200	1,222	(1,222)	(46)	-			12,177		

* Includes foreign exchange gain of BD 1,525 thousands (2006: BD 1,200 thousands) on revaluation of investments.

The accompanying notes 1 to 34 form an integral part of these financial statements.

STATEMENT OF SOURCES AND USES OF CHARITY AND ZAKAH FUND

FOR THE YEAR ENDED 31 DECEMBER 2007

	2007	BD 000's 2006
Sources of charity and zakah fund		
Contributions by the Bank	150	-
Non-Islamic income	3	3
Total sources	153	3
Uses of charity fund and zakah fund		
Contributions to charitable organisations	-	-
Total uses	-	-
Excess of sources over uses	153	3
Balance at the beginning of the year	3	-
Undistributed charity and zakah fund at 31 December (note 14)	156	3

The accompanying notes 1 to 34 form an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2007

1 INCORPORATION AND PRINCIPAL ACTIVITY

Khaleeji Commercial Bank BSC (c) ("the Bank") was incorporated on 24 November 2004 in the Kingdom of Bahrain under Commercial Registration No. 55133. The Bank operates under a license granted by the Central Bank of Bahrain ("CBB") on 20 October 2003.

The Bank's activities are regulated by the Central Bank of Bahrain (CBB) and supervised by a Religious Supervisory Board whose role is defined in the Bank's Articles of Association.

The principal activities of the Bank include financing real estate and related activities, investment advisory services and investment transactions which comply with Islamic rules and principles according to the opinion of the Bank's Shari'a Board.

2 SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies applied in the preparation of these financial statements are set out below. These accounting policies have been consistently applied by the Bank and are consistent with those used in the previous year.

(a) Statement of compliance

The financial statements have been prepared in accordance with Financial Accounting Standards ('FAS') issued by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI). In line with the requirement of AAOIFI and the CBB Rule Book, for matters for which no AAOIFI standards exist, the Bank uses guidance from the relevant International Financial Reporting Standard.

(b) Basis of preparation

The financial statements are presented in Bahraini Dinars, being the principal currency of the Bank's operations. They are prepared on the historical cost basis.

The preparation of financial statements requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Bank's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements, are disclosed in note 20.

(c) Foreign currency transactions

Items included in the financial statements of the Bank are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The financial statements are presented in Bahraini Dinars, which is the Bank's functional and presentation currency. Foreign currency transactions are translated using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

(d) Available-for-sale investments

Available-for-sale investments are those investments that are not classified as trading investments or are held-to-maturity. These include investments in certain quoted and unquoted equity securities. The Bank recognises these investments initially at fair value, plus attributable transaction costs. Subsequent to initial recognition, available-for-sale investments are re-measured to fair value.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2007

2 Significant accounting policies (continued)

(d) Available-for-sale investments (continued)

Fair value changes are recognised in a separate fair value reserve and when the investments are sold, impaired, collected or otherwise disposed of, the cumulative gain or loss previously recognised in the fair value reserve is transferred to the income statement.

Fair value for quoted investments is their market bid price. Investments for which there is no quoted market price or other appropriate methods from which to derive reliable fair value, are stated at cost less impairment allowances.

(e) Islamic financing assets

Islamic financing assets comprise shari'a compliant commercial financing provided by the Bank. These include Murabaha, Mudaraba, Musharaka, Istisna and Wakala financing which are stated at cost less impairment allowances.

(f) Held to maturity Investments in sukuk

Held-to-maturity investments are financial assets with fixed or determinable payments and fixed maturity that to Bank has the positive intention and ability to hold to maturity. Investments in sukuk are categorised as held-to-maturity investments and are stated at amortised cost less impairment allowances.

(g) Placements with financial institutions

These comprise placements in the form of Murabaha contracts which are stated at cost less impairment allowances.

(h) Impairment of financial assets

The Bank assesses at each balance sheet date whether there is objective evidence that a financial asset is impaired. In the case of investments in equity securities classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the assets are impaired. If any such evidence exists for available-for-sale investments, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognised in income statement – is removed from equity and recognised in the income statement. Impairment losses recognised in the income statement on equity instruments are not subsequently reversed through the income statement.

Impairment losses on Islamic financing assets and investments in sukuks carried at amortised cost are measured as the difference between the carrying amount of the financial assets and the present value of estimated cash flows discounted at the assets' original effective profit rate. Losses are recognised in income statement and reflected in an allowance account against Islamic financial assets and investment in sukuks. When a subsequent event causes the amount of impairment loss to decrease, the impairment loss is reversed through the income statement.

(i) Cash and cash equivalents

For the purpose of the statement of cash flows, cash and cash equivalents comprise cash and balances with banks including Central Bank and placement with financial institutions with maturities of three months or less when acquired.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2007

2 Significant accounting policies (continued)

(j) Investment in property

Investment in properties include trading properties and investment properties. Trading properties are properties held for sale in the ordinary course of business. Trading properties are stated at the lower of cost and net realisable value. Investment property are properties held to earn rental income or for capital appreciation or for both. Investment property is measured at fair value with fair value changes recognised in the income statement.

(k) Assets acquired for leasing

Assets acquired for leasing (Ijarah Muntahia Bittamleek) are stated at cost less accumulated depreciation and any impairment in value. Depreciation is provided on a straight-line basis over the period of the lease. The Company assesses at each balance sheet date whether there is objective evidence that the assets acquired for leasing are impaired. Impairment losses are measured as the difference between the carrying amount of the asset and the estimated recoverable amount. Impairment losses, if any, are recognised in the income statement.

(l) Associates

Associates are those enterprises in which the Bank has significant influence, but not control, over the financial and operating policies. Associates are equity accounted in the financial statements. Under the equity accounting method, the Bank's share of the associate's total recognised gains and losses are included in the financial statements. When the Bank's share of losses exceeds its interest in an associate, the Bank's carrying amount is reduced to nil and recognition of further losses is discontinued except to the extent that the Bank has incurred legal or constructive obligations or made payments on behalf of an associate.

(m) Equipment

Equipment is stated at cost, net of accumulated depreciation. Depreciation is computed using the straight-line method to write-off the cost of the assets over their estimated useful lives ranging from 3 to 5 years. The assets residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

(n) Impairment of other assets

The carrying amount of the Bank's assets other than for financial assets (refer note 2 (h)), are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. An impairment loss is recognised whenever the carrying amount of an asset exceeds its estimated recoverable amount. Impairment losses are recognised in the income statement. Impairment losses are reversed only if there is an indication that the impairment loss may no longer exist and there has been a change in the estimates used to determine the recoverable amount.

