



STRENGTH IN DIRECTION
ANNUAL REPORT 2008



Khaleeji
Commercial
Bank







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**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

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STRENGTH IN DIRECTION

ESTABLISHED IN NOVEMBER 2004 AND WITH A PAID-UP CAPITAL OF BD100 MILLION, KHALEEJI COMMERCIAL BANK (KHCB) IS AN ISLAMIC BANK, HEADQUARTERED IN THE KINGDOM OF BAHRAIN, AND OPERATING UNDER A RETAIL ISLAMIC BANKING LICENSE GRANTED BY THE CENTRAL BANK OF BAHRAIN (CBB).

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.

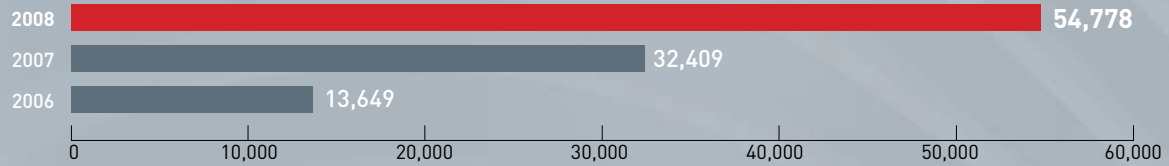
MISSION To participate in the economic development of Bahrain, the GCC and the MENA region, maximising client and shareholder value in accordance with the principles of Shari'a, contributing towards the growth of Islamic banking, and providing a challenging environment to our employees to be innovative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

FINANCIAL HIGHLIGHTS

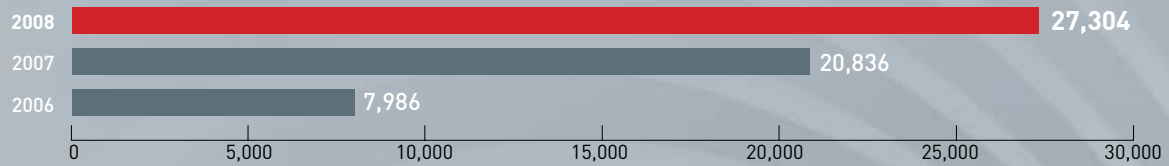
TOTAL INCOME

BD 000's



NET INCOME

BD 000's



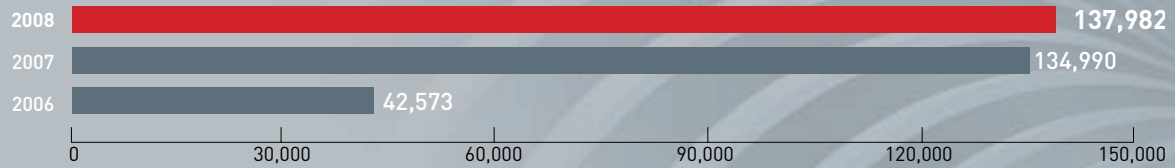
TOTAL ASSETS

BD 000's



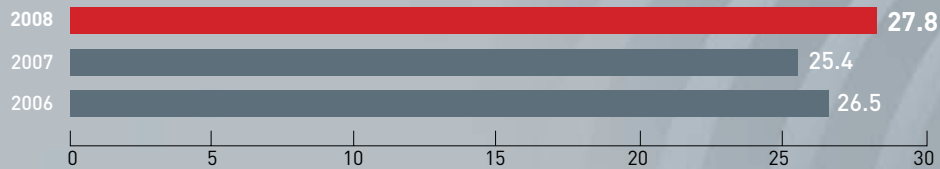
TOTAL SHAREHOLDERS' EQUITY

BD 000's



EARNINGS PER SHARE

BAHRAIN FILS



BOARD OF DIRECTORS



1. Dr. Fuad Abdulla Al-Omar
Chairman
2. Dr. Esam Yousif Janahi
Vice Chairman
3. Mr. Ebrahim H. Ebrahim
Director & Chief Executive
Officer
4. Mr. Rashad Y. Janahi
Director
5. Mr. Talal Hazim Al Ghalib
Director
6. Mr. Abdul Latif Abdulla
Al-Meer
Director

7. Mr. A. Latif Al-Abdul Razaq
Director
8. Mr. Hesham A. Latif Al Jabr
Director
9. Mr. Abdulla Abdul Karim
Showaiter
Director
10. Mr. A. Rahman Mohammed
Al Shared
Director (Resigned in
October 2008)

1	2	3	4
5	6	7	8
9	10		



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
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.



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 31st December 2008. The year 2008, which is the fourth year of operation of the Bank started exceptionally well and I am delighted to report that in spite of very difficult market conditions, the Bank has posted excellent financial results. We also continued to invest significantly in our human resources, which we believe will enable us to develop the operational and institutional capacity to achieve our long term objectives.

During the year, the Bank's Annual General Meeting elected a new Board of Directors reflecting the new diversified shareholding structure. We would like to thank Mr. Sameer Al Nafisi, Mr. Yusuf Al Khayat and Mr. Waleed Roweiah who have resigned as members of the Board in February 2008 for their valuable contribution and service to KHCB since inception.

Financial Performance

The effect of the global credit crisis has gradually worked through the global financial system to emerging markets in general and markets in the GCC. Like every other financial institution, the current market environment has a

direct and indirect impact on the Bank. Nevertheless, we have been proactive in ensuring that the Bank maintains strong liquidity and capital position with minimal long term funding or refinancing pressure.

With the blessing of Allah the Almighty, the Bank has continued to grow and deliver excellent financial results, notwithstanding the extraordinarily tough market conditions. Net income increased by 31% from BD20.8 million in 2007 to BD 27.3 million in 2008, generating a return on average equity of 20%. Total assets stood at BD465 million, an increase of 72.5% compared to the previous year and total shareholders' equity grew by 2.2% to BD138 million. Return on average assets also reached 7.4%. Following these results, the Board of Directors has recommended, a cash dividend of 15% and a bonus share of 5%, subject to the necessary regulatory approvals.

Strategic Progress

The excellent financial results delivered by the Bank were achieved by executing a clearly defined strategy to position the Bank as a leading regional Islamic financial institution delivering innovative Islamic financial products and services to customers in the GCC and MENA regions. We continued to execute a robust business strategy based on a hybrid business model and the increase in our paid up capital last year from BD30 million to BD100 million enabled us to pursue our strategy more aggressively both in the commercial banking and investment banking business segments. We also entertained positive support from our strategic partners that include some of the most reputable financial institutions in the region.

Listing of the Bank's Shares on the Bahrain Stock Exchange

I am proud to state that the Bank's shares were listed on the Bahrain Stock Exchange (BSE) in June 2008 in line with our strategic plan. The conversion from a closed to a public shareholding company and listing on BSE thereafter, has been a turning point in the history of the Bank. The listing has enabled the Bank to diversify its shareholder base while providing liquidity to its existing shareholders. Listing of the shares on the BSE has been a natural step in the evolution of the Bank as a leading player in the local and regional banking sector. We also believe that the listing will enhance our position among investors in the Regional Capital Markets.

Operational Achievements

The Bank has established a healthy deal flow in both the investment banking and commercial banking businesses. The financial results indicate both increasing volumes as well as improved profitability of the Bank.

Our commercial banking activities made considerable progress during the year. The number of customers increased by more than 88%. In a mature market like Bahrain, attracting deposits, especially Unrestricted Investment Accounts (URIA), is a challenging task. Yet, I am pleased to report that the Bank has successfully overcome this challenge by increasing

customer deposits including URIA by 209.8% to BD231.8 million. Islamic financing assets have also grown significantly from BD88.4 million in 2007 to BD163.6 million in 2008, a growth of 85%, further widening our customer base.

We have successfully launched one new restricted investment account, enabling our clients to actively participate and benefit from the regional economic growth. In addition the Bank successfully structured and launched two investment products. Furthermore, the Bank closed one investment in India and existed from two other investments. We also made further reach to new markets such as Australia through an equity investments. The Bank also continued to participate in regional investment opportunities in the form of sukuku and other products.

The Board and the management appreciate the need to offer best in class services to the Bank's customers. During the year, the Bank launched its online banking and SMS banking solutions for its customers. The Bank also launched a new Visa branded debit card and expanded its own ATM networks by installing new ATM machines.

Organisational Development

The past year witnessed significant growth and expansion in both the scope and scale of the Bank's operations. This 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 believe that a committed and well trained work force is a key enabler in achieving our long term objectives. Unprecedented growth in the economy as well as the Banking sector in the past few years has presented a huge challenge in terms of recruitment. I am pleased to note that we have been able to overcome this challenge and recruit 65 staff to increase our staff strength by 90% to 137.

During the year, the Board implemented the Bank's corporate governance framework in line with global best practices and regulatory requirements, which was approved in 2007. Furthermore, considerable progress was achieved in enhancing the Bank's compliance and risk management framework. Policies and procedures for effectively managing enterprise wide risk including the Internal Capital Adequacy Assessment Process (ICAAP) were approved for implementation. The Board has also been monitoring the progress towards complying with requirements under Basel 2, and as required by Central Bank of Bahrain. The bank also completed an assessment of its risk management framework by an independent consulting firm.

CHAIRMAN'S STATEMENT (CONTINUED)

Awards and Accolades

I am very pleased to report that Khaleeji Commercial Bank won two prestigious industry awards during this past year. In November, KHCB received the award for the Best Islamic Investment Advisory Institution during the Banker Middle East Industry Awards for 2008. In January 2008, KHCB was selected as the Best Islamic Retail Bank during the Banker Middle East Islamic Finance awards event. We are honoured to receive these awards, as they reflect the confidence of our peers and customers.

In a recently published report by (The Banker), a Financial Times publication, Khaleeji Commercial Bank was also ranked the strongest Bank in the Arab world in terms of Soundness of Capital Assets Ratio. The Bank was ranked 3rd in terms of Return on Assets, as well as having moved up 20 places in the overall ranking to take the 67th place among the top 500 Arab banks.

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 corporate social responsibility.

Looking Ahead

2008 has been a year of unprecedented dislocation in the global financial markets, and we have seen the impact of these conditions gradually reaching our primary markets in the GCC. As yet, it is not certain if the worst of this economic situation is behind us. Global and regional recovery will, to a large extent, depend on the responses of the governments, regulators and key players in the system. As we look to 2009, we see a challenging year ahead although we believe that there are opportunities for growing our business both in our primary markets in GCC as well as in other markets across the world.

We believe that the Bank can positively respond to the new challenges and opportunities in the economy in general, and the financial services sectors in particular. It now has the scale, strategic depth as well as financial strength to capitalize on these opportunities. Our key shareholders and strategic partners are among the most successful and reputable financial institutions in the region, and they are geared up to help us grow our business and expand our market reach. We will continue to execute a clear and conservative strategy to sustain profitability and growth.

Appreciation

On behalf of the Board of Directors, I would like to express my gratitude to His Majesty King Hamad Bin Isa Al Khalifa, His Highness Shaikh Khalifa Bin Salman Al Khalifa, the Prime Minister, and His Highness Shaikh Salman Bin Hamad Al Khalifa, the Crown Prince and Deputy Supreme

Commander of Bahrain Defence Force, 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



THE CONVERSION FROM A CLOSED TO A PUBLIC SHAREHOLDING COMPANY AND LISTING ON BSE THEREAFTER, HAS BEEN A TURNING POINT IN THE HISTORY OF THE BANK



From left to right: **Mr. Silvan Varghese**, DGM & COO; **Mr. Ebrahim H. Ebrahim**, Chief Executive Officer and Board Member; **Mr. Dimitry Blasi**, DGM, Head of Investment Banking; **Mr. Fuad Taqi**, DGM, Head of Commercial Banking; **Mr. Mahdi A. Nabi**, AGM, Head of Operations & Administration.

CHIEF EXECUTIVE OFFICER'S REPORT



Ebrahim H. Ebrahim

I am pleased to report that during 2008, 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. Both of our business units performed well given the extremely challenging market environment, especially during the last quarter of 2008.

Commercial Banking

The Bank continued to execute its commercial banking expansion strategy by expanding both its deposit base and financing assets. 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 88%. Customer deposits including Unrestricted Investment Accounts (URIA) also grew by 209.3% to BD231.8 million by the end of the year. We are increasingly focusing on delivering a comprehensive range of services, both personal and business, to our high net worth clients, which has helped us in growing and diversifying our customer base.

With larger capital and an enlarged team, we continued to enhance our market penetration in local corporate and business markets. Islamic financing assets, which included Ijara, Murabaha, Musharaka etc., grew by 85% to BD163.6 million from BD88.4 million in 2007. During the year, we have also been successful in

developing a client base in other GCC countries. We expect to maintain a steady rate of penetration in the local and regional markets, increasing our market share gradually.

The Bank continued to invest and participate in regional sukuk issues with a total commitment of BD47 million as at the end of the year. The Bank lead managed the financing of the new Headquarters of Liquidity Management Centre (LMC) and also financing of the Porta Reef project in Bahrain.

The Bank continued to invest in technologies to enhance customer service by making it easier for customers to access their accounts at any time. During the year, the Bank launched electronic banking and SMS banking solutions for its customers. The Bank also expanded its own ATM network by installing new ATM machines in Seef Mall and Bahrain City Centre. Our customers continue to have access to other ATMs through the Benefit network in Bahrain and the GCC net in other countries in the region. With the launch of our Visa Electron branded debit card, our customers will soon be able to access their accounts from ATMs throughout the world.

In 2009, 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 our infrastructure.

CHIEF EXECUTIVE OFFICER'S REPORT

(CONTINUED)

Investment Banking

Investment Banking has been key to the Bank's growth and success in the last few years. In 2008 investment banking business grew significantly. We successfully launched one new restricted investment account (RIA 5 - North Gate). In addition, the Bank successfully structured and launched two investment products, namely, Jawhara Greens (USD250 million) and Global Logistics (USD430 million) as well as closing the \$163 million Danat India Investment Company. Furthermore, the bank also successfully completed the partial redemption of Eqarat Al Khaleej, Amlak 2, and Surooh. During 2008 the Bank reached new markets such as Australia by investing and taking a significant share in Locata corporation, a specialist in high-technology positioning products, domiciled in Canberra in the Australian Capital Territory. During the year, Bank successfully exited investors from its investments RIA 2 - Hajar Tower and RIA 3 - Aramis.

Our investment portfolio includes the following:

Al Hareth French: Launched in 2005, this 25 million Euro investment product was designed to deliver attractive return from income producing properties in France. The portfolio has yielded 9.5% p.a. exceeding the 9% promised to investors initially. An approximate capital redemption of 30% was completed in April 2007.

Eqarat Al Khaleej: This private equity investment company was established with the purpose of investing in income-generating properties across

the GCC region. This private placement issued in late 2005 received an enthusiastic response, closing with investor subscriptions exceeding US\$51 million. A partial capital redemption of 30% was completed in November 2007. A capital gain of 42% was realized on the distributed portion of the portfolio. A second partial redemption was completed in November 2008 distributing 10.5% of the Investor's original investment amount. The income distributed to Investors recently is in excess of the expected quarterly distribution of 9% p.a.

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 two-year investment tenor. A capital redemption of approximately 30% has been effected in the second quarter of 2008 along with a Pro-rated capital gain of 15.379% on the redeemed amount.

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. A capital redemption of approximately 34% has been effected in the second quarter of 2008. In addition to the redemption amount a Pro-rated return on investment of 30% on the redeemed amount was distributed to Investors.

RIA 1 - Safana: Launched on 1 May 2007, this BD 9.5 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 product was fully subscribed and closed at the end of May, following strong customer demand.

RIA 2 - Hajar Tower (exited in 2008): This \$3 million RIA offered our customers the opportunity to generate a potential return of just over 14.9% over the course of 12 months. The underlying asset was a 28% interest in the leasehold of the 21st floor of the



INVESTMENT BANKING HAS BEEN KEY TO THE BANK'S GROWTH AND SUCCESS IN THE LAST FEW YEARS. IN 2008 INVESTMENT BANKING BUSINESS GREW SIGNIFICANTLY





OUR NEW BRANCH AT BAHRAIN FINANCIAL HARBOUR WILL PROVIDE ANOTHER CONVENIENT POINT OF CONTACT FOR OUR CUSTOMERS AND ENABLE US TO OPTIMALLY UTILISE OUR INFRASTRUCTURE

CHIEF EXECUTIVE OFFICER'S REPORT (CONTINUED)

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. This product was successfully exited during the second quarter of the year.

RIA 3 - Aramis (exited in 2008):

Launched and closed in May 2007, this US\$17.5 million Ria account offered customers an opportunity to participate in an enhanced murabaha backed by a Promjisory note issued by a Guarantor SPV with BBB+ rating. The Ria product had a 3 month rolling investment tenor with minimum subscription of US\$10,000. Investors were successfully exited from this investment during the second quarter of 2008.

RIA 4 - Janayen: Launched in June 2007, the offering to the investors was of approximately US\$55 million, with an investment term of 30 months and target total return on investment of just over 44%. This restricted Mudharaba investment account was designed to invest in income generating assets in the GCC/MENA regions. Total cash yield on portfolio is currently in the region of 11% p.a. with quarterly distributions of 2.75% which is over the quarterly distribution rate of 2.50% specified in the offering documents.

Danat India: 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 east of New Delhi.

Jawhara Greens: This US\$250 million Investment Company was launched in 2008. A company established with the principal purpose of owning the beneficial interest of a land (i.e. a 266,567 m² land site) in Lusail area of the state of Qatar. The investment will revolve around developing a master plan and basic infrastructure prior to selling the land plots to the developers and other interested parties. The investment period is 24 months with the objective to achieve a total return of 40% over the investment.

RIA 5 - North Gate: A Restricted Mudharabah Investment Account which owns a 6.0% stake in Shaden Real Estate Investment WLL which will in turn through its subsidiaries, hold a parcel of reclaimed land and measuring approximately 3.875 million sq. meter located in Al Hidd, Muharraq. The mixed-use plot will be sold to end-users subsequent to the completion of infrastructure works.

Global Logistix Navi Mumbai: Launched in June 2008. A company registered in the Cayman Islands with the principal purpose of indirectly owning 100% of the beneficial interest of a 400 acre site in Navi Mumbai, to develop a premium logistics park inclusive of a broad range of ancillary services.

Organisational developments

During 2008, 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 increased our employee numbers by 90% to 137, bringing

in specialist expertise to support the business infrastructure as well as customer facing operations of the Bank. We have also commenced a graduate trainee programme, with the objective of recruiting highly talented students and grooming them for senior roles in the banking industry.

We also built upon the progress made during earlier years in developing the Bank's corporate governance, risk management, and corporate policies, processes and procedures. As required by the rules of the Central Bank of Bahrain, an external consultant was assigned to undertake an assessment of the Bank's risk profile and risk management practices. The consultant has since completed the assignment.

We continue to develop our infrastructure. In June 2008, we moved into our new offices on four floors of Bahrain Financial Harbour.

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.

