BANK SOHAR SAOG

FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012

Registered office and principal place of business:

Bank Sohar Building
P.O. Box 44, Hai Al-Mina,
PC 114, Muscat
Sultanate of Oman

Board of Directors Report 2012

It is my privilege to present you with Bank Sohar's financial performance report for the year ending December 31, 2012.

2012 proved to be a truly prosperous year for Oman and the Banking sector. Not only did The Sultanate record a 16.2% year-on-year growth in its GDP, but it also celebrated its 42nd National Day anniversary, marking yet another milestone for Oman under the wise leadership of His Majesty Sultan Qaboos bin Said.

Last year was also a momentous one for Bank Sohar, having recorded a net profit of OMR 23.011 million, an impressive growth of 58.73% over the previous year and marking Bank Sohar as the fastest growing Bank in Oman in terms of profitability for 2012.

As a result, the Board of Directors has recommended a cash dividend of 3.5% for the year, which corresponds to 3.5 baizas per share. The Board of Directors has also recommended 6.5% dividend in form of mandatorily convertible bonds.

ECONOMY

The Omani economy experienced another year of growth in 2012 and the Oman banking sector's outlook remains positive. This pleasing outcome is primarily due to high levels of growth on the back of increased hydrocarbons production and sustained growth of the real economy. The economic figures from the first half of 2012 showed that GDP soared by 16.2% year-on-year. The opening six months of 2012 saw GDP total $39.6 billion, compared to $33.8 billion for the same period the previous year. This strong showing, and a similar increase in earnings in the third quarter, saw the state budget record a surplus of $7.5 billion in the nine months ending September 30, more than 200% up on the same period in 2011.

Much of this growth came as a result of high oil prices and an increase in hydrocarbons output. Earnings from the oil and gas sector rose by 19.9% in the first half of the year, contributing $20.47 billion to GDP. However, the non-oil sector also performed strongly, adding just over $20.84 billion to the economy, an improvement of 12.6% over the opening six months of 2011.

With greater participation of commercial banks in the development process together with larger investment outlays by the Government, the balance sheets of banks are expected to remain healthy. The total assets of commercial banks increased by 15.3% to RO 20.68 billion in November 2012 compared to RO 17.93 billion in November 2011. Total credit expanded by 16% to RO 14.33 billion at the end of October 2012 from RO 12.35 billion a year ago. On the liabilities side of the balance sheet, total deposits of commercial banks increased by 15.1% to RO 14.13 billion as of November 2012.

In line with the key goal of the Eighth Plan, to ensure that inflation is brought within control and remains within acceptable limits, inflation has remained subdued during 2012, with the consumer price index rising by just 3.2% as of the end of October, down on the 4% of 2011. This lower rate of inflation helped the Central Bank of Oman keep interest rates at near-historic lows, with the reserve cutting its repo rate from 2% in March to just 1%, in line with its policy of supporting private sector lending and investment.

Underscoring the inherent strengths of the Omani banking sector, international ratings agency Moody's affirmed the outlook on the Sultanate's banks as 'stable' in its review of the sector last September. Highlighting Oman's improved operating environment as a contributing factor coupled with the banks' solid capitalisation, stable funding bases, high liquidity buffers, low levels of non-performing loans, and expectation of adequate earnings despite higher operating costs.

The government is looking to maintain this growth with higher allocations for capital works projects in the 2013 budget. As such, development funding for government departments was increased by 30% in the draft budget. The new budget also foresees a 40% increase in spending on education, job creation programmes and social support schemes, many of which were aimed at providing young Omanis with the skills to enter the private sector. However, even with a higher level of government spending, the 2013 budget should still return a surplus, given that it has been calculated on a base price for crude of $85 per barrel, which is more than $20 below the international trading rate of around $109 per barrel, as of mid-December 2012.

FINANCIAL OVERVIEW 2012

2012 has proved to be yet another great year for Oman's youngest Commercial Bank. Bank Sohar, now completing six years of successful operation, has made an impressive net profit of OMR 23.011 million for the year, which is 58.73% higher than the previous year's net profit of OMR 14.497 million. The operating profit for the year was OMR 28.644 million as compared to OMR 20.007 million in 2011, an increase of 43.17%. Net interest income during the year climbed 20.53% to OMR 41.894 million, as compared to OMR 34.757 million in 2011. The operating income for the year 2012 increased to OMR 52.317 million, an increase of 21.14% as compared to OMR 43.186 million in 2011. The cost to income ratio stood at 45.2% in 2012, down from 53.7% in 2011.

Impressive gains were achieved in other areas of the Bank's business as well. Net loans and advances jumped 12.4% during the year to touch OMR 1,146 million, against the previous year's level of OMR 1,020 million. Customer deposits grew 14.17% to OMR 1,337 million during the year, as compared to OMR 1,171 million in 2011. The Bank's share of Private Sector Credit stood at 8.59% till December 2012 as compared to 8.57% in December 2011 while the Bank's share of Private Sector Deposit was 8.55% in December 2012, marginally up from 6.80% at the end of 2011.

Bank Sohar's impressive financial performance during 2012 was in no small part the result of the continued hard work and commitment of the bank's staff to deliver excellent service to our customers and clients in a very competitive environment. It is through their efforts that Bank Sohar has succeeded in building customer's trust in our establishment and delivering sustainable value to our shareholders. These efforts were supplemented by an intensive drive by the management to improve the overall quality of its assets, enhance yield growth, and reduce operating expenses.

Reaffirming its confidence in Bank Sohar's policies and growth strategy, leading international ratings agency Fitch has once again assigned a Long Term Issuer Default Rating of BBB+ to the Bank in 2012. The positive rating is in recognition of the bank's earnings and profitability, which are strengthening in line with its widening franchise and market share. It also acknowledges the Bank's success in growing its deposit base in the past few quarters, particularly in low cost and stable retail deposits, which has in turn improved Bank Sohar's funding profile. In essence, the BBB+ Rating is a testament to the excellent asset quality of the Bank and its prudent functioning.

FUTURE PLANS

As we look back on 2012, it is clear we have made consistent progress right across the Bank and have entered 2013 in a stronger position. We recognise that in order to maintain our financial growth we need to improve profitability substantially going forward and we are determined to do that, using all the means within our control to drive the business.

A key objective for this year is the introduction of Islamic Banking. Islamic Banking as an industry has seen dramatic growth in acceptability and market size in various countries across the world. With the introduction of an Islamic Banking licence by the CBO, yet another window of opportunity has been opened within Oman's financial environment in 2013. Bank Sohar has already filed the initial application for license with CBO and has been working to bring an authentic and Sharia-based banking solution to its customers that respect the basic tenets of Islam, the sensibilities of the Omani people and uphold the stricture of the Central Bank of Oman (CBO) to develop a unique Omani model of Islamic Banking. As a result, the bank has entered into an agreement with Dar Al Sharia legal & Financial Consultancy of UAE to help it with all aspects of its Islamic Banking window. We intend to commence operations with four new branches by the first half of 2013.

As of the end of 2012 Bank Sohar has obtained an Investment Banking License from The Capital Market Authority and CBO. With this license in place, the Bank will begin providing advisory, fund structuring and fund management services in 2013. In fact, Bank Sohar has already initiated a ground-breaking project called Entrepreneurial Investment Banking, wherein the Bank will structure and manage a fund to invest in new medium-sized manufacturing ventures in Oman, partnering with internationally dominant players in the respective industries. Through this effort, Bank Sohar will not only earn a more diversified revenue stream, but also aid and assist in the industrial progress of Oman, diversification of the economy and most importantly, in the creation of employment opportunities.

We have also launched the Bank Sohar GCC Fixed Income Fund in partnership with Rasmala Investment Bank. This fund aims to provide investors with higher fixed income returns by actively managing a portfolio of MENA sukuks and bonds of varying duration but good credit quality. We hope to grow this business by providing similar meaningful investment opportunities to our clients.

In tune with one of the visions of our Bank, Wholesale Banking has scaled up the value added corporate services like Advisory and syndication of major projects in the Free Trade Zones at Sohar & Salalah, which are of national importance. This will propel the economic growth besides increasing the job opportunities for skilled and semi skilled Omanis. The response for the new focus area of the Bank has been quite encouraging due to highly satisfactory services extended by Wholesale Banking Division. This further enhanced the image of Bank Sohar as a value service provider in this market.

People are the cornerstone of our Bank's successes. We will continue to invest in the development of our staff as great assets to the Bank and the country. We will use best practice people development tools such as assessment centres, blended learning, leadership and executive development initiatives to enhance the skills and competencies of our staff to meet all future challenges and their career aspirations. Ongoing development in this field will continue to be a long term strategy of the bank and continuous training and development will continue with vigour and commitment at all levels within the Bank.

All the above are significant milestones that we aim to achieve over the course of 2013. Once accomplished, they will go a long way toward building a solid institution that is responsive to the financial needs of Omani Market. We are well positioned to take advantage of these opportunities and manage the risks in the emerging economic landscape for 2013. As we look forward, we shall consolidate the Bank's achievements, always aiming for strategic fit, quality and effectiveness in the course of fulfilling our mandate and meeting our customer's expectations.

CORPORATE GOVERANCE

The Bank has included a comprehensive report on Corporate Governance duly certified by the statutory auditors within the Annual Report for the year 2012. This Report has been made in line with the directives provided for the same under the Code of Corporate Governance promulgated by the Capital Market Authority. Bank Sohar continues to confirm its adherence to the best traditions of Corporate Governance and to provide both adequate disclosure and accountability. We have consistently honored that assurance during the current year and will continue to do so in years to come. The Bank's system of internal control is based on an ongoing process designed to identify the principal risks to the achievement of the Bank's aims and objectives. It is also designed to identify the nature and extent of those risks and manage them efficiently and economically, thereby providing reasonable assurance the Bank's shareholders, board of directors and customers of the Bank's effectiveness.

CORPORATE SOCIAL RESPONSIBILITY

The Bank continued to build on its deep faith in carrying out its social obligations. This has become an integral part of the Bank's brand image, which subsequently led to the Bank extending its support to Muscat Festival and the Salalah Tourism Festival in 2012.

Generous contributions also helped support and fund various charitable associations and organisation covering all aspects of welfare, health, employment and education initiatives with a long history of exemplary services to the underprivileged segments of society. There are numerous welfare and volunteer support organisation in the country that have benefited and are still benefiting from Bank Sohar's ongoing programme of philanthropy.

At the social level, Bank Sohar supported the recent Traffic Safety Exhibition held in Muscat and participated in the Earth Hour. Bank Sohar also supported a number of campaigns to increase health awareness which included the Cancer Awareness Campaign conducted during the Muscat Festival and the "Health Week" held in collaboration with Directorate of Health Services at Al Buraimi Governorate.

As a testament to its pioneering CSR efforts, Bank Sohar has received accolades in the Arab world as it bagged a prestigious award and certificate of excellence at an event organised by The Arab Organisation for Social Responsibility in Dubai, last year.

IN CONCLUSION

I take this opportunity and conclude this report by expressing my appreciation to the Board of Directors, management, staff and other stakeholders for their cooperation and strong commitment, creating a stepping stone for a bank as young and dynamic as Bank Sohar. It is essential for us to mention our loyal customers who have been a pillar of strength, constantly encouraging us by showing interest and confidence in our products and inspiring us to outdo ourselves in our path forward.

I would also like to extend our gratitude to the Central Bank of Oman and the Capital Market Authority for steering the financial services sector in the Sultanate with such vigour. We must also recognise the efforts of the Government of His Majesty the Sultan for their commendable efforts in making the banking sector an environment of transparency, in line with the vision of His Majesty. Most significantly, we offer our heartfelt thanks to His Majesty the Sultan for his vision, foresight and benevolent leadership.

Salim Said Al Fannah Al Araimi
Chairman

Bank Sohar SAOG

STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2012

2011 USD'000	**2012 USD'000**		Notes	**2012 RO'000**	2011 RO'000
		ASSETS			
159,774	**316,223**	Cash and balances with Central Bank	B1	**121,746**	61,513
601,455	**871,140**	Due from banks and other money market lending	B2	**335,389**	231,560
2,648,192	**2,976,683**	Loans and advances-net	B3	**1,146,023**	1,019,554
222,491	**396,588**	Investment securities	B4	**152,686**	85,659
29,239	**31,655**	Property, equipment and fixtures	B5	**12,187**	11,257
7,532	**7,532**	Investment properties	B6	**2,900**	2,900
50,738	**42,169**	Other assets	B7	**16,235**	19,534
3,719,421	**4,641,990**			**1,787,166**	1,431,977
		LIABILITIES			
112,042	**581,943**	Due to banks and other money market borrowings	B8	**224,048**	43,136
3,042,694	**3,473,766**	Customers' deposits	B9	**1,337,400**	1,171,437
100,566	**80,099**	Other liabilities	B10	**30,838**	38,718
129,870	**129,870**	Subordinated loans	B11	**50,000**	50,000
3,385,172	**4,265,678**			**1,642,286**	1,303,291
		SHAREHOLDERS' EQUITY			
259,740	**259,740**	Share capital	B12	**100,000**	100,000
14,818	**20,795**	Legal reserve	B13	**8,006**	5,705
1,073	**1,073**	General reserve	B14	**413**	413
(5,283)	**(2,210)**	Fair value reserve	B15	**(851)**	(2,034)
-	**10,823**	Subordinated loans reserve	B11	**4,167**	-
63,901	**86,091**	Retained earnings		**33,145**	24,602
334,249	**376,312**			**144,880**	128,686
3,719,421	**4,641,990**			**1,787,166**	1,431,977
		Net assets per share (in baizas)	B16	**144.88**	128.69
33.43	**37.63**	**Net assets per share (in cents)**	B16		
477,039	**529,753**	**CONTINGENT LIABILITIES**	B17	**203,955**	183,660
721,242	**421,371**	**COMMITMENTS**	B17	**162,228**	277,678

The financial statements on pages 2 to 55 were approved and authorized for issue by the Board of Directors on .... and signed on their behalf by:

Chairman

Deputy Chairman

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STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2012

2011 USD'000	2012 USD'000		Notes	2012 RO'000	2011 RO'000
157,961	**187,644**	Interest income	C1	**72,243**	60,815
(67,683)	**(78,829)**	Interest expense	C2	**(30,349)**	(26,058)
90,278	**108,815**	**Net interest income**		**41,894**	34,757
21,894	**27,073**	Other operating income	C3	**10,423**	8,429
112,172	**135,888**	**OPERATING INCOME**		**52,317**	43,186
		OPERATING EXPENSES			
(36,592)	**(37,293)**	Staff costs		**(14,358)**	(14,088)
(18,888)	**(20,504)**	Other operating expenses	C4	**(7,894)**	(7,272)
(4,725)	**(3,691)**	Depreciation	B5	**(1,421)**	(1,819)
(60,205)	**(61,488)**			**(23,673)**	(23,179)
51,967	**74,400**	**OPERATING PROFIT**		**28,644**	20,007
(44)	**(44)**	Impairment on investments		**(17)**	(17)
(2,288)	**(3,510)**	Impairment allowance on portfolio basis	B3	**(1,351)**	(881)
(6,717)	**(3,532)**	Impairment allowance on specific basis	B3	**(1,360)**	(2,586)
42,918	**67,314**	**PROFIT BEFORE TAX**		**25,916**	16,523
(5,262)	**(7,545)**	**Income tax expense**	C5	**(2,905)**	(2,026)
37,656	**59,769**	**PROFIT FOR THE YEAR**		**23,011**	14,497
		Other comprehensive income			
(8,231)	**3,281**	Net changes in fair value of available for sale financial assets-net of income tax		**1,263**	(3,169)
(8,231)	**3,281**	**Other comprehensive income for the year, net of income tax**		**1,263**	(3,169)
29,425	**63,050**	**TOTAL COMPREHENSIVE INCOME FOR THE YEAR**		**24,274**	11,328
		Basic earnings per share - in baizas	C6	**23.01**	14.50
3.77	**5.98**	Basic earnings per share - in cents	C6		

The notes and other explanatory information on pages 7 to 55 form an integral part of these financial statements.

