



### INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF AL AHLI BANK OF KUWAIT K.S.C.

We have audited the accompanying consolidated financial statements of Al Ahli Bank of Kuwait K.S.C. (the Bank) and its Subsidiary (collectively "the Group"), which comprise the consolidated balance sheet as of 31 December 2008 and the consolidated income statement, consolidated statement of changes in "shareholders' equity" and consolidated cash flow statement for the year then ended, and a summary of Significant Accounting Policies and other explanatory notes.

#### Management's responsibility for the financial statements

The Bank's management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as adopted for use by the State of Kuwait. This responsibility includes: designing, implementing and maintaining internal controls relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

#### Auditors' responsibility

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

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

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

#### Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 31 December 2008, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted for use by the State of Kuwait.

#### Report on other legal and regulatory requirements

Furthermore, in our opinion proper books of account have been kept by the Group and the consolidated financial statements, together with the contents of the report of the Bank's Board of Directors relating to these consolidated financial statements, are in accordance therewith. We further report that we obtained all the information and explanations that we required for the purpose of our audit and that the consolidated financial statements incorporate all information that is required by the Capital Adequacy Regulations issued by Central Bank of Kuwait as stipulated in CBK Circular number 2/BS/184/2005 dated 21 December 2005, as amended, Commercial Companies Law of 1960, as amended, and by the Bank's Articles of Association, that an inventory was duly carried out and that, to the best of our knowledge and belief, no violations of Capital Adequacy Regulations issued by Central Bank of Kuwait as stipulated in CBK Circular number 2/BS/184/2005 dated 21 December 2005, as amended, Commercial Companies Law of 1960, as amended, nor of the Articles of Association have occurred during the year ended 31 December 2008 that might have had a material effect on the business of the Group or on its financial position.

We further report that, during the course of our audit, we have not become aware of any material violations of the provisions of Law No. 32 of 1968, as amended, concerning currency, the Central Bank of Kuwait and the organisation of banking business, and its related regulations during the year ended 31 December 2008.

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WALEED A. AL OSAIMI  
LICENCE NO. 68 A  
OF ERNST & YOUNG

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BADER A. AL WAZZAN  
LICENCE NO. 62 A  
PRICEWATERHOUSECOOPERS

22 February 2009  
Kuwait

## Consolidated Income Statement

Year ended 31 December 2008

	Notes	2008 (KD 000s)	2007 (KD 000s)
Interest income	3	185,341	175,002
Interest expense	4	116,869	108,610
<b>Net interest income</b>		<b>68,472</b>	<b>66,392</b>
Net fees and commission income	5	24,493	18,415
Net foreign exchange gains		5,073	5,135
Net (loss) gain on investments at fair value through profit or loss		(3,297)	2,563
Net gain on sale of investments available for sale		5,436	4,499
Dividend income		6,590	4,889
Other income	6	6,235	15,412
<b>INCOME</b>		<b>113,002</b>	<b>117,305</b>
Staff expenses		18,393	17,355
Depreciation		1,238	1,645
Other operating expenses		9,302	7,938
<b>EXPENSES</b>		<b>28,933</b>	<b>26,938</b>
<b>PROFIT FOR THE YEAR BEFORE PROVISION / IMPAIRMENT LOSSES</b>		<b>84,069</b>	<b>90,367</b>
Net provision / impairment losses	7	(34,702)	(10,416)
<b>PROFIT FOR THE YEAR AFTER PROVISION / IMPAIRMENT LOSSES</b>		<b>49,367</b>	<b>79,951</b>
Directors' fees		255	351
Taxation	8	3,076	3,559
<b>NET PROFIT FOR THE YEAR</b>		<b>46,036</b>	<b>76,041</b>
<b>BASIC AND DILUTED EARNINGS PER SHARE</b>	9	<b>42 fils</b>	<b>69 fils</b>

The attached notes 1 to 25 form part of these consolidated financial statements.

# Consolidated Balance Sheet

31 December 2008

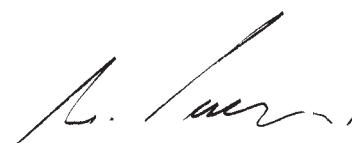
	Notes	2008 (KD 000s)	2007 (KD 000s)
<b>ASSETS</b>			
Cash and balances with banks	10	378,897	583,695
Treasury bonds	11	291,020	189,326
Central Bank of Kuwait bonds	11	9,999	69,727
Investments at fair value through profit or loss		3,732	23,024
Loans and advances	12	2,129,103	1,870,012
Investments available for sale	13	155,541	182,071
Other assets	14	34,845	29,346
Premises and equipment	15	33,822	13,956
<b>TOTAL ASSETS</b>		<b>3,036,959</b>	<b>2,961,157</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
<b>LIABILITIES</b>			
Due to banks and other financial institutions		648,567	335,401
Customers' deposits	16	1,991,676	2,207,998
Certificates of deposit		-	22,436
Other liabilities	17	84,304	76,228
<b>TOTAL LIABILITIES</b>		<b>2,724,547</b>	<b>2,642,063</b>
<b>SHAREHOLDERS' EQUITY</b>			
Share capital	18	109,804	100,738
Proposed bonus shares	18	5,490	9,066
Treasury shares	18	(3,140)	(2,601)
Reserves	18	178,374	166,708
Proposed dividend	18	21,884	45,183
<b>TOTAL SHAREHOLDERS' EQUITY</b>		<b>312,412</b>	<b>319,094</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>		<b>3,036,959</b>	<b>2,961,157</b>



Ahmed Yousuf Behbehani  
Chairman



Ali Hilal Al Mutairi  
Deputy Chairman and Managing Director



Colin Plowman  
Chief General Manager and  
Chief Executive Officer

The attached notes 1 to 25 form part of these consolidated financial statements.