(o) Statutory reserve

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2007

2 Significant accounting policies (continued)

(p) Revenue recognition

Income from investment banking services is recognised when the service is provided and income is earned. This is usually when the Bank has performed all significant acts in relation to service and it is highly probable that the economic benefits from the transaction will flow to the Bank.

Placement, management fees and arrangement are recognised as income when earned.

Income from Murabaha contracts are recognised on a time-apportioned basis over the period of the contract.

Income from Mudaraba financing contracts that continue for more than one financial period are recognised to the extent such profits are declared.

Income from Musharaka contracts that continue for more than one financial period are recognised when a partial or final settlement takes place during the financial period and profits are distributed and its share of the losses are recognised to the extent that such losses are deducted from the Bank's share of Musharaka capital.

Istisna'a revenue and the associated profit margin is recognised in the Bank's books according to the percentage of completion method.

Income from assets acquired on lease (ijarah muntahia bittamleek) are recognised proportionately over the lease term.

Income from sukuk is recognised at its effective profit rate over the term of the Sukuk.

Income from investments (**dividend income**) is recognised when the right to receive is established.

(q) Restricted investment accounts

Restricted investment accounts represents assets acquired by funds provided by holders of restricted investment accounts and their equivalent and managed by the Bank as an investment manager based on either a Mudaraba contract or agency contract. The restricted investment accounts are exclusively restricted for investment in specified projects as directed by the investments account holders.

(r) Unrestricted investment accounts

Unrestricted investment accounts are funds held by the Bank, which it can invest at its own discretion. The unrestricted investment account holder authorises the Bank to invest the account holders' funds in a manner which the Bank deems appropriate without laying down any restrictions as to where, how and for what purpose the funds should be invested.

The Bank charges management fee (Mudarib fees) to unrestricted investment account holders. Of the total income from unrestricted investment accounts, the income attributable to customers is allocated to investment accounts after setting aside provisions and deducting the Bank's share of income. The allocation of income is determined by the management of the Bank within the allowed profit sharing limits as per the terms and conditions of the unrestricted investment accounts. Administrative expenses incurred in connection with the management of the funds are borne directly by the Bank and are not charged separately to investment accounts.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2007

2 Significant accounting policies (continued)

(s) Earnings prohibited by Shari'a

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

(t) Employees benefits

(i) Bahraini employees

Pensions and other social benefits for Bahraini employees are covered by the General Organisation for Social Insurance scheme, which is a "defined contribution scheme" in nature, and to which employees and employers contribute monthly on a fixed-percentage-of-salaries basis.

(ii) Expatriate employees

Expatriate employees on fixed contracts are entitled to leaving indemnities payable under the Bahraini Labour Law for the Private Sector of 1976, based on length of service and final remuneration. Provision for this unfunded commitment has been made by calculating the notional liability had all employees left at the balance sheet date.

(iii) Share-based employee compensation scheme

The Bank operates, share-based compensation scheme for its employees (the "Scheme") whereby employee are granted the Bank's shares as compensation.

The grant date fair value of shares granted to employees is recognised as an employee expense, with a corresponding increase in equity, over the period in which the employees become unconditionally entitled to the shares. The amount recognised as an expense is adjusted to reflect the actual number of share grant that vest.

Incentives which are settled in cash are recognised as expense, with a corresponding increase in liabilities for any unsettled amounts. The liability is remeasured at each reporting date and at settlement date. Any change in the value of the liability is recognised as staff cost in the income statement.

(iv) Employee savings scheme

The Bank has a voluntary employees saving scheme. The Bank and the employee contribute monthly on a fixed percentage of salaries basis to the scheme. The scheme is managed and administered by a board of trustees.

(u) Zakah

In accordance with its articles of association, the Bank is not required to pay Zakah. However, the Bank is required to calculate and notify, under a separate report, shareholders of their pro-rata share of the Zakah payable amount. These calculations are approved by the Sharia'a Supervisory Board.

(v) Trade date accounting

All "regular way" purchases and sales of financial assets are recognised on trade date, i.e. the date that the Bank contracts to purchase or deliver the asset. Regular way purchases or sale are purchases or sale of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2007

3 CASH AND BANK BALANCES

	2007	BD 000's 2006
Cash	374	112
Balances with banks	1,670	440
Current account with Central Bank	1,060	2,182
Reserve deposit with Central Bank	3,065	550
	6,169	3,284

4 PLACEMENTS WITH FINANCIAL INSTITUTIONS

These represent short-term commodity murabaha placements with financial institutions.

	2007	BD 000's 2006
Gross Commodity Murabaha	79,175	32,877
Less: Deferred profits	[110]	[39]
	79,065	32,838

The average profit rate on placement with financial institutions as of 31 December 2007 was 5.04% per annum (2006: 4.65% per annum).

5 INVESTMENT IN PROPERTIES

	2007	BD 000's 2006
Trading properties	621	1,116
Investment properties	-	3,956
At 31 December	621	5,072

6 ISLAMIC FINANCING ASSETS

	2007	BD 000's 2006
Murabaha	55,606	9,373
Mudaraba	-	1,933
Musharaka	5,176	393
Wakala	13,884	-
Istisna	796	-
At 31 December	75,462	11,699

Murabaha financing receivables are net of deferred profits of BD 2,051 thousand (2006: BD 957 thousand).

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2007

7 AVAILABLE-FOR-SALE INVESTMENTS

	2007	BD 000's 2006
At 1 January	14,262	5,175
Acquisitions during the year	34,214	10,236
Disposals during the year, at carrying value	(10,249)	(1,149)
At 31 December	38,227	14,262

Available-for-sale investments comprise mainly unquoted investments in projects of the Bank. The investments are being carried at cost in the absence of a reliable estimate of fair value.

8 ASSETS ACQUIRED FOR LEASING

	Property	Equipment	2007	BD 000's 2006
Cost				
Additions during the year	7,994	4,869	12,863	-
At 31 December	7,994	4,869	12,863	-
Accumulated Depreciation				
Charge for year	1,300	733	2,033	-
At 31 December	1,300	733	2,033	-
Net book value				
At 31 December	6,694	4,136	10,830	-
Add: Lease income receivable	1,064	1,092	2,156	-
Balance at 31 December 2007	7,758	5,228	12,986	-

9 INVESTMENTS IN ASSOCIATES

	2007	BD 000's 2006
At 1 January	-	-
Acquisitions during the year	6,578	-
Share of profits from an associate	105	-
	6,683	-
Summarised financial information of investments in associates		
Total assets	15,415	-
Total liabilities	5	-
Total revenues	806	-
Total net profits	575	-

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2007

10 HELD-TO-MATURITY INVESTMENTS - SUKUKS

	2007	BD 000's 2006
At 1 January	14,515	5,745
Acquisitions during the year	20,483	8,770
Redemptions during the year, at carrying value	(2,186)	-
	32,812	14,515

The average profit rate on sukuks was 7.27% per annum (2006: 7.15%).

