

**KHALEEJI COMMERCIAL
BANK BSC**

**CONSOLIDATED FINANCIAL STATEMENTS
31 DECEMBER 2008**

Commercial registration	:	55133 (registered with Central Bank of Bahrain as a retail Islamic bank).
Office	:	Bahrain Financial Harbour East Wing PO Box 10006, Manama, Kingdom of Bahrain
Directors	:	Dr. Fuad Abdulla Al-Omar, <i>Chairman</i> Dr. Esam Yousif A. Janahi, <i>Vice Chairman</i> Abdul Latif Abdulla Al-Meer Abdul Latif Mosa Al-Abdul Razaq Abdulla Abdulkarim Showaiter Ebrahim Hussain Ebrahim Hisham A.Latif Al-Jabr Rashad Yousif A. Janahi Talal Hazim Al-Qalib
Chief Executive Officer	:	Ebrahim Hussain Ebrahim
Company secretary	:	Amin Bahaaldin Mohammed
Auditors	:	KPMG

CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2008

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CHAIRMAN'S REPORT
for the year ended 31 December 2008

Dear Shareholders

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

On behalf of the Board of Directors, it is my pleasure to present the annual report of Khaleeji Commercial Bank (KHCB) for the year ended 31 December 2008. The year 2008, which is the fourth year of operations started exceptionally well and I am delighted to report that in spite of the 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 strategic 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 Al Roweiah, who resigned as members of the Board in February 2008, for their valuable contribution and service to KHCB since inception.

Financial Performance

The impact 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 both a direct and indirect impact on the Bank. Nevertheless, we have been proactive in ensuring that the Bank maintains a 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 to BD27.3 million, 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 BD 138 million.. Following these results, the Board of Directors has recommended, a cash dividend of 15% and a bonus share issuance 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 company 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. We believe that the listing on the BSE will also enhance our position among investors in the regional capital markets and assist in our progression into a leading player in the local and regional banking sector.

CHAIRMAN'S REPORT
for the year ended 31 December 2008 *(continued)*

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 has 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 by 85%, from BD88.4 million in 2007 to BD163.6 million in 2008, further expanding our customer base..

We have successfully launched one new restricted investment account (RIA), enabling our clients to actively participate and benefit from regional economic growth. We also structured and launched two investment products, namely, Jawhara Greens (USD250 million) and Global Logistics (USD430 million) in addition to the of \$ 163 million closing for Danat India Investment Company. We also broadened our investment reach to new markets such as Australia by acquiring an equity stake in Locata Corporation PTY limited as well as participating in sukuks and other regional opportunities.

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 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 GCC net in other countries of the region. With the launch of our Visa branded debit card, our customers will now be able to access their accounts from ATMs throughout the world.

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 strategic 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. Further, 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.

Awards and Accolades

I am very proud 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 2009 KHCB was selected as the Best Islamic Retail Bank during the Banker Middle East Islamic Finance awards. We are honoured to receive these awards, as they reflect the confidence of our industry peers, customers and the broader market.

CHAIRMAN'S REPORT
for the year ended 31 December 2008 *(continued)*

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 moving up 20 places in the overall ranking to take the 67th place among the top global 500 Arab banks.

Corporate Social Responsibility

We are also aware that as a growing institution we have a responsibility towards contributing 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 program 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 further expanding our business, both in our primary markets in the 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 sector 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, that are geared up to help us expand 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 take this opportunity to express my gratitude to His Majesty the King; His Highness the Prime Minister; and His Highness the Crown Prince and Deputy Supreme Commander of Bahrain Defence Force, for their wise and inspired leadership of the Kingdom of Bahrain, and for their encouragement for the growth of the private sector and the development of the banking and finance industry. I also extend my thanks to the Central Bank of Bahrain and all Government Ministries 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

26 January 2009

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS
KHALEEJI COMMERCIAL BANK BSC
Manama, Kingdom of Bahrain

26 January 2009

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 at 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 at 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 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.

