



## **Board of Directors Report for the half year ended 30<sup>th</sup> June 2011**

On behalf of the Board of Directors, I am pleased to present the results of your bank as at 30<sup>th</sup> June 2011.

Your bank achieved a Net Profit of OMR 6.928 million during the six month period ended 30<sup>th</sup> June 2011 as compared to a Net Profit of OMR 6.035 million during the same period in the previous year, a growth of 14.8%. The bank is continuing with its efforts for achieving a sustainable and profitable growth.

The Net Interest Income witnessed a significant improvement of 10.5% from OMR 15.145 million for the period ended 30<sup>th</sup> June 2010 to OMR 16.742 million for the period ended 30<sup>th</sup> June 2011. The operating income increased by a noteworthy 20% from OMR 17.261 million in the first six months of last year to OMR 20.727 million in the first six months of the current year. The operating cost increased by 26.25% from OMR 9.216 million to OMR 11.636 million during the same period.

Gross loans has reached one billion this quarter and Net loans and advances grew by 8.75% from OMR 903 million as at 31<sup>st</sup> December 2010 to reach OMR 982 million as at 30<sup>th</sup> June 2011, while customer deposits declined by 1.10% from OMR 999 million as at 31<sup>st</sup> December 2010 to OMR 988 Million as at 30<sup>th</sup> June 2011. The bank's market share of Private Sector Credit was 8.94 % while the Private Sector Deposit share was 6.67% as at end of June 2011.

The Omani banking sector landscape is changing once again, with the announcement of the licensing of a new Islamic bank, granting permission to local banks to operate Islamic windows, and the granting of an in-principle approval to one new commercial bank in the sector. Bank Sohar is actively working on all fronts to place itself suitably in this new competitive environment, and is carefully weighing all its options.

Bank Sohar recognises customer satisfaction as a key factor in the success of an organisation. In order to get closer to our customers, the bank has spread its branch network to the Buraimi region by opening a branch in Al Buraimi during the month of June 2011. This strategic investment will help provide a closer point of contact and service centres to our retail and corporate customers in Al Buraimi, and will assist us in meeting their increasing demands for banking services.

Furthermore, the bank continues to invest in the upgrading of our technological infrastructure by enabling the cash deposit option to our existing and new Automated Teller Machines (ATMs). This will enable the customers to safely store cash by

depositing into their own accounts at any time, day or night and get instant credit into their accounts. The bank also offers other services through a variety of outlets such as branches, ATMs, the Call Centre as well as electronic banking outlets such as Internet and SMS banking. The bank presently has a network of 22 branches and 19 offsite ATM's totaling to (41) ATMs.

Our staff are our most valuable resources, and we continuously invest in their learning and development to enable them to grow and succeed in their careers. In order to develop a strong breed of future managers and leaders in the bank, we have undertaken a leadership and development program which identifies the key development needs for the high potential candidates. This program is designed to groom them and mentor them in order to take up higher responsibilities in various areas in the bank in the future. The Bank has also conducted training programs on competency based interviewing systems, which focuses on identifying proven competencies in candidates being interviewed for positions in the bank. The total staff headcount as at 30th June 2011 stood at 539 and the Omanisation ratio is at 88.9%.

Your Bank continued to play an important role in the community during the second quarter of 2011 by supporting a number of events. The bank sponsored the Corporate Governance Conference organised by the CMA, the Symposium on Nation Building organised by the Ministry of Civil Services focused on development of human resources, and other corporate, social and community events. Further, recognising the importance of living a healthy life, the bank partnered with the Ministry of Health and UNICEF in organising a six-week Health Campaign to create awareness on the importance of nutrition to the whole family. The bank also continues to show its commitment and support to the cause of lifelong learning, and had contributed to the establishment of the centre at the Educational Village Project in Yiti.

We also take this opportunity to raise our deepest congratulations and blessings to His Majesty Sultan Qaboos bin Said on the occasion of the blessed Renaissance 23 / July, and express my humble gratitude and pay tribute to His Majesty for his wise and discerning leadership that has firmly set Oman on the path of progress and sustainable development.

On behalf of the Board of Directors, management and staff of the Bank, I would like to thank the Central Bank of Oman and the Capital Market Authority for their astute regulation and guidance.

Salim Said Al Fannah Al Araimi  
Chairman



## STATEMENT OF FINANCIAL POSITION

As at 30 June 2011

	<i>Notes</i>	<b>30 June 2011 RO'000</b>	<b>31 December 2010 RO'000</b>
<b>ASSETS</b>			
Cash and balances with Central Bank	<i>B1</i>	<b>50,276</b>	105,022
Due from Banks and other money market placements	<i>B2</i>	<b>88,318</b>	119,462
Loans and advances (net)	<i>B3</i>	<b>982,262</b>	903,034
Investment securities	<i>B4</i>	<b>83,149</b>	107,149
Property, equipment and fixtures	<i>B5</i>	<b>13,686</b>	13,765
Other assets	<i>B6</i>	<b>12,669</b>	10,183
		<b>1,230,360</b>	1,258,615
<b>LIABILITIES</b>			
Due to Banks and other money market deposits	<i>B7</i>	<b>31,776</b>	51,277
Certificates of deposit	<i>B8</i>	<b>7,038</b>	7,038
Customers' deposits	<i>B9</i>	<b>988,197</b>	999,135
Deferred income	<i>B10</i>	<b>7,000</b>	7,000
Other liabilities	<i>B11</i>	<b>30,192</b>	27,634
Subordinated loans	<i>B12</i>	<b>50,000</b>	50,000
		<b>1,114,203</b>	1,142,084
<b>SHAREHOLDERS' EQUITY</b>			
Share capital	<i>B13</i>	<b>100,000</b>	100,000
Legal reserve	<i>B14</i>	<b>3,555</b>	3,555
General reserve	<i>B14</i>	<b>413</b>	413
Fair value reserve	<i>B15</i>	<b>6</b>	1,308
Retained earnings		<b>12,183</b>	11,255
		<b>116,157</b>	116,531
		<b>1,230,360</b>	1,258,615
<b>Net assets per share (in baizas)</b>	<i>B16</i>	<b>116.157</b>	116.531
<b>CONTINGENT LIABILITIES</b>			
	<i>B17</i>	<b>186,068</b>	179,889
<b>COMMITMENTS</b>	<i>B17</i>	<b>258,942</b>	209,777

The financial statements were approved and authorized for issue by the Board of Directors on **30 July 2011** and signed on their behalf by:

