

Independent Auditors' Report

to the Shareholders of Kuwait Finance House - Bahrain

We have audited the accompanying consolidated financial statements of Kuwait Finance House (Bahrain) B.S.C. (c) [the "Bank"] and its subsidiaries [together the "Group"] which comprise the consolidated balance sheet as at 31 December 2007 and the consolidated statement of income, the consolidated statement of cash flows, the consolidated statement of changes in equity and the consolidated statement of restricted investment accounts for the year then ended and a summary of significant accounting policies and other explanatory notes.

Board of Directors' Responsibility for the Financial Statements

The Board of Directors is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with both the Financial Accounting Standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions, to operate in accordance with Islamic Shari'a, and International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal controls relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with both the International Standards on Auditing and Auditing Standards for Islamic Financial Institutions. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate for the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal controls. An audit also includes evaluating

the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Board of Directors, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 31 December 2007 and of its financial performance and its cash flows for the year then ended in accordance with Financial Accounting Standards issued by the Accounting and Auditing Organization for Islamic Financial Institutions and the Islamic Shari'a Rules and Principles as determined by the Shari'a Supervisory Board of the Bank.

In addition, in our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 31 December 2007 and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Other Regulatory Matters

We confirm that, in our opinion, proper accounting records have been kept by the Group and the consolidated financial statements, and the contents of the Report of the Board of Directors relating to these consolidated financial statements, are in agreement therewith. We further report, to the best of our knowledge and belief, that no violations of the Bahrain Commercial Companies Law, nor of the Central Bank of Bahrain and Financial Institutions Law, nor of the memorandum and articles of association of the Bank have occurred during the year ended 31 December 2007 that might have had a material adverse effect on the business of the Group or on its consolidated financial position, and that the Bank has complied with the terms of its banking license.



13 February 2008
Manama, Kingdom of Bahrain

Consolidated Balance Sheet

at 31 December 2007

	Notes	2007 BD 000s	2006 BD 000s
ASSETS			
Cash and balances with banks and Central Bank of Bahrain	5	23,640	21,383
Murabaha and Mudaraba contracts with banks	6	80,685	66,654
Murabaha, Musharaka, Istisna'a and Ijarah Muntahia Bittamleek contracts relating to customers	7	276,061	161,956
Investments	8	141,872	83,063
Investment in associates	9	41,356	15,385
Investment properties	10	105,097	27,623
Receivables and prepayments	11	40,658	11,268
Goodwill and intangibles	12	6,927	2,508
Premises and equipment		18,995	13,204
TOTAL ASSETS		735,291	403,044
LIABILITIES, UNRESTRICTED INVESTMENT ACCOUNTS AND EQUITY			
LIABILITIES			
Murabaha contracts with banks	13	77,329	110,366
Murabaha contracts with non-banks	14	287,269	99,345
Customers' current accounts	15	107,150	46,549
Other liabilities	17	46,191	12,875
		517,939	269,135
UNRESTRICTED INVESTMENT ACCOUNTS		53,091	44,375
EQUITY ATTRIBUTABLE TO SHAREHOLDERS OF THE PARENT			
Share capital	19	70,016	44,560
Share premium	19	15,040	760
Statutory reserve	20	8,238	5,098
General reserve		20,173	13,800
Investment revaluation reserve		22,390	12,058
Retained earnings		17,925	10,827
		153,782	87,103
MINORITY INTEREST		10,479	2,431
		164,261	89,534
TOTAL LIABILITIES, UNRESTRICTED INVESTMENT ACCOUNTS AND EQUITY		735,291	403,044
RESTRICTED INVESTMENT ACCOUNTS		66,066	19,109
CREDIT COMMITMENTS AND CONTINGENT ITEMS	28	59,372	31,003

Bader A. M. Mukhaizeem
Chairman and Managing Director

Mohamed bin Sh. Eshaq
Vice Chairman

Abdulhakeem Y. Alkhayyat
General Manager

The attached notes 1 to 33 form part of these consolidated financial statements.

Consolidated Statement of Income

Year ended 31 December 2007

	Notes	2007 BD 000s	2006 BD 000s
Income from investment activities	21	29,908	28,180
Income from retail and corporate banking activities	22	25,863	17,819
Share of income of associates	9	14,173	512
Other income		2,049	864
		<u>71,993</u>	<u>47,375</u>
Less: Profit on Murabaha contracts		14,639	9,039
		<u>57,354</u>	<u>38,336</u>
Staff costs		8,106	6,438
Depreciation		1,871	1,493
Provisions		3,233	2,284
Other operating expenses	23	9,812	6,158
		<u>23,022</u>	<u>16,373</u>
NET INCOME BEFORE PROFIT ON UNRESTRICTED INVESTMENT ACCOUNTS		34,332	21,963
Less: Profit on unrestricted investment accounts	18	1,662	1,200
NET INCOME FOR THE YEAR		32,670	20,763
Attributable to:			
Shareholders of the Parent		31,399	21,130
Minority interest		1,271	(367)
		<u>32,670</u>	<u>20,763</u>

The attached notes 1 to 33 form part of these consolidated financial statements.

Consolidated Statement of Cash Flows

Year ended 31 December 2007

	Notes	2007 BD 000s	2006 BD 000s
OPERATING ACTIVITIES			
Net income for the year		32,670	20,763
Adjustments for:			
Provisions		3,233	2,284
Depreciation		1,871	1,493
Share of income of associates	9	(14,173)	(512)
Unrealised gain on investments	21	(7,147)	(6,705)
Unrealised gain on investment properties	21	(9,625)	(1,363)
Profit on sale of investment properties	21	(2,736)	(1,875)
Operating income before changes in operating assets and liabilities		4,093	14,085
Changes in operating assets and liabilities:			
Mandatory reserve with Central Bank of Bahrain		(6,100)	(1,680)
Murabaha and Mudaraba contracts with banks		4,408	15,497
Murabaha, Musharaka, Istisna'a and Ijarah Muntahia Bittamleek contracts relating to customers		(124,089)	(53,712)
Receivables and prepayments		(24,022)	(2,694)
Murabaha contracts with banks		(26,135)	54,022
Murabaha contracts with non-banks		169,686	31,166
Customers' current accounts		61,455	15,367
Other liabilities		7,661	5,182
Net cash from operating activities		66,957	77,233
INVESTING ACTIVITIES			
Acquisition of a subsidiary - net of cash and bank balances acquired	12	(2,236)	-
Additional investment in acquired subsidiary		(8,892)	-
Purchase of investments		(37,178)	(31,696)
Investments in associates		(16,315)	-
Purchase of investment properties		(21,730)	(12,233)
Proceeds from sale of investment properties		4,037	2,585
Purchase of intangibles		(1,552)	-
Purchase of premises and equipment		(7,534)	(3,657)
Net cash used in investing activities		(91,400)	(45,001)
FINANCING ACTIVITIES			
Increase in unrestricted investment accounts		8,716	13,568
Issue of new shares of the Bank		35,280	2,320
Net movement in minority interest		(4,653)	-
Net Cash from financing activities		39,343	15,888
NET CHANGE IN CASH AND CASH EQUIVALENTS			
Cash and cash equivalents at 1 January		77,610	29,490
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	24	92,510	77,610

The attached notes 1 to 33 form part of these consolidated financial statements.

Consolidated Statement of Changes in Equity

Year ended 31 December 2007

	Attributable to the shareholders of the parent							Total	Minority interest	Total equity
	Notes	Share Capital BD 000s	Share premium BD 000s	Statutory reserve BD 000s	General reserve BD 000s	Investment revaluation reserve BD 000s	Retained earnings BD 000s			
Balance at										
1 January 2006		38,500	-	2,985	-	3,992	18,325	63,802	2,777	66,579
Income for the year		-	-	-	-	-	21,130	21,130	(367)	20,763
Transfer to investment revaluation reserve		-	-	-	-	11,738	(11,738)	-	-	-
Transfer to retained earnings on sale of investments		-	-	-	-	(3,672)	3,672	-	-	-
Directors' remuneration		-	-	-	-	-	(149)	(149)	-	(149)
Net movement in minority interest		-	-	-	-	-	-	-	21	21
Transfer to general reserve		-	-	-	18,300	-	(18,300)	-	-	-
Bonus shares issued		4,500	-	-	(4,500)	-	-	-	-	-
Issue of new shares		1,560	760	-	-	-	-	2,320	-	2,320
Transfer to statutory reserve		-	-	(2,113)	-	-	2,113	-	-	-
Balance at										
31 December 2006		44,560	760	5,098	13,800	12,058	10,827	87,103	2,431	89,534
Income for the year		-	-	-	-	-	31,399	31,399	1,271	32,670
Transfer to investment revaluation reserve		-	-	-	-	11,717	(11,717)	-	-	-
Transfer to retained earnings on sale of investments	10	-	-	-	-	(1,385)	1,385	-	-	-
Net movement in minority interests		-	-	-	-	-	-	-	6,777	6,777
Transfer to general reserve		-	-	-	10,829	-	(10,829)	-	-	-
Bonus shares issued	19	4,456	-	-	(4,456)	-	-	-	-	-
Issue of new shares	19	21,000	14,280	-	-	-	-	35,280	-	35,280
Transfer to statutory reserve		-	-	3,140	-	-	(3,140)	-	-	-
Balance at 31										
December 2007		70,016	15,040	8,238	20,173	22,390	17,925	153,782	10,479	164,261

Note: Included in retained earnings is a non-distributable reserve amounting to BD 349 thousands (2006: BD 47 thousands) relating to subsidiaries of the Bank.

The attached notes 1 to 33 form part of these consolidated financial statements.