## Consolidated Statement of Changes in Shareholders' Equity

Year ended 31 December 2008

	Reserves													
	Share capital (KD 000s)	Proposed bonus shares (KD 000s)	Treasury shares (KD 000s)	Share premium (KD 000s)	Statutory reserve (KD 000s)	General reserve (KD 000s)	Treasury shares reserve (KD 000s)	Cumulative changes in fair value (KD 000s)	Revaluation surplus (KD 000s)	Foreign currency translation reserve (KD 000s)	Retained earnings (KD 000s)	Total reserves (KD 000s)	Proposed dividend (KD 000s)	Total (KD 000s)
Balance as at 1 January 2007	95,941	4,797	(1,517)	36,838	25,953	25,506	4,704	5,320	-	-	27,354	125,675	38,287	263,183
Effect of changes in fair values of "investments available for sale"	-	-	-	-	-	-	-	17,185	-	-	-	17,185	-	17,185
Impairment loss / net gain on sale of "investments available for sale"	-	-	-	-	-	-	-	2,054	-	-	-	2,054	-	2,054
Income directly recognised in equity	-	-	-	-	-	-	-	19,239	-	-	-	19,239	-	19,239
Net profit for the year	-	-	-	-	-	-	-	-	-	-	76,041	76,041	-	76,041
Total recognised income and expenses for the year	-	-	-	-	-	-	-	19,239	-	-	76,041	95,280	-	95,280
Bonus shares issued	4,797	(4,797)	-	-	-	-	-	-	-	-	-	-	-	-
Dividend paid	-	-	-	-	-	-	-	-	-	-	-	-	(38,285)	(38,285)
Treasury shares purchased	-	-	(1,084)	-	-	-	-	-	-	-	-	-	-	(1,084)
Dividend on treasury shares	-	-	-	-	-	-	-	-	-	-	2	2	(2)	-
Transfers to reserves	-	-	-	-	7,913	7,913	-	-	-	(15,826)	(9,066)	(9,066)	-	-
Proposed bonus shares	-	9,066	-	-	-	-	-	-	-	(9,066)	(9,066)	-	-	-
Proposed dividend	-	-	-	-	-	-	-	-	-	(45,183)	(45,183)	45,183	-	-
Balance as at 31 December 2007	100,738	9,066	(2,601)	36,838	33,866	33,419	4,704	24,559	-	-	33,322	166,708	45,183	319,094
Revaluation of freehold land (Note 15)	-	-	-	-	-	-	-	-	11,473	-	-	11,473	-	11,473
Effect of changes in fair values of "investments available for sale"	-	-	-	-	-	-	-	(41,512)	-	-	-	(41,512)	-	(41,512)
Impairment loss / net gain on sale of "investments available for sale"	-	-	-	-	-	-	-	21,139	-	-	-	21,139	-	21,139
(Expense) / income directly recognised in equity	-	-	-	-	-	-	(20,373)	11,473	-	-	-	(8,900)	-	(8,900)
Net profit for the year	-	-	-	-	-	-	-	-	-	-	46,036	46,036	-	46,036
Total recognised (expense) income for the year	-	-	-	-	-	-	(20,373)	11,473	-	-	46,036	37,136	-	37,136
Foreign currency translation	-	-	-	-	-	-	-	-	82	-	-	82	-	82
Bonus shares issued (Note 18)	9,066	(9,066)	-	-	-	-	-	-	-	-	-	-	-	-
Dividend paid (Note 18)	-	-	-	-	-	-	-	-	-	-	-	-	(45,130)	(45,130)
Treasury shares purchased	-	-	(4,797)	-	-	-	-	-	-	-	-	-	-	(4,797)
Treasury shares sold	-	-	4,258	-	-	-	1,769	-	-	-	-	1,769	-	6,027
Dividend on treasury shares	-	-	-	-	-	-	-	-	-	-	53	53	(53)	-
Transfers to reserves (Note 18)	-	-	-	-	4,837	4,837	-	-	-	(9,674)	(9,674)	-	-	-
Proposed bonus shares (Note 18)	-	5,490	-	-	-	-	-	-	-	(5,490)	(5,490)	-	-	-
Proposed dividend (Note 18)	-	-	-	-	-	-	-	-	-	(21,884)	(21,884)	21,884	-	-
Balance as at 31 December 2008	109,804	5,490	(3,140)	36,838	38,703	38,256	6,473	4,186	11,473	82	42,363	178,374	21,884	312,412

The attached notes 1 to 25 form part of these consolidated financial statements.

## Consolidated Cash Flow Statement

Year ended 31 December 2008

	2008 (KD 000s)	2007 (KD 000s)
<b>OPERATING ACTIVITIES</b>		
Net profit for the year	46,036	76,041
Adjustments for:		
Net gain on sale of investments available for sale	(5,436)	(4,499)
Dividend income	(6,590)	(4,889)
Gain on sale of premises and equipment	(4,797)	(13,704)
Depreciation	1,238	1,645
Net provision / impairment losses	34,702	10,416
Operating profit before changes in operating assets and liabilities	65,153	65,010
<b>Changes in operating assets and liabilities:</b>		
Deposits with banks	141,616	(154,381)
Treasury bonds	(101,694)	32,705
Central Bank of Kuwait bonds	59,728	(64,771)
Investments at fair value through profit or loss	19,292	(4,602)
Loans and advances	(274,304)	(437,952)
Government debt bond	-	90,431
Other assets	(5,499)	(10,762)
Due to banks and other financial institutions	313,166	(81,977)
Customers' deposits	(216,322)	631,329
Certificates of deposit	(22,436)	(16,998)
Other liabilities	7,504	11,432
Net cash (used in) from operating activities	(13,796)	59,464
<b>INVESTING ACTIVITIES</b>		
Purchase of investments available for sale	(61,890)	(52,291)
Proceeds from sale of investments available for sale	46,908	28,064
Net sale of premises and equipment	2,824	12,409
Dividend income	6,590	4,889
Net cash used in investing activities	(5,568)	(6,929)
<b>FINANCING ACTIVITIES</b>		
Dividend paid	(45,130)	(38,285)
Purchase of treasury shares	(4,797)	(1,084)
Sale of treasury shares	6,027	-
Repayment of medium term borrowings	-	(65,057)
Net cash used in financing activities	(43,900)	(104,426)
Foreign currency translation	82	-
<b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(63,182)</b>	<b>(51,891)</b>
<b>CASH AND CASH EQUIVALENTS AT 1 JANUARY</b>	<b>326,010</b>	<b>377,901</b>
<b>CASH AND CASH EQUIVALENTS AT 31 DECEMBER</b>	<b>262,828</b>	<b>326,010</b>
<b>Cash and cash equivalents comprise:</b>		
Cash and balances with banks (Note 10)	105,859	19,147
Deposits with banks maturing within thirty days (Note 10)	156,969	306,863
	262,828	326,010

The attached notes 1 to 25 form part of these consolidated financial statements.

# Notes to the Consolidated Financial Statements

31 December 2008

## 1 INCORPORATION AND REGISTRATION

Al Ahli Bank of Kuwait K.S.C. ("the Bank") is a public shareholding company incorporated in Kuwait on 23 May 1967 and is registered as a Bank with the Central Bank of Kuwait. Its registered office is at Al Safat Square, Ahmed Al Jaber Street, Kuwait City. It is engaged in banking, primarily in Kuwait, and in the United Arab Emirates.

The Bank has a wholly owned subsidiary company, Ahli Capital Investment Company K.S.C. (Closed) ("the Subsidiary"). The subsidiary is engaged in investment management and advisory activities and is under the supervision of the Central Bank of Kuwait.

These consolidated financial statements of the Bank and its Subsidiary (collectively "the Group") were approved for issue by the Bank's Board of Directors on 22 February 2009. The annual general assembly of the shareholders has the power to amend these consolidated financial statements after issuance.

## 2 SIGNIFICANT ACCOUNTING POLICIES

### Basis of presentation

The consolidated financial statements are prepared under the historical cost convention as modified by the revaluation of "investments at fair value through profit or loss", financial assets held as "investments available for sale", freehold land and derivative contracts.

The consolidated financial statements have been presented in Kuwaiti Dinars, which is the Group's functional and presentation currency, rounded to the nearest thousand except when otherwise stated.

### Statement of compliance

The consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted for use by the State of Kuwait for financial services institutions regulated by the Central Bank of Kuwait (CBK). These regulations require adoption of all IFRS except for the IAS 39 requirement for collective provision, which has been replaced by the CBK's requirement for a minimum general provision as described under the accounting policy for impairment of financial assets.

### Changes in accounting policies

The accounting policies are consistent with those used in the previous year except for the fair valuation of freehold land. With effect from the current year, freehold land is measured at fair value using the revaluation model instead of the cost model.

The following International Accounting Standard Board (IASB) and International Financial Reporting Interpretation Committee (IFRIC) have been issued but are not yet effective and have not been adopted by the Group:

IAS 1: Presentation of Financial Statements – Revised  
IFRS 8: Operating Segments  
IFRIC 11: IFRS 2 – Group and Treasury Share Transactions  
IFRIC 12: Service Concession Arrangements  
IFRIC 13: Customer Loyalty Program

The application of these standards will be made in the consolidated financial statements when these standards and interpretations become effective and are not expected to have a material impact on the consolidated financial statements of the Group.

Following are the major changes:

#### IAS 1 Presentation of financial statements – (revised):

The revised standard introduces changes to the presentation of the consolidated financial statements and does not affect the recognition, measurement or disclosure of specific transactions. The standard will not affect the financial position or results of the Group but will introduce some changes to the presentation of the financial position, changes in equity and financial results of the Group. Other changes to the standard are not expected to have a material impact on the consolidated financial statements of the Group.

#### IFRS 8 – Operating segments:

The standard relates to disclosure requirements for segmental information and replaces IAS 14 – Segmental Reporting. The new standard intends to disclose segment information in line with information provided to the senior management.