Ebrahim H. Ebrahim
Chief Executive Officer and Board Member

CORPORATE GOVERNANCE STRUCTURE

The Bank's corporate governance framework focuses on Board responsibility, oversight and management accountability vis-à-vis governing regulations and better practices. The framework is in line with global best practices and regulatory requirements which seek to balance entrepreneurship, control and transparency, while creating value for all stakeholders.

Corporate governance, the way the Board and Management is organised and how they operate in practice ultimately aims at leading the Bank toward 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 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 practices.

Board of Directors

The Board of Directors is currently comprised of ten members elected by the shareholders during the AGM held in February 2008 which represents the new and changed shareholding of the Bank. The Chairman of the Board of Directors is charged with regular supervision and assessment of executive management and is responsible for leading the Board, ensuring its effectiveness, monitoring the performance of the CEO and maintaining a dialogue with the Bank's stakeholders. The Board has constituted certain committees with specific delegated authorities to oversee and guide the management in specific areas of the Bank's operations and decision-making. The Board, either directly or through its various committees, will oversee the management of the Bank.

Board Committees Structure

The Board of Directors has constituted four Committees with specific delegated authorities.

- Board Audit Committee, which is responsible for internal and external audit, compliance and anti-money laundering.
- Board Investment & Credit 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, which is responsible for setting policies for compensation and incentives, human resources and administration. It is also responsible for the corporate governance framework of the Bank.
- Board Risk Management Committee, which is responsible for ensuring that the Bank's overall risk management framework is effective and that key risks are managed within parameters established by the Board.

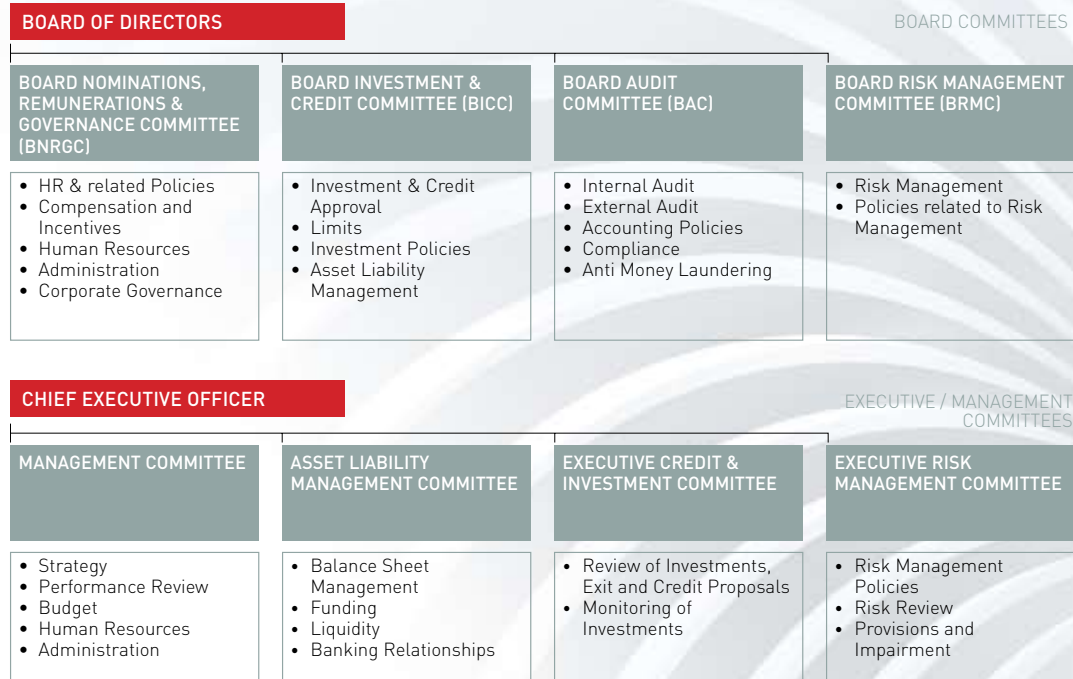
The Chairman, the Board of Directors and the Board Committees have direct access to the heads of Internal Audit, Risk Management, Regulatory Compliance and Shari'a Compliance.



During 2008, the Board of Directors held 5 meetings, the Board Investment & Credit Committee held 4 meetings, the Board Nomination, Remuneration & Governance Committee held 3 meetings, the Board Risk Management Committee held 2 meetings and the Board Audit Committee held 3 meetings.

Executive / Management Committee Structure

The Board of Directors delegates the authority for day-to-day management of the business to the Chief Executive Officer who is responsible for implementing the Bank's strategic plan. The CEO manages the Bank through the following management committees



RISK MANAGEMENT

Risk Management Framework

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 risk 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 optimise 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 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 will report regularly to the Board Risk Management Committee. The Risk Management department of the Bank, independent of the business units, is responsible for the day to day oversight and

management of the various risks faced by the Bank. 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 of Directors.

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, as well as 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.

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 for the creation of adequate allowance for impairment losses that represents the estimated future loss on its portfolio.

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), that 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. As on date, the Bank does not have an active trading book.

Operational Risk

Operational risk is the risk of loss arising from systems and control failures, as well as 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. The operational risk management software, in order to comply with requirements of the Central Bank of Bahrain, is already in place.

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 CEO and is comprised of 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.

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.

Foreign Exchange Risk

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

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.

RISK MANAGEMENT

(CONTINUED)

Capital Adequacy & the Internal Capital Adequacy Assessment Process (ICAAP)

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, the CBB requires the Bank to maintain a prescribed ratio of total capital to total risk-weighted assets. Effective January 2008, the Bank was subject to a new capital adequacy framework in compliance with Basel 2 requirements. The Board of Directors of the Bank has approved an Internal Capital Adequacy Assessment process, 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 Internal Capital Adequacy Assessment Process (ICAAP) is a requirement of Pillar II of Basel 2 for capital management and comprises of procedures and measures designed to ensure appropriate identification, measurement, aggregation and monitoring of the Bank's risks. In addition, it is a requirement to maintain an appropriate level of internal capital in relation to the Bank's overall risk profile and business plan.

The Bank has adopted a structured approach to identify and assess all of its material risks (Pillar I & II) by employing different methodologies and their sum will be calculated to determine the resulting capital needs. The ICAAP also establishes guidelines to incorporate the future capital needs of the Bank in line with its business plans over its strategic time horizon. In doing so, the Bank performs sensitivity analysis to determine how sensitive its capital is to changes in internal and external factors such as business risks and changes in business cycles.

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, leading 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.

Disclosures

The Bank recognizes its continuous disclosure obligations set forth by the Central Bank of Bahrain (CBB), Bahrain Stock Exchange and other relevant regulatory bodies. The Bank has approved policies related to External Communications & Disclosures in line with Basel & CBB requirements which ensure disclosure of all relevant information to stakeholders on a timely basis in a timely manner.

The Pillar III disclosure requirements prescribed by the Central Bank of Bahrain (CBB) are disclosed through this annual report in the general sections, as part of the notes to financial statements or in the section titled Pillar 3 disclosures.

SHARI'A SUPERVISORY BOARD REPORT

ON THE ACTIVITIES OF KHALEEJI COMMERCIAL BANK BSC
FOR THE FINANCIAL YEAR ENDING 31 DECEMBER 2008

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 has reviewed the Bank's activities through its annual review and through shari'a compliance department and compared them with the previously issued fatwas and rulings during the financial year ending 31st December 2008 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 on 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 an Income Statement for the financial year ended 31 December 2008 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 charity account 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.

Praise 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
Member

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS

KHALEEJI COMMERCIAL BANK BSC

26 January 2009

Manama, Kingdom of Bahrain

Report on the consolidated financial statements

We have audited the accompanying consolidated financial statements of Khaleeji Commercial Bank B.S.C. ("the Bank") and its subsidiary (together the "Group"), which comprise the consolidated balance sheet as of 31 December 2008, and the consolidated income statement, the consolidated statement of changes in equity, the consolidated statement of cash flows, the consolidated statement of changes in restricted investment accounts and the consolidated statement of sources and uses of charity and zakah fund for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Respective responsibilities of board of directors and auditors

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

Basis of opinion

We conducted our audit in accordance with Auditing Standards for Islamic Financial Institutions issued by Accounting and Auditing Organisation for Islamic Financial Institutions. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated 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 consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 31 December 2008 and the results of its operations, changes in its consolidated 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 consolidated financial statements that are in agreement therewith. We have reviewed the accompanying report of the Chairman and confirm that the information contained therein is consistent with the consolidated 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
26 January 2009



STRENGTH IN DIRECTION
FINANCIAL STATEMENTS 2008



CONSOLIDATED BALANCE SHEET

AS AT 31 DECEMBER 2008

	Note	31 December 2008	BD 000's 31 December 2007
ASSETS			
Cash and bank balances	3	23,378	6,169
Placements with financial institutions	4	131,952	79,065
Islamic financing assets	5	140,143	75,462
Investment securities	6	102,398	70,739
Assets acquired for leasing	7	23,482	12,986
Investment in associates	8	6,385	6,683
Asset held-for-sale	9	5,655	-
Other assets	10	26,077	17,028
Equipment	11	5,523	1,379
Total assets		464,993	269,511
LIABILITIES			
Investors' funds	12	53,359	11,953
Placements from financial institutions and others		30,229	41,561
Customers' current accounts		69,024	10,724
Other liabilities	13	11,583	6,183
Total liabilities		164,195	70,421
Unrestricted investment accounts	14	162,816	64,100
EQUITY			
Share capital	15	100,000	100,000
Share premium		581	-
Statutory reserve		5,988	3,258
Treasury shares		(4,915)	-
Unvested employee incentive scheme shares		(2,380)	-
Share grant reserve		442	2,630
Retained earnings		38,266	29,102
Total equity (page 30)		137,982	134,990
Total liabilities, unrestricted investment accounts and equity		464,993	269,511
Off-balance sheet items			
Restricted investment accounts (page 32)		47,445	42,965

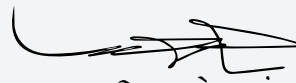
The financial statements, which consist of pages 28 to 70, were approved by the Board of directors on 26 January 2009 and signed on its behalf by:



Dr. Fuad Abdulla Al-Omar
Chairman



Dr. Esam Yousif Janahi
Vice-Chairman



Ebrahim Hussain Ebrahim
Chief Executive Officer & Board member

The accompanying notes 1 to 35 form an integral part of these consolidated financial statements.

CONSOLIDATED INCOME STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2008

	Note	2008	BD 000's 2007
Income from investment banking services		32,338	14,324
Placement, management and arrangement fees		1,349	2,301
Income from placements with financial institutions		3,612	4,197
Income from Islamic financing assets and assets acquired for leasing		10,628	3,508
Income from investment securities	16	4,800	5,490
Income from investment in properties		-	2,484
Share of profits from associate companies	8	762	105
Other income		1,289	-
Total income before return on unrestricted investment accounts		54,778	32,409
Less: Return on unrestricted investment accounts	14	(7,050)	(2,446)
Total net income		47,728	29,963
Staff cost	17	7,992	5,907
Financing expenses		2,190	1,653
Impairment allowances	18	5,824	-
Investments related expenses		861	488
Other expenses	19	3,557	1,079
Total expenses		20,424	9,127
PROFIT FOR THE YEAR		27,304	20,836
Basic earnings per share (fils)	24	27.81	25.47
Diluted earnings per share (fils)	24	27.58	25.44

The accompanying notes 1 to 35 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31 DECEMBER 2008

31 December 2008	Share capital	Share premium	Statutory reserve	Treasury shares	Unvested employee incentive scheme shares	Share grant reserve	Retained earnings	BD 000's
								Total
Balance at 1 January 2008	100,000	-	3,258	-	-	2,630	29,102	134,990
Profit for the year	-	-	-	-	-	-	27,304	27,304
Total recognised income and expense for the year	-	-	-	-	-	-	27,304	27,304
Transfer to statutory reserve	-	-	2,730	-	-	-	(2,730)	-
Treasury shares acquired	-	-	-	(8,368)	-	-	-	(8,368)
Treasury shares sold	-	-	-	3,453	-	-	-	3,453
Treasury shares acquired for employee incentive scheme (note 20)	-	-	-	-	(3,648)	-	-	(3,648)
Reserve utilised towards acquisition of shares for employee incentive scheme	-	-	-	-	-	(2,106)	-	(2,106)
Vesting charge for the year	-	-	-	-	-	499	-	499
Adjustment for vesting and issue of shares	-	581	-	-	1,268	(581)	-	1,268
Transfer to charity fund (2007)	-	-	-	-	-	-	(250)	(250)
Directors fees (2007)	-	-	-	-	-	-	(160)	(160)
Dividend declared (2007)	-	-	-	-	-	-	(15,000)	(15,000)
Balance at 31 December 2008	100,000	581	5,988	(4,915)	(2,380)	442	38,266	137,982
31 December 2007	Share capital	Share premium	Statutory reserve	Treasury shares	Unvested employee incentive scheme shares	Share grant reserve	Retained earnings	Total
Balance at 1 January 2007	30,154	-	1,174	-	-	680	10,565	42,573
Profit for the year	-	-	-	-	-	-	20,836	20,836
Total recognised income and expense for the year	-	-	-	-	-	-	20,836	20,836
Transfer to statutory reserve	-	-	2,084	-	-	-	(2,084)	-
Shares issued during the year	69,846	-	-	-	-	-	-	69,846
Unvested share grants	-	-	-	-	-	1,657	-	1,657
Vesting charge for the year	-	-	-	-	-	293	-	293
Transfer to charity fund (2006)	-	-	-	-	-	-	(150)	(150)
Directors fees (2006)	-	-	-	-	-	-	(65)	(65)
Balance at 31 December 2007	100,000	-	3,258	-	-	2,630	29,102	134,990

The accompanying notes 1 to 35 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED 31 DECEMBER 2008

	Note	2008	BD 000's 2007
OPERATING ACTIVITIES			
Proceeds from investment banking services		28,390	1,590
Islamic financing, net		(56,881)	(60,260)
Placement, management and arrangement fees received		2,480	1,170
Income from placements with financial institutions received		3,612	4,197
Investors' funds received/ (paid), net		40,531	6,736
Returns paid to unrestricted investment accounts		(6,159)	(2,092)
Receipts from unrestricted investment account holders, net		98,716	41,887
Payment for expenses		(9,846)	(3,914)
Disbursements for ijarah assets, net		(10,339)	(12,984)
Directors fees paid		(160)	-
Net increase in customers' current accounts		58,300	7,973
Proceeds from other income		324	-
Cash flows from operating activities		148,968	(15,697)
INVESTING ACTIVITIES			
Purchase of investment securities		(50,150)	(54,697)
Proceeds from sale of investment securities		11,912	16,090
Dividend/ income from investment securities received		5,045	1,477
Purchase of investment in associates		-	(6,578)
Distributions from investment in associates received		1,060	-
Purchase of asset held-for-sale		(5,655)	-
Proceeds from sale of investments in properties		621	21,746
Purchase of equipment and capital advances made		(4,620)	(732)
Cash flows from investing activities		(41,787)	(22,694)
FINANCING ACTIVITIES			
Proceeds from issue of share capital		-	69,846
Placements from financial institutions and other, net		(11,332)	19,310
Net payment for treasury shares		(4,915)	-
Purchase of treasury shares for employee incentive scheme		(3,648)	-
Finance expenses paid		(2,190)	(1,653)
Dividends paid		(15,000)	-
Cash flows from financing activities		(37,085)	87,503
Net increase (decrease) in cash and cash equivalents		70,096	49,112
Cash and cash equivalents at 1 January		85,234	36,122
Cash and cash equivalents at 31 December		155,330	85,234
Cash and cash equivalent comprise:			
Cash and bank balances	3	23,378	6,169
Placements with financial institutions	4	131,952	79,065
		155,330	85,234

The accompanying notes 1 to 35 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN RESTRICTED INVESTMENT ACCOUNTS

FOR THE YEAR ENDED 31 DECEMBER 2008

31 December 2008	Balance at 1 January 2008			Movements during the year						Balance at 31 December 2008		
	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
Al Hareth French Property Fund	17.05	556.51	9,489	-	(317)	918	(871)	(46)	(1)	17.05	537.95	9,172
Safana Investment WLL (RIA 1)	9,563	1.00	9,563	-	-	-	-	-	-	9,563	1.00	9,563
Hajer Tower, Mecca (RIA 2)	3,021	0.377	1,139	(1,139)	-	170	(170)	-	-	-	-	-
Aramis (RIA 3)	7,685	0.377	2,912	(2,912)	-	-	-	-	-	-	-	-
Janayen Holding Limited (RIA 4)	52,684	0.377	19,862	-	-	3,506	(2,180)	-	(578)	52,684	0.39	20,610
Shaden Real Estate Investment WLL (RIA 5)	-	-	-	8,100	-	-	-	-	-	8,100	1.00	8,100
			42,965	4,049	(317)	4,594	(3,221)	(46)	(579)			47,445

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
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
Safana Investment WLL (RIA 1)	-	-	-	9,563	-	-	-	-	-	9,563	1.00	9,563
Hajer Tower, Mecca (RIA 2)	-	-	-	1,139	-	-	-	-	-	3,021	0.377	1,139
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
			12,177	28,996	1,525	1,721	(1,370)	(84)	-			42,965

* Includes foreign exchange gain of BD 317 thousands on revaluation of investments.

** Includes foreign exchange gain of BD 1,525 thousands on revaluation of investments.

The accompanying notes 1 to 35 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF SOURCES AND USES OF CHARITY AND ZAKAH FUND

FOR THE YEAR ENDED 31 DECEMBER 2008

	2008	BD 000's 2007
Sources of charity and zakah fund		
Contributions by the Bank	250	150
Non-Islamic income	4	3
Late payment fees collected from customers	32	-
Total sources	286	153
Uses of charity fund and zakah fund		
Contributions to charitable organisations	-	-
Total uses	-	-
Excess of sources over uses	286	153
Balance at the beginning of the year	156	3
Undistributed charity and zakah fund at 31 December (note 13)	442	156

The accompanying notes 1 to 35 form an integral part of these consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2008

1 INCORPORATION AND PRINCIPAL ACTIVITY

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

During the year, the Bank's legal status was changed to a public stockholding company and its shares were listed on the Bahrain Stock Exchange (BSE). The shares commenced trading on 12 June 2008.

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.

During the year, the Bank set up a wholly owned subsidiary, Hawafiz Khaleeji Management Company BSC (c) ('Hawafiz'), to manage its employee incentive scheme. Accordingly, the financial statements for the year ended 31 December 2008 has been prepared on a consolidated basis and comprise the financial statements of the Bank and its subsidiary (together referred to as "the Group") and the Group's interest in associates.

2 SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies applied in the preparation of these consolidated 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 that are not covered by AAOIFI standards, the Group uses guidance from the relevant International Financial Reporting Standard.

(b) Basis of preparation

The consolidated financial statements are presented in Bahraini Dinars, being the principal currency of the Bank's operations. They are prepared on the historical cost basis except for the measurement at fair value of certain available-for-sale investments and derivative financial instruments.