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*Chairman*

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*Deputy Chairman*



## STATEMENT OF COMPREHENSIVE INCOME

Period ended 30 June 2011

	Notes	6 Months ended 30 June 2011 RO'000	6 Months ended 30 June 2010 RO'000	3 Months ended 30 June 2011 RO'000	3 Months ended 30 June 2010 RO'000
Interest income	C1	29,918	28,219	15,112	14,336
Interest expense	C2	(13,176)	(13,074)	(6,355)	(6,669)
<b>Net interest income</b>		<b>16,742</b>	15,145	<b>8,757</b>	7,667
Other operating income	C3	3,985	2,116	2,033	1,224
<b>OPERATING INCOME</b>		<b>20,727</b>	17,261	<b>10,790</b>	8,891
<b>OPERATING EXPENSES</b>					
Staff costs		(6,881)	(5,782)	(3,480)	(3,178)
Other operating expenses	C4	(3,679)	(2,542)	(1,751)	(1,219)
Depreciation	B5	(1,076)	(892)	(544)	(440)
		<b>(11,636)</b>	(9,216)	<b>(5,775)</b>	(4,837)
<b>OPERATING PROFIT</b>		<b>9,091</b>	8,045	<b>5,015</b>	4,054
Impairment on investments		-	-	-	-
Impairment allowance on portfolio basis	B3	(567)	(581)	(196)	(250)
Impairment allowance on specific basis	B3	(748)	(620)	(424)	(168)
<b>NET PROFIT BEFORE TAX</b>		<b>7,776</b>	6,844	<b>4,395</b>	3,636
<b>Income tax expense</b>	C5	<b>(848)</b>	(809)	<b>(525)</b>	(432)
<b>NET PROFIT/ (LOSS) FOR THE PERIOD</b>		<b>6,928</b>	6,035	<b>3,870</b>	3,204
Basic earnings/ (loss) per share for the period – in baizas	C6	<b>6.928</b>	6.035	<b>3.870</b>	3.204
Basic earnings/ (loss) per share for the period (annualized) – in baizas	C6	<b>13.971</b>	12.170	<b>15.523</b>	12.851
Net changes in fair value of available for sale financial assets		(1,171)	(49)	(463)	(356)
<b>Other comprehensive income for the period net of income tax</b>		<b>(1,171)</b>	(49)	<b>(463)</b>	(356)
<b>TOTAL COMPREHENSIVE INCOME FOR THE PERIOD</b>		<b>5,757</b>	5,986	<b>3,407</b>	2,848

**STATEMENT OF CHANGES IN EQUITY**

Period ended 30 June 2011

	<i>Share capital RO'000</i>	<i>Legal reserve RO'000</i>	<i>General reserve RO'000</i>	<i>Fair value reserve RO'000</i>	<i>Retained earnings RO'000</i>	<i>Total RO'000</i>
Balance as at 1 January 2010	100,000	2,533	-	426	2,470	105,429
Total comprehensive income for the period						
Net profit for the period	-	-	-	-	6,035	6,035
Other comprehensive income						
Net change in fair value of available for sale financial assets	-	-	-	(49)	-	(49)
Total comprehensive income for the period	100,000	2,533	-	377	8,505	114,415
Transfer to legal reserve	-	-	-	-	-	-
Balance as at 30 June 2010	100,000	2,533	-	377	8,505	111,415
Balance as at 1 July 2010	100,000	2,533	-	377	8,505	111,415
Total Comprehensive income for the period						
Net profit for the period	-	-	-	-	4,185	4,185
Other Comprehensive Income						
Net change in fair value of available for sale financial assets	-	-	-	931	-	931
Transfers	-	1,022	413	-	(1,435)	-
Balance as at 31 December 2010	100,000	3,555	413	1,308	11,255	116,531
	<b>RO'000</b>	<b>RO'000</b>	<b>RO'000</b>	<b>RO'000</b>	<b>RO'000</b>	<b>RO'000</b>
<b>Balance as at 1 January 2011</b>	<b>100,000</b>	<b>3,555</b>	<b>413</b>	<b>1,308</b>	<b>11,255</b>	<b>116,531</b>
<b>Total comprehensive income for the period</b>						
Net profit for the period	-	-	-	-	6,928	6,928
<b>Other comprehensive income</b>						
Net change in fair value of available for sale financial assets	-	-	-	(1,171)	-	(1,171)
Release on Sale of available for sale of financial assets	-	-	-	(131)	-	(131)
Dividend paid for the year 2010	-	-	-	-	(6,000)	(6,000)
<b>Balance as at 30 June 2011</b>	<b>100,000</b>	<b>3,555</b>	<b>413</b>	<b>6</b>	<b>12,183</b>	<b>116,157</b>

The attached notes A1 to D5 form an integral part of these financial statements

**STATEMENT OF CASH FLOWS**

Period ended 30 June 2011

	<i>30 June 2011 RO'000</i>	<i>30 June 2010 RO'000</i>
<b>OPERATING ACTIVITIES</b>		
Net profit/(loss) for the period before tax	7,776	6,844
Adjustments for:		
Depreciation	1,076	892
Impairment for credit losses	1,315	1,201
(Profit) / loss on sale of investment securities	(117)	1
Interest on investment	(454)	(294)
	<hr/>	<hr/>
<b>Operating profit before changes in operating assets and liabilities</b>	<b>9,596</b>	8,644
Change in due from banks and money market deposits	42,800	(82,775)
Changes in loans and advances	(80,543)	(61,448)
Changes in other assets	(2,487)	(334)
Changes in customers' deposits	(10,938)	45,427
Changes in due to banks and other money market deposits	(12,731)	11,760
Changes in other liabilities	3,772	6,692
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<b>Cash from (used in ) operating activities</b>	<b>(50,531)</b>	(72,034)
	<hr/>	<hr/>
<b>Income tax paid</b>	<b>(1,318)</b>	(742)
	<hr/>	<hr/>
<b>Net cash (used in) / from operating activities</b>	<b>(51,849)</b>	(72,776)
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<b>INVESTING ACTIVITIES</b>		
Purchase of investments (net)	(7,420)	-
Proceeds from sale/ redemption of investments	308	-
Purchase of property, equipment and fixtures	(1,000)	(1,237)
Interest received on investments	454	294
Proceeds from sale of property, equipment and fixtures	3	37
	<hr/>	<hr/>
<b>Net cash used in investing activities</b>	<b>(7,655)</b>	(906)
	<hr/> <hr/>	<hr/> <hr/>
<b>FINANCING ACTIVITIES</b>		
Dividends Paid	(6,000)	-
	<hr/>	<hr/>
<b>Net cash from financing activities</b>	<b>(6,000)</b>	-
	<hr/> <hr/>	<hr/> <hr/>
<b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>	<b>(65,504)</b>	(73,682)
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<b>CASH AND CASH EQUIVALENT AT BEGINNING OF THE PERIOD</b>	<b>171,313</b>	175,457
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<b>CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD</b>	<b>105,809</b>	101,775
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<b>REPRESENTING:</b>		
Cash and balances with Central Banks	50,276	52,934
Due from Banks and other money market placements	22,817	25,968
Investments securities	64,493	38,491
Due to Banks and other money market deposits	(31,777)	(15,618)
	<hr/>	<hr/>
	<b>105,809</b>	101,775
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## NOTES TO FINANCIAL STATEMENTS

At 30 June 2011

### **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 corporate and retail banking activities within the Sultanate of Oman. The Bank operates in Oman 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 employed 539 employees as of 30 June 2011 (31 December 2010: 513).

### **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 the following:

- derivative financial instruments are measured at fair value
- financial instruments at fair value through statement of income are measured at fair value
- available for sale financial assets are measured at fair value

#### **A2.3 Functional and presentation currency**

These financial statements are presented in Rials Omani rounded, except as indicated, to the nearest thousand Rials Omani. The functional currency of the Bank’s operations is Rial Omani.