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STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2012

	Share capital RO'000	Legal reserve RO'000	General reserve RO'000	Fair value reserve RO'000	Subordinated loans reserve RO'000	Retained earnings RO'000	Total RO'000
Balance as at 1 January 2011	100,000	4,255	413	1,308	-	17,555	123,531
Total comprehensive income							
Profit for the year	-	-	-	-	-	14,497	14,497
Other comprehensive income							
Net change in fair value of available for sale investments - net of tax (note B4)	-	-	-	(3,169)	-	-	(3,169)
Release on sale of available for sale financial assets	-	-	-	(173)	-	-	(173)
Total comprehensive income	-	-	-	(3,342)	-	14,497	11,155
Dividends paid for the year 2010	-	-	-	-	-	(6,000)	(6,000)
Transfers	-	1,450	-	-	-	(1,450)	-
Balance as at 31 December 2011	100,000	5,705	413	(2,034)	-	24,602	128,686
Balance as at 1 January 2012	**100,000**	**5,705**	**413**	**(2,034)**	**-**	**24,602**	**128,686**
Total comprehensive income							
Profit for the year	**-**	**-**	**-**	**-**	**-**	**23,011**	**23,011**
Other comprehensive income							
Net change in fair value of available for sale investments - net of tax (note B4)	**-**	**-**	**-**	**1,263**	**-**	**-**	**1,263**
Release on sale of available for sale financial assets	**-**	**-**	**-**	**(80)**	**-**	**-**	**(80)**
Total comprehensive income	**-**	**-**	**-**	**1,183**	**-**	**23,011**	**24,194**
Dividends paid for the year 2011	**-**	**-**	**-**	**-**	**-**	**(8,000)**	**(8,000)**
Transfers	**-**	**2,301**	**-**	**-**	**4,167**	**(6,468)**	**-**
Balance as at 31 December 2012	**100,000**	**8,006**	**413**	**(851)**	**4,167**	**33,145**	**144,880**

The notes and other explanatory information on pages 7 to 55 form an integral part of these financial statements.

Report of the Auditors - page 1.

STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2012

	Share capital USD'000	Legal reserve USD'000	General reserve USD'000	Fair value reserve USD'000	Subordinated loans reserve USD'000	Retained earnings USD'000	Total USD'000
Balance as at 1 January 2011	259,740	11,052	1,073	3,397	-	45,597	320,859
Total comprehensive income							
Profit for the year	-	-	-	-	-	37,656	37,656
Other comprehensive income							
Net change in fair value of available for sale investments - net of tax (note B4)	-	-	-	(8,231)	-	-	(8,231)
Release on sale of available for sale financial assets	-	-	-	(449)	-	-	(449)
Total comprehensive income	-	-	-	(8,680)	-	37,656	28,976
Dividends paid for the year 2010	-	-	-	-	-	(15,586)	(15,586)
Transfers	-	3,766	-	-	-	(3,766)	-
Balance as at 31 December 2011	259,740	14,818	1,073	(5,283)	-	63,901	334,249
Balance as at 1 January 2012	**259,740**	**14,818**	**1,073**	**(5,283)**	**-**	**63,901**	**334,249**
Total comprehensive income							
Profit for the year	**-**	**-**	**-**	**-**	**-**	**59,769**	**59,769**
Other comprehensive income							
Net change in fair value of available for sale investments - net of tax (note B4)	**-**	**-**	**-**	**3,281**	**-**	**-**	**3,281**
Release on sale of available for sale financial assets	**-**	**-**	**-**	**(208)**	**-**	**-**	**(208)**
Total comprehensive income	**-**	**-**	**-**	**3,073**	**-**	**59,769**	**62,842**
Dividends paid for the year 2011	**-**	**-**	**-**	**-**	**-**	**(20,779)**	**(20,779)**
Transfers	**-**	**5,977**	**-**	**-**	**10,823**	**(16,800)**	**-**
Balance as at 31 December 2012	**259,740**	**20,795**	**1,073**	**(2,210)**	**10,823**	**86,091**	**376,312**

The notes and other explanatory information on pages 7 to 55 form an integral part of these financial statements.

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STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2012

2011 USD'000	2012 USD'000		2012 RO'000	2011 RO'000
		Operating activities		
42,918	**67,314**	Profit before tax	**25,916**	16,523
		Adjustments for:		
4,725	**3,691**	Depreciation	**1,421**	1,819
9,049	**7,086**	Impairment for credit losses and investment	**2,728**	3,484
(488)	**(1,091)**	Gain on sale of investment securities	**(420)**	(188)
-	**(122)**	Gain on sale of property, equipment and fixtures	**(47)**	-
(2,205)	**(7,042)**	Interest on investment	**(2,711)**	(849)
53,999	**69,836**	**Operating profit before changes in working capital**	**26,887**	20,789
(311,657)	**(335,530)**	Loans and advances	**(129,179)**	(119,988)
(24,083)	**8,338**	Other assets	**3,210**	(9,272)
(18,281)	**-**	Certificates of deposit	**-**	(7,038)
447,535	**431,075**	Customers' deposits	**165,963**	172,301
(7,093)	**87,000**	Due to banks and other money market borrowings	**33,495**	(2,731)
(159,675)	**(272,034)**	Due from banks and other money market lendings	**(104,733)**	(61,475)
29,223	**(23,455)**	Other liabilities	**(9,030)**	11,251
9,967	**(34,770)**	**Cash (used in) / from operating activities**	**(13,387)**	3,837
(3,423)	**(4,779)**	**Income tax paid**	**(1,840)**	(1,318)
6,544	**(39,549)**	**Net cash (used in) / from operating activities**	**(15,227)**	2,519
		Investing activities		
(38,304)	**(32,248)**	Purchase of investments	**(12,414)**	(14,747)
4,057	**18,743**	Proceeds from sale/redemption of investments	**7,216**	1,562
(5,748)	**(6,109)**	Purchase of property, equipment and fixtures	**(2,352)**	(2,213)
2,205	**7,042**	Interest received on investments	**2,711**	849
8	**125**	Proceeds from sale of property, equipment and fixtures	**48**	3
(37,782)	**(12,447)**	**Net cash used in investing activities**	**(4,791)**	(14,546)
		Financing activities		
(15,586)	**(20,779)**	Dividend paid	**(8,000)**	(6,000)
(15,586)	**(20,779)**	**Net cash used in financing activities**	**(8,000)**	(6,000)
(46,823)	**(72,775)**	**Net change in cash and cash equivalents**	**(28,018)**	(18,027)
444,969	**398,146**	**Cash and cash equivalents at beginning of the year**	**153,286**	171,313
398,146	**325,371**	**Cash and cash equivalents at the end of the year**	**125,268**	153,286
		Representing:		
159,774	**316,223**	Cash and balances with Central Bank	**121,746**	61,513
160,481	**158,132**	Due from banks and other money market lendings	**60,881**	61,785
163,961	**319,982**	Investment securities	**123,193**	63,125
(86,070)	**(468,966)**	Due to banks and other money market borrowings	**(180,552)**	(33,137)
398,146	**325,371**		**125,268**	153,286

The notes and other explanatory information on pages 7 to 55 form an integral part of these financial statements.

Report of the Auditors - page 1.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012

A1 Legal status and principal activities

Bank Sohar SAOG ("the Bank") was established in the Sultanate of Oman on 4 March 2007 as a joint stock company and is primarily engaged in commercial and investment banking activities through a network of twenty five branches within the Sultanate of Oman. The Bank operates under a banking licence issued by the Central Bank of Oman and is covered by its deposit insurance scheme. The Bank started commercial operations from 9 April 2007. The registered address of the Bank is PO Box 44, Hai Al Mina, Postal Code 114, Muscat, Sultanate of Oman. The Bank has its primary listing on the Muscat Securities Market.

The Bank employed 573 employees as of 31 December 2012 (31 December 2011: 549).

A2 Basis of preparation

A2.1 Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"), requirements of the Oman Commercial Companies Law of 1974, as amended and the disclosure requirements of the Capital Market Authority and the applicable regulations of the Central Bank of Oman.

A2.2 Basis of measurement

The financial statements have been prepared under the historical cost convention except for derivative financial instruments and available for sale financial assets which have been measured at fair value.

A2.3 Functional and presentation currency

These financial statements are presented in Rial Omani, which is the Bank's functional currency and also in US Dollars, for the convenience of the readers. The US Dollar amounts, which are presented in these financial statements have been translated from the Rial Omani amounts at an exchange rate of US Dollar 1 = RO 0.385. All financial information presented in Rial Omani and US Dollars has been rounded to the nearest thousands.

A2.4 Use of estimates and judgements

The preparation of financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that effect the application of accounting policies and reported amounts of assets and liabilities, income and expenses. Actual results may differ from these estimates.

The estimates and associated assumptions are based on industry data and various other factors that are believed by the Bank to be reasonable under the circumstances, the results of which form the basis of making the judgments about carrying values of assets and liabilities that are not readily apparent from other sources.

The estimates and underlying assumptions are reviewed on a regular basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods. Estimates considered by the Bank to have a significant risk of material adjustment in subsequent periods are discussed in note A4.

A2.5 Standards, amendments and interpretations effective in 2012 and relevant for the Bank's operations

For the year ended 31 December 2012, the Bank has adopted all of the new and revised standards and interpretations issued by the International Accounting Standards Board (IASB) and the International Financial Reporting Interpretations Committee (IFRIC) of the IASB that are relevant to its operations and effective for periods beginning on 1 January 2012.

The adoption of those standards and interpretations has not resulted in changes to the Bank's accounting policies and has not affected the amounts reported for the current period.

A2 Basis of preparation (continued)

A2.6 Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Bank:

The following standards, amendments and interpretations to existing standards have been published and are mandatory for the Bank's accounting periods beginning on or after 1 January 2013 or later periods, but the Bank has not early adopted them and the impact of these standards and interpretations is not reasonably estimable as at 31 December 2012:

IAS 1 (Amendments), 'Presentation of financial statements', (effective on or after 1 January 2013);
IAS 19 (Amendments), 'Employee benefits', (effective on or after 1 January 2013);
IFRS 9, 'Financial instruments', (effective on or after 1 January 2015);
IFRS 10, 'Consolidated financial statements' (effective on or after 1 January 2013);
IFRS 12, 'Disclosures of interests in other entities' (effective on or after 1 January 2013); and
IFRS 13, 'Fair value measurement' (effective on or after 1 January 2013).

A3 Significant accounting policies

The accounting policies set out below have been applied consistently by the Bank to all periods presented in these financial statements, unless otherwise stated.

A3.1 Foreign currency translation

Transactions in foreign currencies are translated into functional currency at the spot exchange rate at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated into the functional currency at the spot exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the period, adjusted for the effective interest and payments during the period, and the amortised cost in the foreign currency translated at the spot exchange rate at the end of the period. The non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated into the functional currency at the spot exchange rate at the date the fair value was determined. Foreign currency differences arising on retranslation are recognized in the statement of comprehensive income, except for non-monetary financial assets, such as equities classified as available-for-sale, which are included in other comprehensive income. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.

A3.2 Revenue and expense recognition

A3.2.a Interest income and expense

Interest income and expense is recognised in the statement of comprehensive income using the effective interest method. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or liability. The effective interest rate is established on initial recognition of the financial asset/liability and is not revised subsequently. Interest income and expense presented in the statement of comprehensive income include:

- Interest on financial assets and liabilities at amortised cost on an effective interest rate basis;
- Interest on available for sale investment securities on an effective interest rate basis; and
- Fair value changes in qualifying derivatives (including hedge ineffectiveness) and related hedged items when interest rate risk is the hedged risk.

Interest income which is doubtful of recovery is included in impairment allowance and excluded from income until it is received in cash.

A3.2.b Fair value gains and losses

Fair value changes on derivatives held for risk management purposes and available for sale financial assets are presented in the statement of other comprehensive income.

A3 Significant accounting policies (continued)

A3.2.b Fair value gains and losses (continued)

Net income from financial assets at fair value through profit or loss, including all realised and unrealised fair value changes, interest, dividend and foreign exchange differences are presented in the income statement.

A3.2.c Dividend income

Dividend income is recognized when the right to receive dividend is established.

A3.2.d Fees and commission

Fees and commission income and expenses that are integral to the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate.

Other fees and commission income include account servicing fees, credit related fees, advisory fees, administration fees and other management fees, sales commission, placement fees and syndication fees. These are recognised as the related services are performed.

A3.2.e Provisions

A provision is recognised if, as a result of a past event, the Bank has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are equivalent to the amortised value of the future liabilities which is determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risk specific to the liability.

A3.2.f Offsetting of income and expense

Income and expenses are presented on a net basis only when permitted by the IFRS, or for gains and losses arising from a group of similar transactions such as in the Bank's trading activity.

A3.3 Financial assets and liabilities

A3.3.a Classification

The Bank classifies its financial assets in the following categories: at fair value through profit or loss, loans and receivables, held to maturity and available-for-sale. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition.

Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss are financial assets held for trading. A financial asset is classified in this category if acquired principally for the purpose of selling in the short-term. Derivatives are also categorised as held for trading unless they are designated as hedging instruments.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and the Bank does not intend to sell immediately or in the near term.

Loans and receivables are initially recognised at fair value which is the cash consideration to originate or purchase the loan including any transaction costs - and measured subsequently at amortised cost using the effective interest method less specifically identified and collective allowance for impairment and recognised in the statement of comprehensive income as 'impairment allowance'. Specific provisions are made against the carrying amount of loans and receivables that are identified as being impaired based on regular reviews of outstanding balances to reduce the impaired loans and receivables to their recoverable amounts. Loans and receivables are reported in the statement of financial position as loans and advances to banks or customers. Interest on loans is included in the statement of comprehensive income and is reported as 'interest income'.

A3 Significant accounting policies (continued)

A3.3 Financial assets and liabilities (continued)

A3.3.a Classification (continued)

Held to maturity financial assets

Held to maturity financial assets are non-derivative assets with fixed or determinable payments and fixed maturity that the Bank has the positive intent and ability to hold to maturity and which are not designated at fair value through profit or loss or available-for-sale.

These are initially recognised at fair value including direct and incremental transaction costs and measured subsequently at amortised cost, using the effective interest method.

Interest on held to maturity investments is included in the statement of comprehensive income and reported as ‘interest income’. In the case of impairment, the impairment loss is been reported as a deduction from the carrying value of the investment and recognised in the statement of comprehensive income as ‘impairment on investments’. Held to maturity investments include corporate bonds and other debt securities.

Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories.

Available-for-sale investments are financial assets that are intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices or that are not classified as loans and receivables, held to maturity investments or financial assets at fair value through profit or loss.

Available-for-sale financial assets are initially recognised at fair value, which is the cash consideration including any transaction costs, and measured subsequently at fair value with gains and losses being recognised in the statement of other comprehensive income, except for impairment losses and foreign exchange gains and losses, until the financial asset is derecognised. If an available-for-sale financial asset is determined to be impaired, the cumulative gain or loss previously recognised in the statement of other comprehensive income is recognised in the statement of comprehensive income. However, interest is calculated using the effective interest method, and foreign currency gains and losses on monetary assets classified as available for sale are recognised in the statement of comprehensive income. Dividends on available-for-sale equity instruments are recognised in the statement of comprehensive income in ‘other operating income’ when the Bank’s right to receive payment is established.

A3.3.b Recognition

The Bank initially recognises loans and advances, deposits, debt securities issued and subordinated liabilities on the date that they are originated. All other financial assets and liabilities are initially recognised on the trade date at which the Bank becomes a party to the contractual provisions of the instrument.

A3.3.c Derecognition

The Bank derecognises a financial asset when the contractual rights to receive the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. The Bank derecognises a financial liability when its contractual obligations are discharged or cancelled or expired.

A3.3.d Offsetting of financial assets and financial liabilities

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Bank has a legal right to set off the amounts and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

A3 Significant accounting policies (continued)

A3.3 Financial assets and liabilities (continued)

A3.3.e Amortised cost measurement

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortisation using effective interest method of any difference between the initial amount recognised and the maturity amount, minus any reduction for impairment.

