1 INCORPORATION AND PRINCIPAL ACTIVITIES

United Gulf Bank B.S.C. ("the Bank") is a joint stock company incorporated in the Kingdom of Bahrain in 1980, under Commercial Registration (CR) number 10550, and listed on the Bahrain and Kuwait Stock Exchanges. The address of the Bank's registered office is UGB Tower, Diplomatic Area, P.O. Box 5964, Manama, Kingdom of Bahrain.

The Bank operates in Bahrain under a Wholesale Banking License issued by the Central Bank of Bahrain ("the CBB").

The principal activities of the Bank and its subsidiaries (the Group) comprise of investment and commercial banking. Investment banking includes asset portfolio management, corporate finance, advisory, investment in quoted and private equity/ funds, real estate, capital markets, international banking and treasury functions. Commercial banking includes extending loans and other credit facilities, accepting deposits and current accounts from corporate and institutional customers.

The Bank's parent and ultimate holding company is Kuwait Projects Company (Holding) K.S.C. (KIPCO), a company incorporated in the State of Kuwait and listed on the Kuwait Stock Exchange. As at 31 December 2007 KIPCO owned 88% of the Bank's outstanding shares (2006: 76%).

These consolidated financial statements were authorised for issue by the Board of Directors on 16 February 2008.

2 SIGNIFICANT ACCOUNTING POLICIES

The following is a summary of the significant accounting policies which are consistent with those used in the previous year:

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

The consolidated financial statements have been presented in US Dollars being the functional currency of the Bank.

Accounting convention
The consolidated financial statements have been prepared under the historical cost convention as modified by the remeasurement at fair value of investments carried at fair value through statement of income, investments available for sale, investment properties and derivative financial instruments.

Future changes in accounting policies
The following standards have been issued at 31 December 2007 but are effective for the financial years beginning on or after the dates mentioned below:

		Effective
IFRIC 11	IFRS 2 Group and Treasury Share Transactions. This will result in amendment in accounting of such transactions.	1 March 2007
IFRS 8	Operating Segments. This will result in additional disclosures relating to operating segments.	1 January 2009
IAS 1 Revised	Presentation of Financial Statements. This will result in amendments to the presentation of financial statements.	1 January 2009

The application of the above standards are 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 preparation of the financial statements.

The Group adopted the following IFRS in the current year

- IFRS 7 Financial Instruments: Disclosures
  The application of IFRS 7 has resulted in amended and additional disclosures relating to financial instruments and associated risks.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

- IAS 1 Presentation of financial statements (amended)

  The application of IAS 1 (amended) has resulted in amended and additional disclosures relating to an entity's objectives, policies and processes for managing capital.

Comparatives

Additional prior year figures have been included to conform to the presentation adopted in the current year as a result of adoption of IFRS 7. Such inclusion did not affect previously reported net income or the shareholder's equity.

Principles of consolidation

The consolidated financial statements include the financial statements of the Bank and its subsidiaries ("the Group"). Subsidiaries are those entities controlled by the Bank, other than in a fiduciary capacity. Control exists when the Bank has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

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

Subsidiaries are fully consolidated from the date on which control is transferred to the Bank. 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 or disposed of during the year are included in the consolidated statement of income from the date of acquisition or up to the date of disposal, as appropriate.

Minority interests represent the portion of profit or loss and net assets not owned, directly or indirectly, by the Bank and are presented separately in the income statement and within equity in the consolidated balance sheet, separately from parent shareholders' equity. Acquisitions of minority interests are accounted for using the parent entity extension method, whereby, the difference between the consideration and the fair value of the share of the net assets acquired is recognised as goodwill. Any deficiency of the cost of acquisition below the fair values of the identifiable net assets acquired (i.e. a discount on acquisition) is recognised directly in the consolidated statement of income in the year of acquisition.

The principal subsidiaries of the Group are as follows:

Name of the subsidiary	Country of incorporation	Effective ownership as at 31 December 2007	Effective ownership as at 31 December 2006	Year of Incorporation
Algeria Gulf Bank	Algeria	83%	83%	2003
KIPCO Asset Management Company (KAMCO)	Kuwait	72%	71%	1998
Tunis International Bank	Tunisia	77%	77%	1982
United Gulf Bank Securities Company	Bahrain	92%	91%	1998
United Gulf Financial Services Company	Qatar	89%	88%	2006
Held through KAMCO				
Al–Nuzoul Holding Company K.S.C. (Closed) [Formerly Al–Ahlia Arabian Markets Company K.S.C. (Closed)]	Kuwait	60%	96%	2005
Al–Janah Holding Company K.S.C. (Closed) [Formerly First Arabian Markets Company K.S.C. (Closed)]	Kuwait	60%	96%	2005
KAMCO Real Estate Company S.P.C.	Bahrain	100%	100%	2005
Advantage Management Consulting Company K.S.C. (Closed)	Kuwait	58%	58%	2005
Al Zad Real Estate W.L.L.	Kuwait	100%	–	2007
Al Dhiyafa United Real Estate Company W.L.L.	Kuwait	100%	–	2007
First North Africa Real Estate Company W.L.L.	Kuwait	100%	–	2007
Al Raya Real Estate Projects Company W.L.L.	Kuwait	100%	–	2007

Associated companies
An associated company (or associate) is one in which the Group exercises significant influence (but not control) over its operations, generally accompanying, directly or indirectly, a shareholding of between 20% and 50% of the equity share capital and is accounted for by the equity method.

Under the equity method, the investment in an associate is initially recognised at cost and adjusted thereafter for the post–acquisition change in the Group's share of net assets of the investee. The Group recognises in the consolidated statement of income its share of the total recognised profit or loss of the associate from the date that influence or ownership effectively commences until the date that it effectively ceases. Distributions received from an associate reduce the carrying amount of the investment. Adjustments to the carrying amount may also be necessary for changes in the Group's share in the associate arising from changes in its equity that have not been recognised in the associate's profit or loss. The Group's share of those changes is recognised directly in equity. Unrealised gains on transactions with an associate are eliminated to the extent of the Group's share in the associate.

An assessment of an associate is performed when there is an indication that the asset has been impaired, or that impairment losses recognised in prior years no longer exist. Whenever the impairment requirements of IAS 36 indicate that investment in an associate may be impaired, the entire carrying amount of investment is tested by comparing its recoverable amount with its carrying value. The recoverable amount of an asset or a cash–generating unit is the higher of its fair value less costs to sell and its value in use. Goodwill is included in the carrying amount of an investment in associate and, therefore, is not separately tested for impairment.

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

Goodwill
Goodwill represents the excess of the cost of an acquisition over the Group's share of the fair value of the net identifiable assets of the acquired subsidiary or associate at the date of the acquisition. Goodwill arising on the acquisition of a subsidiary is recognised as a separate asset in the balance sheet. Any excess, at the date of acquisition, of the Group's share in the fair value of the net identifiable assets acquired over the cost of the acquisition is recognised as negative goodwill. Negative goodwill arising on an acquisition is recognised immediately in the consolidated statement of income.

Goodwill is stated at cost less impairment losses. Goodwill of subsidiaries is allocated to cash–generating units and is tested annually for impairment. If the recoverable amount of the cash generating unit is less than the carrying amount of the unit, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit and then to the other assets of the unit prorata on the basis of the carrying amount of each asset in the unit. Any impairment loss recognised for goodwill is not reversed in a subsequent period. On disposal of a part of subsidiary, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

Investments
All investments are initially recognised at cost being the fair value of consideration given including, in the case of investments not at fair value through statement of income, incremental acquisition charges associated with the investment. After initial recognition, investments other than investments in associated companies are remeasured using the following policies:

Investments carried at fair value through statement of income
Investments carried at fair value through statement of income comprise securities held for trading and investments in funds. Investments are classified as carried at fair value through the statement of income if they are acquired principally for the purpose of selling in the short term or if so designated by management. All subsequent gains and losses arising from remeasurement at fair value are recognised in the consolidated statement of income.

Investments held for trading
All investments held for trading are listed on active markets, therefore, the fair value of these securities is determined by reference to their quoted bid prices. Realised and unrealised gains and losses on investments held for trading are included in the consolidated statement of income. Dividends are included in dividend income. Interest income is recorded in "gain on investments held for trading".