#### **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 primarily consist of the provision for impairment of loans and advances.

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## NOTES TO FINANCIAL STATEMENTS

At 30 June 2011

### 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.

#### A3.1 Foreign currency translation

Transaction in foreign currencies are translated into respective functional currency of the operation at 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 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 & expense recognition

##### A3.2.a Interest income & expense

Interest income and expense is recognised in the statement of income using the effective interest rate 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 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 basis.
- Fair value changes in qualifying derivatives (including hedge ineffectiveness) and related hedged items when interest rate risk is the hedged risk.

##### 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 as 'net income from other financial instruments carried at fair value' in the statement of income.

Net Income from financial instruments at fair value relates to non-qualifying derivatives held for risk management purposes and financial assets designated at fair value through profit or loss, and include all realised and unrealised fair value changes interest, dividend and foreign exchange differences.

##### A3.2.c Dividend income

Dividend income is recognized when the right to receive income 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.

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.

##### A3.2.f Offsetting of income & 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 Banks trading activity



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## NOTES TO FINANCIAL STATEMENTS

At 30 June 2011

### A3 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

#### A3.3 Financial Assets and Liabilities

##### **A3.3.a 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 (including assets and liabilities designated at fair value through statement of income) are initially recognised on the trade date at which the Bank becomes a party to the contractual provisions of the instrument. Where assets are received without consideration these are accounted at 'fair value' in the statement of financial position under the appropriate classification and consequently 'deferred income' is created and disclosed as 'other liabilities'. Deferred income is recognized as 'other income' based on the encumbrance stipulated or usage of the asset.

##### **A3.3.b Derecognition**

The Bank derecognises a financial asset when the contractual rights to the cash flows from the asset expire, or its 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.c Offsetting of assets and liabilities**

Financial assets and liabilities are set off 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.

##### **A3.3.d 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.e Fair value measurement**

For investments traded in organized financial markets, fair value is determined by reference to quoted market prices at the close of business on the statement of financial position date.

The fair value of interest-bearing items is estimated based on discounted cash flows using interest rates for items with similar terms and risk characteristics. 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.

##### **A3.3.f Loans and advances**

Loans and advances 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 advances are carried at amortized cost less specifically identified and collective allowance for impairment. Specific provisions are made against the carrying amount of loans and advances that are identified as being impaired based on regular reviews of outstanding balances to reduce the impaired loans and advances to their recoverable amounts.

##### **A3.3.g Identification and measurement of impairment**

Collective impairment provisions are maintained in respect of incurred losses, which have not yet been specifically identified within the portfolio of loans and advance. The recoverable amount of loans and advances is calculated at the present value of the expected future cash flows discounted at the original effective interest rate. Short-term balances are not discounted.

When a loan is known to be uncollectible, all the necessary legal procedures have been completed, and the final loss has been determined, the loan is written off directly to the profit or loss in statement of income. Non specific provisions are established to meet the credit risks inherent within the loans and advances portfolio. This provision has been made to cover potential impairment which although not specifically identified, is to be present in the Bank's portfolio of financial assets based on industry data.

##### **A3.3.h Cash and cash equivalents**

Cash and cash equivalents consist of cash on 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.

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## NOTES TO FINANCIAL STATEMENTS

At 30 June 2011

### A3 SIGNIFICANT ACCOUNTING POLICIES (continued)

#### A3.3 Financial Assets and Liabilities (continued)

##### A3.3.i Balances due from Banks and other money market placements

These are stated at amortized cost less any allowance for impairment.

##### A3.3.j Designation at fair value through profit or loss

This category includes those assets and liabilities, which are initially recognized at cost and re-measured at fair value. All related realized and unrealized gains or losses are included in the profit or loss in the period in which they arise.

##### A3.3.k Trading assets and liabilities

Trading assets and liabilities are those assets and liabilities that the Bank acquires or incurs principally for the purpose of selling or repurchasing in the near term, or holds as a portfolio that is managed together for short term profit or position taking.

Trading assets and liabilities are initially recognised and subsequently measured at fair value in the statement of financial position with transaction costs taken directly to profit or loss. All changes in fair value realised or unrealised are recognised as a part of net trading income in the statement of income. Trading assets and liabilities are not reclassified subsequent to their initial recognition. Interest earned or dividends received are included in the interest and dividend income respectively.

##### A3.3.l Non-trading investments

These are classified as follows:

- Available for sale
- Held to maturity

All non –trading investments are initially recognised at cost, being the fair value of the consideration given including acquisition costs.

##### *Available for sale*

Available-for-sale financial investments are those which are designated as such or do not qualify to be classified as designated at fair value through profit or loss, held to maturity or loans and advances. They may be sold in response to liquidity needs or changes in market conditions. They include equity instruments, money market papers and other debt instruments.

After initial measurement, available for sale financial investments are subsequently measured at fair value. Unrealised gains and losses are recognised directly in other comprehensive income. When the security is disposed off, the cumulative gain or loss previously recognised in equity is recognised in the statement of income. Interest earned whilst holding available for sale financial investments are reported as interest income using the effective interest rate. Dividends earned whilst holding available for sale financial investments are recognised in the statement of income when the right of income has been established. The losses arising from impairment of such investments are recognised the statement of income.

##### *Held to maturity*

Held-to-maturity investments are non derivative assets with fixed or determinable payments and fixed maturity that the Bank has the positive intent and ability to hold financial assets to maturity; they are stated at amortized cost using the effective interest rate method less impairment losses. Any sale or re-classification of a significant amount of held-to-maturity investments not close to their maturity would result in the re-classification of all held-to-maturity investments as available-for-sale, and prevent the Bank from classifying investment securities as held-to-maturity for the current and following two financial years.

##### A3.3.m Repurchase and resale agreements

Assets 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 financial institutions. The difference between sale and repurchase price is treated as interest expense and accrued over the life of the repo agreement. Assets 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 deposits with Banks and other financial institutions. The difference between purchase and resale price is treated as interest income and accrued over the life of the reverse repo agreement.

##### A3.3.n 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 - statement of financial position commitment for acceptances.

## NOTES TO FINANCIAL STATEMENTS

At 30 June 2011

### A3 SIGNIFICANT ACCOUNTING POLICIES (continued)

#### A3.3 Financial Assets and Liabilities (continued)

##### A3.3.o 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. Derivative 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 profit or loss 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 profit or loss 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 profit or loss.

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 profit or loss 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 profit or loss 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 profit or loss as a component of net income on other financial instruments carried at fair value.

##### A3.3.p Property, equipment and fixtures

Items of property, equipment and fixtures are measured at cost less accumulated depreciation and impairment losses. 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. The estimated useful lives for the current period are as follows:

	Years
Motor vehicles	3
Furniture & fixtures	3
Office equipment	6-7
Production software	6-7

The assets' residual values, useful lives and depreciation methods are reviewed and adjusted if appropriate at each statement of financial position date.