A3.3.f Fair value measurement

A number of the Bank's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on a number of accounting policies and methods. Where applicable, information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

For investments where there is no quoted market price, a reasonable estimate of the fair value is determined by reference to the current market value of a similar investment, or is based on the expected discounted cash flows. Investments having short term maturities are not discounted.

The fair value of loans and advances is estimated at the present value of future cash flows, discounted at the market rate of interest at the reporting date.

The fair value of forward exchange contracts is based on their quoted price, if available. If a quoted price is not available, then fair value is estimated by discounting the difference between the contractual forward price and the current forward price for the residual maturity of the contract using a risk-free interest rate (based on government bonds). The fair value of interest rate swaps is based on broker quotes. Those quotes are tested for reasonableness by discounting estimated future cash flows based on the terms and maturity of each contract and using market interest rates for a similar instrument at the measurement date. Fair values reflect the credit risk of the instrument and include adjustments to take account of the credit risk of the Bank and counterparty when appropriate.

Fair value, which is determined for disclosure purposes, is calculated based on the present value of future principal and interest cash flows, discounted at the market rate of interest at the reporting date.

A3.3.g Identification and measurement of impairment of financial assets

(i) Assets carried at amortised cost

The Bank assesses at each reporting date whether there is objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is impaired and an impairment loss is incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a loss event) and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention of the Bank about the following loss events as well as considering the guidelines issued by the Central Bank of Oman:

- significant financial difficulty of the issuer or obligor;
- a breach of contract, such as a default or delinquency in interest or principal payments;
- the Bank granting to the borrower, for economic or legal reasons relating to the borrower's financial difficulty, a concession that the lender would not otherwise consider;
- it becoming probable that the borrower will enter bankruptcy or other financial reorganisation;
- the disappearance of an active market for that financial asset because of financial difficulties; or
- observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the Bank, including adverse changes in the payment status of borrowers in the group, or national or local economic conditions that correlate with defaults on the assets in the Bank.

A3 Significant accounting policies (continued)

A3.3 Financial assets and liabilities (continued)

A3.3.g Identification and measurement of impairment of financial assets (continued)

(i) Assets carried at amortised cost (continued)

The Bank first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss on loans and receivables or held-to-maturity investments carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. 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 comprehensive income. If a loan or held-to-maturity investment has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract.

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.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the group and historical loss experience for assets with credit risk characteristics similar to those in the group.

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

When a loan is uncollectible, it is written off against the related allowance for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the statement of comprehensive income.

(ii) Assets classified as available-for-sale

The Bank assesses at the end of each reporting period whether there is objective evidence that a financial asset or a group of financial assets is impaired. For debt securities, the Bank uses the criteria referred to in (i) above. In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is also evidence that the assets are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss - measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss - is removed from equity and recognised in the statement of comprehensive income. Impairment losses recognised in the statement of comprehensive income on equity instruments are not reversed through the statement of comprehensive income.

A3.3.h Cash and cash equivalents

Cash and cash equivalents consist of cash in hand, unrestricted balances held with central banks and highly liquid financial assets with original maturities of upto three months, which are subject to insignificant risk of changes in their fair value, and are used by the Bank in management of its short term commitments. Cash and cash equivalents are carried at amortised cost in the statement of financial position.

A3 Significant accounting policies (continued)

A3.3 Financial assets and liabilities (continued)

A3.3.i Repurchase and resale agreements

Securities sold with a commitment to repurchase (repos) at a specified future date are recognised in the statement of financial position and are measured in accordance with accounting policies for trading securities or investment securities. The counterparty liability for amounts received under these agreements is included in 'due to banks and other money market borrowings'. The difference between sale and repurchase price is treated as interest expense and accrued over the life of the repo agreement.

Securities purchased with a corresponding commitment to resell at a specified future date (reverse repos) are not recognised in the statement of financial position and the amounts paid under these agreements are included in 'due from banks and other money market lendings'. The difference between purchase and resale price is treated as interest income and accrued over the life of the reverse repo agreement.

A3.3.j Acceptances

Acceptances are disclosed on the statement of financial position under other assets with corresponding liability disclosed under other liabilities. Therefore, there is no off-balance sheet commitment for acceptances.

A3.3.k Derivatives held for risk management purposes

Derivatives held for risk management purposes include all derivative assets and liabilities that are not classified as trading assets and liabilities. Derivatives held for risk management purposes are measured at fair value in the statement of financial position. The treatment of changes in their fair value depends on their classification into the following categories:

Fair value hedge

When a derivative is designated as a hedge of the change in fair value of a recognised asset or liability or a firm commitment, changes in the fair value of the derivative are recognised immediately in statement of comprehensive income together with changes in the fair value of the hedged item that are attributable to the hedged risk.

If the derivative expires or is sold, terminated, or exercised, no longer meets the criteria for fair value hedge accounting, or the designation is revoked, hedge accounting is discontinued. Any adjustment up to that point, to a hedged item for which the effective interest method is used, is amortised to profit or loss as part of the recalculated effective interest rate of the item over its remaining life.

Cash flow hedge

When a derivative is designated as the hedging instrument in a hedge of the variability in cash flows attributable to a particular risk associated with a recognised asset or a liability or a highly probable forecast transaction that could affect profit or loss, the effective portion of changes in the fair value of the derivative is recognised in other comprehensive income in hedging reserve. The amount recognised in other comprehensive income is reclassified to comprehensive income as a reclassification adjustment in the same period as the hedged cash flows affect profit or loss, and in the same line item in the statement of comprehensive income. Any ineffective portion of changes in the fair value of the derivative is recognised immediately in statement of comprehensive income.

If the hedging derivative expires or is sold, terminated, or exercised, or the hedge no longer meets the criteria for cash flow hedge accounting, or the hedge designation is revoked, then the hedge accounting is discontinued prospectively. In a discontinued hedge of a forecast transaction the cumulative amount recognized in other comprehensive income from the period when the hedge was effective is reclassified from the equity to statement of comprehensive income as a reclassification adjustment when the forecast transaction occurs and affects profit or loss. If the forecast transaction is no longer expected to occur, then the balance in other comprehensive income is reclassified immediately to statement of comprehensive income as a reclassification adjustment.

Other non-trading derivative

When a derivative is not held for trading, and is not designated in a qualifying hedge relationship, all changes in its fair value are recognised immediately in statement of comprehensive income.

A3 Significant accounting policies (continued)

A3.4 Property, equipment and fixtures

Items of property, equipment and fixtures are measured at historical cost less accumulated depreciation and impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the asset. Depreciation is provided on a straight-line basis over the estimated useful lives of property, equipment and fixtures, except freehold land. The estimated useful lives for the current period are as follows:

	Years
Motor vehicles	5
Furniture and fixtures	6-7
Office equipment	6-7
Production software	10

The assets' residual values, useful lives and depreciation methods are reviewed and adjusted if appropriate at each reporting date. Based on the recent estimation, the Bank has changed the useful life of furniture and fixtures to 6-7 years and production software to 10 years. The change of estimated useful live is accounted for as a change in estimate by adjusting the depreciation charge for the current year as the change affects the current year and by adjusting the charge for future years to the extent that it affects the future years.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount and are recognised within 'other operating income' in the statement of comprehensive income.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the group and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognised. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

A3.5 Investment properties

Investment properties comprise plots of land held for a currently undetermined business use and not occupied by the Bank. Investment properties are carried at cost, less impairment. Any required impairment charge is recorded in the statement of comprehensive income.

A3.6 Deposits, debt securities issued and subordinated liabilities

All money market and customer deposits are initially measured at fair value plus transaction cost and subsequently carried at amortised cost. Deposits, debt securities issued and subordinated liabilities are measured at their amortized cost using the effective interest method. The Bank classifies capital instruments as financial liabilities or equity instruments in accordance with the substance of the contractual terms of the instrument.

A3.7 Taxation

Taxation is provided in accordance with Omani fiscal regulations. Income tax comprises current and deferred tax. Income tax expense is recognised in the statement of comprehensive income except to the extent that it relates to items recognised directly in equity or other comprehensive income.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

A3 Significant accounting policies (continued)

A3.7 Taxation (continued)

Deferred tax assets/liabilities are calculated using the liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is measured at the tax rates that are expected to be applied to the temporary difference when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

A3.8 Fiduciary assets

Assets held in trust or in a fiduciary capacity are not treated as assets of the Bank and accordingly are not included in these financial statements.

A3.9 Trade and settlement date accounting

All “regular way” purchases and sales of financial assets are recognised on the trade date, i.e. the date that the entity commits to purchase or sell the asset. Regular way purchase 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.

A3.10 Leases

Operating lease payments are recognised as an expense in the statement of comprehensive income on a straight-line basis over the lease term.

A3.11 Financial guarantees

Financial guarantees are contracts that require the Bank to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment, when due in accordance with the terms of a debt instrument.
Financial guarantee liabilities are initially recognised at their fair value, and the initial fair value is amortised over the life of the financial guarantee. The guarantee liability is subsequently carried at the higher of this amortised amount and the present value of any expected payment (when a payment under the guarantee has become probable). The unamortized value or present value of the expected payment arising from the financial guarantee as the case may be is included in the other liabilities.

A3.12 Employee benefits

A3.12.a Terminal benefits

End of service benefits are accrued in accordance with the terms of employment of the Bank's employees at the reporting date, having regard to the requirements of the Oman Labour Law 2003, as amended.

Contributions to a defined contribution retirement plan and occupational hazard insurance for Omani employees in accordance with the Omani Social Insurances Law of 1991 are recognised as an expense in the statement of comprehensive income as incurred.

A3.12.b Short term benefits

Short term benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided.

A provision is recognised for the amount expected to be paid if the Bank has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

A3 Significant accounting policies (continued)

A3.13 Earnings per share

The Bank presents basic and diluted earnings per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Bank by the weighted average number of ordinary shares outstanding during the year. Annualised EPS is calculated by annualizing the basic EPS for the whole year. Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders and weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, which comprise convertible notes or similar instruments.

A3.14 Corresponding figures

The corresponding figures included for comparative purposes have been reclassified to conform to the presentation in the current year.

A3.15 Segment reporting

An operating segment is the component of the Bank that engages in business activities from which it may earn revenues and incur expenses, including revenue and expenses that relate to transaction with any of the Bank's other components, whose operating results are reviewed regularly by the Bank's CEO (being the chief operating decision maker) to make decisions about resources allocated to each segment and assess its performance, and for which discrete financial information is available.

A4 Critical accounting estimates and judgements

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and reported amounts of assets, liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. The resulting accounting estimates will, by definition, seldom equal the related actual results.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods. The Bank's significant accounting estimates are on:

A4.1 Impairment losses on loans and advances

The Bank reviews its loan portfolios to assess impairment on a monthly basis. In determining whether an impairment loss should be recorded in the statement of comprehensive income, the Bank makes judgements as to whether there is any observable data indicating an impairment followed by measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified within that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers and or national or local economic conditions that correlate with defaults on assets. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed periodically to reduce any difference between loss estimates and actual loss experience. For individually significant loans and advances which are impaired, the necessary impairment loss is considered based on the future cash flow estimates. Individually significant loans and advances which are not impaired and all individually insignificant loans and advances are then assessed collectively considering historical experience and observable data on a portfolio basis, in group of assets with similar risk characteristics to determine whether collective impairment loss to be made. In determining collective impairment loss, the Bank takes into account several factors including credit quality, concentration risk, levels of past due, sector performance, available collateral and macro economic conditions.

A4 Critical accounting estimates and judgements (continued)

A4.2 Fair value of derivatives and other financial instruments

The fair value of financial instruments that are not traded in an active market (for example, over-the-counter derivatives) is determined by using valuation techniques. The Bank uses its judgement to select a variety of methods and makes assumptions that are mainly based on market conditions existing at the end of each reporting period. The Bank uses expected cash flow analysis for various available-for-sale financial assets that are not traded in active markets.

A4.3 Impairment of available-for-sale equity investments

The Bank determines that available-for-sale equity investments are impaired when there has been a significant or prolonged decline in the fair value below its cost or objective evidence of impairment exists. This determination of what is considered to be significant or prolonged requires judgement. In applying judgement, the Bank evaluates among other factors, the volatility in share price. Objective evidence of impairment may be due to deterioration in the financial health of the investee, industry and sector performance.

B1 Cash and balances with Central Bank

2011 USD'000	**2012 USD'000**		**2012 RO'000**	2011 RO'000
20,691	**28,506**	Cash	**10,975**	7,966
1,299	**1,299**	Capital deposit with Central Bank of Oman	**500**	500
137,784	**286,418**	Unrestricted balances with Central Bank	**110,271**	53,047
159,774	**316,223**		**121,746**	61,513

The capital deposit with the Central Bank of Oman cannot be withdrawn without its approval.

B2 Due from banks and other money market lending

2011 USD'000	**2012 USD'000**		**2012 RO'000**	2011 RO'000
		Local currency:		
38,961	**5,195**	Money market lending	**2,000**	15,000
38,961	**5,195**		**2,000**	15,000
		Foreign currency:		
535,974	**843,010**	Money market lending	**324,559**	206,350
26,520	**22,935**	Demand balances	**8,830**	10,210
562,494	**865,945**		**333,389**	216,560
601,455	**871,140**		**335,389**	231,560

B3 Loans and advances - net

2011 USD'000	2012 USD'000		2012 RO'000	2011 RO'000
78,190	**99,177**	Loans to banks	**38,183**	30,103
1,669,805	**1,946,743**	Corporate loans	**749,496**	642,875
955,711	**996,403**	Personal loans	**383,615**	367,949
2,703,706	**3,042,323**	Loans and advances - gross	**1,171,294**	1,040,927
(35,218)	**(38,728)**	Impairment allowance on portfolio basis	**(14,910)**	(13,559)
(20,296)	**(26,912)**	Impairment allowance on specific basis (including reserved interest)	**(10,361)**	(7,814)
2,648,192	**2,976,683**	Loans and advances - net	**1,146,023**	1,019,554

Personal loans include RO 16,560,954 provided to staff on concessional terms (2011 - RO 16,190,703).

Loans and advances comprise:

2011 USD'000	2012 USD'000		2012 RO'000	2011 RO'000
2,456,537	**2,794,756**	Loans	**1,075,981**	945,767
164,216	**138,442**	Overdrafts	**53,300**	63,223
55,434	**83,808**	Loan against trust receipts	**32,266**	21,342
27,519	**25,317**	Bills discounted	**9,747**	10,595
2,703,706	**3,042,323**	Loans and advances - gross	**1,171,294**	1,040,927
(35,218)	**(38,728)**	Impairment allowance on portfolio basis	**(14,910)**	(13,559)
(20,296)	**(26,912)**	Impairment allowance on specific basis (including reserve interest)	**(10,361)**	(7,814)
2,648,192	**2,976,683**	Loans and advances - net	**1,146,023**	1,019,554

As per the CBO requirements, the movement in the impairment allowance is analysed as below:

2011 USD'000	2012 USD'000		2012 RO'000	2011 RO'000
		Impairment allowance on portfolio basis		
32,930	**35,218**	Balance at beginning of year	**13,559**	12,678
2,288	**3,510**	Provided during the year	**1,351**	881
35,218	**38,728**	Balance at the end of the year	**14,910**	13,559
		Impairment allowance on specific basis		
		Loan loss provision		
9,943	**16,660**	Balance at beginning of year	**6,414**	3,828
12,940	**8,538**	Provided during the year	**3,287**	4,982
(6,223)	**(5,005)**	Write back during the year	**(1,927)**	(2,396)
16,660	**20,193**	Balance at the end of the year	**7,774**	6,414
		Reserved interest		
1,558	**3,636**	Balance at beginning of year	**1,400**	600
2,878	**3,803**	Reserved during the year	**1,464**	1,108
(800)	**(719)**	Interest released during the year	**(277)**	(308)
3,636	**6,720**	**Balance at end of the year**	**2,587**	1,400
20,296	**26,912**		**10,361**	7,814

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FOR THE YEAR ENDED 31 DECEMBER 2012 (continued)

B3 Loans and advances - net (continued)

Impairment allowance on portfolio basis is established to meet the credit risks inherent within the loans and advances on a portfolio basis.