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Investments designated at fair value through statement of income
The Group classifies its investments in managed portfolios, as investments designated at fair value through statement of income. The fair values of the funds that are listed on active markets are determined by reference to their quoted bid prices. The fair values of unlisted funds are based on net asset values which are determined by the fund manager using the quoted market prices of the underlying assets, if available, or other acceptable methods such as a recent price paid by another investor, the market value of a comparable company.

Non–trading investments
These are classified as follows:

- Held to maturity
- Available for sale

Held to maturity
The Group classifies investments as held to maturity if the requirements of IAS 39 are met and in particular the Group has the intention and ability to hold these investments to maturity.

After initial recognition investments held to maturity are carried at amortised cost using the effective interest rate method, less impairment losses, if any.

Investments available for sale
Investments available for sale are those non–derivative financial assets that are designated as available for sale or are not classified as investment at fair value through statement of income, investment held to maturity or loans and advances.

After initial recognition, investments available for sale are measured at fair value with gains and losses being recognised as a separate component of equity until the investment is derecognised or until the investment is determined to be impaired at which time the cumulative gain or losses previously reported in equity is recognised in the statement of income. Investments whose fair value cannot be reliably measured are carried at cost less impairment losses, if any.

Investment properties
All properties held for rental or for capital appreciation purposes, or both, are classified as investment properties. Where a property is partially occupied by the Group and the portions could be sold separately, the Group accounts for the portions separately either as an investment property or property and equipment, as appropriate. If the portions cannot be sold separately, the property is classified as an investment property only if an insignificant portion is held for use for administrative purposes.

All investment properties are initially recorded at cost, being the fair value of the consideration given including acquisition charges associated with the property. Subsequent to initial recognition, all investment properties are remeasured at fair value and changes in fair value are recognised in the consolidated statement of income.

Loans and advances
Debt instruments which do not meet the definition of held to maturity and which have fixed or determinable payments but are not quoted in an active market are classified as loans and advances. Loans and advances are carried at amortised cost, less any amount written off, and net of any provision for impairment.

Derivatives
Derivatives are stated at fair values.

For the purpose of hedge accounting, hedges are classified into two categories: (a) fair value hedges which hedge the exposure to changes in the fair value of a recognised asset or liability; and (b) cash flow hedges which hedge exposure to variability in cash flows of a recognised asset or liability or a forecasted transaction.

In relation to fair value hedges, that qualify for hedge accounting, any gain or loss from remeasuring the hedging instrument to fair value, as well as related changes in fair value of the item being hedged, are recognised immediately in the consolidated statement of income.

In relation to cash flow hedges the effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognised directly in the fair value reserve in the consolidated statement of changes in equity. The gain or loss relating to the ineffective portion is recognised immediately in the consolidated statement of income.

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. For discontinued fair value hedges of financial instruments with fixed maturities any adjustment arising from hedge accounting is amortised over the remaining term to maturity. For discontinued cash flow hedges, any cumulative gain or loss on the hedging instrument recognised in equity remains in equity until the hedged transaction occurs. If the hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the consolidated statement of income.

Property and equipment and related depreciation
Property and equipment are stated at cost less accumulated depreciation and impairment losses. When assets are sold or retired, their cost and accumulated depreciation are eliminated from the balance sheet and any gain or loss resulting from disposal is included in the consolidated statement of income.

Depreciation is computed on a straight–line basis over estimated useful lives of 3 to 20 years on all property and equipment other than freehold land which is deemed to have an indefinite life. Expenditure for maintenance and repairs is expensed as incurred.

Loans, Murabaha payable, bonds and subordinated debt
These are stated at amortised cost. Transaction costs are amortised over the period of the debt using the effective yield method.

Treasury shares and treasury share reserve
Treasury shares are stated at cost. Any gain or loss arising on reissuance of treasury shares is taken directly to treasury share reserve in the statement of changes in equity.

Cash and cash equivalents
Cash and cash equivalents are cash, demand and call deposits, and time deposits with an original maturity up to 90 days.

Fiduciary assets
Assets held in a fiduciary capacity are not treated as assets of the Group in the consolidated balance sheet.

Taxes
There is no tax on corporate income in the Kingdom of Bahrain. Taxation on foreign operations is provided in accordance with the fiscal regulations of the respective countries in which the Group operates.

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

(a) the right to receive cash flows from the asset have expired;

(b) the Group retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a ‘pass through’ arrangement; or

(c) the Group has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

When the Group has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Group’s continuing involvement in the asset.

A financial liability is derecognised when the obligation specified in the contract is discharged, cancelled or expired.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

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

Trade and settlement date accounting
All "regular way" purchases and sales of financial assets are recognised on the settlement date, i.e. the date the asset is delivered to the counterparty.

Employees benefits
The Group provides for end of service benefits to all its employees. Entitlement to these benefits is usually based upon the employees' length of service and the completion of a minimum service period. The expected costs of these benefits are accrued over the period of employment. Bahraini employees are also covered by the General Organisation of Social Insurance scheme and the Bank's obligations are limited to the amount contributed to the scheme.

The Group operates an equity–settled, share–based Employee Stock Option Plan (ESOP). Under the terms of the plan, share options are granted to permanent employees, which are exercisable in a future period. The fair value of the options is recognised as an expense over the vesting period with a corresponding credit to equity. The fair value of the options is determined using Black–Scholes option pricing model.

The proceeds received are credited to share capital (nominal value) and share premium when the options are exercised.

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

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

(a) for assets carried at fair value, impairment loss is the difference between carrying value and fair value.

(b) for assets carried at amortised cost, impairment is based on estimated future cash flows discounted at the original effective interest rate.

(c) for assets carried at cost, impairment is present value of future cash flows discounted at the current market rate of return for a similar financial asset.

For non equity financial assets the carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the statement of income. 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. For available for sale equity investments no allowance account is used and subsequent increases are reflected as cumulative changes in fair value through equity.

In addition, a provision is made to cover impairment for specific groups of assets where there is a measurable decrease in estimated future cash flows.

Fair values
For financial instruments traded in an active market, fair value is determined by reference to quoted market bid prices for assets and quoted market offer prices for liabilities. The fair value of investments in managed funds or similar investment vehicles, where available, are based on last published bid price.

For financial instruments where there is no active market fair value is normally based on one of the following:

- brokers' quotes
- recent transactions
- the expected cash flows discounted at current rates applicable for items with similar terms and risk characteristics
- option pricing models

The estimated fair value of deposits with no stated maturity, which includes non–interest bearing deposits, is the amount payable on demand.

Foreign currencies
Translation of foreign currency transactions
Exchange differences arising on the retranslation of monetary items, are included in the consolidated statement of income for the year. Exchange differences arising on the retranslation of non–monetary investments carried at fair value through the statement of income are included in the consolidated statement of income for the period. Exchange differences arising on the retranslation of available for sale equity investments, other than those which are carried at cost, are recognised directly in a fair value reserve in the consolidated statement of changes in equity.

Translation of financial statements of foreign operations
Assets (including goodwill) and liabilities of foreign operations are translated at the exchange rates prevailing at the balance sheet date. Income and expense items are translated at average exchange rates for the relevant period. All resulting exchange differences are taken directly to a foreign currency translation reserve in the consolidated statement of changes in equity.

Recognition of income and expenses
Interest income and related fees are recognised using the effective yield method, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the effective interest rate, but not future credit losses. The carrying amount of the financial asset or financial liability is adjusted if the Group revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest income or expense.

Commission income and other fees is recognised when earned. Rental income on investment properties is recognised on a straight line basis. Dividend income is recognised when the Group's right to receive dividend is established.

Recognition of interest income is suspended when loans become impaired. Notional interest is recognised on impaired loans and other financial assets based on the rate used to discount future cash flows to their net present value.

Contingent liabilities and contingent assets
Contingent liabilities are not recognised in the financial statements, but are disclosed unless the possibility of an outflow of resources embodying economic benefits is remote.

Contingent assets are not recognised in the financial statements, but are disclosed when an inflow of economic benefits is probable.