Consolidated Statement of Restricted Investment Accounts

Year ended 31 December 2007

	Balance at 1 January 2006 BD 000s	Deposits BD 000s	Gross Income BD 000s	Mudarib Fee BD 000s	Withdrawals / distributions BD 000s	Balance at 31 December 2006 BD 000s
Murabaha contracts	-	5,363	208	(54)	(154)	5,363
Istisna'a contracts	11,007	4,534	1,050	(260)	(2,585)	13,746
	<u>11,007</u>	<u>9,897</u>	<u>1,258</u>	<u>(314)</u>	<u>(2,739)</u>	<u>19,109</u>

	Balance at 1 January 2007 BD 000s	Deposits BD 000s	Gross Income BD 000s	Mudarib Fee BD 000s	Withdrawals / distributions BD 000s	Balance at 31 December 2007 BD 000s
Murabaha contracts	5,363	59,800	1,766	(380)	(8,680)	57,869
Istisna'a contracts	13,746	-	973	(237)	(6,285)	8,197
	<u>19,109</u>	<u>59,800</u>	<u>2,739</u>	<u>(617)</u>	<u>(14,965)</u>	<u>66,066</u>

The attached notes 1 to 33 form part of these consolidated financial statements.

Notes to the Consolidated Financial Statements

At 31 December 2007

1 CORPORATE INFORMATION

Kuwait Finance House (Bahrain) B.S.C. (c) [‘the Bank’] is a closed joint stock company incorporated in the Kingdom of Bahrain on 22 January 2002 under the Bahrain Commercial Companies Law No. 21/2001 and is registered with the Ministry of Industry and Commerce under commercial registration (CR) number 48128. The Bank is regulated and supervised by the Central Bank of Bahrain (the ‘CBB’) and has a retail Islamic banking license, is operating under Islamic principles and in accordance with all the relevant regulatory guidelines for Islamic banks issued by the CBB. The address of the Bank’s registered office is Building 121, Government Avenue, Block 304, Manama, Kingdom of Bahrain.

The Bank offers a full range of Islamic banking services and products. The activities of the Bank include accepting Shari’a money placements/deposits, managing Shari’a profit sharing investment accounts, offering Shari’a financing contracts, dealing in Shari’a compliant financial instruments as principal/agent, managing Shari’a compliant financial instruments and other activities permitted under the CBB’s Regulated Banking Services as defined in the licensing framework. The activities of the Bank’s subsidiaries are mentioned in note 4.

The Bank is a subsidiary of Kuwait Finance House K.S.C. (the ‘Parent Company’), a public company incorporated in the State of Kuwait. The Bank’s Shari’a Supervisory Board is entrusted to ensure the Bank’s adherence to Shari’a rules and principles in its transactions and activities.

The Bank and its subsidiaries (together the ‘Group’) operate in the Kingdom of Bahrain and Hashemite Kingdom of Jordan.

The consolidated financial statements were authorized for issue in accordance with a resolution of the Board of Directors on 13 February 2008.

2 BASIS OF PREPARATION

The consolidated financial statements have been prepared under the historical cost basis, except for investments and investment properties that have been measured at fair value. The consolidated financial statements are presented in Bahraini Dinars which is the functional currency of the Group. All the values are rounded to the nearest BD thousand.

Statement of Compliance

The consolidated financial statements have been prepared in accordance with Financial Accounting Standards [FAS] issued by the Accounting and Auditing Organization for Islamic Financial Institutions [AAOIFI], International Financial Reporting Standards [IFRS] and in conformity with the Bahrain Commercial Companies Law and the Central Bank of Bahrain and Financial Institutions Law.

Basis of Consolidation

The consolidated financial statements comprise the financial statements of the Group as at 31 December each year. The financial statements of the subsidiaries are prepared for the same reporting year as the Bank, using consistent accounting policies.

All intra-group balances, transactions, income and expenses and profits and losses resulting from intra-group transactions are eliminated in full.

Subsidiaries are fully consolidated from the date of acquisition, being the date on which the Group obtains control, which is other than fiduciary in nature, and continue to be consolidated until the date that such control ceases.

Minority interests represent the portion of profit or loss and net assets not held by the Group and are presented separately in the consolidated statement of income and within equity in the consolidated balance sheet, separately from the Bank’s shareholders’ equity.

Notes to the Consolidated Financial Statements

At 31 December 2007

3 ACCOUNTING POLICIES

Significant accounting judgments and estimates

In the process of applying the Group's accounting policies, management has used its judgments and made estimates in determining the amounts recognised in the consolidated financial statements. The most significant use of judgments and estimates are as follows:

Valuation of unquoted equity investments

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

- recent arm's length market transactions;
- current fair value of another instrument that is substantially the same ;
- the expected cash flows discounted at current rates applicable for items with similar terms and risk characteristics; or
- other valuation models.

The Group calibrates the valuation techniques periodically and tests these for validity using either prices from observable current market transactions in the same instrument or other available observable market data. Nonetheless, the actual amount that is realised in a future realisation transaction may differ from the current valuation and may still be different from the management's estimates, given the inherent uncertainty surrounding valuations of unquoted equity investments.

Impairment losses on Murabaha, Musharaka, Istisna'a and Ijarah Muntahia Bittamleek contracts (the "Financial Contracts") relating to customers

The Group reviews its problem financial contracts at each reporting date to assess whether an allowance for impairment should be recorded in the consolidated statement of income. In particular, judgment by management is required in the estimation of the amount and timing of future cash flows when determining the level of allowance required. Such estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the allowance.

In addition to specific allowances against individually significant financial contracts, the Group also makes a collective impairment allowance against exposures which, although not specifically identified as requiring a specific allowance, have a greater risk of default than when originally granted. This take into consideration factors such as any deterioration in country risk, industry, and technological obsolescence, as well as identified structural weaknesses or deterioration in cash flows.

Impairment of equity investments

The Group treats available-for-sale equity investments as impaired when there has been a significant or prolonged decline in the fair value below its cost or where other objective evidence of impairment exists. The determination of what is 'significant' or 'prolonged' requires judgment. In addition, the Group evaluates other factors, such as the share price volatility.

Change in accounting policy and disclosures

The accounting policies adopted are consistent with those of the previous financial year except as follows:

The Group has adopted the following new and amended IFRS and IFRIC interpretations during the year. Adoption of these revised standards and interpretations did not have any effect on the financial performance of the Group. They did however give rise to additional disclosures in the financial statements.

- IFRS 7 Financial Instruments: Disclosures
- IAS 1 Amendment—Presentation of Financial Statements
- IFRIC 8 Scope of IFRS 2
- IFRIC 10 Interim Financial Reporting and Impairment

The principal effects of these changes are as follows:

IFRS 7 Financial Instruments: Disclosures

This standard requires disclosures that enable users of the financial statements to evaluate the significance of the Groups financial instruments and the nature and extent of risks arising from those financial instruments. The new disclosures are included throughout the consolidated financial statements. While there has been no effect on the financial position or results, comparative information has been added where needed.

Notes to the Consolidated Financial Statements

At 31 December 2007

3 ACCOUNTING POLICIES (continued)

IAS 1 Presentation of Financial Statements

This amendment requires the Group to make new disclosures to enable users of the financial statements to evaluate the Group's objectives, policies, and processes for managing capital. These new disclosures are shown in Note 27.

IFRIC 8 Scope of IFRS 2

This interpretation requires IFRS 2 to be applied to any arrangements in which the entity cannot identify specifically some or all of the goods received, in particular where equity instruments are issued for consideration which appears to be less than fair value. As equity instruments are only issued to employees in accordance with the employee share scheme at price approximating fair values, the interpretation had no impact on the financial position or performance of the Group.

IFRIC 10 Interim Financial Reporting and Impairment

The Group adopted IFRIC interpretation 10 as of 1 January 2007, which requires that an entity must not reverse an impairment loss recognised in a previous interim period in respect of goodwill or an investment in either an equity instrument or a financial asset carried at cost. As the Group had no impairment losses previously reversed, the interpretation had no impact on the financial position or performance of the Group.

Summary of Significant Accounting Policies

The significant accounting policies adopted in the preparation of the consolidated financial statements are set out below:

(i) Murabaha contracts

Murabaha contracts consist of deferred sales transaction agreements and are stated net of deferred profits, any amounts written-off and provision for impairment.

(ii) Mudaraba contracts

Mudaraba contracts are partnerships in which the Bank provides capital to the Mudarib and Mudarib manages the capital for a mudarib fee. These are stated at the fair value of consideration given less any amounts written-off and provision for impairment.

(iii) Musharaka contracts

Musharaka contracts are partnerships in which the Bank contributes capital. These are stated at the fair value of consideration given less any amounts written-off and provision for impairment.

(iv) Ijarah Muntahia Bittamleek

Ijarah Muntahia Bittamleek comprises assets, mainly land and buildings, leased to third parties, under terms that would transfer the ownership of the assets to third parties at the end of the lease period.

Ijarah assets are recorded at cost. Depreciation is provided on all Ijarah assets at rates calculated to write off the cost of each asset over the period of the lease to its residual value.

(v) Istisna'a

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

(vi) Investments

These are classified as follows:

- Carried at fair value through income statement
- Available for sale

All investments are initially recognised at cost being the fair value of consideration given including acquisition charges associated with the investment. After initial recognition, investments are remeasured using the policies given below:

Carried at fair value through income statement

Investments carried at fair value through income statement includes investments held for trading and investments designated upon initial recognition as carried at fair value through income statement.

Notes to the Consolidated Financial Statements

At 31 December 2007

3 ACCOUNTING POLICIES (continued)

Investments are classified as held for trading if they are acquired for the purpose of selling in the near term. Gains or losses on investments held for trading are recognised in consolidated statement of income.

Investments are designated at initial recognition as carried at fair value through income statement if the fair value of the investment can be reliably measured and the classification as fair value through income statement is as per the documented strategy of the Bank. Investments classified as "Investments carried at fair value through income statement" upon initial recognition are remeasured at fair value with all changes in fair value being recorded in the consolidated statement of income.

Available for sale

Available for sale investments are those which are designated as such or do not qualify to be classified as carried at fair value through income statement. They include equity investments and sukuk.