All loans and advances require payment of interest, some at fixed rates and others at rates that reprice prior to maturity. Interest reserve account is maintained by the Bank to comply with rules, regulations and guidelines issued by CBO against loans and advances which are impaired. As of 31 December 2012, loans and advances on which interest is not being accrued or where interest has been reserved amounted to RO 18,280,354 (2011 - RO 15,998,677).

The table below analyses the concentration of gross loans and advances by economic sector:

2011 USD'000	**2012 USD'000**		**2012 RO'000**	2011 RO'000
955,712	**996,403**	Personal	**383,615**	367,949
487,701	**522,395**	Construction	**201,122**	187,765
353,099	**461,813**	Whole sale and Retail Trade	**177,798**	135,943
305,922	**333,647**	Services	**128,454**	117,780
140,784	**269,016**	Financial institutions	**103,571**	54,202
134,265	**122,522**	Transport and Communication	**47,171**	51,692
95,229	**122,226**	Manufacturing	**47,057**	36,663
85,751	**80,088**	International trade	**30,834**	33,014
53,725	**52,416**	Mining and quarrying	**20,180**	20,684
52,234	**50,964**	Electricity and Gas and water	**19,621**	20,110
34,608	**29,488**	Non-resident	**11,353**	13,324
2,597	**1,000**	Agriculture and allied activities	**385**	1,000
1,153	**249**	Government	**96**	444
926	**96**	Other	**37**	357
2,703,706	**3,042,323**		**1,171,294**	1,040,927

B4 Investment securities

2011 USD'000	**2012 USD'000**		**2012 RO'000**	2011 RO'000
205,504	**379,601**	Available for sale	**146,146**	79,119
16,987	**16,987**	Held to maturity	**6,540**	6,540
222,491	**396,588**		**152,686**	85,659

Available for sale investments comprise:

	Carrying/ fair value 2012 RO'000	**Cost 2012 RO'000**	Carrying/ fair value 2011 RO'000	Cost 2011 RO'000
Unquoted securities	**1,629**	**2,019**	6,040	7,774
Quoted securities	**21,324**	**21,851**	9,954	10,460
Treasury bills	**123,193**	**123,179**	63,125	63,113
	146,146	**147,049**	79,119	81,347

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012 (continued)

B4 Investment securities (continued)

	Carrying/ fair value 2012 USD'000	Cost 2012 USD'000	Carrying/ fair value 2011 USD'000	Cost 2011 USD'000
Unquoted securities	4,231	5,244	15,688	20,192
Quoted securities	55,388	56,756	25,855	27,169
Treasury bills	319,982	319,945	163,961	163,930
	379,601	381,945	205,504	211,291

Held to maturity investments comprise:

2011 USD'000	2012 USD'000		2012 RO'000	2011 RO'000
4,000	4,000	Corporate bonds	1,540	1,540
12,987	12,987	Debt securities	5,000	5,000
16,987	16,987		6,540	6,540

B5 Property, equipment and fixtures

	Freehold land* RO'000	Production software RO'000	Furniture & fixtures RO'000	Office equipments RO'000	Motor vehicles RO'000	Capital work in progress RO'000	Total RO'000
Cost:							
At 1 January 2012	4,100	6,172	3,119	3,692	596	203	17,882
Additions	-	416	122	294	12	1,508	2,352
Disposals	-	-	-	-	(103)	-	(103)
At 31 December 2012	4,100	6,588	3,241	3,986	505	1,711	20,131
Accumulated depreciation:							
At 1 January 2012	-	(2,908)	(1,656)	(1,694)	(367)	-	(6,625)
Depreciation	-	(471)	(291)	(591)	(68)	-	(1,421)
Disposals	-	-	-	-	102	-	102
At 31 December 2012	-	(3,379)	(1,947)	(2,285)	(333)	-	(7,944)
Net book value:							
At 31 December 2012 (OMR)	4,100	3,209	1,294	1,701	172	1,711	12,187
At 31 December 2012 (USD'000)	10,649	8,335	3,361	4,418	447	4,445	31,655

B5 Property, equipment and fixtures (continued)

	Freehold land* RO'000	Production software RO'000	Furniture & fixtures RO'000	Office equipments RO'000	Motor vehicles RO'000	Capital work in progress RO'000	Total RO'000
Cost:							
At 1 January 2011	4,100	5,684	2,229	3,109	525	25	15,672
Additions	-	488	891	586	71	178	2,214
Disposals	-	-	(1)	(3)	-	-	(4)
At 31 December 2011	4,100	6,172	3,119	3,692	596	203	17,882
Accumulated depreciation:							
At 1 January 2011	-	(2,003)	(1,321)	(1,173)	(310)	-	(4,807)
Depreciation	-	(905)	(335)	(522)	(57)	-	(1,819)
Disposals	-	-	-	1	-	-	1
At 31 December 2011	-	(2,908)	(1,656)	(1,694)	(367)	-	(6,625)
Net book value:							
At 31 December 2011	4,100	3,264	1,463	1,998	229	203	11,257
At 31 December 2011 (USD'000)	10,649	8,478	3,800	5,190	595	527	29,239

*Freehold land represents a plot of land received by the Bank as grant from the Government of Sultanate of Oman during the year 2008. The Bank has recorded the land based on the average valuation of the two professional valuators carried out during 2008. The plot of land is being used for the construction of new Head Office.

B6 Investment properties

Investment properties represent two plots of land received by the Bank as grant from the Government of Sultanate of Oman during the year 2008. The Bank has recorded the land based on the average valuation of the two professional valuators carried out during 2008. The plots of land are currently held vacant. The fair value of these properties as at 31 December is RO 1.160 million.

B7 Other assets

2011 USD'000	**2012 USD'000**		**2012 RO'000**	2011 RO'000
6,868	**16,753**	Interest receivable	**6,450**	2,644
34,553	**12,174**	Acceptances	**4,687**	13,303
3,644	**1,060**	Prepayments and deposits	**408**	1,403
231	**-**	Deferred tax asset (note C5)	**-**	89
5,442	**12,182**	Other	**4,690**	2,095
50,738	**42,169**		**16,235**	19,534

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FOR THE YEAR ENDED 31 DECEMBER 2012 (continued)

B8 Due to banks and other money market borrowings

2011 USD'000	**2012 USD'000**		**2012 RO'000**	2011 RO'000
		Local currency:		
-	**116,000**	Money market borrowings	**44,660**	-
725	**556**	Demand balances	**214**	279
725	**116,556**		**44,874**	279
		Foreign currency:		
111,317	**465,332**	Money market borrowings	**179,153**	42,857
-	**55**	Demand balances	**21**	-
111,317	**465,387**		**179,174**	42,857
112,042	**581,943**		**224,048**	43,136

B9 Customers' deposits

2011 USD'000	**2012 USD'000**		**2012 RO'000**	2011 RO'000
2,014,514	**2,135,231**	Term deposits	**822,064**	775,588
611,904	**835,127**	Demand deposits	**321,524**	235,583
411,517	**498,226**	Saving deposits	**191,817**	158,434
4,759	**5,182**	Margin accounts	**1,995**	1,832
3,042,694	**3,473,766**		**1,337,400**	1,171,437
		Retail customers:		
411,517	**498,226**	Saving deposits	**191,817**	158,434
57,681	**40,439**	Term deposits	**15,569**	22,207
23,395	**36,621**	Demand deposits	**14,099**	9,007
		Corporate customers:		
1,956,834	**2,094,789**	Term deposits	**806,494**	753,381
588,509	**798,509**	Demand deposits	**307,426**	226,576
4,758	**5,182**	Other	**1,995**	1,832
3,042,694	**3,473,766**		**1,337,400**	1,171,437

B10 Other liabilities

2011 USD'000	**2012 USD'000**		**2012 RO'000**	2011 RO'000
35,681	**31,992**	Interest payable	**12,317**	13,737
34,553	**12,174**	Acceptances	**4,687**	13,303
6,963	**7,657**	Staff entitlements	**2,948**	2,681
5,140	**7,782**	Income tax payable	**2,996**	1,979
-	**346**	Deferred tax liability (note C5)	**133**	-
18,229	**20,148**	Other accruals and provisions	**7,757**	7,018
100,566	**80,099**		**30,838**	38,718
		Staff entitlements:		
766	**1,049**	End of service benefits	**404**	295
6,197	**6,608**	Other liabilities	**2,544**	2,386
6,963	**7,657**		**2,948**	2,681
		Movement in the end of service benefits liability:		
579	**766**	At 1 January	**295**	223
390	**332**	Expenses recognized in the profit or loss	**128**	150
(203)	**(49)**	End of service benefits paid	**(19)**	(78)
766	**1,049**	At 31 December	**404**	295

B11 Subordinated loans

The Bank raised an unsecured subordinated loan of RO 50 million in 2011 with a maturity of 7 years. The instrument is unlisted, non-transferable, non-negotiable and non-convertible with no early call option. The instrument carries a fixed rate of interest of 6.5%. According to the Regulations of Central Bank of Oman, the subordinated loan is considered as Tier II capital for Capital Adequacy purposes. Principal amount of the subordinated loan is repayable on maturity while interest is payable semi-annually. The Bank is required to create a subordinated loan reserve equal to 20% of the issue value annually from August 2012 up till the maturity of the subordinated loans. This reserve is created from retained earnings. Accordingly, during the year a reserve of RO 4,166,667 is created (2011 - RO nil).

B12 Share capital

The authorised share capital of the bank is 2,000,000,000 shares of RO 0.100 each (2011 - 1,000,000,000 of RO 0.100 each). The issued and paid up share capital of the Bank is 1,000,000,000 shares of RO 0.100 each (2011 - 1,000,000,000 shares of RO 0.100 each).

On 13 August 2012, the shareholders in their meetings approved a right issue of share of RO 10,000,000 (2011 – nil).

As of 31 December 2012, the following shareholders held 10% or more of the Bank's capital, either individually or together with family members:

	Number of shares	*% Holding*
The Royal Court of Affairs	**145,690,340**	**14.57%**
Oman Investment & Finance Company SAOG	**134,527,675**	**13.45%**

B13 Legal reserve

In accordance with the Commercial Companies Law of Oman of 1974, an annual appropriation of 10% of the net profit for the year is required to be made to legal reserve until such time that the accumulated reserve is equal to at least one third of the Bank's issued share capital.

B14 General Reserve

The Board of Directors had decided to create a non distributable general reserve with the amount of RO 412,500 during the year 2010.

B15 Fair value reserve

The fair value reserve includes the cumulative net change in the fair value of the available-for-sale investments net of applicable income tax until the investment is derecognised or impaired.

B16 Net assets per share

The calculation of net assets per share is based on net assets of RO 144,880,000 as at 31 December 2012 (2011 - RO 128,686,000) attributable to ordinary shareholders on 1,000,000,000 ordinary shares, being the number of shares outstanding as at 31 December 2012.

B17 Contingent liabilities and commitments

B17.1 Contingent liabilities

Standby letters of credit and guarantees commit the Bank to make payments on behalf of customers contingent upon the failure of the customer to perform under the terms of the contract.

2011 USD'000	**2012 USD'000**		**2012 RO'000**	2011 RO'000
321,218	**426,553**	Guarantees	**164,223**	123,669
155,821	**103,200**	Documentary letters of credit	**39,732**	59,991
477,039	**529,753**		**203,955**	183,660

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012 (continued)

B17 Contingent liabilities and commitments (continued)

B17.1 Contingent liabilities (continued)

The table below analyses the concentration of contingent liabilities by economic sector:

2011 USD'000	2012 USD'000		2012 RO'000	2011 RO'000
121,351	**221,953**	Construction	**85,452**	46,720
98,584	**134,530**	Financial institution	**51,794**	37,955
59,122	**74,205**	International trade	**28,569**	22,762
74,566	**39,039**	Services	**15,030**	28,708
23,530	**20,451**	Manufacturing	**7,874**	9,059
81,478	**18,104**	Government	**6,970**	31,369
4,870	**6,294**	Transport and communication	**2,423**	1,875
13,538	**15,177**	Others	**5,843**	5,212
477,039	**529,753**		**203,955**	183,660

B17.2 Commitments

Contractual obligations including contracts for purchase and sale of foreign exchange are stated at fair value as commitments. Credit related commitments include commitments to extend credit, standby letters of credit and guarantees, which are designed to meet the requirements of the Bank's customers. Commitments to extend credit represent contractual commitments to make loans and revolving credits. Commitments generally have fixed expiry dates or other termination clauses and require the payment of a fee. Since commitments may expire without being drawn upon, the total contract amounts do not necessarily represent future cash obligations.

2011 USD'000	2012 USD'000		2012 RO'000	2011 RO'000
2,743	**3,135**	Capital commitments	**1,207**	1,056
718,499	**418,236**	Credit related commitments	**161,021**	276,622
721,242	**421,371**		**162,228**	277,678

B18 Related parties

In the ordinary course of business the Bank conducts transactions with certain of its directors, shareholders, senior management and companies in which they have a significant interest. These transactions are conducted on an arm's length basis and are approved by the Bank's management and Board of Directors.

No specific provision has been established in respect of the loans given to related parties.

The aggregate amount of balances and the income and expenses generated with such related parties are as follows:

2011 USD'000	2012 USD'000		2012 RO'000	2011 RO'000
219,127	**82,608**	Loans and advances (balance at end of year)	**31,804**	84,364
171,104	**1,085,075**	Loans disbursed during the year	**417,754**	65,875
(125,494)	**(1,079,294)**	Loans repaid during the year	**(415,528)**	(48,315)
222,696	**114,496**	Deposits (balance at end of year)	**44,081**	85,738
879,494	**523,273**	Deposits received during the year	**201,460**	338,605
(763,753)	**(499,031)**	Deposits paid during the year	**(192,127)**	(294,045)
5,608	**3,974**	Interest income (during the year)	**1,530**	2,159
(5,561)	**(1,694)**	Interest expense(during the year)	**(652)**	(2,141)
		Senior Management compensation		
8,065	**9,244**	Salaries and other short term benefits	**3,559**	3,105
506	**514**	**Directors' sitting fees and remuneration**	**198**	195

B19 Fair value of financial instruments

The Bank considers that the fair value of financial instruments is not significantly different to their carrying value at each of those dates. The table below sets out the classification of each class of financial assets and liabilities, and their fair values as at 31 December 2012:

At 31 December 2012	**Loans and receivables RO'000**	**Held to maturity RO'000**	**Available for sale RO'000**	**Total carrying/fair value RO'000**
Assets as per statement of financial position				
Cash and balances with Central Bank	**121,746**	**-**	**-**	**121,746**
Due from banks and other money market lendings	**335,389**	**-**	**-**	**335,389**
Loans and advances	**1,146,023**	**-**	**-**	**1,146,023**
Investment securities	**-**	**6,540**	**146,146**	**152,686**
Other assets (excluding prepayments)	**15,827**	**-**	**-**	**15,827**
Total	**1,618,985**	**6,540**	**146,146**	**1,771,671**

	Financial Liabilities Total carrying/fair value RO'000
Liabilities as per statement of financial position	
Due to banks and other money market borrowings	**224,048**
Customers' deposits	**1,337,400**
Other liabilities (excluding accruals)	**19,952**
Subordinated loans	**50,000**
Total	**1,631,400**

At 31 December 2011	Loans and receivables RO'000	Held to maturity RO'000	Available for sale RO'000	Total carrying/fair value RO'000
Assets as per statement of financial position				
Cash and balances with Central Bank	61,513	-	-	61,513
Due from banks and other money market lendings	231,560	-	-	231,560
Loans and advances	1,019,554	-	-	1,019,554
Investment securities	-	6,540	79,119	85,659
Other assets (excluding prepayments)	18,042	-	-	18,042
Total	1,330,669	6,540	79,119	1,416,328

	Financial Liabilities Total carrying/fair value RO 000
Liabilities as per statement of financial position	
Due to banks and other money market borrowings	43,136
Customers' deposits	1,171,437
Other liabilities (excluding accruals)	29,721
Subordinated loans	50,000
Total	1,294,294

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B19 Fair value of financial instruments (continued)

At 31 December 2012	**Loans and receivables USD'000**	**Held to maturity USD'000**	**Available for sale USD'000**	**Total carrying/fair value USD'000**
Assets as per statement of financial position				
Cash and balances with Central Bank	**316,223**	**-**	**-**	**316,223**
Due from banks and other money market lendings	**871,140**	**-**	**-**	**871,140**
Loans and advances	**2,976,683**	**-**	**-**	**2,976,683**
Investment securities	**-**	**16,987**	**379,601**	**396,588**
Other assets (excluding prepayments)	**41,107**	**-**	**-**	**41,107**
Total	**4,205,153**	**16,987**	**379,601**	**4,601,741**

	Financial Liabilities Total carrying/fair value USD'000
Liabilities as per statement of financial position	
Due to banks and other money market borrowings	**581,943**
Customers' deposits	**3,473,766**
Other liabilities (excluding accruals)	**51,823**
Subordinated loans	**129,870**
Total	**4,237,402**

At 31 December 2011	Loans and receivables USD'000	Held to maturity USD'000	Available for sale USD'000	Total carrying/fair value USD'000
Assets as per statement of financial position				
Cash and balances with Central Bank	159,774	-	-	159,774
Due from banks and other money market lendings	601,455	-	-	601,455
Loans and advances	2,648,192	-	-	2,648,192
Investment securities	-	16,987	205,504	222,491
Other assets (excluding prepayments)	46,863	-	-	46,863
Total	3,456,284	16,987	205,504	3,678,775

	Financial Liabilities Total carrying/fair value USD'000
Liabilities as per statement of financial position	
Due to banks and other money market borrowings	112,042
Customers' deposits	3,042,694
Other liabilities (excluding accruals)	77,197
Subordinated loans	129,870
Total	3,361,803

B19 Fair value of financial instruments (continued)

Estimation of fair values

The following summarises the major methods and assumptions used in estimating the fair values of assets and liabilities.