11 OTHER ASSETS

	2007	BD 000's 2006
Receivable for investment banking services	13,180	968
Placement fees receivable	1,131	-
Receivable from sale of trading properties	-	12,312
Receivable from sukuks	1,047	289
Prepayments and other receivables	749	151
	16,107	13,720

12 EQUIPMENT

	Furniture and fixtures	Equipment	Computers	Work in Progress	2007 Total	BD 000's 2006 Total
Cost						
Balance as at 1 January	376	21	574	-	971	-
Additions	40	6	339	347	732	971
At 31 December	416	27	913	347	1,703	971
Accumulated Depreciation						
Balance as at 1 January	71	3	37	-	111	-
Charge for year	81	5	127	-	213	111
At 31 December	152	8	164	-	324	111
Net book value						
at 31 December 2007	264	19	749	347	1,379	860
Net book value						
at 31 December 2006	305	18	537	-	860	

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2007

13 INVESTORS' FUNDS

These represent funds of projects set-up or promoted by the Bank which are placed with the Bank pending utilisation for project purposes.

14 OTHER LIABILITIES

	2007	BD 000's 2006
Employee related accruals	2,783	863
Accounts payable	2,830	150
Charity payable (page 10)	156	3
Other payables and accrued expenses	414	229
	6,183	1,245

15 UNRESTRICTED INVESTMENT ACCOUNTS

The average gross rate of return in respect of unrestricted investment accounts was 8.50% for 2007 (2006: 7.53%). Approximately 5.21% (2006: 4.73%) was distributed to investors and the balance was either set aside for provisions and/or retained by the Bank as a Mudarib fee.

Unrestricted investment accounts include profit equalisation reserve of BD 205 thousand (2006: BD 60 thousand) and investment risks reserve of BD 134 thousand (2006: BD 44 thousand).

The funds received from unrestricted investment account holders have been commingled and jointly invested with the Bank in the following assets:

	2007	BD 000's 2006
Investment in sukuku	32,812	14,515
Islamic financing assets	75,462	11,699

16 SHARE CAPITAL

	2007	BD 000's 2006
Authorised:		
3,000,000,000 ordinary shares of BD 0.100 each (2006: 753,863,550 shares of BD 0.100 each)	300,000	75,386
Issued and fully paid up:		
1,000,000,000 ordinary shares of BD 0.100 each (2006: 301,540,000 shares of BD 0.100 each)	100,000	30,154

The Extra-ordinary General Assembly of the shareholders held on 14 February 2007 resolved to:

- increase the Bank's authorised share capital from BD 75,386,355 to BD 300,000,000
- increase paid-up share capital from BD 30,154,000 to BD 150,000,000
- split of the Bank's share from BD 1 per share to BD 0.100 per share.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2007

16 Share capital (continued)

During the year, the Bank has given effect to the share split, increase in authorised capital to BD 300 million and has increased its in paid up capital to BD 100 million and accordingly amended its articles and memorandum of association to reflect the revised capital structure.

During the year, Gulf Finance House BSC, previously the parent company of the Bank, sold 59.93% of its stake in the Bank to other investors changing the shareholding pattern of the Bank as follows:

	% Ownership
Gulf Finance House BSC	40.07
Other financial institutions	16.74
Corporate and other entities	27.90
Individual shareholders	15.29
Total	100.00

17 STAFF COST

	2007	BD 000's 2006
Salaries and related expenses	1,771	837
Social insurance expenses	120	63
Management incentive expense (note 19)	4,016	1,430
	5,907	2,330

18 OTHER EXPENSES

	2007	BD 000's 2006
Administration and support services *	184	842
Premises	134	86
Advertisement and marketing	347	-
Postage, courier and subscription	36	39
Printing and stationery	36	65
Professional fees	81	15
Shari'a committee expenses	16	12
Board expenses	9	-
Depreciation	213	111
Others	23	80
	1,079	1,250

* In 2006 the Bank had a service level agreement with Gulf finance house (GFH) previously the parent company, whereby GFH were providing various administration and support services for an agreed fee.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2007

19 SHARE-BASED EMPLOYEE COMPENSATION SCHEME

The Bank operates an equity-settled, share-based compensation scheme for its employees (the "Scheme") whereby employee are granted the Bank's shares as compensation

The shares vest to the employees in a staggered manner over a 5 year vesting period (service condition). The vested shares will be settled by physical delivery on completion of vesting conditions. In case the employee leaves before satisfying the vesting conditions, he would be entitled for a cash payment for the unvested shares in accordance with the terms of the scheme. Such unvested shares will be retained by a special purpose entity which will be set up for this purpose and may be offered to other employees in the scheme.

The maximum number of shares to be issued under the scheme is 30.4 million ordinary shares at BD 0.12 each to be issued in different stages in accordance with a pre-determined criterion set out in the Scheme document. During the year, as per the terms of the scheme, the Bank has issued 13.09 million share grants to employees of which 2.62 million shares have vested during the year.

On a cumulative basis, 18.8 million share grants have been issued under the terms of scheme of which 8.54 million share grants have been vested to employees up to 31 December 2007. The Bank is in the process of issuing shares to employees for the vested share grants. The Bank intends to settle the share grants with the employees by acquisition of treasury shares from existing shareholders.

The share grants have been recognised at their fair values at the grant date, determined based on recent transaction prices in the shares of the Bank. The fair value charge on the equity settled share-based payment component of the current year grant amounted to BD 746 thousand (2006 BD 140 thousand) of which BD 248 thousand (2006 BD 95 thousand) has been charged to the income statement during the year and included in staff cost.

20 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

The Bank makes estimates and assumptions that effect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectation of future events that are believed to be reasonable under the circumstances.

Impairment of available-for-sale investments

The Bank determines that available-for-sale equity securities are impaired when there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgment. Where fair values are not readily available and the investments are carried at cost, the recoverable amount of such investment is estimated to test for impairment. In making this judgment, the Bank evaluates among other factors, evidence of a deterioration in the financial health of the investee, industry and sector performance, changes in technology, and operational and financing cash flows.