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 Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in note 21.

(c) Basis of consolidation

(i) Subsidiaries

The consolidated financial statements of the Group comprise the financial statements of the Bank and its subsidiary. Subsidiaries are those enterprises (including special purpose vehicles) controlled by the Bank. Control exists when the Group has the power, directly or indirectly, to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities. Subsidiaries are consolidated from the date on which control is transferred to the Group and de-consolidated from the date that control ceases.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2008

2 Significant accounting policies (continued)

(c) Basis of consolidation (continued)

(ii) Associates

Associates are those enterprises in which the Group hold, directly or indirectly, more than 20% of the voting power and exercises significant influence, but not control, over the financial and operating policies. The financial statements include the Company's share of the total recognised gains and losses of the associates on an equity accounted basis from the date that significant influence commences until the date that the significant influence ceases. When the Group's share of losses exceeds its interest in an associate, the Group's carrying amount is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of an associate.

(iii) Transactions eliminated on consolidation

Intra-group balances and transactions, and any unrealised gains arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Unrealised losses are also eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment. Accounting policies of the subsidiary and associates have been changed where necessary to ensure consistency with the policies adopted by the Group.

(d) Foreign currency transactions

Items included in the consolidated financial statements of the Group are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The consolidated 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.

The other Group companies functional currencies are either denominated in Bahraini dinars or US dollars which is effectively pegged to the Bahraini dinar. Hence, the translation of financial statements of the group entities that have a functional currency different from the presentation currency do not result in exchange differences.

(e) Investment securities

Investment securities are non-derivative investments of the Bank and exclude investments in subsidiaries and associate companies. Investment securities comprise of equity investments in entities where the Bank holds less than 20% of the equity interest in an entity and investment in sukuks (Islamic bonds).

(i) Classification

Investment in equity securities are classified either as trading or available-for sale.

Trading investments are those investments which the Group acquires or incurs principally for the purpose of selling or repurchasing in the near term, or holds as part of a portfolio that is managed together for short-term profit or position taking. The Bank currently does invest in trading securities.

Held-to-maturity investments are financial assets with fixed or determinable payments and fixed maturity that the Group has the positive intention and ability to hold to maturity, and which are not designated as trading or as available-for-sale. These include investments in medium to long-term sukuks.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2008

2 Significant accounting policies (continued)

(e) Investment securities (continued)

(i) Classification (continued)

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 and short-term sukuk which the Bank may not hold till maturity.

(ii) Recognition and de-recognition

Trading investments are initially recognised at fair value and transaction cost are expensed in the income statement. Other investment securities are recognised initially at fair value, plus attributable transaction costs. Investment securities are derecognised when the rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all risk and rewards of ownership.

(iii) Measurement

Investment securities are measured initially at fair value, which is the value of the consideration given, including transaction costs.

Subsequent to initial recognition, held-to-maturity investments are measured at amortised cost using the effective profit method less any impairment allowances.

Subsequent to initial recognition, available-for-sale investments are re-measured to fair value. Available-for-sale investments which do not have a quoted market price or other appropriate methods from which to derive reliable fair values, are stated at cost less impairment allowances. Fair value changes on available-for-sale investments 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.

(iv) Measurement principles

Amortised cost measurement

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortisation using the effective profit method of any difference between the initial amount recognised and the maturity amount, minus any reduction for impairment. The calculation of the effective profit rate includes all fees and points paid or received that are an integral part of the effective profit rate.

Fair value measurement

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

The Group measures the fair value of quoted investments using the market bid-prices in an active market for that instrument.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2008

2 Significant accounting policies (continued)

(f) Islamic financing assets

Islamic financing assets comprise shari'a compliant retail and commercial financing provided by the Bank with fixed or determinable payments. These include financing provided through Murabaha, Musharaka, Istisna and Wakala contracts. Islamic financing assets are stated at their amortised cost less impairment allowances, if any.

(g) Placements with and from financial institutions

These mainly comprise placements made and received in the form of international commodity murabaha contracts. Placements are usually for short-term and are stated at their amortised cost.

(h) 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.

(i) Derivative financial instruments

Derivative financial instruments are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at their fair value. The fair value of a derivative is the equivalent of the unrealised gain or loss from marking to market the derivative using prevailing market rates. Derivatives with positive market values (unrealised gains) are disclosed under other assets and derivatives with negative market values (unrealised losses) are disclosed under other liabilities in the balance sheet. For derivatives that are not designated in a qualifying hedge relationship, all changes in its fair value are recognised immediately in the income statement.

(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 and 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. For balance sheet presentation purposes, assets acquired for leasing include the amount of instalments receivable from customers at the balance sheet date in relation to the leased assets.

(l) Assets held-for-sale

The Group classifies non-current assets or disposal groups as held for sale if its carrying amount is expected to be recovered principally through a sale transaction rather than through continuing use within twelve months. Non-current assets or disposal groups classified as held for sale are measured at the lower of its carrying amount and fair value less costs to sell.

(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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2008

2 Significant accounting policies (continued)

(n) Customers' current accounts

Balances in current (non-investment) accounts are recognised when received by the Bank. The transaction are measured by the amount received by the Bank at the time of contracting. At the end of the accounting period, the accounts are measured at their book value.

(o) Treasury shares

The amount of consideration paid including all directly attributable costs incurred in connection with the acquisition of the treasury shares are recognised in equity. Consideration received on sale of treasury shares is presented in the financial statements as a change in equity. No gain or loss is recognised on the Group's income statement on the sale of treasury shares.

(p) 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.

(q) Impairment of assets

The Bank assesses at each balance sheet date whether there is objective evidence that a asset is impaired. Objective evidence that financial assets (including equity securities) are impaired can include default or delinquency by a borrower, restructuring of a loan or advance by the Group on terms that the Group would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group. In addition, for an investment in an equity security, a significant or prolonged decline in its fair value below its cost is objective evidence of impairment.

Financial assets carried at amortised cost

For financial assets carried at amortised cost impairment is 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. When a subsequent event causes the amount of impairment loss to decrease, the impairment loss is reversed through the income statement. The Group considers evidence of impairment for Islamic financing assets and held-to-maturity investments at both a specific asset and collective level. All individually significant Islamic financing assets and held-to-maturity investments are assessed for specific impairment. All individually significant financial assets found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Islamic financing assets and held-to-maturity investments that are not individually significant are collectively assessed for impairment by grouping together assets with similar risk characteristics.

Available-for-sale investments

In the case of investments in equity securities classified as available-for-sale and measured at fair value, 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. For available-for-sale investments carried at cost, the Group makes an assessment of whether there is an objective evidence of impairment for each investment by assessment of financial and other operating and economic indicators. Impairment is recognised if the estimated recoverable amount is assessed to be below the cost of the investment.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2008

2 Significant accounting policies (continued)

(q) Impairment of assets (continued)

Other non-financial assets

The carrying amount of the Group's assets (other than for financial assets covered above), 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.

(r) Revenue recognition

Income from investment banking services is recognised as per contractual terms when the service is provided and income is earned. This is usually when the Bank has performed all significant acts in relation to a transaction and it is highly probable that the economic benefits from the transaction will flow to the Bank. Significant acts in relation to a transaction is determined based on the terms agreed in the private placement memorandum/ contracts for each transaction. The assessment of whether economic benefits from a transaction will flow to the Bank is based on the extent of binding firm commitments received from underwriters and placements made with external investors. Income from investment banking services received in-kind in the form of shares is measured at the fair value of the consideration received. Generally the shares received are in privately held entities and there is no immediate market for trading. Fair value of consideration received in-kind is measured by reference to the transaction price paid by investors and as per the agreed pricing terms specified in the private placement memorandums.

Fees and commission income that are integral to the effective profit rate on a financial asset carried at amortised cost are included in the measurement of the effective profit rate of the financial asset. Other fees and commission income, including account servicing fees, sales commission, management fees, placement and arrangement fees and syndication fees, are recognised as the related services are performed. When an Islamic financing commitment is not expected to result in the draw-down of that commitment, financing commitment fees are recognised on a straight-line basis over the commitment period.

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

Profit or losses in respect of the Bank's share in **Musharaka financing** transaction that commence and end during a single financial period is recognised in the Income Statement at the time of liquidation (closure of the contract). Where the Musharaka financing continues for more than one financial period, profit is recognised to the extent that such profits are being distributed during that period in accordance with profit sharing ratio as stipulated in the Musharaka agreement.

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 for leasing (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.

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2008

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) 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, reserves (Profit equalisation reserve and Investment risk reserve) 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.

Unrestricted investment accounts are carried at their book values and include amounts retained towards profit equalisation and investment risk reserves. Profit equalisation reserve is the amount appropriated by the Bank out of the Mudaraba income, before allocating the mudarib share, in order to maintain a certain level of return to the deposit holders on the investments. Investment risk reserve is the amount appropriated by the Branch out of the income of unrestricted investment account holders, after allocating the mudarib share, in order to cater against future losses for investment account holders. Creation of an these reserves results in an increase in the liability towards the pool of unrestricted investment accounts.

(u) 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. Assets that are held in such capacity are not included as assets of the Bank in the consolidated financial statements.

(v) Employee benefits

(i) Short-term benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. A provision is recognised for the amount expected to be paid under short-term cash bonus or profit-sharing plans if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

(ii) Post-employment benefits

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. Contributions by the Bank are recognised as an expense in income statement when they are due.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2008

2 Significant accounting policies (continued)

(u) Employee benefits (continued)

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.

These benefits qualify as "defined benefit scheme" and any increase or decrease in the benefit obligation is recognised in the income statement.

The Bank also operates a voluntary employees saving scheme under which the Bank and the employee contribute monthly on a fixed percentage of salaries basis. The scheme is managed and administered by a board of trustees. The scheme is in the nature of a defined contribution scheme and contributions by the Bank are recognised as an expense in the income statement when they are due.

(iii) Share-based employee incentive scheme

The Bank operates a share-based incentive scheme for its employees (the "Scheme") whereby employee are granted the Bank's shares as compensation on achievement of certain non-market based performance conditions and additional service conditions (the 'vesting conditions').

The grant date fair value of equity instruments 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 share awards. The amount recognised as an expense is adjusted to reflect the number of share awards for which the related service and non-market performance vesting conditions are expected to be met, such that the amount ultimately recognised as an expense is based on the number of share awards that do meet the related service and non-market performance conditions at the vesting date.

(w) 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.

(x) Dividends and board remuneration

Dividends to shareholders and board remuneration are recognised as liabilities in the period in which they are declared.

(y) Provisions

A provision is recognised if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation.

(z) 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 CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2008

3 CASH AND BANK BALANCES

	2008	BD 000's 2007
Cash	309	374
Balances with banks	4,867	1,670
Balances with the Central Bank		
- Current account	5,588	1,060
- Reserve account	12,614	3,065
	23,378	6,169

The reserve account with the Central Bank of Bahrain is not available for day-to-day operational purposes.

4 PLACEMENTS WITH FINANCIAL INSTITUTIONS

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

	2008	BD 000's 2007
Gross Murabaha receivable	132,016	79,175
Less: Deferred profits	(64)	(110)
	131,952	79,065

The average profit rate on placement with financial institutions for 2008 was 2.3% per annum (2007: 5.04% per annum).

5 ISLAMIC FINANCING ASSETS

	2008	BD 000's 2007
Murabaha	123,325	55,606
Musharaka	13,278	5,176
Wakala	7,096	13,884
Istisna	688	796
	144,387	75,462
Less: Impairment allowances – specific	(2,828)	-
Less: Impairment allowances – collective	(1,416)	-
At 31 December	140,143	75,462

Murabaha financing receivables are net of deferred profits of BD 9,296 thousand (2007: BD 2,051 thousand).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2008

6 INVESTMENT SECURITIES

	2008	BD 000's 2007
Available-for-sale investments		
- Equity securities (quoted)	170	-
- Equity securities (unquoted)	54,930	37,927
- Sukuks	16,910	-
Held-to-maturity investments		
- Sukuks	30,388	32,812
At 31 December	102,398	70,739

Unquoted available-for-sale investments comprise investments in closed companies managed by external investment managers or represent investments in projects promoted by the Group. The Group intends to exit these investments principally by means of private placements, strategic buy outs or through initial public offerings.

The movement in impairment allowances for available-for-sale investments were as follows:

	2008	BD 000's 2007
At 1 January	-	-
Impairment allowances on equity securities (quoted)	396	-
Impairment allowances on equity securities (unquoted)	1,184	-
At 31 December	1,580	-

7 ASSETS ACQUIRED FOR LEASING

	Property	Equipment	2008	BD 000's 2007
Cost				
Opening balance	7,994	4,869	12,863	-
Additions during the year	9,630	3,186	12,816	12,863
Settlements during the year	(650)	-	(650)	-
At 31 December	16,974	8,055	25,029	12,863
Accumulated Depreciation				
Opening balance	1,300	733	2,033	-
Charge for year	2,840	2,295	5,135	2,033
Settlements during the year	(650)	-	(650)	-
At 31 December	3,490	3,028	6,518	2,033
Net book value				
At 31 December	13,484	5,027	18,511	10,830
Add: Lease installments receivable	4,031	940	4,971	2,156
Balance at 31 December	17,515	5,967	23,482	12,986

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2008

8 INVESTMENT IN ASSOCIATES

	2008	BD 000's 2007
At 1 January	6,683	-
Additions during the year	-	6,578
Distributions during the year	(1,060)	-
Share of profits for the year	762	105
At 31 December	6,385	6,683

Summarised financial information of associates that have been equity accounted not adjusted for the percentage ownership held by the Group (based on unaudited management accounts)

	2008	BD 000's 2007
Total assets	31,513	15,415
Total liabilities	7,829	5
Total revenues	2,084	806
Total net profits	1,599	575

9 ASSET HELD-FOR-SALE

Assets-held-for sale comprise an investment in associate company made during the year which the Bank intends to structure and place with investors within 12 months.

10 OTHER ASSETS

	2008	BD 000's 2007
Income from investment banking services receivable	17,128	13,180
Placement fees receivable	-	1,131
Income from sukuk receivable	803	1,047
Fair value of derivative financial instruments	811	-
Investment in property	-	621
Advance towards investments	5,000	-
Prepayments and other receivables	2,335	1,049
	26,077	17,028

The Bank does not engage in proprietary trading activities in derivatives. However, the Bank enters into shari'a compliant foreign exchange risk management transactions to hedge economic risks to cover significant open positions under its risk management guidelines. These instruments are not specifically designated for hedge accounting purposes. Consequently, only the gains or losses resulting from the re-measurement to fair value of these instruments are taken to the income statement.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2008

11 EQUIPMENT

	Furniture and fixtures	Computers	Motor Vehicle	Other Equipment	Work in Progress	2008 Total	BD 000's 2007 Total
Cost							
Balance as at 1 January	416	913		27	347	1,703	971
Additions	3,015	1,018	73	71	736	4,913	732
Disposals/ capitalisation	(1)	(1)	-	-	(291)	(293)	-
At 31 December	3,430	1,930	73	98	792	6,323	1,703
Accumulated Depreciation							
Balance as at 1 January	152	164	-	8	-	324	111
Charge for year	90	364	8	14	-	476	213
Disposals	-	-	-	-	-	-	-
At 31 December	242	528	8	22	-	800	324
Net book value							
at 31 December 2008	3,188	1,402	65	76	792	5,523	1,379
Net book value at 31 December 2007	264	749	-	19	347	1,379	-

12 INVESTORS' FUNDS

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

13 OTHER LIABILITIES

	2008	BD 000's 2007
Employee related accruals	5,852	2,783
Accounts payable	3,546	2,830
Charity payable (page 33)	442	156
Other payables and accrued expenses	1,743	414
	11,583	6,183

14 UNRESTRICTED INVESTMENT ACCOUNTS

The average gross rate of return in respect of unrestricted investment accounts during the year was 7% (2007: 8.50%). Approximately 5.5% (2007: 5.21%) 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 649 thousand (2007: BD 205 thousand) and investment risk reserve of BD 473 thousand (2007: BD 134 thousand).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2008

14 UNRESTRICTED INVESTMENT ACCOUNTS (continued)

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

	2008	BD 000's 2007
Investment in sukuks	47,298	32,812
Islamic financing assets	140,143	75,462

15 SHARE CAPITAL

	2008	BD 000's 2007
Authorised:		
3,000,000,000 ordinary shares of BD 0.100 each	300,000	300,000
Issued and fully paid up:		
1,000,000,000 ordinary shares of BD 0.100 each	100,000	100,000

Distribution schedule of equity shares, setting out the number of holders and percentage in the following categories:

Categories*	Number of Shares	Number of Shareholders	% of total outstanding shares
Less than 1%	103,795,340	503	10.38
1% up to less than 5% **	196,554,681	10	19.66
5% up to less than 10%	90,000,000	1	9.00
10% up to less than 20%	240,000,000	2	24.00
20% and less than 50%	369,649,979	1	36.96
	1,000,000,000	517	100.00

* Expressed as a percentage of total outstanding shares of the Bank.

** Includes treasury shares and unvested employee incentive scheme shares

The Bank has only one class of equity shares and the holders of these shares have equal voting rights.

Names and nationalities of the major shareholders and the number of equity shares held in which they have an interest of 5% or more of outstanding shares

	Nationality	Number of shares	% of total outstanding shares
Gulf Finance House BSC	Bahrain	369,649,979	36.96
Al Imtiaz Investment Company KSCC	Kuwait	140,000,000	14.00
Dr. Esam Yousif Abdulla Janahi	Bahrain	100,000,000	10.00
Emirates Islamic Bank PJSC	UAE	90,000,000	9.00

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2008

16 INCOME FROM INVESTMENT SECURITIES

	2008	BD 000's 2007
Income from available-for-sale investments:		
- Dividend income	659	658
- Profit on sale of investments	2,159	3,127
- Income from Sukuks	91	-
	2,909	3,785
Income from held-to-maturity investments - Sukuks	1,891	1,705
	4,800	5,490

17 STAFF COST

	2008	BD 000's 2007
Salaries and benefits	7,667	5,712
Social insurance expenses	203	120
Other staff costs	122	75
	7,992	5,907

18 IMPAIRMENT ALLOWANCES

	2008	BD 000's 2007
Islamic financing assets (note 5)	4,244	-
Available-for-sale equity securities (note 6)	1,580	-
	5,824	-

19 OTHER EXPENSES

	2008	BD 000's 2007
Administration and support services	379	205
Premises	667	134
Advertisement and marketing	720	347
Printing and stationery	425	51
Professional fees	645	81
Shari'a committee expenses	49	16
Board expenses	139	9
Depreciation	476	213
Others	57	23
	3,557	1,079

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2008

20 SHARE-BASED EMPLOYEE COMPENSATION SCHEME

The Bank operates an equity-settled share-based incentive scheme for its employees (the "Scheme") whereby employees are granted the Bank's shares as compensation on achievement of certain non-market performance conditions. The Group has incorporated a special purpose vehicle, Hawafiz Khaleeji Management Company BSC (c) ('Hawafiz'), to hold the shares for the beneficial interest of the Scheme until they vest.

