

Ahli United Bank B.S.C.
CONSOLIDATED FINANCIAL STATEMENTS
31 DECEMBER 2007

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INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF AHLI UNITED BANK B.S.C.

We have audited the accompanying consolidated financial statements of Ahli United Bank B.S.C. ('the Bank') and its subsidiaries ('the Group'), as at 31 December 2007 comprising the consolidated balance sheet as at 31 December 2007 and the related consolidated statements of income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Board of Directors' Responsibility for the Consolidated Financial Statements

The Board of Directors is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of the 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 International Standards on Auditing. 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 consolidated financial statements. The procedures selected depend on the auditors' judgement, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal 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 consolidated financial statements.

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

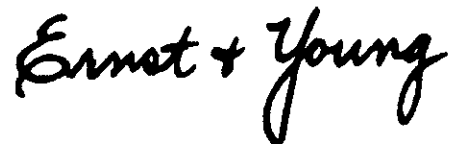
**INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF
AHLI UNITED BANK B.S.C. (continued)**

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2007 and its consolidated financial performance and its consolidated 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 Bank and the consolidated financial statements, and the contents of the Board of Directors' Report 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 Bank or on its consolidated financial position and that the Bank has complied with the terms of its banking licence.



11 February 2008
Manama, Kingdom of Bahrain

CONSOLIDATED STATEMENT OF INCOME

Year ended 31 December 2007

	Note	2007 <u>US\$ '000</u>	2006 <u>US\$ '000</u>
Interest income	4	1,310,634	966,514
Interest expense	5	982,516	688,058
Net interest income		<u>328,118</u>	<u>278,456</u>
Fees and commissions - net	6	157,525	116,378
Trading income - net	7	44,068	17,251
Gains on sale of available-for-sale investments		54,724	34,283
Share of profit from associates		57,134	28,288
Dividend income		17,811	13,215
Other operating income		7,385	4,986
		<u>338,647</u>	<u>214,401</u>
OPERATING INCOME		<u>666,765</u>	<u>492,857</u>
Provision for loan losses - net	9e	24,388	17,572
Provision for impairment of non-trading investments and contingencies - net	10	31,574	17,922
		<u>55,962</u>	<u>35,494</u>
NET OPERATING INCOME		<u>610,803</u>	<u>457,363</u>
Staff costs		140,749	114,321
Depreciation		15,750	14,187
Other operating expenses		82,124	67,789
OPERATING EXPENSES		<u>238,623</u>	<u>196,297</u>
PROFIT BEFORE TAX		372,180	261,066
Income tax expense	21	12,354	3,243
NET PROFIT FOR THE YEAR		<u>359,826</u>	<u>257,823</u>
<i>Attributable to:</i>			
Bank's equity shareholders		296,317	207,480
Minority interest		63,509	50,343
		<u>359,826</u>	<u>257,823</u>
EARNINGS PER SHARE ATTRIBUTABLE TO BANK'S EQUITY SHAREHOLDERS FOR THE YEAR :			
Basic earnings per share (US cents)	22	<u>9.1</u>	<u>6.4</u>
Diluted earnings per share (US cents)	22	<u>7.9</u>	<u>5.6</u>

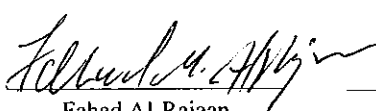
The attached notes 1 to 37 form part of these consolidated financial statements.


Ahli United Bank B.S.C.


CONSOLIDATED BALANCE SHEET

31 December 2007

	Note	<u>2007</u> US\$ '000	<u>2006</u> US\$ '000
ASSETS			
Cash and balances with central banks	8	142,590	137,683
Treasury bills and bonds		867,074	959,713
Trading securities		112,201	75,829
Deposits with banks and other financial institutions		4,396,781	6,011,145
Loans and advances	9	12,035,153	8,873,357
Non-trading investments	10	3,525,277	3,339,102
Investments in associates	11	768,471	554,280
Premises and equipment	12	292,461	146,501
Other assets	13	414,487	268,956
Goodwill and other intangible assets	14	495,357	432,341
TOTAL ASSETS		<u>23,049,852</u>	<u>20,798,907</u>
LIABILITIES, SUBORDINATED LIABILITIES AND EQUITY			
LIABILITIES			
Deposits from banks and other financial institutions		6,989,024	7,326,916
Customers' deposits	15	10,780,914	9,039,466
Term debt	16	1,350,000	1,542,497
Other liabilities	17	693,569	439,779
Total liabilities		<u>19,813,507</u>	<u>18,348,658</u>
SUBORDINATED LIABILITIES	18	<u>588,224</u>	<u>623,577</u>
EQUITY			
Ordinary share capital	19	844,201	682,500
Preference share capital	19	173,001	148,941
Reserves	20	1,292,518	711,677
Attributable to the Bank's equity shareholders		2,309,720	1,543,118
Minority interest		338,401	283,554
Total equity		<u>2,648,121</u>	<u>1,826,672</u>
TOTAL LIABILITIES, SUBORDINATED LIABILITIES AND EQUITY		<u>23,049,852</u>	<u>20,798,907</u>


 Fahad Al-Rajaan
 Chairman
 Board of Directors


 Hamad Al-Marzouq
 Deputy Chairman
 Board of Directors


 Adel A. El-Labban
 Group Chief Executive Officer
 & Managing Director

The attached notes 1 to 37 form part of these consolidated financial statements.

Ahli United Bank B.S.C.

CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended 31 December 2007

	2007	2006
Note	US\$ '000	US\$ '000
OPERATING ACTIVITIES		
Profit before tax	372,180	261,066
Adjustments for:		
Depreciation	15,750	14,187
Gains on sale of available-for-sale investments - net	(54,724)	(34,283)
Provision for loan losses - net	24,388	17,572
Provision for impairment of non-trading investments, and contingencies - net	31,574	17,922
Share of profit from associates	(57,134)	(28,288)
Staff costs - fair value amortisation of share based transactions	5,196	2,394
Operating profit before changes in operating assets and liabilities	337,230	250,570
Changes in:		
Mandatory reserve deposits with central banks	(21,485)	(8,304)
Treasury bills and bonds	92,639	23,137
Trading securities	(36,372)	(23,064)
Deposits with banks and other financial institutions	(359,380)	(711,016)
Loans and advances	(3,186,184)	(2,904,533)
Other assets	(145,531)	(37,703)
Deposits from banks and other financial institutions	(337,892)	3,486,719
Customers' deposits	1,741,448	2,376,362
Other liabilities	253,790	99,989
Cash (used in) from operations	(1,661,737)	2,552,157
Income tax paid	(1,367)	(9,556)
Net cash (used in) from operating activities	(1,663,104)	2,542,601
INVESTING ACTIVITIES		
Purchase of non-trading investments	(1,270,425)	(1,474,034)
Proceeds from sale or redemption of non-trading investments	1,114,527	702,776
Investments in associates	(174,844)	(193,489)
Additional investment in a subsidiary	(74,611)	-
Increase in premises and equipment	(67,420)	(33,376)
Net cash used in investing activities	(472,773)	(998,123)
FINANCING ACTIVITIES		
Proceeds from rights issue	373,805	-
Proceeds from issue of Class B preference shares	69,259	43,094
(Repayment) increase of subordinated liabilities	(35,353)	184,574
(Repayment) increase of term debt	(192,497)	575,560
Dividends and other appropriations paid	(110,114)	(88,373)
Net cash from financing activities	105,100	714,855
Foreign currency translation adjustments	40,455	635
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(1,990,322)	2,259,968
Cash and cash equivalents at 1 January	4,367,208	2,107,240
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	2,376,886	4,367,208

The attached notes 1 to 37 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

Year ended 31 December 2007

Attributable to Bank's equity shareholders

	Reserves											Minority interest US\$ '000	Total reserves US\$ '000	Total US\$ '000			
	Ordinary share capital					Preference share capital					Foreign currency translation adjustments US\$ '000				Retained earnings US\$ '000	Proposed appropriations US\$ '000	Cumulative changes in fair values US\$ '000
	US\$ '000	US\$ '000	US\$ '000	US\$ '000	US\$ '000	US\$ '000	US\$ '000	US\$ '000	US\$ '000	US\$ '000							
Balance at 31 December 2006	682,500	148,941	235,820	307	71,420	-	(4,375)	158,901	112,097	137,507	711,677	283,554	1,826,672				
Directors' fees paid	-	-	-	-	-	-	-	-	(833)	-	(833)	-	(833)				
Donations approved	-	-	-	-	-	-	-	-	(500)	-	(500)	-	(500)				
Currency translation adjustments	-	-	-	-	-	40,455	-	-	-	-	40,455	-	40,455				
Net fair value movements during the period (note 20(f))	-	-	-	-	-	-	-	-	-	4,573	4,573	21,230	25,803				
Revaluation of freehold land (note 12)	-	-	-	-	94,290	-	-	-	-	-	94,290	2,718	97,008				
Net income recognised directly in equity	-	-	-	-	94,290	40,455	-	-	(1,333)	4,573	137,985	23,948	161,933				
Net profit for the year	-	-	-	-	94,290	40,455	296,317	-	-	-	296,317	63,509	359,826				
Total recognised income and expense for the year	-	-	-	-	94,290	40,455	296,317	(1,333)	4,573	4,573	434,302	87,457	521,759				
Class A preference share dividend paid (note 20)	-	-	-	-	-	-	-	-	(14,288)	-	(14,288)	-	(14,288)				
Class B preference share dividend paid (note 20)	-	-	-	-	-	-	-	-	(926)	-	(926)	-	(926)				
Ordinary share dividend paid (note 20)	-	-	-	-	-	-	-	-	(95,550)	-	(95,550)	(34,868)	(130,418)				
Bonus shares issued (note 19(b))	68,250	-	-	-	-	-	(68,250)	-	-	-	(68,250)	-	-				
Other equity movements of a subsidiary	-	-	-	-	-	-	-	-	-	-	-	2,258	2,258				
Rights issue (note 19(b))	93,451	-	280,354	-	-	-	-	-	-	-	280,354	-	373,805				
Class B preference shares issued (note 19(b))	-	24,060	45,199	-	-	-	-	-	-	-	45,199	-	69,259				
Transfer to statutory reserve (note 20(c))	-	-	-	-	29,632	-	(29,632)	-	-	-	-	-	-				
Proposed dividend on Class A preference shares – convertible portion (note 20(e))	-	-	-	-	-	-	(15,366)	15,366	-	-	-	-	-				
Proposed dividend on Class B preference shares (note 20(e))	-	-	-	-	-	-	(5,716)	5,716	-	-	-	-	-				
Proposed dividend on ordinary shares (note 20(e))	-	-	-	-	-	-	(105,780)	105,780	-	-	-	-	-				
Proposed directors' fees	-	-	-	-	-	-	(1,002)	1,002	-	-	-	-	-				
Proposed donations	-	-	-	-	-	-	(1,000)	1,000	-	-	-	-	-				
Balance at 31 December 2007	844,201	173,001	561,373	307	101,052	94,290	36,080	228,472	128,864	142,080	1,292,518	338,401	2,648,121				

The attached notes 1 to 37 form part of these consolidated financial statements.

Ahli United Bank B.S.C.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

Year ended 31 December 2007

Attributable to Bank's equity shareholders

	Reserves											Total reserves US\$ '000	Minority interest US\$ '000	Total US\$ '000	
	Preference share					Foreign currency					Cumulative changes in fair values US\$ '000				Total reserves US\$ '000
	Ordinary share capital US\$ '000	Preference share capital US\$ '000	Share premium US\$ '000	Capital reserve US\$ '000	Statutory reserve US\$ '000	Revaluation reserve US\$ '000	Reserve adjustments US\$ '000	Retained earnings US\$ '000	Proposed appropriations US\$ '000	Retained earnings US\$ '000					
Balance at 31 December 2005	650,000	125,000	216,667	307	50,672	-	(5,010)	116,766	89,403	123,813	592,618	255,580	1,623,198		
Directors' fees paid	-	-	-	-	-	-	-	-	(617)	-	(617)	-	(617)		
Donations approved	-	-	-	-	-	-	-	-	(413)	-	(413)	-	(413)		
Currency translation adjustments	-	-	-	-	-	635	-	-	-	-	635	-	635		
Net fair value movements during the period (note 20(f))	-	-	-	-	-	-	-	-	-	13,694	13,694	3,553	17,247		
Net income recognised directly in equity	-	-	-	-	-	635	-	-	(1,030)	13,694	13,299	3,553	16,852		
Net profit for the year	-	-	-	-	-	-	207,480	-	-	-	207,480	50,343	257,823		
Total recognised income and expense for the year	-	-	-	-	-	635	207,480	-	(1,030)	13,694	220,779	53,896	274,675		
Class A preference share dividend paid	-	-	-	-	-	-	-	-	(10,373)	-	(10,373)	-	(10,373)		
Class B preference share dividend paid	-	-	-	-	-	-	-	-	-	-	-	-	-		
Ordinary share dividend paid	-	-	-	-	-	-	-	-	(78,000)	-	(78,000)	(22,107)	(100,107)		
Bonus shares issued	32,500	-	-	-	-	-	(32,500)	-	-	-	(32,500)	-	-		
Other equity movements of a subsidiary	-	-	-	-	-	-	-	-	-	-	-	-	-		
Class B preference shares issued (note 19(b))	-	23,941	19,153	-	-	-	-	-	-	-	19,153	(3,815)	(3,815)		
Transfer to statutory reserve (note 20(e))	-	-	-	-	20,748	-	(20,748)	-	-	-	-	-	43,094		
Proposed dividend on Class A preference shares - convertible portion (note 20(e))	-	-	-	-	-	-	(14,288)	-	14,288	-	-	-	-		
Proposed dividend on Class B preference shares (note 20(e))	-	-	-	-	-	-	(926)	-	926	-	-	-	-		
Proposed dividend on ordinary shares (note 20(e))	-	-	-	-	-	-	(95,550)	-	95,550	-	-	-	-		
Proposed directors' fees	-	-	-	-	-	-	(833)	-	833	-	-	-	-		
Proposed donations	-	-	-	-	-	-	(500)	-	500	-	-	-	-		
Balance at 31 December 2006	682,500	148,941	235,820	307	71,420	-	(4,375)	158,901	112,097	137,507	711,677	283,554	1,826,672		

The attached notes 1 to 37 form part of these consolidated financial statements.