CONSOLIDATED BALANCE SHEET
as at 31 December 2008

BD 000's

	Note	31 December 2008	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 7)		137,982	134,990
Total liabilities, unrestricted investment accounts and equity		464,993	269,511
Off-balance sheet items			
Restricted investment accounts (page 10)		47,445	42,965

The financial statements, which consist of pages 5 to 53, 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 A. 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

BD 000's

	Note	2008	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

BD 000's

31 December 2008

	Share capital	Share premium	Statutory reserve	Treasury shares	Unvested employee incentive scheme shares	Share grant reserve	Retained earnings	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

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 (continued)

BD 000's

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

BD 000's

	Note	2008	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

BD 000's

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	Adminstration 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

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

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 (continued)

BD 000's

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	Adminstration 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 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

BD 000's

	2008	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

BD 000's

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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2008

BD 000's

2 *Significant accounting policies (continued)***(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.

(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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2008

BD 000's

2 *Significant accounting policies (continued)***(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.

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 sukuks 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.

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2 *Significant accounting policies (continued)*(e) *Investment securities (continued)***(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.

(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.

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2 *Significant accounting policies (continued)***(j) Investment in property**

Investment in properties include trading properties and investment properties. Trading properties are properties held for sale in the ordinary course of business 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.

(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.

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2 *Significant accounting policies (continued)***(q) Impairment of assets**

The Bank assesses at each balance sheet date whether there is objective evidence that an 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.

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.

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2 *Significant accounting policies (continued)***(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 a loan commitment is not expected to result in the draw-down of a loan, loan 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.

(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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2008

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2 *Significant accounting policies (continued)***(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.

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2 Significant accounting policies (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.

(u) Employee benefits (continued)

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.

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for the year ended 31 December 2008

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3 CASH AND BANK BALANCES

	2008	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	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	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
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6 INVESTMENT SECURITIES

	2008	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	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	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 instalments receivable	4,031	940	4,971	2,156
Balance at 31 December	17,515	5,967	23,482	12,986

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8 INVESTMENT IN ASSOCIATES

	2008	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	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	2007
Income from investment banking services receivable	17,128	13,180
Placement fees receivable	-	1,131
Income from sukuks 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.

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11 EQUIPMENT

	Furniture and fixtures	Computers	Motor Vehicle	Other Equip-ment	Work-in-progress	2008 Total	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	2007
Employee related accruals	5,852	2,783
Accounts payable	3,546	2,830
Charity payable (page 12)	442	156
Other payables and accrued expenses	1,743	414
	11,583	6,183

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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).

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

	2008	2007
Investment in sukuku	47,298	32,812
Islamic financing assets	140,143	75,462

15 SHARE CAPITAL**Authorised:**

3,000,000,000 ordinary shares of BD 0.100 each

Issued and fully paid up:

1,000,000,000 ordinary shares of BD 0.100 each

	2008	2007
	300,000	300,000
	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.

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15 *SHARE CAPITAL (continued)*

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

16 **INCOME FROM INVESTMENT SECURITIES**

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

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19 OTHER EXPENSES

	2008	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

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.

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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.

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.

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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.

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	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	-

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23 *RELATED PARTY TRANSACTIONS (continued)*

	2008	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	-

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	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.

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23 **RELATED PARTY TRANSACTIONS** (continued)

Details of material contracts involving Directors' include:

	2008	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 2007. 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

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).