# Notes to the Consolidated Financial Statements

31 December 2008

## 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

### Basis of consolidation

The consolidated financial statements comprise the financial statements of the Bank and its subsidiary. The financial statement of the subsidiary is prepared for the same reporting year as the Bank using consistent accounting policies.

Subsidiaries are all entities that are controlled by the Group. Control exists when the Group has the power, directly or indirectly, to govern the financial and operating policies of the entity generally accompanying a shareholding of more than one half of the voting rights. Subsidiaries are consolidated from the date on which the Group obtains control and continue to be consolidated until the date that such control ceases.

All material intra-group balances and transactions, including material unrealised gains and losses arising on intra-group transactions are eliminated on consolidation.

### Financial instruments

#### Classification of financial instruments

The Group classifies financial instruments as “financial assets at fair value through profit or loss”, “loans and receivables”, “financial assets available for sale” and “financial liabilities other than at fair value through profit or loss”. Management determines the appropriate classification of each instrument at the time of acquisition.

#### Recognition / de-recognition

A financial asset or a financial liability is recognised when the Group becomes a party to the contractual provisions of the instrument. All regular way purchase and sale of financial assets are recognised using settlement date accounting. Changes in fair value between the trade date and settlement date are recognised in the consolidated income statement or in consolidated statement of changes in shareholders' equity in accordance with the policy applicable to the related instrument. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulations or conventions in the market place.

A financial asset (in whole or in part) is derecognised either when:

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

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

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

### Measurement

All financial assets or financial liabilities are initially measured at fair value. Transaction costs are added to the cost on all financial instruments except on financial assets classified as financial assets at fair value through profit or loss. Transaction costs on financial assets classified as financial assets at fair value through profit or loss are recognised in the consolidated income statement.

#### Financial assets at fair value through profit or loss

This category has two sub-categories: financial assets held for trading, and those designated at fair value through profit or loss at inception. A financial asset is classified as held for trading if is acquired principally for the purpose of selling or repurchasing in the near term. Financial assets are designated at fair value through profit or loss in accordance with a documented risk management or investment strategy and reported to key management personnel on that basis. These are subsequently measured at fair value and any resultant gains or losses are recognised in the consolidated income statement.

## 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

### Financial instruments (continued)

#### Measurement (continued)

##### Loans and receivables

These are non-derivative financial assets having fixed or determinable payments that are not quoted in an active market. These are subsequently measured at amortised cost using the effective yield method adjusted for effective fair value hedges less any provision for impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees and costs that are an integral part of the effective interest rate. The amortisation is included in "Interest income" in the consolidated income statement. The losses arising from impairment are recognised in the consolidated income statement in the "Provision for impairment losses account".

Cash and balances with banks, treasury bonds, Central Bank of Kuwait bonds, loans and advances to banks and customers and other assets are classified as "loans and receivables".

##### Financial assets available for sale

These are non-derivative financial assets principally acquired to be held for an indefinite period of time that may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices. These are subsequently measured at fair value and any resultant gains or losses are recognised in equity. When the asset is disposed of, or impaired, the related accumulated fair value adjustments are transferred to the consolidated income statement as gains or losses.

##### Financial liabilities other than at fair value through profit or loss

These are subsequently measured at amortised cost using the effective yield method. Due to banks and other financial institutions, customer deposits, certificates of deposit and other liabilities are classified as "financial liabilities other than at fair value through profit or loss".

##### Derivative financial instruments and hedging

Derivatives include interest rate swaps and futures, credit default swaps, forward foreign exchange contracts and currency options. Derivatives are recorded at fair value. Derivatives with positive fair values (unrealised gains) are included in other assets and derivatives with negative fair values (unrealised losses) are included in other liabilities in the consolidated financial statements. For hedges, which do not qualify for hedge accounting and for "held for trading" derivatives, any gains or losses arising from changes in the fair value of the derivative are taken directly to the consolidated income statement.

The Group makes use of derivative instruments to manage exposures to interest rate, foreign currency and credit risks. Certain derivatives embedded in other financial instruments are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract and the host contract is not carried at fair value through the consolidated income statement. These embedded derivatives are measured at fair value with the changes in fair value recognised in the consolidated income statement.

In order to manage particular risks, the Group applies hedge accounting for transactions which meet the specified criteria. At inception of the hedge relationship, the Group formally documents the relationship between the hedged item and the hedging instrument, including the nature of the risk, the objective and strategy for undertaking the hedge and the method that will be used to assess the effectiveness of the hedging relationship.

Also at the inception of the hedge relationship, a formal assessment is undertaken to ensure the hedging instrument is expected to be highly effective in offsetting the designated risk in the hedged item. Hedges are formally assessed at each reporting date. A hedge is regarded as highly effective if the changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated are expected to offset in a range of 80 per cent to 125 per cent.

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

##### Fair value hedge

In relation to fair value hedges, which meet the conditions for hedge accounting, any gain or loss from re-measuring the hedging instrument to fair value is recognised in 'Other assets' or 'Other liabilities' and in the consolidated income statement. Any gain or loss on the hedged item attributable to the hedged risk is adjusted against the carrying amount of the hedged item and recognised in the consolidated income statement.

If the hedging instrument expires or is sold, terminated or exercised, or where the hedge no longer meets the criteria for hedge accounting, the hedge relationship is terminated. For hedged items recorded at amortised cost, using the effective interest rate method, the difference between the carrying value of the hedged item on termination and the face value is amortised over the remaining term of the original hedge. If the hedged item is derecognised, the unamortised fair value adjustment is recognised immediately in the consolidated income statement.

# Notes to the Consolidated Financial Statements

31 December 2008

## 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

### Financial instruments (continued)

#### Measurement (continued)

##### Cash flow hedge

For designated and qualifying cash flow hedges, the effective portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised directly in consolidated shareholders' equity and the ineffective portion is recognised in the consolidated income statement.

When the hedged cash flow affects the consolidated income statement, the gain or loss on the hedging instrument is 'recycled' in the corresponding income or expense line of the consolidated income statement. When a hedging instrument expires, or is sold, terminated, exercised, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in shareholders' equity at that time remains in shareholders' equity and is recognised when the hedged forecast transaction is ultimately recognised in the consolidated income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in shareholders' equity is immediately transferred to the consolidated income statement.

##### Financial guarantees

In the ordinary course of business, the Group gives financial guarantees, consisting of letters of credit, guarantees and acceptances. Financial guarantees are initially recognised in the consolidated financial statements at fair value, being the premium received, in other liabilities. The premium received is recognised in the consolidated income statement in 'fees and commission income' on a straight-line basis over the life of the guarantee. The guarantee liability is subsequently carried at initial measurement less amortisation. When a payment under the guarantee is likely to become payable, the present value of the expected cash flows, less the unamortised premium, is charged to the consolidated income statement.

##### Offsetting

Financial assets and liabilities are offset when the Group has a legally enforceable right to offset and intends to settle either on a net basis or to realise the asset and settle the liability simultaneously.

##### Fair values

Fair values of quoted instruments are based on quoted closing bid prices. If the market for a financial asset is not active and for unquoted instruments, fair value is derived from recent arm's length transactions, discounted cash flow analysis, other valuation techniques commonly used by market participants or determined with reference to market values of similar instruments. For investments in equity instruments, where a reasonable estimate of fair value cannot be determined, the investment is carried at cost.

The fair value of financial instruments carried at amortised cost is estimated by discounting the future contractual cash flows at the current market interest rates for similar financial instruments.

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.

##### Impairment of financial assets

The Group assesses at each balance sheet date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets are impaired if, and only if, there is objective evidence of impairment as a result of one or more loss events that has occurred after the initial recognition of the financial asset and that the loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets. For the purpose of assessing impairment, the financial assets are grouped at the lowest levels for which there are separately identifiable cash flows.