31 December 2007

1 CORPORATE INFORMATION

The parent company, Ahli United Bank B.S.C. (AUB or the Bank) was incorporated in the Kingdom of Bahrain on 31 May 2000 originally as a closed company and changed on 12 July 2000 to a public shareholding company by Amiri Decree no. 16/2000. The Bank and its subsidiaries as detailed below (collectively known as the Group) are engaged in retail, commercial, islamic and investment banking business, global fund management and private banking services through 43 branches in the Kingdom of Bahrain, the State of Kuwait and the United Kingdom. It also operates in the State of Qatar, Republic of Iraq, Arab Republic of Egypt and Sultanate of Oman through its associates. The Bank operates under a retail banking licence issued under the new integrated licensing framework of the Central Bank of Bahrain. The Bank's registered office is located at Building 2495, Road 2832, Al Seef District 428, Kingdom of Bahrain.

The consolidated financial statements for the year ended 31 December 2007 were authorised for issue in accordance with a resolution of the directors on 11 February 2008.

2 BASIS OF CONSOLIDATION

The consolidated financial statements comprise the financial statements of the Bank and its subsidiaries (collectively known as the Group) as at and for the year ended 31 December 2007. The financial statements of the subsidiaries are prepared for the same reporting year as the Bank, using consistent accounting policies.

All material intra-group balances, transactions, income and expenses and profits and losses resulting from intra-group transactions are eliminated on consolidation.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group. Control is achieved where the Bank has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The results of subsidiaries acquired are included in the consolidated statement of income from the date of acquisition.

The following are the Bank's principal subsidiaries:

<i>Name</i>	<i>Country of incorporation</i>	<i>Effective percentage holding</i>	
		<i>31 December 2007</i>	<i>31 December 2006</i>
Ahli United Bank (U.K.) PLC (AUBUK)	United Kingdom	100%	100%
Bank of Kuwait and the Middle East K.S.C. (BKME)	State of Kuwait	75%	75%
Kuwait and Middle East Financial Investment Co. K.S.C. (closed) (KMEFIC) (a subsidiary of BKME)	State of Kuwait	63%	48%

During the year, the Bank and its subsidiary, BKME, increased their direct holding in the voting capital of KMEFIC through the purchase of 37.1 million additional shares. The consideration paid for the acquisition was US\$ 74.6 million (KD 20.7 million). This resulted in an incremental goodwill of US\$ 39.0 million (KD 10.6 million) under the 'Parent entity extension' method. Refer note 14 for further details.

3 ACCOUNTING POLICIES

3.1 Basis of preparation

The consolidated financial statements have been prepared on a historical cost basis as modified for the re-measurement at fair value of freehold land, trading and available-for-sale financial assets and all derivatives. In addition, as more fully discussed below, assets and liabilities that are fair value hedged are adjusted to the extent of the fair value of the risk being hedged. The consolidated financial statements are presented in US Dollars which is the Bank's functional currency, and all values are rounded to the nearest thousand (US Dollar thousand) except where otherwise indicated.

During the year the Group adopted IFRS 7 Financial Instruments: Disclosures and consequent amendments to IAS 1 – Capital Disclosures which has resulted in amended and additional disclosures regarding financial instruments and associated risks and capital management.

Statement of compliance

The consolidated financial statements of the Bank have been prepared in accordance with International Financial Reporting Standards (IFRS) and in conformity with the Bahrain Commercial Companies Law and the Central Bank of Bahrain and Financial Institutions Law.

New standards and interpretations issued but not yet effective

The following standards and interpretations have been issued by the International Accounting Standards Board (IASB) but are not yet mandatory for these consolidated financial statements :

- IFRS 8 Operating Segments (effective for financial year commencing 1 January 2009)
- IFRIC Interpretation 11 IFRS 2 – Group and Treasury Share Transactions (effective for annual periods commencing 1 March 2007)
- IAS 1 - Presentation of financial statements (Revised) (effective for annual periods commencing 1 January 2009)

The application of the above is not expected to have a material impact on the consolidated financial statements as and when they become effective. However, the application of IAS 1 (Revised) will result in amendments to the presentation of the consolidated financial statements.

3.2 Significant accounting judgements and estimates

The preparation of the consolidated financial statements requires management to make judgements and estimates that affect the reported amount of financial assets and liabilities and disclosure of contingent liabilities. These judgements and estimates also affect the revenues and expenses and the resultant provisions as well as fair value changes reported in equity.

Judgements

Judgements are made in the classification of available-for-sale, held-for-trading and held-to-maturity investments based on management's intention at acquisition of the financial asset, and the allocation of goodwill to cash generating units. Judgements are also made in determination of the objective evidence that a financial asset is impaired.

Estimates

Pension plans

Estimates and assumptions are used in determining the Group's pension liabilities. The principal actuarial assumptions used for the defined benefit plan are set out in note 25 to the consolidated financial statements.

3 ACCOUNTING POLICIES (continued)

3.2 Significant accounting judgements and estimates (continued)

Impairment losses on loans and advances and non-trading investments

Estimates are made regarding the amount and timing of future cash flows when measuring the level of provisions required for non-performing loans, portfolios of performing loans with similar risk characteristics where the risk of default has increased, as well as provisions for non-trading investments. These are more fully described in note 3.3 (g).

Fair value of financial instruments

Estimates are also made in determining the fair values of financial assets and derivatives that are not quoted in an active market. Such estimates are necessarily based on assumptions about several factors involving varying degrees of uncertainty and actual results may differ resulting in future changes in such provisions.

The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

3.3 Summary of significant accounting policies

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years presented except for the accounting policy of revaluation of freehold land as more fully explained in note 12.

(a) Investments in associates

Associated companies are companies in which the Group exerts significant influence but does not control, normally represented by an interest of between 20% and 50% in the voting capital. Investments in associated companies are accounted for using the equity method.

The reporting dates of the associates and the Group are identical and the associates' accounting policies materially conform to those used by the Group for like transactions and events in similar circumstances. Adjustments are made to bring into line any dissimilar accounting policies that may exist.

(b) Foreign currency translation

(i) Transactions and balances

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

Monetary assets and liabilities denominated in foreign currencies are retranslated at the relevant functional currency rate of exchange ruling at the balance sheet date. All differences are taken to "Trading income - net" in 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 available-for-sale items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined and the differences are included in equity as part of the fair value adjustment of the respective items, unless these items are part of an effective hedging strategy.

3 ACCOUNTING POLICIES (continued)

3.3 Summary of significant accounting policies (continued)

(b) Foreign currency translation (continued)

(i) Group companies

Assets and liabilities of foreign subsidiaries are translated into US Dollars at the rates of exchange prevailing at the balance sheet date. Income and expense items are translated at average exchange rates prevailing for the period. Any exchange differences arising on translation are taken to "foreign currency translation adjustments" forming part of equity.

(c) Financial instruments

The classification of financial instruments at initial recognition depends on the purpose for which the financial instruments were acquired and their characteristics. All financial instruments are initially recognised at the fair value of consideration given, including acquisition costs associated with the investment, except in the case of trading securities, the acquisition costs of which are expensed. Premiums and discounts are amortised on a systematic basis to maturity using the effective interest method and taken to interest income or interest expense as appropriate.

(i) Date of recognition

All "regular way" purchases and sales of financial assets are recognised on the settlement date, i.e. the date that the Group receives or delivers the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place.

The Group accounts for any changes in the fair value of the asset to be received during the period between the trade date and the settlement date in the same way as it accounts for the acquired asset. The change in fair value is recognised in the consolidated statement of income for assets classified as financial assets at fair value through profit or loss and it is recognized in equity for assets classified as available for sale. The change in value is not recognized for assets carried at cost or amortised cost.

(ii) Treasury bills and bonds

Treasury bills and bonds are initially recognised at cost. Premiums and discounts are amortised on a systematic basis to their maturity. These treasury bonds are issued by the Central Bank of Kuwait on behalf of the Ministry of Finance and are held to maturity.

(iii) Trading securities

A financial asset is classified as "held-for-trading" if it is acquired or incurred principally for the purpose of generating profit from short term fluctuations in price. Trading securities are initially recognised at cost, being the fair value of the consideration given and are subsequently measured at fair value. Resultant unrealised gains and losses arising from changes in fair value are included in the consolidated statement of income under "Trading income - net" while dividend income is recorded in "Dividend income" according to the terms of the contract, or when the right of the payment has been established.

31 December 2007

3 ACCOUNTING POLICIES (continued)

3.3 Summary of significant accounting policies (continued)

(c) Financial instruments (continued)

(iv) Held-to-maturity

Non-trading investments with fixed or determinable payments and fixed maturities and which the Group has the intention and ability to hold to maturity are classified as held-to-maturity. After initial measurement, these are subsequently measured at amortised cost using the effective interest rate method, less allowance for impairment. The losses arising from impairment of such investments are recognised in the consolidated statement of income line "Provision for impairment of non-trading investments, other assets and contingencies - net".

(v) Loans and advances

Loans and advances are financial assets with fixed or determinable payments and fixed maturities that are not quoted in an active market. This accounting policy relates to the balance sheet captions "Deposits with banks and other financial institutions" and "Loans and advances". After initial measurement, the loans and advances are subsequently measured at amortised cost using the effective interest rate method, adjusted for effective fair value hedges, less any amounts written off and provision for impairment. The losses arising from impairment of such loans and advances are recognised in the consolidated statement of income in "Provision for loan losses-net" and in an impairment allowance account in the consolidated balance sheet. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate. The amortisation is included in "Interest income" in the consolidated statement of income.

(vi) Available-for-sale

Non-trading investments that are not classified as held-to-maturity, held-for-trading or loans and advances are classified as available-for-sale. After initial recognition, available-for-sale investments are remeasured at fair value. For investments in equity instruments, where a reasonable estimate of the fair value cannot be determined, the investment is carried at cost less impairment provision. Unless unrealised gains and losses on remeasurement to fair value are part of an effective hedging relationship, they are reported as a separate component of equity until the investment is sold, collected or otherwise disposed of, or the investment is determined to be impaired, at which time the cumulative gain or loss previously reported in equity is included in the consolidated statement of income for the period.

Any gain or loss arising from a change in fair value of available-for-sale investments, which is part of an effective hedging relationship, is recognised directly in the consolidated statement of income to the extent of the changes in fair value being hedged.

(vii) Embedded derivatives

Derivatives embedded in other financial instruments are treated as separate derivatives and recorded at fair value, when their economic characteristics and risks are not closely related to those of the host contract and the host contract is not carried as held for trading. The embedded derivatives are, where material, separated from the host contract and carried at fair value with the changes in fair value recognised in the consolidated statement of income.

(vii) Deposits, term debts and subordinated liabilities

These financial liabilities are carried at amortised cost, less amounts repaid.

3 ACCOUNTING POLICIES (continued)

3.3 Summary of significant accounting policies (continued)

(d) Derecognition of financial assets and financial liabilities

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised where:

- the rights to receive cash flows from the asset have expired;
- the Group has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass-through' arrangement; or
- the Group has transferred its rights to receive cash flows from the asset and either (i) has transferred substantially all the risks and rewards of the asset, or (ii) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

A financial liability is derecognised when the obligation under the liability is discharged, cancelled or expires.

(e) Repurchase and resale agreements

Where investments are sold subject to a commitment to repurchase them at a predetermined price, they remain on the consolidated balance sheet and the consideration received is classified as "Deposits from banks and other financial institutions". The difference between the sale price and repurchase price is treated as interest expense and is accrued over the life of the agreement using the effective interest rate method.

Conversely, securities purchased under similar commitments to resell are not recognised on the consolidated balance sheet and the consideration paid is recorded in "Deposits with banks and other financial institutions". The difference between the purchase price and resale price is treated as interest income and is accrued over the life of the agreement using the effective interest rate method.

(f) Determination of fair value

The fair value of financial instruments that are quoted in an active market is determined by reference to market bid and ask prices respectively at the close of business on the balance sheet date.

The fair value of liabilities with a demand feature is the amount payable on demand.

The fair value of interest-bearing financial assets and liabilities that are not quoted in an active market and are not payable on demand is determined by a discounted cash flow model using the current market interest rates for financial instruments with similar terms and risk characteristics.

For equity investments that are not quoted in an active market, a reasonable estimate of the fair value is determined by reference to the current market value of another instrument that is substantially similar, or is determined using net present valuation techniques.

Investment in funds are stated at net asset values provided by fund managers.

The fair value of unquoted derivatives is determined either by discounted cash flows or option-pricing models.

3 ACCOUNTING POLICIES (continued)

3.3 Summary of significant accounting policies (continued)

(g) Impairment of financial assets

An assessment is made at each balance sheet date to determine whether there is any objective evidence that a specific financial asset or a group of financial assets may be impaired. If such evidence exists, the estimated recoverable amount of that asset or a group of financial assets is determined and any impairment loss, based on the net present value of future anticipated cash flows, is recognised in the consolidated statement of income and credited to an allowance account. In the case of equity investments, impairment is reflected directly as a write down of the financial asset.