Segment information
A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment), or in providing products and services within a particular economic environment (geographical segment).

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Judgments
In the process of applying the Group's accounting policies, management has made the following judgments, apart from those involving estimations, which have the most significant effect in the amounts recognised in the consolidated financial statements:

Classification of investments
Management decides on acquisition of an investment whether it should be classified as carried at fair value through statement of income, held to maturity, or available for sale.

Classification of investments as fair value through statement of income depends on how management monitors the performance of these investments. For those deemed to be held to maturity management ensures that the requirements of IAS 39 are met and in particular the Group has the intention and ability to hold these to maturity.

All other investments are classified as available for sale.

Estimation uncertainty
The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

Impairment of investments
The Group treats available for sale equity investments as impaired when there has been a significant or prolonged decline in the fair value below its cost or where other objective evidence of impairment exists. The determination of what is "significant" or "prolonged" requires considerable judgment.

Impairment of goodwill
The Group determines whether goodwill is impaired at least on an annual basis. This requires an estimation of the value in use of the cash generating units to which the goodwill is allocated. Estimating the value in use requires the Group to make an estimate of the expected future cash flows from the cash–generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows.

Impairment losses on loans and advances
The Group reviews its loans and advances on a quarterly basis to assess whether a provision for impairment should be recorded in the consolidated statement of income. In particular, considerable judgment by management is required in the estimation of the amount and timing of future cash flows when determining the level of provisions required. Such estimates are necessarily based on assumptions about several factors involving varying degrees of judgment and uncertainty, and actual results may differ resulting in future changes to such provisions.

Collective impairment provisions on loans and advances
In addition to specific provisions against individually significant loans and advances, the Group also makes a collective impairment provision against loans and advances, which although not specifically identified against a loan have a greater risk of default than when originally granted. This collective provision is based on any deterioration in the internal grade of the loan since it was granted. The amount of the provision is based on the historical loss pattern for loans within each grade and is adjusted to reflect current economic changes.

These internal gradings take into consideration factors such as any deterioration in country risk, industry, technological obsolescence as well as identified structural weaknesses or deterioration in cash flows.

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

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

3 INVESTMENTS CARRIED AT FAIR VALUE THROUGH STATEMENT OF INCOME

	2007 US$ 000	2006 US$ 000
Investments held for trading		
Quoted equities	89,624	57,521
Quoted debt securities	–	1,432
	89,624	58,953
Investments designated at fair value through statement of income		
Managed funds	266,845	285,048
	356,469	344,001

Managed funds primarily represent private equity funds invested through unlisted companies and limited partnership interests. The fund managers have created these legal structures for tax efficiency and to meet other investors' requirements. The underlying investments in these funds are primarily in quoted debt and equity instruments in Kuwait and international markets. Please refer to note 24 for geographical distribution.

4 NON–TRADING INVESTMENTS

These are stated at fair value or at cost net of provision for impairment.

	Held to maturity US$ 000	Available for sale US$ 000	Total 2007 US$ 000	Total 2006 US$ 000
Quoted				
Equities	–	130,353	130,353	84,504
Debt securities	12,823	4,674	17,497	25,184
	12,823	135,027	147,850	109,688
Unquoted				
Equities	–	179,994	179,994	226,371
Real estate managed funds	–	10,677	10,677	10,301
Other managed funds	–	225,181	225,181	176,574
Debt securities	–	1,465	1,465	3,518
	–	417,317	417,317	416,764
Total	12,823	552,344	565,167	526,452

Investments in other managed funds primarily represents investment in fund of fund structure. The underlying investments of these funds are mainly private equity securities.

Included under unquoted equity investments are unquoted available for sale equity investments amounting to US$ 165 million (2006: US$ 119 million), which are carried at cost due to the unpredictable nature of their future cash flows and the lack of other suitable methods for arriving at a reliable fair value for these investments.

5 LOANS AND ADVANCES

	2007 US$ 000	2006 US$ 000
Commercial loans	268,892	289,934
Overdrafts	33,281	22,752
Staff loans	2,973	2,080
	305,146	314,766
Less: provision for doubtful loans	(13,280)	(6,486)
	291,866	308,280

5 LOANS AND ADVANCES (continued)

The composition of the loans and advances portfolio is as follows:

	Middle East/ Africa US$ 000	Europe US$ 000	Total 2007 US$ 000	Total 2006 US$ 000
Corporate businesses and others	230,947	–	230,947	248,925
Banks and financial institutions	70,199	4,000	74,199	65,841
	301,146	4,000	305,146	314,766
Less: provision for doubtful loans	(13,280)	–	(13,280)	(6,486)
31 December 2007	287,866	4,000	291,866	
31 December 2006	300,780	7,500	–	308,280

The movements in provision for doubtful loans are as follows:

	2007 US$ 000	2006 US$ 000
At 1 January	6,486	3,864
Charge for the year	3,877	2,635
Write back of provision	(636)	(234)
Other adjustments	3,553	221
At 31 December	13,280	6,486

	2007 US$ 000	2006 US$ 000
Individual impairment	8,080	4,059
Collective impairment	5,200	2,427
	13,280	6,486
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	8,135	6,400

The majority of the provision for doubtful loans relates to the commercial loans.

6 INVESTMENT PROPERTIES

	2007 US$ 000	2006 US$ 000
Cost	25,362	17,936
Accumulated fair value adjustments	1,453	(287)
	26,815	17,649
The movements are as follows:		
At 1 January	17,649	14,519
Additions	7,426	1,933
Disposals	(646)	(1,250)
Change in fair values (note 15)	2,386	2,447
At 31 December	26,815	17,649
Investment properties at 31 December consist of the following:		
Buildings	16,109	14,693
Land	10,706	2,956
	26,815	17,649

Investment properties are stated at fair values, which have been determined based on valuations performed by external professional valuers at the year end.

7 OTHER ASSETS

	2007 US$ 000	2006 US$ 000
Accounts receivable	14,521	16,576
Due from customers	30,903	15,809
Prepayments	10,110	8,023
Interest receivable	3,451	2,256
Others	15,474	7,665
	74,459	50,329

Due from customers is stated net of provision of US$ 9.6 million (2006: US$ 3.4 million). The charge for the year amounted to US$ 9.4 million (2006: US$ Nil).

8 INVESTMENTS IN ASSOCIATED COMPANIES

Investments in associated companies comprise the following:

		Activity	Carrying value 2007 US$ 000	Ownership 2007 %	Carrying value 2006 US$ 000	Ownership 2006 %
a)	Al–Dhiyfa Holding Company	Hotel and tourism	50,110	27	47,225	27
b)	Arab Leadership Academy Company K.S.C.	Providing exclusive and sophisticated leadership programs and training services	550	25	–	–
c)	Bank of Baghdad	Commercial banking	58,714	45	17,977	25
d)	Dhow Development Company	Real estate	399	20	376	20
e)	Kuwait Education Fund	Education	6,808	31	–	–
f)	Jordan Kuwait Bank	Commercial banking	156,788	44	138,325	44
g)	Kuwait Private Equity Opportunities Fund	Private equity fund	20,910	45	21,741	45
h)	Manafae Investment Company	Islamic investment	24,857	27	19,229	27
i)	North Africa Holding Company	Investments	44,842	23	36,634	21
j)	Royal Capital Company P.S.C.	Asset management and financial services	35,941	44	–	–
k)	Salem Al–Marzouk & Sabah Abi Hana	Architecture consulting services	1,224	29	1,483	30
l)	Syria Gulf Bank	Commercial banking	15,233	28	7,513	26
m)	United Cable Company	Telecommunication	13,494	28	16,476	28
n)	United Medical Services Company	Healthcare	28,391	30	13,108	30
o)	United Real Estate Company Jordan	Real estate	15,570	27	–	–
p)	United Industries Company	Industrial and manufacturing	143,985	45	108,202	45
q)	United Real Estate Company	Real estate	171,820	35	147,469	35
r)	United Universal Real Estate Company	Real estate	731	20	68	20
s)	United Warehousing and Cooling	Warehousing and refrigeration	–	–	4,084	25
			790,367		579,910	