For loans and receivables, if there is objective evidence of impairment loss, the financial asset is written down to its recoverable amount. For loans and receivables with fixed interest rates, the recoverable amount is the present value of expected future cash flows discounted at the original effective interest rate and for loans and receivables with variable interest rates, the recoverable amount is discounted at the current effective interest rate as determined under the contract. Future cash flow includes amounts recoverable from guarantees and collateral. Financial guarantees and letters of credit are assessed and provision made in a similar manner as for loans and receivables. The carrying amount of the asset is reduced through the use of a provision account and the amount of impairment loss is recognised in the consolidated income statement. Loans and receivables together with the associated provision account are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the Group.

# Notes to the Consolidated Financial Statements

31 December 2008

## 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

### Financial instruments (continued)

#### Impairment of financial assets (continued)

If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the provision account. If a write off is later recovered, the recovery is recognised in the consolidated income statement.

For available for sale equity investments, the Group assesses on each balance sheet date whether there is objective evidence that an investment or a group of investments is impaired. When there is evidence of impairment, the cumulative loss, measured as the difference between the acquisition cost and the current fair value less any impairment loss on that investment previously recognised in the consolidated income statement, is transferred from equity and recognised in the consolidated income statement. Impairment losses on equity investments are not reversed through the consolidated income statement; increases in their fair value after impairment are recognised directly in equity.

For available for sale debt investments, the Group assesses the instruments at an individual level to determine whether there is any objective evidence for impairment. When there is objective evidence of impairment, the amount of loss is measured as the difference between the instrument's carrying value and the present value of the future cash flows. Interest continues to be accrued at the original effective interest rate on the reduced carrying amount of the asset and is recorded as part of 'Interest income'. If, in a subsequent year, the fair value of a debt investment increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the consolidated income statement, the impairment loss is reversed through the consolidated income statement.

In March 2007, the Central Bank of Kuwait issued a circular amending the basis of making minimum general provisions on facilities, changing the rate from 2 per cent to 1 per cent for cash facilities and from 1 per cent to 0.5 per cent for non-cash facilities. The required rates were to be applied effective from 1 January 2007 on the net increase in facilities, net of certain restricted categories of collateral during the reporting period. The minimum general provision in excess of the present 1 per cent for cash facilities and 0.5 per cent for non-cash facilities, net of provision released during the year, is retained as a general provision until further directive from the Central Bank of Kuwait.

#### Renegotiated loans

Where possible, the Bank seeks to renegotiate loans and advances rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, the facility is neither considered past due nor impaired. Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur.

#### Cash and cash equivalents

Cash and cash equivalents consists of cash on hand and deposits with banks with maturity not exceeding thirty days from original maturity.

#### Premises and equipment

Premises and equipment other than freehold land are stated at cost less accumulated depreciation and impairment losses. Depreciation is provided on all premises and equipment, other than freehold land, at rates calculated to write off the cost of each asset on a straight line basis over its estimated useful life.

Freehold land is initially recognised at cost. After initial recognition freehold land is carried at its revalued amount which is the fair value at the date of revaluation based on valuations by external independent valuers. The resultant revaluation surplus or deficit is recognised as a separate component under equity, to the extent the deficit does not exceed the previously recognised surplus. The portion of the revaluation deficit that exceeds a previously recognised deficit is recognised in the consolidated income statement. To the extent that a revaluation surplus reverses a revaluation decrease previously recognised in the consolidated income statement, the increase is recognised in the consolidated income statement. Upon disposal the revaluation surplus relating to the freehold land sold is transferred directly to retained earnings.

The assets' residual values, useful lives and methods of depreciation are reviewed, and adjusted if appropriate, at each financial year end. The estimated useful lives of the assets for the calculation of depreciation are as follows:

Buildings	20 years
Leasehold premises	period of lease
Furniture & equipment	3 to 5 years

The carrying amounts of premises and equipment are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the assets are written down to their recoverable amounts and the impairment loss is recognised in the consolidated income statement.

# Notes to the Consolidated Financial Statements

31 December 2008

## 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

### Treasury shares

Treasury shares consist of the Bank's own issued shares that have been reacquired by the Bank and not yet reissued or cancelled. The treasury shares are accounted for using the cost method. Under this method, the weighted average cost of the shares reacquired is charged to a contra account in equity. When the treasury shares are reissued, gains are credited to the "treasury shares reserve", which is not distributable. Any realised losses are charged to the same account to the extent of the credit balance in that account. Any excess losses are charged to retained earnings then to the reserves. No cash dividends are paid on these shares. The issue of bonus shares increases the number of treasury shares proportionately and reduces the average cost per share without affecting the total cost of treasury shares.

### Revenue recognition

Interest income and expenses are recognised on effective yield basis. Once a financial instrument categorised as loans and receivables is impaired, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. Interest income and expenses for all interest-bearing financial instruments, including those classified as fair value through profit or loss and available for sale, are recognised within interest income in the consolidated income statement.

Fees and commission that are an integral part of the effective interest rate of a financial instrument are treated as an adjustment to the effective interest rate. Other fees and commission are recognised when the service has been provided. Dividend income is recognised when the right to receive payment is established.

### Taxation

#### Provision for tax

Taxation is provided for in accordance with the fiscal regulations in Kuwait and in the United Arab Emirates where the Group operates.

### Foreign currencies

Foreign currency transactions are recorded at rates of exchange ruling at value dates of the transactions. Monetary assets and liabilities in foreign currencies outstanding at the year end are translated into Kuwaiti Dinars at rates of exchange ruling at the balance sheet date, and forward foreign exchange contracts are valued at the prevailing forward rates of exchange.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary assets and liabilities in foreign currencies that are stated at fair value are translated to Kuwaiti Dinars at the foreign exchange rates ruling at the dates that the values were determined. In case of non-monetary assets whose changes in fair values are recognised directly in equity, foreign exchange differences are recognised directly in equity. For other non-monetary assets foreign exchange differences are recognised directly in the consolidated income statement.

Assets and liabilities, both monetary and non-monetary, of foreign operations are translated at the exchange rates prevailing at the balance sheet date. Operating results of such operations are translated at average exchange rates for the year. The resulting exchange differences are accumulated in a separate section of equity, foreign currency translation reserve, until the disposal of the foreign operation.

### Segment information

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment), or in providing products and services within a particular economic environment (geographic segment), which is subject to risks and rewards that are different from those of other segments.

### Fiduciary assets

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

### Use of estimates

In accordance with the accounting principles contained in the International Financial Reporting Standards, management is required to make estimates and assumptions that may affect the carrying values of loans and receivables, investments available for sale and derivatives.

The basis used by management in determining the carrying values of loans and receivables and investments available for sale and the underlying risks therein are discussed below:

# Notes to the Consolidated Financial Statements

31 December 2008

## 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

### Use of estimates (continued)

#### Provisions for loan losses

The Group reviews its loans and advances on a quarterly basis to assess whether an impairment loss should be recorded in the consolidated income statement. In particular, considerable judgement by management is required in the estimation of the amount and timing of future cash flows when determining the level of provisions required. Such estimates are necessarily based on assumptions about several factors involving varying degrees of judgement and uncertainty.

#### Valuation of unquoted investments available for sale

The valuation techniques for unquoted investments available for sale make use of estimates such as future cash flows and discount factors, current market prices adjusted for market, credit and model risks and related costs and other valuation techniques commonly used by market participants where appropriate.

Any changes in these estimates and assumptions as well as the use of different, but equally reasonable, estimates and assumptions may have an impact on carrying amounts of loans and receivables and investments available for sale for the year.

### Judgements

In the process of applying the Group's accounting policies, management is required to make the following judgements, apart from those involving estimations, which have the most significant effect in the amounts recognised in the consolidated financial statements:

#### Classification of financial assets

On acquisition of financial assets, management decides whether it should be classified as financial assets at fair value through profit or loss or available for sale.