The present value of the estimated future cash flows for loans and other interest bearing financial assets is discounted at the financial asset's original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest 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.

In addition to specific provisions against individually significant financial assets, the Group also makes collective impairment provisions on groups of financial assets, which although not identified as requiring a specific provision, have a greater risk of default than the risk at initial recognition. Financial assets are grouped on the basis of similar credit risk characteristics that are indicative of the debtors' ability to pay all amounts due according to the contractual terms and the collective impairment provision is estimated for any such group where credit risk characteristics of the group of financial assets has deteriorated. Factors such as any deterioration in country risk, industry, technological obsolescence as well as identified structural weaknesses or deterioration in cash flows are taken into consideration and the amount of the provision is based on the historical loss pattern within each group, adjusted to reflect current economic changes.

Loans 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 'Provision for loan losses - net'.

(h) Hedge accounting

The Group enters into derivative instruments including futures, forwards, swaps and options to manage exposures to interest rate and foreign currency, including exposures arising from forecast transactions. In order to manage particular risks, the Group applies hedge accounting for transactions which meet the specified criteria. Derivatives are stated at fair value. Derivatives with positive market values are included in "Other assets" and derivatives with negative market values are included in "Other liabilities" in the consolidated balance sheet.

At inception of the hedge relationship, the Group formally documents the relationship between the hedged item and the hedging instrument, including the nature of the risk, management objectives and strategy for undertaking the hedge. The methods that will be used to assess the effectiveness of the hedging relationship form part of the Group's documentation.

Also at the inception of the hedge relationship, a formal assessment is undertaken to ensure the hedging instrument is expected to be highly effective in offsetting the designated risk in the hedged item. Hedges are formally assessed at each reporting date. A hedge is regarded as highly effective if the changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated were offset in a range of 80% to 125%. For situations where the hedged item is a forecast transaction, the Group assesses whether the transaction is highly probable and presents an exposure to variations in cash flows that could ultimately affect the consolidated statement of income.

3 ACCOUNTING POLICIES (continued)

3.3 Summary of significant accounting policies (continued)

(h) Hedge accounting (continued)

For the purposes of hedge accounting, hedges are classified into two categories: (i) fair value hedges which hedge the exposure to changes in the fair value of a recognised asset or liability; and (ii) cash flow hedges which hedge exposure to variability in cash flows that is attributable to a particular risk associated with a recognised asset or liability or a forecasted transaction.

(i) Fair value hedges

For fair value hedges which meet the conditions for hedge accounting, any gain or loss from remeasuring the hedging instrument at fair value is recognised immediately in the consolidated statement of income. The hedged item is adjusted for fair value changes relating to the risk being hedged and the difference is recognised in the consolidated statement of income.

If the hedging instrument expires or is sold, terminated or exercised, or where the hedge no longer meets the criteria for hedge accounting, the hedge relationship is terminated. For hedged items recorded at amortised cost, the difference between the carrying value of the hedged item on termination and the value at which it would have been carried without being hedged is amortised over the remaining term of the original hedge. If the hedged item is derecognised, the unamortised fair value adjustment is recognised immediately in the consolidated statement of income.

(ii) Cash flow hedges

For cash flow hedges which meet the conditions for hedge accounting, the portion of the gain or loss on the hedging instrument which is determined to be an effective hedge is recognised initially in equity. The ineffective portion of the gain or loss, if any, on the hedging instrument is recognised immediately in the consolidated statement of income as "Trading income - net".

The gains or losses on effective cash flow hedges recognised initially in equity are either transferred to the consolidated statement of income in the period in which the hedged transaction impacts the consolidated statement of income or included in the initial measurement of the related asset or liability.

For hedges which do not qualify for hedge accounting, any gains or losses arising from changes in the fair value of the hedging instrument are taken directly to the consolidated statement of income for the year.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. In the case of cash flow hedges, the cumulative gain or loss on the hedging instrument recognised in equity remains in equity until the forecasted transaction occurs, unless the hedged transaction is no longer expected to occur, in which case the net cumulative gain or loss recognised in equity is transferred to the consolidated statement of income for the year.

(i) Offsetting financial instruments

Financial assets and financial liabilities are only offset and the net amount reported in the consolidated balance sheet when there is a currently enforceable legal right to offset the recognised amounts and the Group intends to settle on a net basis.

3 ACCOUNTING POLICIES (continued)

3.3 Summary of significant accounting policies (continued)

(j) Revenue recognition

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

(i) Interest income

Interest income is recognised using the effective interest method, taking account of the principal outstanding and the rate applicable. Interest that is 90 days or more overdue is excluded from income. Notional interest is recognised on impaired loans and advances and other financial assets based on the rate used to discount future cash flows to their net present values.

(ii) Fees and commissions income

Credit origination fees are treated as an integral part of the effective interest rate of financial instruments and are recognised over their lives, except when the underlying risk is sold to a third party at which time it is recognised immediately. Other fees and commissions income are recognised when earned.

(iii) Dividend income

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

(k) Goodwill and other intangible assets

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 acquired. Following initial recognition, goodwill is reviewed for impairment annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. After initial recognition, goodwill is measured at cost less any accumulated impairment losses.

Impairment is determined by assessing the recoverable amount of the cash-generating unit (or group of cash-generating units), to which the goodwill relates. Where the recoverable amount of the cash-generating unit (or group of cash-generating units) is less than the carrying amount, an impairment loss is recognised immediately in the consolidated statement of income.

For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the Group are assigned to those units or groups of units. Each unit or group of units to which the goodwill is allocated:

- represents the lowest level within the Group at which the goodwill is monitored for internal management purposes; and
- is not larger than a segment based on either the Group's primary or the Group's secondary reporting format determined in accordance with IAS 14 Segment Reporting.

Intangible assets are measured on initial recognition at cost. 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 their useful economic lives and assessed for impairment whenever there is an indication that an intangible asset may be impaired. Intangible assets with indefinite useful lives are not amortised but are tested annually for impairment or more frequently whenever there is an indication that they may be impaired.

3 ACCOUNTING POLICIES (continued)

3.3 Summary of significant accounting policies (continued)

(l) Premises and equipment

Freehold land is initially recognised at cost. After initial recognition, freehold land is carried at the revalued amount. The revaluation is carried out periodically by independent professional property valuers. The resultant revaluation surplus is recognised, as a separate component under equity. Revaluation deficit, if any, is recognised in the statement of income, except that a deficit directly offsetting a previously recognised surplus on the same asset is directly offset against the surplus in the revaluation reserve.

Premises and equipment are stated at cost, less accumulated depreciation.

Depreciation on buildings and other premises and equipment is provided on a straight-line basis over their estimated useful lives.

The estimated useful lives of the assets for the calculation of depreciation are as follows:

- Freehold buildings	15 to 30 years
- Leasehold land and buildings	Over the lease period
- Other premises and equipment	2 to 5 years

(m) Cash and cash equivalents

Cash and cash equivalents comprise cash and balances with central banks, excluding mandatory reserve deposits, together with those deposits with banks and other financial institutions and treasury bills having an original maturity of three months or less.

(n) Provisions

Provisions are recognised when the Group has a present obligation arising from a past event, and the costs to settle the obligation are both probable and able to be reliably estimated.

(o) Employee benefits

Defined benefit pension plan

Pension costs are recognised on a systematic basis so that the costs of providing retirement benefits to employees are evenly matched, so far as possible, to the service lives of the employees concerned. Any excess or deficiency of the actuarial value of assets over the actuarial value of liabilities of the pension scheme is allocated over the average remaining service lives of the scheme members.

Other defined benefit plan

In accordance with the labour laws prevalent in each country where the Group operates, the Group provides for end of service benefits for its expatriate employees. The provision is based on accumulated periods of service and latest salary.

Defined contribution plans

For defined contribution plans, the Group makes contributions to publicly administered pension insurance plans. The Group has no further payment obligations once the contributions have been paid. The contributions are recognised as employee benefit expense when they are due.

3 ACCOUNTING POLICIES (continued)

3.3 Summary of significant accounting policies (continued)

(p) Taxes

There is no tax on corporate income in the Kingdom of Bahrain. Taxation on income from foreign entities is provided for in accordance with the fiscal regulations of the countries in which the respective Group entities operate.

Deferred taxation is provided for using the liability method on all temporary differences calculated at the rate at which it is expected to be payable. Deferred tax assets are only recognised if recovery is probable.

(q) Fiduciary assets

Assets held in trust or in a fiduciary capacity are not treated as assets of the Group and, accordingly, are not incorporated in the consolidated balance sheet.

(r) Minority interest

Minority interest represents the portion of profit or loss and net assets in the subsidiaries not attributable to the Bank's shareholders.

(s) Redeemable preference shares

Preference shares which carry a mandatory coupon, and are redeemable at a fixed future date, are recognised as liabilities in the consolidated balance sheet, at amortised cost. The corresponding dividends on those shares are charged as interest expense in the consolidated statement of income.

(t) Dividend on ordinary shares

Dividend on ordinary shares are recognised as liability and deducted from equity when they are approved by the Bank's shareholders.

Dividends for the period that are approved after the balance sheet date are shown as an appropriation and reported in the consolidated statement of changes in equity, as an event after the balance sheet date.

(u) Employees' share purchase plan

The Group operates an employees' share purchase plan for certain eligible employees. The difference between the issue price and the fair value of the shares at the grant date is amortised over the vesting period in the consolidated statement of income with a corresponding effect to equity.

(v) Financial guarantees

In the ordinary course of business, the Group gives financial guarantees, consisting of letters of credit, guarantees and acceptances.

Financial guarantees are initially recognised in the consolidated financial statements at fair value, being the commission received. Subsequent to initial recognition, the Group's liability under each guarantee is measured at the higher of the amortised commission and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee.

3 ACCOUNTING POLICIES (continued)

3.3 Summary of significant accounting policies (continued)

(w) Islamic banking

The activities of the Islamic branches are conducted in accordance with Islamic Shari'a principles, as approved by the Shari'a Supervisory Board. The Islamic branches' financial statements are prepared in accordance with the Financial Accounting Standards issued by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and Central Bank of Bahrain regulations.

(x) Islamic financing

Revenues on Islamic financing transactions are recognised on accrual basis using the reducing installment method. Income on non performing financing accounts is suspended when it is not certain the branches will receive it.

(y) Unrestricted investment accounts' share of profit

The profit arrived at after taking into account all income and expenses at the end of financial year is distributed between unrestricted investment account holders and shareholders. The share of profit of the unrestricted account holders is calculated on the basis of their daily deposit balances over the year, after reducing the agreed and declared Mudaraba fee.

In the case of expenses, which arise out of issues relating to non compliance with Shari'a regulations, then such expenses are not to be borne by the unrestricted investment account holders.

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4 INTEREST INCOME

	<u>2007</u>	<u>2006</u>
	<u>US\$'000</u>	<u>US\$'000</u>
Treasury bills and bonds	58,633	47,228
Deposits with banks and other financial institution	280,587	217,136
Loans and advances	817,562	591,042
Non-trading investments	153,852	111,108
	<u>1,310,634</u>	<u>966,514</u>

5 INTEREST EXPENSE

	<u>2007</u>	<u>2006</u>
	<u>US\$'000</u>	<u>US\$'000</u>
Deposits from banks and other financial institutions	359,031	329,255
Customers' deposits	496,721	300,263
Term debt	85,703	35,314
Subordinated liabilities	41,061	23,226
	<u>982,516</u>	<u>688,058</u>

6 FEES AND COMMISSIONS - NET

	<u>2007</u>	<u>2006</u>
	<u>US\$'000</u>	<u>US\$'000</u>
Fees and commissions income		
- Retail and corporate banking	76,516	56,863
- Management, performance and brokerage fees	96,084	65,979
Fees and commissions expense	(15,075)	(6,464)
	<u>157,525</u>	<u>116,378</u>

Included in 'Management, performance and brokerage fees' is US\$ 32.0 million (2006: US\$ 19.1 million) of fee income relating to trust and other fiduciary activities.

7 TRADING INCOME - NET

	<u>2007</u>	<u>2006</u>
	<u>US\$'000</u>	<u>US\$'000</u>
Foreign exchange gains	29,437	14,022
Gain on trading securities	15,489	2,985
Others	(858)	244
	<u>44,068</u>	<u>17,251</u>

8 CASH AND BALANCES WITH CENTRAL BANKS

	<u>2007</u>	<u>2006</u>
	<u>US\$'000</u>	<u>US\$'000</u>
Cash and balances with central banks, excluding mandatory reserve deposits (note 23)	72,206	88,784
Mandatory reserve deposits with central banks	70,384	48,899
	<u>142,590</u>	<u>137,683</u>

Mandatory reserve deposits are not available for use in the day-to-day operations.

31 December 2007

9 LOANS AND ADVANCES (continued)

c) Age analysis of past due but not impaired loans and advances (continued)

	2006			Total US\$ '000
	Less than 30 days US\$ '000	Less than 60 days US\$ '000	61 to 90 days US\$ '000	
Loans and advances				
Retail	27,620	33,158	16,098	76,876
Corporate	16,095	41,870	430	58,395
	43,715	75,028	16,528	135,271

The above past due loans and advances include those that are only past due by a few days. None of the above past due loans are considered to be impaired.

d) Individually impaired loans and advances

	2007			2006		
	Retail US\$ '000	Corporate US\$ '000	Total US\$ '000	Retail US\$ '000	Corporate US\$ '000	Total US\$ '000
Gross impaired loans	80,558	60,399	140,957	45,175	64,359	109,534
Specific impairment	(75,108)	(56,784)	(131,892)	(41,727)	(62,841)	(104,568)
	5,450	3,615	9,065	3,448	1,518	4,966

The fair value of collateral that the bank holds relating to loans individually determined to be impaired at 31 December 2007 amounts to US\$ 35.7 million (31 December 2006: US\$ 58.4 million). The collateral consists of securities, letters of guarantee and properties.