##### A3.3.q Deposits, debt securities issued and subordinated liabilities

All money market and customer deposits are 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.

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## NOTES TO FINANCIAL STATEMENTS

At 30 June 2011

### A3 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

#### **A3.3.r Impairment of financial assets and provisions**

An assessment is made at each statement of financial position date to determine whether there is objective evidence that a specific financial asset may be impaired. If such evidence exists, the estimated recoverable amount of that asset is determined and any impairment loss, based on the net present value of future anticipated cash flows or fair value, recognised in the statement of income.

A provision for onerous contracts is recognised when the expected benefits to be derived by the Bank from the contract are lower than the unavoidable cost of meeting its obligation under the contract. The provision is measured at the present value of the lower of the expected cost of terminating the contract and the expected net cost of continuing with the contract. The Bank also recognises any impairment loss on the asset associated with the contract before establishing a provision.

#### **A3.4 Taxation**

Taxation is provided for based on the tax laws of Sultanate of Oman. Income tax comprises current and deferred tax. Income tax expense is recognised in the profit or loss 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 statement of financial position date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided using the financial position 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 statement of financial position 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 statement of financial position date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

#### **A3.5 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.

#### **A3.6 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.

#### **A3.7 Leases**

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

#### **A3.8 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.

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## NOTES TO FINANCIAL STATEMENTS

At 30 June 2011

### A3 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

#### A3.9 Employee benefits

##### A3.9.a Terminal benefits

The terminal benefits for Omani employees are provided in accordance with the Sultanate of Oman's Social Insurance Law of 1991, and are recognised as an expense in the statement of income on accrual basis.

The Bank's obligation in respect of non Omani terminal benefits, which is an unfunded defined benefit retirement plan, is amount of future benefit that such employees have earned in return for their services in the current and prior periods. The obligation is calculated using the project unit credit methods and is discounted to its present value.

##### A3.9.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.

#### A3.10 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.

#### A3.11 Comparative figures

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

#### A3.12 New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are effective for annual periods beginning after 1 January 2010, and have not been applied in preparing these financial statements. None of these is expected to have a significant effect on the financial statements of the Bank, except for IFRS 9 Financial Instruments, which becomes mandatory for the Bank's 2013 financial statements and could change the classification and measurement of financial assets. The Bank does not plan to adopt this standard early and the extent of the impact has not been determined.

#### A3.13 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.

#### A3.14 Determination of fair values

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 the following methods. When applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

##### A3.14.a Equity and debt securities

The fair value of equity and debt securities is determined by reference to their quoted closing bid price at the reporting date, or if unquoted, determined using a valuation technique. Valuation techniques employed include market multiples and discounted cash flow analysis using expected future cash flows and a market-related discount rate. The fair value of held-to-maturity investments is determined for disclosure purposes only.



## NOTES TO FINANCIAL STATEMENTS

At 30 June 2011

### A3 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

#### A3.14 Determination of fair values *(continued)*

##### *A3.14.b Loans and advances*

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.

##### *A3.14.c Derivatives*

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.

##### *A3.15.d Non-derivative financial liabilities*

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. For finance leases the market rate of interest is determined by reference to similar lease agreements.

**NOTES TO FINANCIAL STATEMENTS**

At 30 June 2011

**B1 CASH AND BALANCES WITH CENTRAL BANK**

	<i>30 June</i>	<i>31 December</i>
	<i>2011</i>	<i>2010</i>
	<i>RO'000</i>	<i>RO'000</i>
Cash	7,268	6,530
Capital deposit with Central Bank of Oman	500	500
Balance with Central Bank	42,508	97,992
	<u>50,276</u>	<u>105,022</u>

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

**B2 DUE FROM BANKS AND OTHER MONEY MARKET PLACEMENTS**

	<i>30 June</i>	<i>31 December</i>
	<i>2011</i>	<i>2010</i>
	<i>RO'000</i>	<i>RO'000</i>
<i>Local currency:</i>		
Due from other Banks	3,900	1,000
	<u>3,900</u>	<u>1,000</u>
<i>Foreign currency:</i>		
Due from other Banks	73,343	107,800
Nostro balances abroad	11,075	10,662
	<u>84,418</u>	<u>118,462</u>
	<u>88,318</u>	<u>119,462</u>

**B3 LOANS AND ADVANCES**

	<i>30 June</i>	<i>31 December</i>
	<i>2011</i>	<i>2010</i>
	<i>RO'000</i>	<i>RO'000</i>
Lending to Banks	22,608	5,775
Corporate loans	615,422	549,807
Personal loans	362,991	364,558
	<u>1,001,021</u>	<u>920,140</u>
Gross loans and advances	1,001,021	920,140
Impairment allowance on portfolio basis	(13,245)	(12,678)
Impairment allowance on specific basis	(5,514)	(4,428)
	<u>982,262</u>	<u>903,034</u>
Net loans and advances	982,262	903,034

Personal loans include RO 15,757,215 provided to staff on concessional terms (2010: RO 15,124,351).

**NOTES TO FINANCIAL STATEMENTS**

At 30 June 2011

**B3 LOANS AND ADVANCES (continued)**

Loans and advances comprise:

	<i>30 June</i>	<i>31 December</i>
	<i>2011</i>	<i>2010</i>
	<i>RO'000</i>	<i>RO'000</i>
<b>Lending to Banks</b>	<b>22,608</b>	5,775
<b>Loans to Customers</b>		
Loans	<b>896,992</b>	837,028
Overdrafts	<b>45,490</b>	55,349
Loan against trust receipts	<b>29,215</b>	15,031
Bills discounted	<b>6,716</b>	6,957
	<hr/>	<hr/>
Gross loans and advances	<b>1,001,021</b>	920,140
Impairment allowance on portfolio basis	<b>(13,245)</b>	(12,678)
Impairment allowance on specific basis	<b>(5,514)</b>	(4,428)
	<hr/>	<hr/>
Net loans and advances	<b>982,262</b>	903,034
	<hr/> <hr/>	<hr/> <hr/>

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

<b>Loan Loss Provision</b>	<i>30 June</i>	<i>31 December</i>
	<i>2011</i>	<i>2010</i>
	<i>RO'000</i>	<i>RO'000</i>
<b>Impairment allowance on portfolio basis</b>		
Balance at beginning of period	<b>12,678</b>	11,618
Provided during the period	<b>567</b>	1,060
	<hr/>	<hr/>
Balance at the end of the period	<b>13,245</b>	12,678
	<hr/> <hr/>	<hr/> <hr/>
<b>Impairment allowance on specific basis</b>		
<b>1) Loan loss provision</b>		
Balance at beginning of period	<b>3,828</b>	904
Provided during the period	<b>1,674</b>	3,844
Write back during the period	<b>(926)</b>	(920)
	<hr/>	<hr/>
Balance at the end of the period	<b>4,576</b>	3,828
	<hr/> <hr/>	<hr/> <hr/>
<b>2) Reserved interest</b>		
Balance at beginning of period	<b>600</b>	145
Reserved during the period	<b>402</b>	576
Interest released during the period	<b>(64)</b>	(121)
	<hr/>	<hr/>
Balance at end of the period	<b>938</b>	600
	<hr/> <hr/>	<hr/> <hr/>
Total	<b>5,514</b>	4,428
	<hr/> <hr/>	<hr/> <hr/>

Impairment allowance on portfolio basis is established to meet the credit risks inherent within the loans and advances on 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 30 June 2011, loans and advances on which interest is not being accrued or where interest has been reserved amounted to RO 10,333,865 (Dec 2010: RO 8,051,521).