The shares granted vest to eligible employees in a staggered manner over a 5 year vesting period (service condition). The shares granted shall be eligible to receive dividends. 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 Hawafiz and may be offered to other employees as per the terms of the Scheme.

The maximum number of shares to be issued to employees under the scheme is 30.4 million ordinary shares at an exercise price of BD 0.12 per share, to be issued over the vesting period in accordance with the terms of the Scheme. Up to 31 December 2007, 17.48 million shares were granted to eligible employees. In April 2008, the Board of Directors resolved to grant the remaining 12.92 shares to eligible employees. During the year, the Bank, through Hawafiz, has acquired 30.4 million shares for the Scheme from Gulf Finance House BSC, a shareholder of the Bank to meet the settlement obligations under the scheme (note 23).

On a cumulative basis, 30.4 million share grants have been issued under the terms of Scheme of which 10,563 million shares have vested up to 31 December 2008. The Bank is in the process of issuing shares to employees in settlement of the vested share grants.

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 adjusted for exercise price and other terms of Scheme, over the period in which the employees become unconditionally entitled to the shares. The amount of vesting expense recognised is adjusted to reflect the actual number of share grants that vest. The fair value charge on the share grants awarded during the current year amounted to BD 1,033 thousand of which BD 389 thousand has been charged to the income statement during the year. The cumulative vesting expense for the period, net of reversals due to forfeitures, amounted to BD 499 thousand.

21 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.

Judgements

Classification of investments

In the process of applying the Group's accounting policies, management decides on acquisition of an investment whether it should be classified as held-to-maturity or available-for-sale investments. The classification of each investment reflects the management's intention in relation to each investment and is subject to different accounting treatments based on such classification [refer note 2 (e)].

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's intention and ability to make operational decisions for the SPE.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2008

21 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES (continued)

Estimations

Impairment of available-for-sale investments

The Group determines that available-for-sale equity securities are impaired when there is an objective evidence on impairment and 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. In case of quoted equity securities, the Group considers a decline of more than 30% in the fair value below cost to be significant and considers a decline below cost which persists for more than 6 months as prolonged. 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 (q). 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/ collaterals. 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. On evaluation of the portfolio for impairment on a collective basis, in view of the management, given the availability of collaterals and credit assessments made throughout the year, no additional impairment allowances are required on a collective basis.

22 ASSETS UNDER MANAGEMENT

The Bank provides corporate administration, investment management and advisory services to its project entities, which involve the Group making decisions on behalf of such entities. Assets that are held in such capacity are not included in these consolidated financial statements. At the balance sheet date, the Group had assets under management of BD 297.15 million (2007: BD 227.1 million). During the year, the Bank has charged management fees amounting to BD 188 thousands (2007: BD 84 thousands) for the management of assets.

23 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.

Details of Directors' interests in the Bank's ordinary shares as at the end of the year were :

Categories*	Number of Shares	Number of Directors
Less than 1%	7,859,801	5
1% up to 10%	100,000,000	1

* Expressed as a percentage of total outstanding shares of the Bank.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2008

23 RELATED PARTY TRANSACTIONS (continued)

A significant portion of the Bank's income from investment advisory services 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 2008	BD 000's 31 December 2007
Assets		
Placements with financial institution	154	41,155
Available-for-sale investments	35,953	22,728
Islamic financing assets	9,219	2,081
Other assets	19,022	13,195
Investment in associates	6,385	6,683
Investments in Sukuks	12,479	5,665
Liabilities		
Investors' funds	53,359	11,953
Placement from financial institutions and others	11,328	11,228
Customers' current accounts	12,133	2,513
Unrestricted investment accounts	10,601	8,089
Other liabilities	2,090	-
	2008	BD 000's 2007
Income		
Income from investment banking services	32,338	13,260
Placement, management and arrangement fees	964	841
Income from placements with financial institutions	503	3,816
Income from Islamic financing assets and assets acquired for leasing	606	87
Income from available-for-sale investments	2,931	210
Income from investment in sukuks	504	435
Income from investment in properties	-	-
Share of profits from associates	762	105
Other income	811	-
Expenses		
Murabaha expenses	366	42
Return on unrestricted investment accounts	1,115	187
Investments related expenses	-	16
Other expenses	-	-
Equity transactions		
Purchase of shares for the employee incentive scheme (note 20)	3,648	-

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2008

23 RELATED PARTY TRANSACTIONS (continued)

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:-

	2008	BD 000's 2007
Board member fees	250	160
Salaries and other short-term benefits	2,050	1,284
Equity settled-share based payments	1,853	850

Transactions with restricted investment accounts

Transactions involving transfer/ sale of assets to restricted investment accounts are generally executed based on the pre-agreed values as per the terms of the contracts for each restricted investment product. During the year, in its normal course of business, the Bank sold certain investments at agreed contractual values amounting to BD 8,100 thousand (2007: BD 33,476 thousand) to its restricted investment accounts at a profit of BD 2,100 thousand (2007: BD 3,128 thousand). Further, during the period the Bank purchased financial assets amounting to BD 2,912 on maturity of a restricted investment account during the year.

Details of material contracts involving Directors' include:

	2008	BD 000's 2007
Participation in investments promoted by the Group	-	57
Financing facilities provided to companies in which Directors' are interested	13,045	4,161

The financing facilities have been provided on commercial terms in the ordinary course of business of the Bank.

24 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. The Bank has dilutive equity instruments in the form of share grants in issue.

Basic EPS	2008	2007
Profit for the year (BD 000's)	27,304	20,836
Weighted average number of equity shares (Nos. in 000's)	981,749	818,209
Basic earnings per share (in fils)	27.81	25.47
Diluted EPS	2008	2007
Profit for the year (BD 000's)	27,304	20,836
Weighted average number of equity shares (Nos. in 000's)	989,732	819,072
Diluted earnings per share (in fils)	27.58	25.44

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2008

25 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.

26 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 2008 is 0.516 fils (2007: 0.386 fils) for every share held. (refer note 31).

27 MATURITY PROFILE

The maturity profile of for placements with and from financial institutions, Islamic financing assets and assets acquired for leasing assets has been presented using contractual cash flows. For other balances, maturity profile is based on expected cash flows/ settlement profile of the.

2008	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	23,378	-	-	-	-	23,378
Placements with financial institutions	131,952	-	-	-	-	131,952
Islamic financing assets	28,499	27,105	22,725	39,171	22,643	140,143
Investment securities	12,410	1,195	21,008	38,251	29,534	102,398
Assets acquired for leasing	1,561	1,839	692	9,221	10,169	23,482
Investment in associates	-	-	2,572	3,813	-	6,385
Asset held for sale	5,655	-	-	-	-	5,655
Other assets	26,077	-	-	-	-	26,077
Equipment	-	-	-	-	5,523	5,523
Total assets	229,532	30,139	46,997	90,456	67,869	464,993
Liabilities						
Investors funds	32,014	-	21,345	-	-	53,359
Placements with financial institutions and others	30,229	-	-	-	-	30,229
Customer current account	69,024	-	-	-	-	69,024
Other liabilities	11,583	-	-	-	-	11,583
Total liabilities	142,850	-	21,345	-	-	164,195
Unrestricted Investment accounts	144,322	-	18,494	-	-	162,816
Restricted Investment accounts	-	-	-	47,445	-	47,445
Commitments	18,443	10,402	7,611	-	-	36,465

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2008

27 Maturity profile (continued)

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
Islamic financing assets	23,657	9,816	12,551	16,751	12,687	75,462
Investment securities	277	11,010	3,692	27,910	27,850	70,739
Assets acquired for leasing	-	6,959	1,451	-	4,576	12,986
Investment in associates	-	-	-	3,592	3,091	6,683
Assets held for sale	-	-	-	-	-	-
Other assets	17,028	-	-	-	-	17,028
Equipment	-	-	-	-	1,379	1,379
Total assets	126,196	27,785	17,694	48,253	49,583	269,511
Liabilities						
Investors funds	11,953	-	-	-	-	11,953
Placements with financial institutions and others	41,561	-	-	-	-	41,561
Customer current account	10,724	-	-	-	-	10,724
Other liabilities	6,183	-	-	-	-	6,183
Total liabilities	70,421	-	-	-	-	70,421
Unrestricted investment accounts	55,058	7,679	1,363	-	-	64,100
Restricted Investment accounts	-	-	1,138	38,914	2,913	42,965
Commitments	4,835	3,978	9,282	-	-	18,095

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2008

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

(a) Industry sector

2008	Banks and financial institutions	Real estate	Others	BD 000's Total
Assets				
Cash and bank balances	23,378	-	-	23,378
Placements with financial institutions	131,952	-	-	131,952
Islamic financing assets	9,279	98,857	32,277	140,143
Investments securities	40,108	62,120	170	102,398
Assets acquired for leasing	-	15,965	7,517	23,482
Investment in associates	-	6,385	-	6,385
Asset held for sale	-	-	5,655	5,655
Other assets	987	18,458	6,632	26,077
Equipment	-	-	5,523	5,523
Total assets	205,704	201,515	57,774	464,993
Liabilities				
Investors' funds	-	53,359	-	53,359
Placements from financial institutions and others	30,229	-	-	30,229
Customers' current accounts	737	48,485	19,802	69,024
Other liabilities	-	-	11,583	11,583
Total liabilities	30,966	101,844	31,385	164,195
Unrestricted investment accounts	12,675	42,086	108,055	162,816
Off-Balance sheet items				
Restricted investment accounts	-	47,445	-	47,445

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2008

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

(a) Industry sector (continued)

2007	Banks and financial institutions	Real estate	Others	BD 000's Total
Assets				
Cash and bank balances	6,169	-	-	6,169
Placements with financial institutions	79,065	-	-	79,065
Islamic financing assets	6,459	44,528	24,475	75,462
Investment securities	11,059	59,680	-	70,739
Assets acquired for leasing	-	8,479	4,507	12,986
Investment in associates	-	6,683	-	6,683
Other assets	4,617	11,445	966	17,028
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	64,100
Off-Balance sheet items				
Restricted investment accounts	-	42,965	-	42,965

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2008

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

(b) Geographic region

2008	GCC countries	Europe	USA	Asia	Australia	Africa	BD 000's Total
Assets							
Cash and bank balances	21,699	207	1,472	-	-	-	23,378
Placements with financial institutions	125,725	6,227	-	-	-	-	131,952
Islamic financing assets	133,190	6,953	-	-	-	-	140,143
Investment securities	76,869	5,039	-	18,605	-	1,885	102,398
Assets acquired for leasing	23,482	-	-	-	-	-	23,482
Investment in associates	6,385	-	-	-	-	-	6,385
Asset held for sale	-	-	-	-	5,655	-	5,655
Other assets	26,077	-	-	-	-	-	26,077
Equipment	5,523	-	-	-	-	-	5,523
Total assets	418,950	18,426	1,472	18,605	5,655	1,885	464,993
Liabilities							
Investors' funds	53,359	-	-	-	-	-	53,359
Placements from financial institutions and others	30,229	-	-	-	-	-	30,229
Customers' current accounts	69,024	-	-	-	-	-	69,024
Other liabilities	11,583	-	-	-	-	-	11,583
Total liabilities	164,195	-	-	-	-	-	164,195
Unrestricted investment accounts	162,816	-	-	-	-	-	162,816
Restricted investment accounts	38,273	9,172	-	-	-	-	47,445

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2008

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

(b) Geographic region (continued)

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
Islamic financing assets	73,560	1,902	-	-	-	75,462
Investment securities	52,697	6,223	6,164	3,770	1,885	70,739
Assets acquired for leasing	12,986	-	-	-	-	12,986
Investment in associates	6,683	-	-	-	-	6,683
Other assets	17,028	-	-	-	-	17,028
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

29 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.

The fair values of quoted held-to-maturity Sukuks carried at amortised cost of BD 18,236 thousand (2007: 18,888 thousand) amounts to BD 15,569 thousand as at 31 December 2008.

Other than available-for-sale investments of BD 71,840 thousand (2007: BD 37,927 thousand), asset held-for-sale of BD 5,655 thousand and unquoted held-to-maturity investment in sukuks of BD 12,152 thousand (2007: 13,924 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 CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2008

30 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 also continuously monitors consistent implementation of the Board approved policies in the Bank and reports deviations if any to the Board. 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 exposures to placements with financial institutions, Islamic financing assets, outstanding balance of receivables against assets acquired for leasing, investment in Sukuks and financial assets receivables classified under other assets. For risk management reporting purposes, the Bank considers and consolidates all elements of credit risk exposure (such as individual and group exposure risk, country and sector concentration risk, related party exposure etc).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2008

30 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 Risk and Credit Management Department (RMD), 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 approval to the Board of Directors.
- 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 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 Chief Executive Officer, Chairman, Board Investment and Credit Committee or the full Board, as the case may be.
- Reviewing and assessing credit risk. RMD assesses all credit exposures and signs off on the relevant proposals prior to approval of the facilities by the appropriate authorities. Renewal and review 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 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. During the year Bank has restated the risk grades from alphabetic grades to numeric grades (1 to 10). The responsibility for setting risk grades lies with the final approving executive / committee as appropriate, on the recommendations of the RMD. Risk grades are subject to regular reviews by RMD.
- 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. RMD also provides 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 CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2008

30 Risk management (continued)

Exposure to credit risk

2008	Placements with financial institutions	Islamic financing assets	Assets acquired for leasing	Investment securities- Sukuks	Other assets	BD 000's Total
Impaired						
Grade 9: Impaired	-	6,600	-	-	-	6,600
Allowance for impairment	-	(2,828)	-	-	-	(2,828)
Carrying amount	-	3,772	-	-	-	3,772
Past Due but not impaired						
Grade 1-6 Low-Fair Risk	-	658	-	-	-	658
Grade 7-8 Watch list	-	4,610	-	-	-	4,610
Unrated	-	-	-	-	17,128	17,128
Past due comprises:						
0-30 days	-	658	-	-	17,128	17,786
30-60 days	-	4,610	-	-	-	4,610
60-90 days	-	-	-	-	-	-
90-180days	-	-	-	-	-	-
180 days +	-	-	-	-	-	-
Carrying amount	-	5,268	-	-	17,128	22,396
Neither past due nor impaired						
Grade 1-6 Low-Fair Risk	131,952	129,089	23,482	30,388	-	314,911
Grade 7,8: Watch list	-	3,430	-	-	-	3,430
Unrated	-	-	-	-	8,949	8,949
Carrying amount	131,952	132,519	23,482	30,388	8,949	327,290
Less:						
Collective impairment provisions	-	(1,416)	-	-	-	(1,416)
Total	131,952	140,143	23,482	30,388	26,077	352,042

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2008

30 Risk management (continued)

Exposure to credit risk (continued)

2007	Placements with financial institutions	Islamic financing assets	Assets acquired for leasing	Investment securities- Sukuku	Other assets	BD 000's Total
Impaired	-	-	-	-	-	-
Carrying amount	-	-	-	-	-	-
Past Due but not impaired						
Grade 1-6 Low-Fair Risk	-	1,763	-	-	-	1,763
Unrated	-	-	-	-	4,310	4,310
Past due comprises:						
0-30 days	-	-	-	-	-	-
30-60 days	-	1,763	-	-	-	1,763
60-90 days	-	-	-	-	-	-
90-180days	-	-	-	-	-	-
180 days +	-	-	-	-	4,310	-
Carrying amount	-	1,763	-	-	4,310	6,073
Neither past due nor impaired						
Grade 1-6 Low-Fair Risk	79,065	73,699	12,986	32,812	-	198,562
Unrated	-	-	-	37,927	12,097	50,024
Carrying amount	79,065	73,699	12,986	70,739	12,097	248,586
Total	79,065	75,462	12,986	70,739	16,407	254,659

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. Generally these assets fall under risk grades 9 or 10 (grades E to F in the erstwhile grading), for other financial assets impairment is assessed on an individual basis for each exposure under the Bank's internal credit risk grading system.

Past due but not impaired exposures

The exposure pertains to Islamic financing assets 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.

Past due but not impaired other assets primarily comprise income from investment banking services receivable. The Bank recognises investment banking income based on underwriting commitments and external placements with investors of the products promoted by the Bank. External placements are made with the Bank's select high net worth customer base which comprise sophisticated individual investors, corporates and financial institutions whose subscription commitments are settled within 90 days. As per the Bank's policy, the Bank only engages with underwriters (mainly regulated financial institutions) who satisfy the qualitative and quantitative credit criteria set by the Board of Directors of the Bank. In case of shortfall in placements, the underwriting commitments are required to be settled within six months of the date of the commitment.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2008

30 Risk management (continued)

Past due but not impaired exposures (continued)

As at 31 December 2008, due to current market liquidity conditions, the placement closure of certain products were delayed and the income receivable from investment banking services have been rendered past due. However, based on the funds collected till date and financial strength of the underwriters, the Bank does not consider these amounts to be impaired.

Renegotiated facilities

Exposures classified as neither past due nor impaired financing facilities include facilities renegotiated during the year amounting to BD 1,344 thousand (2007: Nil) that would otherwise be past due as per their original repayment terms. The renegotiated terms usually require settlement of profits accrued till date on the facility and obtaining of additional collateral coverage. The renegotiated facilities are subject to revised credit assessments and independent review by the RMD.

Allowances for impairment

The Bank makes provisions for impairment on individual assets classified under grades 9 and 10. This is done on the basis of the present value of projected future cash flows from the assets themselves or the collateral securities available. On a collective basis, the Bank has provided for impairment losses based on management's judgement on the current economic and credit conditions.

Write-off policy

The Bank writes off an asset / security balance (net of any related allowances for impairment losses) when 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.

Collaterals

The Bank holds collateral against Islamic financing assets and receivables from assets acquired for leasing 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. 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2008

30 Risk management (continued)

	As at 31 December 2008			As at 31 December 2007		
	Islamic financing assets	Assets acquired for leasing	Total	Islamic financing assets	Assets acquired for leasing	Total
Against impaired	-	-	-	-	-	-
Against past due but not impaired						
Property	4,671	-	4,671	-	-	-
Against neither past due nor impaired						
Property	150,537	36,270	186,807	56,858	12,664	69,522
Equities	11,833	-	11,833	5,554	-	5,554
Other	23,048	8,659	31,707	10,425	4,869	15,294
Total	190,089	44,929	235,018	72,837	17,533	90,370

For analysis of concentration of total assets and liabilities refer note 28 .