After initial measurement, available for sale investments are subsequently measured at fair value. Unrealised gains and losses are recognised directly in equity in the "Available for sale reserve". When the investment is disposed off, the cumulative gain or loss previously recognised in equity is recognised in the consolidated statement of income in income from investment activities. Where the Group holds more than one investment in the same security they are deemed to be disposed off on a weighted average basis. Profit earned whilst holding available for sale investments is reported as income from debt instruments using the effective profit rate. Dividends earned whilst holding available for sale investments are recognised in the consolidated statement of income as 'Other income' when the right of the payment has been established.

(vii) Determination of fair values

The fair value for financial instruments traded in active markets at the balance sheet date is based on their quoted market price or dealer price quotations, without any deduction for transaction costs. The fair value of investments in managed funds is based on net asset values provided by fund manager.

For all other financial instruments not listed in an active market, the fair value is determined by using appropriate valuation techniques. Valuation techniques include net present value techniques, comparison to similar instruments for which market observable prices exist and other relevant valuation models.

(viii) Premises and equipment

Premises and equipment are stated at cost excluding the costs of day-to-day servicing, less accumulated depreciation and accumulated impairment in value.

Depreciation is calculated using the straight-line method to write down the cost of premises and equipment to their residual values over their estimated useful lives. Land is not depreciated. The estimated useful lives are as follows:

Premises:	20 Years
Equipment:	3 Years

An item of property and equipment is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is recognised in the consolidated statement of income in the year the asset is derecognised.

(ix) Investment in associates

The Group's investment in its associate is accounted for under the equity method of accounting. An associate is an entity in which the Group has significant influence and which is neither a subsidiary nor a joint venture.

Under the equity method, the investment in the associate is carried in the balance sheet at cost plus post-acquisition changes in the Group's share of net assets of the associate. Goodwill relating to an associate is included in the carrying amount of the investment and is not amortized. After application of the equity method, the Group determines whether it is necessary to recognize any additional impairment loss with respect to the Group's net investment in the associate. The consolidated statement of income reflects the share of the results of operations of the associate. Where there has been a change recognized directly in the equity of the associate, the Group recognizes its share of any changes and discloses this, when applicable, in the consolidated statement of changes in equity. Profits and losses resulting from transactions between the Group and the associate are eliminated to the extent of the interest in the associate.

Notes to the Consolidated Financial Statements

At 31 December 2007

3 ACCOUNTING POLICIES (continued)

The reporting dates of the associate and the Group are identical and the associates' accounting policies conform to those used by the Group for like transactions and events in similar circumstances.

(x) Investment properties

The Group holds certain properties as investments to earn rental income, for capital appreciation or both. Investment properties are measured initially at cost, including transaction costs. Subsequent to initial recognition, investment properties are stated at fair value, which reflects market conditions at the balance sheet date. Gains or losses arising from changes in the fair values of investment properties are included in the consolidated statement of income in 'Income from investment activities' in the year in which they arise.

(xi) Investment revaluation reserve

Unrealized gains resulting from revaluation of investments and investment properties, are appropriated to investment revaluation reserve and are not available for distribution to shareholders. Upon disposal of these investments, the related cumulative gain is transferred to retained earnings and is available for distribution.

(xii) Business combinations and goodwill

Business combinations are accounted for using the purchase method of accounting. This involves recognising identifiable assets (including previously unrecognised intangible assets) and liabilities (including contingent liabilities and excluding future restructuring) of the acquired business at fair value. Any excess of the cost of acquisition over the fair values of the identifiable net assets acquired is recognised as goodwill. If the cost of acquisition is less than the fair values of the identifiable net assets acquired, the discount on acquisition is recognised directly in the consolidated statement of income in the year of acquisition.

Goodwill acquired in a business combination is initially measured at cost being the excess of the cost of the business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is reviewed for impairment, annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired.

When subsidiaries are sold, the difference between the selling price and the net assets plus cumulative translation differences and related goodwill is recognised in the consolidated statement of income.

(xiii) Intangible assets

Intangible assets include the value of patents and license rights. Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is their fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses.

The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortised over the useful economic life. The amortisation period and the amortisation method for an intangible asset with a finite useful life are reviewed at least at each financial year end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are accounted for by changing the amortisation period or method, as appropriate, and treated as changes in accounting estimates. The amortisation expense on intangible assets with finite lives is recognised in the consolidated statement of income in the expense category consistent with the function of the intangible asset. Amortisation is calculated using the straight-line method to write down the cost of intangible assets to their residual values over their estimated useful lives.

(xiv) Inventories held for consumer finance

Inventories are stated at the lower of cost and net realisable value. Costs are those expenses incurred in bringing the inventories to its present location and condition, such as purchase cost. Net realisable value is based on estimated selling price less any further costs expected to be incurred on disposal.

(xv) Unrestricted Investment accounts

All unrestricted investment accounts are carried at cost less amounts repaid.

Notes to the Consolidated Financial Statements

At 31 December 2007

3 ACCOUNTING POLICIES (continued)

(xvi) Provisions

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

(xvii) Offsetting Financial Instruments

Financial assets and financial liabilities are only offset and the net amount reported in the balance sheet when there is a legally enforceable right to set off the recognized amounts and the Group intends to either settle on a net basis, or to realise the asset and settle the liability simultaneously.

(xviii) Cash and Cash Equivalents

Cash and cash equivalents comprise of cash and balances with banks and the Central Bank of Bahrain (excluding mandatory reserve deposits) and murabahas and mudarabas with banks with original maturities of 90 days or less.

(xix) Revenue recognition

Murabaha

Where the income is quantifiable and contractually determined at the commencement of the contract, income is recognized on a time-apportioned basis over the period of the contract based on the principal amounts outstanding. Where the income from a contract is not quantifiable, it is recognized when realized. Accrual of income is suspended when the Group believes that the recovery of these amounts may be doubtful or when the repayments are overdue by 90 days, whichever is earlier.

Mudaraba

Income and losses on Mudaraba transactions are recognized when the right to receive is established or these are declared by the Mudarib, whichever is earlier.

Musharaka

Income on musharaka contracts is recognised when the right to receive payment is established or on distribution. Income related to accounts that are 90 days overdue is excluded from the consolidated statement of income.

Ijarah

Ijarah income is recognized on a time-apportioned basis over the lease term.

Istisna

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

Dividends

Dividends from investments in equities are recognized when the right to receive the payment is established.

Fees and commission income

Fees and commission income is recognized when earned.

(xx) Allocation of income

Income is allocated proportionately between unrestricted investment accounts and shareholders on the basis of the average balances outstanding during the year and share of the funds invested.

(xxi) Foreign currency translation

The consolidated financial statements are presented in Dinars, which is Group functional and presentational currency. Each entity in the group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency.

Transactions and balances

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

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

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

Notes to the Consolidated Financial Statements

At 31 December 2007

3 ACCOUNTING POLICIES (continued)

(xxi) Foreign currency translation (continued)

Group companies

As at the reporting date, the assets and liabilities of subsidiaries are translated into the Bank's presentation currency (the Bahraini Dinars) at the rate of exchange ruling at the balance sheet date, and their statements of income are translated at the average exchange rates for the year. Exchange differences arising on translation are taken directly to a separate component of equity. On disposal of a foreign entity, the deferred cumulative amount recognised in equity relating to that particular foreign operation is recognised in the income statement in 'Other operating expenses' or 'Other operating income', respectively.

(xxii) Trade and settlement date accounting

Purchases and sales of financial assets are recognized on the trade date, i.e. the date that the Group commits to purchase or sell the asset.

(xxiii) Fiduciary assets

Assets held in a fiduciary capacity are not reported in the consolidated financial statements, as they are not the assets of the Group.

(xxiv) Restricted investment accounts

Restricted investment accounts represents assets held in trust or in a fiduciary capacity by the Group for the benefit of the investment accounts holders. The restricted investment accounts are exclusively restricted for investment in specified projects as directed by the investments account holders.

(xxv) Impairment of financial assets

The Group assesses at each balance sheet date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in profit or principal payments, the probability that they will enter bankruptcy or other financial reorganisation and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

Balances with banks and Murabaha, Musharaka, Istisna'a and Ijarah Muntahia Bittamleek contracts relating to customers

For balances with banks and Murabaha, Musharaka, Istisna'a and Ijarah Muntahia Bittamleek contracts relating to customers carried at amortised cost, the Group first assesses individually whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the consolidated statement of income. Income from Murabaha, Musharaka, Istisna'a and Ijarah Muntahia Bittamleek contracts continue to be accrued on the reduced carrying amount based on the original effective profit rate.

Financial contracts together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the Group. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account. If a future write-off is later recovered, the recovery is credited to the 'Income from retail and corporate banking activities'.

Notes to the Consolidated Financial Statements

At 31 December 2007

3 ACCOUNTING POLICIES (continued)

(xxv) Impairment of financial assets (continued)

The present value of the estimated future cash flows is discounted at the financial asset's original effective profit rate. If a financial asset has a variable profit rate, the discount rate for measuring any impairment loss is the current effective profit rate. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of the Group's internal credit grading system that considers credit risk characteristics such as asset type, industry, geographical location, collateral type, past-due status and other relevant factors.

Future cash flows on a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the Group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the years on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. Estimates of changes in future cash flows reflect, and are directionally consistent with, changes in related observable data from year to year (such as changes in unemployment rates, property prices, commodity prices, payment status, or other factors that are indicative of incurred losses in the Group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Available for sale investments

For available for sale investments, the Group assesses at each balance sheet date whether there is objective evidence that an investment or a group of investments is impaired.

In the case of equity investments classified as available for sale, objective evidence would include a significant or prolonged decline in the fair value of the investment below its cost. Where there is evidence of impairment, 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 the consolidated statement of income is removed from equity and recognised in the consolidated statement of income. Impairment losses on equity investments are not reversed through the consolidated statement of income; increases in their fair value after impairment are recognised directly in equity.