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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	Total
Assets						
Cash and bank balances	23,378	-	-	-	-	23,378
Placements with financial institutions	131,952	-	-	-	-	131,952
Islamic financing assets	28,495	27,105	22,725	39,171	22,643	140,143
Investment securities	12,450	1,195	21,008	38,251	29,534	102,398
Assets acquired for leasing	1,500	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

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27 Maturity profile (continued)

	Up to 3 months	3 to 6 months	6 months-1 year	1 to 3 years	Over 3 years	Total
2007						
Assets						
Cash and bank balances	6,169	-	-	-	-	6,169
Placements with financial institutions	79,065	-	-	-	-	79,065
Islamic financing assets	23,651	9,816	12,551	16,751	12,687	75,462
Investment securities	-	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	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

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BD 000's

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

(a) Industry sector

2008	Banks and financial institutions	Real estate	Others	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
for the year ended 31 December 2008

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

2007	Banks and financial institutions	Real estate	Others	Total
Assets				
Cash and bank balances	6,169	-	-	6,169
Placements with financial institutions	79,065	-	-	79,065
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
Unrestricted investment accounts	12,090	10,944	41,066	64
Off-Balance sheet items				
Restricted investment accounts	-	42,965	-	42

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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BD 000's

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

(b) Geographic sector

2008	GCC countries	Europe	USA	Asia	Austral ia	Africa	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

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BD 000's

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

2007	GCC countries	Europe	USA	Asia	Africa	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
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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).

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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.

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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	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
<u>Past due comprises:</u>						
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

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30 Risk management (continued)*Credit risk (continued)*

2007	Place-ments with financial institutions	Islamic financing assets	Assets acquired for leasing	Investment securities- sukuk	Other assets	Total
<u>Impaired</u>	-	-	-	-	-	-
<u>Carrying amount</u>	-	-	-	-	-	-
<u>Past Due but not impaired</u> Grade 1-6 Low-Fair Risk	-	1,763	-	-	-	1,763
Unrated <u>Past due comprises:</u>	-	-	-	-	4,310	4,310
0-30 days	-	-	-	-	-	-
30-60 days	-	1,763	-	-	-	1,763
60-90 days	-	-	-	-	-	-
90-180days	-	-	-	-	-	-
180 days +	-	-	-	-	4,310	-
<u>Carrying amount</u>	-	1,763	-	-	4,310	6,073
<u>Neither past due nor impaired</u> Grade 1-6 Low-Fair Risk	79,065	73,699	12,986	32,812	-	198,562
Unrated <u>Carrying amount</u>	-	-	-	37,927	12,097	50,024
	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.

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30 Risk management (continued)**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.

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.

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30 Risk management (continued)

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.

	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
<u>Against impaired</u>	-	-	-	-	-	-
<u>Against past due but not impaired</u>						
Property	4,671	-	4,671	-	-	-
<u>Against neither past due nor impaired</u>						
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 .

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for the year ended 31 December 2008

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30 Risk management (continued)

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.

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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENT
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BD 000's

30 Risk management (continued)

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	142%	179%
Average for the period	194%	144%
Maximum for the period	270%	269%
Minimum for the period	142%	83%

For maturity profile of assets and liabilities refer note 27.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2008

BD 000's

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
for the year ended 31 December 2008

BD 000's

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	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

	Upto 3 months	3 - 6 months	6 months - 1 year	1 - 3 years	More than 3 years	Total
Assets						
Placements with financial institutions	79,065	-	-	-	-	79,065
Islamic Financing assets	33,405	14,225	9,291	17,447	1,094	75,462
Assets acquired for leasing	(362)	7,480	5,868	-	-	12,986
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

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BD 000's

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.

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BD 000's

32 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.

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BD 000's

32 Risk management (continued)**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.

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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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BD 000's

32 Risk management (continued)**Capital management (continued)**

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	31 December 2007 Basel I
Total risk weighted assets	328,906	272,011
Tier 1 capital	138,247	132,360
Tier 2 capital	649	-
Total regulatory capital	138,896	132,360
Total regulatory capital expressed as a percentage of total risk weighted assets	42.23	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

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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32 COMMITMENTS

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

	2008	2007
Undrawn commitments to extend finance	21,376	18,095
Underwriting commitments	15,080	-

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.