Loans and advances

Fair value is calculated based on discounted expected future principal and interest cash flows. Loan repayments are assumed to occur at contractual repayment dates, where applicable. For loans that do not have fixed repayment dates or that are subject to prepayment risk, repayments are estimated based on experience in previous periods when interest rates were at levels similar to current levels, adjusted for any differences in interest rate outlook. Expected future cash flows are estimated considering credit risk and any indication of impairment. Expected future cash flows for homogeneous categories of loans are estimated on a portfolio basis and discounted at current rates offered for similar loans to new borrowers with similar credit profiles. The estimated fair values of loans reflect changes in credit status since the loans were made and changes in interest rates in the case of fixed rate loans.

Investments carried at amortised cost and derivatives

Fair value is based on quoted market prices at the reporting date without any deduction for transaction costs. If a quoted market price is not available, fair value is estimated based on discounted cash flow and other valuation techniques.

Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate is a market related rate for a similar instrument at the reporting date.

Bank and customer deposits

For demand deposits and deposits with no defined maturities, fair value is taken to be the amount payable on demand at the reporting date. The estimated fair value of fixed-maturity deposits, including certificates of deposit, is based on discounted cash flows using rates currently offered for deposits of similar remaining maturities. The value of long-term relationships with depositors is not taken into account in estimating fair values.

Other on-balance sheet financial instruments

The fair values of all on-balance sheet financial instruments are considered to approximate their book values.

Off-balance sheet financial instruments

No fair value adjustment is made with respect to credit-related off-balance sheet financial instruments, which include commitments to extend credit, standby letters of credit and guarantees, as the related future income streams materially reflect contractual fees and commissions actually charged at the reporting date for agreements of similar credit standing and maturity.

Foreign exchange contracts are valued based on market prices. The market value adjustments in respect of foreign exchange contracts are included in the book values of other assets and other liabilities.

Valuation of financial instruments:

The Bank measures fair values using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements:

Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 - Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices).

Level 3 - Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs).

B19 Fair value of financial instruments (continued)

The table below analyses financial instruments measured at fair value at the end of the reporting period:

	31 December 2012			31 December 2011		
	Investment securities RO '000	Derivatives RO '000	Total RO '000	Investment securities RO '000	Derivatives RO '000	Total RO '000
Level 1	6,787	-	6,787	5,525	-	5,525
Level 2	139,359	(41)	139,318	73,594	59	73,653
Level 3	6,540	-	6,540	6,540	-	6,540
	152,686	(41)	152,645	85,659	59	85,718

	31 December 2012			31 December 2011		
	Investment securities USD '000	Derivatives USD '000	Total USD '000	Investment securities USD '000	Derivatives USD '000	Total USD '000
Level 1	17,630	-	17,630	14,351	-	14,351
Level 2	361,971	(107)	361,864	191,153	153	191,306
Level 3	16,987	-	16,987	16,987	-	16,987
	396,588	(107)	396,481	222,491	153	222,644

B20 Derivatives

In the ordinary course of business the Bank 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 instrument, reference rate or index. These derivatives are stated at fair value. The fair value of a derivative is the equivalent of the unrealised gain or loss from marking to market the derivative using prevailing market rates or internal pricing models. Unrealised gains or losses are included in the statement of comprehensive income. The derivative financial instruments used by the Bank are described below:

B20.1 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.

Swaps are contractual agreements between two parties to exchange interest or foreign currency differentials based on a specific notional amount. For interest rate swaps, counter parties 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, foreign currency or financial instrument at a fixed price, either at a fixed future date or at any time within a specified period.

B20.2 Derivatives held or issued for hedging purposes

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

The Bank uses forward foreign exchange contracts, to hedge against specifically identified currency risks. The Bank uses forward foreign exchange contracts to hedge against exposures in various currencies to meet the net open position limit as specified by Central Bank of Oman.

B20 Derivatives (continued)

B20.2 Derivatives held or issued for hedging purposes (continued)

For interest rate risk strategic hedging is carried out by monitoring the re-pricing of financial assets and liabilities and entering into interest rate swaps to hedge a proportion of the interest rate exposure. As strategic hedging does not qualify for special hedge accounting, the related derivatives are accounted for as trading instruments.

The table below shows the notional amounts of derivative financial instruments as on the reporting date, which are 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.

At 31 December 2012

		Notional amounts by term to maturity		
	Notional amount	**Within 3 months**	**3 - 12 months**	**1 - 5 years**
	RO'000	**RO'000**	**RO'000**	**RO'000**
Forward foreign exchange purchase contracts	**564,957**	**367,790**	**197,167**	**-**
Forward foreign exchange sales contracts	**565,398**	**368,054**	**197,344**	**-**
	USD'000	**USD'000**	**USD'000**	**USD'000**
Forward foreign exchange purchase contracts	**1,467,421**	**955,299**	**512,122**	**-**
Forward foreign exchange sales contracts	**1,468,566**	**955,984**	**512,582**	**-**

At 31 December 2011

		Notional amounts by term to maturity		
	Notional amount	Within 3 months	3 - 12 months	1 - 5 years
	RO'000	RO'000	RO'000	RO'000
Forward foreign exchange purchase contracts	381,474	330,125	51,349	-
Forward foreign exchange sales contracts	381,647	330,238	51,409	-
	USD'000	USD'000	USD'000	USD'000
Forward foreign exchange purchase contracts	990,842	857,468	133,374	-
Forward foreign exchange sales contracts	991,291	857,761	133,530	-

B21 Proposed dividend

For the year 2012, the Board of Directors have proposed a cash dividend of 3.5% of the share capital i.e. 3.5 baizas per share (2011 – 8% of the share capital and 8 baizas per share) and 6.5% of the share capital in the form of mandatory convertible bonds (2011 – nil) carrying an annual coupon rate of 4.5%. The proposed dividend is subject to formal approval of the shareholders at the Annual General Meeting.

The convertible bonds will be listed on the Muscat Securities Market. These bonds will be converted into ordinary shares of the bank in three equal installments at the end of 3rd, 4th and 5th years from their dates of issue at a conversion price derived by applying a discount of 20% to the 3 months average share price of the Bank on the Muscat Securities Market prior to the date of conversion.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012 (continued)

C1 Interest income

2011 USD'000	2012 USD'000		2012 RO'000	2011 RO'000
149,995	**158,927**	Loans and advances to customers	**61,187**	57,748
5,761	**21,675**	Due to banks and other money market lendings	**8,345**	2,218
2,205	**7,042**	Investment securities	**2,711**	849
157,961	**187,644**		**72,243**	60,815

C2 Interest expense

2011 USD'000	2012 USD'000		2012 RO'000	2011 RO'000
55,935	**64,582**	Customers' deposits	**24,864**	21,535
8,442	**8,465**	Subordinated loans	**3,259**	3,250
2,823	**5,782**	Due to banks and other money market borrowings	**2,226**	1,087
483	**-**	Certificates of deposits	**-**	186
67,683	**78,829**		**30,349**	26,058

C3 Other operating income

2011 USD'000	2012 USD'000		2012 RO'000	2011 RO'000
17,283	**18,275**	Fees and commission	**7,036**	6,654
2,255	**3,961**	Net gains from foreign exchange dealings	**1,525**	868
1,868	**1,414**	Dividend income	**544**	719
-	**122**	Profit on sale of fixed assets	**47**	-
-	**2,210**	Net realised gains from held for trading investment securities	**851**	-
488	**1,091**	Net realised gains from available for sale investment securities	**420**	188
21,894	**27,073**		**10,423**	8,429

C4 Other operating expenses

2011 USD'000	2012 USD'000		2012 RO'000	2011 RO'000
14,247	**15,338**	Operating and administration costs	**5,905**	5,485
4,135	**4,652**	Establishment costs	**1,791**	1,592
506	**514**	Directors' sitting fees	**198**	195
18,888	**20,504**		**7,894**	7,272

C5 Income tax

a) Recognised in the statement of comprehensive income

2011 USD'000	2012 USD'000		2012 RO'000	2011 RO'000
4,927	**7,421**	Current tax	**2,857**	1,897
335	**124**	Deferred tax expense	**48**	129
5,262	**7,545**	Total tax expenses	**2,905**	2,026

The Bank is liable to income tax for the year 2012 in accordance with the income tax laws of the Sultanate of Oman at the rate of 12% on taxable profits in excess of RO 30,000.

b) Reconciliation

2011 USD'000	2012 USD'000		2012 RO'000	2011 RO'000
42,918	**67,314**	Accounting profit for the year	**25,916**	16,523
5,151	**8,078**	Income tax	**3,110**	1,983
5	**5**	Non deductible expenses	**2**	2
(229)	**(662)**	Tax exempt income	**(255)**	(88)
335	**124**	Current year deferred tax	**48**	129
5,262	**7,545**	Income tax expense	**2,905**	2,026

c) Deferred tax (liability) / asset

2011 USD'000	2012 USD'000		2012 RO'000	2011 RO'000
-	**(434)**	On comprehensive income items	**(167)**	-
231	**88**	On other comprehensive income items	**34**	89
231	**(346)**		**(133)**	89

d) Tax assessment

The assessments of the Bank for the years 2007 to 2011 have not yet been agreed with the Secretariat General for Taxation at the Ministry of Finance. The Bank is of the opinion that additional taxes, if any, related to the open tax years would not be significant to the financial position of the Bank as at 31 December 2012.

C6 Basic earnings per share

Earnings per share is calculated by dividing the net profit for the year by the weighted average number of shares outstanding during the year.

2011 USD'000	2012 USD'000		2012 RO'000	2011 RO'000
37,656	59,769	Net profit for the year	23,011	14,497
1,000,000	1,000,000	Weighted average number of shares of RO 0.100 each outstanding during the year (in thousands)	1,000,000	1,000,000
		Net earnings per share for the year (in baizas)	23.01	14.50
3.77	5.98	Net earnings per share for the year (in cents)		

No figure for diluted earnings per share has been presented, as the Bank has not issued any convertible instruments, which would have an impact on earnings per share when exercised.

D Financial risk management

The primary objective of the risk management system is to safeguard the Bank's capital, its financial resources and from various risks. The Bank has exposure to the following risk from its use of financial instruments:

- Credit risk
- Liquidity risk
- Market risk
- Operational risk

The Board of Directors has overall responsibility for the establishment and oversight of the Bank's risk management framework. The Board has established the Asset and Liability Committee (ALCO) and Risk Management Committee, which are responsible for developing and monitoring the Bank's risk management policies in their specified areas. All board committees report regularly to the Board of Directors on their activities.

The Bank's risk management policies will focus on identification, measurement, monitoring and mitigation of credit risk, irrespective of its manner of manifestation. In this process, the Bank recognizes that dynamics of markets may necessitate decisions that may deviate on few occasions from the principles of CRM and to cater to such requirements, minimal and requisite level of flexibilities need to be built into the Bank's Credit Policy, along with suitable and adequate safeguards/controls.

The Bank's Audit Committee is responsible for monitoring compliance with the Bank's risk management policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Bank. The Bank's Audit Committee is assisted in these functions by Internal Audit department. Internal Audit department undertakes both regular and ad-hoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee.

D1 Credit risk

Credit risk is the risk of financial loss to the Bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations, In simpler terms, it represents the probability of default by any counterparty in repayment of principal obligations and / or servicing interest obligations in accordance with the set redemption schedule or terms of contract.

D Financial risk management (continued)

D1 Credit risk (continued)

D1.1 Management of credit risk (continued)

The Board of Directors has delegated responsibility for the monitoring of credit risk to its Risk Management Committee of the Board and is responsible for handling all facets of risk. Bank has a Chief Risk Officer who heads the management of Risk reporting to the Risk Management Committee. Credit risk will be managed by the following:

- setting up risk limits and boundaries, within the regulatory guidelines, for risk origination to be within the approved risk appetite of the bank;
- continuous monitoring of these stand-alone credit risks in the ‘corporate’ and ‘emerging corporate’ portfolio as well as in the retail credit portfolio through an independent loan review group (LRG), reporting to head of risk, for risk grading of the portfolios and tracking the movement of the grades;
- portfolio credit risk measurement through tracking on the set portfolio risk parameters such as concentration risk;
- the bank will not entertain credit proposals from entities/individuals, whose name appears in the CBO classified list under BCSB. However, in exceptional cases in the retail business unit, loans are approved, with strong justifications and risk mitigations for considering any such proposals, and then these have to be referred to delegated authorities, as per the retail loan policy;
- retail credit risk is managed at the origination stage by ensuring adherence to the various retail product parameters which are set in the respective product policy approved by the Risk Management Committee of the board, after a risk review by the CRM. Only credit with exceptions to the policy will be reviewed by the CRM for offering risk observations to the approving authority;
- in the ‘corporate’, ‘financial institution group’ and ‘emerging corporate’ lending business, individual credit proposals are reviewed by the CRM of risk management department with a template through which the following risks are examined and risk observations given to the approving authority:
  - risk of non-compliance to the regulatory guidelines and other applicable laws (example: related party exposure or connected party exposure, margin requirement for loans against shares);
  - risks in the industry in which the borrower is conducting his business or to the prospects of which the business has very high positive correlation;
  - risks out of the business model being followed (risks on the business cash flows);
  - risks out of ownership, absence of succession and absence of professional management team etc.;
  - financial risks indicated out of an analysis of their last three years’ financials where ever available. The overall risk rating with quantitative inputs from financials and qualitative inputs by the credit analyst on business, management etc are approved or overridden by risk management department;
  - risks out of wrong structuring of credit facilities, inadequacy of critical covenants and securities. Comments on risk-pricing will be given by risk objectively after setting up a model to price loans to the risk that it has;
  - risk of adverse selection and mitigation by more due diligence while taking over loans from other banks or buying loan assets from secondary market, especially when it is sold at a discount; and
  - risk of non availability of loan repayments tied up and aligned to specific identified cash flows with assignment.
- renewals and reviews of facilities are subject to the same review process. The process also includes approval by risk of borrower ratings arrived at by the business units;
- limiting concentrations of exposure to counterparties, geographies and industries (for loans and advances), and by issuer, market liquidity and country (for investment securities);
- developing and maintaining the bank’s risk grading in order to categorise exposures according to the degree of risk of financial loss faced and to focus management on the attendant risks; and
- providing advice, guidance and specialist skills to business units to promote best practice throughout the bank in the management of credit risk.