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:

Concentration by Sector	As at 31 December 2008			As at 31 December 2007		
	Islamic financing assets	Assets acquired for leasing	Total	Islamic financing assets	Assets acquired for leasing	Total
Financial	9,279	3,000	12,279	6,424	-	6,424
Real estate:						
- Property	45,378	12,404	57,782	20,796	8,479	29,275
- Infrastructure development	28,731	-	28,731	14,255	-	14,255
- Land	21,046	468	21,514	13,334	-	13,334
Construction	3,431	-	3,431	2,478	-	2,478
Trading	15,969	-	15,969	4,972	-	4,972
Manufacturing	4,031	-	4,031	-	-	-
Others	12,278	7,610	19,888	13,203	4,507	17,710
Total carrying amount	140,143	23,482	163,625	75,462	12,986	88,448

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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2008

30 Risk management (continued)

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 RMD.

Liquidity risk

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

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. The Bank has in place a Liquidity Contingency Plan, the elements of which are periodically tested. 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 2009. 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 bank balances and placements with financial Institutions less placements from financial institution, and deposits comprise current accounts, unrestricted investment Accounts and investors' funds. 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:

	2008	2007
At 31 December	49.80%	67.70%
Average for the period	61.30%	118.00%
Maximum for the period	108.60%	249.50%
Minimum for the period	45.90%	67.70%

For maturity profile of assets and liabilities refer note 27.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2008

30 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. Market risk comprises three types of risk: currency risk, profit rate risk and other price risk. 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. The Bank has no trading positions in equity or commodities and the main source of market risk for the Bank is its foreign exchange exposure.

The Bank does not do any trading in foreign exchange. The Bank does not engage in proprietary trading of foreign exchange derivatives. However, the Bank enters into shari'a compliant foreign exchange risk management transactions to hedge economic risks to cover significant open positions under its risk management guidelines. 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 rests with the Treasury department.

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

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 CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2008

30 Risk management (continued)

A summary of the Bank's profit rate gap position at 31 December 2008 is as follows:

2008	Up to 3 months	3 - 6 months	6 months- 1 year	1 - 3 years	More than 3 years	BD 000's Total
Assets						
Placements with financial institutions	131,952	-	-	-	-	131,952
Islamic Financing assets	37,326	27,105	22,725	30,753	22,234	140,143
Assets acquired for leasing	18,388	3,261	692	332	809	23,482
Investments securities (sukuks)	29,703	10,055	1,885	-	5,655	47,298
Total profit rate sensitive assets	217,369	40,421	25,302	31,085	28,698	342,875
Liabilities						
Placements from financial institutions and others	(30,230)	-	-	-	-	(30,230)
Investors funds	(32,015)	-	(21,344)	-	-	(53,359)
Unrestricted investments accounts	(144,322)	-	(17,373)	-	-	(161,695)
Total profit rate sensitive liabilities	(206,567)		(38,717)			(245,284)
Profit rate gap	10,802	40,421	(13,415)	31,085	28,698	97,591

2007	Up to 3 months	3 - 6 months	6 months- 1 year	1 - 3 years	More than 3 years	BD 000's 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
Investment securities (sukuks)	20,057	4,750	-	6,120	1,885	32,812
Total profit rate sensitive assets	132,165	26,455	15,159	23,567	2,979	200,325
Liabilities						
Placement from banks and financial institutions	(41,561)	-	-	-	-	(41,561)
Investors funds	(11,953)	-	-	-	-	(11,953)
Unrestricted investments accounts	(48,170)	(3,017)	(12,913)	-	-	(64,100)
Total profit rate sensitive liabilities	(101,684)	(3,017)	(12,913)	-	-	(117,614)
Profit rate gap	30,481	23,438	2,246	23,567	2,979	82,711

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2008

30 Risk management (continued)

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.

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 2008	± 990	±495
At 31 December 2007	± 827	± 414

Overall non-trading profit rate risk positions are managed by Treasury, which uses short term 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 Group had the following significant net exposures denominated in foreign currency as of 31 December:

	2008 BHD Equivalent	2007 BHD Equivalent
Sterling Pounds	2,960	3,507
Euros	5,163	512
US Dollars*	74,525	48,109
Kuwaiti Dinars	2,838	3,012
Other GCC Currencies *	2,147	(3,429)

(*) 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 was economically hedged through a forward contract for 4.5 million sterling pounds maturing on the 22 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 sterling pounds exposure.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2008

30 Risk management (continued)

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:

	2008 BHD Equivalent	2007 BHD Equivalent
Sterling Pounds	±148	±175
Kuwaiti Dinars	±142	±151
Euros	±258	±26

Exposure to other market risks – non-trading portfolios

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

The Group's available-for-sale equity securities carried at cost are exposed to risk of changes in equity values. Refer note 21 for significant estimates and judgements in relation to impairment assessment of available-for-sale equity investments carried at cost. The Group manages exposure to other price risks by actively monitoring the performance of the equity securities. The performance assessment is performed on a quarterly basis and is reported to the Board Investment Committee.

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. The Risk Management Department is in charge of identifying, monitoring and managing operational risk in the bank. The Bank already has an approved policy for doing this and all required organisational and physical infrastructure are in place.

The Bank is currently in the process of conducting Risk Control Self Assessment of Operational risk in all departments of the Bank to identify the important Key Risk Areas and Key Risk Triggers. This process is expected to be completed by the end of March 2009. A software for monitoring these triggers and recording actual and near miss losses is already in place. The medium term objective of the Bank is to generate statistically reliable data to upgrade to more sophisticated modes of Operational Risk Control both to manage the risk better and to reduce capital commitment.

Capital management

The Central Bank of Bahrain (CBB), 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's regulatory capital is analysed into two tiers:

- *Tier 1 capital*, includes ordinary share capital, disclosed reserves including share premium, general reserves, legal / statutory reserve as well as retained earnings after deductions for goodwill and other regulatory adjustments relating to items that are included in equity but are treated differently for capital adequacy purposes. As on 31 December 2008, the deductions to Tier 1 was Nil.
- *Tier 2 capital*, includes interim retained profits reviewed by the auditors and an allowed portion profit equalisation reserve and investment risk reserves. As per CBB, the PER & IRR can be up to a maximum amount equal to the capital charge pertaining to 30% of the risk weighted assets financed by unrestricted investment account holder.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2008

30 Risk management (continued)

Capital management (continued)

Certain limits are applied to elements of the capital base in line with regulatory requirements. Tier 1 capital should represent at least half of the total eligible capital, i.e., Tier 2 capital is limited to 100% of Tier 1 capital. The limit on Tier 2 capital is based on the amount of Tier 1 capital after all deductions of investments pursuant to Prudential Consolidation and Deduction Requirements (PCD) Module of the CBB. The PCD Module sets out the regulatory rules for prudential consolidation and pro-rata consolidation for banks where they own controlling or significant minority stakes in regulated financial entities, insurance entities and have significant exposures to investment in commercial entities. It also sets out the framework for the prudential deductions from capital for various instances including exposures to counterparties exceeding the large exposure limits as set out by CBB. As on 31 December 2008, the Bank was not required to make any deductions under the requirements of the PCD Module.

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.

With effect from 1 January 2008 the Bank is required to comply with the provisions of the revised Capital Adequacy Module of the CBB (revised based on the Basel II framework) in respect of regulatory capital. The Bank has adopted the standardised approach to credit and operational risk management under the revised framework. There has been no significant change in the amount of available regulatory capital under the two norms. Further, as the Bank has not migrated to advanced approach for computation of risk weighted assets and it has not claimed any of the benefits under permissible credit risk mitigation, there is no significant change in the measurement of risk weighted assets for credit risk.

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

	31 December 2008 Basel II	BD 000's 31 December 2007 Basel I
Total risk weighted assets	334,291	272,011
Tier 1 capital	137,540	132,360
Tier 2 capital	1,122	-
Total regulatory capital	138,662	132,360
Total regulatory capital expressed as a percentage of total risk weighted assets	41.48	48.66

The Bank has complied with all externally imposed capital requirements throughout the year.

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 CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

FOR THE YEAR ENDED 31 DECEMBER 2008

31 PROPOSED APPROPRIATIONS

The Board of Directors propose the following appropriations of profits for 2008 which are subject to shareholders approval in the ensuing Annual General Meeting:

	2008	BD 000's 2007
Directors' remuneration	250	160
Proposed cash dividend	15,000	15,000
Proposed issue of Bonus shares as dividend	5,000	-
Charity	250	250

32 COMMITMENTS

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

	2008	BD 000's 2007
Undrawn commitments to extend finance	12,076	18,095
Underwriting commitments	15,080	-
Guarantees	5,020	-

Performance obligations

During the ordinary course of business, the Group may enter into performance obligations in respect of certain of its infrastructure development projects. It is the usual practice of the Group to pass these performance obligations, wherever possible, on to the companies that own the projects. In the opinion of the management, no liabilities are expected to materialise on the Group at 31 December 2008 due to the performance of any of its projects.

33 SOCIAL RESPONSIBILITY

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

34 NEW STANDARDS AND INTERPRETATIONS NOT YET ADOPTED

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

- IFRS 2 Share-based Payment: Vesting Conditions and Cancellations (effective for annual period beginning on or after 1 January 2009); and
- IAS 32 Financial Instruments: Presentation and IAS 1 Presentation of Financial Statements: Puttable Financial Instruments and Obligations Arising on Liquidation (effective for annual period beginning on or after 1 January 2009)

The adoption of these standards and interpretations and certain other amendments to existing standards with varied effective dates made by International Accounting Standards Board as part of its first annual improvements project are not expected to have any material impact on the financial statements.

35 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.



RISK MANAGEMENT DISCLOSURES

(based on Basel 2 and IFSB guidelines)

31 DECEMBER 2008



These disclosures have been prepared in accordance with the Public Disclosure Module ("PD"), Section PD-1.3: Disclosures in Annual Reports, CBB Rule Book, Volume II for Islamic Banks. To avoid any duplication, information required under PD module but already disclosed in other sections of annual report has not been reproduced. These disclosures are part of the annual report for the year ended 31 December 2008 and should be read in conjunction with the financial statements for the year ended 31 December 2008 and other sections of the annual report.

RISK MANAGEMENT DISCLOSURES

(based on Basel 2 and IFSB guidelines)

Executive Summary

The Central Bank of Bahrain's (CBB) Basel 2 guidelines outlining the capital adequacy framework for banks incorporated in the Kingdom of Bahrain became effective from 1 January 2008. These disclosures have been prepared in accordance with the CBB requirements outlined in the Public Disclosure Module ("PD"), Section PD-1.3: Disclosures in Annual Reports and CBB Rule Book, Volume II for Islamic Banks. Section PD-1.3 reflect the requirements of Basel 2 - Pillar 3 and the Islamic Financial Services Board's (IFSB) recommended disclosures for Islamic banks.

The disclosures in this report are in addition to or in some cases, serve to clarify the disclosures set out in the consolidated financial statements for the year ended 31 December 2008, presented in accordance with the Financial Accounting Standards (FAS) issued by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI). To avoid any duplication, information required under PD module but already disclosed in other sections of Annual report has not been produced in these disclosures.

All figures presented in this section are reported in BD thousands and are as of 31 December 2008 unless otherwise stated.

Khaleeji Commercial Bank BSC (the "Bank") has adopted the Standardised Approach for Credit Risk and Market Risk and the Basic Indicator Approach for Operational Risk to determine its capital requirements. This section contains a description of the Bank's risk management and capital adequacy policies and practices including detailed quantitative information on risk components and capital adequacy.

The Bank's Tier I and total capital adequacy ratios comply with the minimum capital requirements under the CBB's Basel 2 framework.

The Banks total risk weighted assets as at 31 December 2008 amounted to BD 334,291. Credit risk accounted for 88.62 per cent, operational risk 8.96 per cent, and market risk 2.42 per cent of the total risk weighted assets. Tier I and regulatory capital were BD 137,540 and BD 138,662 respectively

At 31 December 2008, Bank's Tier I and total adequacy ratios were 41.14 per cent and 41.48 per cent respectively.

1 Group Structure

The Bank operates under a retail banking license granted by the Central Bank of Bahrain ("CBB") on 20 October 2003. The Bank does not have significant operating subsidiaries. The subsidiaries set-up are primarily special purpose entities with nominal capital to execute specific investment transactions. The subsidiaries qualify as commercial entities as per the CBB capital computation guidelines and are risk weighted as investments for capital adequacy purposes.

2 Introduction to Basel II & Risk Management

The Central Bank of Bahrain (CBB) has mandated that the Basel Committee on Banking Supervision's (Basel Committee) Basel II capital adequacy framework is applicable to all banks incorporated in the Kingdom of Bahrain from 1st January 2008. The Bank has accordingly taken steps to comply with these requirements. The Basel II framework is intended to strengthen risk management practices and processes within the financial institutions.

CBB's Basel II framework is based on three pillars, consistent with the Basel II framework adopted by the Basel Committee, as follows:

- Pillar I: calculation of the risk weighted assets (RWAs) and capital requirement.
- Pillar II: the supervisory review process, including the Internal Capital Adequacy Assessment Process (ICAAP).
- Pillar III: rules for the disclosure of risk management and capital adequacy information.

Pillar I

Pillar I defines the regulatory minimum capital requirements for each bank to cover the credit risk, market risk and operational risk inherent in its business model. It also defines the methodology for measurement of these risks and the various elements of qualifying capital. The capital adequacy ratio is calculated by dividing the regulatory capital base by the total Risk Weighted Assets (RWAs). CBB has mandated that the ratio be maintained at a minimum of 12 % and has set a trigger ratio of 12.5%. If the capital adequacy ratio falls below 12.5 per cent, additional prudential reporting requirements apply, and a formal action plan to restore the ratio above the target level is to be formulated and submitted to the CBB.

The table below summarises the Pillar I risks and the approach used by the Bank to calculate the RWAs in each case in accordance with the CBB's Basel II capital adequacy framework:

Risk Type	Approach used by KHCB
Credit Risk	Standardised Approach
Market Risk	Standardised Approach
Operational Risk	Basic Indicator Approach

Pillar II

Pillar II defines the process of supervisory review of an institution's risk management framework and, ultimately its capital adequacy.

Under the CBB's Pillar II guidelines, each bank is to be individually assessed by the CBB and an individual minimum capital adequacy ratio is to be determined for each bank. The CBB is currently undertaking the assessment exercises, which will allow their setting of minimum capital ratios in excess of 8 per cent, based on the CBB's assessment of the financial strength and risk management practices of the institution. Currently, pending finalisation of the assessment process all banks incorporated in Bahrain are required to continue to maintain 12 per cent minimum capital adequacy ratio. An external consultant has been appointed to undertake this assessment process on behalf of CBB and the assessment report is under consideration by the CBB.

Pillar II comprises two processes:

- An Internal Capital Adequacy Assessment Process (ICAAP), and
- A supervisory review and evaluation process.

The Bank has recently adopted certain ICAAP procedures for computation of economic capital for all risks including those not covered under Pillar I. The Bank regularly monitors its internal capital adequacy ratio to ensure that there is adequate cover for all risks faced by the Bank.

Pillar III

Pillar III complements the other two pillars and focuses on enhanced transparency in disclosure of information by the Banks to promote better market discipline. The information to be disclosed covers all areas including business performance, capital adequacy, risk management etc. The disclosures are designed to enable stakeholders and market participants to assess an institution's risk appetite and risk exposures and to encourage all banks, via market pressures, to move toward more advanced forms of risk management.

In April 2008, the Central Bank published a paper covering the detailed disclosure requirements to be followed by licensed banks in Bahrain to be in compliance with Pillar III under the Basel II frame work. This document is prepared in accordance with these directives and the disclosures herein are in addition to those in the audited consolidated financial statements.

2.1 The Risk Management Function

The Board of Directors (BoD) has overall responsibility for risk management in the Bank. The Board lays down the risk management policies of the Bank and quantifies its risk appetite through appropriate definitions of various risk limits and tolerances. The Board discharges its risk management responsibilities through the Board Risk Management Committee (BRMC).

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 Board Risk Management Committee.

The day to day risk management functions are performed by the Risk Management Department (RMD) of the Bank. RMD is responsible to ensure that the policies laid down by the Board are consistently implemented across the Bank and to review the adequacy of these policies periodically. It monitors all risk taking activities and ensures that the risk limits defined by the Board are complied with. The department has specialised personnel dealing with Credit, Market and Operational Risks. It is independent of all risk taking functions in the Bank and reports to the BRMC through the Executive Risk Management Committee (ERMC) chaired by the Chief Executive Officer (CEO).

The Asset Liability Management Committee (ALCO) of the Bank acting through the Treasury department monitors the Bank's liquidity position and recommends appropriate action to the Board where necessary. There is a high level of co-ordination between the Risk Management Department and ALCO.

A risk overview report which details out the various risks faced by the Bank is prepared by RMD and discussed at the ERMC, BRMC and the Board on a quarterly basis.

The RMD, 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 of Directors.

3 Capital Management and Capital Adequacy ratio

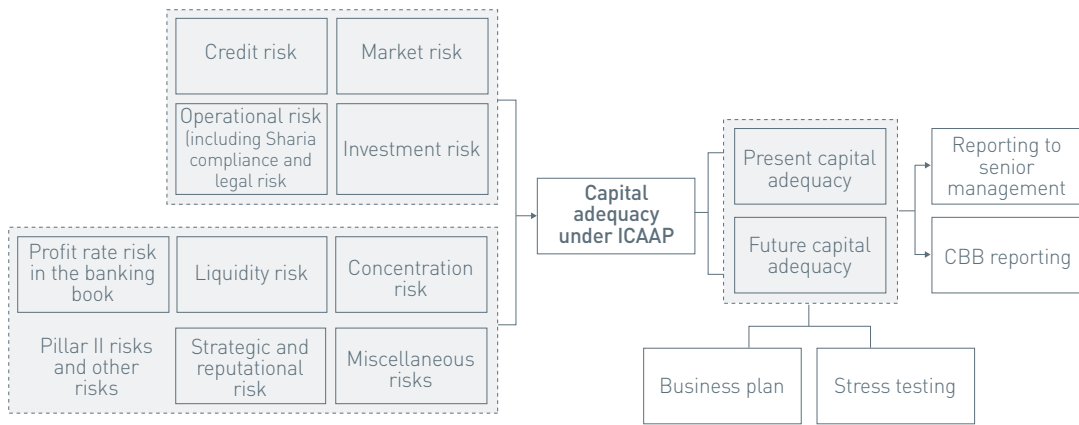
3.1 Capital management

The Bank’s policy is to maintain a strong capital base to develop investor, creditor and market confidence and to sustain the future development of business. The Bank recognises the impact of a high level of capital on shareholders’ returns, while not losing sight of the security and market confidence afforded by a sound capital base. The Bank aims to maintain a minimum total capital adequacy ratio significantly in excess of that mandated by the CBB.

3.2 Internal Capital Adequacy Assessment Process (“ICAAP”)

The Bank has recently developed its Internal Capital Adequacy Assessment Process (“ICAAP”) as per the requirements under Pillar II of Basel II. ICAAP prescribes procedures and measures designed to ensure appropriate identification, measurement, aggregation and monitoring of the Bank’s risks. It also defines an appropriate level of internal capital in relation to the Bank’s overall risk profile and business plan.