The carrying amount of renegotiated loans as at 31 December 2007 is US\$ 19.1 million (31 December 2006: US\$ 8.1 million).

e) Impairment allowance for loans and advances

A reconciliation of the allowance for impairment losses for loans and advances by class is as follows:

	2007			2006		
	Retail US\$ '000	Corporate US\$ '000	Total US\$ '000	Retail US\$ '000	Corporate US\$ '000	Total US\$ '000
At 1 January	57,112	77,354	134,466	38,087	78,020	116,107
Add/(Less):						
Amounts written off during the year	(3,543)	(2,880)	(6,423)	(787)	(5,413)	(6,200)
Charge for the year	37,227	26,811	64,038	26,333	20,072	46,405
Recoveries during the year	(8,992)	(18,067)	(27,059)	(6,555)	(22,278)	(28,833)
Interest suspended during the year (net)	190	769	959	146	567	713
Exchange rate adjustments/other	3,086	1,121	4,207	(112)	6,386	6,274
At 31 December	85,080	85,108	170,188	57,112	77,354	134,466

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31 December 2007

9 LOANS AND ADVANCES (continued)

e) Impairment allowance for loans and advances (continued)

The charge for the year for provision for loan losses in the statement of income is determined as follows:

	2007	2006
	US\$ '000	US\$ '000
Charge for the year	64,038	46,405
Recoveries during the year (including from loans written off)	(39,650)	(28,833)
Provision for loan losses - net	<u>24,388</u>	<u>17,572</u>

10 NON-TRADING INVESTMENTS

	2007			2006
	<i>Held-to- maturity</i>	<i>Available- for-sale</i>	<i>Total</i>	<i>Total</i>
	US\$ '000	US\$ '000	US\$ '000	US\$ '000
Quoted investments				
GCC and US government bonds and debt securities	-	380,460	380,460	581,911
Other government bonds and debt securities	-	106,802	106,802	90,445
Floating rate notes and certificates of deposit:				
- issued by banks and other financial institutions	-	1,491,803	1,491,803	975,653
- issued by corporate bodies	-	620,114	620,114	775,869
Equity shares	-	395,004	395,004	326,236
	-	<u>2,994,183</u>	<u>2,994,183</u>	<u>2,750,114</u>
Unquoted investments				
GCC and US government bonds and debt securities	-	-	-	181,156
Other government bonds and debt securities	-	15,718	15,718	81,300
Floating rate notes and certificates of deposit:				
- issued by banks and other financial institutions	-	223,511	223,511	135,427
- issued by corporate bodies	-	6,490	6,490	16,544
Equity shares at cost	-	16,143	16,143	36,626
Funds at net asset value	-	195,178	195,178	120,259
Other investments	-	118,497	118,497	32,488
	-	<u>575,537</u>	<u>575,537</u>	<u>603,800</u>
Total	-	<u>3,569,720</u>	<u>3,569,720</u>	3,353,914
(Less): Allowance for impairment	-	<u>(44,443)</u>	<u>(44,443)</u>	(14,812)
	-	<u>3,525,277</u>	<u>3,525,277</u>	<u>3,339,102</u>
31 December 2006	181,155	3,157,947	3,339,102	

Refer note 30(c) for disclosure of credit quality of non-trading investments.

31 December 2007

10 NON-TRADING INVESTMENTS (continued)

The movements in provision for impairment were as follows:

	<u>2007</u>	<u>2006</u>
	<u>US\$ '000</u>	<u>US\$ '000</u>
At 1 January	14,812	17,793
Add/(Less):		
Charge for the period	29,762	3,262
Amounts written off during the period	(242)	(4,634)
Exchange rate adjustments/other	111	(1,609)
At 31 December	<u>44,443</u>	<u>14,812</u>

During the year an amount of US\$ 1,812 thousand was allocated to contingencies out of total charge for the year of US\$ 31,574 thousand.

The impairment provision relates entirely to available-for-sale debt securities.

Non-trading investments include US\$ 811 million (31 December 2006: US\$ 571 million) investments sold under agreements to repurchase against which the Group had borrowings of US\$ 789 million (31 December 2006: US\$ 486 million), included under "Deposits from banks and other financial institutions".

11 INVESTMENTS IN ASSOCIATES

The principal associates of the Group are:

<i>Name</i>	<i>Country of incorporation</i>	<i>Percentage holding</i>	
		<u>2007</u>	<u>2006</u>
Ahlibank Q.S.C.	State of Qatar	40.0%	40.0%
Commercial Bank of Iraq P.S.C.	Republic of Iraq	49.6%	49.6%
Ahli United Bank (Egypt) S.A.E. (formerly known as Delta International Bank S.A.E.)	Arab Republic of Egypt	49.8%	49.8%
Alliance Housing Bank S.A.O.G.	Sultanate of Oman	35.0%	-

During the year, the Group acquired 35% of the share capital of Alliance Housing Bank S.A.O.G., a bank specialising in residential mortgage lending through its seven branches in the Sultanate of Oman. The consideration paid for the acquisition was US\$ 131.2 million. Subsequent to the acquisition, the bank's name has been changed to Ahlibank S.A.O.G. (ABO) effective from 5 January 2008. The Bank has signed a five year renewable technical services and management agreement to provide technical and management services to ABO. Following the receipt of Central Bank of Oman's approval to convert its operations from a specialized mortgage finance provider into a full fledged commercial bank and receipt of a commercial banking licence effective 27 December 2007, ABO is extending corporate, retail, treasury and private banking services to its customers.

During the year, the Group acquired an interest in Middle East Financial Investment Company (MEFIC), at a consideration of US\$ 47 million.

As at 31 December 2007, the Group no longer exercised significant influence over Future Bank B.S.C. (c).

31 December 2007

11 INVESTMENTS IN ASSOCIATES (continued)

The summarised financial information of the Group's associates was as follows:

	<u>2007</u>	<u>2006</u>
	<i>US\$ '000</i>	<i>US\$ '000</i>
Assets	6,283,909	4,478,353
Liabilities	5,397,909	3,849,603
Revenues	383,402	158,587
Net profit for the year	120,972	84,542

12 PREMISES AND EQUIPMENT

The net book values of the Group's premises and equipment are:

	<u>2007</u>	<u>2006</u>
	<i>US\$ '000</i>	<i>US\$ '000</i>
Freehold land	161,289	68,832
Freehold buildings	12,557	13,139
Leasehold land and buildings	66,188	27,345
Capital work-in-progress	25,960	16,450
Others	26,467	20,735
	<u>292,461</u>	<u>146,501</u>

During the year, the accounting policy for freehold land has been changed in order to disclose a more relevant carrying value. The impact of the change was to increase the carrying value of freehold land by US\$ 97.0 million with corresponding increases of US\$ 94.3 million in revaluation reserve and US\$ 2.7 million in minority interest.

13 OTHER ASSETS

	<u>2007</u>	<u>2006</u>
	<i>US\$ '000</i>	<i>US\$ '000</i>
Tax assets (note 21)	540	9,335
Interest receivable	192,368	136,753
Prepayments and others	221,579	122,868
	<u>414,487</u>	<u>268,956</u>

14 GOODWILL AND OTHER INTANGIBLE ASSETS

	<u>2007</u>			<u>2006</u>		
	<i>Goodwill</i>	<i>Intangible assets</i>	<i>Total</i>	<i>Goodwill</i>	<i>Intangible assets</i>	<i>Total</i>
	<i>US\$'000</i>	<i>US\$'000</i>	<i>US\$'000</i>	<i>US\$'000</i>	<i>US\$'000</i>	<i>US\$'000</i>
At 1 January 2007	388,716	43,625	432,341	393,364	43,197	436,561
Acquisitions during the period	38,967	-	38,967	-	-	-
Exchange rate adjustments	21,200	2,849	24,049	(4,648)	428	(4,220)
At 31 December	<u>448,883</u>	<u>46,474</u>	<u>495,357</u>	<u>388,716</u>	<u>43,625</u>	<u>432,341</u>

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14 GOODWILL AND OTHER INTANGIBLE ASSETS (continued)

Goodwill acquired through business combinations has been allocated to the cash-generating units for impairment testing purposes. There was no impairment during the year ended 31 December 2007 (31 December 2006: nil).

Substantially all of the goodwill relates to the Group's acquisition of its interest in the Bank of Kuwait and the Middle East K.S.C.(BKME). Goodwill acquired during the year relates to the Group's additional investment in Kuwait and Middle East Financial Investment Co K.S.C. (Closed) (KMEFIC) (note 2).

The carrying amount of goodwill allocated to each of the cash-generating units is as follows:

	<u>2007</u>	<u>2006</u>
	<u>US\$'000</u>	<u>US\$'000</u>
Retail banking	165,265	146,584
Corporate banking, treasury and investments	178,750	164,320
Private banking and wealth management	104,868	77,812
	<u>448,883</u>	<u>388,716</u>

The recoverable amount of each cash-generating unit's goodwill is based on value-in-use calculations using cash flow projections from financial budgets approved by senior management. The discount rate applied to cash flow projections represent the risk-free interest rate with an appropriate market risk premium for these business segments.

Intangible assets comprises a brokerage licence relating to Bank's subsidiary KMEFIC. This has indefinite useful life and is reviewed for impairment annually or more frequently when there are indications of impairment.

15 CUSTOMERS' DEPOSITS

	<u>2007</u>	<u>2006</u>
	<u>US\$ '000</u>	<u>US\$ '000</u>
Current and call accounts	1,487,800	1,244,012
Saving accounts	619,026	569,980
Time deposits	8,674,088	7,225,474
	<u>10,780,914</u>	<u>9,039,466</u>

16 TERM DEBT

Included under term debt is a medium term syndicated deposit of US\$ 1,200 million (31 December 2006: US\$ 1,200 million) maturing in October 2009. This facility bears an interest rate of three-month LIBOR plus 0.325% (31 December 2006: three-month LIBOR plus 0.325%).

17 OTHER LIABILITIES

	<u>2007</u>	<u>2006</u>
	<u>US\$ '000</u>	<u>US\$ '000</u>
Accruals	165,627	126,839
Interest payable	228,179	183,659
Other credit balances	299,763	129,281
	<u>693,569</u>	<u>439,779</u>

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18 SUBORDINATED LIABILITIES

These borrowings are subordinated to the claims of all other creditors of the respective banks.

	<u>2007</u>	<u>2006</u>
	<u>US\$ '000</u>	<u>US\$ '000</u>
(a) Ahli United Bank B.S.C.		
- US Dollars – non-convertible portion (50%) of Class A Non-Cumulative Preference Shares carrying interest at 1.50% over twelve-month LIBOR, repayable on 1 January 2015, with an issuer option to redeem after 1 January 2010 subject to three months notice (also refer note 19 (e)).	225,000	225,000
- US Dollars – interest at three-month LIBOR plus a margin of 0.95% up to 2010 and margin of 1.45% thereafter, repayable on 2 December 2015 with an issuer option to redeem after 2 December 2010 subject to one month notice.	100,000	100,000
- Great Britain Pounds – interest at six-month LIBOR plus 1.00%, repayable 2012.	40,070	39,235
- US Dollars- interest at six-month LIBOR plus a margin of 0.82%, repayable on 13 November 2016, convertible into ordinary shares at the holder's option at the rate of US\$ 1.24 per share between the third and sixth anniversary from the loan agreement dated 18 November 2006 (also refer	200,000	200,000
(b) Ahli United Bank (U.K.) PLC		
- US Dollars – interest at three-month LIBOR plus ¾%, repayable 2007.	-	32,775
- Great Britain Pounds - interest at six-month LIBOR plus ¾%, repayable 2007.	-	2,149
- US Dollars – interest at three-month LIBOR plus ¾%, repayable 2007.	-	1,546
- Great Britain Pounds - interest at six-month LIBOR plus ¾%, repayable 2011.	2,108	2,064
- US Dollars - interest at six-month LIBOR plus ¾%, repayable 2011.	1,485	1,485
- Great Britain Pounds - interest at six-month LIBOR plus ¾%, repayable at 5 years and one day notice.	11,478	11,240
- US Dollars - interest at three-month LIBOR plus ¾%, repayable at 5 years and one day notice.	8,083	8,083
	<u>588,224</u>	<u>623,577</u>

19 SHARE CAPITAL

	<u>2007</u>	<u>2006</u>
	<u>US\$ '000</u>	<u>US\$ '000</u>
(a) Authorised :		
- Ordinary share capital 8,000 million shares of US\$ 0.25 each (2006: 4,000 million shares of US\$0.25 each) (Note 19 (h))	<u>2,000,000</u>	<u>1,000,000</u>
- Preference share capital 1,000 million Class A Preference Shares of US\$ 0.25 each	<u>250,000</u>	<u>250,000</u>
250 million Non-Cumulative Fully Convertible Class B Preference Shares of US\$ 0.25 each	<u>62,500</u>	<u>62,500</u>

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19 SHARE CAPITAL (continued)

	<u>2007</u>	<u>2006</u>
	US\$ '000	US\$ '000
(b) Issued and fully paid:		
- Ordinary share capital		
3,376.8 million shares of US\$ 0.25 each (2006: 2,730 million shares of US\$ 0.25 each). During the period, the Bank issued 273 million shares of US\$ 0.25 each as bonus issue and 373.8 million shares of US\$ 0.25 each as right issue (notes 19 (c) and (d)).	<u>844,201</u>	<u>682,500</u>
- Preference share capital		
1,000 million Class A Preference Shares of US\$ 0.25 each (50% convertible portion) (note 19 (e))	<u>125,000</u>	<u>125,000</u>
192 million Non-Cumulative Fully Convertible Class B Preference Shares of US\$ 0.25 each [2006 : 95.8 million Non-Cumulative Fully Convertible Class B Preference Shares] (note 19 (f))	<u>48,001</u>	<u>23,941</u>

(c) The Annual General Assembly of Shareholders' meeting held on 25 March 2007 approved a bonus share issue of 10% (1 ordinary share for every 10 shares held) resulting in an increase in the ordinary share capital by 273 million ordinary shares to 3,003 million ordinary shares. In 2006, the bonus share issue was 5% (1 ordinary share for every 20 shares held). The 50% convertible portion of all issued Class A Preference Shares and all Class B Preference Shares are automatically adjusted by these bonus share issues upon their conversion into ordinary shares under the terms of the respective issues.