The Bank employs a range of policies and practices to mitigate credit risk. The Bank follows a risk mitigation practice of identifying business cash flows as the primary take out for the advances extended. These cash flows are then tested for sustainability over the tenor of the credit facility and a suitable mechanism is put in place to capture the same into the client account with the Bank. To cover unforeseen risk, which dries up the cash flows, additional tangible securities are taken such as real estate or equity shares. The Bank implements guidelines on the acceptability of specific classes of collateral credit risk mitigation. The principal types of collaterals for loans and advances are:

- mortgages over properties;
- charges over business assets such as premises inventory and accounts receivable;
- Charges over financial instruments such as debt securities and equities.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012 (continued)

D Financial risk management (continued)

D1 Credit risk (continued)

D1.1 Management of credit risk (continued)

All loans and advances of the Bank are regularly monitored to ensure compliance with the stipulated repayment terms. Those loans and advances are classified into one of the 5 risk classification categories: Standard, Special Mention, Substandard, Doubtful, and Loss – as stipulated by Central Bank of Oman regulations and guidelines. The responsibility for identifying problem accounts and classifying them rests with business line function.

D1.2 Exposure to credit risk

The credit exposure of the Bank as on the reporting date is as follows:

	2012			2011		
	Loans and advances-Gross RO'000	**Due from banks and other money market lendings RO'000**	**Investment securities RO'000**	Loans and advances-Gross RO'000	Due from banks and other money market borrowings RO'000	Investment securities RO'000
Carrying amount	**1,171,294**	**335,389**	**135,137**	1,040,927	231,560	71,369
Past due but not impaired						
1-30 days	**13,126**	-	-	15,783	-	-
31-60 days	**3,434**	-	-	2,995	-	-
61-89 days	**2,154**	-	-	1,360	-	-
	18,714	-	-	20,138	-	-
Past due and impaired	**18,280**	-	-	15,999	-	-
Neither past due nor impaired	**1,134,300**	**335,389**	**135,137**	1,004,790	231,560	71,369

	2012			2011		
	Loans and advances-Gross USD'000	**Due from banks and other money market lendings USD'000**	**Investment securities USD'000**	Loans and advances-Gross USD'000	Due from banks and other money market borrowings USD'000	Investment securities USD'000
Carrying amount	**3,042,323**	**871,140**	**351,005**	2,703,706	601,455	185,374
Past due but not impaired						
1-30 days	**34,094**	-	-	40,995	-	-
31-60 days	**8,919**	-	-	7,779	-	-
61-89 days	**5,595**	-	-	3,532	-	-
	48,608	-	-	52,306	-	-
Past due and impaired	**47,481**	-	-	41,556	-	-
Neither past due nor impaired	**2,946,234**	**871,140**	**351,005**	2,609,844	601,455	185,374

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012 (continued)

D Financial risk management (continued)

D1 Credit risk (continued)

D1.2 Exposure to credit risk (continued)

Maximum exposure to credit risk before collateral held or other credit enhancements for all on-balance sheet assets are based on net carrying amounts as reported in the statement of financial position.

The maximum credit risk exposures relating to off-balance sheet items calculated as per Basel II guidelines are provided in note D5. The amounts represented in the note D5 represent a worst case scenario of credit risk exposure as of 31 December 2012 and 2011, without taking into account of any collateral held or other credit enhancements attached.

D1.3 Credit rating analysis

The table below presents an analysis of debt securities, treasury bills and other eligible bills by rating agency designation at 31 December 2012, based on Moody's ratings or equivalent.

2011 USD'000	**2012 USD'000**		**2012 RO'000**	2011 RO'000
4,000	**4,000**	B-	**1,540**	1,540
17,413	**27,023**	Unrated bonds	**10,404**	6,704
163,961	**319,982**	Sovereign treasury bills	**123,193**	63,125

The following table shows the gross placements held with counterparties at the reporting date:

2011 USD'000	**2012 USD'000**		**2012 RO'000**	2011 RO'000
163,244	**113,945**	Aaa to Aa3	**43,869**	62,849
186,600	**40,600**	A1 to A3	**15,631**	71,841
251,525	**711,400**	Baa1 to Baa3	**273,889**	96,837
-	**5,195**	Caa2	**2,000**	-
86	**-**	Unrated	**-**	33

The Bank performs an independent assessment based on quantitative and qualitative factors in cases where a bank is unrated.

D1.4 Impaired loans and securities

These are loans and securities for which the Bank determines that it is probable that it will be unable to collect all the principal and interest due according to the contractual terms of the loan /securities agreement.

D1.4.a Past due but not impaired

These are loans and securities where contractual interest or principal payments are past due but the Bank believes that impairment is not appropriate on the basis of the level of security /collateral available and /or the stage of collection of amounts owed by the Bank.

D Financial risk management (continued)

D1 Credit risk (continued)

D1.4 Impaired loans and securities (continued)

D1.4.b Loans with renegotiated terms

Loans with renegotiated terms are loans that have been restructured due to deterioration in the borrower's financial position and where the Bank has made concessions that it would not otherwise consider. Once the loan is restructured it remains in this category independent of satisfactory performance after restructuring.

D1.4.c Allowances for impairment

The Bank establishes an allowance for impairment losses account that represents its estimate of incurred losses in its loan portfolio. The main components of this allowance are specific loss components that relate to individually significant exposures, and a collective loan loss allowance established for group of homogenous assets in respect of losses that have been incurred but have not been identified on loans subject to individual assessment for impairment.

D1.4.d Write off policy

The Bank writes off a loan/security balance (and any related allowances for impairment losses) when the Bank determines that the loan/security is uncollectible. This determination is reached after considering information such as the occurrence of significant changes in the borrower/issuer's financial position such that the borrower/issuer can no longer repay the obligation, or that proceeds from the collateral will not be sufficient to pay back the entire exposure. For smaller balance standardised loans, charge off decisions generally are based on a product specific past due status.

Set out below is an analysis of gross and net (of allowances for impairment) amounts of individually impaired assets by risk classification.

	2012		2011	
	Loans and advances		Loans and advances	
Particulars	**Gross**	**Net**	Gross	Net
	RO'000	**RO'000**	RO'000	RO'000
Sub-standard	**1,224**	**897**	7,178	5,186
Doubtful	**8,437**	**5,187**	2,279	1,099
Loss	**8,619**	**1,835**	6,542	1,900
	18,280	**7,919**	15,999	8,185
Particulars	**Gross**	**Net**	Gross	Net
	USD'000	**USD'000**	USD'000	USD'000
Sub-standard	**3,179**	**2,330**	18,644	13,470
Doubtful	**21,915**	**13,473**	5,919	2,855
Loss	**22,387**	**4,766**	16,993	4,935
	47,481	**20,569**	41,556	21,260

D 1.5 Collateral securities

The Bank holds collateral against the loans and advances to customers in the form of mortgage interests over property, other registered securities, assets and guarantees. Estimates of fair value are based on the value of the collateral assessed at the time of borrowing and updated once in three years, except when a loan is individually assessed as impaired. The shares of MSM listed companies which are taken as securities are valued on fortnightly basis, unless there is significant fluctuations whereby the valuation is done on daily basis to manage the risks of extreme volatility.

.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012 (continued)

D Financial risk management (continued)

D1 Credit risk (continued)

D 1.5 Collateral securities (continued)

An estimate of the fair value of collateral and other security enhancements held against loans and advances is shown below:

2011 USD'000	2012 USD'000		2012 RO'000	2011 RO'000
		Against past due but not impaired		
80,771	**47,870**	Property	**18,430**	31,097
1,177	**-**	Fixed deposits	**-**	453
2,304	**-**	Equity	**-**	887
84,252	**47,870**		**18,430**	32,437
		Against past due and impaired		
7,571	**20,719**	Property	**7,977**	2,915
		Against neither past due nor impaired		
333,039	**553,725**	Property	**213,184**	128,220
209,312	**276,719**	Commercial mortgage	**106,537**	80,585
63,099	**59,094**	Fixed deposits	**22,751**	24,293
52,649	**75,647**	Equity	**29,124**	20,270
37,094	**35,213**	Guarantees	**13,557**	14,281
695,193	**1,000,398**		**385,153**	267,649
787,016	**1,068,987**		**411,560**	303,001

D1.6 Settlement Risk

Settlement risk is the risk of loss due to the failure of a party to honour its obligations to deliver cash, securities or other assets as contractually agreed on the day of settlement.

In foreign exchange trades, though there is fulfilment of both the legs of the transaction on the settlement date as is common practice between trading partners (free settlement), there will be risk on account of different time zones. In these cases, the settlement risk is mitigated through the execution of bilateral payment netting agreements.

D1.7 Concentrations

Concentrations of credit risk arise when a number of counter parties 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 affected similarly by changes in economic, political or other conditions. Concentrations of credit risk indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry or geographic location.

The Bank seeks to manage its credit risk exposure through diversification of lending activities to avoid undue concentrations of risks with individuals or group of customers in specific locations or businesses. It also obtains appropriate security.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012 (continued)

D Financial risk management (continued)

D1 Credit risk (continued)

D1.7 Concentrations (continued)

	2012 Loans and advances-Gross	2012 Due from banks and other money market lendings	2012 Investment securities	2011 Loans and advances-Gross	2011 Due from banks and other money market lendings	2011 Investment securities
	RO'000	RO'000	RO'000	RO'000	RO'000	RO'000
Concentration by sector						
Corporate	787,679	-	29,493	672,978	-	22,534
Personal	383,615	-	-	367,949	-	-
Sovereign	-	-	123,193	-	-	63,125
Banks	-	335,389	-	-	231,560	-
	1,171,294	335,389	152,686	1,040,927	231,560	85,659
Concentration by location						
Middle east	1,131,186	134,402	19,434	1,014,362	104,361	80,041
Europe	28,558	63,923	133,252	-	55,670	4,150
North America	-	11,035	-	-	4,075	1,468
Asia	11,550	126,017	-	26,565	67,449	-
Australia	-	12	-	-	5	-
	1,171,294	335,389	152,686	1,040,927	231,560	85,659
	USD'000	USD'000	USD'000	USD'000	USD'000	USD'000
Concentration by sector						
Corporate	2,045,920	-	76,605	1,747,995	-	58,530
Personal	996,403	-	-	955,711	-	-
Sovereign	-	-	319,983	-	-	163,961
Banks	-	871,140	-	-	601,455	-
	3,042,323	871,140	396,588	2,703,706	601,455	222,491
Concentration by location						
Middle east	2,938,145	349,096	50,479	2,634,706	271,069	207,899
Europe	74,178	166,034	346,109	-	144,597	10,779
North America	-	28,662	-	-	10,584	3,813
Asia	30,000	327,317	-	69,000	175,192	-
Australia	-	31	-	-	13	-
	3,042,323	871,140	396,858	2,703,706	601,455	222,491

Concentration by location for loans and advances is measured based on the location of the entity holding the asset, which has a high correlation with the location of the borrower. Concentration by location for investment securities is measured based on the location of the issuer of the security. The Bank seeks to manage its credit risk exposure through diversification of lending activities to avoid undue concentrations of risk with banks or customers in a specific currency. It also obtains security when appropriate. An analysis of the Bank's gross exposure to relevant segments is provided in note D6.

D Financial risk management (continued)

D2 Liquidity risk

Liquidity risk is the risk that the Bank will encounter difficulty in meeting its obligations associated with its financial liabilities that are settled by delivering cash or another financial asset.

D2.1 Management of liquidity risk

The Bank's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions without incurring unacceptable losses or risking damage to the Bank's reputation. The Bank has put in place an approved Contingency Liquidity Plan to facilitate management of liquidity

Liquidity risk is managed by the Bank through closely monitoring the liquidity gap against the limit fixed.

Adequate liquidity is ensured by Treasury, which receives information from other business units regarding the liquidity profile of their financial assets and liabilities and details of other projected cash flows arising from projected future business. Central Treasury then maintains a portfolio of short-term liquid assets, largely made up of short-term liquid investment securities, loans and advances to banks and other inter-bank facilities, to ensure that sufficient liquidity is maintained within the Bank as a whole. In this process due care is taken to ensure that the Bank complies with all the Central Bank regulations.

All liquidity policies and procedures are subject to review and approved by ALCO.

D2.2 Exposure to liquidity risk

The lending ratio, which is the ratio of the total loans and advances to customer deposits and capital, is monitored on a daily basis in line with the regulatory guidelines. Internally the lending ratio is set at a more conservative basis than required by regulation. The Bank also manages its liquidity risk on regular basis and by monitoring the liquid ratio which is a ratio of net liquid assets to total assets on monthly basis. For this purpose net liquid assets are considered as including cash and cash equivalents and investment grade debt securities for which there is an active and liquid market.

Details of the reported lending and liquid ratio as at 31 December 2012 were as follows:

	2012		2011	
	Lending ratio	**Liquid ratio**	Lending ratio	Liquid ratio
Average for the year	**83.47**	**30.00%**	84.28%	21.46%
Maximum for the year	**85.60**	**32.47%**	85.33%	26.43%
Minimum for the year	**80.70**	**26.14%**	83.42%	17.43%

The table below summarises the maturity profile of the Bank's liabilities as on the reporting date based on contractual repayment arrangements. The contractual maturities of assets and liabilities have been determined on the basis of the remaining period at the statement of financial position date to the contractual maturity date and do not take account of the effective maturities as indicated by the Bank's deposit retention history and the availability of liquid funds.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012 (continued)

D Financial risk management (continued)

D2 Liquidity risk (continued)

D2.2 Exposure to liquidity risk (continued)

	Within three months RO'000	Four months to 12 months RO'000	One to three years RO'000	More than three years RO'000	Total RO'000
31 December 2012					
Assets					
Cash and balances with Central Banks	67,316	23,773	13,893	16,764	121,746
Due from banks and other money market lendings	120,170	215,219	-	-	335,389
Loans and advances	258,582	142,986	173,296	571,159	1,146,023
Investment securities	123,201	-	21,920	7,565	152,686
Property and equipment and other assets	8,231	2,892	138	17,161	28,422
Investment properties	-	-	-	2,900	2,900
Total assets	577,500	384,870	209,247	615,549	1,787,166
Liabilities and equity					
Due to banks and other money market borrowings	210,572	13,476	-	-	224,048
Customers' deposits	351,516	434,589	253,969	297,326	1,337,400
Other liabilities	17,075	5,821	1,945	5,997	30,838
Subordinated loans	-	-	-	50,000	50,000
Shareholders' funds	-	-	-	144,880	144,880
Total liabilities and equity	579,163	453,886	255,914	498,203	1,787,166

	Within three months USD'000	Four months to 12 months USD'000	One to three years USD'000	More than three years USD'000	Total USD'000
31 December 2012					
Assets					
Cash and balances with Central Banks	174,846	61,748	36,086	43,543	316,223
Due from banks and other money market lendings	312,130	559,010	-	-	871,140
Loans and advances	671,642	371,392	450,119	1,483,530	2,976,683
Investment securities	320,004	-	56,935	19,649	396,588
Property and equipment and other assets	21,380	7,512	358	44,574	73,824
Investment properties	-	-	-	7,532	7,532
Total assets	1,500,002	999,662	543,498	1,598,828	4,641,990
Liabilities and equity					
Due to banks and other money market borrowings	546,940	35,003	-	-	581,943
Customers' deposits	913,028	1,128,803	659,660	772,275	3,473,766
Other liabilities	44,351	15,119	5,052	15,577	80,099
Subordinated loans	-	-	-	129,870	129,870
Shareholders' funds	-	-	-	376,312	376,312
Total liabilities and equity	1,504,319	1,178,925	664,712	1,294,034	4,641,990

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012 (continued)

D Financial risk management (continued)

D2 Liquidity risk (continued)

D2.2 Exposure to liquidity risk (continued)

	Within three months RO'000	Four months to 12 months RO'000	One to three years RO'000	More than three years RO'000	Total RO'000
31 December 2011					
Assets					
Cash and balances with Central Banks	23,423	20,566	6,883	10,641	61,513
Due from banks and other money market lendings	158,025	73,535	-	-	231,560
Loans and advances	254,441	109,096	142,167	513,850	1,019,554
Investment securities	63,126	-	14,289	8,244	85,659
Property and equipment and other assets	16,454	2,740	100	14,397	33,691
Total assets	515,469	205,937	163,439	547,132	1,431,977
Liabilities and equity					
Due to banks and other money market borrowings	43,136	-	-	-	43,136
Customers' deposits	342,622	453,452	151,761	223,602	1,171,437
Other liabilities	27,243	8,814	1,187	1,474	38,718
Subordinated loans	-	-	-	50,000	50,000
Shareholders' funds	-	-	-	128,686	128,686
Total liabilities and equity	413,003	462,266	152,948	403,762	1,431,977

	Within three months USD'000	Four months to 12 months USD'000	One to three years USD'000	More than three years USD'000	Total USD'000
31 December 2011					
Assets					
Cash and balances with Central Banks	60,839	53,418	17,878	27,639	159,774
Due from banks and other money market lendings	410,455	191,000	-	-	601,455
Loans and advances	660,886	283,366	369,265	1,334,675	2,648,192
Investment securities	163,964	-	37,114	21,413	222,491
Property and equipment and other assets	42,737	7,117	260	37,395	87,509
Total assets	1,338,881	534,901	424,517	1,421,122	3,719,421
Liabilities and equity					
Due to banks and other money market borrowings	112,042	-	-	-	112,042
Customers' deposits	889,927	1,177,797	394,184	580,786	3,042,694
Other liabilities	70,761	22,894	3,083	3,828	100,566
Subordinated loans	-	-	-	129,870	129,870
Shareholders' funds	-	-	-	334,249	334,249
Total liabilities and equity	1,072,730	1,200,691	397,267	1,048,733	3,719,421

D Financial risk management (continued)

D2 Liquidity risk (continued)

D2.2 Exposure to liquidity risk (continued)

The Bank prepares a liquidity gap report to monitor the Bank's short term liquidity position on the Rial denominated assets and liabilities in a time horizon spanning one month. The gap is adjusted for availability of instruments for repo or refinance and also for unavailed committed lines of credit, if any. This statement of short term liquidity is to be reported to the ALCO every month.