8 INVESTMENTS IN ASSOCIATED COMPANIES (continued)

Summarised financial information in respect of the Group's associated companies is set out below:

	2007 US$ 000	2006 US$ 000
Total assets	5,685,867	4,025,454
Total liabilities	3,705,682	2,810,665
Net assets	1,980,185	1,214,789
Revenue	455,788	433,309
Profit for the year	306,426	160,651

a) Al–Dhiyfa Holding Company K.S.C. (Closed) is a closed company incorporated in State of Kuwait during 2005. The Bank directly owns 16.6% (2006: 16.6%) of the associate and indirectly owns additional 10.2% (2006: 10.2%) interest through its subsidiaries KAMCO and TIB.

c) Bank of Baghdad (BoB) is a bank incorporated in Iraq in 1992 and listed on the Iraq Stock Exchange. During the year the Bank's ownership was increased to 45%. The fair value of the Bank's investment in BoB as of 31 December 2007 based on the last bid price of BoB was US$ 60.2 million (2006: US $ 19.8 million).

e) Kuwait Education Fund is a fund with a variable capital of KD 50 million. The Bank directly owns 14.6% of the associate and indirectly owns additional 16.6% interest through its subsidiary KAMCO.

f) Jordan Kuwait Bank (JKB) is a bank incorporated in the Kingdom of Jordan in 1976 and listed on the Amman Stock Exchange. The fair value of the Bank's investment in JKB as of 31 December 2007 based on the last bid price of JKB was US$ 382 million (2006: US$ 303 million).

g) The Bank directly owns 15% (2006: 15%) of Kuwait Private Equity Opportunities Fund, a closed company incorporated in Kuwait in 2004, and indirectly owns an additional 30% (2006: 30%) through its subsidiary KAMCO.

h) The Bank directly owns 1% (2006:1%) of Manafae Investment Company, a closed company incorporated in State of Kuwait in 2005 and indirectly owns an additional 25.5% (2006:25.5%) through its subsidiaries KAMCO and TIB.

i) The Bank directly owns 15.3% (2006: 14%) of North Africa Holding Company, a closed company incorporated in State of Kuwait in 2006, and indirectly owns an additional 8% (2006: 7%) through its subsidiaries KAMCO and TIB.

j) The Bank directly owns 18% of Royal Capital, a closed company incorporated in United Arab Emirates in 2007, and indirectly owns an additional 25% through its subsidiary KAMCO.

l) Syria Gulf Bank (SGB) is a commercial bank incorporated in the Syrian Arab Republic in 2006. SGB has commenced commercial operations in 2007.

m) The Bank directly owns 20.14% (2006: 20.14%) of United Cable Company (UCC), a closed company incorporated in State of Kuwait in 2001, and indirectly owns an additional 8% (2006: 8%) through its subsidiary KAMCO.

o) The Bank directly owns 17% of United Real Estate Company Jordan, a closed company incorporated in Jordan in 2006, and indirectly owns an additional 10% through its subsidiary KAMCO.

p) United Industries Company (UIC) is a company owned through its subsidiary KAMCO, incorporated in the State of Kuwait in 1979 and listed on the Kuwait Stock Exchange. The fair value of the Group's investment in UIC as of 31 December 2007 based on the last bid price was US$139.2 million (2006: US$ 97.9 million).

q) United Real Estate Company (URC), is a company listed on the Kuwait Stock Exchange. The listed price of the Bank's investment in URC as of 31 December 2007 based on the last bid price of URC was US$ 138 million (2006: US$ 148 million).

(b,d, k, n, r & s) These companies are owned through Bank's subsidiary KAMCO, and are all incorporated in State of Kuwait.

9 LOANS AND MURABAHA PAYABLE

	Currency	2007 US$ 000	2006 US$ 000
Floating rate loans			
Commodity Murabaha due on October 2008	US$	175,000	175,000
Loan due on 9 December 2007	US$	–	65,000
Loan due on 22 December 2008	US$	20,000	20,000
Loan due on 20 June 2012	US$	200,000	–
Loan due on 28 August 2010 (note 9.1)	KWD	75,418	–
Loan due on 20 September 2009 (note 9.1)	KWD	29,301	27,674
Loan due on 17 June 2009 (note 9.1)	KWD	27,470	–
Loan due on 30 June 2009 (note 9.1)	KWD	–	51,886
Loan due on 30 June 2009 (note 9.1)	US$	–	13,002
Loan due on 20 September 2007 (note 9.1)	KWD	–	13,837
Fixed rate loans			
Loan due on 14 January 2008 (note 9.1)	KWD	9,156	–
Loan due on 15 January 2008 (note 9.1)	KWD	14,650	–
Loan due on 15 January 2008 (note 9.1)	KWD	3,663	–
Loan due on 15 January 2008 (note 9.1)	KWD	10,988	–
Loan due on 04 February 2008 (note 9.1)	KWD	11,903	–
		577,549	366,399

9.1 These loans relate to the Bank's subsidiary KAMCO.

10 OTHER LIABILITIES

	2007 US$ 000	2006 US$ 000
Due to customers and other payables	35,199	22,069
Accrued expenses	16,190	10,164
Staff related payables	17,538	8,288
Interest payable	17,612	9,452
Dividends payable	1,112	1,407
Others	564	758
	88,215	52,138

11 BONDS

	2007 US$ 000	2006 US$ 000
Bonds – issued by the Bank (11.1)	–	54,990
Bonds – issued by a subsidiary (note 11.2)	72,336	69,183
	72,336	124,173

11.1 Bonds were repaid in September 2007.

11.2 On 21 June 2004, the Bank's subsidiary KAMCO issued floating rate bonds of KWD 10 million and fixed rate bonds of KWD 10 million each for a term of 5 years. During the year KD 250,000 of the issued bonds were redeemed prior to their maturity date.

12 SUBORDINATED DEBT

On 13 October 2006, the Bank issued floating rate notes amounting to US$ 100 million for a term of 10 years maturing on 12 October 2016. For the first five years the notes carry interest at the rate of 1.8% per annum above the LIBOR for 3 month U.S. dollar deposits and after 13 October 2011 the notes will carry interest at the rate of 2.7% per annum above LIBOR for 3 month U.S. dollar deposits. The notes carry a call option exercisable by the Bank after 5 years from the date of issue.

13 EQUITY

Share capital
The authorised share capital as of 31 December 2007 comprised 1 billion shares of US$ 0.25 each (2006: 1 billion shares of US$ 0.25 each).

The issued and fully paid up share capital as of 31 December 2007 comprised 814,989,567 shares of US$ 0.25 each (2006: 802,104,874 shares of US$ 0.25 each). The increase is due to exercise of share options by employees under the employee share option plan.

Share premium
Share premium represents a non–distributable reserve arising from the exercise of the Bank's employee share options. The reserve is credited with the difference between the proceeds from the exercise of share options and the par value of shares issued.

Treasury shares and treasury shares reserve
At the end of the year the Bank held 875,302 shares (2006: 875,302 shares). These treasury shares do not carry any voting rights and are not entitled to dividends. The net gain or loss on reissuance of treasury shares is taken to treasury share reserve in the consolidated statement of changes in equity and is not available for distribution. The value of treasury shares based on the last bid price as of 31 December 2007 is US$ 1.4 million (2006: US$ 0.9 million).

Statutory reserve
In accordance with the Bahrain Commercial Companies Law and the Bank's articles of association, 10% of the income for the year is transferred to a statutory reserve until such time as the reserve reaches 50% of the Bank's paid–up share capital. The reserve is not available for distribution, except in circumstances as stipulated in the Bahrain Commercial Companies Law and following the approval of the CBB.

General reserve
The directors have approved a transfer of 10% of the net profit of the Group for the year to general reserve in accordance with the Bank's Articles of Association. The transfer is subject to shareholders' approval at the forthcoming Annual General Meeting. The general reserve is distributable subject to the approval of the CBB.

Foreign currency translation reserve
The foreign currency translation adjustment represents the net foreign exchange gain (loss) arising from translating the financial statements of the Bank's foreign subsidiaries and associated companies from their functional currencies into United States Dollars.