In the case of debt instruments classified as available for sale, impairment is assessed based on the same criteria as financial assets carried at amortised cost. Profit continues to be accrued at the original effective profit rate on the reduced carrying amount of the asset and is recorded as part of 'Income from investment activities'. If, in a subsequent year, the fair value of a debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the consolidated statement of income, the impairment loss is reversed through the consolidated statement of income.

Cars inventory

Inventories are held at the lower of cost and net realisable value. When inventories become old or obsolete, an estimate is made of their net realisable value. For individually significant amounts this estimation is performed on an individual basis. Amounts which are not individually significant, but which are old or obsolete, are assessed collectively and an allowance applied according to the inventory type and the degree of ageing or obsolescence, based on historical selling prices.

Future changes in accounting policies

The International Financial Reporting Standards and Financial Accounting Standards issued by the Accounting and Auditing Organization for Islamic Financial Institutions, effective 1 January 2008, will not have any significant impact on the consolidated financial statements of the Group.

Notes to the Consolidated Financial Statements

At 31 December 2007

4 INVESTMENT IN SUBSIDIARIES

Key subsidiaries, all of which have 31 December as their year end, are as follows:

Subsidiary	Activities	Year of incorporation	Country of incorporation	Ownership %
Mena Telecom W.L.L.	The company is a licensed telecommunications company and a Satellite Access Service Provider.	2003	Kingdom of Bahrain	100.00
Miracle Graphics Company W.L.L.	The company is engaged in the business of designing, big format printing, reprographics and publishing.	2003	Kingdom of Bahrain	70.00
Baytik Investment Advisory W.L.L.	The principal activity of the company is providing advisory services to the Bank and its affiliates.	2003	Kingdom of Bahrain	100.00
Al-Enma House for Real Estate W.L.L.	The company is engaged in property management of commercial, industrial and residential buildings in the Kingdom of Bahrain. (Note 12)	2003	Kingdom of Bahrain	59.28
Bayan Group for Investment Properties W.L.L.	The principal activity of the company is to buy, sell and lease properties and to undertake joint ventures with other companies engaged in similar activities.	2004	Kingdom of Bahrain	100.00
Al Kindi Pharmaceutical Industries (Public Shareholding Company)	The company is engaged in the manufacture of drugs in all their pharmaceutical dosage forms and the manufacturing of semi-pharmaceutical products specialised for skin care, cosmetics and others.	1997	Hashemite Kingdom of Jordan	82.20
Kuwait Finance House - Jordan	The company will be engaged in investment advisory, acquisition and development of private equity investments in the Hashemite Kingdom of Jordan.	2007	Hashemite Kingdom of Jordan	100.00

Notes to the Consolidated Financial Statements

At 31 December 2007

5 CASH AND BALANCES WITH BANKS AND CENTRAL BANK OF BAHRAIN

	2007 BD 000s	2006 BD 000s
Cash	2,027	1,276
Balances with banks - nostros	4,525	9,519
Balances with Central Bank of Bahrain	17,088	10,588
	23,640	21,383

6 MURABAHA AND MUDARABA CONTRACTS WITH BANKS

	Europe		Middle East		Total	
	2007 BD 000s	2006 BD 000s	2007 BD 000s	2006 BD 000s	2007 BD 000s	2006 BD 000s
Murabaha contracts with banks - international commodities	-	-	80,796	62,226	80,796	62,226
Deferred profits	-	-	(111)	(472)	(111)	(472)
	-	-	61,754	36,451	61,754	36,451
Mudaraba contract with banks	-	4,900	-	-	-	4,900
	-	4,900	80,685	61,754	80,685	66,654

7 MURABAHA, MUSHARAKA, ISTISNA'A AND IJARAH MUNTAHIA BITTAMLEEK CONTRACTS RELATING TO CUSTOMERS

	2007 BD 000s	2006 BD 000s
Murabaha contracts	125,072	72,620
Deferred profits	(10,283)	(7,295)
	114,789	65,325
Ijarah Muntahia Bittamleek (Note 7.1)	107,122	69,892
Musharaka contracts	7,535	2,709
Istisna'a contracts	56,369	30,695
	285,815	168,621
Provisions	(9,754)	(6,665)
	276,061	161,956

Notes to the Consolidated Financial Statements

At 31 December 2007

7 MURABAHA, MUSHARAKA, ISTISNA'A AND IJARAH MUNTAHIA BITTAMLEEK CONTRACTS RELATING TO CUSTOMERS (continued)

7.1 Movement in Ijarah Muntahia Bittamleek assets is as follows:

	2007 BD 000s	2006 BD 000s
At 1 January	72,601	47,921
Additions during the year	42,182	28,508
Ijarah assets' depreciation - net	(7,661)	(3,828)
At 31 December	107,122	72,601

The rentals received against Ijarah Muntahia Bittamleek are included in income from retail and corporate banking activities. During the year, BD 4,607 thousand (2006: BD 2,358 thousand) has been provided as depreciation which is included in the rentals received. Certain Ijarah have completed the contracted period whose accumulated depreciation amounted to BD 774 thousand (2006: BD 493 thousand).

The composition of the Murabaha, Musharika, Istisna'a and Ijarah Muntahia Bittamleek contracts, net of deferred profits and provision, based on the status of the customer to the contract, is as follows:

	2007 BD 000s	2006 BD 000s
Commercial and business	76,524	23,632
Real estate	118,260	63,078
Private individuals	81,277	75,246
	276,061	161,956

The movements in provisions were as follows:

	2007 BD 000s	2006 BD 000s
At 1 January	6,665	4,756
Charge for the year	3,089	1,909
At 31 December	9,754	6,665

At 31 December 2007 Murabaha, Musharaka, Istisna'a and Ijarah Muntahia Bittamleek contracts on which profit is not being accrued, amounted to BD 447 thousand (2006: BD 336 thousand). Unrecognised profit relating to such contracts amounted to BD 72 thousand (2006: BD 47 thousand).

Notes to the Consolidated Financial Statements

At 31 December 2007

8 INVESTMENTS

At 31 December 2007 the Group has the following investments:

	2007 BD 000s	2006 BD 000s
Classified as		
Carried at fair value through income statement:		
Held for trading equities - quoted	11,830	-
Equities	67,809	51,139
Managed funds	8,155	8,648
Available for sale:		
Equities	28,336	11,733
Government sukuks	12,275	7,773
Other sukuks	13,467	3,770
	<u>141,872</u>	<u>83,063</u>

The composition of the investment portfolio is as follows:

	New Zealand/ Australia BD 000s	Middle East BD 000s	Others BD 000s	Total 2007 BD 000s	2006 BD 000s
Commercial and technology	5,077	-	7,742	12,819	5,058
Real estate development	-	72,171	-	72,171	35,670
Others	18,288	32,573	6,021	56,882	42,335
	<u>23,365</u>	<u>104,744</u>	<u>13,763</u>	<u>141,872</u>	<u>83,063</u>

9 INVESTMENT IN ASSOCIATES

The Group has investment in Durrat Khaleej Al Bahrain B.S.C. (c), an associate with 48% (2006: 37.7%) interest. The associate, incorporated in the Kingdom of Bahrain, is currently engaged in developing Durrat Al-Bahrain Island, a real estate project in the Kingdom of Bahrain. During the year, Al-Enma House for Real Estate W.L.L. (previously an associate) has become a subsidiary (Note 12).

The following table illustrates the summarised financial information of the Group's investment in associates.

	2007 BD 000s	2006 BD 000s
Share of associate's balance sheet		
Current assets	30,283	17,800
Non current assets	51,733	26,396
Current liabilities	(16,221)	(5,149)
Non current liabilities	(39,627)	(30,489)
Net assets	<u>26,168</u>	<u>8,558</u>
Share of associates' revenue and net income		
Revenue	40,936	6,805
Net income for the year	14,173	512

Notes to the Consolidated Financial Statements

At 31 December 2007

10 INVESTMENT PROPERTIES

	2007 BD 000s	2006 BD 000s
Cost		
At 1 January	22,591	11,068
Additions	60,387	12,233
Relating to a subsidiary acquired during the year	9,718	-
Disposals	(1,301)	(710)
At 31 December	91,395	22,591
Fair value adjustment		
At 1 January	5,032	3,669
Unrealised gain on investment properties	9,625	3,017
Relating to a subsidiary acquired during the year	430	-
Relating to disposals	(1,385)	(1,654)
At 31 December	13,702	5,032
Total	105,097	27,623

Investment properties, held in the Kingdom of Bahrain, at 31 December consist of the following:

	2007 BD 000s	2006 BD 000s
Buildings	31,199	6,211
Land	73,898	21,412
	105,097	27,623

Investment properties were revalued as of dates close to the balance sheet date, by independent consultants who have reasonable and sufficient experience in the location and category of the properties being valued.

These include certain properties in which the Bank's share is valued at BD 614 thousand (2006: BD 3,300 thousand) which are jointly owned with third parties and are subject to normal conditions applicable to joint ownership.

Notes to the Consolidated Financial Statements

At 31 December 2007

11 RECEIVABLES AND PREPAYMENTS

	2007 BD 000s	2006 BD 000s
Advance for purchase of investment property	11,000	-
Performance and management fees receivable (Note 25)	8,101	1,083
Investment liquidation proceeds receivable	4,305	-
Project expenses receivable (Note 25)	3,915	3,343
Inventories held for consumer finance	2,669	-
Profit receivable	1,726	1,473
Receivable relating to investment property	1,675	-
Trade receivables of a subsidiary	1,586	1,375
Inventories and work in progress of a subsidiary	650	568
Prepaid expenses	486	445
Other assets	4,545	2,981
	<u>40,658</u>	<u>11,268</u>

12 GOODWILL AND INTANGIBLES

	2007 BD 000s	2006 BD 000s
Goodwill	4,221	1,354
Intangibles	2,706	1,154
At 31 December	<u>6,927</u>	<u>2,508</u>

Acquisition of additional shares in Al Enma' House for Real Estate B.S.C.(c)

Until 9 July 2007, the Group had a 39.52% stake in Al Enma' House for Real Estate B.S.C.(c) which was treated as an associate and accounted for under the equity method of accounting. On 10 July 2007, the Bank increased its holding to 59.28% through a purchase of 990,000 shares. As a result, from 10 July 2007, Al Enma' House for Real Estate B.S.C.(c) became a subsidiary of the Group and has been consolidated from that date.