Impairment of Islamic financing assets

Islamic financing assets are evaluated for impairment on a basis described in accounting policy 2 (h). Each counterparty exposure is evaluated individually for impairment and is based upon management's best estimate of the present value of the cash flows that are expected to be received. In estimating these cash flows, management makes judgements about a counterparty's financial situation and the net realisable value of any underlying assets. Each impaired asset is assessed on its merits, and the workout strategy and estimate of cash flows considered recoverable are independently evaluated by the Risk Management Department and approved by the Board of Directors

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2007

20 Critical accounting estimates and judgements in applying accounting policies (continued)

Special purpose entities

The Bank sponsors the formation of special purpose entities (SPE's) primarily for the purpose of allowing clients to hold investments. The Bank does not consolidate SPE's that it does not have the power to control. In determining whether the Bank has the power to control an SPE, judgements are made about the objectives of the SPE's activities, its exposure to the risks and rewards, as well as about the Group ability to make operational decisions for the SPE.

21 ASSETS UNDER MANAGEMENT

The Bank provides corporate administration, investment management and advisory services to its project companies, which involve the Bank making decisions on behalf of such entities. Assets that are held in such capacity are not included in these financial statements. At the balance sheet date, the Bank had assets under management of BD 187.05 million (2006: BD 88.02 million). During the year, the Bank has charged management fees amounting to BD 34 thousands (2006 BD 46 thousands for the management of assets).

22 RELATED PARTY TRANSACTIONS

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions. Related parties include the significant shareholders and entities over which the Bank and the shareholders exercises significant influence, directors and executive management of the Bank.

A significant portion of the Bank's income from investment advisory services and placement, arrangement and management fees arises from entities over which the Bank or its significant shareholders exercises influence. Although these entities are considered related parties, the Bank administers and manages these entities on behalf of its clients, who are by and large third parties and are the economic beneficiaries of the underlying investments.

The related party balances and transactions included in these financial statements are as follows:

	31 December 2007	BD 000's 31 December 2006
Assets		
Placements with financial institution	41,155	32,838
Available-for-sale investments	22,728	7,092
Islamic financing assets	2,081	3,866
Other assets	13,195	13,360
Investment in associates	6,683	-
Investments in Sukuks	5,665	-

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2007

22 Related party transactions (continued)

	31 December 2007	BD 000's 31 December 2006
Liabilities		
Investors' funds	11,953	5,217
Placement from financial and non-financial institutions	11,228	7,578
Customers' current accounts	2,513	2,062
Unrestricted investment accounts	8,089	3,993
Income		
Income from investment banking services	13,260	8,826
Placement, management and arrangement fees	841	-
Income from placements with financial institutions	3,816	1,560
Income from Islamic financing assets and assets acquired for leasing	87	165
Income from available-for-sale investments	210	-
Income from investment in sukuks	435	-
Income from investment in properties	-	715
Share of profits from an associate company	105	-
Expenses		
Murabaha expenses	42	486
Return on unrestricted investment accounts	187	485
Investments related expenses	16	12
Other expenses	-	842

Key management personnel of the Bank comprise of the Board of Directors and key members of management having authority and responsibility for planning, directing and controlling the activities of the Bank. The key management personnel compensation is as follows:-

	2007	BD 000's 2006
Board member fees	160	-
Salaries and other short-term benefits	1,284	425
Equity settled-share based payments	850	258

Transactions with restricted investment accounts

Transactions involving transfer/ sale of assets to restricted investment accounts are executed based on the fair values of the assets at the date of the transaction. During the year, in its normal course of business, the Bank sold certain properties and investments at their fair market values on the date of the transaction amounting to BD 33,476 thousand (2006: Nil) to its restricted investment accounts at a profit of BD 3,128 thousand (2006: Nil).

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2007

23 EARNINGS PER SHARE

Basic earnings per share is calculated by dividing the profit for the year by the weighted average number of equity shares outstanding during the year ended 31 December 2007. The Bank has dilutive equity instruments in the form of share grants issued during the year.

	2007	2006
Basic EPS		
Profit for the year (BD 000's)	20,836	7,986
Weighted average number of equity shares (Nos. in 000's)	818,209	301,540
Basic earnings per share (in fils)	25.47	26.48
Diluted EPS		
Profit for the year (BD 000's)	20,836	7,986
Weighted average number of equity shares (Nos. in 000's)	823,247	301,540
Diluted earnings per share (in fils)	25.31	26.48

24 SHARI'A SUPERVISORY BOARD

The Bank's Shari'a Supervisory Board consists of three Islamic scholars who review the Bank's compliance with general Shari'a principles and specific fatwas, rulings and guidelines issued. Their review includes examination of evidence relating to the documentation and procedures adopted by the Bank to ensure that its activities are conducted in accordance with Islamic Shari'a principles.

25 ZAKAH

Zakah is directly borne by the shareholders on distributed profits and investors in restricted investment accounts. The Bank does not collect or pay Zakah on behalf of its shareholders and investors in restricted investment accounts. Zakah payable by the shareholders is computed by the Bank on the basis of the method prescribed by the Bank's Shari'a Supervisory Board and notified to shareholders annually. Zakah payable by the shareholders in respect of the proposed distributable profits for the year ended 31 December 2007 is 0.386 fils (2006: Nil) for every share held. (refer note 28).

26 SOCIAL RESPONSIBILITY

The Bank discharges its social responsibilities through donations to charitable causes and organisations.

27 COMMITMENTS

The commitments contracted in the normal course of business of the Bank:

	2007	BD 000's 2006
Undrawn commitments to extend finance	18,095	3,035
Investment commitments	-	8,722

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2007

28 PROPOSED APPROPRIATIONS

The Board of Directors propose the following appropriations of profits for 2007 which are subject to shareholders approval in the ensuing Annual General Meeting:

	2007	BD 000's 2006
Directors' remuneration	160	65
Proposed cash dividend	15,000	-
Charity	250	-

29 MATURITY PROFILE

2007	Up to 3 months	3 to 6 months	6 months- 1 year	1 to 3 years	Over 3 years	BD 000's Total
Assets						
Cash and bank balances	6,169	-	-	-	-	6,169
Placements with financial institutions	79,065	-	-	-	-	79,065
Investment in properties	-	-	621	-	-	621
Islamic financing assets	23,657	9,816	12,551	16,751	12,687	75,462
Available-for-sale investments	50	11,310	3,692	20,370	2,805	38,227
Assets acquired for leasing	-	6,959	1,451	-	4,576	12,986
Investment in associates	-	-	-	3,592	3,091	6,683
Investment in sukuku	227	-	-	7,540	25,045	32,812
Other assets	16,107	-	-	-	-	16,107
Equipment	-	-	-	-	1,379	1,379
Total assets	125,275	28,085	18,315	48,253	49,583	269,511
2006	51,363	935	5,672	24,415	13,865	96,250
Liabilities						
Investors' funds	11,953	-	-	-	-	11,953
Placements from financial institution and others	41,561	-	-	-	-	41,561
Customers' current account	10,724	-	-	-	-	10,724
Other liabilities	6,183	-	-	-	-	6,183
Total liabilities	70,421	-	-	-	-	70,421
2006	30,594	870	-	-	-	31,464
Unrestricted investment accounts	55,058	7,679	1,363	-	-	64,100
2006	14,987	-	7,226	-	-	22,213