**NOTES TO FINANCIAL STATEMENTS**

At 30 June 2011

**B4 INVESTMENT SECURITIES**

	<i>30 June 2011 RO'000</i>	<i>31 December 2010 RO'000</i>
Available for sale investment	76,609	103,109
Held to maturity investment	6,540	4,040
	<u>83,149</u>	<u>107,149</u>

**B4.a Available for sale investment comprise:**

	<i>Carrying/ fair value 30 June 2011 RO'000</i>	<i>Cost 30 June 2011 RO'000</i>	<i>Carrying/ fair value 31 December 2010 RO'000</i>	<i>Cost 31 December 2010 RO'000</i>
Unquoted equity securities	2,956	3,083	427	515
Equity securities with readily determinable fair value	9,161	9,208	8,262	7,379
Treasury Bills	64,492	64,451	94,420	94,385
	<u>76,609</u>	<u>76,742</u>	<u>103,109</u>	<u>102,279</u>

**B4.b Held-to-maturity investments comprise:**

	<i>30 June 2011 RO'000</i>	<i>31 December 2010 RO'000</i>
Corporate bonds	1,540	1,540
Debt securities	5,000	2,500
	<u>6,540</u>	<u>4,040</u>

**NOTES TO FINANCIAL STATEMENTS**

At 30 June 2011

**B5 PROPERTY, EQUIPMENT AND FIXTURES**

	<i>Freehold Land*</i>	<i>Production Software</i>	<i>Furniture &amp; fixtures</i>	<i>Office Equipments</i>	<i>Motor Vehicles</i>	<i>Capital Work in progress</i>	<i>Total</i>
	<i>RO'000</i>	<i>RO'000</i>	<i>RO'000</i>	<i>RO'000</i>	<i>RO'000</i>	<i>RO'000</i>	<i>RO'000</i>
<b>At cost:</b>							
1 January 2011	7,000	5,684	2,229	3,109	525	25	18,572
Additions	-	266	339	335	16	44	1,000
Disposals/ reallocation	-	-	-	(3)	-	-	(3)
<b>Carrying value at cost</b>	<b>7,000</b>	<b>5,950</b>	<b>2,568</b>	<b>3,441</b>	<b>541</b>	<b>69</b>	<b>19,569</b>
<b>Accumulated depreciation:</b>							
1 January 2011	-	(2,003)	(1,321)	(1,173)	(310)	-	(4,807)
Depreciation	-	(442)	(318)	(253)	(63)	-	(1,076)
<b>Total depreciation</b>	<b>-</b>	<b>(2,445)</b>	<b>(1,639)</b>	<b>(1,426)</b>	<b>(373)</b>	<b>-</b>	<b>(5,883)</b>
<b>Net carrying value at 30 June 2011</b>	<b>7,000</b>	<b>3,505</b>	<b>929</b>	<b>2,015</b>	<b>168</b>	<b>69</b>	<b>13,686</b>
<i>Net carrying value at 31 December 2010</i>	<i>7,000</i>	<i>3,681</i>	<i>908</i>	<i>1,936</i>	<i>215</i>	<i>25</i>	<i>13,765</i>

\* Free hold land represents three plots of land received by the Bank as grant from the Government of Sultanate of Oman during the year 2008, one plot is in Sohar and two plots are in Muscat region. The Bank has recorded the land based on the average valuation of the two professional valuers carried out during 2009. The valuation was conducted on an estimated market value basis assuming a willing buyer and seller acting prudently, knowledgeably and assuming the price is not affected by extraneous circumstances. An amount equivalent to the value of the land has also been recorded as deferred income and disclosed as a separate liability.

**B6 OTHER ASSETS**

	<i>30 June 2011 RO'000</i>	<i>31 December 2010 RO'000</i>
Interest receivable	2,395	2,530
Prepayments and deposits	1,460	1,117
Acceptances	7,474	5,334
Fair value receivables – forward exchange contracts	16	79
Deferred tax asset ( <i>Note C5</i> )	11	11
Others	1,313	1,112
	<b>12,669</b>	<b>10,183</b>

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**NOTES TO FINANCIAL STATEMENTS**

At 30 June 2011

**B7 DUE TO BANKS AND OTHER MONEY MARKET DEPOSITS**

	<i>30 June</i>	<i>31 December</i>
	<i>2011</i>	<i>2010</i>
	<i>RO'000</i>	<i>RO'000</i>
<i>Local currency:</i>		
Money market borrowings	-	3,850
Vostro balances	<b>591</b>	46
	<hr/>	<hr/>
	<b>591</b>	3,896
	<hr/>	<hr/>
<i>Foreign currency:</i>		
Money market borrowings	<b>31,185</b>	47,381
	<hr/>	<hr/>
	<b>31,185</b>	47,381
	<hr/>	<hr/>
	<b>31,776</b>	51,277
	<hr/> <hr/>	<hr/> <hr/>

**B8 CERTIFICATES OF DEPOSIT**

	<i>30 June</i>	<i>31 December</i>
	<i>2011</i>	<i>2010</i>
	<i>RO'000</i>	<i>RO'000</i>
Balance at beginning of period	<b>7,038</b>	39,038
Redeemed during the period	-	(32,000)
	<hr/>	<hr/>
Balance at end of period	<b>7,038</b>	7,038
	<hr/> <hr/>	<hr/> <hr/>

**NOTES TO FINANCIAL STATEMENTS**

At 30 June 2011

**B9 CUSTOMERS' DEPOSITS**

	<i>30 June</i> <i>2011</i> <i>RO'000</i>	<i>31 December</i> <i>2010</i> <i>RO'000</i>
Demand deposits	<b>208,322</b>	171,773
Saving deposits	<b>135,236</b>	116,636
Term deposits	<b>642,280</b>	709,406
Margin accounts	<b>2,359</b>	1,320
	<u><b>988,197</b></u>	<u>999,135</u>
<i>Retail customers:</i>		
Demand deposits	<b>7,585</b>	8,514
Term deposits	<b>27,204</b>	30,176
Saving deposits	<b>135,236</b>	116,636
<i>Corporate customers:</i>		
Demand deposits	<b>200,737</b>	163,259
Term deposits	<b>615,076</b>	679,230
Others	<b>2,359</b>	1,320
	<u><b>988,197</b></u>	<u>999,135</u>

**B10 DEFERRED INCOME**

	<i>30 June</i> <i>2011</i> <i>RO'000</i>	<i>31 December</i> <i>2010</i> <i>RO'000</i>
Deferred income on grants received from the Government in the form of freehold land ( <i>Note B5</i> )	<b>7,000</b>	7,000
	<u><b>7,000</b></u>	<u>7,000</u>

**NOTES TO FINANCIAL STATEMENTS**

At 30 June 2011

**B11 OTHER LIABILITIES**

	<i>30 June</i>	<i>31 December</i>
	<i>2011</i>	<i>2010</i>
	<i>RO'000</i>	<i>RO'000</i>
Interest payable	16,775	15,738
Staff entitlements	1,470	1,880
Acceptances	7,474	5,334
Accounts payable in suspense	31	33
Fair value payables – forward exchange contract	24	32
Income tax payable (net)	930	1,400
Other accruals and provisions	3,488	3,217
	<u>30,192</u>	<u>27,634</u>

**B12 SUBORDINATED LOANS**

During the year 2010 the Bank raised a subordinated loan of RO 50 Million with a maturity of 7 years and carrying a fixed rate of interest. 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 periodically. The bank is required to create a subordinated loan reserve equal to 20% of the issue value annually from 2012 till the maturity of the subordinated loans.