The fair value and the carrying value of identifiable assets and liabilities of Al Enma' House for Real Estate B.S.C.(c) as at the date of acquisition were as follows:

	BD 000s
Assets	
Cash and balances with banks	1,464
Investments	1,003
Investment properties	10,148
Receivables and prepayments	4,649
Equipment	94
	<u>17,358</u>
Liabilities	
Murabaha contracts with banks	7,759
Other liabilities	320
Net assets	<u>9,279</u>

Notes to the Consolidated Financial Statements

At 31 December 2007

12 GOODWILL AND INTANGIBLES (continued)

	BD 000s
Acquisition of additional shares representing 19.76% interest	1,834
Goodwill arising on acquisition	1,866
Total Consideration	3,700

	BD 000s
Cash and balances with banks acquired with the subsidiary	1,464
Cash paid on acquisition	(3,700)
Net cash and balances with banks paid on acquisition	(2,236)

From the date of consolidation, Al Enma' House for Real Estate B.S.C.(c) has contributed BD 3,918 thousand to the net income of the Group. If the combination had taken place at the beginning of the year, the net income of the Group would have been higher by BD 754 thousand and income from investment activities would have been higher by BD 891 thousand.

Acquisition of additional shares in an existing subsidiary

During the year, the Group has increased its interest in Al Kindi Pharmaceutical Industries (Public Shareholding Company) from 55.0% to 82.20%, which has resulted in an increase in goodwill of BD 1,001 thousand.

The goodwill of BD 4,221 thousand represents the fair value of expected synergies arising from the acquisition.

13 MURABAHA CONTRACTS WITH BANKS

Murabaha contracts with banks represent funds received from banks on the principles of Murabaha contracts.

14 MURABAHA CONTRACTS WITH NON-BANKS

These represent funds received from non-banks on the principles of Murabaha contracts.

15 CUSTOMERS' CURRENT ACCOUNTS

These represent customers' accounts which are not entitled to any profit distributions in accordance with the terms of the related agreements.

16 FUNDS UNDER MANAGEMENT

At 31 December 2007, clients' funds managed in a fiduciary capacity amounted to BD 127,200 thousand (2006: BD 97,078 thousand).

Notes to the Consolidated Financial Statements

At 31 December 2007

17 OTHER LIABILITIES

	2007 BD 000s	2006 BD 000s
Payable against purchase of investment properties	26,945	3,372
Pay orders issued not presented	7,727	831
Payable on account of financing contracts	3,378	1,143
Staff related accruals	2,989	2,320
Profit payable on account of Murabaha contracts	1,115	576
Others	4,037	4,633
	46,191	12,875

18 UNRESTRICTED INVESTMENT ACCOUNTS

Profit allocation between unrestricted investment accounts and shareholders is as follows:

	2007 BD 000s	2006 BD 000s
Shareholders of the parent and minority interest	32,670	20,763
Unrestricted investment accounts	1,662	1,200
	34,332	21,963

Unrestricted investment account holders' funds are commingled with the Bank's funds for investing in short term highly liquid investments and medium term murabahas, no priority is granted to any party for the purpose of distribution of profits. According to the terms of acceptance of the unrestricted investment accounts, 100% of the funds are invested after deductions of mandatory reserve and sufficient operational cash requirements. The mudarib fee on investment accounts ranges from 20% to 35% depending on the investment period and in case of saving accounts, where there is no restriction of cash withdrawal, the mudarib fee ranges from 50% to 60%. However, during the year, in addition to depositors share of profit, the Bank has distributed profit to investors from its own share of mudarib fee.

The provision against Murabaha receivables is charged to both the shareholders and the holders of the unrestricted investment accounts, considering the allocation of various assets. Any reversal in provision is reversed to the extent it was charged to shareholders or the holders of the unrestricted investment accounts. Expenses are allocated in proportion to average unrestricted investment account to total average assets of the Bank.

Notes to the Consolidated Financial Statements

At 31 December 2007

19 SHARE CAPITAL

	2007 BD 000s	2006 BD 000s
Authorised share capital as of 31 December 2007 represents 3,500,000 thousand (2006 : 350,000 thousand) shares of BD 0.1 (2006 : BD 1) each.	350,000	350,000

Issued and fully paid-up share capital as of 31 December 2007 comprised as follows:

Held by the Parent of the Bank - 675,654 thousand (2006 : 43,000 thousand) shares of BD 0.1 (2006 : BD 1) each.	67,565	43,000
Held under Employee Share Ownership Plan ("ESOP") - 24,506 thousand (2006 : 1,560 thousand) shares of BD 0.1 (2006 : BD 1) each.	2,451	1,560
	70,016	44,560

Following a resolutions passed by the shareholders of the Bank at an Extraordinary General Meeting (EGM) held on 25 March 2007, the Bank has:

- issued 4,456 thousand bonus shares amounting to BD 4,456 thousand by transfer from general reserves;
- changed the nominal value of the ordinary shares from BD 1 per share to BD 0.1 per share; and
- increased the issued and paid up capital to BD 70,016 thousand by issuing 210 million ordinary shares at a value of BD 0.168 per share including a premium of BD 0.068 per share.

Shares issued for the ESOP, approved by the shareholders, are offered to eligible employees of the Bank through a special purpose vehicle.

20 STATUTORY RESERVE

As required by Bahrain Commercial Companies Law and the Bank's articles of association, 10% of the net income for the year has been transferred to the statutory reserve. The Bank may resolve to discontinue such annual transfers when the reserve totals 50% of paid up share capital. The reserve is not distributable except in such circumstances as stipulated in the Bahrain Commercial Companies Law and following the approval of the Central Bank of Bahrain.

21 INCOME FROM INVESTMENT ACTIVITIES

	2007 BD 000s	2006 BD 000s
Unrealised gain on investments *	7,147	6,705
Gain on sale of investments	1,305	16,893
Unrealised gain on investment properties **	9,625	1,363
Gain on sale of investment properties	2,736	1,875
Performance and management fees (Note 25)	4,869	376
Other income	4,226	968
	29,908	28,180

* This includes gain of BD 4,323 thousand relating to held for trading investments.

** This includes gain of BD 732 thousand relating to minority shareholders of a subsidiary.

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At 31 December 2007

22 INCOME FROM RETAIL AND CORPORATE BANKING ACTIVITIES

	2007 BD 000s	2006 BD 000s
Income from Murabaha contracts	7,958	5,944
Income from Ijarah Muntahia Bittamleek	7,310	4,847
Income from Musharaka contracts	602	220
Income from Istisna'a contracts	4,366	2,456
Income from Murabaha and Mudaraba contracts with banks	4,577	4,002
Fees and commission	1,050	350
	25,863	17,819

23 OTHER OPERATING EXPENSES

	2007 BD 000s	2006 BD 000s
Business development	3,201	1,793
Technology and communication	973	871
Premises - rentals and maintenance	611	412
Administration, professional and others	5,027	3,082
	9,812	6,158

24 CASH AND CASH EQUIVALENTS

Cash and cash equivalents included in the consolidated statement of cash flows comprise of the following balance sheet amounts:

	2007 BD 000s	2006 BD 000s
Cash	2,027	1,276
Balances with banks - nostros	4,525	9,519
Balances with Central Bank of Bahrain excluding mandatory reserve deposit	5,273	4,873
Murabaha contracts with banks	80,685	57,984
Mudaraba contracts with banks	-	3,958
	92,510	77,610

25 RELATED PARTY TRANSACTIONS

Related parties represent associated companies, parent company and its major shareholders, directors and key management personnel of the Bank, and entities controlled, jointly controlled or significantly influenced by such parties. Pricing policies and terms of these transactions are approved by the Group's management. All the facilities to the related parties are performing facilities and are free of any provision for possible credit losses.

Notes to the Consolidated Financial Statements

At 31 December 2007

25 RELATED PARTY TRANSACTIONS (continued)

The following balances arise from the transactions, in addition to those relating to investment transactions, entered into with the related parties:

	Associated companies BD 000s	Parent and its major shareholders BD 000s	Directors and key management personnel BD 000s	Other related parties BD 000s	2007 BD 000s	2006 BD 000s
Murabaha and Mudaraba						
contracts with banks	-	-	-	4,336	4,336	10,178
Murabaha contracts						
relating to customers	-	-	563	23,716	24,279	622
Performance and management						
fees receivable (Note 11)	8,101	-	-	-	8,101	1,083
Project expenses receivable						
(Note 8)	365	-	-	3,550	3,915	3,343
Murabaha contracts						
with non-banks	30,921	-	107	30,748	61,776	14,869
Customers' current accounts	8,626	3,712	30	59,392	71,760	3,914
Payable against purchase						
of investment properties	23,591	-	-	-	23,591	-
Other liabilities	151	-	-	-	151	3,372
Unrestricted investment						
accounts	102	-	2,594	4,750	7,446	7,906
Letter of credit	5,655	-	-	8,671	14,326	5,678
Guarantees	-	-	-	2,451	2,451	2,451

The income and expenses in respect of related parties included in the consolidated financial statements are as follows:

	Associated companies BD 000s	Parent and its major shareholders BD 000s	Directors and key management personnel BD 000s	Other related parties BD 000s	2007 BD 000s	2006 BD 000s
Income from Murabaha and						
Mudaraba contracts with banks	-	56	-	58	114	480
Income from Murabaha contracts						
relating to customers	-	-	-	1,411	1,411	634
Performance and management						
fees (Note 21)	4,365	-	-	504	4,869	376
Income from managed funds	-	-	-	726	726	971
Fee and commission income	-	-	-	-	-	90
Profit on Murabaha contracts						
with non-banks	1,097	-	-	1,652	2,749	1,090
Profit on unrestricted						
investment accounts	2	-	26	81	109	147
Operating expenses	-	-	-	581	581	594

Compensation of key management personnel, included in consolidated statement of income, is as follows:

	2007 BD 000s	2006 BD 000s
Short term employee benefits	2,822	2,301
Long term employee benefits	5	1

Notes to the Consolidated Financial Statements

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26 MATURITY ANALYSIS OF ASSETS AND LIABILITIES

The table below shows an analysis of assets and liabilities analysed according to when they are expected to be recovered or settled. Group's contractual undiscounted repayment obligations are disclosed in Note 27 'Risk Management'.