#### Impairment of available for sale investments

The Group treats investments available for sale as impaired when there has been a significant or prolonged decline in the fair value below its cost or where other objective evidence of impairment exists. The determination of what is "significant" or "prolonged" requires considerable judgement and involves evaluating factors including industry and market conditions, future cash flows and discount factors.

## 3 INTEREST INCOME

	2008 (KD 000s)	2007 (KD 000s)
Loans and advances to banks and customers	154,112	138,249
Deposits with banks	16,478	14,406
Bonds and other debt instruments	14,751	22,347
	185,341	175,002

Interest income on loans and advances to banks and customers has been reduced by KD 1,748 thousand (31 December 2007: KD 1,908 thousand) in the last quarter of the year. This represents an adjustment arising from revised estimates of future cash flows, discounted at the original contracted rates of interest from a portfolio of performing loans that have had their terms modified during the current and prior year. An amount equivalent to current year adjustment has been released from the general provision. (Note 12)

## 4 INTEREST EXPENSE

	2008 (KD 000s)	2007 (KD 000s)
Due to customers:		
- Sight deposits	487	677
- Time deposits	98,978	81,858
Due to banks and other financial institutions	17,404	26,075
	116,869	108,610

## Notes to the Consolidated Financial Statements

31 December 2008

### 5 NET FEES AND COMMISSION INCOME

	2008 (KD 000s)	2007 (KD 000s)
Fees and commission income	25,383	19,367
Fees and commission expense	(890)	(952)
	24,493	18,415

Fees and commission income includes KD 1,473 thousand (2007: KD 1,971 thousand) from fiduciary activities.

### 6 OTHER INCOME

Other income includes gains of KD 4,797 thousand (2007: KD 13,704 thousand) realised in May 2008 on sale of land.

### 7 PROVISION / IMPAIRMENT LOSSES

The following amounts were (released) / charged during the year:

	2008 (KD 000s)	2007 (KD 000s)
Loans and advances to banks and customers (Note 12)	15,213	1,872
Credit related off balance sheet items	572	1,991
Investments available for sale	26,575	6,553
Freehold land (Note 15)	(7,658)	-
	34,702	10,416

### 8 TAXATION

	2008 (KD 000s)	2007 (KD 000s)
Contribution to Kuwait Foundation for the Advancement of Sciences	435	712
Contribution to National Labour Support Tax	1,159	1,977
Contribution for Zakat	483	48
Provision for tax on overseas branch	999	822
	3,076	3,559

### 9 BASIC AND DILUTED EARNINGS PER SHARE

Basic and diluted earnings per share are computed by dividing the net profit for the year by the weighted average number of shares outstanding during the year.

	2008	2007
Net profit for the year (KD 000s)	46,036	76,041
Weighted average number of the Bank's issued and paid-up shares	1,098,042,247	1,098,042,247
Less: Weighted average number of treasury shares	(2,467,082)	(2,447,310)
Weighted average number of shares outstanding during the year	1,095,575,165	1,095,594,937
Basic and diluted earnings per share (fils)	42	69

The prior year comparative has been restated for the effect of bonus shares issued during the current year (Note 18).

## Notes to the Consolidated Financial Statements

31 December 2008

### 10 CASH AND BALANCES WITH BANKS

	2008 (KD 000s)	2007 (KD 000s)
Balances and deposits with the Central Bank of Kuwait	64,363	14,467
Cash in hand and on current account with other banks	41,496	17,680
Deposits with banks	273,038	551,548
	<b>378,897</b>	<b>583,695</b>

For cash, balances and deposits with banks with an original maturity not exceeding thirty days refer to the consolidated cash flow statement.

### 11 TREASURY BONDS AND CENTRAL BANK OF KUWAIT BONDS

These financial instruments are issued by the Central Bank of Kuwait on behalf of the Ministry of Finance or on its own behalf and are acquired from the primary market by the Group.

### 12 LOANS AND ADVANCES

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

	Loans to Banks			Loans to Customers			Total		Grand Total
	Specific (KD 000s)	General (KD 000s)	Total (KD 000s)	Specific (KD 000s)	General (KD 000s)	Total (KD 000s)	Specific (KD 000s)	General (KD 000s)	(KD 000s)
<b>2008</b>									
At 1 January	16,797	-	16,797	32,254	51,830	84,084	49,051	51,830	100,881
Exchange difference	176	-	176	223	-	223	399	-	399
Amounts written off during the year	-	-	-	(1,198)	-	(1,198)	(1,198)	-	(1,198)
Recoveries	-	-	-	1,156	-	1,156	1,156	-	1,156
Release of general provision (Note 3 and Note 7)	-	-	-	-	(1,748)	(1,748)	-	(1,748)	(1,748)
(Release) / charge for the year (Note 7)	-	-	-	(4,099)	21,060	16,961	(4,099)	21,060	16,961
At 31 December	<b>16,973</b>	<b>-</b>	<b>16,973</b>	<b>28,336</b>	<b>71,142</b>	<b>99,478</b>	<b>45,309</b>	<b>71,142</b>	<b>116,451</b>

	Loans to Banks			Loans to Customers			Total		Grand Total
	Specific (KD 000s)	General (KD 000s)	Total (KD 000s)	Specific (KD 000s)	General (KD 000s)	Total (KD 000s)	Specific (KD 000s)	General (KD 000s)	(KD 000s)
<b>2007</b>									
At 1 January	17,761	-	17,761	37,542	48,662	86,204	55,303	48,662	103,965
Ceded to the Central Bank of Kuwait	(964)	-	(964)	(1,129)	-	(1,129)	(2,093)	-	(2,093)
Exchange difference	-	-	-	(1,379)	-	(1,379)	(1,379)	-	(1,379)
Amounts written off during the year	-	-	-	(3,054)	-	(3,054)	(3,054)	-	(3,054)
Recoveries	-	-	-	1,570	-	1,570	1,570	-	1,570
(Release) / charge for the year	-	-	-	(1,296)	3,168	1,872	(1,296)	3,168	1,872
At 31 December	<b>16,797</b>	<b>-</b>	<b>16,797</b>	<b>32,254</b>	<b>51,830</b>	<b>84,084</b>	<b>49,051</b>	<b>51,830</b>	<b>100,881</b>

## Notes to the Consolidated Financial Statements

31 December 2008

### 12 LOANS AND ADVANCES (continued)

The Bank's policy for calculating the provision for impairment losses on loans and advances agrees in all material respects with the requirements of the Central Bank of Kuwait in respect of specific provisions.

The analysis of the provisions stated above is based upon the requirements of the Central Bank of Kuwait. In accordance with the Central Bank of Kuwait instructions, a minimum general provision of 1 per cent is provided on regular cash facilities and 0.5 per cent on regular non cash facilities, net of certain restricted categories of collateral to which Central Bank of Kuwait instructions are applicable. Further to the minimum general provision, the Bank has an additional provision of KD 38,414 thousand (2007: KD 20,402 thousand). Interest income on impaired loans and advances is immaterial.

The split of non-performing facilities granted and related provisions between pre-invasion and post liberation are as follows:

	Pre-invasion (KD 000s)	Post liberation (KD 000s)	Total (KD 000s)
<b>2008</b>			
Loans and advances	36,863	18,757	55,620
Provisions	36,863	8,446	45,309
<b>2007</b>			
Loans and advances	36,463	23,191	59,654
Provisions	36,463	12,588	49,051

The Central Bank of Kuwait, in accordance with Decree No. 32/92 and Law No. 41/93, as amended, funds provisions in respect of pre-invasion loans and advances. Any recoveries made against these provisions are ceded to the Central Bank of Kuwait in accordance with the prevalent law, and are not included in the consolidated income statement of the Group.

### 13 INVESTMENTS AVAILABLE FOR SALE

	2008 (KD 000s)	2007 (KD 000s)
Quoted securities	121,552	135,547
Unquoted securities	33,989	46,524
	155,541	182,071

Investments available for sale include debt investments of KD 81,516 thousand (2007: KD 62,682 thousand) of which quoted debt investments amount to KD 81,045 thousand (2007: KD 56,586 thousand).