Proposed dividend
The Board of Directors have recommended to the Annual General Meeting (AGM) to be held on 13 March 2008 a dividend of US 16.25 cents per issued share of US 25 cents par value. Dividend would be paid to the shareholders who hold the shares on the date of the AGM.

14 FAIR VALUE RESERVE

	2007 US$ 000	2006 US$ 000
Available for sale investments		
Balance at 1 January	68,937	36,805
Transferred to income statement on sale (note 15)	(99,797)	(25,698)
Net movement in unrealised fair value during the year	83,265	57,830
Balance at 31 December	52,405	68,937
Cash flow hedge		
Balance at 1 January	2,297	2,375
Net movement in unrealised fair value during the year	(1,958)	(78)
Balance at 31 December	339	2,297
	52,744	71,234

15 INVESTMENT INCOME

	2007 US$ 000	2006 US$ 000
Gain on investments designated at fair value through statement of income	61,181	31,698
Gain on investments held for trading	19,534	3,357
Dividend income	17,717	11,214
Gain on sale of investments available for sale (note 14)	99,797	25,698
(Loss) / gain on sale of associated companies	(21)	21,524
Impairment loss on associated company	(2,085)	–
Rental income from investment properties	1,101	1,113
Changes in fair value of investments properties (note 6)	2,386	2,447
Others	485	(566)
	200,095	96,485

Gain on sale of available for sale investments includes a gain of US$ 7.3 million (2006: US$ 9.6 million) on the sale of securities having a carrying value of US$ 12.1 million (2006: US$ 54.6 million) that were carried at cost.

16 FEES AND COMMISSIONS

	2007 US$ 000	2006 US$ 000
Management fees from fiduciary activities	47,044	20,493
Credit related fees and commission	11,333	9,318
Advisory fees	19,376	22,554
Other fees received	3,631	2,087
	81,384	54,452

17 SHARE OF RESULTS OF ASSOCIATED COMPANIES

	2007 US$ 000	2006 US$ 000
United Industries Company	45,502	10,369
Jordan Kuwait Bank	27,875	24,312
United Medical Services Company	13,986	4,468
United Real Estate Company	12,743	11,860
Manafae Investment Company	4,512	777
Kuwait Private Equity Opportunities Fund	3,874	–
Bank of Baghdad	3,081	1,852
North Africa Holding Company	1,322	–
Salem Al–Marzouk & Sabah Abi Hana	519	470
Kuwait Education Fund	71	–
Syria Gulf Bank	(482)	–
United Warehousing and Cooling	(2,239)	(60)
United Cable Company	(3,831)	(500)
	106,933	53,548

18 EARNINGS PER SHARE

Basic

Basic earnings per share is calculated by dividing the income attributable to the equity shareholders of the parent by the weighted average number of shares outstanding during the year as follows:

		2007	2006
Income attributable to equity shareholders of the parent	US$ 000	220,855	101,468
Weighted average number of shares outstanding during the year for the purpose of basic earnings per share (in thousands)		809,192	792,013
Basic earnings per share	US cents	27.3	12.8

Diluted

Diluted earnings per share is calculated by dividing the income attributable to the equity shareholders of the parent, adjusted for the effect of conversion of employees share options, 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 all employees' share options. The Bank has outstanding share options, issued under the Employee Stock Options Plan, which have dilutive effect on earnings.

		2007	2006
Income attributable to equity shareholders of the parent	US$ 000	220,855	101,468
Weighted average number of shares outstanding during the year for the purpose of basic earnings per share (in thousands)		809,192	792,013
Effect of dilutive potential ordinary shares:			
Share options (in thousands)		10,804	5,455
		819,996	797,468
Diluted earnings per share	US cents	26.9	12.7

19 FUNDS UNDER MANAGEMENT

The Group holds assets amounting to US$ 8.5 billion (2006: US$ 6.5 billion) under its management on behalf of third parties. As these are third party funds managed in a fiduciary capacity, without risk or recourse to the Group, these are not included in the assets on the consolidated balance sheet.

20 CASH AND CASH EQUIVALENTS

	2007 US$ 000	2006 US$ 000
Demand and call deposits with banks	79,560	47,020
Time deposits with maturities of ninety days or less	432,151	435,222
	511,711	482,242

21 SEGMENTAL INFORMATION

Primary segment information

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

Investment banking – Principally undertaking, asset portfolio management, corporate finance, advisory, investments in quoted and private equity/funds, real estate, capital markets, international banking and treasury activities.

Commercial banking – Principally loans and other credit facilities, deposit and current accounts from corporate and institutional customers.

Segmental information for the year ended **31 December 2007** was as follows:

	Investment banking US$ 000	Commercial banking US$ 000	Total US$ 000
Total income	388,072	53,175	441,247
Segment result before provisions and impairment	258,832	25,581	284,413
Impairment loss on non trading investments	(3,831)	–	(3,831)
Provision for doubtful loans, guarantees and other assets, net	(9,319)	(2,987)	(12,306)
Segment result	245,682	22,594	268,276
Income attributable to equity shareholders of the parent			220,855
Income attributable to minority			47,421
			268,276
OTHER INFORMATION			
Segment assets	1,961,685	705,948	2,667,633
Segment liabilities	1,282,716	580,179	1,862,895

Segmental information for the year ended 31 December 2006 was as follows:

	Investment banking US$ 000	Commercial banking US$ 000	Total US$ 000
Total income	205,644	36,186	241,830
Segment result before provisions	104,329	18,063	122,392
Provision for doubtful loans, guarantees and other assets, net	283	(2,635)	(2,352)
Segment result	104,612	15,428	120,040
Income attributable to equity shareholders of the parent			101,468
Income attributable to minority			18,572
			120,040
OTHER INFORMATION			
Segment assets	1,873,729	477,005	2,350,734
Segment liabilities	1,297,876	460,007	1,757,883

Secondary segment information

Geographic

The Group operates in four geographic markets: Middle East/Africa, Europe, North America and Asia. The following tables show the distribution of the Group's total income, total assets and total liabilities by geographical segment, allocated based on the location in which the assets and liabilities are located, for the years ended 31 December 2007 and 2006:

	Middle East/ Africa US$ 000	Europe US$ 000	North America US$ 000	Asia US$ 000	Total US$ 000
31 December 2007					
Total income	404,329	22,779	14,099	40	441,247
Total assets	2,216,058	286,374	164,543	658	2,667,633
Total liabilities	1,452,885	374,627	4,133	31,250	1,862,895
31 December 2006					
Total income	212,473	21,295	6,711	1,351	241,830
Total assets	1,873,663	282,928	192,443	1,700	2,350,734
Total liabilities	1,450,264	275,604	7,015	25,000	1,757,883

22 RELATED PARTY TRANSACTIONS

The Group enters into transactions with its parent, major shareholders, associated companies, directors, senior management and entities which are either controlled or significantly influenced by any of the above mentioned parties.

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

	Major shareholders US$ 000	Associates US$ 000	Other related parties US$ 000	Total 2007 US$ 000	Total 2006 US$ 000
Gain on investments carried at fair value through statement of income	–	7	18,329	18,336	3,877
Gain on sale of investment in associated companies	–	–	–	–	8,444
Fees and commissions income	18,554	4,715	8,014	31,283	11,020
Dividend income	633	18	1,866	2,517	1,713
Interest income	674	121	2,846	3,641	4,351
Interest expense	(93)	(634)	(7,974)	(8,701)	(7,246)
Provision for doubtful debts	–	(239)	(6,414)	(6,653)	–

Compensation of the key management personnel and directors' remuneration are as follows:

	2007 US$ 000	2006 US$ 000
Short term employee benefits	19,016	8,833
Share based payments	3,072	655
Total compensation	22,088	9,488

The year–end balances in respect of related parties included in the consolidated financial statements are as follows:

	Major shareholders US$ 000	Associates US$ 000	Other related parties US$ 000	Total 2007 US$ 000	Total 2006 US$ 000
Demand and call deposits with banks	67	431	10,905	11,403	5,968
Time deposits with banks	–	10,000	35,000	45,000	–
Investments carried at fair value through statement of income	14,906	1,975	25,834	42,715	47,254
Investments, carried at fair value through statement of income, in funds managed by related party	–	–	13,869	13,869	91,796
Non–trading investments	8,699	916	99,432	109,047	176,082
Loans and advances	–	7	1,888	1,895	94,558
Other assets	90	3,889	6,812	10,791	15,902
Due to banks and other financial institutions	–	26,334	96,489	122,823	35,990
Deposits from customers	825	345	11,310	12,480	57,885
Loans taken by a subsidiaries (KAMCO)	–	–	39,373	39,373	53,639
Murabaha payable	–	–	31,250	31,250	31,250
Other liabilities	–	42	5,748	5,790	3,880
Letters of credit	–	260	12,819	13,079	27,448
Guarantees	–	–	–	–	8,531
Funds managed or advised by the Group (included in funds under management)	–	–	173,222	173,222	147,676

Except as above, all related party exposures are performing and are free of any provision for possible credit losses.