**B13 SHARE CAPITAL**

The authorised, issued and paid up share capital of the Bank is 1,000,000,000 shares of RO 0.100 each.

The Bank issued 100,000,000 shares of RO 1 each to the public in December 2006. An amount of RO 0.500 with the issue expenses of RO 0.020 was payable on application. Each RO 1 share was split into 10 shares of RO 0.100 each in an extraordinary general meeting held on 26 April 2009. Consequently the balance callable amount was reduced to RO 0.050 per share. The balance RO 0.050 per share was called upon to be paid by the shareholders on 10 May 2009. The Bank has received the call money on the issued shares.

As of 30 June 2011, the following shareholders held 10% or more of the Bank's capital, either individually or together with family members.

	<i>Number of shares</i>	<i>% Holding</i>
The Royal Court of Affairs	145,690,340	14.57%
Al Ghadeer Investments	105,000,000	10.50%

**B14 RESERVES**
**B14.1 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 which has been complied with. The legal reserves also include excess of issue fee of RO 0.020 per shares which were collected from the shareholders of the Bank net of issue expenses. The movement in the reserve has been disclosed in the statement of changes in equity.

**B14.2 General reserve**

A non distributable general reserve of RO 412,500 was created during the year 2010.

**NOTES TO FINANCIAL STATEMENTS**

At 30 June 2011

**B15 FAIR VALUE RESERVE**

The fair value reserve includes the cumulative net change in the fair value of the available-for-sale investments 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 116,157,000 as at 30 June 2011 (RO 116,531,000 as at 31 December 2010) attributable to ordinary shareholders on 1,000,000,000 ordinary shares, being the number of shares outstanding as at 30 June 2011.

**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.

	<i>30 June 2011 RO'000</i>	<i>31 December 2010 RO'000</i>
Guarantees	132,269	118,304
Documentary letters of credit	53,799	61,585
	<u>186,068</u>	<u>179,889</u>

**B17.2 Commitments**

Contractual obligation 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 requirements.

	<i>30 June 2011 RO'000</i>	<i>31 December 2010 RO'000</i>
Capital commitments	908	1,324
Credit related commitments	258,034	208,453
	<u>258,942</u>	<u>209,777</u>

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**NOTES TO FINANCIAL STATEMENTS**

At 30 June 2011

**B18 RELATED PARTY TRANSACTIONS**

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 arms length basis and are approved by the Bank's management.

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:

	<i>30 June</i>	<i>31 December</i>
	<i>2011</i>	<i>2010</i>
	<i>RO'000</i>	<i>RO'000</i>
<b>A) Loans and Advances</b>	<b>26,490</b>	25,943
<b>B) Deposits</b>	<b>10,211</b>	18,869
<b>C) Statement of comprehensive income</b>		
Interest income	7,732	209
Interest expense	<b>(1,063)</b>	(518)
<b>D) Senior Management compensation</b>		
Salaries and other short term benefits,	<b>1,669</b>	2,215
<b>E) Remuneration and sitting fees paid to directors</b>	<b>182</b>	58

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## NOTES TO FINANCIAL STATEMENTS

At 30 June 2011

### **B19 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. The derivative financial instruments used by the Bank are described below:

#### **B19.1 Derivative product types**

Forwards 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. The Bank transacts in derivative products for its customers or to hedge the Bank's proprietary positions. The Bank does not use derivative products for speculative purposes.

#### **B19.2 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. Hedging specific financial instruments and forecasted transactions as well as strategic hedging against overall statement of financial position exposures achieve this.

The Bank uses forward foreign exchange contracts, options and currency swaps 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 of 40% as mandated by the Central Bank of Oman.

In addition, the Bank uses interest rate swaps to hedge against the cash flows risks arising from certain fixed interest rate loans and deposits.

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.



**NOTES TO FINANCIAL STATEMENTS**

At 30 June 2011

**B19 DERIVATIVES (continued)**
**B19.3 Derivatives held or issued for hedging purposes (continued)**

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.

As at 30 June 2011

	<i>Notional amount</i> <i>RO'000</i>	<i>Notional amounts by term to maturity</i>		
		<i>Within 3 months</i> <i>RO'000</i>	<i>3 - 12 months</i> <i>RO'000</i>	<i>1 - 5 years</i> <i>RO'000</i>
<b>Forward foreign exchange purchase contracts</b>	<b>309,400</b>	<b>299,160</b>	<b>10,240</b>	<b>-</b>
<b>Forward foreign exchange sales contracts</b>	<b>309,572</b>	<b>299,317</b>	<b>10,255</b>	<b>-</b>

As at 31 December 2010

	<i>Notional amount</i> <i>RO'000</i>	<i>Notional amounts by term to maturity</i>		
		<i>Within 3 months</i> <i>RO'000</i>	<i>3 - 12 months</i> <i>RO'000</i>	<i>1 - 5 years</i> <i>RO'000</i>
Forward foreign exchange purchase contracts	329,299	253,767	75,532	-
Forward foreign exchange sales contracts	329,883	254,302	75,581	-

**NOTES TO FINANCIAL STATEMENTS**

At 30 June 2011

**C1 INTEREST INCOME**

	<i>6 Months ended 30 June 2011 RO'000</i>	<i>6 Months ended 30 June 2010 RO'000</i>	<i>3 Months ended 30 June 2011 RO'000</i>	<i>3 Months ended 30 June 2010 RO'000</i>
Due from Banks	667	159	116	127
Loans and advances to customers	28,797	27,766	14,597	14,059
Investment securities	454	294	399	150
	<u>29,918</u>	<u>28,219</u>	<u>15,112</u>	<u>14,336</u>

**C2 INTEREST EXPENSE**

	<i>6 Months ended 30 June 2011 RO'000</i>	<i>6 Months ended 30 June 2010 RO'000</i>	<i>3 Months ended 30 June 2011 RO'000</i>	<i>3 Months ended 30 June 2010 RO'000</i>
Due to Banks and other money market deposits	887	655	464	322
Customers' deposits	10,494	12,419	4,989	6,347
Certificates of deposits	183	-	92	-
Subordinated Debt	1,612	-	810	-
	<u>13,176</u>	<u>13,074</u>	<u>6,355</u>	<u>6,669</u>