### 14 OTHER ASSETS

	2008 (KD 000s)	2007 (KD 000s)
Interest receivable	18,435	19,785
Others	16,410	9,561
	34,845	29,346

### 15 PREMISES AND EQUIPMENT

In December 2008, the Bank revalued its freehold land at KD 28,060 thousand which was previously carried at KD 8,929 thousand. As a result, KD 7,658 thousand has been taken to the consolidated income statement which represents reversal of previously recognised impairment loss on the freehold land. The remaining balance of KD 11,473 thousand has been taken to revaluation surplus in shareholders' equity.

## Notes to the Consolidated Financial Statements

31 December 2008

### 16 CUSTOMERS' DEPOSITS

	2008 (KD 000s)	2007 (KD 000s)
Sight deposits	332,424	322,020
Time deposits	1,659,252	1,885,978
	<b>1,991,676</b>	<b>2,207,998</b>

### 17 OTHER LIABILITIES

	2008 (KD 000s)	2007 (KD 000s)
Interest payable	26,284	25,824
Interest received in advance	2,359	577
Staff related provisions	6,263	4,396
Provision for credit related off balance sheet items	15,989	15,417
Others	33,409	30,014
	<b>84,304</b>	<b>76,228</b>

### 18 SHARE CAPITAL & RESERVES

- a) The authorised, issued and fully paid share capital comprises 1,098,042,246 shares (2007: 1,007,378,208 shares) of 100 fils each.

The shareholders at the Extraordinary General Meeting held on 20 September 2008 approved the Board's decision to increase the share capital by 20 per cent from KD 109,804 thousand to KD 131,765 thousand by a rights issue of 219,608,449 shares, each with a nominal value of 100 fils and a share premium of 500 fils. The increase in share capital is subject to approval by an Amiri decree.

- b) The balance in the share premium account is not available for distribution.
- c) As required by the Commercial Companies Law and the Bank's articles of association, 10 per cent of the profit for the year before directors' fees, contribution to Kuwait Foundation for the Advancement of Sciences, National Labour Support tax and Zakat has been transferred to statutory reserve. The Bank may resolve to discontinue such annual transfers when the reserve totals 50 per cent of paid up share capital.

Distribution of this reserve is limited to the amount required to enable the payment of a dividend of 5 per cent of share capital in years when accumulated profits are not sufficient for the payment of a dividend of that amount.

- d) The articles of association of the Bank require that an amount of not less than 10 per cent of the profit for the year before directors' fees, contribution to Kuwait Foundation for the Advancement of Sciences, National Labour Support tax and Zakat be transferred annually to a general reserve. There is no restriction on distribution of this reserve.
- e) In accordance with the instructions of the Central Bank of Kuwait, dividend earned in prior years on the Bank's own shares, which have been transferred to the general reserve, is not available for distribution. General reserve equivalent to the cost of the treasury shares held has been earmarked as non-distributable.
- f) As at 31 December 2008, the Bank held 3,827,285 (2007: 3,311,484) of its own shares equivalent to 0.35 per cent (2007: 0.33 per cent) of the total issued share capital at the balance sheet date. The market value of these shares at 31 December 2008 amounted to KD 2,603 thousand (31 December 2007 KD 4,371 thousand).
- g) The directors have proposed a cash dividend of 20 per cent (2007: 45 per cent cash dividend) and bonus shares of 5 per cent (2007: 9 per cent) subject to the approval of the shareholders at the annual general meeting.

## Notes to the Consolidated Financial Statements

31 December 2008

### 19 RELATED PARTY TRANSACTIONS

These represent transactions with certain related parties (shareholders, directors, executive officers and key management of the Group, close members of their families and companies of which they are principal owners or over which they are able to exercise significant influence) who were customers of the Group during the year. The terms of these transactions are approved by the Group's management.

In the normal course of business, directors, executive officers and parties related to them have deposits with the bank and credit facilities granted to them by the Bank. The year-end balances included in the consolidated financial statements are as follows:

	Number of directors		Number of parties related to directors		Amount	
	2008	2007	2008	2007	2008 (KD 000s)	2007 (KD 000s)
<b>Directors</b>						
Loans and advances	1	1	1	3	1,236	2,221
Deposits	7	7	5	4	13,822	7,374
Commitments and contingent liabilities	1	-	2	2	1,199	1,015

The Group has collateral amounting to KD 67,349 thousand (2007: KD 107,107 thousand) against the credit facilities granted.

	Number of executive officers		Number of parties related to executive officers		Amount	
	2008	2007	2008	2007	2008 (KD 000s)	2007 (KD 000s)
<b>Executive officers</b>						
Loans and advances	6	6	-	-	159	153
Deposits	7	7	-	-	204	153
Commitments and contingent liabilities	1	2	-	-	1	1

The compensation paid to key management is as follows:

	2008 (KD 000s)	2007 (KD 000s)
Salaries and other benefits	833	787
Post employment benefits	168	253
	1,001	1,040

## Notes to the Consolidated Financial Statements

31 December 2008

### 20 COMMITMENTS AND CONTINGENT LIABILITIES

	2008 (KD 000s)	2007 (KD 000s)
Acceptances	200,583	240,396
Letters of credit	241,174	764,073
Guarantees	729,443	689,366
	<b>1,171,200</b>	<b>1,693,835</b>

The above balances indicate the contractual amounts of the Group's off balance sheet financial instruments that commit it to extend credit to customers. The contractual amounts represent the credit risk, assuming that the amounts are fully advanced and that any collateral or other security is of no value. However, the total contractual amount of commitments to extend credit does not necessarily represent future cash requirements, since many of these commitments may expire or terminate without being funded.

Commitments to extend credit at the balance sheet date amounted to KD 229,617 thousand (2007: KD 300,897 thousand).

### 21 DERIVATIVE FINANCIAL INSTRUMENTS

In the normal course of its business the Group utilises derivative financial instruments to manage its exposure to fluctuations in interest and foreign exchange rates.

Derivative transactions result, to varying degrees, in credit as well as market risks.

The Group's measure of derivative related credit risk is the cost of replacing contracts at current market rates should the counter party default prior to the settlement date, and is limited to the positive fair value of instruments that are favourable to the Group.

Market risk arises as interest and foreign exchange rates fluctuate, affecting the value of a contract. For risk management purposes and to control these activities, the Group has established appropriate procedures and limits approved by the Board of Directors.

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

	2008			2007		
	Assets (KD 000s)	Liabilities (KD 000s)	Notional amounts (KD 000s)	Assets (KD 000s)	Liabilities (KD 000s)	Notional amounts (KD 000s)
<b>Derivatives held for trading:</b>						
Forward foreign exchange contracts	4,221	2,350	147,072	895	825	131,689
Interest rate swaps	-	-	-	64	-	2,730
Credit default swap	-	53	6,899	104	-	6,825
Currency options	91	91	14,996	350	350	30,303
<b>Derivatives held for hedging:</b>						
<b>Fair value hedges</b>						
Interest rate swaps	3,375	2,955	180,849	98	403	198,307
	<b>7,687</b>	<b>5,449</b>	<b>349,816</b>	<b>1,511</b>	<b>1,578</b>	<b>369,854</b>

Interest rate swaps are contractual agreements between two parties to exchange interest based on notional value in a single currency for a fixed period of time.

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

The Group uses interest rate swaps to hedge changes in interest rate risk arising from fixed rate investments available for sale and customer deposits.

## Notes to the Consolidated Financial Statements

31 December 2008

### 22 FAIR VALUES OF FINANCIAL INSTRUMENTS

Fair values of all financial instruments are not materially different from their carrying values. For financial assets and financial liabilities that are liquid or having a short-term maturity (less than three months), the carrying amount approximates their fair value and this applies to demand deposits, savings accounts without a specific maturity and variable rate financial instruments.