(d) In accordance with the resolutions approved at the Extraordinary General Assembly of Shareholders' meetings held on 25 March 2007 and 18 October 2007 and at Board of Directors meetings held on 3 September 2007 and 20 November 2007, the Bank issued 300 million ordinary shares to existing shareholders on a pre-emptive rights basis and 73.8 million ordinary shares to holders of convertible Class A and Class B shares both at US\$ 1.01 per share, including issue expense of US\$ 0.01 per share. The first issue was allotted on 9 December 2007 while the second issue was allotted on 25 December 2007.

(e) The Class A preference shares represent "Non-Cumulative Partly Convertible Preference Shares" issued on 1 January 2005 at an issue price of US\$ 0.45 per share. 50% of the Class A Preference Shares are convertible on 1 January 2008 into an equivalent number of ordinary shares at US\$ 0.45 per share as adjusted for any bonus issues. The resultant effect upon conversion, duly adjusted for bonus share issues, for the years of 2005 and 2006 is as follows;

	<i>Numbers in million</i>
Number of Class A Convertible Preference Shares	<u>500.0</u>
Add: Bonus shares @ 5% for 2005 as approved at the Bank's Annual General Assembly of Shareholders' meeting held on 27 March 2006	<u>25.0</u>
	<u>525.0</u>
Add: Bonus shares @ 10% for 2006 as approved at the AUB Annual General Assembly of Shareholders' meeting held on 25 March 2007	<u>52.5</u>
Total number of ordinary shares when converted	<u><u>577.5</u></u>

The remaining 50% of the Class A Preference shares are redeemable in cash on 1 January 2015, or at an earlier date after 1 January 2010 if exercised by the Bank, at US\$ 0.45 per share. The Class A Preference Shares carry a dividend at a rate equal to 1.50% over twelve-month US Dollar LIBOR, payable annually. The payment of dividends on Preference Shares is subject to recommendation by the Board of Directors and approval by the Annual General Assembly of Shareholders' meeting.

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19 SHARE CAPITAL (continued)

The 50% of Class A Preference Shares not subject to conversion (subordinated liabilities) would receive preferential treatment over holders of Ordinary Shares and Class B Preference Shares, but shall be subordinated to all other liabilities of the Bank. The redeemable portion of the Class A Preference Shares amounting to US\$ 225 million (31 December 2006: US\$ 225 million) is included in subordinated liabilities (note 18(a)). The mandatorily convertible portion of the Class A Preference shares is included in equity.

(f) The Employee Share Purchase Plan ("ESPP") was established in accordance with the Board of Directors' approval and the subsequent approval of the Extraordinary General Assembly of Shareholders' meeting dated 5 October 2004 and further regulatory approvals obtained from:

(i) Capital Markets Supervision Directorate of CBB vide their letters dated 2 September 2004, 9 November 2004 and 18 April 2005;

(ii) Banking Supervision Directorate of CBB vide their letters dated 5 September 2004 and 17 April 2005; and

(iii) Ministry of Commerce vide their letters dated 8 September 2004 and 9 April 2005.

Subsequent amendments were duly approved by the regulatory authorities.

As per the approved plan, the Non-Cumulative Fully Convertible Class B Preference Shares ("Class B Preference Shares") were authorised for issuance to the employees of the Bank and its subsidiary in UK, in five annual tranches over a five-year period commencing 1 January 2005 at prices determined by the Board of Directors within set parameters. The Class B Preference Shares are mandatorily convertible into an equivalent number of ordinary shares adjusted for any bonus share issues on the conversion date of each tranche.

During 2007, 96.2 million Class B Preference Shares were issued and outstanding. The details of Class B Preference Shares issued, conversion dates of respective issues and the resultant conversion effect duly adjusted for bonus share issues for the years 2005 and 2006 are as follows:

	<i>Numbers in million</i>	<i>Conversion date</i>
Number of Class B Preference Shares issued :		
Tranche - I	119.9	1 January 2008
Tranche - II	36.0	1 January 2009
Tranche - III	38.4	1 January 2010
Total Issue Class B Preference Shares - 31 December 2007	<u>194.3</u>	
Add: Bonus shares @ 5% for 2005 as approved at the Bank's Annual General Assembly of Shareholders' meeting held on 27 March 2006	9.7	
	<u>204.0</u>	
Add: Bonus shares @ 10% for 2006 as approved at the Bank's Annual General Assembly of Shareholders' meeting held on 25 March 2007	20.4	
	<u>224.4</u>	
Add: Rights issue conversion adjustment factor @ 2.834% as approved at the Bank's Extraordinary General Assembly of Shareholders' meeting held on 18 October 2007.	6.3	
Total number of ordinary shares when converted	<u><u>230.7</u></u>	

31 December 2007

19 SHARE CAPITAL (continued)

The weighted average issue price was US\$ 0.72 per share (2006: US\$ 0.45 per share) while the weighted average fair value was US\$ 0.81 per share (2006: US\$ 0.50 per share). In accordance with IFRS 2: Share-based Payment, the difference between issue price and fair value of these shares is amortised over the vesting period and included under "Staff costs" in the consolidated statement of income.

- (g) Upon conversion of the Class A and Class B Preference Shares, the resultant ordinary shares totalling to 808.2 million shares (comprising 577.5 million shares of Class A and 230.7 million shares of Class B, both including the effect of ordinary bonus share issues to 31 December 2006) will rank pari-passu with the ordinary shares in issue.

(h) Increase in authorised share capital

The Extraordinary General Assembly of Shareholders' Meeting held on 3 July 2007 approved an increase in the authorised share capital of the Bank from US\$ 1 billion (4,000 million shares of US\$ 0.25 each) to US\$ 2 billion (8,000 million shares of US\$ 0.25 each).

20 RESERVES**a) Share premium**

The share premium arising on issue of ordinary and preference shares is not distributable except in such circumstances as stipulated in the Bahrain Commercial Companies Law.

b) Capital reserve

As required by the Bahrain Commercial Companies Law, any profit on the sale of treasury stock is transferred to a capital reserve. The reserve is not distributable except in such circumstances as stipulated in the Bahrain Commercial Companies Law.

c) Statutory reserve

As required by the Bahrain Commercial Companies Law and the Bank's Articles of Association, 10% of the net profit is transferred to a statutory reserve on an annual basis. The Bank may resolve to discontinue such transfers when the reserve totals 50% of the paid up capital. The reserve is not distributable except in such circumstances as stipulated in the Bahrain Commercial Companies Law.

d) Revaluation reserve

The revaluation reserve arising on revaluation of freehold land is not distributable except in such circumstances as stipulated in the Bahrain Commercial Companies Law.

e) Dividends paid and proposed

	<u>2006</u>
	<i>US\$ '000</i>
Declared and paid during the year	
Cash dividend on the Class A Preference shares @ US cents 2.9 per share	28,575
Cash dividend on the Class B Preference shares @ US cents 2.9 per share	926
Cash dividend on the Ordinary shares @ US cents 3.5 per share	95,550
Bonus share issue	10%

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20 RESERVES (continued)

e) Dividends paid and proposed (continued)

	<u>2007</u>
	<u>US\$'000</u>
Proposed for approval at the forthcoming Annual General Assembly of Shareholders' Meeting	
Cash dividend on the Class A Preference shares @ US cents 3.1 per share	30,732
Cash dividend on the Class B Preference shares @ US cents 3.1 per share	5,716
Cash dividend on the Ordinary shares @ US cents 3.5 per share	105,780
Bonus share issue	10%

f) Cumulative changes in fair value

	<u>2007</u>	<u>2006</u>
	<u>US\$'000</u>	<u>US\$'000</u>
Available-for-sale investments		
At 1 January	136,089	127,969
<u>Add/(Less):</u>		
Change in fair value on investments sold during the year.	24,309	36,777
Realised during the year	(54,724)	(34,283)
Changes in unrealised fair values during the year	40,564	15,293
Share of changes in fair values of available-for-sale investments of associates	10,427	(9,667)
	<u>156,665</u>	<u>136,089</u>
Cash flow hedges		
At 1 January	1,418	(4,156)
<u>Add/(Less):</u>		
Transferred to consolidated statement of income	252	7,714
Changes in fair values during the year	(16,255)	(2,140)
	<u>(14,585)</u>	<u>1,418</u>
Total	<u>142,080</u>	<u>137,507</u>

21 TAXATION

	<u>2007</u>	<u>2006</u>
	<u>US\$'000</u>	<u>US\$'000</u>
Consolidated balance sheet (note 13):		
- Current tax asset	540	6,929
- Deferred tax asset	-	2,406
	<u>540</u>	<u>9,335</u>
Consolidated statement of income		
- Current tax rate expense on domestic operations	-	-
- Current tax expense on foreign operations	12,354	3,125
- Deferred tax expense on foreign operations	-	118
	<u>12,354</u>	<u>3,243</u>

There is no taxation in the Kingdom of Bahrain. In view of the operations of the Group being subject to various tax jurisdictions and regulations, it is not practical to provide a reconciliation between the accounting and taxable profits together with the details of effective tax rates. Substantially all of the tax expense relates to AUB UK.

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22 EARNINGS PER SHARE

Basic earnings per share are calculated by dividing the net profit for the year attributable to the Bank's ordinary equity shareholders less Class A and B preference share dividends, by the weighted average number of ordinary shares outstanding during the period.

Diluted earnings per share amounts are calculated by dividing the net profit attributable to the Bank's ordinary equity shareholders by the weighted average number of ordinary shares outstanding during the year plus the weighted average number of ordinary shares that would be issued on the conversion of Class A and Class B preference shares into ordinary shares.

The convertible subordinated debt issued (note 18(a)) is anti-dilutive for 2007 and 2006 and therefore ignored in calculating diluted earnings per share. The number of ordinary shares potentially issuable upon conversion of this debt amounts to 161.3 million shares as at 31 December 2007 (2006: 161.3 million).

The following reflects the income and share data used in basic and diluted earnings per share computations :

	<u>2007</u>	<u>2006</u>
	<u>US\$ '000</u>	<u>US\$ '000</u>
Net profit for basic earnings per share computation		
Net profit attributable to Bank's equity shareholders	296,317	207,480
(Less): Class A preference share dividend	(15,366)	(14,288)
(Less): Class B preference share dividend	(5,716)	(926)
Adjusted net profit attributable to Bank's ordinary equity shareholders for basic earnings per share	<u>275,235</u>	<u>192,266</u>
Net profit for diluted earnings per share computation		
Net profit attributable to Bank's equity shareholders before preference share dividend	296,317	207,480
Add: Staff costs - fair value amortisation of share based transaction	5,196	2,394
Adjusted net profit attributable to Bank's ordinary equity shareholders for diluted earnings per share	<u>301,513</u>	<u>209,874</u>
	Number of shares	
	(in millions)	
	<u>2007</u>	<u>2006</u>
Weighted average number of ordinary shares for basic earnings per share	3,022	3,003
Effect of dilution – Class A preference shares (note 19(e))	578	578
Effect of dilution – Class B preference shares (note 19(f))	231	185
Weighted average number of ordinary shares for diluted earnings per share	<u>3,831</u>	<u>3,766</u>

23 CASH AND CASH EQUIVALENTS

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

	<u>2007</u>	<u>2006</u>
	<u>US\$ '000</u>	<u>US\$ '000</u>
Cash and balances with central banks, excluding mandatory reserve deposits (note 8)	72,206	88,784
Deposits with banks and other financial institutions - with an original maturity of three months or less	2,304,680	4,278,424
	<u>2,376,886</u>	<u>4,367,208</u>

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24 RELATED PARTY TRANSACTIONS

The Group enters into transactions with major shareholders, associates, directors, senior management and companies which are controlled, jointly controlled or significantly influenced by such parties in the ordinary course of business at arm's length. All the loans and advances to related parties are performing and are free of any provision for possible loan losses. The Group has sufficient unutilised lines of credit as a back up for related party deposits.