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2007

29 Maturity Profile (continued)

2007						BD 000's
	Up to 3 months	3 to 6 months	6 months- 1 year	1 to 3 years	Over 3 years	Total
Off balance sheet						
Restricted investment accounts	-	-	1,138	38,914	2,913	42,965
2006	-	-	-	12,177	-	12,177
Undrawn Commitments	4,835	3,978	9,282	-	-	18,095
2006	3,035	-	-	-	-	3,035

30 CONCENTRATION OF ASSETS, LIABILITIES, UNRESTRICTED AND RESTRICTED INVESTMENT ACCOUNTS

(a) Industry sector

2007				BD 000's
	Banks and financial institutions	Real estate	Others	Total
Assets				
Cash and bank balances		6,169	-	6,169
Placements with financial institutions	79,065	-	-	79,065
Investment in properties	-	621	-	621
Islamic financing assets	6,459	44,528	24,475	75,462
Available-for-sale investments	-	38,227	-	38,227
Assets acquired for leasing	-	8,479	4,507	12,986
Investment in associates	-	6,683	-	6,683
Held-to-maturity investment sukuks	11,059	21,753	-	32,812
Other assets	4,617	10,524	966	16,107
Equipment	-	-	1,379	1,379
Total assets	107,369	130,815	31,327	269,511
Liabilities				
Investors' funds	-	11,953	-	11,953
Placements from financial institutions and others	41,561	-	-	41,561
Customers' current accounts	-	10,724	-	10,724
Other liabilities	-	-	6,183	6,183
Total liabilities	41,561	22,677	6,183	70,421
Unrestricted investment accounts		12,090	10,944	41,066
Off-Balance sheet items				
Restricted investment accounts		-	42,965	42,965

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2007

30 Concentration of assets, liabilities, restricted and unrestricted accounts (continued)

(a) Industry sector (continued)

2006	Banks and financial institutions	Real estate	Others	BD 000's Total
Assets				
Cash and bank balances	3,284	-	-	3,284
Placement with financial institution	32,838	-	-	32,838
Investment in trading properties	-	5,072	-	5,072
Islamic financing assets	2,140	6,870	2,689	11,699
Available-for-sale investments	-	14,262	-	14,262
Investment in sukuks	-	13,573	942	14,515
Other assets	754	12,966	-	13,720
Equipment	860	-	-	860
Total assets	39,876	52,743	3,631	96,250
Liabilities				
Investors' funds	-	5,217	-	5,217
Placements from financial institutions and others	20,922	-	1,329	22,251
Customers' current accounts	-	2,751	-	2,751
Other liabilities	-	-	1,245	1,245
Total liabilities	20,922	7,968	2,574	31,464
Unrestricted investment accounts	5,003	3,164	14,046	22,213
Off-Balance sheet items				
Restricted investment accounts	-	12,177	-	12,177

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2007

30 Concentration of assets, liabilities and unrestricted and restricted investment accounts (continued)

(b) Geographic region

2007	GCC countries	Europe	USA	Asia	Africa	BD 000's Total
Assets						
Cash and bank balances	5,239	272	658	-	-	6,169
Placements with financial institutions	79,065	-	-	-	-	79,065
Investment in properties	621	-	-	-	-	621
Islamic financing assets	73,560	1,902	-	-	-	75,462
Available-for-sale investments	25,840	6,223	6,164	-	-	38,227
Assets acquired for leasing	12,986	-	-	-	-	12,986
Investment in associates	6,683	-	-	-	-	6,683
Investment in sukuks	27,157	-	-	3,770	1,885	32,812
Other assets	16,107	-	-	-	-	16,107
Equipment	1,379	-	-	-	-	1,379
Total assets	248,637	8,397	6,822	3,770	1,885	269,511
Liabilities						
Investors' funds	11,953	-	-	-	-	11,953
Placements from financial institutions and others	41,561	-	-	-	-	41,561
Customers' current accounts	10,724	-	-	-	-	10,724
Other liabilities	6,183	-	-	-	-	6,183
Total liabilities	70,421	-	-	-	-	70,421
Unrestricted investment accounts	64,100	-	-	-	-	64,100
Restricted investment accounts	33,476	9,489	-	-	-	42,965

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2007

30 Concentration of assets, liabilities and unrestricted and restricted investment accounts (continued)

(b) Geographic region (continued)

2006	GCC countries	Europe	USA	Asia	Africa	BD 000's Total
Assets						
Cash and bank balances	2,927	59	298	-	-	3,284
Placements with financial institutions	32,838	-	-	-	-	32,838
Investments in properties	5,072	-	-	-	-	5,072
Islamic financing assets	11,699	-	-	-	-	11,699
Available-for-sale investments	9,259	5,003	-	-	-	14,262
Investment in sukuks	14,515	-	-	-	-	14,515
Other assets	13,720	-	-	-	-	13,720
Equipment	860	-	-	-	-	860
Total assets	90,890	5,062	298	-	-	96,250
Liabilities						
Investors' funds	5,217	-	-	-	-	5,217
Placements from financial institutions and others	22,251	-	-	-	-	22,251
Customers' current accounts	2,751	-	-	-	-	2,751
Other liabilities	1,245	-	-	-	-	1,245
Total liabilities	31,464	-	-	-	-	31,464
Unrestricted investment accounts	22,213	-	-	-	-	22,213
Restricted investment accounts	-	12,177	-	-	-	12,177

31 FAIR VALUE

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

Other than available-for-sale investments of BD 37,661 thousand (2006: BD 14,262 thousand) and investment in sukuks of BD 32,812 thousand (2006: 14,515 thousand) that are carried at cost, the estimated fair values of the Bank's other financial instruments are not significantly different from their carrying values.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2007

32 RISK MANAGEMENT

Introduction and overview

The Bank has exposure to the following risks from its use of financial instruments:

- credit risk
- liquidity risk
- market risks
- operational risks

This note presents information about the Bank's exposure to each of the above risks, the Bank's objectives, policies and processes for measuring and managing risk, and the Bank's management of capital.