As of 31 December 2008 fair values of financial assets at fair value through profit or loss and investments available for sale based on quoted market prices and observable market data amounted to KD 127,381 thousand (2007: KD 161,013 thousand). Certain financial instruments are recorded at fair value using valuation techniques as current market transactions or observable market data are not available. Their fair value is determined using a valuation model that has been tested against the prices of actual market transactions and using the Bank's best estimate of the most appropriate model inputs. These are adjusted to reflect the marketability, earnings spread of these instruments and limitations of the model. The impact on consolidated income statement and equity would be immaterial if the assumptions were changed by 5 per cent.

The methodologies and assumptions used to determine fair values of financial instruments is described in fair value section of Note 2: Significant Accounting Policies.

### 23 SEGMENTAL INFORMATION

#### Primary segment information

The Group is organised into functional divisions in order to manage its various lines of business. For the purposes of segment reporting the management has grouped the products and services into the following business segments:

- Retail and Commercial Banking – Comprising a full range of credit, deposit and related banking services provided to retail, corporate and international customers.
- Treasury and Investment – Comprising money market, foreign exchange, treasury bonds, asset management and investment securities.

Segment results include revenue and expenses directly attributable to a segment and an allocation of cost of funds based on the daily weighted average balance of segment assets.

Segment assets and liabilities comprise those operating assets and liabilities that are directly attributable to the segment.

Capital expenditure represents the total cost incurred during the year to acquire assets that are expected to be used during more than one year.

Segment results include revenue and expense directly attributable to each reporting segment as the group does not have any inter segment charges.

## Notes to the Consolidated Financial Statements

31 December 2008

### 23 SEGMENTAL INFORMATION (continued)

#### Primary segment information (continued)

Segmental information for the years ended 31 December is as follows:

	Retail and Commercial Banking		Treasury and Investment		Total	
	2008 (KD 000s)	2007 (KD 000s)	2008 (KD 000s)	2007 (KD 000s)	2008 (KD 000s)	2007 (KD 000s)
Segment revenue	187,368	164,160	37,706	48,051	225,074	212,211
Segment result	52,363	65,666	(928)	15,392	51,435	81,058
Unallocated income					4,797	13,704
Unallocated expense					(7,120)	(15,162)
Profit before tax					49,112	79,600
Segment assets	2,129,103	1,870,012	839,189	1,047,843	2,968,292	2,917,855
Unallocated assets					68,667	43,302
Total assets					3,036,959	2,961,157
Segment liabilities	1,645,239	1,617,383	995,004	948,452	2,640,243	2,565,835
Unallocated liabilities					84,304	76,228
Total liabilities					2,724,547	2,642,063
Capital expenditure	-	-	-	-	2,360	1,383
Depreciation	-	-	-	-	1,238	1,645
Net charge of provision / impairment losses	15,785	3,863	26,575	6,553	42,360	10,416

#### Secondary segment information

The Group operates in two geographic markets; Kuwait, which is designated as domestic, and United Arab Emirates, which is designated as International. The geographic analysis of revenue, total assets and capital expenditure is based primarily upon the location of the branch responsible for reporting the results. The following table shows the distribution of the Group's segment revenue, total assets and capital expenditure by geographical segment:

	Domestic		International		Total	
	2008 (KD 000s)	2007 (KD 000s)	2008 (KD 000s)	2007 (KD 000s)	2008 (KD 000s)	2007 (KD 000s)
Segment revenue	211,048	199,704	14,026	12,507	225,074	212,211
Total assets	2,731,807	2,720,136	305,152	241,021	3,036,959	2,961,157
Capital expenditure	2,281	1,358	79	25	2,360	1,383

# Notes to the Consolidated Financial Statements

31 December 2008

## 24 RISK MANAGEMENT

### A. CREDIT RISK

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. The financial instruments exposed to these risks, the objectives, policies and procedures for managing and measuring these risks is explained in the Risk Management section of the annual report.

The maximum exposure to credit risk as at the balance sheet date is represented by the carrying amount of each financial asset in the consolidated balance sheet.

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 similarly affected by changes in economic, political or other conditions. Concentrations of credit risk indicate the relative sensitivity of the Group's performance to developments affecting a particular industry or geographic location. Maximum concentration of credit risk to a single or group of related counterparties is limited to 15 per cent of the Group's comprehensive capital as determined by the regulatory guidelines.

In accordance with the instructions of the Central Bank of Kuwait dated 18 December 1996, setting out the rules and regulations regarding the classification of credit facilities, the Group has formed an internal committee which is composed of competent professional staff and which has as its purpose the study and evaluation of the existing credit facilities of each customer of the Group. This Committee is required to identify any abnormal situations and difficulties associated with a customer's position, which might cause the debt to be classified as irregular, and to determine an appropriate provisioning level.

#### Derivative financial instruments

Credit risk arising from derivative financial instruments is limited to those with positive fair values, as recorded in the consolidated balance sheet. In the case of credit derivatives, the Bank is also exposed to the risk of default of the underlying entity referenced by the derivative.

#### Credit-related commitments risks

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

Geographical and industry sector concentrations of financial assets and off balance sheet items are as follows:

	2008		2007	
	Assets (KD 000s)	Off balance sheet items (KD 000s)	Assets (KD 000s)	Off balance sheet items (KD 000s)
<b>Geographic region:</b>				
Domestic (Kuwait)	2,380,241	625,756	1,969,465	662,208
Other Middle East	434,536	156,895	630,918	544,764
Europe	80,554	126,973	164,857	141,811
United States of America	14,788	91,358	531	83,114
Asia and Pacific	4,945	157,889	20,810	250,025
Rest of the world	2,249	19,228	10,852	18,738
	<b>2,917,313</b>	<b>1,178,099</b>	<b>2,797,433</b>	<b>1,700,660</b>
<b>Industry sector:</b>				
Trading and manufacturing	404,435	168,516	327,843	250,152
Banks and other financial institutions	551,721	286,423	774,425	398,388
Construction and real estate	628,998	250,036	614,395	381,654
Other	1,332,159	473,124	1,080,770	670,466
	<b>2,917,313</b>	<b>1,178,099</b>	<b>2,797,433</b>	<b>1,700,660</b>

## Notes to the Consolidated Financial Statements

31 December 2008

### 24 RISK MANAGEMENT (continued)

#### A. CREDIT RISK (continued)

The table below shows the maximum exposure to credit risk for the components of the balance sheet, including commitments and derivatives, without taking account of any collateral and other credit enhancements. The maximum exposure is shown gross, before the effect of mitigation through the use of master netting and collateral agreements.

	Gross maximum exposure 2008 (KD 000s)	Gross maximum exposure 2007 (KD 000s)
<b>Credit risk exposures relating to on-balance sheet items:</b>		
Due from banks	371,745	577,190
Treasury bonds (Note 11)	291,020	189,326
Central Bank of Kuwait bonds (Note 11)	9,999	69,727
Loans and advances		
- Loans to customers	2,095,970	1,806,460
- Loans to banks	33,133	63,552
Debt investments available for sale (Note 13)	81,516	62,682
Other financial assets	33,930	28,496
	<b>2,917,313</b>	<b>2,797,433</b>
<b>Credit risk exposures relating to off-balance sheet items:</b>		
Commitments (Note 20)	1,171,200	1,693,835
Credit default swap (Note 21)	6,899	6,825
	<b>1,178,099</b>	<b>1,700,660</b>
<b>Total credit risk exposure</b>	<b>4,095,412</b>	<b>4,498,093</b>

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

#### Collateral and other credit enhancements

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

The main types of collateral obtained are cash, securities, and charges over real estate properties and counter-guarantees.

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

It is the Group's policy to dispose of repossessed properties in an orderly fashion. The proceeds are used to reduce or repay the outstanding claim. In general, the Group does not occupy repossessed properties for business use.

At 31 December 2008, 25.14 per cent (31 December 2007: 41.32 per cent) of the total outstanding loans were secured with a collateral coverage of 1.70 times (2007: 1.91 times) the underlying loans.