	Upto one year			Over one year				Total 2007 BD 000s
	Up to 3 months 2007 BD 000s	3 months to 12 months 2007 BD 000s	Subtotal Less than 12 months 2007 BD 000s	1 to 5 years 2007 BD 000s	5 to 10 years 2007 BD 000s	Over 10 years 2007 BD 000s	Subtotal Over 1 year 2007 BD 000s	
ASSETS								
Cash and balances with banks and Central Bank of Bahrain	11,825	-	11,825	-	-	11,815	11,815	23,640
Murabaha and Mudaraba contracts with banks	80,685	-	80,685	-	-	-	-	80,685
Murabaha, Musharaka, Istisna'a and Ijarah Muntahia Bittamleek contracts relating to customers	19,805	64,539	84,344	119,468	43,795	28,454	191,717	276,061
Investments	11,830	6,620	18,450	29,915	80,314	13,193	123,422	141,872
Investment in associates	-	-	-	-	-	41,356	41,356	41,356
Investment properties	-	-	-	105,097	-	-	105,097	105,097
Receivables and prepayments	15,026	14,236	29,262	11,396	-	-	11,396	40,658
Goodwill and intangibles	-	-	-	-	-	6,927	6,927	6,927
Premises and equipment	-	-	-	-	-	18,995	18,995	18,995
TOTAL	139,171	85,395	224,566	265,876	124,109	120,740	510,725	735,291
LIABILITIES AND UNRESTRICTED INVESTMENT ACCOUNTS								
Murabaha contracts with banks	73,559	3,770	77,329	-	-	-	-	77,329
Murabaha contracts with non-banks	254,182	33,087	287,269	-	-	-	-	287,269
Customers' current accounts	53,575	21,430	75,005	32,145	-	-	32,145	107,150
Other liabilities	15,486	29,142	44,628	47	-	1,516	1,563	46,191
Unrestricted investment accounts	26,921	15,294	42,215	10,876	-	-	10,876	53,091
TOTAL	423,723	102,723	526,446	43,068	-	1,516	44,584	571,030
NET	(284,552)	(17,328)	(301,880)	222,808	124,109	119,224	466,141	164,261

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26 MATURITY ANALYSIS OF ASSETS AND LIABILITIES (continued)

	Upto one year			Over one year			Subtotal Over 1 year 2006 BD 000s	Total 2006 BD 000s
	Up to 3 months 2006 BD 000s	3 months to 12 months 2006 BD 000s	Subtotal Less than 12 months 2006 BD 000s	1 to 5 years 2006 BD 000s	5 to 10 years 2006 BD 000s	Over 10 years 2006 BD 000s		
ASSETS								
Cash and balances with banks and Central Bank of Bahrain	15,668	-	15,668	-	-	5,715	5,715	21,383
Murabaha and Mudaraba contracts with banks	61,942	4,712	66,654	-	-	-	-	66,654
Murabaha, Musharaka Istisna'a and Ijarah Muntahia Bittamleek contracts relating to customers	11,321	25,699	37,020	88,109	31,108	5,719	124,936	161,956
Investments	1,208	910	2,118	18,073	62,872	-	80,945	83,063
Investment in associates	-	-	-	-	-	15,385	15,385	15,385
Investment properties	-	-	-	27,623	-	-	27,623	27,623
Receivables and prepayments	11,268	-	11,268	-	-	-	-	11,268
Goodwill and intangibles	-	-	-	-	-	2,508	2,508	2,508
Premises and equipment	-	-	-	-	-	13,204	13,204	13,204
TOTAL	101,407	31,321	132,728	133,805	93,980	42,531	270,316	403,044
LIABILITIES AND UNRESTRICTED INVESTMENT ACCOUNTS								
Murabaha contracts with banks	100,941	9,425	110,366	-	-	-	-	110,366
Murabaha contracts with non-banks	96,437	1,100	97,537	1,808	-	-	1,808	99,345
Customers' current accounts	23,275	9,310	32,585	13,964	-	-	13,964	46,549
Other liabilities	12,875	-	12,875	-	-	-	-	12,875
Unrestricted investment accounts	23,600	12,754	36,354	8,021	-	-	8,021	44,375
TOTAL	257,128	32,589	289,717	23,793	-	-	23,793	313,510
NET	(155,721)	(1,268)	(156,989)	110,012	93,980	42,531	246,523	89,534

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27 RISK MANAGEMENT

27.1 Introduction

Risk is inherent in the Group's activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Group's continuing profitability and each individual within the Group is accountable for the risk exposures relating to his or her responsibilities. The Group is exposed to credit risk, liquidity risk and market risk, the latter being subdivided into trading and non-trading risks. It is also subject to prepayment risk and operating risks.

The independent risk control process does not include business risks such as changes in the environment, technology and industry. They are monitored through the Group's strategic planning process.

Risk management structure

The Board of Directors is ultimately responsible for identifying and controlling risks; however, there are separate independent bodies responsible for managing and monitoring risks.

Board of Directors

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

Executive Committee

The Executive Committee has the responsibility to monitor the overall risk process within the Group.

Shari'a Supervisory Board

The Bank's Shari'a Supervisory Board is entrusted with the responsibility to ensure the Bank's adherence to Shari'a rules and principles in its transactions and activities.

Risk Committee

The Risk Committee has the overall responsibility for the development of the risk strategy and implementing principles, frameworks, policies and limits. It is responsible for the fundamental risk issues and manages and monitors relevant risk decisions.

Risk Management Unit

The Risk Management Unit is responsible for implementing and maintaining risk related procedures to ensure an independent control process and also monitoring compliance with risk principles, policies and limits, across the Bank. The unit is also responsible for the independent control of risks, including monitoring the risk of exposures against limits and the assessment of risks of new products and structured transactions. This unit also ensures the complete capture of the risks in risk measurement and reporting systems.

Asset and Liability Committee

The Asset and Liability Committee establishes policy and objectives for the asset and liability management of the Bank's balance sheet in terms of structure, distribution, risk and return and its impact on profitability. It also monitors the cash flow, tenor and cost/yield profiles of assets and liabilities and evaluates the Bank's balance sheet both from profit rate sensitivity and liquidity points of view, making corrective adjustments based upon perceived trends and market conditions, monitoring liquidity, monitoring foreign exchange exposures and positions.

Bank Treasury

Bank Treasury is responsible for managing the Bank's assets and liabilities and the overall financial structure. It is also primarily responsible for the funding and liquidity risks of the Bank.

Audit Committee

The Audit Committee is appointed by the Board of Directors and consists of three members who are Directors, including one non-Executive Director. The Board Audit Committee assists the Board in carrying out its responsibilities with respect to assessing the quality and integrity of financial reporting, the audit thereof, the soundness of the internal controls of the Bank, the measurement system of risk assessment and relating these to the Bank's capital, and the methods for monitoring compliance with laws, regulations and supervisory and internal policies.

Notes to the Consolidated Financial Statements

At 31 December 2007

27 RISK MANAGEMENT (continued)

27.1 Introduction (continued)

Internal Audit

Risk management processes throughout the Bank are audited by the internal audit function, that examines both the adequacy of the procedures and the Bank's compliance with the procedures. Internal Audit discusses the results of all assessments with management, and reports its findings and recommendations to the Audit Committee.

Risk measurement and reporting systems

The Groups risks are measured using a method which reflects both the expected loss likely to arise in normal circumstances and unexpected losses, which are an estimate of the ultimate actual loss based on statistical models. The models make use of probabilities derived from historical experience, adjusted to reflect the economic environment. The Bank also runs worse case scenarios that would arise in the event that extreme events which are unlikely to occur do, in fact, occur.

Monitoring and controlling risks is primarily performed based on limits established by the Group. These limits reflect the business strategy and market environment of the Group as well as the level of risk that the Group is willing to accept, with additional emphasis on selected industries. In addition, the Group monitors and measures the overall risk bearing capacity in relation to the aggregate risk exposure across all risk types and activities.

Information compiled from all the businesses is examined and processed in order to analyse, control and identify early risks. This information is presented and explained to the Board of Directors, the Risk Committee, and the head of each business division. The report includes aggregate credit exposure, credit metric forecasts, hold limit exceptions, liquidity ratios and risk profile changes. On a monthly basis detailed reporting of industry, customer and geographic risks takes place. Senior management assesses the appropriateness of the allowance for credit losses on a quarterly basis. The Board of Directors receives a comprehensive risk report once a quarter which is designed to provide all the necessary information to assess and conclude on the risks of the Group.

For all levels throughout the Group, specifically tailored risk reports are prepared and distributed in order to ensure that all business divisions have access to extensive, necessary and up-to-date information. A daily briefing is given to the General Manager and all other relevant members of the Bank on the utilisation of market limits, proprietary investments and liquidity, plus any other risk developments.

Excessive risk concentration

Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Group's performance to developments affecting a particular industry or geographical location.

In order to avoid excessive concentrations of risk, the Group's policies and procedures include specific guidelines to focus on maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly.

27.2 Credit Risk

Credit risk is the risk that the Group will incur a loss because its customers, clients or counterparties failed to discharge their contractual obligations. The Group manages and controls credit risk by setting limits on the amount of risk it is willing to accept for individual counterparties and for geographical and industry concentrations, and by monitoring exposures in relation to such limits.