ICAAP framework at the Bank



3.2.1 Risk Addressed by the ICAAP

Risk Type	Metrics based on which internal capital is allocated
Credit risk Market risk Investment risk Operational risk	Regulatory capital adequacy guidelines to be used as proxy for internal capital for Pillar I risks
Liquidity risk	Maximum cumulative gap, Liquidity ratio, Financing to deposit ratio
Profit rate risk (banking book)	Revaluation sensitivity of the repricing gaps
Credit concentration risk	Thresholds for counterparty, country, sector exposure
Fiduciary Risk	Size of off balance sheet vehicles (RIAs) & Large Investment Products
Reputational risk	Credit quality, Operational risk, Reputation related loss
Other Risks (strategic, Shari'a/regulatory compliance, business cycle)	Additional capital based on Pillar 1 risk weighted exposures

3.3 Capital Structure, minimum capital requirements and capital adequacy

Net Available Capital	31 December 2008
Issued and fully paid ordinary shares	100,000
Less: Treasury shares	(4,915)
Less: ESOP shares	(2,380)
Statutory reserve	5,988
Share premium	581
Others reserves	-
Retained earning	38,266
Tier 1 Capital	137,540
Profit equalisation reserve	649
Investment risk reserve	473
Tier 2	1,122
Net Available Capital	138,662
Risk Weighted Assets	December 2008
Credit Risk Weight Exposures	296,228
Market Risk Weight Exposures	8,100
Operational Risk Weight Exposures	29,963
Total Risk Weighted Assets	334,291
Capital Adequacy Ratio (Tier 1)	41.14%
Capital Adequacy Ratio (Total Capital)	41.48%

The capital adequacy ratio is calculated by dividing the regulatory capital base by the total Risk Weighted Assets (RWAs).

Regulatory capital components

The above components of Tier I and Tier II capital are as per the relevant CBB guidelines. According to these Tier II capital is restricted to 100 % of Tier I capital after all deductions of investments pursuant to PCD module of CBB rule book. As at 31st Dec 08 Bank was not required to make any prudential deduction from its regulatory capital base.

Risk Weighted Assets

Credit risk

For regulatory reporting purposes the Bank calculates the capital requirements for credit risk based on the standardised approach. Under the standardised approach the on-and off-balance sheet credit exposures are assigned risk weights based on the type of counterparty, underlying exposure, or source of funding – URIA or own funds. . The risk weights for types of counterparties and exposures are prescribed by CBB. . Further for capital adequacy computations 100% of the RWA's is reckoned for self financed assets while only 30 % is considered for assets funded through URIA.

Market risk

The Bank uses standardised approach to measure market risk. Market risk is primarily on account of the foreign exchange exposures that are considered as specific risks. As per the CBB guidelines, capital for foreign exchange risk is computed at 8% of overall net open foreign currency positions of the Bank and is multiplied by 12.5 to derive the market RWAs.

Operational risk

The Bank adopts the Basic Indicator Approach to evaluate operational risk charge in accordance with the CBB capital adequacy module for Islamic Banks. According to this approach, Bank's average gross income for past three financial years is multiplied by a fixed coefficient alpha of 15% set by CBB and a multiple of 12.5% is used to arrive at the risk weighted assets that are subject to capital charge.

Break up of capital requirement in accordance with the Capital Adequacy Module of the CBB for the year ended 31 December 2008.

Risk Weighted Assets	Exposure			Risk weighted assets			Capital requirement		
	Self – financed	URIA	Total	Self – financed	URIA	Total	Self – financed	URIA	Total
Cash and collection items	309	-	309	-	-	-	-	-	-
Sovereigns	18,202	19,260	37,462	-	-	-	-	-	-
Banks	136,819	-	136,819	27,364	-	27,364	3,284	-	3,284
Corporates	67,528	114,397	181,925	67,528	34,319	101,847	8,103	4,118	12,221
Investments in equities/funds	170	28,038	28,208	170	12,617	12,787	20	1,514	1,534
Holdings of real estate	61,315	-	61,315	122,630	-	122,630	14,716	-	14,716
Other assets	31,600	-	31,600	31,600	-	31,600	3,792	-	3,792
Credit Risk Weight Exposures:	315,943	161,695	477,638	249,292	46,936	296,228	29,915	5,632	35,547
Market Risk Weight Exposures	648	-	648	8,100	-	8,100	972	-	972
Operational Risk Weight Exposures			29,963			29,963		-	3,596
Total Risk Weighted Assets	316,591	161,695	508,249	257,392	46,936	334,291	30,887	5,632	40,115
Capital Adequacy Ratio (Tier I)						41.14%			
Total Capital Adequacy Ratio						41.48%			

4 Credit Risk

4.1 Credit risk management

Credit Risk is the risk that a counterparty fails to meet its obligations in accordance with agreed terms and conditions. The major sources of credit risk in the Bank are under the following classes of assets:

- Placements with other Banks and Financial Institutions
- Islamic Financing Assets
- Assets acquired for leasing
- Available-for-sale investments
- Investments in Sukuks
- Investment in Associates
- Other receivables

The Bank has the necessary internal processes for assessing, monitoring and controlling credit risk both at the individual credit and portfolio levels. Credit limits are approved after a thorough assessment which takes into account the financial strength of the counterparty, the technical feasibility and economic viability of the business being financed, the adequacy and quality of the cash flow available for repayment etc. in addition to availability of collateral security by way of physical assets or guarantees. The RMD reviews every credit proposal and incorporates its remarks on the proposal before the same is considered by the appropriate authority as per delegated approval levels granted by the Board of Directors.

At the portfolio level, the Board has established risk concentration limits for single counterparties, related counterparties forming a business group, geographical and economic sectors as well as exposures to counterparties connected to the Bank and/or its major shareholders. The RMD regularly monitors compliance with these limits and deviations if any are reported regularly to the Senior Management, Risk Management Committees and the Board of Directors.

4.2 Growth in Exposure levels

Years 2007 and 2008 saw significant growth in overall credit exposure levels. The table below shows Gross credit exposure as on 31st December 2008 along with average credit exposure broken down under different exposure classes.

Gross / Average Credit Exposures

	Average Exposure ⁽¹⁾	Gross Exposure	
		Self	URIA
Cash and Bank balances	22,615	23,069	-
Placement with Banks/FIs	140,503	131,952	-
Islamic Financing Assets	122,731	25,746	114,397
Investments in equity securities	60,563	55,100	-
Assets Acquired for Leasing	20,145	23,482	-
Investment in Sukuks	30,949	-	47,298
Investments in Associates	6,460	6,385	-
Asset held for sale	5,655	5,655	-
Other assets	26,141	26,077	-
Total On Balance Sheet Credit Exposure	435,762	297,466	161,695
Guarantees Issued	5,020	5,020	-
Other Non Funded Commitments	43,052	27,156	-
Total Off Balance Sheet Credit Exposure	48,072	32,176	-

⁽¹⁾ Average exposure for the year has been computed based on quarterly average balances for the year 2008.

4.3 Concentration of credit risk

4.3.1 Geographic distribution

The geographical exposure profile as at 31 December 2008 was as follows:

2008	GCC countries	Europe	Asia	Australia	Africa	Total
Assets						
Bank balances	21,390	207	1,472	-	-	23,069
Placements with financial institutions	125,725	6,227	-	-	-	131,952
Islamic financing assets	133,190	6,953	-	-	-	140,143
Investment securities	76,869	5,039	18,605	-	1,885	102,398
Assets acquired for leasing	23,482	-	-	-	-	23,482
Investment in associates	6,385	-	-	-	-	6,385
Asset held for sale	-	-	-	5,655	-	5,655
Other assets	26,077	-	-	-	-	26,077
Total funded exposures	413,118	18,426	20,077	5,655	1,885	459,161
Commitments to finance	10,375	1,701	-	-	-	12,076
Underwriting commitments	-	-	-	-	15,080	15,080
Guarantees	5,020	-	-	-	-	5,020
Total unfunded exposures	15,395	1,701	-	-	15,080	32,176

4.3.2 Industry/ sector wise distribution of exposure

The Board of Directors has stipulated maximum exposures to various industry sectors. The industry sector wise non-funded exposure is as follows:

2008	Banks and financial institutions	Real estate	Others	Total
Assets				
Bank balances	23,069	-	-	23,069
Placements with financial institutions	131,952	-	-	131,952
Islamic financing assets	9,279	83,968	46,896	140,143
Investments securities	40,108	62,120	170	102,398
Assets acquired for leasing	-	15,965	7,517	23,482
Investment in associates	-	6,385	-	6,385
Asset held for sale	-	-	5,655	5,655
Other assets	-	-	26,077	26,077
Total funded exposures	204,408	168,438	86,315	459,161
Off-balance sheet items				
Commitments to finance	-	2,640	9,436	12,076
Underwriting commitments	-	15,080	-	15,080
Guarantees	-	-	5,020	5,020
Total unfunded exposures	-	17,720	14,456	32,176

4.3.3 Transactions with connected counterparties

Connected counterparties are those entities which are connected to the Bank through significant shareholding or control or both. The Bank has entered into business transactions with such counterparties, and all such transactions have been done at an arms length basis and on commercial terms that bring no disadvantage to the Bank. For the purpose of identification of connected parties the Bank strictly follows the guidelines issued by Central Bank of Bahrain for the purpose. Detailed break up is presented in note no 23 in the notes to the consolidated financial statements for the year ended 31 December 2008

4.3.4 Exposures in excess of 15% of capital base

Single exposures in excess of 15 % of the Bank's capital base on individual counterparties require prior approval of CBB except where exempted under para CM 4.5 of the rule book. The Bank does not have any such 'large exposures' that are not exempted and therefore requires prior approval of CBB.

Exposures exceeding single exposure limits as of 31 December 2008

	Amount in BD
Banks	
Bank A	18,946
Bank B	25,227
Total	44,173
Non-Banks	
Counterparty A	27,877
Counterparty B	28,303
Total	56,180
Grand Total	100,353

4.3.5 Exposures in highly leveraged counterparties

The Bank has no exposure to highly leveraged and other high risk counterparties as per definition provided in the CBB rule book PD 1.3.24.

4.3.6 Residual maturity of the credit portfolio

The Bank's policy allows exposures up to a maximum period of 7 years. However, most of the Bank's exposures are limited to an original maturity of 5 years. The Bank constantly monitors the residual maturity profile of its assets to ensure that any mismatch with the maturity of its liabilities is kept within acceptable limits. The actual residual maturity profile of the Bank's credit portfolio is given in the table below.

Maturity Scale	< 1 M	1 - 3 M	3 - 6 M	6M - 1 Y	1 - 3 Y	> 3 Y	Total
Murabaha	-	25,694	19,803	22,724	29,240	21,700	119,161
Musharaka	-	-	3,268	-	9,931	-	13,199
Wakala	-	2,805	4,035	-	-	256	7,096
Istisna	-	-	-	-	-	687	687
Ijarah	-	1,561	1,839	692	9,221	10,169	23,482
Total		30,060	28,945	23,416	48,392	32,812	163,625
Investment securities							
Investments in							
sukuks	2,910	9,500	6,850	-	11,059	16,979	47,298
Total	2,910	9,500	6,850	-	11,059	16,979	47,298
Grand Total	2,910	39,560	35,795	23,416	59,451	49,791	210,923

* Credit Portfolio includes Islamic Financing Assets and Assets acquired for Leasing

4.4 Equity risk in banking book

The Bank does not have a trading book and hence all of its equity investments are classified in the banking book and are subject to credit risk weighting under the capital adequacy framework. For regulatory capital computation purposes, the Bank's equity investments in the banking book include available-for-sale investments, majority investments in commercial entities and associate investments in non-financial entities.

Please refer to the notes to the consolidated financial statements for policies covering the valuation and accounting of equity holdings, including the accounting policies and valuation methodologies used, key assumptions and practices affecting valuation.

The RMD works alongside the Investment Department at all stages of the deal cycle, from pre-investment due diligence to exit, and provides an independent review of every transaction. An impairment assessment of investments takes place every quarter with inputs from the Investment department and RMD. Quarterly updates of investments are reviewed by the Board of Directors. Regular audits of business units and processes are undertaken by Internal Audit.

The Bank's equity investments are predominantly in its own projects, which include private equity and infrastructure development projects. The intent of such investments is a later stage exit along with the investors principally by means of strategic sell outs at the project level or through initial public offerings. The Bank also has a strategic investment portfolio which is aligned with the long term investment objectives of the Bank.

Information on equity investments

Privately held	54,930
Quoted in an active market	170
Realised gain/ (loss) during the year	-
Unrealised gain/ (loss) in equity	(396)

Capital adequacy computations for various categories of equity investments are given in the table below.

Equity investments in banking book	Gross exposure		Risk weighted exposure		Capital charge	
	Self financed	URIA financed	Self	URIA	Self financed	URIA
Quoted equity investment	170	-	170	-	20	-
Unquoted equity investment	-	-	-	-	-	-
Investments in managed funds	-	-	-	-	-	-
Real estate holdings	54,930	-	109,860	-	6,592	-
Total	55,100	-	110,030	-	6,612	-

4.5 Risk grading of exposures

The Bank has an internal risk grading system for credit exposures based on a 10 point scale in which grades 9 and 10 are non performing exposures. Each counterparty credit exposure is assigned a risk grade based on several quantitative and qualitative factors, including financial strength, past record and availability of collateral security. The grading is done at the time of assuming an exposure and each renewal of the same. The grading sheets are prepared by the Business Department and approved by the RMD. No new exposure will be assumed if the assigned grade for any counterparty is below 6. Grades are continuously monitored by the Bank's credit administration department within RMD and are downgraded as and when the quality of the exposure has deteriorated, based on criteria in the Bank's credit policy.

For exposures or potential exposures with the Banks and Financial Institutions, the Bank has established internal ratings which have been classified into 6 categories, A to F, in descending order of creditworthiness. These ratings are derived on the basis of the external credit ratings provided by established credit rating agencies like Moody's, Standard & Poor (S&P), Capital Intelligence (CI) & Fitch. When the ratings of S&P and/or Moody's are available, those ratings will be used. In case of differences in ratings of these agencies, the more conservative rating will be used for classification. The ratings of these agencies have been mapped to internal categories as follows:

External Rating Agencies	Internal Ratings					
	A	B	C	D	E	F
S & P	>= AA-	>=A-	>=BBB-	>=B-	Below B-	Unrated
Moody's	>=aa3	>=A3	>=Baa3	>=B3	C & D	
CI	>= AA-	>=A-	>=BBB-	>=B-	C & D	
Fitch	>= AA-	>=A-	>=BBB-	>=B-	Below B-	

Please refer to Note 30 of the consolidated financial statements for the year ended 31 December 2008 for details of the rating profile of exposures of the Bank.

4.6 Past dues, impaired accounts, provisions

Customers may occasionally fail to meet their obligations to the Bank on due dates. Any amount not paid when due is classified as past due and the Bank initiates focused recovery efforts on such accounts.

However if the account remains past due for a continuous period of 90 days it is considered as impaired. The Bank conducts a comprehensive review of all such accounts on a quarterly basis and provisions are created through Profit & Loss (P&L) account where necessary. Such provisions are made on the basis of expected shortfall in present value of projected future cash flows from the assets / securities and the estimates of such cash flows are done on a conservative basis.

On each balance sheet date the Bank reviews all assets classified as Available-for-Sale for any objective evidence that the financial assets are impaired. In case of any such evidence the asset is revalued at cost of acquisition less impairment and a provision is created for the difference amount through the profit and loss account.

For a detailed policy on impairment of financial assets, refer note 2 (q) in the notes to the consolidated financial statements for the year ended 31 December 2008.

For the quantitative disclosures relating to exposure which were past due or impaired as of 31 December 2008, please refer to Note 30 to the consolidated financial statements for the year ended 31 December 2008.

During the year 2008, Bank has undertaken a detailed assessment of its credit portfolio and has considered specific impairment allowances where necessary. In view of the current market conditions, the Bank has also created a portfolio provision at a level of approximately 1% of its Islamic financing assets. The Bank is in the process of developing a detailed risk rating based model to identify and maintain collective provision on portfolio basis going forward.

4.7 Restructured/renegotiated credit facilities

For disclosure of renegotiated loans refer note 30 to the consolidated financial statements for the year ended 31 December 2008

4.8 Legal Action and Write off of exposures

The Bank has policies for initiation and prosecution of legal action when all other avenues for recovery of dues from a customer has exhausted. No such legal action has been initiated so far.

The Bank has a policy that permits write off of exposures when there is no possibility of recovery of the dues through legal and other means. However the Bank has so far not written off any such dues or exposures.

4.9 Penalties for Delayed Payments

In cases where customers delay the payments of dues to the Bank, the Bank has the right to collect penalties, subject to the provisions of the agreement between the customer and the Bank. The Bank recovers such penalties from customers when the amounts are significant. As per policy such penalties are maintained in a separate account and used for charity purposes approved by the Bank's Shari'a Board.

For quantitative disclosures refer Statement of sources and uses of Zakah and Charity fund for the year ended 31 December 2008.

4.10 Credit Risk Mitigation

The Bank uses a variety of tools to mitigate its credit risk, the primary one being that of securing the exposure by suitable collateral security. While existence of collateral security is not a policy precondition for financing, in practice a large part of current exposures are at least partially collateralised. The Bank has clear policies on the type of assets that can be accepted as collateral security and the mode of valuation of these assets. In general all assets accepted as collateral are valued at least once in a year. The legal validity and enforceability of the documents used for creating these collaterals have been established by external legal experts.

The position of collateral cover for all credit exposures categorised on the basis of the type of security is given in the table below.

Extent of collateral security cover for credit exposures for the year ended 31 December 2008;

Collateral Type	Murabaha	Musharaka	Wakala	Istisna	Ijarah	Value of Collateral ⁽¹⁾	Total Gross Exposure	% age of cover	% age of total
Real Estate	132,785	5,905	13,644	1,107	38,037	191,478	100,536	190	82
Listed Securities	5,598	985	-	-	-	6,583	5,000	132	3
Unlisted Securities	5,344	-	-	-	-	5,344	4,540	118	2
Bank Guarantee	1,000	9,425	-	-	-	10,425	9,419	111	4
Cash Collateral	5,077	-	-	-	-	5,077	4,652	109	2
Unsecured	-	-	-	-	-	-	31,039	0	0
Others	473	6,979	-	-	8,659	16,111	9,475	170	7
Total	150,277	23,294	13,644	1,107	46,696	235,018	164,661	143	100

[1] (Represents the last valuation carried out based on the Bank's valuation policy)

Real Estate properties are reckoned at values certified by qualified valuers. Other physical assets like machinery are valued at book value, invoice value or as certified by an outside expert. Listed securities are valued at market price while unlisted ones are at book value. The Bank has an approved panel of valuers for real estate property. Valuations are arrived at by the Risk Management Department of the Bank, independent of the business units.

Assets financed under Ijara Muntahia Bittamleek are considered at par with physical collateral and included under Real Estate or Others in the above calculations.