Risk management framework

The Board of Directors has overall responsibility for the establishment and oversight of the Bank's risk management framework. The Board has established an Executive Risk Management Committee, which is responsible for developing and monitoring the Bank's risk management policies in the specified areas. The committee consists of heads of business and other functional units in the Bank and reports regularly to the Risk Management Committee of the Board.

The Bank's risk management policies are established to identify and analyse the risks faced by the Bank, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered. The Bank, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment, in which all employees understand their roles and obligations.

The Bank's Audit Committee is responsible for monitoring compliance with the risk management policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Bank. The Audit Committee is assisted in these functions by Internal Audit. Internal Audit undertakes both regular and ad-hoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee.

Credit risk

Credit risk is the risk of financial loss to the Bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Bank's Islamic financing transactions and Investments. For risk management reporting purposes, the Bank considers and consolidates all elements of credit risk exposure (such as individual obligor default risk, country and sector risk).

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2007

32 Risk management (continued)

Credit risk (continued)

The Board of Directors has delegated responsibility for the management of credit risk to its Executive Risk Management Committee [ERMC]. A separate Bank Risk and Credit Department (BRCD), reporting to the ERMC is responsible for oversight of the Bank's credit risk, including:

- Formulating credit policies in consultation with business units, covering collateral requirements, credit assessment, risk grading and reporting, documentary and legal procedures, and compliance with regulatory and statutory requirements and submitting the same for Board Approval.
- Establishing the authorisation structure for the approval and renewal of credit facilities. Authorisation limits are not at present allocated to business units. Smaller exposures are approved by the General Manager or an Executive Credit & Investment Committee consisting of heads of business units and the Deputy General Manager and Chief Operating Officer. Larger facilities require approval by the Chairman, Board Investment and Credit Committee or the full Board, as the case may be.
- Reviewing and assessing credit risk. BRCD assesses all credit exposures prior to facilities being committed to customers by the business unit concerned. Renewals and reviews of facilities are subject to the same process.
- Limiting concentrations of exposure to counterparties, countries and industries in respect of Islamic Financing assets as well as investments.
- Developing and maintaining the Bank's risk gradings in order to categorise exposures according to the degree of probable risk of financial loss to focus management on the attendant risks. The risk grading system is also used to identify specific exposures for which impairment provisions may be required. The current risk grading framework for the Bank's financing portfolio consists of ten grades (A plus, A minus, B plus, B minus, C plus, C minus, D plus, D minus, E and F) reflecting varying degrees of risk of default and the availability of collateral or other credit risk mitigation. Investments are not currently being graded and are evaluated individually or a case-by-case basis. The responsibility for setting risk grades lies with the final approving executive / committee as appropriate, on the recommendations of the BRCD. Risk grades are subject to regular reviews by BRCD.
- Reviewing compliance of business units with agreed exposure limits, including those for selected industries, country risk and product types. Regular reports are submitted to the Board on the compliance levels. Providing advice, guidance and specialist skills to business units to promote best practice throughout the Bank in the management of credit risk.
- Each business unit is required to implement the Bank credit policies and procedures in respect of exposures assumed by them and are responsible for the quality and performance of its credit portfolio and for monitoring and controlling all credit risks in its portfolios, irrespective of the approving authority for the exposure. Regular audits of business units and Bank Credit processes are undertaken by Internal Audit.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2007

32 Risk management (continued)

Credit risk (continued)

	BD 000's						
2007	Placements with financial institutions	Islamic financing assets	Assets acquired for leasing	Available for sale investments	HTM investment -sukuk	Other assets	Total
Past Due but not impaired							
Grade A-C Low-Fair Risk	-	1,763	-	-	-	-	1,763
Unrated						4,310	4,310
Past due comprises:				-	-	-	
30-60 days	-	1,763	-	-	-	-	1,763
60-90 days	-	-	-	-	-	-	-
90-180days	-	-	-	-	-	-	-
180 days +	-	-	-	-	-	4,310	-
	-	1,763	-	-	-	4,310	6,073
Neither past due nor impaired							
Grade A-C Low-Fair Risk	79,065	73,699	12,986	-	32,812	-	198,562
Unrated	-	-	-	38,227	-	11,797	50,024
	79,065	73,699	12,986	38,227	32,812	11,797	248,586
Total carrying amount	79,065	75,462	12,986	38,227	32,812	16,107	254,659

	BD 000's						
2006	Placements with financial institutions	Islamic financing assets	Available for sale investments	HTM investment -sukuk	Other assets	Total	
Past due but not impaired							
Neither past due nor impaired							
Grade A-C Low-Fair Risk		32,838	11,699	-	14,515	-	59,052
Unrated		-	-	14,262	-	13,720	27,982
Total carrying amount		32,838	11,699	14,262	14,515	13,720	87,034

Impaired financial assets

Impaired financial assets are those for which the Bank determines that it is probable that it will be unable to collect all principal and profit due according to the contractual terms of the exposure. In case of Islamic financing asset these exposure are graded E or F, for other financial assets impairment is assessed on an individual basis for each exposure under the Bank's internal credit risk grading system. The Bank does not have any impaired asset in its books as on date.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2007

32 Risk management (continued)

Past due but not impaired loans

The exposure pertains to Islamic assets and securities where contractual profit or principal payments are past due but the Bank believes that impairment is not appropriate on the basis of the level of security / collateral available and / or the stage of collection of amounts owed to the Bank.

Allowances for impairment

As on date, the Bank has not made any allowances for impairment.

Write-off policy

The Bank writes off an asset / security balance (net of any related allowances for impairment losses) when the it determines that the asset / security are uncollectible. This determination is reached after considering information such as the occurrence of significant changes in the counterparty's financial position such that he can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure. As on date the Bank has not made any write off.

The Bank holds collateral against Islamic financing assets in the form of mortgage/ pledge over property, listed/ unlisted securities, other assets and guarantees. Estimates of fair value are based on the value of collateral assessed at the time of borrowing, and updated periodically generally at annual intervals. Collateral generally is not held against exposure to other banks and financial institutions. Collateral usually is not held against investment securities, and no such collateral was held at 31 December 2006 or 31 December 2007.

An estimate of the fair value of collateral and other security enhancements held against financial assets is shown below. This includes the value of financial guarantees from banks, but not corporate and personal guarantees as the values thereof are not readily quantifiable.