The income, expense and the period end balances in respect of related parties included in the consolidated financial statements were as follows:

	<i>2007</i>			
	<i>US\$ '000</i>			
	<i>Major shareholders</i>	<i>Associates</i>	<i>Directors and senior management</i>	<i>Total</i>
Interest income	2,503	3,650	7,404	13,557
Interest expense	162,232	176	2,386	164,794
Fees and commissions	-	3,400	-	3,400
Deposits with banks and other financial institutions	25	100,398	-	100,423
Loans and advances	-	-	114,448	114,448
Deposits from banks and other financial institutions	-	11,673	-	11,673
Customers' deposits ^(a)	2,572,224	-	40,744	2,612,968
Subordinated liabilities	52,411	-	-	52,411
Commitments and contingent liabilities (notional)	-	27	12,487	12,514
Derivatives (notional)	-	107,200	-	107,199
	<i>2006</i>			
	<i>US\$ '000</i>			
	<i>Major shareholders</i>	<i>Associates</i>	<i>Directors and senior management</i>	<i>Total</i>
Interest income	6,085	3,029	5,240	14,354
Interest expense	51,304	66	2,233	53,603
Fees and commission	-	1,746	-	1,746
Deposits with banks and other financial institutions	23	65,615	-	65,638
Loans and advances	76,608	-	72,226	148,834
Deposits from banks and other financial institutions	-	199,154	-	199,154
Customers' deposits ^(a)	2,518,406	-	72,168	2,590,574
Subordinated liabilities	68,677	-	-	68,677
Commitments and contingent liabilities (notional)	-	29	11,983	12,012
Derivatives (notional)	-	176,901	-	176,901

- (a) Customers' deposits include deposits from GCC government-owned institutions totalling to US\$ 2,572 million (31 December 2006: US\$ 2,518 million).

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24 RELATED PARTY TRANSACTIONS (continued)

The compensation of key management personnel of the Group included under staff costs was as follows:

	<u>2007</u>	<u>2006</u>
	<u>US\$ '000</u>	<u>US\$ '000</u>
Short term employee benefits	13,689	11,192
End of service benefits	847	913
Post employment benefits	200	150
Total benefits	<u>14,736</u>	<u>12,255</u>
Headcount	<u>27</u>	<u>23</u>

Included in short term employee benefits is the fair value amortisation charge relating to share based transactions of US\$ 2.8 million (2006: US\$ 1.9 million).

25 EMPLOYEE BENEFITS**Defined benefits pension plan**

AUBUK operates a funded defined benefits scheme for its employees who joined prior to 1 March 2001. The assets of the pension scheme are held independently of the Group's assets in a separate trustee administered fund.

The pension scheme is valued by independent actuaries periodically using the projected unit cost method. The latest actuarial valuation of AUBUK's pension scheme, carried out on 31 December 2007 revealed a deficit in the pension scheme's assets over its obligations as noted below. The principal assumptions used in the actuarial valuation were an expected investment return of 6.70% per annum (2006: 6.70% per annum) a future rate of salary progression of 3.30% per annum (2006: 2.40% per annum) future pension increases of 3.4% (2006: 2.90% per annum) and discount rate of 5.80% (2006: 5.30% per annum).

The overall expected rate of return on plan assets is determined based on best estimates of the fair value of the plan assets over the period of the plan.

The charge recognised in the consolidated income statement was as follows:

	<u>2007</u>	<u>2006</u>
	<u>US\$ '000</u>	<u>US\$ '000</u>
Current service cost	1,643	1,660
Interest cost	8,026	7,201
(Less): Expected return on plan assets	(8,184)	(7,160)
Net actuarial losses recognised in the year	<u>1,058</u>	<u>1,193</u>
	<u>2,543</u>	<u>2,894</u>

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25 EMPLOYEE BENEFITS (continued)**Defined benefits pension plan (continued)**

The amounts recognised in the consolidated balance sheet were as follow:

	<u>2007</u>	<u>2006</u>
	<u>US\$ '000</u>	<u>US\$ '000</u>
Present value of scheme's obligations	158,447	149,012
(Less): Fair value of plan assets	(133,978)	(118,300)
	<u>24,469</u>	<u>30,712</u>
(Less): Unrecognised net actuarial losses	(27,467)	(27,327)
(Asset) liability in the balance sheet	<u>(2,998)</u>	<u>3,385</u>

The actual returns on plan assets were US\$ 7,311 thousand (2006: US\$ 8,775 thousand).

The movement in the (asset) liability recognised in the consolidated balance sheet during the year was as follows:

	<u>2007</u>	<u>2006</u>
	<u>US\$ '000</u>	<u>US\$ '000</u>
At 1 January	3,385	3,443
<u>Add/(Less):</u>		
Total expenses as stated above	2,543	2,894
Contributions by the Group	(8,996)	(3,434)
Exchange rate and other adjustments	70	482
At 31 December	<u>(2,998)</u>	<u>3,385</u>

The changes in the present value of the scheme's obligations were as follows:

	<u>2007</u>	<u>2006</u>
	<u>US\$ '000</u>	<u>US\$ '000</u>
At 1 January	149,012	126,380
<u>Add/(Less):</u>		
Interest cost	8,026	7,201
Current service cost	1,643	1,660
Actuarial gains	(254)	(2,164)
Benefits paid	(3,176)	(1,784)
Exchange rate and other adjustments	3,196	17,719
At 31 December	<u>158,447</u>	<u>149,012</u>

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25 EMPLOYEE BENEFITS (continued)**Defined benefits pension plan (continued)**

The changes in the fair value of the plan assets were as follows:

	<u>2007</u>	<u>2006</u>
	<u>US\$ '000</u>	<u>US\$ '000</u>
At 1 January	118,300	94,600
<u>Add/(Less):</u>		
Expected return	8,184	7,160
Contributions by the Group	8,996	3,434
Actuarial gains	(874)	1,615
Benefits paid	(3,176)	(1,784)
Exchange rate and other adjustments	2,548	13,275
At 31 December	<u>133,978</u>	<u>118,300</u>

The major categories of plan assets as a percentage of the fair value of the total plan assets were as follows:

	<u>2007</u>	<u>2006</u>
	<u>%</u>	<u>%</u>
Equities	67	69
Government bonds	15	14
Corporate bonds	17	16
Others	1	1
Total	<u>100</u>	<u>100</u>

All bonds in the plan assets are investment grade and traded in an active market.

The present value of scheme's obligations, the fair value of plan assets and the deficit arising thereon along with the effect of differences between the previous actuarial assumptions and what has actually occurred (experience adjustments) for the years ended 31 December have been presented below:

	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
	<u>US\$ '000</u>	<u>US\$ '000</u>	<u>US\$ '000</u>	<u>US\$ '000</u>	<u>US\$ '000</u>
Present value of scheme's obligations	158,447	149,012	126,380	114,722	86,223
Fair value of plan assets	(133,978)	(118,300)	(94,600)	(87,489)	(71,656)
Deficit	<u>24,469</u>	<u>30,712</u>	<u>31,780</u>	<u>27,233</u>	<u>14,567</u>
Experience adjustments on:					
Plan liabilities	3,690	2,154	4,868	2,270	(86)
Plan assets	874	(1,615)	(10,187)	(3,374)	(5,316)

Other defined benefit plans

The charge to the consolidated statement of income on account of end of service benefits for the year amounted to US\$ 2,543 thousand (2006: US\$ 2,894 thousand). There are no material differences between the carrying amount of the provision for end of service benefits and the amount arising from an actuarial computation thereof.

Defined contribution plans

The Group contributed US\$ 372 thousand (2006: US\$ 358 thousand) during the year towards defined contribution plans. The Group's obligations are limited to the amounts contributed to various schemes.

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26 MANAGED FUNDS

Funds administrated on behalf of customers to which the Group does not have legal title are not included in the consolidated balance sheet. The total market value of all such funds at 31 December 2007 was US\$ 8,352 million (31 December 2006: US\$ 6,316 million).

27 DERIVATIVES

In the ordinary course of business the Group enters into various types of transactions that involve derivative financial instruments. A derivative financial instrument is a financial contract between two parties where payments are dependent upon movements in price in one or more underlying financial instruments, reference rates or indices.

Derivatives include financial options, futures and forwards, interest rate swaps and currency swaps, which create rights and obligations that have the effect of transferring between the parties of the instrument one or more of the financial risks inherent in an underlying primary financial instrument. On inception, a derivative financial instrument gives one party a contractual right to exchange financial assets or financial liabilities with another party under conditions that are potential favourable, or a contractual obligation to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavourable. However, they generally do not result in a transfer of the underlying primary financial instrument on inception of the contract, nor does such a transfer necessarily take place on maturity of the contract. Some instruments embody both a right and an obligation to make an exchange. Because the term of the exchange are determined on inception of the derivative instruments, as prices in financial markets change those terms may become either favourable or unfavourable.

The table below shows the net fair values of derivative financial instruments together with the notional amounts. The notional amount is the amount of a derivative's underlying asset, reference rate or index and is the basis upon which changes in the value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding at period-end and are neither indicative of the market risk nor credit risk.

	2007			2006		
	<i>Notional amount</i>	<i>Derivative assets</i>	<i>Derivative liabilities</i>	<i>Notional amount</i>	<i>Derivative assets</i>	<i>Derivative liabilities</i>
	US\$ '000	US\$ '000	US\$ '000	US\$ '000	US\$ '000	US\$ '000
<i>Derivatives held for trading:</i>						
Interest rate swaps	3,481,700	30,410	25,686	3,651,363	21,712	18,049
Forward foreign exchange contracts	2,733,093	64,531	55,393	3,987,638	51,028	48,274
Forward rate agreements	-	-	-	2,983,126	434	700
Options	179,433	4,442	4,259	241,646	5,035	4,424
Interest rate futures	1,783,480	74	128	1,483,522	211	322
Credit derivatives	25,731	-	8	116,584	674	320
<i>Derivatives held as fair value hedges:</i>						
Interest rate swaps	1,460,839	9,905	27,664	1,682,947	24,066	8,807
Options	86,542	13,567	-	93,510	13,559	-
<i>Derivatives held as cash flow hedges:</i>						
Interest rate swaps	600,940	750	15,335	887,698	5,328	3,910
	10,351,758	123,679	128,473	15,128,034	122,047	84,806

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27 DERIVATIVES (continued)

Cash flow hedges

The schedule of forecast principal balances on which the expected interest cash flows arise as at 31 December 2007 is as follows:

	<i>3 months or less</i>	<i>More than 3 months upto 1 year</i>	<i>5 years or less but more than 1 year</i>	<i>More than 5 years</i>	<i>Total</i>
	<i>US\$'000</i>	<i>US\$'000</i>	<i>US\$'000</i>	<i>US\$'000</i>	<i>US\$'000</i>
At 31 December 2007					
Cash inflows from assets	-	-	-	-	-
Cash outflows from liabilities	-	6,034	100,270	533,263	639,567
Net cash outflows	-	6,034	100,270	533,263	639,567
Statement of income	1,138	9,036	48,554	5,262	63,990
At 31 December 2006					
Cash inflows from assets	-	-	-	-	-
Cash outflows from liabilities	-	-	377,416	804,257	1,181,673
Net cash outflows	-	-	377,416	804,257	1,181,673
Statement of income	2,358	6,370	176,621	83,985	269,334

No hedge ineffectiveness on cash flow hedges was recognised in 2006 and 2007.

Fair value hedges

Losses arising from fair value hedge instruments during 2007 were US\$ 16,483 thousand (2006 : US\$ 3,000 thousand) while the gains on the hedged items attributable to risk was US\$ 16,483 thousand (2006 : US\$ 3,000 thousand). These gains and losses are included in "Trading income-net" in the consolidated statement of income during 2006 and 2007.

Derivative product types

Forwards and futures are contractual agreements to either buy or sell a specified currency, commodity or financial instrument at a specific price and date in the future. Forwards are customised contracts transacted in the over-the-counter market. Foreign currency and interest rate futures are transacted in standardised amounts on regulated exchanges and are subject to daily cash margin requirements. Forward rate agreements are effectively tailor-made interest rate futures which fix a forward rate of interest on a notional loan, for an agreed period of time starting on a specified future date.

Swaps are contractual agreements between two parties to exchange interest or foreign currency differentials based on a specific notional amount. For interest rate swaps, counterparties generally exchange fixed and floating rate interest payments based on a notional value in a single currency.

Options are contractual agreements that convey the right, but not the obligation, to either buy or sell a specific amount of a commodity or financial instrument at a fixed price, either at a fixed future date or at any time within a specified period.

27 DERIVATIVES (continued)

Derivatives held for trading purposes

Most of the Group's derivative trading activities relate to customer driven transactions as well as positioning and arbitrage. Positioning involves managing positions with the expectation of profiting from favourable movements in prices, rates or indices. Arbitrage involves identifying and profiting from price differentials between markets or products.

Derivatives held for hedging purposes

The Group has adopted a comprehensive system for the measurement and management of risk.

As part of its asset and liability management the Group uses derivatives for hedging purposes in order to reduce its exposure to currency and interest rate movements. This is achieved by hedging specific financial instruments and forecasted transactions, as well as strategic hedging against overall balance sheet exposures.

The Group uses options and currency swaps to hedge against specifically identified currency and equity risks. In addition, the Group uses interest rate swaps and forward rate agreements to hedge against the interest rate risk arising from specifically identified, or a portfolio of, fixed interest rate investments and loans. The Group also uses interest rate swaps to hedge against the cash flow risks arising on certain floating rate deposits. In all such cases the hedging relationship and objective, including details of the hedged item and hedging instrument, are formally documented and the transactions are accounted for as fair value hedges.

Hedging of interest rate risk is also carried out by monitoring the duration of assets and liabilities and entering into interest rate swaps to hedge net interest rate exposures. Since hedging of net positions does not qualify for special hedge accounting, related derivatives are accounted for the same way as trading instruments.

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28 COMMITMENTS AND CONTINGENT LIABILITIES**Credit-related commitments**

Credit-related commitments include commitments to extend credit, standby letters of credit, guarantees and acceptances which are designed to meet the requirements of the Group's customers.

Commitments to extend credit represent contractual commitments to make loans and revolving credits available and generally have fixed expiration dates or other termination clauses. Since commitments may expire without being drawn upon, the total contract amounts do not necessarily represent future cash requirements.

Standby letters of credit, guarantees and acceptances (standbys) commit the Group to make payments on behalf of customers contingent upon their failure to perform under the terms of the contract. Standbys would have market risk if issued or extended at a fixed rate of interest. However, these contracts are primarily made at floating rates.