D3 Market risk

Market risk is the exposure to loss resulting from the changes in the interest rates, foreign currency exchange rates, equity prices and commodity prices. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return to risk.

D3.1 Measurement of market risk

The Bank is mainly engaged in Spots, Forwards and Currency swaps. Since the positions are taken mainly for customer transactions, the complexity is further reduced. In view of above, the Bank measures and controls the risk by using a limit framework. As and when the Bank enters into more complex derivatives, it will have more sophisticated models and techniques to measure market risk, supported by suitable mechanism.

D3.2 Management of market risks

The Bank separates its exposure to market risk between trading and non trading portfolios. Trading portfolios include all positions arising from market making and proprietary position taking, together with financial assets and liabilities that are managed on a fair value basis.

All foreign exchange risk within the Bank is transferred by Central Treasury to the trading book. Accordingly, the foreign exchange position is treated as a part of the Bank's trading portfolio for risk management purposes. Foreign currency risk is monitored and managed by the Bank by establishment of Mid Office to monitor the market risk, and the risk is managed by putting in place Market Risk Management Policy, and implementing limit framework, reporting tools like Currency Position Report, Risk Analysis of Currency Position, Breach Analysis Report, and Dealer Limit Breach report.

Overall authority for market risk is vested in ALCO. The risk management function is responsible for development of detailed risk management policies (subject to approval by ALCO and Risk Management Committee of the Board). The Market Risk Policy is periodically reviewed to keep it up to date with the market developments.

D3.3 Exposure to interest rate risk – non trading portfolios

Interest rate risk arises from the possibility that changes in interest rates will affect future profitability or the fair values of financial instruments. The Bank is exposed to interest rate risk as a result of mismatches of interest rate and re-pricing tenure of rate sensitive assets and liabilities.

The effective interest rate (effective yield) of a monetary financial instrument is the rate used in a present value calculation which results in the carrying amount of the instrument. The rate is a historical rate for a fixed rate instrument carried at amortised cost and a current rate for a floating rate instrument or an instrument carried at fair value.

The principal risk to which non-trading portfolios are exposed is the risk of loss from fluctuations in the future cash flows or fair values of financial instrument because of a change in market interest rates. Interest rate risk is managed principally through monitoring interest rate gaps. The ALCO is the monitoring body for compliance with these limits and is assisted by Risk Management in its day-to-day monitoring activities. A summary of the Bank's interest rate gap position on non-trading portfolios is provided in this note. The Bank also assesses interest rate risk by assessing the interest rate impact (both earnings perspective and economic value perspective) as per Basel-II guidelines communicated by Central Bank of Oman by applying interest rate shock of 200 bps and takes measures to reduce the impact. The Bank also assesses impact on earnings of interest rate shock of 50,100 and 200 bps.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012 (continued)

D Financial risk management (continued)

D3 Market risk (continued)

D3.3 Exposure to interest rate risk – non trading portfolios (continued)

The Bank's interest sensitivity position based on contractual re-pricing arrangements at 31 December 2012 was as follows:

	Effective annual interest rate %	Within three months RO'000	Four months to 12 months RO'000	Over one year RO'000	Non-sensitive to interest rate RO'000	Total RO'000
31 December 2012						
Assets						
Cash and balances with Central Banks	0.01	-	-	-	121,746	121,746
Due from banks and other money market lendings	2.87	120,170	215,219	-	-	335,389
Loans and advances	5.63	474,247	220,706	452,978	(1,908)	1,146,023
Investment securities	1.72	128,201	2,573	9,434	12,478	152,686
Property, equipment and fixtures	-	-	-	-	12,187	12,187
Investment properties	-	-	-	-	2,900	2,900
Other assets	-	-	-	-	16,235	16,235
Total assets		722,618	438,498	462,412	163,638	1,787,166
Liabilities and equity						
Due to banks and other money market borrowings	1.49	210,572	13,476	-	-	224,048
Customers' deposits	1.94	225,721	335,975	266,103	509,601	1,337,400
Other liabilities	-	-	-	-	30,838	30,838
Subordinated loans	6.5	-	-	-	50,000	50,000
Shareholders' funds	-	-	-	-	144,880	144,880
Total liabilities and equity		436,293	349,451	266,103	735,319	1,787,166
Total interest rate sensitivity gap		286,325	89,047	196,309	(571,681)	-
Cumulative interest rate sensitivity gap		286,325	375,372	571,681	-	-

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012 (continued)

D Financial risk management (continued)

D3 Market risk (continued)

D3.3 Exposure to interest rate risk – non trading portfolios (continued)

	Effective annual interest rate %	Within three months USD'000	Four months to 12 months USD'000	Over one year USD'000	Non-sensitive to interest rate USD'000	Total USD'000
31 December 2012						
Assets						
Cash and balances with Central Banks	0.01	-	-	-	316,223	316,223
Due from banks and other money market lendings	2.87	312,130	559,010	-	-	871,140
Loans and advances	5.63	1,231,811	573,262	1,176,566	(4,956)	2,976,683
Investment securities	1.72	332,991	6,683	24,504	32,410	396,588
Property, equipment and fixtures	-	-	-	-	31,655	31,655
Investment properties	-	-	-	-	7,532	7,532
Other assets	-	-	-	-	42,169	42,169
Total assets		1,876,932	1,138,955	1,201,070	425,033	4,641,990
Liabilities and equity						
Due to banks and other money market borrowings	1.49	546,940	35,003	-	-	581,943
Customers' deposits	1.94	586,288	872,662	691,177	1,323,639	3,473,766
Other liabilities	-	-	-	-	80,099	80,099
Subordinated loans	6.5	-	-	-	129,870	129,870
Shareholders' funds	-	-	-	-	376,312	376,312
Total liabilities and equity		1,133,228	907,665	691,177	1,909,920	4,641,990
Total interest rate sensitivity gap		743,704	231,290	509,893	(1,484,887)	-
Cumulative interest rate sensitivity gap		743,704	974,994	1,484,887	-	-

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012 (continued)

D Financial risk management (continued)

D3 Market risk (continued)

D3.3 Exposure to interest rate risk – non trading portfolios (continued)

	Effective annual interest rate %	Within three months RO'000	Four months to 12 months RO'000	Over one year RO'000	Non-sensitive to interest rate RO'000	Total RO'000
31 December 2011						
Assets						
Cash and balances with Central Banks	0.02	-	-	-	61,513	61,513
Due from banks and other money market lendings	1.68	158,025	73,535	-	-	231,560
Loans and advances	5.92	435,059	169,453	428,601	(13,559)	1,019,554
Investment securities	1.27	68,126	3,244	4,197	10,092	85,659
Property, equipment and fixtures	-	-	-	-	14,157	14,157
Other assets	-	-	-	-	19,534	19,534
Total assets		661,210	246,232	432,798	91,737	1,431,977
Liabilities and equity						
Due to banks and other money market borrowings	0.91	43,136	-	-	-	43,136
Customers' deposits	2.14	240,968	390,275	147,375	392,819	1,171,437
Other liabilities	-	-	-	-	38,718	38,718
Subordinated loans	6.50	-	-	50,000	-	50,000
Shareholders' funds	-	-	-	-	128,686	128,686
Total liabilities and equity		284,104	390,275	197,375	560,223	1,431,977
Total interest rate sensitivity gap		377,106	(144,043)	235,423	(468,486)	-
Cumulative interest rate sensitivity gap		377,106	233,063	468,486	-	-

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012 (continued)

D Financial risk management (continued)

D3 Market risk (continued)

D3.3 Exposure to interest rate risk – non trading portfolios (continued)

	Effective annual interest rate %	Within three months USD'000	Four months to 12 months USD'000	Over one year USD'000	Non-sensitive to interest rate USD'000	Total USD'000
31 December 2012						
Assets						
Cash and balances with Central Banks	0.02	-	-	-	159,774	159,774
Due from banks and other money market lendings	1.68	410,455	191,000	-	-	601,455
Loans and advances	5.92	1,130,023	440,138	1,113,249	(35,218)	2,648,192
Investment securities	1.27	176,951	8,426	10,901	26,213	222,491
Property, equipment and fixtures	-	-	-	-	36,771	36,771
Other assets	-	-	-	-	50,738	50,738
Total assets		1,717,429	639,564	1,124,150	238,278	3,719,421
Liabilities and equity						
Due to banks and other money market borrowings	0.91	112,042	-	-	-	112,042
Customers' deposits	2.14	625,891	1,013,701	382,792	1,020,310	3,042,694
Other liabilities	-	-	-	-	100,566	100,566
Subordinated loans	6.50	-	-	129,870	-	129,870
Shareholders' funds	-	-	-	-	334,249	334,249
Total liabilities and equity		737,933	1,013,701	512,662	1,455,125	3,719,421
Total interest rate sensitivity gap		979,496	(374,137)	611,488	(1,216,847)	-
Cumulative interest rate sensitivity gap		979,496	605,359	1,216,847	-	-

D Financial risk management (continued)

D3 Market risk (continued)

D3.3 Exposure to interest rate risk – non trading portfolios (continued)

The Bank's present business is being done with basic products. The risk is managed by taking views on interest rate movements for the year and realigning the portfolios and covenants of lending, so as to be proactive and minimize any adverse effects. The benchmark presently available in Oman is the 28-day Central Bank of Oman CD rate. The statistics on movement of the rate in CDs and weighted average cost of deposits and the interest on loans are provided below:

2012	**Jan**	**Feb**	**Mar**	**Apr**	**May**	**Jun**	**Jul**	**Aug**	**Sep**	**Oct**	**Nov**
CD rate	**0.11%**	**0.09%**	**0.08%**	**0.09%**	**0.08%**	**0.07%**	**0.08%**	**0.08%**	**0.07%**	**0.07%**	**0.15%**
Deposit rate	**1.39%**	**1.36%**	**1.32%**	**1.30%**	**1.31%**	**1.30%**	**1.32%**	**1.33%**	**1.30%**	**1.30%**	**1.28%**
Lending rate	**6.17%**	**6.15%**	**6.09%**	**6.01%**	**5.90%**	**5.90%**	**5.89%**	**5.84%**	**5.77%**	**5.74%**	**5.71%**

2011	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
CD rate	0.06%	0.06%	0.06%	0.06%	0.04%	0.03%	0.02%	0.03%	0.03%	0.07%	0.11%	0.11%
Deposit rate	1.52%	1.44%	1.41%	1.37%	1.35%	1.36%	1.33%	1.35%	1.36%	1.35%	1.41%	1.41%
Lending rate	5.91%	5.87%	5.81%	5.79%	5.76%	5.69%	5.69%	5.68%	5.64%	5.57%	6.22%	6.20%

The management of interest rate risk is one of the critical components of market risk management in banks. Interest rate risk primarily arises on account of mismatch of the Bank's assets with its liabilities that fund the assets. There are basically two approaches to management of interest rate risk in banks, namely "Earnings Approach" and "Economic Value Approach". The interest rate risk is assessed based on the impact of interest rate shock on the Bank's earnings and capital.

The focus of earnings approach is understanding the impact of interest rate changes (shock) of assets and liabilities on the Net Interest Income of the Bank. It measures the extent of capability of the Bank to absorb decline in net interest income caused by interest rate changes.

Interest rate risk also influences the present value of bank's asset and liabilities. Economic value perspective considers the present value of banks assets and liabilities and assesses the potential longer term impact of interest rates on the Bank. This perspective focuses on how the economic value of bank's assets, liabilities, change with movements in interest rates and it reflects the impact of fluctuation in the interest rates on the economic value of the institution.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012 (continued)

D Financial risk management (continued)

D3 Market risk (continued)

D3.3 Exposure to interest rate risk – non trading portfolios (continued)

Basel-II Accord has recommended for assessing the impact of interest rate risk by applying 200 bps interest rate sensitivity and accordingly the impact of 200 bps interest rate shock on Bank's earnings and capital is provided below:

2011 USD'000	2012 USD'000		2012 RO'000	2011 RO'000
90,278	**108,815**	**Net interest income**	**41,894**	34,757
90,278	**108,815**	**Annualized net interest income**	**41,894**	34,757
477,808	**524,013**	**Capital**	**201,745**	183,956
		Based on 50 bps interest rate shock		
4,135	**4,205**	Impact of 50 bps interest rate shock	**1,619**	1,592
4.58%	**3.86%**	Impact as % to net interest income	**3.86%**	4.58%
0.83%	**0.80%**	Impact as % to capital	**0.80%**	0.83%
		Based on 100 bps interest rate shock		
8,268	**8,408**	Impact of 100 bps interest rate shock	**3,237**	3,183
9.16%	**7.73%**	Impact as % to net interest income	**7.73%**	9.16%
1.66%	**1.60%**	Impact as % to capital	**1.60%**	1.66%
		Based on 200 bps interest rate shock		
16,538	**16,818**	Impact of 200 bps interest rate shock	**6,475**	6,367
18.32%	**15.45%**	Impact as % to net interest income	**15.45%**	18.32%
3.32%	**3.21%**	Impact as % to capital	**3.21%**	3.32%

D3.4 Exposure to other market risks

Investment value risk is the risk of reduction in the market value of the Bank's portfolio as a result of diminishment in the market value of individual investments. The responsibility for management of investment value risk rests with the Investment division under the supervision and guidance of the Management Investment Committee and Board Executive Committee of the Bank. The Bank's investments are governed by an investment policy approved by the Board of Directors. The rating and price of the instruments are monitored on a regular basis and necessary actions are taken to reduce exposure if needed. The portfolio is revalued at market price to ensure that unrealised losses, if any, on account of reduction in the market value of the investments remains within the acceptable parameters.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012 (continued)

D Financial risk management (continued)

D3 Market risk (continued)

D3.4 Exposure to other market risks (continued)

Security as per country	Changes in fair value +/- 5%	
	2012 RO'000	2011 RO'000
Oman	**572**	498
GCC	**52**	6
UAE	**15**	14
UK	**450**	208
Bermuda	**58**	71

Security as per country	Changes in fair value +/- 5%	
	2012 USD'000	2011 USD'000
Oman	**1,486**	1,294
GCC	**135**	16
UAE	**39**	36
UK	**1,169**	540
Bermuda	**151**	184

Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Board has set limits on the overall open position and for open position for each currency. The open position limits include overnight open position and intraday open position. Open positions are monitored on a daily basis and hedging strategies used to ensure positions are maintained within established limits. The Bank had the following net exposures denominated in foreign currencies:

		2012			2011	
	Assets RO'000	**Liabilities RO'000**	**Net assets RO'000**	Assets RO'000	Liabilities RO'000	Net assets RO'000
US Dollar	**675,201**	**681,359**	**(6,158)**	399,918	435,884	(35,966)
Saudi Rial	**317**	**-**	**317**	64,162	64,170	(8)
Euro	**33,448**	**33,427**	**21**	15,807	15,815	(8)
UAE Dirhams	**14,963**	**11,408**	**3,555**	3,872	793	3,080
Qatari Rial	**32**	**19**	**13**	22	19	3
Kuwaiti Dinar	**11**	**5**	**6**	68	15	53
Japanese Yen	**17,364**	**17,391**	**(27)**	4	1	3
Pound Sterling	**1,757**	**1,764**	**(7)**	2,402	2,402	-
Indian Rupee	**39**	**1**	**38**	283	223	59
Others	**217**	**96**	**121**	461	270	191

D Financial risk management (continued)

D3 Market risk (continued)

D3.4 Exposure to other market risks (continued)

	2012			2011		
	Assets USD'000	**Liabilities USD'000**	**Net Assets USD'000**	Assets USD'000	Liabilities USD'000	Net Assets USD'000
US Dollar	**1,753,769**	**1,769,764**	**(15,995)**	1,038,748	1,132,166	(93,418)
Saudi Rial	**823**	**-**	**823**	166,655	166,675	(21)
Euro	**86,878**	**86,823**	**55**	41,057	41,078	(21)
UAE Dirhams	**38,865**	**29,631**	**9,234**	10,057	2,060	8,000
Qatari Rial	**83**	**49**	**34**	57	49	8
Kuwaiti Dinar	**29**	**13**	**16**	177	39	138
Japanese Yen	**45,101**	**45,171**	**(70)**	10	3	8
Pound Sterling	**4,564**	**4,582**	**(16)**	6,239	6,239	-
Indian Rupee	**101**	**3**	**98**	735	579	153
Others	**564**	**249**	**315**	1,201	703	498

The Bank takes on exposure to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Board sets limits on the level of exposure by currency and in aggregate for both overnight and intra-day positions, which are monitored daily.