In addition to the above, other transactions with related parties included in the consolidated financial statements are as follows:

	2007 US$ 000	2006 US$ 000
Carrying value of associate sold to an associated company	–	40,308

23 OFF BALANCE SHEET ITEMS

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 customers.

Letters of credit, guarantees (including standby letters of credit) and acceptances commit the Group to make payments on behalf of customers if certain conditions are made under the terms of the contract.

Commitments to extend credit represents contractual commitments to make loans and revolving credits. Commitments 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.

The Group has the following credit and investment related commitments:

	2007 US$ 000	2006 US$ 000
Credit related		
Letters of credit	31,651	26,378
Guarantees	119,286	109,966
	150,937	136,344
Investment related	28,036	36,403
	178,973	172,747

All credit related commitments mature within one year

Investment related commitments represent commitments for capital calls of fund of fund structures. These commitments can be called during the investment period of the fund which normally is one to five years.

The Group does not anticipate any material losses in respect of the above.

Other off balance sheet financial instruments

It is the policy of the Group not to engage in derivatives trading or market–making activities. The main off balance sheet financial instruments used to cover foreign exchange risks are forward foreign exchange purchases and sales contracts.

			Notional amounts by term to maturity			
	Positive fair value US$ 000	Negative fair value US$ 000	Notional amount Total US$ 000	Within 3 months US$ 000	3–12 months US$ 000	1–5 years US$ 000
31 December 2007						
Derivatives held for hedging: Interest rate swaps	339	–	75,000	–	50,00	25,000
Other derivatives:						
Forward foreign exchange contracts*	42	(85)	305,482	305,482	–	–
31 December 2006						
Derivatives held for hedging: Interest rate swaps	2,297	–	75,000	–	–	75,000
Other derivatives:						
Forward foreign exchange contracts	36	(116)	314,936	314,936	–	–

23 OFF BALANCE SHEET ITEMS (continued)

Forward foreign exchange contracts are contractual agreements to either buy or sell a specified currency, at a specific price and date in the future, and are customised contracts transacted in the over–the–counter market.

* The Group has undertaken these forward foreign exchange transactions for hedging purposes but as these did not qualify for hedge accounting under IAS 39, these are accounted as derivatives held for trading.

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.

Cash flow hedges

The Group is exposed to variability in future interest cash flows on liabilities which bear interest at a variable rate. The Group uses interest rate swaps as cash flow hedges of these interest rate risks. A schedule indicating as at 31 December 2007 the periods when the hedged cash flows are expected to occur and when they are expected to affect the income statement is as follows:

	Within 1 year US$ 000	1–3 years US$ 000
Cash outflows (Liabilities)	2,125	1,062
Income statement	221	118

The ineffectiveness on cash flow hedges on reclassification from equity to statement of income is not material.

24 RISK MANAGEMENT

24.1 Introduction

Risk is inherent in the Group's activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is considered critical to the Group's continuing profitability.

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

The major risks to which the Group is exposed to while conducting its business and operations, and the means and organisational structure it employs to manage them strategically for building shareholder value, are outlined below.

Risk management structure

Each subsidiary of the Bank is responsible for managing its own risks and has its own Board Committees, including Audit and Executive Committees in addition to other management committees such as Credit / Investment Committee and (in the case of major subsidiaries) ALCO, or equivalent, with responsibilities generally analogous to the Bank's committees.

The Board's role is to approve investment strategies for the Bank. However, it has delegated authority for day to day decision making to the Executive Committee so that risk can be effectively managed within the Bank.

The Managing Director of the Bank has overall responsibility for representing the Board in managing the affairs of the Bank. The Board of Directors has delegated the Executive Management of the Bank to the Chief Executive Officer (who is not a Director) and has appointed several Board committees to work with him and to form and define policies and approve procedures for all spectrums of the Bank's activities.

The Executive Management of the Bank is headed by the Chief Executive Officer who is broadly responsible for the day to day conduct of the Bank's business in line with the Board's approved policies and procedures and complements and facilitates the Board in meeting its responsibility towards all stakeholders. He is assisted by the Deputy Chief Executive Officer. Additionally, several management committees have been formed which are chaired by the Managing Director/Chief Executive Officer.

The Executive Committee comprises four directors including the Chairman, Vice Chairman, Managing Director and a fourth Director. It meets in between Board meetings to approve all proposals not within the Investment Committee's risk authority, as well as to act on all matters within the Board's remit.

The Investment Committee is mainly responsible for approving or recommending approval to the Executive Committee limits for individual exposures, investments and concentrations towards banks, countries, industries, risk rating classes, or other special risk asset categories. In addition, the Committee also monitors the overall risk profile of the Bank and recommends provision levels to the Executive Committee. The Investment Committee is constituted by a majority motion passed in the Executive Committee. Currently the Committee consists of five members and is headed by the Managing Director.

The Audit Committee is appointed by the Board and consists of three members who are Directors, including one non–Executive Director. The Board Audit Committee assists the Board in carrying out its responsibilities with respect to assessing (a) the quality and integrity of financial reporting, (b) the audit thereof, (c) the soundness of the internal controls of the Bank, (d) the risk assessment of Bank's activities, and (e) the methods for monitoring compliance with laws, regulations and supervisory and internal policies.

The Risk and Compliance Committee is responsible for the monitoring and assessment of risks facing the Bank, the review of compliance with internal and external guidelines, the review and recommendation of provisioning requirements, the assessment of the impact on the Bank from new regulatory requirements, and review and ratification of Investment Committee decisions. The Committee is headed by the Chief Executive Officer and includes eight other senior executives of the Bank.

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

The Management Committee acts as the steering committee of the Bank as well as a management forum to discuss any relevant issues. It meets on a weekly basis and consists of the Chief Executive Officer, Deputy Chief Executive Officer and all Department Heads as well as Internal Audit. It also serves to follow up on a weekly basis on the daily conduct of the Bank's business activities. The Committee is headed by the Chief Executive Officer/Deputy Chief Executive Officer.

The Insider Trading Committee comprises three members constituted from the Board of Director members and the Chief Executive Officer with the Deputy Chief Executive Officer as the alternate member. The Committee is mainly responsible for the supervision of adequacy of compliance with the Central Bank of Bahrain guidelines on insider trading.

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

Risk mitigation
As part of its overall risk management, the Group uses derivatives and other instruments to manage exposures resulting from changes in interest rates and foreign currency transactions.

The risk profile is assessed before entering into hedge transactions, which are authorised by the appropriate level of seniority within the Group.

Where warranted, the Bank enters into legally enforceable netting arrangements covering its money market and foreign exchange trading activities whereby only net amount may be settled at maturity. In areas where the Bank acts as agent for commodity trading on behalf of certain financial institutions, the risk is managed through simultaneous spot and forward trading in commodities through well established financial and commodity trading institutions in the overseas market. With regard to the credit risk in the off balance sheet exposures, third party guarantees are obtained wherever possible as a risk mitigation measure.

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

24 RISK MANAGEMENT (continued)

In order to avoid excessive concentrations of risk, the Group's policies and procedures include specific guidelines to focus on country and counter party limits and maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly. Robust limit structures put in place by the Board ensures effective monitoring and control of concentration risk and any limit breaches are immediately rectified and reported to the Board.

24.2 Credit risk

Credit risk arises from the extension of credit facilities in the Group's banking and trading activities as well as in the investment activity where there is a possibility that a counterparty may fail to honour its commitment whenever an investment may fail.