The Group has the following credit related commitments:

	<u>2007</u>	<u>2006</u>
	<u>US\$ '000</u>	<u>US\$ '000</u>
Commitments on behalf of customers:		
Guarantees	1,101,614	903,074
Acceptances	79,216	35,962
Letters of credit	378,564	342,764
	<u>1,559,394</u>	<u>1,281,800</u>
Irrevocable commitments:		
Undrawn loan commitments	<u>1,335,841</u>	<u>1,754,641</u>

The Group's commitments in respect of non-cancellable operating leases were as follows:

	<u>2007</u>	<u>2006</u>
	<u>US\$ '000</u>	<u>US\$ '000</u>
Within one year	2,085	-
Within one to five years	634	2,382
Over five years	2,377	2,352
	<u>5,096</u>	<u>4,734</u>

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29 SEGMENT INFORMATION**Primary segment information**

For management purposes the Group is organised into three major business segments:

Retail banking	principally handling individual customers' deposit and current accounts, providing consumer loans, residential mortgages, overdrafts, credit cards and fund transfer facilities.
Corporate banking, treasury and investments	principally handling loans and other credit facilities, and deposit and current accounts for corporate and institutional customers and providing money market, trading and treasury services, as well as management of the Group's funding.
Private banking and wealth management	principally servicing high net worth clients through a range of investment products, funds, credit facilities, trusts and alternative investments.

These segments are the basis on which the Group reports its primary segment information. Transactions between segments are conducted at approximate market rates on an arm's length basis. Interest is charged/credited to business segments based on a pool rate which approximates the cost of funds.

Segment information for the year ended **31 December 2007** is as follows:

	<i>Retail banking</i>	<i>Corporate banking, treasury and investments</i>	<i>Private banking and wealth management</i>	<i>Total</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>
Net interest and other income before share of profit of associates	189,325	335,512	84,794	609,631
	31.1%	55.0%	13.9%	100.0%
Share of profit of associates				57,134
Operating income				666,765
Profit before tax - excluding share of profit from associates	65,760	196,753	52,533	315,046
	20.9%	62.5%	16.6%	100.0%
Share of profit of associates				57,134
(Less): Income tax expense				(12,354)
(Less): Net profit attributable to minority interest				(63,509)
Net profit attributable to the Bank's equity shareholders				296,317

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29 SEGMENT INFORMATION (continued)

Primary segment information

Segment information as at 31 December 2007 is as follows:

	<i>Retail banking</i>	<i>Corporate banking, treasury and investments</i>	<i>Private banking and wealth management</i>	<i>Total</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>
Other information				
Segment assets	2,912,295	16,969,588	1,481,663	21,363,546
Goodwill	165,265	178,750	104,868	448,883
Investments in associates				768,471
Unallocated assets				468,952
Total assets				<u>23,049,852</u>
Segment liabilities	2,253,769	15,483,743	2,288,015	20,025,527
Unallocated liabilities				376,204
Total liabilities and subordinated liabilities				<u>20,401,731</u>

Segment information for the year ended 31 December 2006 is as follows:

	<i>Retail banking</i>	<i>Corporate banking, treasury and investments</i>	<i>Private banking and wealth management</i>	<i>Total</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>
Net interest and other income before share of profit of associates	169,305	240,394	54,870	464,569
	36.4%	51.8%	11.8%	100.0%
Share of profit of associates				28,288
Operating income				<u>492,857</u>
Profit before tax - excluding share of profit from associates	63,511	144,266	25,001	232,778
	27.3%	62.0%	10.7%	100.0%
Share of profit of associates				28,288
(Less): Income tax expense				(3,243)
(Less): Net profit attributable to minority interest				(50,343)
Net profit attributable to the Bank's equity shareholders				<u>207,480</u>

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29 SEGMENT INFORMATION (continued)**Primary segment information**

Segment information as on 31 December 2006 was as follows:

	<i>Retail banking</i>	<i>Corporate banking, treasury and investments</i>	<i>Private banking and wealth management</i>	<i>Total</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>
Other information				
Segment assets	2,779,748	15,910,019	722,984	19,412,751
Goodwill	146,584	164,320	77,812	388,716
Investment in associates				554,280
Unallocated assets				443,160
Total assets				<u>20,798,907</u>
Segment liabilities	1,457,621	15,511,115	1,577,210	18,545,946
Unallocated liabilities				426,289
Total liabilities and subordinated liabilities				<u>18,972,235</u>

Secondary segment information

Although the management of the Group is based primarily on business segments, the Group operates in two geographic markets: the Gulf Co-operation Council (Kingdom of Bahrain, State of Kuwait, Sultanate of Oman, State of Qatar, Kingdom of Saudi Arabia and the United Arab Emirates), designated as regional, and the remainder (Europe, U.S.A., Asia and the rest of the world), is designated as international. The following table shows the distribution of the Group's operating income and total assets by geographical segment:

	<i>Regional</i>		<i>International</i>		<i>Total</i>	
	<i>2007</i>	<i>2006</i>	<i>2007</i>	<i>2006</i>	<i>2007</i>	<i>2006</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>
Operating income	596,343	391,538	70,422	101,319	666,765	492,857
	89.4%	79.4%	10.6%	20.6%	100.0%	100.0%
Total assets	16,585,776	12,346,496	6,464,076	8,452,411	23,049,852	20,798,907
	72.0%	59.4%	28.0%	40.6%	100.0%	100.0%

RISK MANAGEMENT

30 CREDIT RISK

Credit risk is the risk that one party to a financial instrument will fail to discharge a financial obligation and cause the other party to incur a financial loss. In the case of derivatives this is limited to positive fair values. The Group attempts to control credit risk by monitoring credit exposures, limiting transactions with specific counterparties, and continually assessing the creditworthiness of counterparties.

a. Concentration risk

Concentrations of credit risk 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 of credit risk indicate the relative sensitivity of the Group's performance to developments, affecting a particular industry or geographic location.

The Group manages its credit risk exposure so as to avoid over concentration to any sector or geographic location. It also obtains security where appropriate. Guidelines are in place regarding the acceptability of types of collateral and valuation parameters.

The principal collateral types are as follows:

- In the personal sector – mortgages over residential properties;
- In the commercial sector – charges over business assets such as premises, stock, receivables and corporate or bank guarantees;
- In the commercial real estate sector – charges over the properties being financed; and
- In the financial sector – charges over financial instruments, such as debt securities and equities.

The Group monitors the market value of collateral and requests additional collateral when necessary in accordance with the underlying agreement.

Details of the concentration of the loans and advances by geographic region and industry sector are disclosed in note 9.

Details of the industry sector analysis and the geographical distribution of the assets, liabilities and commitments on behalf of customers are set out in note 31.

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30 CREDIT RISK (continued)**b. 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.

	<i>Gross maximum exposure 2007</i>	<i>Gross maximum exposure 2006</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>
Balances with central banks	118,355	116,637
Treasury bills and bonds	867,074	959,713
Deposits with banks and other financial institutions	4,396,781	6,011,145
Loans and advances	12,035,153	8,873,357
Non-trading investments	2,800,455	2,828,406
Other assets	316,586	268,136
Total	20,534,404	19,057,394
Contingent liabilities	1,559,394	1,281,800
Undrawn loan commitments	1,335,841	1,754,641
Total credit related commitments	2,895,235	3,036,441
Total credit risk exposure	23,429,639	22,093,835

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.

c. Credit quality per class of financial assets

The table below shows distribution of financial assets neither past due nor impaired.

	<i>Neither past due nor impaired</i>		
	<i>High standard grade</i>	<i>Standard grade</i>	<i>Total</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>
At 31 December 2007			
Balances with central banks	118,355	-	118,355
Treasury bills and bonds	867,074	-	867,074
Deposits with banks and other financial institutions	4,248,562	148,219	4,396,781
Loans and advances			-
Retail	717,442	2,767,351	3,484,793
Corporate	6,568,525	1,867,214	8,435,739
Non trading investments			-
Available-for-sale	2,587,149	257,750	2,844,899
Held to maturity	-	-	-
Other assets - derivatives	123,679	-	123,679

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30 CREDIT RISK (continued)**Credit quality per class of financial assets**

The table below shows distribution of financial assets neither past due nor impaired.

	<i>Neither past due nor impaired</i>		<i>Total</i>
	<i>High standard grade</i>	<i>Standard grade</i>	
	<i>US\$ '000</i>	<i>US\$ '000</i>	
At 31 December 2006			
Balances with central banks	116,637	-	116,637
Treasury bills and bonds	959,713	-	959,713
Deposits with banks and other financial institutions	5,792,911	218,234	6,011,145
Loans and advances			
Retail	609,602	2,207,630	2,817,232
Corporate	3,670,984	2,274,801	5,945,785
Non trading investments			
Available-for-sale	2,357,951	304,112	2,662,063
Held to maturity	181,155	-	181,155
Other assets - derivatives	122,047	-	122,047

It is the Group's policy to maintain consistent internal risk ratings across the credit portfolio. The credit quality of the portfolio of loans and advances that were neither past due nor impaired can be assessed by reference to the Group's internal credit rating system. This facilitates focused portfolio management of the inherent level of risk across all lines of business. The three credit quality ratings given can be equated to the following risk rating grades:

Credit quality rating	Risk rating	Definition
High standard	Risk rating 1 to 4	Undoubted through to good credit risk
Standard	Risk rating 5 to 6	Satisfactory through to adequate credit risk
Watch list	Risk rating 7	Watch list credit risk

The risk rating system is supported by a various financial analytics and qualitative market information for the measurement of counterparty risk.

There are no financial assets which are past due but not impaired other than those disclosed under note 9(c).

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31 CONCENTRATION ANALYSIS

The distribution of assets, liabilities and commitments on behalf of customers by geographic region and industry sector was as follows:

	2007			2006		
	<i>Assets</i>	<i>Liabilities</i>	<i>Commitments on behalf of customers</i>	<i>Assets</i>	<i>Liabilities</i>	<i>Commitments on behalf of customers</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>
Geographic region:						
GCC countries	16,585,776	14,870,559	1,441,618	12,346,496	14,241,183	1,179,131
United Kingdom (UK)	2,890,226	743,819	20,751	3,328,820	551,871	15,072
Europe (excluding UK)	1,838,287	1,945,435	30,211	3,734,486	1,885,524	45,033
United States of America	538,388	356,392	36,600	506,393	420,847	36,603
Asia (excluding GCC)	490,814	1,725,194	9,334	333,944	1,583,171	2,545
Rest of the world	706,361	760,332	20,880	548,768	289,639	3,416
	23,049,852	20,401,731	1,559,394	20,798,907	18,972,235	1,281,800
Industry sector:						
Banks and other financial institutions	9,720,536	9,661,430	304,711	10,192,105	9,237,660	192,627
Consumer	3,996,099	3,852,940	43,447	3,298,410	2,927,322	30,184
Trading and manufacturing	2,856,752	1,404,035	477,201	2,456,253	1,432,849	500,857
Real estate	3,716,859	489,944	512,112	1,996,516	396,998	269,859
Government/public sector	698,133	3,222,590	1,040	799,127	2,630,732	75,155
Others	2,061,473	1,770,792	220,883	2,056,496	2,346,674	213,118
	23,049,852	20,401,731	1,559,394	20,798,907	18,972,235	1,281,800

32 MARKET RISK

Market risk is the risk of potential financial loss that may arise from adverse changes in the value of financial instrument or portfolio of financial instruments due to movements in interest rates, foreign exchange rates, equity, commodity prices and derivatives. This risk arises from asset - liability mismatches, changes that occur in the yield curve, foreign exchange rates and changes in volatilities/IMPLIED volatilities in the market value of derivatives. The Group classifies exposures to market risk into either trading or non-trading portfolios. Given the Group's low risk strategy, aggregate market risk levels are considered low. The Group utilises Value-at-Risk (VaR) models to assist in estimating potential losses that may arise from adverse market movements in addition to non-quantitative risk management techniques. The market risk for the trading portfolio is managed and monitored on a VaR methodology which reflects the inter-dependency between risk variables. Non-trading portfolios are managed and monitored using stop loss limits and other sensitivity analyses.

a. Market risk-trading

The Group calculates Historical Simulation VaR using a one day holding period at a confidence level of 95%, which takes into account the actual correlations observed historically between different markets and rates.

Since VaR is an integral part of the Group's market risk management, VaR limits have been established for all trading operations and exposures are reviewed daily against the limits by management. Actual outcomes are compared to the VaR model derived predictions on a regular basis as a means of validating the assumptions and parameters used in the VaR calculation.

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32 MARKET RISK (continued)**a. Market risk-trading**

The table below summarises the risk factor composition of the VaR including the correlative effects intrinsic to the trading book:

	<i>Foreign exchange</i>	<i>Interest rate</i>	<i>Effects of correlation</i>	<i>Total</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>
2007 - 31 December	50	362	(77)	335
2006 - 31 December	1,300	1,053	(142)	2,211

b. Market risk-non-trading**Interest rate risk**

Interest rate risk arises from the possibility that changes in interest rates will affect the value of financial instruments or the future profitability of the Group. The Group is exposed to interest rate risk as a result of mismatches or gaps in the amounts of assets and liabilities and off balance sheet instruments that mature or reprice in a given period. The Group measures and manages interest rate risk by establishing levels of interest rate risk by setting limits on the interest rate gaps for stipulated periods. Interest rate gaps on assets and liabilities are reviewed on a weekly basis and hedging strategies used to reduce the interest rate gaps to within the limits established by the Bank's Board of Directors.