BD 000's

	As at 31 December 2007			As at 31 December 2006		
	Islamic financing assets	Assets acquired for leasing	Total	Islamic financing assets	Assets acquired for leasing	Total
Against past due but not impaired						
Property	-	-	-	-	-	-
Equities	-	-	-	-	-	-
Other	-	-	-	-	-	-
Against neither past due nor impaired						
Property	56,858	12,664	69,522	12,843	-	12,843
Equities	5,554	-	5,554	-	-	-
Other	10,425	4,869	15,294	-	-	-
Total	72,837	17,533	90,370	12,843	-	12,843

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2007

32 Risk management (continued)

For analysis of concentration of total assets and liabilities refer note 30 . Further, for Islamic financing assets and Assets acquired for leasing the Bank monitors concentrations of credit risk by sector and by geographic location. An analysis of concentrations of credit risk at the reporting date is shown below:

BD 000's

Concentration by Sector	As at 31 December 2007			As at 31 December 2006		
	Islamic financing assets	Assets acquired for leasing	Total	Islamic financing assets	Assets acquired for leasing	Total
Finance	6,424	-	6,424	6,354	-	6,354
Real estate property	20,796	8,479	29,275	2,484	-	2,484
Real estate/ infrastructure development	14,255	-	14,255	437	-	437
Land	13,334	-	13,334	-	-	-
Construction	2,478	-	2,478	-	-	-
Trading	4,972	-	4,972	-	-	-
Manufacturing	-	-	-	-	-	-
Others	13,203	4,507	17,710	2,424	-	2,424
Total carrying amount	75,462	12,986	88,448	11,699	-	11,699

Concentration by location for Islamic financing assets is measured based on the location of the counterparty, which has a high correlation with the location of the collateral for the exposure.

Settlement risk

The Bank's activities may give rise to risk at the time of settlement of transactions and trades. Settlement risk is the risk of loss due to the failure of a company to honour its obligations to deliver cash, securities or other assets as contractually agreed.

Settlement limits form part of the credit approval / limit monitoring process described earlier. Acceptance of settlement risk on free settlement trades requires transaction specific or counterparty specific approvals from BRCD.

Liquidity risk

Liquidity risk is the risk that the Bank will encounter difficulty in meeting obligations under its financial liabilities.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2007

32 Risk management (continued)

Management of liquidity risk

The Bank's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Bank's reputation.

Financial Control Department (FCD) collates data from treasury and other business units regarding the liquidity profile of their financial assets and liabilities and details of other projected cash flows arising from projected future business. FCD communicates the information to the treasury who manages the Bank's portfolio of short-term liquid assets, largely made up of short-term placements with other banks and other inter-bank facilities, to ensure that sufficient liquidity is maintained within the Bank as a whole

The daily liquidity position is monitored by FCD. Tools for implementation of regular stress testing under various scenarios are under implementation and the practice is expected to be stabilised by the first quarter of 2008. All liquidity policies and procedures are subject to review and approval by ALCO. A summary report, including any exceptions and remedial action taken, is submitted regularly to ALCO.

Exposure to liquidity risk

The key measure used by the Bank for managing liquidity risk is the ratio of net liquid assets to deposits from customers. For computation of this, net liquid assets are considered as including cash and cash equivalents and investment grade debt securities for which there is an active and liquid market less any deposits from banks, debt securities issued and commitments maturing within the next month. An identical calculation is used to measure the Bank's compliance with the liquidity limit established by the Central Bank of Bahrain

Details of the reported Bank ratio of net liquid assets to deposits and customers at the reporting date and during the reporting period were as follows:

	2007	2006
At 31 December	179%	165%
Average for the period	144%	162%
Maximum for the period	269%	189%
Minimum for the period	83%	126%

For maturity profile of assets and liabilities refer note 29.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2007

32 Risk management (continued)

Market risks

Market risk is the risk that changes in market prices, such as profit rate, equity prices, foreign exchange rates and credit spreads will affect the Bank's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

Management of market risks

The Bank separates its exposure to market risk between trading and non-trading portfolios.

Bank does not do any trading in foreign exchange. All foreign exchange income/ losses arising out of customer transactions and revaluation of balance sheet assets and liabilities are booked by the treasury operations. The responsibility for monitoring and managing the related risks also rest with the treasury.

Overall authority for market risk is vested in ALCO. The Bank Risk Management Department is responsible for the development of detailed risk management policies (subject to review and approval by ALCO) and the Financial Control Department for the day-to-day review of their implementation.

Exposure to market risks – trading portfolios

The Bank does not have an active trading book. All equity and debt investments are either available-for-sale or held-to-maturity and are marked to market at periodic intervals not exceeding one year. The Bank does not therefore do VaR calculations for its portfolio.

Exposure to profit rate risk – non-trading portfolios

The principal risk to which non-trading portfolios are exposed is the risk of loss from fluctuations in the future cash flows or fair values of financial instrument because of a change in market profit rates. Profit rate risk is managed principally through monitoring profit rate gaps and by having pre-approved limits for repricing bands. The ALCO is the monitoring body for compliance with these limits and is assisted by the Bank's Risk Management Department in its day-to-day monitoring activities.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2007

32 Risk management (continued)

A summary of the Bank's profit rate gap position at 31 December 2007 is as follows:

	BD 000's					
2007	Up to 3 months	3 to 6 months	6 months- 1 year	1 to 5 years	More than 5 years	Total
Assets						
Placements with financial institutions	79,065	-	-	-	-	79,065
Islamic Financing assets	33,405	14,225	9,291	17,447	1,094	75,462
Assets acquired for leasing	(362)	7,480	5,868	-	-	12,986
Investments in sukuk	20,057	4,750	-	6,120	1,885	32,812
Total earning assets	132,165	26,455	15,159	23,567	2,979	200,325
Liabilities						
Placement from banks and financial institutions	(41,561)	-	-	-	-	(41,561)
Unrestricted investments accounts	(48,170)	(3,017)	(12,913)	-	-	(64,100)
Profit rate gap	42,434	23,438	2,246	23,567	2,979	94,664

	BD 000's					
2006	Up to 3 months	3 to 6 months	6 months- 1 year	1 to 5 years	More than 5 years	Total
Assets						
Placements with financial institutions	32,782	-	-	-	-	32,782
Islamic Financing assets	1,453	675	127	9,444	-	11,699
Assets acquired for leasing	-	-	-	-	-	-
Investments in sukuk	7,352	5,278	-	1,885	-	14,515
Total earning assets	41,587	5,953	127	11,329	-	58,996
Liabilities						
Placement from Banks and Financial institutions	(22,251)	-	-	-	-	(22,251)
Unrestricted Investments Accounts	(16,693)	(1,045)	(4,475)	-	-	(22,213)
Profit rate gap	2,643	4,908	(4,348)	11,329	-	14,532

The management of profit rate risk against profit rate gap limits is supplemented by monitoring the sensitivity of the Bank's financial assets and liabilities to various standard and non-standard profit rate scenarios. Standard scenarios that are considered on a monthly basis include a 100 basis point parallel fall or rise across all yield curves and a 50 bp rise or fall of all yield curves.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2007

32 Risk management (continued)

An analysis of the Bank's sensitivity to an increase or decrease in market profit rates (assuming no asymmetrical movement in yield curves and a constant balance sheet position) is as follows:

	100bp parallel increase/ decrease	50bp increase/ decrease
At 31 December 2007	± 947	± 473
At 31 December 2006	± 185	± 93

Overall non-trading profit rate risk positions are managed by Treasury, which uses investment securities, placement with banks and placement from banks to manage the overall position arising from the Bank's non-trading activities.