Credit risk is mitigated through:
(i) Establishing an appropriate credit risk environment;
(ii) Operating under a sound credit and investment approval process;
(iii) Maintaining appropriate credit administration, measurement and monitoring processes; and
(iv) Ensuring adequate controls over the credit risk management process.

Well defined policies approved at the Board level are in place. These provide carefully documented guidelines for credit risk management. There is a two tier committee structure to approve and review credit and investment risk. The Investment Committee (IC) includes the Managing Director, Chief Executive Officer, Deputy Chief Executive Officer, Head of Investment Banking and Head of Asset Management. Exposures beyond IC limits are approved by the Board's Executive Committee or by the full Board.

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 on and off balance sheet. The maximum exposure shown is gross before effect of mitigation through the use of master netting and collateral arrangements.

	2007 US$ 000	2006 US$ 000
Demand and call deposits with banks	79,613	47,073
Time deposits with banks	459,923	459,294
Non–trading investments	18,962	28,702
Loans and advances	291,866	308,280
Other assets	64,349	42,304
Off balance sheet items	150,937	136,344
	1,065,650	1,021,997

Risk concentrations of the maximum exposure to credit risk
Concentration of risk is managed by client/counterparty, by geographical region and by industry sector. The maximum credit exposure to any single client or counterparty as of 31 December 2007 was US$ 45.6 million (2006: US$ 30.2 million) before taking account of collateral or other credit enhancements.

	Total 2007 US$ 000	Total 2006 US$ 000
Gulf Co–operation Council countries (G.C.C.)	343,250	394,588
Middle East and North Africa (excluding G.C.C.)	531,299	408,026
North America	2,559	13,018
European Union countries	188,367	206,082
Asia	164	264
Others	11	19
Total	1,065,650	1,021,997

An industry sector analysis of the Group's financial assets, before taking into account collateral held or other credit enhancements, is as follows:

	Gross maximum exposure 2007 US$ 000	Gross maximum exposure 2006 US$ 000
Trading and manufacturing	172,060	157,125
Banks and other financial institutions	789,849	793,762
Construction and real estate	1,039	2,350
Government and public sector	7,909	8,636
Individuals	8,979	4,176
Others	85,814	55,948
Total	1,065,650	1,021,997

Collateral and other credit enhancements

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are implemented regarding the acceptability of types of collateral and valuation parameters.

The main types of collateral obtained are as follows:

- For commercial lending, charges over real estate properties, inventory, trade receivables, bank guarantees; and
- For retail lending, mortgages over residential properties, claim over employees' end of service benefits etc.

The Group also obtains guarantees from parent companies for loans to their subsidiaries.

Management monitors the market value of collateral and requests additional collateral in accordance with the underlying agreement, during its review of the adequacy of the allowance for impairment losses.

Credit risk exposure for each credit rating

	Total 2007 US$ 000	Total 2006 US$ 000
Risk rating		
Investment grade	459,652	413,899
Non–investment grade	74,268	32,406
Unrated	531,730	575,692
Total	1,065,650	1,021,997

It is the Bank's policy to maintain accurate and consistent risk ratings across the credit portfolio. This facilitates focused management of the applicable risks and the comparison of credit exposures across all lines of business, geographic regions and products. All internal risk ratings which are largely subjective are tailored to the various categories and are derived in accordance with the rating policy and practices. The attributable risk ratings are assessed and updated regularly.

Renegotiated loans

Where possible, the Group seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, the loan is no longer considered past due. The carrying amount of the loans whose terms have been renegotiated as at 31 December 2007 and 2006 are not material.

24.3 Market risk

Market risk is defined as the risk of losses in the value of on–or–off balance sheet financial instruments caused by a change in market prices or rates, (including changes in interest rates and foreign exchange rates). The Group's policy guidelines for market risk have been vetted by the Board of Directors in compliance with the rules and guidelines provided by the Central Bank of Bahrain. The Central Bank guidelines introduced a risk measurement framework whereby all locally incorporated banks in Bahrain are required to measure and apply capital charges in respect of their market risk in addition to capital requirement for credit risk.

24 RISK MANAGEMENT (continued)

The market risk subject to capital charge normally arises from change in value due to market forces in the following exposures:

- Interest rate instruments and securities in the trading book.
- Foreign exchange and commodities throughout the banking book.

The Bank has entered into interest rate swaps and forward foreign exchange contracts for hedging purposes and does not actively trade in commodities and derivatives.

Interest rate risk
Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments. Positions are monitored on a daily basis and hedging strategies are used to ensure positions are maintained within the established limits.

The following table demonstrates the sensitivity to a reasonable possible change in interest rates, with all other variables held constant, of the Group's income statement based on the balance sheet position as of 31 December 2007.

Currency	Increase in basis points 2007	Sensitivity of net interest income 2007 US$ 000
Kuwaiti Dinar	+ 25	(421)
United States Dollar	+ 25	(1,517)
Euro	+ 25	68
Pound Sterling	+ 25	(14)
Others	+ 25	116

The decrease in the basis points will have an opposite impact on the net interest income.

The sensitivity of the income statement is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate financial assets and financial liabilities held at 31 December 2007, including the effect of hedging instruments.

There are no material interest bearing securities in non trading investments, hence no sensitivity of equity has been disclosed.

The following table demonstrates the sensitivity to a reasonable possible change in interest rates, with all other variables held constant, of the Group's income statement based on the balance sheet position as of 31 December 2006.

Currency	Increase in basis points 2006	Sensitivity of net interest income 2006 US$ 000
Kuwaiti Dinar	+ 25	(817)
United States Dollar	+ 25	(1,499)
Euro	+ 25	102
Pound Sterling	+ 25	17
Others	+ 25	177

The decrease in the basis points will have an opposite impact on the net interest income.

Currency risk
Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Group considers United States Dollar as its functional currency. Positions are monitored on a daily basis and hedging strategies used to ensure positions are maintained within established limits.

The table below indicates the effect on profit before tax and on equity for the positions (including net investments) as at balance sheet date as a result of change in the currency rate with all other variables held constant.

Currency	Change in currency rate in % 2007 Increase/ (decrease)	Effect on profit before tax 2007 US$ 000	Effect on equity 2007 US$ 000	Change in currency rate in % 2006 Increase/ (decrease)	Effect on profit before tax 2006 US$ 000	Effect on equity 2006 US$ 000
Kuwaiti Dinar	1	(1,993)	8,878	1	(1,231)	6,960
Euro	1	(257)	333	1	20	281
Jordanian Dinar	1	–	1,786	1	–	1,389
Kuwaiti Dinar	(1)	1,993	(8,878)	(1)	1,231	(6,960)
Euro	(1)	257	(333)	(1)	(20)	(281)
Jordanian Dinar	(1)	–	(1,786)	(1)	–	(1,389)

Equity price risk

Equity price risk arises from the change in fair values of equity investments. The Group manages this risk through diversification of investments in terms of geographical distribution and industry concentration.

The Group's financial assets available for sale and financial assets at fair value through statement of income by geographical regions are as follows:

Geographical distribution

	Middle East/ Africa 2007 US$ 000	Europe 2007 US$ 000	North America 2007 US$ 000	Asia 2007 US$ 000	Total 2007 US$ 000	Total 2006 US$ 000
Investments carried at fair value through statement of income						
Equities	80,393	94	8,695	442	89,624	57,521
Managed funds	150,779	71,836	44,230	–	266,845	285,048
					356,469	342,569
Non trading investments available for sale						
Equities – Quoted	121,914	3,137	5,302	–	130,353	84,504
Equities – Unquoted	122,860	21,412	35,722	–	179,994	226,371
Managed funds	164,080	10,991	50,110	–	225,181	176,574
					535,528	487,449
Total					891,997	830,018

Any change in equity price index or the net asset values of the above financial instruments will have a direct impact on income or equity. The majority of the equities in the Middle East/Africa region are quoted in the Kuwait Stock Exchange.

For unquoted investments carried at cost the impact of the changes in the equity prices will only be reflected in the consolidated statement of income when the investment is sold or deemed to be impaired.