The following table demonstrates the sensitivity of the Group's net interest income to a change in interest rates, with all other variables held constant. The sensitivity is based on the floating rate financial assets and financial liabilities held at 31 December 2007 including the effect of hedging instruments. Equity is not sensitive to changes in interest rates as there are no fixed rate instruments held in the available-for-sale portfolio.

Sensitivity analysis - interest rate risk

	<i>Less than three months</i>	<i>Three months to one year</i>	<i>Over one year</i>	<i>Total</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>
31 December 2007				
at 25 bps increase	(280)	(2,961)	5,535	2,294
at 15 bps increase	(168)	(1,777)	3,321	1,376
at 10 bps increase	(112)	(1,184)	2,214	918
31 December 2006				
at 25 bps increase	(733)	1,925	860	2,052
at 15 bps increase	(440)	1,155	516	1,231
at 10 bps increase	(293)	770	344	821

Currency risk

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

The risk management process manages the Group's exposure to fluctuations in foreign exchange rates (currency risk) through the asset and liability management process. It is the Group's policy to reduce its exposure to currency to acceptable levels as determined by the Board of Directors. The Board has established levels of currency risk by setting limits on currency position exposures. Positions are monitored on a daily basis and hedging strategies used to ensure positions are maintained within established limits.

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32 MARKET RISK (Continued)**b. Market risk-Non-Trading (continued)****Sensitivity analysis - currency risk**

All foreign currency exposures with the exception of strategic investments are captured as part of the trading book. The risk of the exposures are subject to quantification via a daily VaR calculation, the results of which are disclosed in note 32 (a).

Equity price risk

Equity price risk arises from fluctuations in equity indices and prices. The Board has set limits on the amount and type of investments that may be accepted. This is monitored on an ongoing basis by the Group Investment Committee. The non-trading equity price risk exposure arises from the Group's investment portfolio.

The effect on equity valuations (as a result of a change in the fair value of equity investments held as available-for-sale) due to a reasonably possible change in equity indices, with all other variables held constant is as follows:

	<i>Change in equity price</i>	<i>Effect on equity 2007</i>	<i>Effect on equity 2006</i>
<i>Market indices</i>	%	US\$ '000	US\$ '000
Doha Securities Market	+15%	1,037	457
Saudi Stock Exchange	+5%	81	N/A
Bahrain Stock Exchange	+10%	24	5,576
Kuwait Stock Exchange	+10%	6,794	2,320
Tokyo Nikkei	+5%	(307)	N/A

33 FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value of financial instruments, with the exception of unquoted equity investments, approximate their carrying values.

The fair value of unquoted equity investments cannot be determined with sufficient accuracy, as future cash flows are not determinable. The Group has unquoted equity investments carried at cost amounting to US\$ 16.1 million (2006: US\$ 36.6 million) where the impact of changes in equity prices will only be reflected when the investment is sold or deemed to be impaired, when the consolidated statement of income will be impacted; or when a material third party transaction in the investment gives a reliable indication of fair value which will be reflected in equity.

The Group intends to hold these securities until an opportunity to dispose them presents itself in the GCC markets.

Investments in associates include quoted equity investments of Ahli Bank Q.S.C. on the Doha Securities Market, Ahli United Bank (Egypt) S.A.E. on the Cairo and Alexandria Stock exchanges and Alliance Housing Bank S.A.O.G. on the Muscat stock exchange. The table below shows the market value based on closing price as at 31 December 2007 and carrying value of these investments :

	<u>2007</u>	<u>2006</u>
	<i>US\$ (million)</i>	<i>US\$ (million)</i>
Market value	769	572
Carrying value	613	472

31 December 2007

34 LIQUIDITY RISK

Liquidity risk is the risk that an institution will be unable to meet its funding requirements. Liquidity risk can be caused by market disruptions or a credit downgrade which may cause certain sources of funding to dry up immediately. To guard against this risk, management has diversified funding sources and assets are managed with liquidity in mind, maintaining a healthy balance of cash, cash equivalents and readily marketable securities.

The Group Asset and Liability Committee (GALCO) monitors the maturity profile on an overall basis with ongoing liquidity monitoring by the Group's treasury department.

The maturity profile of the assets and liabilities at **31 December 2007** given below reflects management's best estimates of the maturities of assets and liabilities that have been determined on the basis of the remaining period at the balance sheet date to the contractual maturity date, except in the case of customer deposits. The liquidity profile of customer deposits has been determined on the basis of the effective maturities indicated by the Group's deposit retention history.

	<i>US\$ '000</i>					<i>Undated</i>	<i>Total</i>
	<i>Up to one month</i>	<i>One month to three months</i>	<i>Over three months to one year</i>	<i>Over one year to five year</i>	<i>Over five years</i>		
ASSETS							
Cash and balances							
with central banks	141,953	-	637	-	-	-	142,590
Treasury bills and bonds	32,553	126,016	455,445	179,534	73,526	-	867,074
Trading securities	44,592	67,609	-	-	-	-	112,201
Deposits with banks and other financial institutions	3,587,659	728,955	80,167	-	-	-	4,396,781
Loans and advances	1,308,228	1,948,682	2,446,979	2,865,404	3,465,860	-	12,035,153
Non-trading investments	530,396	149,600	222,949	1,422,892	1,199,440	-	3,525,277
Investments in associates	-	-	-	-	-	768,471	768,471
Premises and equipment	-	-	-	-	-	292,461	292,461
Other assets	104,440	183,729	46,976	45,034	34,308	-	414,487
Goodwill and other intangible assets	-	-	-	-	-	495,357	495,357
Total	5,749,821	3,204,591	3,253,153	4,512,864	4,773,134	1,556,289	23,049,852
LIABILITIES							
Deposits from banks and other financial institutions	3,191,768	2,365,136	544,106	888,014	-	-	6,989,024
Customers' deposits	3,282,078	969,341	915,333	4,145,610	1,468,552	-	10,780,914
Term debt	-	-	-	1,350,000	-	-	1,350,000
Other liabilities	169,689	249,610	162,896	88,467	22,907	-	693,569
Subordinated liabilities	-	-	-	43,662	544,562	-	588,224
Total	6,643,535	3,584,087	1,622,335	6,515,753	2,036,021	-	20,401,731
Net liquidity gap	(893,714)	(379,496)	1,630,818	(2,002,889)	2,737,113	1,556,289	2,648,121

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34 LIQUIDITY RISK (continued)

The maturity profile of the assets and liabilities at 31 December 2006 was as follows:

	US\$ '000						Total
	Up to one month	One month to three months	Over three months to one year	Over one year to five year	Over five years	Undated	
ASSETS							
Cash and balances with central banks	137,683	-	-	-	-	-	137,683
Treasury bills and bonds	-	-	549,490	410,223	-	-	959,713
Trading securities	75,829	-	-	-	-	-	75,829
Deposits with banks and other financial institutions	5,575,656	275,489	160,000	-	-	-	6,011,145
Loans and advances	673,148	997,320	1,958,473	2,858,036	2,386,380	-	8,873,357
Non-trading investments	285,857	244,778	341,960	1,511,266	955,241	-	3,339,102
Investments in associates	-	-	-	-	-	554,280	554,280
Premises and equipment	-	-	-	-	-	146,501	146,501
Other assets	92,845	38,164	96,035	38,415	3,497	-	268,956
Goodwill and other intangible assets	-	-	-	-	-	432,341	432,341
Total	6,841,018	1,555,751	3,105,958	4,817,940	3,345,118	1,133,122	20,798,907
LIABILITIES							
Deposits from banks and other financial institutions	3,820,268	1,995,693	1,023,760	485,913	1,283	-	7,326,917
Customers' deposits	3,311,372	1,281,484	506,734	2,688,361	1,251,515	-	9,039,466
Term debt	-	-	342,497	1,200,000	-	-	1,542,497
Other liabilities	237,835	74,769	67,952	54,988	4,236	-	439,780
Subordinated liabilities	3,695	-	32,775	3,549	583,558	-	623,577
Total	7,373,170	3,351,946	1,973,718	4,432,811	1,840,592	-	18,972,237
Net liquidity gap	(532,152)	(1,796,195)	1,132,240	385,129	1,504,526	1,133,122	1,826,670

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34 LIQUIDITY RISK (continued)

Analysis of financial liabilities by remaining contractual maturities

The table below summarises the maturity profile of the Group's financial liabilities based on contractual undiscounted repayment obligations.

	US\$ '000						
	Up to one month	One month to three months	Over three months to one year	Over one year to five year	Over five years	Undated	Total
As at 31 December 2007							
Deposits from banks and other financial institutions	3,783,049	2,481,759	570,935	497,903	-	-	7,333,646
Customers' deposits	7,092,384	2,218,196	1,871,202	139,658	1,545	-	11,322,985
Term debt	613	12,964	57,451	1,577,374	-	-	1,648,402
Subordinated liabilities	255	1,377	19,011	168,981	645,982	-	835,606
Total	10,876,301	4,714,296	2,518,599	2,383,916	647,527	-	21,140,639
Credit related commitments and contingencies	308,701	671,284	1,208,379	790,315	602,931	-	3,581,610
Derivatives	961,603	907,362	868,724	(48,593)	5,292	-	2,694,388

	US\$ '000						
	Up to one month	One month to three months	Over three months to one year	Over one year to five year	Over five years	Undated	Total
As at 31 December 2006							
Deposits from banks and other financial institutions	3,988,235	2,083,384	1,068,642	507,293	1,339	-	7,648,893
Customers' deposits	6,829,170	1,689,665	626,755	149,998	42,180	-	9,337,768
Term debt	594	13,296	681,144	1,331,110	-	-	2,026,144
Subordinated liabilities	7,663	1,328	86,473	131,084	714,784	-	941,332
Total	10,825,662	3,787,673	2,463,014	2,119,485	758,303	-	19,954,137
Credit related commitments and contingencies	211,355	394,982	1,015,375	819,013	595,716	-	3,036,441
Derivatives	2,245,461	591,435	1,130,175	11,339	(3,681)	-	3,974,729

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35 CAPITAL ADEQUACY

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. Capital adequacy for each of the group companies is also managed separately at its individual level.

In order to maintain or adjust the capital structure, the Group may adjust the amount of dividend payment to shareholders or issue capital securities. No changes were made in the objectives, policies and processes from the previous years.

The risk asset ratio, calculated in accordance with the capital adequacy guidelines approved by the Central Bank of Bahrain, for the Group, is as follows:

	<u>2007</u>	<u>2006</u>
	<u>US\$ '000</u>	<u>US\$ '000</u>
Capital base:		
Tier 1 capital	1,529,852	1,004,730
Tier 2 capital	1,181,663	957,942
Total capital base (a)	<u>2,711,515</u>	<u>1,962,672</u>
Risk weighted assets (b)	<u>16,689,586</u>	<u>13,227,725</u>
Capital adequacy (a/b * 100)	<u>16.2%</u>	<u>14.8%</u>
Minimum requirement	<u>12.0%</u>	<u>12.0%</u>

36 DEPOSIT PROTECTION SCHEME

Certain customers' deposits of the Group are covered by deposit protection schemes established by the Central Bank of Bahrain and Financial Services Compensation Scheme, UK. The schemes apply to all non-bank private sector deposits subject to specific exclusions mainly relating to maximum deposit amounts, maximum total amount covered in one calendar year and maximum total amount of the Deposit Protection Board's financial resources. No up-front contribution is required to the schemes and no liability is due unless the Bank or any of its subsidiaries is unable to meet its depository obligations.

37 ISLAMIC BANKING

On 7 May 2007, the Bank obtained a no objection certificate from the Central Bank of Bahrain to launch its Islamic banking services. Subsequently, as part of the Group's strategy to provide greater Islamic product offerings across the Group, the Bank launched its Al Hilal Islamic Banking Services in July 2007 in the Kingdom of Bahrain. It currently has two branches in the Kingdom of Bahrain providing a wide array of accounts and financing products including: personal finance, auto finance, home finance, current accounts and investment accounts.

Earlier in 2006, the Group through its associate, Ahli Bank Q.S.C., successfully launched its fully dedicated Al Hilal Islamic Banking Services branch to offer a full range of Islamic banking solutions.

Ahli United Bank B.S.C.

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37 ISLAMIC BANKING (continued)

The balance sheet and statement of income of the Bank's Islamic branches which are incorporated into the consolidated balance sheet and statement of income, are presented below:

Balance sheet at 31 December 2007

	<u>2007</u>
	<u>US\$ '000</u>
ASSETS	
Cash in hand	599
Due from banks	4,056
Receivable balances from islamic financing activities	17,916
Property, furniture and equipment	589
TOTAL ASSETS	<u><u>23,160</u></u>
LIABILITIES	
Due to banks	3,578
Customers' deposits	3,674
Other liabilities	1,829
	<u>9,081</u>
Unrestricted investment accounts	414
	<u>9,495</u>
EQUITY	
Branch capital	13,963
Accumulated losses	(298)
	<u>13,665</u>
TOTAL LIABILITIES, UNRESTRICTED INVESTMENT ACCOUNTS AND EQUITY	<u><u>23,160</u></u>

Statement of income for the six-month period ended 31 December 2007

	<u>2007</u>
	<u>US\$ '000</u>
Net income from islamic financing activities	321
	<u>321</u>
Fee and commissions - net	42
NET OPERATING INCOME	<u>363</u>
Staff costs	262
Depreciation	3
Other operating expenses	393
OPERATING EXPENSES	<u>658</u>
NET LOSS FOR THE PERIOD BEFORE THE SHARE OF PROFIT OF UNRESTRICTED INVESTMENT ACCOUNT HOLDERS.	(295)
Less : Share of profit of unrestricted investment account holders	(3)
NET LOSS FOR THE PERIOD	<u><u>(298)</u></u>