**C3 OTHER OPERATING INCOME**

	<i>6 Months ended 30 June 2011 RO'000</i>	<i>6 Months ended 30 June 2010 RO'000</i>	<i>3 Months ended 30 June 2011 RO'000</i>	<i>3 Months ended 30 June 2010 RO'000</i>
Net gain from foreign exchange dealings	477	297	281	113
Fees and commission	2,705	1,751	1,611	1,072
Dividend income	686	67	24	39
Realised gains on financial investments through profit or loss	117	1	117	-
	<u>3,985</u>	<u>2,116</u>	<u>2,033</u>	<u>1,224</u>

**C4 OTHER OPERATING EXPENSES**

	<i>6 Months ended 30 June 2011 RO'000</i>	<i>6 Months ended 30 June 2010 RO'000</i>	<i>3 Months ended 30 June 2011 RO'000</i>	<i>3 Months ended 30 June 2010 RO'000</i>
Establishment costs	738	639	355	343
Operating and administration costs	2,759	1,875	1,372	865
Directors remuneration and sitting fees	182	28	24	11
	<u>3,679</u>	<u>2,542</u>	<u>1,751</u>	<u>1,219</u>

**NOTES TO FINANCIAL STATEMENTS**

At 30 June 2011

**C5 INCOME TAX**
**a) Recognized in the profit or loss**

	<i>6 Months ended 30 June 2011 RO'000</i>	<i>6 Months ended 30 June 2010 RO'000</i>
<b><i>Tax expenses</i></b>		
Current tax	<b>848</b>	811
Deferred tax expense /(income)	-	(2)
	<hr/>	<hr/>
Total tax expenses	<b>848</b>	809
	<hr/> <hr/>	<hr/> <hr/>

The Bank is liable to income tax 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**

Accounting profit for the year	<u>7,776</u>	<u>6,844</u>
Income tax	<b>933</b>	809
Tax exempt income	<b>(85)</b>	-
	<hr/>	<hr/>
Income tax expense	<b>848</b>	809
	<hr/> <hr/>	<hr/> <hr/>

**c) Deferred tax asset**

	<i>30 June 2011 RO'000</i>	<i>31Dec 2010 RO'000</i>
Fair value adjustment on investments	<u>11</u>	<u>11</u>
	<hr/>	<hr/>
	<b>11</b>	11
	<hr/> <hr/>	<hr/> <hr/>

**b) Tax assessment**

The assessments of the Bank for the years 2007 to 2010 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 30 June 2011.

**NOTES TO FINANCIAL STATEMENTS**

At 30 June 2011

**C6 BASIC EARNINGS / (LOSS) PER SHARE**

Earnings/ (loss) per share is calculated by dividing the net profit/ (loss) for the period by the weighted average number of shares outstanding during the period.

	<i><b>6 months ended 30 June 2011 RO'000</b></i>	<i><b>6 months ended 30 June 2010 RO'000</b></i>	<i><b>3 months ended 30 June 2011 RO'000</b></i>	<i><b>3 months ended 30 June 2010 RO'000</b></i>
Net profit for the period	<b>6,928</b>	6,035	<b>3,870</b>	3,204
Weighted average number of shares of RO 0.100 each outstanding during the year (in thousands) **	<b>1,000,000</b>	1,000,000	<b>1,000,000</b>	1,000,000
Net earnings per share for the period (in baizas)	<b>6.928</b>	6.035	<b>3.870</b>	3.204
Net earnings per share annualized (in baizas)	<b>13.971</b>	12.170	<b>15.523</b>	12.851

\*\*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.



## NOTES TO FINANCIAL STATEMENTS

At 30 June 2011

### 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), Credit and Risk committee, which are responsible for developing and monitoring 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 are established to identify and analyse the risks faced by the Bank, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management polices and systems are reviewed regularly to reflect changes in market conditions, products and services offered. The Bank, through its training and management procedures, aims to develop a constructive control environment, in which all employees understand their roles and obligations.

The Bank 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 Audit Committee is assisted in these functions by Internal Audit. Internal Audit undertakes both regular and ad-hoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee.

#### 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, and arises principally from the Bank's loans and advances to customers and other Banks and investment securities. For risk management reporting purposes the Bank considers and consolidates all elements of credit risk exposure (such as individual obligor default risk, country and sector risk)

##### D1.1 Management of credit risk

The Board of Directors has delegated responsibility for the monitoring of credit risk to its Credit & Risk Committee. A separate Risk Management Department, reporting to the CEO, is responsible for following:

- Formulating credit risk policies in consultation with business units, covering collateral requirements, credit assessment, risk grading and reporting, documentary and legal procedures, and compliance with regulatory and statutory requirements.
- Establishing the authorization structure for the approval and renewal of credit facilities.
- Reviewing and assessing credit risk. The Board Credit & Risk Committee assesses all credit exposures in excess of designated limits, prior to facilities being committed to customers by the business unit concerned. 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.
- Reviewing compliance of business units with agreed exposure limits, including those for selected industries, country risk and product types. Ensuring always to be within the single obligor limit and also within the concentration risk limit, for various sectors, which are continuously monitored.
- Providing advice, guidance and specialist skills to business units to promote best practice throughout the Bank in the management of credit risk.

Each business unit is required to implement Bank's credit risk policies and procedures, with credit approval authorities delegated from the Bank's Credit & Risk Committee. Business units have their counter parts in Risk Management, having specialised expertise in managing risks typical to these business units. Regular audits of business units and Bank's Credit processes are undertaken by Internal Audit.

**NOTES TO FINANCIAL STATEMENTS**

At 30 June 2011

**D FINANCIAL RISK MANAGEMENT (continued)**
**D2 Exposure to liquidity risk**
**As at 30 June 2011**

	<i>Carrying amount</i>	<i>Gross Nominal Outflow</i>	<i>Within 3 months</i>	<i>3 - 12 months</i>	<i>Over 1 year</i>
	<i>RO'000</i>	<i>RO'000</i>	<i>RO'000</i>	<i>RO'000</i>	<i>RO'000</i>
<i>Non-derivative liabilities</i>					
Due to banks and other money market deposits	31,776	31,226	31,226	-	-
Certificates of deposits	7,038	7,042	7,042	-	-
Customers' deposits	988,197	1,026,581	568,754	235,622	222,205
Deferred income	7,000	7,000	-	-	7,000
Subordinated loans	50,000	69,939	1,603	1,603	66,733
Other liabilities	30,192	30,192	30,192	-	-
<b>Total</b>	<b>1,114,203</b>	<b>1,171,980</b>	<b>638,817</b>	<b>237,225</b>	<b>295,938</b>

**As at 31 December 2010**

	<i>RO'000</i>	<i>RO'000</i>	<i>RO'000</i>	<i>RO'000</i>	<i>RO'000</i>
<i>Non-derivative liabilities</i>					
Due to banks and other money market deposits	51,277	51,551	38,563	12,988	-
Certificates of deposits	7,038	7,407	185	7,222	-
Customers' deposits	999,135	1,042,886	499,879	245,176	297,831
Deferred income	7,000	7,000	-	-	7,000
Subordinated loans	50,000	72,781	1,603	1,603	69,575
Other liabilities	27,634	27,634	27,634	-	-
<b>Total</b>	<b>1,142,084</b>	<b>1,209,259</b>	<b>567,864</b>	<b>266,989</b>	<b>374,406</b>

The Bank prepares a liquidity gap report to monitor the Banks 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 an availed committed lines of credit, if any. This Statement of short term liquidity is to be reported to the ALCO and Credit & Risk Committee every month.