The declared value of exposures in all cases is the gross exposure. The Bank does not carry out any on balance sheet or off balance sheet netting for the securities held. The Bank has not claimed any capital relief for Credit Risk Mitigation under Section CA 4 of the Capital Adequacy module of CBB rule book.

The Bank has a policy of disposal of asset held as collateral not readily convertible into cash, after completion of necessary legal formalities. During the year there has been no such instance.

4.11 Regulatory Capital Requirements by type of Islamic financing contracts

Islamic financing contracts	Exposures (BHD'000)		Credit Risk Weighted Assets		Capital requirement	
	Self	URIA	Self	URIA	Self	URIA
Murabaha	25,746	100,431	25,746	100,431	3,090	3,616
Istisna'a receivable	-	-	-	-	-	-
Ijarah assets	23,482	-	23,482	-	2,818	-
Mudaraba	-	-	-	-	-	-
Musharaka	-	13,278	-	13,278	-	478
Wakala	-	-	-	-	-	-
Istisna'a	-	688	-	688	-	25
Total	49,228	114,397	49,228	114,397	5,908	4,119

5 Market Risk

5.1 Market risk management

Market risk is the risk that changes in market prices, such as foreign exchange rates, profit rates, equity prices, and commodity prices will affect the Bank's income or the value of its holdings of financial instruments.

Basel II requires that the Bank separate its exposure to market risk between trading and non-trading portfolios. The Bank has no trading positions in equity or commodities and the main source of market risk for the Bank is its foreign exchange exposure, although this is quite limited. There is also an extent of profit rate risk arising out of mismatches in its asset liability structure. The Bank has well defined policies approved by the Board with clear risk limits and thresholds to effectively manage its market risk.

Details on market risk management, net exposures and sensitivities are given as part of the Note 30 of the consolidated financial statements for the year ended 31 December 2008.

5.2 Regulatory Capital Allocation against Market Rate Risk

Table below shows the capital requirements for each category of the market risk as at year end along with the maximum and minimum values during the period:

	As at 31 December	Max	Min
Equity position risk	-	-	-
Market risk on trading positions in sukuk	-	-	-
Foreign exchange risk	972	1,133	972
Commodity risk	-	-	-
Total	972	1,133	972

6 Operational Risk

6.1 Operational risk management

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people, systems and/or from external events which includes but is not limited to, legal risk and Shari' a compliance risk. Operational risk is an inherent part of normal business operations. Whilst operational risk cannot be eliminated entirely the Bank endeavors to minimise it by ensuring that a strong control infrastructure is in place throughout the organisation. The components of this framework are effective staff training, appropriate controls to safeguard assets and records, regular reconciliation of accounts and transactions, close monitoring of risk limits, segregation of duties, and financial management and reporting.

Details on operational risk management are given as part of the Note 30 of the consolidated financial statements for the year ended 31 December 2008.

The Risk Management Department monitors all operational processes to ensure that the Board directives are fully implemented and also reports deviations if any to the Senior Management and the Board. The department has specialised personnel engaged in this process. In addition, the Bank's policy dictates that the operational functions of booking, recording and monitoring of transactions are carried out by staff that are independent of the individuals initiating the transactions.

6.2 Litigation

As on the reporting date, the Bank has no material legal contingencies including pending legal actions. The Bank has a dedicated legal team who is consulted on all major activities conducted by the bank. All contracts, documents, etc have to be reviewed by the legal department as well.

6.3 Shari'a compliance

The Shari'a Supervisory Board (SSB) is entrusted with the duty of directing, reviewing and supervising the activities of the Bank in order to ensure that they are in compliance with the rules and principles of Islamic Shari'a. The Bank also has a dedicated internal shari'a reviewer, who performs an ongoing review of the compliance with the fatwas and rulings of the SSB on products and processes and also reviews compliance with the requirements of the Shari'a standards prescribed by AAQIFI. The SSB reviews and approves all products and services before launching and offering to the customers and also conducts periodic reviews of the transactions of the Bank. An annual audit report is issued by the SSB confirming the Bank's compliance with shari'a rules and principles.

6.4 Regulatory Capital Allocation against Operational Risk

The Bank uses the Basic Indicator Approach (BIA) in calculating its regulatory capital requirement for operational risk.

The risk weighted assets and capital requirement for operational risk as at 31 December is as given below:

Average gross income for 3 years	15,980
Operational Risk Weighted Assets	29,963
Capital requirement	3,596

7 Other risks

7.1 Liquidity Risk

Liquidity risk is the risk that the Bank will encounter difficulty in meeting its financial obligations on account of a maturity mismatch between assets and liabilities. The Bank's approach to managing liquidity is to ensure, that it will always have sufficient funds to meet its liabilities when due without incurring unacceptable losses or risking damage to the Bank's reputation.

The Bank has a liquidity risk policy in place, which describes the roles and responsibilities of the Asset Liability Management Committee (ALCO), Treasury and other concerned departments in management of liquidity. It also stipulates various liquidity ratios to be maintained by the Bank, as well as gap limits under each time bucket of the maturity ladder. It is the Bank's policy to keep adequate level of high quality liquid assets such as inter-bank placements, CBB sukuks to ensure that funds are available to meet maturing deposits and other liabilities, as and when they fall due.

For maturity profile of assets and liabilities refer note 27 of the consolidated financial statements. The following are the key liquidity ratios which reflect the liquidity position of the Bank:

	2008	2007	2006	2005
Interbank assets to interbank liabilities	293.93	179.02	383.00	-
Liquid assets to total assets	16.38	16.59	26.65	41.11
Liquid assets to total deposits	97.01	155.64	199.50	338.73
Net liquid assets to total deposits	49.80	50.30	46.00	143.90

7.2 Profit rate risk in the banking book

The banking book is exposed to 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.

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 (bps) parallel fall or rise across all yield curves and a 50 bps rise or fall of all yield curves. An analysis of the Bank's sensitivity to an increase or decrease in market profit rates has been disclosed in Note 30 to the consolidated financial statements.

7.3 Counterparty credit risk

Counterparty credit risk is the risk that a counterparty to a contract in the profit rate, foreign exchange, equity or credit market defaults prior to maturity of the contract. The Bank does not engage in proprietary trading of equity, foreign exchange or its derivatives. However, the Bank enters into shari'a compliant foreign exchange risk/ profit rate risk transactions to hedge its risks arising out of mismatch in its asset liability portfolios. Clear policies for such transactions are in place. For other credit market transactions (primarily inter-bank placements), the Bank has established a matrix of counterparty limits based on external credit rating of such counterparties. Such limits are constantly monitored by the Banks Risk Management Department.

7.4 Concentration risk

Concentration risks arises when a number of obligors, counterparties or investees are engaged in similar business activities or activities in the same geographic region such that their ability to meet obligations to the Bank will be similarly affected by changes in economic, political or other conditions. Accordingly, such concentrations indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry or region. The Bank has established exposure limits to various geographic regions and industry sectors.

7.5 Reputational risk

Reputation 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 or lead to costly litigation that could have an adverse impact on liquidity or capital of the Bank. Among the issues that could affect the Bank's reputation are the inability to exit from investments, lower than expected returns on investments and poor communication to investors. The Bank has a well developed and coherently implemented communication strategy to cover such contingencies. Additionally, the RMD has recently put together an Internal Capital Adequacy Assessment Process (ICAAP) Policy to effectively assess and measure non Pillar 1 risks.

7.6 Displaced commercial risk

Displaced Commercial Risk refers to the market pressure to pay returns that exceeds the rate that has been earned on the assets financed by Unrestricted Investment Accounts. This can be due to the return on such assets being lower than that of competitors. The Bank has adequate policies and procedures in place to identify, monitor and address all potential risks that may arise from such activities. Please refer to the section on URIA for further details.

7.7 Other risks

Other risks include strategic risk, fiduciary risks, regulation risks etc. which are inherent in all business and are not easily measurable or quantifiable.. The Bank's Board has overall responsibility for approving and reviewing the risk strategies and amendments to the risk policies. The Bank senior management is responsible for implementing the risk strategy approved by the Board. The management also ensures that internal systems of corporate governance and regulatory compliance for management of fiduciary and reputational risks are robust and effective.

8 Product Disclosures

8.1 Product Descriptions & Consumer Awareness

The Banking license of Khaleeji Commercial Bank BSC permits it to offer to its customers all types of banking products except Consumer/personal facilities other than real estate, retail leasing activities other than real estate, and Assurance. The Bank has approached CBB to remove these restrictions in its license and the request is under consideration of the Central Bank.

Within the above constraints the Bank offers a comprehensive mix of Shari'a compliant commercial and investment banking products. The investment department of the Bank has expertise in creating innovative high end and value added products offering a wide range of structures, expected returns, tenors and risk profiles.

Proposal for any new product is initiated by individual business lines within the Bank. The Executive Risk Management Committee (ERMC) of the Bank reviews such proposal to ensure that the new product/ business is in line with the Bank's business and risk strategy. All new products will need the approval of the Board of Directors and the Shari'a Supervisory Board of the Bank. .

Information on new products or any change in existing products will be placed on the Bank's website www.khcbonline.com and/or published in the media. Product details are also shared with customers and the general public through brochures and/ or, advertisements.

8.2 Complaint Handling

The Bank takes disputes and complaints from all customers very seriously. These have the potential for a breakdown in relationships and can adversely affect the Bank's reputation. Left unattended these can also lead to litigation and possible censure by the regulatory authorities. The Bank has a comprehensive policy on handling of external complaints, approved by the Board. All employees of the Bank are aware of and abide by this policy.

The Bank has a designated nodal officer for handling of all external complaints and his contact details are displayed on the website and also at the Branch and in all printed publicity materials. Complaints are normally investigated by persons not directly related to the subject matter of the complaint. The Bank endeavors to address all complaints within five working days. Wherever this is not possible, the customer is contacted directly and a time frame for rectification of his complaint advised. A periodical report on status of complaints is also submitted to the Board.

8.3 Unrestricted Investment Accounts (URIAs)

Bank offers Unrestricted investment Accounts (URIAs) to both small investors and high net worth individuals. Unrestricted investment Accounts (URIAs) represents funds offered by customers to the Bank to be invested in a Sharia compliant manner, at the Bank's discretion as Mudarib. All URIA accounts are on profit sharing basis, but the Bank does not guarantee any particular level of return. Any loss arising from the investment will be borne by the customer except in the case of the Bank's negligence. The Bank charges a Mudarib fee as its share of profit.

Currently, the Bank offers Unrestricted Investment Accounts in Bahraini Dinar, US Dollar and Euro for maturity periods ranging from 1 month to 18 months. The Bank completes its full range of KYC due diligence prior to accepting any investment. The customer also signs a written agreement covering all terms and conditions of the investment including tenor, basis of profit allocation, early withdrawal etc.

URIA is a significant funding source for the Bank. However, the failure to pay the expected return to URIA holders exposes the Bank to Displaced Commercial Risk leading to loss of reputation and business. The Bank regularly monitors rate of return offered by competitors to evaluate the expectations of its Investment Account Holders. Bank's policy also provides for whole or partial waiver of the Mudarib share of income from investments due to it, to provide a reasonable return to its investors. Bank further mitigates this risk by setting up and maintaining an appropriate level of Profit Equalisation Reserve (PER) and Investment Risk Reserve (IRR) to smoothen return to URIA holders.

The Bank comingles its own funds and URIA funds which are invested together. The Bank has an identified pool of assets where the URIA funds are invested the income from which is allocated to such accounts. Out of the gross income the investor's share is computed after deducting the Mudarib share and contribution to PER and IRR. The profit allocation schedule signed by the customer prior to investment contains the scheme of allocation of the Mudarib share and reserves. Administrative expenses incurred for management of the funds are borne directly by the Bank and are not charged separately to investment accounts.

URIAs are carried at their book values and include amounts retained towards PER and IRR. Creation of these reserves results in an increase in the liability towards the pool of URIAs.

Till date, the Bank has not made any drawals on PER or IRR. Any movements on these accounts are therefore only on account of additional reserves added.

Subject to the provisions thereof, deposits held with the Bahrain office of Khaleeji Commercial Bank are covered by the Deposit Protection Scheme established by the Central Bank of Bahrain regulation concerning the establishment of a Deposit Protection Scheme and a Deposit Protection Board.

The details of income distribution to URIA holders is given below.

	2008	2007	2006	Amount in BD 2005
Allocated Income to URIA	9,106,554	3,012,307	917,000	278,899
Distributed Profit	7,049,799	2,446,444	627,938	206,980
Mudarib Fees	2,056,754	565,863	299,062	71,919
As at 31 December				
URIA ⁽¹⁾	128,813,721	38,404,563	12,083,460	4,856,813
Profit Equalisation Reserve (PER)	648,749	206,099	60,000	13,945
Investment Risk Reserve (IRR)	472,619	133,604	43,277	8,697
Profit Equalisation Reserve-to-URIA	0.50%	0.54%	0.50%	0.29%
Investment Risk Reserve-to-URIA	0.37%	0.35%	0.36%	0.18%

⁽¹⁾ Represents average balance during the year.

Ratio of profit distributed to PSIA by type of URIA (based on tenor)

Tenor	Profit Paid amount in BD				Ratio of profit paid as a percentage of total			
	2008	2007	2006	2005	2008	2007	2006	2005
1 Month Mudharaba	3,346,280	1,576,071	334,753	107,889	47.5	64.4	53.4	52.1
3 Months Mudharaba	1,313,928	148,166	78,003	39,247	18.6	6.1	12.4	19.0
6 Months Mudharaba	372,645	70,774	25,814	9,158	5.3	2.9	4.1	4.4
12 Months Mudharaba	690,499	106,399	44,656	27,473	9.8	4.3	7.1	13.3
VIP Mudharaba	544,780	308,608	64,077	-	7.7	12.6	10.2	-
PER and IRR expenses	781,667	236,426	80,635	23,213	11.1	9.7	12.8	11.2
Total	7,049,799	2,446,444	627,938	206,980	100.0	100.0	100	100

Year	Avg. profit earned from URIA assets (%age of asset)	PER set aside as a %age of profit earned	IRR set aside as a %age of profit earned	Mudharib fees as a %age of profit earned	Profit paid as a %age of profits earned
2008	7.07	0.34	0.26	1.60	4.87
2007	7.84	0.38	0.24	1.47	5.75
2006	7.59	0.38	0.29	2.39	4.53
2005	5.74	0.29	0.18	1.48	3.80

Market Bench mark rates:

The Bank refers to the a group of commercial Islamic banks incorporated in the Kingdom of Bahrain so as to bench mark the rate of return on URIA:

Following are the profit rate declared and distributed to the investors by the Bank.

	2008	2007
1 Month Mudharaba	4.80	6.30
3 Months Mudharaba	5.25	5.20
6 Months Mudharaba	5.13	5.15
12 Months Mudharaba	5.40	5.30
VIP Mudharaba	4.52	5.09
Total Average Profit	5.02	5.41

8.4 Restricted Investment Accounts (RIAs)

The Bank offers Restricted Investment Accounts ("RIAs") to both small investors and high net worth individuals in the GCC. The Bank structures its RIA products to offer its customers an opportunity to choose from a wide range of returns, maturity periods, sectors, asset classes and risk levels.

All RIA offering documents ("Offering Document") are drafted and issued with input from the Bank's Investment Banking, Shari'a, Financial Control, Legal and Risk Management Departments to ensure that the Investors have sufficient information to make an informed decision after considering all relevant risk factors.

The Board of Directors is responsible for providing clear guidelines for the development, management and risk mitigation of its' RIA investments and to ensure that there exist sound management and internal control systems to ensure that the interests of the investment account holders are protected at all times. Wherever it is necessary for the Bank to establish Special Purpose Vehicles for management of the investment, the Board ensures that the management of such SPVs are conducted in a professional and transparent manner by a duly appointed Board.

The Bank is aware of its fiduciary responsibilities in management of the RIA investments and has clear policies on discharge of these responsibilities. The Bank's Policy regarding its' fiduciary responsibilities to the RIA investors and their funds, includes the following:

- Ensuring that the investment structure, Offering Documents and the investment itself are fully compliant with Islamic Shari'a principles and the CBB regulations;
- Appropriately advising Investors, as part of the RIA Offering Document, of all the relevant and known risk factors and making it clear that the investment risk is to be borne by the Investor before accepting the investment funds;
- Completing all necessary legal and financial due diligence on investments undertaken on behalf of the Investors with the same level of rigor as the Bank requires for its' own investments;
- Ensuring that the funds are invested strictly in accordance with the provisions outlined in the Offering Documents;
- Putting in place suitable resources and systems to manage and administer the investment and any necessary RIA SPV(s) to generate optimum return to Investors and to proactively manage all risks;
- Preparing and disseminating periodical investment updates to Investors on a regular basis during the tenor of the investment;
- Exiting the investments at the appropriate time and distributing the capital and profits to the Investor in a just and equitable manner as Mudareb; and
- In all matters related to the RIA, RIA SPV(s) and the investment, act with the same level of care, good faith and diligence as the Bank would apply in managing its own investments.

Within the Bank, the abovementioned responsibilities and functions are provided, managed and monitored by qualified and experienced professionals from the Investment Banking, Shari'a, Financial Control, Legal, Investment Administration and the Risk Management Departments.

Investment update reports are prepared and disseminated by the Bank to the RIA Investors on a periodic (at least on a half yearly) basis outlining any material contracts/decisions, investment performance, distribution (if any) or exit criteria/information.

RIA Name	Details	Launch Date	Projected Returns (%)	Return Frequency	% Returns p.a.			
					2008	2007	2006	2005
Al Hareth French Property Fund	An investment product designed to deliver attractive return from income producing properties in France, which is currently yielding 9.5% p.a. exceeding the 9% promised to investors. An approximate capital redemption of 30% was completed in April 2007. The product generated a capital gain of 6% on the redeemed portion.	2005	9	Annual	9.5	9.5	9.5	4.4
RIA-1 Safana	An investment structure designed to participate in the equity interest of Safana Investment WLL. A company established for the purpose of acquiring reclaimed land to subdivide and sell. The product has a three year term with the distribution expected upon exit in May 2010	2007	61.78 over 3 years	Bullet payment on maturity	-	-	-	-
RIA-2 Hajer Tower	A restricted investment structure designed to acquire the 21st floor of Al-Hajer Tower in the Holy City of Mecca. The exit of this product was completed in June 2008 with the expected return of 14.90% been met.	2007	14.90	Bullet payment on maturity	14.90	-	-	-
RIA-3 Aramis	Participation in Murabaha backed by a promissory issued by a guarantor SPV with BBB+ rating. KHCB offered this as a short-term investment to investors with 3 month term on a renewal option and successfully exited all investors from this project during quarter ended 1 March 2008	2007	3 M LIBOR + 187 bps per quarter	Quarterly	7.5	7.72	6.34	-
RIA 4 Janayen	A restricted Mudarabah Product designed to invest in income generating property mainly designed for labour Accommodation. Total cash yield on portfolio is currently in the region of 11% p.a. with quarterly distributions of 2.75% which is over the quarterly distribution rate of 2.50% (projected from April 2008 onwards) specified in the offering documents. Janayen is expected to exit on completion of 30 months in January 2010.	2007	2.5 per quarter	Quarterly	10.65	-	-	-
RIA-5 North Gate	A Restricted Mudharabah product which owns a 6.0% stake in Shaden Real Estate Investment WLL which will in turn through its subsidiaries, hold a parcel of reclaimed land and measuring approximately 3.875 million sq. meter located in Al Hidd, Muharraq. The mixed-use plot will be sold to end-users subsequent to the completion of infrastructure works. The distribution is expected to be in a bullet payment.	2008	90.66 over 3 years	Bullet return at maturity	-	-	-	-

9 Corporate Governance & Other Disclosures

9.1 Corporate Governance Structure

The Bank's corporate governance framework focuses on Board responsibility, oversight and management accountability vis-à-vis governing regulations and better practices. The framework is in line with global best practices and regulatory requirements which seek to balance entrepreneurship, control and transparency, while creating value for all stakeholders.