Changes in the non parity foreign currency prices as at 31 December 2012 on net assets is considered negligible

D4 Operational risk

Operational risk is defined as the risk of direct or indirect loss resulting from inadequate or failed internal processes, people and systems or from external events. Operational risk arises due to variety of causes associated with the Bank's processes, personnel, technology and infrastructure and from external events and to include risks other than credit, market and liquidity risks.

The Bank's objective is to manage operational risk to avoid/reduce financial losses to the Bank by establishment of necessary controls, systems and procedures. The Bank recognises that over controlled environment will affect the Bank's business and earnings, besides adding to costs. Therefore, the Bank aims at effective management of operational risk through control optimisation and well established systems, methods and governance framework.

The primary responsibility for development and implementation of controls to address operational risk is assigned to senior management within each business unit. This responsibility is supported by the development of overall bank standards in the following areas for management of operational risk:

- Clear reporting lines
- Proper delegation of powers
- Appropriate segregation of duties and authorisation of transactions through a maker checker system and authorisation matrix
- Ownership reconciliation and monitoring of accounts
- Documentation of controls and processes
- Compliance with regulatory and other legal requirements
- Periodic assessment of the operational risks faced and evaluating the adequacy of controls and procedures to address the risks identified
- Reporting of operational losses and incidents triggering operational losses and remedial action
- Development of contingency plans
- Training, skill up gradation and professional development
- Ethical and business standards
- Risk mitigation through insurance, wherever desirable

D Financial risk management (continued)

D4 Operational risk (continued)

Compliance with Bank standards is supported by a programme of periodic reviews undertaken by Internal Audit. The results of Internal Audit reviews are discussed with the management of the business unit to which they relate, with summaries submitted to the Audit Committee and senior management of the Bank. The Bank has also implemented a comprehensive Operational Risk Management Framework by which bank has put in place Operational Risk Management Policy, Risk and Control Self Assessment (RCSA) Policy, Operational Risk Loss Event Reporting Framework, Maintenance of Operational Risk Loss Data Base and RCSA Framework. The Bank has developed an in-house RCSA model and has conducted Risk and Control Self Assessment for all major business activities like Corporate Banking, Retail Banking, Treasury, Card operations, Deposits, HR and E-banking. Bank has further identified Key Risk Indicators (KRI) of operational risk in major activities of the bank and fixed threshold limits which is monitored on monthly basis to guage the level of risk and manage the same.

D5 Capital management

D5.1 Regulatory capital

The Bank's lead regulator, Central Bank of Oman, sets and monitors capital requirements for the Bank as a whole. In implementing current capital requirements Central Bank of Oman requires the Bank to maintain a prescribed ratio of total capital to total risk-weighted assets. The Bank calculates capital requirements for market risk and operational risk based upon the model prescribed by Central Bank of Oman as follows:

- Sovereign entities – Nil
- Banks – Risk weightage based upon ratings by Moody's.
- Retail and Corporate loans – In the absence of credit rating model 100% risk weightage is taken.
- Off balance sheet items – As per credit conversion factors and risk weightage prescribed by Central Bank of Oman.

The Bank's regulatory capital is analysed into three tiers:

- Tier 1 capital, which includes ordinary share capital, share premium, perpetual bonds (which are classified as innovative Tier 1 securities), retained earnings, translation reserve and minority interests after deductions for goodwill and intangible assets, and other regulatory adjustments relating to items that are included in equity but are treated differently for capital adequacy purposes.

- Tier 2 capital, which includes qualifying subordinated liabilities, collective impairment allowances and the element of the fair value reserve relating to unrealised gains on equity instruments classified as available-for-sale.

- Tier 3 capital, which includes short term subordinated debts which if circumstances demand would be capable of becoming the Bank's permanent capital.

Various limits are applied to elements of the capital base. The amount of innovative tier 1 securities cannot exceed 15 percent of total tier 1 capital; qualifying tier 2 capital cannot exceed tier 1 capital; and qualifying term subordinated loan capital may not exceed 50 percent of tier 1 capital. There are also restrictions on the amount of collective impairment allowances that may be included as part of tier 2 capital. Other deductions from capital include the carrying amounts of investments in subsidiaries that are not included in the regulatory consolidation, investments in the capital of Banks and certain other regulatory items.

Banking operations are categorized as either trading book or banking book, and risk-weighted assets are determined according to specified requirements that seek to reflect the varying levels of risk attached to assets and off-balance sheet exposures. To compute the capital charge for operational risk the Bank has considered the gross income for seven quarters, being the period since the commencement of operations, due to non-availability of data for previous three years as required under basic indicator approach for computation of capital for operational risk. The Bank's policy is to maintain a strong capital base as to maintain investor, creditor and market confidence and to sustain future development of the business. The impact of the level of capital on shareholders' return is also recognized and the Bank recognizes the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position. There have been no material changes in the Bank's management of capital during the year.

D Financial risk management (continued)

D5 Capital management (continued)

D5.1 Regulatory capital (continued)

The international standard for measuring capital adequacy is the risk asset ratio, which relates capital to balance sheet assets and off balance sheet exposures weighted according to broad categories of risk.

The risk asset ratio calculated in accordance with the capital adequacy guidelines of the Bank for International Settlement is as follows:

2011 USD'000	**2012 USD'000**		**2012 RO'000**	2011 RO'000
		Tier 1 capital		
259,740	**259,740**	Ordinary share capital	**100,000**	100,000
14,818	**20,795**	Legal reserve	**8,006**	5,705
1,073	**1,073**	General reserve	**413**	413
	10,823	Subordinated loan reserve	**4,167**	-
43,122	**86,091**	Retained earnings	**33,145**	16,602
(5,660)	**(3,784)**	Fair value losses	**(1,457)**	(2,179)
(545)	**(117)**	Deferred tax asset	**(45)**	(210)
312,548	**374,621**	**Total**	**144,229**	120,331
		Tier 2 capital		
35,218	**38,728**	Impairment allowance on portfolio basis	**14,910**	13,559
171	**709**	Fair value gains	**273**	66
129,870	**119,047**	Subordinated loan	**45,833**	50,000
165,259	**158,484**	**Total**	**61,016**	63,625
477,808	**533,105**	**Total regulatory capital**	**205,245**	183,956
		Risk-weighted assets		
3,193,465	**3,673,460**	Retail Bank, corporate Bank and market risk	**1,414,282**	1,229,484
167,377	**203,849**	Operational risk	**78,482**	64,440
3,360,842	**3,877,309**	**Total risk-weighted assets**	**1,492,764**	1,293,924
		Capital adequacy ratio		
14.22%	**13.75%**	Total regulatory capital expressed as a percentage of total risk-weighted assets	**13.75%**	14.22%
9.30%	**9.66%**	Total tier 1 capital expressed as a percentage of total risk-weighted assets	**9.66%**	9.30%

The capital adequacy ratio given above is calculated in accordance with the Basel II norms as adopted by Central Bank of Oman and is before considering the proposed dividend given in note B21 to the financial statements. During February 2013 the bank has successfully raised an additional capital of OMR 10 million by way of a rights issue taking the paid up capital to OMR 110 million. Considering the increased capital and payment of cash dividend on the increased capital the total capital adequacy ratio will be 14.17% and the Tier 1 capital ratio will be 10.08%

D5.2 Capital allocation

The allocation of capital between specific operations and activities is, to a large extent, driven by optimization of the return achieved on the capital allocated. The amount of capital allocated to each operation or activity is based primarily upon the regulatory capital, but in some cases the regulatory requirements do not reflect fully the varying degree of risk associated with different activities. In such cases the capital requirements may be flexed to reflect differing risk profiles, subject to the overall level of capital to support a particular operation or activity not falling below the minimum required for regulatory purposes.

D Financial risk management (continued)

D5 Capital management (continued)

D5.2 Capital allocation (Continued)

The Central Bank of Oman has vide letter dated 23 April 2012 issued road map for implementation of Basel III guidelines in a phased manner beginning 2013 until 2019 and directed the banks to study Basel III announcements carefully and prepare themselves in the light of various requirements. This is under progress as being guided by CBO.

Basel III is different from Basel I and II in that it is more comprehensive in its scope and it also combines micro and macro prudential reforms to address both individual and system level risks. The definition of capital is tightened with strong focus on equity removing the hybrid instruments which are not loss absorbing in nature. It also brought in leverage ratio to serve as a backstop to risk based framework. The leverage ratio has system wide benefits in that it prevents excessive build up of debt across the banking system during boom times.

Global liquidity standards are being introduced to address short term and long term liquidity management. Supervisory Review Process is being enhanced under Pillar 2 and Pillar 3's (Disclosures) market discipline particularly trading and securitisation activities. The micro prudential element is build up of capital buffer in good times that can be drawn down in periods of stress.

Although maximization of the return on risk-adjusted capital is the principal basis used in determining how capital is allocated within the Bank to particular operations or activities, it is not the sole basis used for decision making. Account also is taken of synergies with other operations and activities, the availability of management and other resources, and the fit of the activity with the Bank's longer term strategic objectives.

D6 Segmental information

Segment information is presented in respect of the Bank's operating segments. For management purposes, the Bank is organised into four operating segments based on products and services as follows:

- Wholesale banking includes loans and deposits including current accounts, term deposit etc. for corporate and Trade finance customers.
- Retail banking includes deposits from retail customers, consumer loans, overdrafts, credit card and fund transfer facilities.
- Investments, FIG & Treasury include the banks investment activities including proprietary investments, international banks, international companies, institutional customers and treasury activities.
- Corporate banking includes the pool of resources considered for transfer pricing and absorbs the cost of impairment loss on portfolio basis and income tax expense.

The CEO monitors the operating results of its business units separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance is evaluated based on operating profit or loss. Income taxes are managed on Bank basis and are not allocated to operating segments.

Interest income is reported net as CEO primarily relies on net interest income as a performance measure, not the gross income and expense.

Transfer prices between operating segments are on an arm's length basis in a manner similar to transactions with third parties.

No revenue from transactions with a single external customer or counterparty amounted to 10% or more of the Bank's total revenue in 2012 or 2011.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012

D6 Segmental information (continued)

Segment information is as follows:

	2012 Retail banking RO'000	2012 Wholesale banking RO'000	2012 Investments, FIG & Treasury RO'000	2012 Head Office RO'000	2012 Total RO'000	2011 Retail banking RO'000	2011 Wholesale banking RO'000	2011 Investments, FIG & Treasury RO'000	2011 Head Office RO'000	2011 Total RO'000
Net interest income	19,212	18,248	10,977	(6,543)	41,894	16,821	18,630	3,183	(3,877)	34,757
Other operating income	3,362	4,280	2,781	-	10,423	3,580	3,227	1,651	(29)	8,429
Operating income	22,574	22,528	13,758	(6,543)	52,317	20,401	21,857	4,834	(3,906)	43,186
Operating expenses	(17,824)	(3,805)	(2,044)	-	(23,673)	(17,143)	(4,173)	(1,863)	-	(23,178)
Operating profit/(loss)	4,750	18,723	11,714	(6,543)	28,644	3,259	17,684	2,971	(3,906)	20,007
Impairment on investments	-	-	(17)	-	(17)	-	-	(17)	-	(17)
Portfolio provision	-	-	-	(1,351)	(1,351)	-	-	-	(881)	(881)
Specific provisions	(933)	(80)	(347)	-	(1,360)	(1,199)	(1,387)	-	-	(2,586)
Profit before tax	3,817	18,643	11,350	(7,894)	25,916	2,060	16,297	2,954	(4,787)	16,523
Income tax expense	-	-	-	(2,905)	(2,905)	-	-	-	(2,026)	(2,026)
Segment profit/(loss) for the year	3,817	18,643	11,351	(10,799)	23,011	2,060	16,297	2,954	(6,813)	14,497
Segment assets	376,884	734,513	508,118	167,651	1,787,166	363,263	626,425	338,112	104,179	1,431,979
Segment liabilities and equity	221,485	1,089,291	223,336	253,054	1,787,166	189,648	981,789	48,1200	212,422	1,431,979

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012 (continued)

D6 Segmental information (continued)

Segment information is as follows:

	2012					2011				
	Retail banking USD'000	Wholesale banking USD'000	Investments, FIG & Treasury USD'000	Head Office USD'000	Total USD'000	Retail banking USD'000	Wholesale banking USD'000	Investments, FIG & Treasury USD'000	Head Office USD'000	Total USD'000
Net interest income	49,901	47,397	28,512	(16,995)	108,815	43,692	48,389	8,267	(10,071)	90,277
Other operating income	8,732	11,117	7,223	-	27,072	9,299	8,382	4,288	(75)	21,894
Operating income	58,634	58,514	35,735	(16,995)	135,888	52,991	56,771	12,555	(10,146)	112,171
Operating expenses	(46,296)	(9,884)	(5,307)	-	(61,487)	(44,526)	(10,840)	(4,838)	-	(60,204)
Operating profit/(loss)	12,338	48,630	30,428	(16,995)	74,401	8,464	45,931	7,717	(10,146)	51,966
Impairment on investments	-	-	(44)	-	(44)	-	-	(44)	-	(44)
Portfolio provision	-	-	-	(3,509)	(3,509)	-	-		(2,288)	(2,288)
Specific provisions	(2,423)	(208)	(901)	-	(3,532)	(3,114)	(3,603)	-	-	(6,717)
Profit before tax	9,914	48,422	29,482	(20,504)	67,314	5,350	42,329	-	(12,435)	42,917
Income tax expense	-	-	-	(7,545)	(7,545)	-	-	-	(5,262)	(5,262)
Segment profit/(loss) for the year	9,914	48,422	29,482	(28,049)	59,769	5,350	42,329	7,673	(17,697)	37,655
Segment assets	978,918	1,907,826	1,319,787	435,458	4,641,989	943,541	1,627,078	878,213	270,595	3,719,427
Segment liabilities and equity	575,286	2,829,327	580,094	657,282	4,641,989	492,592	2,550,101	124,987	551,747	3,719,427

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