**NOTES TO FINANCIAL STATEMENTS**

At 30 June 2011

**D FINANCIAL RISK MANAGEMENT (continued)**
**D3 Exposure to interest rate risk – non trading portfolios**

The Bank's interest sensitivity position based on contractual re-pricing arrangements at 30 June 2011 was as follows:

<b>As at 30 June 2011</b>	<i>On demand within 3 months RO'000</i>	<i>3 to 12 months RO'000</i>	<i>Over 1 year RO'000</i>	<i>Non interest sensitive RO'000</i>	<i>Total RO'000</i>
Cash and balances with Central Bank	-	-	-	50,276	50,276
Due from Banks and other money market placements	85,418	2,900	-	-	88,318
Loans and advances	416,093	156,554	428,374	-	1,001,021
Investment securities	69,527	3,369	-	10,253	83,149
Property and equipment	-	-	-	13,686	13,686
Other assets	-	-	-	12,669	12,669
<b>Total assets</b>	<b>571,038</b>	<b>162,823</b>	<b>428,374</b>	<b>86,884</b>	<b>1,249,119</b>
Due to Banks and other money market deposits	31,776	-	-	-	31,776
Certificates of deposit	7,038	-	-	-	7,038
Customers' deposits	223,776	224,275	199,827	340,319	988,197
Deferred income	-	-	-	7,000	7,000
Other liabilities	-	-	-	30,192	30,192
Impairment allowance on portfolio basis	-	-	-	18,759	18,759
Subordinated loan	-	-	-	50,000	50,000
Shareholders' equity	-	-	-	116,157	116,157
<b>Total liabilities and shareholders' equity</b>	<b>262,590</b>	<b>224,275</b>	<b>199,827</b>	<b>562,247</b>	<b>1,249,119</b>
<b>Total interest rate sensitivity gap</b>	<b>308,448</b>	<b>(61,452)</b>	<b>228,547</b>	<b>(475,543)</b>	<b>-</b>
<b>Cumulative interest rate sensitivity gap</b>	<b>308,448</b>	<b>246,996</b>	<b>475,543</b>	<b>-</b>	<b>-</b>
<b>As at 31 December 2010</b>	<i>On demand within 3 months RO'000</i>	<i>3 to 12 months RO'000</i>	<i>Over 1 year RO'000</i>	<i>Non interest sensitive RO'000</i>	<i>Total RO'000</i>
Cash and balances with Central Bank	-	-	-	105,022	105,022
Due from Banks and other money market placements	107,411	12,051	-	-	119,462
Loans and advances	321,905	121,188	472,619	-	915,712
Investment securities	94,420	-	-	12,729	107,149
Property and equipment	-	-	-	13,765	13,765
Other assets	-	-	-	10,183	10,183
<b>Total assets</b>	<b>523,736</b>	<b>133,239</b>	<b>472,619</b>	<b>141,699</b>	<b>1,271,293</b>
Due to Banks and other money market deposits	51,277	-	-	-	51,277
Certificates of deposit	-	7,038	-	-	7,038
Customers' deposits	209,873	232,751	556,511	-	999,135
Deferred income	-	-	-	7,000	7,000
Other liabilities	-	-	-	26,234	26,234
Income tax payable	-	-	-	1,400	1,400
Impairment allowance on portfolio basis	-	-	-	12,678	12,678
Subordinated loan	-	-	50,000	-	50,000
Shareholders' equity	-	-	-	116,531	116,531
<b>Total liabilities and shareholders' equity</b>	<b>261,150</b>	<b>239,789</b>	<b>606,511</b>	<b>163,843</b>	<b>1,271,293</b>
<b>Total interest rate sensitivity gap</b>	<b>262,586</b>	<b>(106,550)</b>	<b>(133,892)</b>	<b>(22,144)</b>	<b>-</b>
<b>Cumulative interest rate sensitivity gap</b>	<b>262,586</b>	<b>156,036</b>	<b>22,144</b>	<b>-</b>	<b>-</b>

**NOTES TO FINANCIAL STATEMENTS**

At 30 June 2011

**D FINANCIAL RISK MANAGEMENT** *(continued)*
**D4 Exposure to 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:

	<i>30 June 2011</i>			<i>31 December 2010</i>		
	<i>Assets</i>	<i>Liabilities</i>	<i>Net Open Position</i>	<i>Assets</i>	<i>Liabilities</i>	<i>Net Open position</i>
	<i>RO'000</i>	<i>RO'000</i>	<i>RO'000</i>	<i>RO'000</i>	<i>RO'000</i>	<i>RO'000</i>
US Dollar	280,129	295,346	15,217	360,222	373,120	12,898
Saudi Rial	60,685	60,678	7	94,746	108,056	13,310
EUR	20,173	20,173	-	18,185	18,184	1
UAE Dirhams	15,880	1,116	14,764	11,019	4,350	6,669
Qatari Rial	279	6	273	114	8	106
Kuwaiti Dinar	49	39	10	65	-	65
Japanese Yen	257	254	3	3	-	3
Pound Sterling	299	304	5	783	785	2
Indian Rupee	30	-	30	8	-	8
Others	6,467	2,249	4,218	897	788	109
Total			<u>34,527</u>			<u>33,171</u>



**NOTES TO FINANCIAL STATEMENTS**

At 30 June 2011

**D FINANCIAL RISK MANAGEMENT** *(continued)*
**D5 CAPITAL MANAGEMENT**

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:

	<i>30 June 2011 RO'000</i>	<i>31 December 2010 RO'000</i>
<b>Tier I capital</b>		
Ordinary share capital	100,000	100,000
Legal reserve	3,555	3,555
General reserve	413	413
Retained earnings	12,183	5,255
Fair value losses	(236)	(112)
Deferred tax asset	(11)	(11)
Total	<u>115,904</u>	<u>109,100</u>
<b>Tier 2 capital</b>		
Impairment allowance on portfolio basis	13,245	12,678
Fair value gains	109	640
Subordinated loan	50,000	50,000
Total	<u>63,354</u>	<u>63,318</u>
<b>Total regulatory capital</b>	<u>179,258</u>	<u>172,418</u>
<b>Risk-weighted assets</b>		
Credit and market risks	1,129,193	1,061,044
Operational risk	46,253	64,328
Total risk-weighted assets	<u>1,175,446</u>	<u>1,125,372</u>
<b>Capital adequacy ratio</b>		
Total regulatory capital expressed as a percentage of total risk-weighted assets	15.25%	15.32%
Total tier I capital expressed as a percentage of total risk-weighted assets	9.86%	9.69%

The capital adequacy ratio is calculated in accordance with the Basel II norms as adopted by Central Bank of Oman.