24.4 Liquidity risk

Analysis of financial liabilities by remaining contractual maturities

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

24 RISK MANAGEMENT (continued)

At 31 December 2007	On demand US$ 000	1 – 6 months US$ 000	6 – 12 months US$ 000	1 – 5 years US$ 000	5–10 years US$ 000	Total US$ 000
Financial liabilities						
Due to banks and other financial institutions	461,208	191,050	27,607	–	–	679,865
Deposits from customers	431,295	53,643	1,117	–	–	486,055
Loans and Murabaha payable	38,580	11,989	204,646	152,554	308,392	716,161
Other liabilities	43,766	–	26,910	17,539	–	88,215
Bonds	354	1,726	2,104	74,303	–	78,487
Subordinated debt	606	2,954	3,600	35,721	119,895	162,776
Total non–derivative undiscounted on balance sheet financial liabilities 2007	975,809	261,362	265,984	280,117	428,287	2,211,559

At 31 December 2006	On demand US$ 000	1 – 6 months US$ 000	6 – 12 months US$ 000	1 – 5 years US$ 000	5–10 years US$ 000	Total US$ 000
Financial liabilities						
Due to banks and other financial institutions	487,814	238,215	1,906	–	–	727,935
Deposits from customers	360,349	26,118	5,982	–	–	392,449
Loans and murabaha payable	–	–	112,685	294,745	–	407,430
Other liabilities	22,752	–	21,097	8,289	–	52,138
Bonds	652	3,156	57,931	75,063	–	136,802
Subordinated debt	618	2,989	3,666	36,405	127,538	171,216
Total non–derivative undiscounted on balance sheet financial liabilities 2006	872,185	270,478	203,267	414,502	127,538	1,887,970

The Bank expects that not all of contingent items or commitments will be drawn before expiry of the commitments.

In order to ensure that the Group can meet its financial obligations as they fall due, there is a close monitoring of its assets / liabilities position. Besides other functions, the Asset and Liability Committee evaluates the balance sheet both from a liquidity and an interest rate sensitivity point of view. The whole process is aimed at ensuring sufficient liquidity to fund its ongoing business activities and to meet its obligations as they fall due. A diversified funding base has evolved in deposits raised from the interbank market, deposits received from customers and medium term funds raised through syndicated and commodity based Murabaha transactions. These, together with the strength of its equity and the asset quality, substantial excess value over cost of its investments in listed subsidiaries and associated companies, ensure that funds are made available at competitive rates.

Notes to the Consolidated Financial Statements

For the year ended 31 December 2007

The maturity analysis of financial assets and liabilities analysed according to when they are expected to be recovered or settled are as follows:

31 December 2007	Up to 3 months US$ 000	3 months to 12 months US$ 000	Sub total less than 12 months US$ 000	1 to 5 years US$ 000	over 5 years US$ 000	Sub total over 12 months US$ 000	Total US$ 000
Demand and call deposits with banks	79,560	–	79,560	–	53	53	79,613
Time deposits with banks	432,151	23,653	455,804	4,119	–	4,119	459,923
Investments carried at fair value through statement of income	356,469	–	356,469	–	–	–	356,469
Non–trading investments	135,027	2,202	137,229	419,336	8,602	427,938	565,167
Loans and advances	66,385	143,557	209,942	81,924	–	81,924	291,866
Other assets	64,349	–	64,349	–	–	–	64,349
Total financial assets	1,133,941	169,412	1,303,353	505,379	8,655	514,034	1,817,387
Due to banks and other financial institutions	546,978	39,705	586,683	–	–	–	586,683
Deposits from customers	417,384	20,728	438,112	–	–	–	438,112
Loans and Murabaha payable	50,361	195,000	245,361	332,188	–	332,188	577,549
Other liabilities	43,766	26,911	70,677	17,538	–	17,538	88,215
Bonds	–	–	–	72,336	–	72,336	72,336
Subordinated debt	–	–	–	–	100,000	100,000	100,000
Total financial liabilities	1,058,489	282,344	1,340,833	422,062	100,000	522,062	1,862,895
Liquidity gap	75,452	(112,932)	(37,480)	83,317	(91,345)	(8,028)	(45,508)
Cumulative liquidity gap	75,452	(37,480)		45,837	(45,508)		

31 December 2006	Up to 3 months US$ 000	3 months to 12 months US$ 000	Sub total less than 12 months US$ 000	1 to 5 years US$ 000	over 5 years US$ 000	Sub total over 12 months US$ 000	Total US$ 000
Demand and call deposits with banks	47,020	–	47,020	–	53	53	47,073
Time deposits with banks	435,222	24,015	459,237	57	–	57	459,294
Investments carried at fair value through statement of income	344,001	–	344,001	–	–	–	344,001
Non–trading investments	96,496	3,365	99,861	426,591	–	426,591	526,452
Loans and advances	90,697	144,805	235,502	72,549	229	72,778	308,280
Other assets	42,306	–	42,306	–	–	–	42,306
Total financial assets	1,055,742	172,185	1,227,927	499,197	282	499,479	1,727,406
Due to banks and other financial institutions	486,738	236,783	723,521	–	–	–	723,521
Deposits from customers	363,419	28,233	391,652	–	–	–	391,652
Loans and Murabaha payable	–	79,837	79,837	286,562	–	286,562	366,399
Other liabilities	22,752	21,097	43,849	8,289	–	8,289	52,138
Bonds	–	–	–	124,173	–	124,173	124,173
Subordinated debt	–	–	–	–	100,000	100,000	100,000
Total financial liabilities	872,909	365,950	1,238,859	419,024	100,000	519,024	1,757,883
Liquidity gap	182,833	(193,765)	(10,932)	80,173	(99,718)	(19,545)	(30,477)
Cumulative liquidity gap	182,833	(10,932)		69,241	(30,477)		

25 FAIR VALUE

Financial instruments
Fair value is the amount for which an asset could be exchanged or a liability settled between knowledgeable and willing parties in an arm's length transaction. Consequently, differences can arise between carrying values and fair value estimates.

As explained in note 4, included under non–trading investments are unquoted available for sale investments amounting to US$ 165 million (2006: US$ 119 million) for which fair value cannot be reliably determined.

The fair values of other on–balance sheet financial instruments are not significantly different from the carrying values included in the financial statements.

Investment in associated companies

	2007 US$ 000	2006 US$ 000
Quoted investments at last bid price	720,572	568,432
Unquoted investments at cost plus share of post acquisition profits	259,062	167,464
	979,634	735,896
Investments carried at cost plus share of post acquisition profits	790,367	579,910
Excess of listed price over carrying value	189,267	155,986
KAMCO (consolidated subsidiary) – Excess of listed price over book value	158,694	115,838

26 CAPITAL ADEQUACY

The Bank maintains an actively managed capital base to cover risks inherent in the business. The adequacy of the Bank's capital is monitored using, among other measures, the rules and ratios established by the Basel Committee on Banking Supervision ("BIS rules/ratios") and adopted by the CBB.

Capital management
The primary objectives of the Group's capital management are to ensure that the Group complies with capital requirements of the CBB and that the Group maintains strong credit ratings and healthy capital ratios in order to support its business and to maximise shareholders' value. In order to maintain or adjust the capital structure, the Bank may adjust the amount of dividend payment to shareholders, or issue capital securities.

The risk asset ratio calculated in accordance with the capital adequacy guidelines issued by the CBB, for the Group is as follows:

	2007 US$ 000	2006 US$ 000
Capital base:		
Tier 1 capital	572,474	497,218
Tier 2 capital	294,030	139,820
Total capital base (a)	866,504	637,038
Credit risk weighted exposure	2,171,150	1,899,211
Market risk weighted exposure	454,878	349,048
Total risk weighted exposure (b)	2,626,028	2,248,259
Capital adequacy (a/b * 100)	33.0%	28.3%
Minimum requirement	12.0%	12.0%

Regulatory capital consists of Tier 1 capital, which comprises share capital, share premium, statutory reserve, general reserves, treasury share reserve, foreign currency reserve and minority interest less goodwill. The other component of regulatory capital is Tier 2 capital, which includes subordinated long term debt and fair value reserves.