Corporate governance, the way the Board and Management is organised 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 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.

9.2 Board of Directors

The Board of Directors currently comprises of ten members. During the year 2008, the shareholders during the Annual General Meeting (AGM), elected a new Board which represents the new and changed shareholding of the Bank. The Chairman of the Board of Directors is charged with regular supervision and assessment of executive management and is responsible for leading the Board, ensuring its effectiveness, monitoring the performance of the Chief Executive Officer (CEO), and maintaining a dialogue with the Bank's stakeholders. The Board has constituted certain committees with specific delegated authorities to oversee and guide the management in specific areas of the Bank's operations and decision-making. The Board, either directly or through its various committees will oversee the management of the Bank.

The names, title, and other positions held by the Board of Directors are set out below.

- **Dr. Fuad Abdulla Al-Omar**, Chairman
Director Since 2004 (Independent and Non-Executive)
Chairman of MENA Real Estate Company, Kuwait
- **Dr. Essam Yousif Janahi**, Vice Chairman
Director Since 2004 (Non-Executive)
Nominated by Gulf Finance House BSC
Chairman - Gulf Finance House
Member - Shura Council of the Kingdom of Bahrain
Chairman - Bahrain Financial Harbour Holding Company
Chairman - Bayan Holding Company
Vice Chairman - Al Areen Holding Company
Board Member - Arab Finance House
Board Member - Legends Development Company
Board Member - Abu Dhabi Investment House
- **Abdul Latif Abdulla Al-Meer**, Director
Director Since 2004 (Non-Executive)
Nominated by Gulf Finance House BSC
CEO - QInvest
Board Member - Islamic Insurance & Assurance Co, Bahrain
Board Member - Arab Finance House, Beirut
Board Member - European Finance House, London
Board Member - Asian Finance House, Malaysia
Board Member - Gulf Finance House
- **Hesham Abdullatif H. Al Jaber**, Director
Director Since February 2008 (Non-Executive)
Nominated by Gulf Finance House BSC
Board Member - Al-Jabr Trading Company, KSA
Board Member - United Gas Transmission Co, UAE
Board Member - Advanced Electronics Equipment, KSA
Board Member - Golden Chip Company, KSA
Board Member - Nattily Company, KSA

- **Talal Hazim R. Al Ghalib**, Director
Nominated by Gulf Finance House BSC
Director Since February 2008 (Non-Executive)
Executive Director - Gulf Finance House
- **Abdulrahman Mohamed Al Shared**, Director
Director Since February 2008 (Independent and Non-Executive)
Secretary General & Board Member -Awqaf and Minor Affairs foundation, Dubai
Board Member -Dubai World Trade Centre
Board Member - Dubai Investment Industry
- **Rashad Yusuf Abdulla Janahi**, Director
Director Since February 2008 (Non-Executive)
Nominated by Esam Yousif Janahi
CEO - Abu Dhabi Investment House
Chairman- Qatar Entertainment City
Board Member - Al Arabi Private Equity Fund
Board Member - Gulf Holding Company
Board Member - Global Banking Corporation (GBCorp)
- **Abdulla A. Karim Showaiter**, Director
Director Since February 2008 (Non-Executive)
Nominated by Emirates Islamic Bank
General Manager – Corporate & Investment, Emirates Islamic Bank
Board Member - Bahrain Islamic Investment Co, Bahrain
Board member - Saba Islamic Bank, Yemen
- **Abdullateef Moosa Al Abdul Razzaq**, Director
Director Since February 2008 (Non-Executive)
Nominated by Al Imtiaz Investment Company
CEO Consultant - Al Imtiaz Investment Company
- **Ebrahim Hussain Ebrahim**, Director
Director Since February 2008 (Executive)
CEO - Khaleeji Commercial Bank
Chairman - Capital Real Estate Company
Chairman - Janayen Holding Company
Chairman - Danat India investment Company
Board member – Eqarat Al Khaleej
Board member – First Gulf Real Estate Company SPC
Board member – Gulf German Residences
Board member – Amlak II Bahrain
Board member – Amlak II Walkers
Board member – Surooh Bahrain SPC
Board member – Danat India Holding Company
Board member – Jawhara Greens Company

Note: The qualifying criteria for 'Independent' Directors are as per the Corporate Governance guidelines of the Central Bank of Bahrain.

The Chairman, the Board of Directors and the Board Committees have direct access to the heads of Internal Audit, Risk Management, Regulatory Compliance & Shari'a Compliance.

9.3 Board of Directors' Interests

The members of the Board collectively held 17,859,801 shares in the Bank as of the year ended 31 December 2008 (2007: 10,285,047 shares).

9.4 Code of Conduct

The Board has approved a code of conduct for all staff of the Bank as well as the Board members. The code which includes how to deal with areas of conflict of interest, binds the directors, executive management and staff to the highest standards of professionalism and due diligence on discharging their duties.

9.5 Insider Trading

During 2008, the Board approved the policy on Insider Trading in line with regulatory requirements with the main objective of preventing abuse of inside information. Insiders include all board members, all executive management and any person from the Bank or working on assignments related to the Bank who have access to material and price sensitive information.

9.6 Board Committees

The Board of Directors has constituted four Committees with specific delegated authorities.

Committee	Members	Primary Responsibilities
Board Nominations, Remunerations & Governance Committee (BNRGC)	Dr. Esam Yusuf Janahi Abdulla Abdulkarim Showaiter A. Latif Moosa Al Abdulrazzaq	Hr & Related Policies Compensation And Incentives Human Resources Administration Corporate Governance
Board Audit Committee (BAC)	A.Latif Abdulla Al Meer Talal Hazim Rajih Al Ghalib Rashad Yousif Janahi	Internal Audit External Audit Accounting Policies Compliance Anti Money Laundering
Board Investment & Credit Committee (BICC)	Dr. Fuad Abdulla Al Omar Dr. Esam Yusuf Janahi Abdulla Abdulkarim Showaiter A. Latif Moosa Al Abdulrazzaq Ebrahim Hussain Ebrahim	Investment & Credit Approval Limits Investment Policies Asset Liability Management
Board Risk Management Committee (BRMC)	Dr. Fuad Abdulla Al Omar Hesham Hamad Abdulatif Al Jabr Abdulrahman Mohamed Al Shared	Risk Management Policies Related To Risk Management
Insiders Committee	Dr. Fuad Abdulla Al Omar Dr. Esam Yusuf Janahi Ebrahim Hussain Ebrahim	Insider Trading

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.

9.7 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.

- **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
Former Lecturer at the 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
Member of Shari'a Supervisory Boards of a number of Islamic banks
PhD in Ibn Hazm's Methodology of Jahala, Edinburgh university, UK
PhD in Al-Bukhari's Methodology, University of Mohammed V, Morocco
- **Shaikh Nizam Mohammed Saleh Yaqoobi**, Member
Executive Member of the Shari'a Supervisory Board of Abu Dhabi Islamic Bank
Executive Member of the Shari'a Supervisory Board of Bahrain Islamic Bank
Executive Member of the Shari'a Supervisory Board of and Shamil Bank
Member of Shari'a Supervisory Boards of a number of Islamic banks
Board Member of the Dow Jones Islamic index

- **Abdulnasser Al Mahmood**
Head of Shari'a Compliance - Regulatory Shari'a & Compliance

9.8 Executive / Management Committee

The Board of Directors delegates the authority for day-to-day management of the business to the Chief Executive Officer (CEO) who is responsible for implementing the Bank's strategic plan. The CEO manages the Bank through the following management committees

Committee	Primary Responsibilities
Management Committee	Strategy, Performance Review, Budget, Human Resources, Administration
Asset Liability Management Committee	Balance Sheet Management, Funding, Liquidity, Banking Relationships
Executive Credit & Investment Committee	Review Of Investments, Exit And Credit Proposals, Monitoring Of Investments
Executive Risk Management Committee	Risk Management Policies, Risk Review, Provisions And Impairment

Executive Management & Other Senior Management

The names & title of each member of our Executive & other Senior Management are set out in the table below:

- **Mr. Ebrahim Hussain Ebrahim**, Chief Executive Officer & Board Member
Experience - Over 25 years of experience in both Islamic and conventional banks and financial institutions. Joined the Bank in 2004.
Qualification - Master of Business Administration with a concentration in Finance
- **Mr. Silvan Varghese**, Deputy General Manager & COO
Experience - Over 16 years experience in banking and financial services industry in the areas of risk and credit management, project finance and corporate banking. Joined the Bank in 2007
Qualification - BS in Chemical Engineering from BITS, Pilani, India, MBA from the Indian Institute of Management (IIM), Lucknow, India, certified by Global Association of Risk Professionals (GARP) as a Financial Risk Manager (FRM)
- **Fuad Ali Taqi**, Deputy General Manager- Commercial Banking
Experience - Over 27 years of banking experience in Islamic and conventional banks. Joined the Bank in 2006.
Qualification - Business Studies Diploma, currently enrolled in an MBA program.
- **Dimitry Blasi**, Deputy General Manager- Investment Banking
Experience - Over 12 years experience Islamic and conventional banking including in a number of prominent international jurisdictions. Joined the Bank in 2005.
Qualification - ACA (United Kingdom), qualified lawyer (NSW, Australia)
- **Mahdi A. Nabi Mohammed**, Assistant General Manager - Operations & Administration
Experience - Over twenty five years of banking experience. Joined the Bank in 2005. Prior to joining the Bank, he held several senior positions including the Head of Treasury and Investment Department and a Deputy Senior Manager for the entire Operations Division.
Qualification - Certified Diploma in Accounting & Finance from The Chartered Association of Certified Accountants (ACCA), MBA from the University of Strathclyde, United Kingdom.
- **Khalil Zaabi**, Head of Investment Placement- Investment Banking
Experience - Over 25 years of banking experience in Islamic, conventional bank and financial institutions. Joined the Bank in 2006.
Qualification - Diploma in Mathematics from Arthur King Collage, Canada, Diploma in Computer Programming from Computer Institute of Canada.
- **Ahmed Ali Bucheery**, Head of Internal Audit
Experience - 15 years of internal audit experience with banks. Joined the Bank in 2007.
Qualification - Certified Internal Auditor (from the Institute of Internal Audit, USA), B.S Accounting from King Fahad University of Petroleum and Minerals.

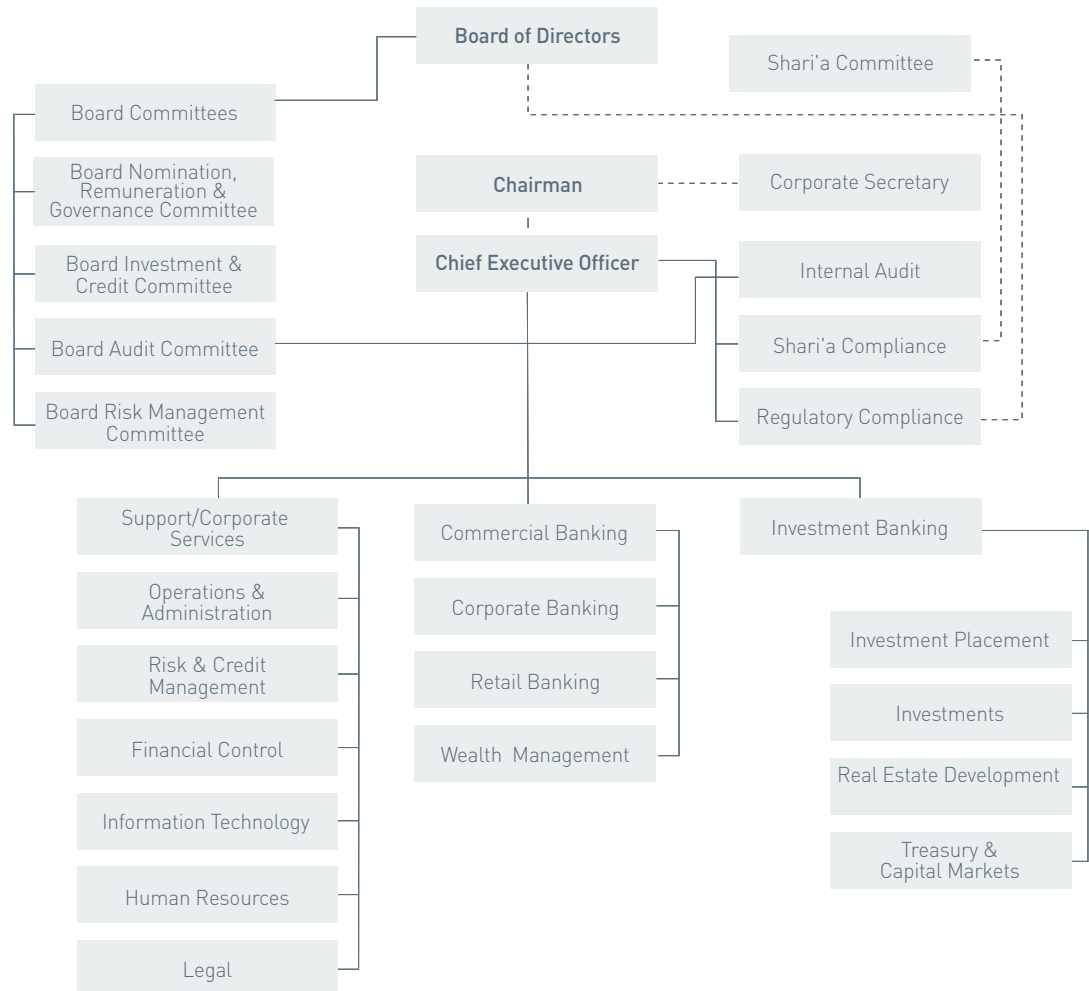
- **Hussam Saif**, Head of Treasury
Experience – 19 years of experience in treasury and Islamic banking. Joined the Bank in 2007.
Qualification - Graduate of Western International University – London with a degree in Business Administration & Management.
- **T N Ramesan**, Head of Risk & Credit Management
Experience - 29 years of banking experience. Joined the Bank in 2007.
Qualification - MSc in Physics from the Indian Institute of Technology, Madras, India, Diploma in International Finance & Investment from Hong Kong Management Association, Certified Associate of the Indian Institute of Bankers
- **Yaser Mudhafar**, Head of Financial Control
Experience – 11 years extensive experience in the Islamic banking industry. Joined the Bank in 2005.
Qualification - CPA, CIPA, EMBA and a Bachelor of Science in accounting from University of Bahrain
- **Fetoo Al Mannai**, Head of Human Resources
Experience – 13 years of experience in human resources, training and administration. Joined the Bank in 2007
Qualification - MBA and a BA (Hons) in Human Resource Management, Member of Bahrain Society for Training and Development (BSTD), Member of Bahrain Management Society (BMS), Fellow of the Chartered Institute of Personnel & Development (Chartered FCIPD), Member of Society of Human Resource Management (SHRM)
- **Ramnath Narayanan**, Head of Legal- Legal Department
Experience – Over 11 years experience in Legal and Banking industry. Joined the Bank in 2008.
Qualification – Master of Laws from the University of Virginia School of Law, USA, Bachelor of Laws from the University of Madras, India, and a Certified associate of the New York Attorney and Solicitors Regulation Authority.
- **Abdulnasser Al Mahmood**, Head of Shari'a Compliance - Regulatory Shari'a & Compliance
Experience – Over 18 years of experience in Shari'a Audit and Islamic banking. Joined the Bank in 2008.
Qualification – BS in Shari'a and Islamic studies, Associate Diploma in Shari'a Control, currently enrolled in MBA Program.
- **Ameen Bahaaldin**, Board Secretary
Experience – 15 years in the legal field. Joined the Bank in 2007.
Qualification - Master in Political Science from University of Khartoum, Postgraduate Diploma in International Relations.

9.9 Executive Management Interests

The members of the Executive Management team held 2,440,608 shares as at 31 December 2008 (2007: 1250,000 shares).

9.10 Organisation Chart

Set out below is the Bank's organisation chart, which outlines the different committees and the lines of reporting.



There have been no major structural changes to the organisation structure from the previous year.

9.11 Executive compensation

The Bank has both a short-term and long-term compensation structure for its executive management which has been developed based on current market surveys and industry norms. The Bank also operates an incentive scheme where in eligible employees are awarded a combination of shares and cash incentives on achievement of pre-determined performance targets. For further details please refer note 20 in the consolidated financial statements for the year ended 31 December 2008. The Board of Directors is entitled to sitting fees and their annual remuneration is subject to the approval of the shareholders at the end of each year.

9.12 Shari'a Compliance, Regulatory Compliance and Anti-Money Laundering

Compliance with Shari'a laws, regulatory and statutory requirements is an ongoing process and the Bank is conscious of its responsibilities in observing all applicable provisions and best international practices in its functioning. The Bank has established the Shari'a Compliance Function and the Regulatory Compliance Function in keeping with Basel and CBB guidelines. The respective units act as a focal point for all Shari'a and regulatory compliance and for adapting other best practice compliance principles.

Anti-Money Laundering measures form an important area of the Compliance Function. The Bank has an Anti-Money Laundering and Combating Terrorist Financing Policy and Procedure approved by the Board, which contains sound Customer Due Diligence measures, procedure for identifying and reporting suspicious transactions, a programme for periodic awareness training to staff, record-keeping, and a designated Money Laundering Reporting Officer (MLRO). The Bank's Anti-Money Laundering measures are audited by independent external auditors every year and their report is submitted to the CBB. The Bank is committed to combating money laundering and, towards this end, implements all 'Prevention of Money Laundering Regulations' and other guidelines issued by the CBB.

10 Financial performance

Following are basic quantitative indicators of the financial performance:

	2008	2007	2006	2005
Return on Average Equity	20.00%	23.50%	20.89%	13.00%
Return on average assets	7.40%	11.50%	9.54%	8.11%
Net finance margin	154.11%	187.97%	144.59%	176.71%
Cost- to- Income-Ratio	42.79%	30.46%	41.49%	37.65%

For detailed discussion on the performance for the year kindly refer Chairman's statement.