The Group has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular collateral revisions. Counterparty limits are established by the use of a credit risk classification system, which assigns each counterparty a risk rating. Risk ratings are subject to regular revision. The credit quality review process allows the Group to assess the potential loss as a result of the risks to which it is exposed and take corrective action.

Notes to the Consolidated Financial Statements

At 31 December 2007

27 RISK MANAGEMENT (continued)

27.2 Credit Risk (continued)

Credit-related commitments risks

The Group makes available to its customers guarantees which may require that the Group makes payments on their behalf. Such payments are collected from customers based on the terms of the letter of credit. They expose the Group to similar risks to financing contracts and these are mitigated by the same control processes and policies.

Maximum exposure to credit risk without taking account of any collateral and other credit enhancements

The table below shows the maximum exposure to credit risk for the components of the balance sheet. The maximum exposure is shown gross, before the effect of mitigation through the use of master netting and collateral agreements.

	Gross Maximum Exposure 2007 BD 000s	Gross Maximum Exposure 2006 BD 000s
Balances with banks and Central Bank of Bahrain	21,613	20,107
Murabaha and Mudaraba contracts with banks	80,685	66,654
Murabaha, Musharaka, Istisna'a and Ijarah Muntahia Bittamleek contracts relating to customers	276,061	161,956
Investments - sukuks	25,742	11,543
Receivables	40,172	10,823
Total	<u>444,273</u>	<u>271,083</u>
Credit commitments and contingent items	59,372	31,003
Total credit risk exposure	<u>503,645</u>	<u>302,086</u>

Where financial instruments are recorded at fair value the amounts shown above represent the current credit risk exposure but not the maximum risk exposure that could arise in the future as a result of changes in values.

Risk concentrations of the maximum exposure to credit risk

Concentration of risk is managed by client/counterparty, by geographical region and by industry sector. The maximum credit exposure to any client or counterparty as of 31 December 2007 was BD 54,718 thousands (2006: BD 30,414 thousands) before taking account of collateral. This facility is fully secured by authenticated mortgage over title deeds of land and building in the favour of the Bank.

The Group financial assets having credit risk, before taking into account any collateral held can be analysed by the following geographical regions:

	2007 BD 000s	2006 BD 000s
Middle East	471,456	294,066
North America	13,394	1,541
Europe	500	-
New Zealand / Australia	10,875	69
Other	7,420	6,410
Total	<u>503,645</u>	<u>302,086</u>

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At 31 December 2007

27 RISK MANAGEMENT (continued)

27.2 Credit Risk (continued)

An industry sector analysis of the Group financial assets having credit risk, before taking into account collateral held, is as follows:

	2007 BD 000s	2006 BD 000s
Trading and Manufacturing	106,324	62,819
Banking and financial institutions	121,941	98,108
Construction and real estate	160,967	68,576
Other	114,413	72,583
Total	503,645	302,086

The Group holds collateral against most of its financial assets having credit risk.

Collateral and other credit enhancements

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. The Bank has guidelines regarding the acceptability of types of collateral and valuation parameters.

The main types of collateral obtained are as follows:

- For commercial financing, lien over investment accounts, charges over real estate properties, inventory and trade receivables; and
- For retail and consumer financing, lien over investment accounts, mortgages over the related assets.

The Bank also obtains personal guarantees from the owners for loans to their companies, but the benefits are not included in the above table. Management monitors the market value of collateral, requests additional collateral in accordance with the underlying agreement, and monitors the market value of collateral obtained during its review of the adequacy of the allowance for impairment losses.

Credit quality per class of financial assets

The credit quality of financial assets is managed by the Bank using internal credit ratings. The table below shows the credit quality by class of financial assets, based on the Bank's credit rating system.

	Neither past due nor impaired 2007 BD 000's	Past due or individually impaired 2007 BD 000's	Total 2007 BD 000's
Murabaha and Mudaraba contracts with banks	80,685	-	80,685
Murabaha, Musharika, Istisna'a and Ijarah Muntahia Bittamleek contracts relating to customers	270,987	14,828	285,815
Investments - sukuks	25,742	-	25,742
Total	377,414	14,828	392,242

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At 31 December 2007

27 RISK MANAGEMENT (continued)

27.2 Credit Risk (continued)

	Neither past due nor impaired 2006 BD 000's	Past due or individually impaired 2006 BD 000's	Total 2006 BD 000's
Murabaha and Mudaraba contracts with banks	66,554	-	66,554
Murabaha, Musharika, Istisna'a and Ijarah Muntahia Bittamleek contracts relating to customers	165,862	2,766	168,628
Investments - sukuks	11,543	-	11,543
Total	243,959	2,766	246,725

An analysis of past due financing contracts, by age, is provided below. The majority of the past due financing contracts are not considered to be impaired.

It is the Group's policy to maintain accurate and consistent risk ratings across the credit portfolio. This facilitates focused management of the applicable risks and the comparison of credit exposures across all lines of business, geographic regions and products. The rating system is supported by a variety of financial analytics, combined with processed market information to provide the main inputs for the measurement of counterparty risk. All internal risk ratings are tailored to the various categories and are derived in accordance with the Group's rating policy. The attributable risk ratings are assessed and updated regularly.

Aging analysis of past due but not impaired receivables per class of financial assets

	Less than 30 days 2007 BD 000's	31 to 60 days 2007 BD 000's	More than 60 days 2007 BD 000's	Total 2007 BD 000's
Murabaha, Musharika, Istisna'a and Ijarah Muntahia Bittamleek contracts relating to customers	4,430	533	5,289	10,252

	Less than 30 days 2006 BD 000's	31 to 60 days 2006 BD 000's	More than 60 days 2006 BD 000's	Total 2006 BD 000's
Murabaha, Musharika, Istisna'a and Ijarah Muntahia Bittamleek contracts relating to customers	11	285	486	782

Carrying amount per class of financial assets whose terms have been renegotiated

At 31 December 2007 and 2006, the Group had no financial assets whose terms have been renegotiated.

Impairment assessment

The main considerations for the impairment assessment include whether any payments of principal or profit are overdue by more than 90 days or there are any known difficulties in the cash flows of counterparties, credit rating downgrades, or infringement of the original terms of the contract. The Group addresses impairment assessment in two areas: individually assessed allowances and collectively assessed allowances.

Notes to the Consolidated Financial Statements

At 31 December 2007

27 RISK MANAGEMENT (continued)

27.2 Credit Risk (continued)

Individually assessed allowances

The Group determines the allowances appropriate for each individually significant financing contract on an individual basis. Items considered when determining allowance amounts include the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, projected receipts and the expected dividend payout should bankruptcy ensue, the availability of other financial support and the realisable value of collateral, and the timing of the expected cash flows. The impairment losses are evaluated at each reporting date, unless unforeseen circumstances require more careful attention.

Collectively assessed allowances

Allowances are assessed collectively for losses on financing contracts that are not individually significant (including credit cards, residential mortgages and unsecured consumer financing) and for individually significant financing contract where there is not yet objective evidence of individual impairment. Allowances are evaluated on each reporting date with each portfolio receiving a separate review.

The collective assessment takes account of impairment that is likely to be present in the portfolio even though there is not yet objective evidence of the impairment in an individual assessment. Impairment losses are estimated by taking into consideration of the following information: historical losses on the portfolio, current economic conditions, the approximate delay between the time a loss is likely to have been incurred and the time it will be identified as requiring an individually assessed impairment allowance, and expected receipts and recoveries once impaired. Management is responsible for deciding the length of this period which can extend for as long as one year. The impairment allowance is then reviewed by credit management to ensure alignment with the Group's overall policy.

Financial guarantees and letters of credit are assessed and provision made in a similar manner as for financing contracts.

27.3 Liquidity risk and funding management

Liquidity risk is the risk that the Group will be unable to meet its payment obligations when they fall due under normal and stress circumstances. To limit this risk, management has arranged diversified funding sources in addition to its core deposit base, manages assets with liquidity in mind, and monitors future cash flows and liquidity on a daily basis. This incorporates an assessment of expected cash flows and the availability of high grade collateral which could be used to secure additional funding if required.

The Group maintains a portfolio of highly marketable and diverse assets that can be easily liquidated in the event of an unforeseen interruption of cash flow. The Group also has committed lines of credit that it can access to meet liquidity needs. In addition, the Bank maintains a statutory deposit with the Central Bank of Bahrain equal to 5% of customer deposits. The liquidity position is assessed and managed under a variety of scenarios, giving due consideration to stress factors relating to both the market in general and specifically to the Bank. The most important of these is to maintain limits on the ratio of liquid assets to customer liabilities. Liquid assets consists of cash and balances with banks and Central Bank of Bahrain, Murabaha and Mudaraba contracts with banks, held for trading investments and Central Bank of Bahrain sukuks. The ratios during the year were as follows:

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At 31 December 2007

27 RISK MANAGEMENT (continued)

27.3 Liquidity risk and funding management (continued)

	2007 %	2006 %
31 December	19.47	37.01
During the year:		
Average	25.92	34.41
Highest	39.11	38.36
Lowest	19.47	28.59

Analysis of financial liabilities by remaining contractual maturities

The table below summarises the maturity profile of the Group's financial liabilities at 31 December 2007 and 2006 based on contractual undiscounted repayment obligations. See note 26 'Maturity analysis of assets and liabilities' for the expected maturities of these liabilities. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Group expects that many customers will not request repayment on the earliest date the Group could be required to pay and the table does not reflect the expected cash flows indicated by the Group's deposit retention history.