Exposure to foreign exchange risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Bank had the following significant net exposures denominated in foreign currency as of 31 December:

	2007 BHD Equivalent	2006 BHD Equivalent
Sterling Pounds	3,507	(10)
Euros	512	4,940
US Dollars*	48,109	12,748
Kuwaiti Dinar	-	2,917
Other GCC Currencies *	(3,429)	1,200

(*)The exposure in US dollars and other GCC currencies does not create any foreign exchange risk for the Bank since Bahrain Dinars and other GCC Currencies are effectively pegged to the US Dollars.

In the current year the sterling pound exposure is hedged through a forward contract for 4.5 million sterling pounds maturing on the 22nd January 2009.

The management of foreign exchange risk against net exposure limits is supplemented by monitoring the sensitivity of the Bank's financial assets and liabilities to various foreign exchange scenarios. Standard scenarios that are considered on a monthly basis include a 5% plus / minus increase in exchange rates, for currencies other than US Dollars, GCC currencies and the hedged sterling pounds exposure.

An analysis of the Bank's sensitivity to an increase or decrease in foreign exchange rates (assuming all other variables, primarily profit rates, remain constant) is as follows:

	2007 BHD Equivalent	2006 BHD Equivalent
Sterling Pounds	-	482
Kuwaiti Dinars	-	146
Euros	256	247

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2007

32 Risk management (continued)

Exposure to other market risks – non-trading portfolios

Credit spread risk on debt securities and equity price risk is subject to regular monitoring by BRCD, but is not currently significant in relation to the overall results and financial position of the Bank.

The Bank's foreign exchange risk arises entirely from its normal credit and investment business and there are no structural foreign exchange positions on account of investments in foreign subsidiaries or branches.

Operational risk

Operational risk is the risk of loss arising from systems and control failures, fraud and human errors, which can result in financial and reputation loss, and legal and regulatory consequences. The Bank manages operational risk through appropriate controls, instituting segregation of duties and internal checks and balances, including internal audit and compliance. In addition the Bank is committed to recruitment in addition to training of staff. The Bank is currently undertaking an operational risk assessment in all divisions as part of internal risk assessment process in preparation for the implementation of the Basle II Capital Accord by the regulator, Central Bank of Bahrain.

Capital management

Regulatory capital

The regulator sets and monitors capital requirements for the Bank as a whole. In implementing current capital requirements CBB requires the Bank to maintain a prescribed ratio of total capital to total risk-weighted assets. The Bank uses its internal gradings as the basis for risk weightings for credit risk, which are also in compliance with CBB and Basel I guidelines as applicable to the Bank as on the date of reporting.

The Bank's regulatory capital is analysed into two tiers:

- *Tier 1 capital*, which includes ordinary share capital, free reserves, share premium, retained earnings, and minority profits after deductions for goodwill and intangible assets, and other regulatory adjustments relating to items that are included in equity but are treated differently for capital adequacy purposes.
- *Tier 2 capital*, which includes qualifying subordinated liabilities, interim retained profits reviewed by the auditors, Asset revaluation reserves, collective impairment allowances and part of the fair value reserve relating to unrealised gains on equity instruments classified as available-for-sale.

Certain limits are applied to elements of the capital base in line with regulatory requirements. Qualifying tier 2 capital cannot exceed tier 1 capital; and qualifying term subordinated loan capital may not exceed 50 percent of tier 1 capital. There are also restrictions on the amount of collective impairment allowances that may be included as part of tier 2 capital. Other deductions from capital include the carrying amounts of investments in subsidiaries that are not included in the regulatory consolidation, investments in the capital of banks and certain other regulatory items.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2007

32 Risk management (continued)

Banking operations are categorised as either trading book or banking book, and risk-weighted assets are determined according to specified requirements that seek to reflect the varying levels of risk attached to assets and off-balance sheet exposures.

The Bank's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The impact of the level of capital on shareholders' return is also recognised and the Bank recognises the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position.

The Bank and its individually regulated operations have complied with all externally imposed capital requirements throughout the period. There have been no material changes in the Bank's management of capital during the period.

The Bank's regulatory capital position at 31 December was as follows:

	31 December 2007	BD 000's 31 December 2006
Total risk weighted assets	272,011	60,272
Tier 1 capital		
Share capital and share premium	100,000	30,154
Statutory reserve	3,258	1,174
Retained earnings	29,102	10,565
Total regulatory capital	132,360	41,893
Total regulatory capital expressed as a percentage of total risk weighted assets	48.66	69.51

Capital allocation

The allocation of capital between specific operations and activities is primarily driven by regulatory requirements. The Bank's capital management policy seeks to maximise return on risk adjusted while satisfying all the regulatory requirements. The Bank's policy on capital allocation is subject to regular review by the Board

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2007

33 NEW STANDARDS AND INTERPRETATIONS NOT YET ADOPTED

During the year the following new/ amended IFRS standards and interpretations have been issued which are not yet mandatory for adoption by the Bank:

- IAS 1 Presentation of Financial Statements (amended)
- IAS 23 - Borrowing Costs (effective for annual period beginning on or after 1 January 2009)
- IFRS 8 - Operating Segments (effective for annual period beginning on or after 1 January 2009);
- IFRIC 11, IFRS-2 Group and Treasury shares transactions (effective for annual period beginning on or after 1 March 2007);
and
- IFRIC 14, IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction (effective for annual period beginning on or after 1 January 2009)

The adoption of these standards and interpretations are not expected to have any material impact on the financial statements.

34 COMPARITIVES

Certain prior period amounts have been reclassified to conform to current year's presentation. Such reclassification did not affect previously reported profit or equity.