	On demand BD 000s	Less than 3 months BD 000s	3 to 12 months BD 000s	1 to 5 years BD 000s	Over 5 years BD 000s	Total BD 000s
At 31 December 2007						
Mudaraba contracts with banks	4,427	69,670	3,980	-	-	78,077
Murabaha contracts with non-banks	-	255,286	33,231	-	-	288,517
Customers' current accounts	107,150	-	-	-	-	107,150
Other liabilities	-	15,486	29,142	47	1,516	46,191
Unrestricted investment	36,255	8,922	8,159	-	-	53,336
Total undiscounted financial liabilities 2007	147,832	349,364	74,512	47	1,516	573,271
At 31 December 2006						
Murabaha contract with banks	-	101,379	9,548	-	-	110,927
Murabaha contracts with non-banks	-	96,853	1,114	1,902	-	99,869
Customers' current accounts	46,549	-	-	-	-	46,549
Other liabilities	12,875	-	-	-	-	12,875
Unrestricted investment accounts	23,779	12,790	-	-	-	36,569
Total undiscounted financial liabilities 2006	83,203	211,022	10,662	1,902	-	306,789

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At 31 December 2007

27 RISK MANAGEMENT (continued)

27.3 Liquidity risk and funding management (continued)

Credit commitments and contingent items

These include commitments to enter into contracts which are designed to meet the requirements of the Group's customers. Commitments represent contractual commitments under Murabaha, Mudaraba and Ijarah Muntahia Bittamleek contracts. Commitments generally have fixed expiration dates, or other termination clauses. Since commitments may expire without being exercised, the total contract amounts do not necessarily represent future cash flow requirements.

Letters of credit and guarantees (including standby letters of credit) commit the Bank to make payments on behalf of customers contingent upon the failure of the customer to perform under the terms of the contract.

The table below shows the contractual expiry by maturity of the Group's Credit commitments and contingent items.

	Upto 1 year BD 000's	Over 1 year BD 000's	Total BD 000's
At 31 December 2007			
Commitments on behalf of customers:			
Letters of credits	20,043	-	20,043
Guarantees	14,580	8,698	23,278
Irrevocable commitments to extend credit	16,051	-	16,051
Total	50,674	8,698	59,372
At 31 December 2006			
Commitments on behalf of customers:			
Letters of credits	8,062	-	8,062
Guarantees	2,313	14,580	16,893
Irrevocable commitments to extend credit	6,048	-	6,048
Total	16,423	14,580	31,003

The Group does not expect any material loss in respect of the above.

27.4 Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as profit rates, foreign exchange rates, and equity prices. The Group managed and monitored the positions using sensitivity analyses.

Profit rate risk

Profit rate risk arises from the possibility that changes in profit rates will affect future profitability or the fair values of financial instruments. The Board has established limits on the profit rate gaps for stipulated periods and the positions are monitored on a daily basis.

The following table demonstrates the sensitivity to reasonably possible change in profit rates, with all other variables held constant of the Group's consolidated statement of income. The sensitivity of the consolidated statement of income is the effect of the assumed changes in profit rates on the net income for the year, based on the non-trading financial assets and financial liabilities held at 31 December 2007. There is no impact on the Group's equity.

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At 31 December 2007

27 RISK MANAGEMENT (continued)

27.4 Market risk (continued)

The effect of decreases in basis points is expected to be equal and opposite to the effect of the increases shown.

	2007 BD 000s	Change in basis points	Effect on net income for the year BD 000s
Assets			
Murabaha and Mudaraba contracts with banks	80,685	+20	161
Musharaka, Istisna'a and Ijarah Muntahia _ Bittamleek contracts relating to customers	171,026	+20	342
Investments - sukuks	25,742	+20	51
Liabilities and Unrestricted Investment Accounts			
Murabaha contracts with banks	77,329	+20	(155)
Murabaha contracts with non-banks	287,269	+20	(575)
Unrestricted investment accounts	53,091	+20	(106)
Total			(282)

	2006 BD 000s	Change in basis points	Effect on net income for the year BD 000s
Assets			
Murabaha and Mudaraba contracts with banks	66,654	+20	133
Musharaka, Istisna'a and Ijarah Muntahia _ Bittamleek contracts relating to customers	103,296	+20	207
Investments - sukuks	11,543	+20	23
Liabilities and Unrestricted Investment Accounts			
Murabaha contracts with banks	110,366	+20	(221)
Murabaha contracts with non-banks	99,345	+20	(199)
Unrestricted investment accounts	44,375	+20	(89)
Total			(146)

Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Board has set limits on positions by currency. Positions are monitored on a daily basis to ensure positions are maintained within established limits.

The tables below indicate the currencies to which the Group had significant exposure at 31 December 2007 on its all monetary assets and liabilities. The analysis calculates the effect of a reasonably possible movement of the currency rate against the Bahraini Dinar, with all other variables held constant on the consolidated statement of income.

The effect of decreases in currency rate is expected to be equal and opposite to the effect of the increases shown.

	Change currency rate %	Effect on profit 2007 BD 000s	Effect on equity 2007 BD 000s	Effect on profit 2006 BD 000s	Effect on equity 2006 BD 000s
NZD	+5	791	232	784	168
KWD	+5	395	-	261	-
JOR	+5	-	242	-	260
GBP	+5	219	-	138	-
Total		1,405	474	1,183	428

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At 31 December 2007

27 RISK MANAGEMENT (continued)

27.4 Market risk (continued)

Equity price risk

Equity price risk is the risk that the fair values of equities decrease as the result of changes in the levels of equity indices and the value of individual stocks. The equity price risk exposure arises from the Group's investment portfolio.

The effect on income (as a result of a change in the fair value of equity instruments at 31 December 2007) due to a reasonably possible change (i.e. +5%) in the value of individual investments, with all other variables held constant, is BD 5,807 thousands (2006: BD 3,576 thousands). The effect of decrease in the value of individual investment is expected to be equal and opposite to the effect of the increase shown.

27.5 Prepayment risk

Prepayment risk is the risk that the Group will incur a financial loss because its customers and counterparties repay or request repayment earlier or later than expected. The Group is not exposed to any significant prepayment risk.

27.6 Operational risk

Operational risk is the risk of loss arising from systems failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Group cannot expect to eliminate all operational risks, but through a control framework and by monitoring and responding to potential risks, the Group is able to manage the risks. Controls include effective segregation of duties, access, authorisation and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

28 CREDIT COMMITMENTS AND CONTINGENT ITEMS

Credit related commitments

These include commitments to enter into contracts which are designed to meet the requirements of the Bank's customers. Commitments represent contractual commitments under Murabaha, Musharaka, Mudaraba and Ijarah Muntahia Bittamleek contracts. Commitments generally have fixed expiration dates, or other termination clauses. Since commitments may expire without being exercised, the total contract amounts do not necessarily represent future cash flow requirements.

Letters of credit and guarantees (including standby letters of credit) commit the Bank to make payments on behalf of customers contingent upon the failure of the customer to perform under the terms of the contract.

The Bank has the following credit related commitments:

	2007 BD 000s	2006 BD 000s
Commitments on behalf of customers:		
Letters of credit	20,043	8,062
Guarantees	23,278	16,893
	43,321	24,955
Irrevocable commitments to extend credit:		
Original term to maturity of one year or less	16,051	6,048
	59,372	31,003

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At 31 December 2007

28 CREDIT COMMITMENTS AND CONTINGENT ITEMS (continued)

Operating lease commitments

At 31 December 2007, the Group had commitments in respect of non cancellable operating leases amounting to BD 4,464 thousand (2006: BD 4,532 thousand) relating to leasehold premises. Of the commitments in respect of operating leases BD 231 thousand (2006: BD 150 thousand) are due within one year and the remaining within two to five years.

Capital commitments

At 31 December 2007, the Group had commitments of BD 1,694 thousand (2006: Nil) principally relating to the office premises.

29 CAPITAL MANAGEMENT

The Group maintains an actively managed capital base to cover risks inherent in the business. The adequacy of the Group's capital is monitored using, among other measures, the rules and ratios established by the Basel Committee on Banking Supervision ("BIS rules/ratios") and adopted by the Central Bank of Bahrain in supervising the Bank. During the past year, the Group had complied in full with all its externally imposed capital requirements.

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

The Group manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Group may adjust the amount of dividend payment to shareholders, return capital to shareholders or issue capital securities. No changes were made in the objectives, policies and processes from the previous years.

Regulatory capital

	2007 BD 000s	2006 BD 000s
Tier 1 capital	116,584	63,207
Tier 2 capital	40,215	25,778
Total capital	156,799	88,985
Risk weighted assets	705,943	366,355
Total capital ratio	22.2%	24.3%
Minimum requirement	12.0%	12.0%

Regulatory capital consists of Tier 1 capital, which comprises share capital, share premium, retained earnings, foreign currency translation and minority interests less goodwill. The other component of regulatory capital is Tier 2 capital, which includes collective provision, current year's profit and revaluation reserves. Certain adjustments are made to IFRS-based results and reserves, as prescribed by the Central Bank of Bahrain.

Notes to the Consolidated Financial Statements

At 31 December 2007

30 EARNINGS AND EXPENSES PROHIBITED BY SHARI'A

The Group did not receive any significant income or incurred significant expenses which were prohibited by the Shari'a.

31 FAIR VALUE OF FINANCIAL INSTRUMENTS

Financial instruments comprise financial assets and financial liabilities. Financial assets consist of cash and balances with banks and Central Bank of Bahrain, Murabaha and Mudaraba contracts with banks, Financial contracts relating to customers, investments, investment properties and receivables. Financial liabilities consist of Murabaha contracts with banks, Murabaha contracts with non-banks, customers current accounts and unrestricted investment accounts.

At 31 December 2007 and 2006, the fair values of financial instruments were not materially different from their carrying values.

32 SOCIAL RESPONSIBILITY

The Bank discharges its social responsibilities through donations to charitable causes and organisations approved by Shari'a Supervisory Board.

33 ZAKAH

In accordance with the instructions of the Sharia'a Supervisory Board of the Bank, payment of Zakah is the responsibility of the shareholders of the Bank. Accordingly, no Zakah has been charged to these consolidated financial statements.