## Notes to the Consolidated Financial Statements

31 December 2008

### 24 RISK MANAGEMENT (continued)

#### A. CREDIT RISK (continued)

##### Credit quality of financial instruments

The table below shows the credit risk exposure by credit quality of financial assets by class, grade and status

	Neither Past due nor Impaired				Total (KD 000s)
	High grade (KD 000s)	Standard grade (KD 000s)	Acceptable grade (KD 000s)	Past due including individually impaired (KD 000s)	
<b>2008</b>					
Due from banks	357,517	14,228	-	-	371,745
Treasury bonds (Note 11)	291,020	-	-	-	291,020
Central Bank of Kuwait bonds (Note 11)	9,999	-	-	-	9,999
Loans and advances					
- Loans to customers	1,507,443	444,619	82,270	61,638	2,095,970
- Loans to banks	27,587	5,546	-	-	33,133
Debt investments available for sale (Note 13)	74,499	7,017	-	-	81,516
Other assets	33,930	-	-	-	33,930
<b>Total</b>	<b>2,301,995</b>	<b>471,410</b>	<b>82,270</b>	<b>61,638</b>	<b>2,917,313</b>
<b>2007</b>					
Due from banks	514,580	62,610	-	-	577,190
Treasury bonds	189,326	-	-	-	189,326
Central Bank of Kuwait bonds	69,727	-	-	-	69,727
Loans and advances					
- Loans to customers	1,403,304	360,199	18,154	24,803	1,806,460
- Loans to banks	56,955	6,597	-	-	63,552
Debt investments available for sale	30,849	25,253	-	6,580	62,682
Other assets	28,496	-	-	-	28,496
<b>Total</b>	<b>2,293,237</b>	<b>454,659</b>	<b>18,154</b>	<b>31,383</b>	<b>2,797,433</b>

The high, standard and acceptable grades of classification of loans to customers above is based on inherent credit quality of the counterparties, the assessed risk profile, acceptability and availability of collateral in accordance with the Group's internal rating model. Grading of due from banks and loans to banks is based on the external rating of the counterparties.

Past due including individually impaired loans and advances above include KD 51,327 thousand (2007: KD 14,200 thousand) which are past due for less than 90 days and are not considered as impaired. The fair value of collateral that the Group held for past due and impaired loans and advances to customers, as at 31 December 2008, was KD 0.76 million (2007: KD 27 million). The Group has taken adequate legal measures to secure recovery of collateral when needed. Provision on loans and advances is disclosed in Note 12.

## Notes to the Consolidated Financial Statements

31 December 2008

### 24 RISK MANAGEMENT (continued)

#### B. LIQUIDITY RISK

Liquidity is the ongoing ability to accommodate maturing liabilities and deposit withdrawals; fund asset growth and business operations; and meet contractual obligations through unconstrained access to funding at reasonable market rates.

Liquidity risk is the risk that the Group will encounter difficulty in raising funds to meet commitments associated with financial instruments. Liquidity risk may also result from an inability to sell a financial asset quickly at close to its fair value. The financial instruments exposed to these risks, the objectives, policies and procedures for managing and measuring these risks are explained in the Risk Management section of the annual report.

The table below summarises the maturity profile of the Group's financial liabilities based on contractual undiscounted repayment obligations. Repayments, which are subject to notice, are treated as if notice were to be given immediately.

Financial liabilities	Less than one month (KD 000s)	One to three months (KD 000s)	Three months to one year (KD 000s)	One to five years (KD 000s)	Total (KD 000s)
<b>2008</b>					
Due to banks and other financial institutions	155,964	228,989	273,589	-	658,542
Customers' deposits	1,231,222	479,230	334,080	2,363	2,046,895
Other liabilities	58,020	-	-	-	58,020
	1,445,206	708,219	607,669	2,363	2,763,457
<b>2007</b>					
Due to banks and other financial institutions	191,957	73,427	83,737	-	349,121
Customers' deposits	1,206,209	484,734	566,603	-	2,257,546
Certificates of deposit	-	23,127	-	-	23,127
Other liabilities	50,404	-	-	-	50,404
	1,448,570	581,288	650,340	-	2,680,198

Other liabilities balance above includes the undiscounted value of net settled derivatives.

The table below shows the contractual expiry by maturity of the Bank's gross settled derivatives positions.

Derivatives	Up to three months (KD 000s)	Three months to one year (KD 000s)	Over one year (KD 000s)	Total (KD 000s)
<b>2008</b>				
Forward foreign exchange contracts	112,157	28,944	1,966	143,067
<b>2007</b>				
Forward foreign exchange contracts	91,460	40,312	-	131,772

Substantially all acceptances and letters of credit commitments expire within a period not exceeding one year, 77 per cent (2007: 77 per cent) of the guarantees expire within one year, while the remaining portion expires within a period not exceeding five years.

The table below summarises the maturity profile of the Group's assets and liabilities. The maturities of assets and liabilities have been determined on the basis of the remaining period at the balance sheet date to the expected maturity date, except for investments at fair value through profit or loss and investments available for sale. The maturity profile for investments at fair value through profit or loss and investments available for sale is determined based on management's estimate of liquidation of those investments.

The actual maturities may differ from the maturities shown below since the borrower may have the right to prepay obligations with or without prepayment penalties, and deposits by customers might have to be repaid on demand.

## Notes to the Consolidated Financial Statements

31 December 2008

### 24 RISK MANAGEMENT (continued)

#### B. LIQUIDITY RISK (continued)

The maturity profile at 31 December 2008 was as follows:

	Less than one month (KD 000s)	One month to one year (KD 000s)	One year to five years (KD 000s)	Over five years (KD 000s)	Total (KD 000s)
<b>ASSETS</b>					
Cash and balances with banks	284,988	93,909	-	-	378,897
Treasury bonds	5,388	218,272	67,360	-	291,020
Central Bank of Kuwait bonds	9,999	-	-	-	9,999
Investments at fair value through profit or loss	-	3,732	-	-	3,732
Loans and advances	585,097	992,992	385,993	165,021	2,129,103
Investments available for sale	-	106,270	44,056	5,215	155,541
Other assets	34,845	-	-	-	34,845
Premises and equipment	-	-	-	33,822	33,822
<b>Total assets</b>	<b>920,317</b>	<b>1,415,175</b>	<b>497,409</b>	<b>204,058</b>	<b>3,036,959</b>
<b>LIABILITIES</b>					
Due to banks and other financial institutions	154,930	493,637	-	-	648,567
Customers' deposits	1,212,083	777,339	2,254	-	1,991,676
Other liabilities	84,304	-	-	-	84,304
<b>Total liabilities</b>	<b>1,451,317</b>	<b>1,270,976</b>	<b>2,254</b>	<b>-</b>	<b>2,724,547</b>

The maturity profile at 31 December 2007 was as follows:

	Less than one month (KD 000s)	One month to one year (KD 000s)	One year to five years (KD 000s)	Over five years (KD 000s)	Total (KD 000s)
<b>ASSETS</b>					
Cash and balances with banks	356,941	226,754	-	-	583,695
Treasury bonds	4,440	134,247	30,559	20,080	189,326
Central Bank of Kuwait bonds	11,893	57,834	-	-	69,727
Investments at fair value through profit or loss	-	23,024	-	-	23,024
Loans and advances	345,659	1,068,727	316,661	138,965	1,870,012
Investments available for sale	-	120,754	52,499	8,818	182,071
Other assets	29,346	-	-	-	29,346
Premises and equipment	-	-	-	13,956	13,956
<b>Total assets</b>	<b>748,279</b>	<b>1,631,340</b>	<b>399,719</b>	<b>181,819</b>	<b>2,961,157</b>
<b>LIABILITIES</b>					
Due to banks and other financial institutions	186,204	149,197	-	-	335,401
Customers' deposits	1,196,840	1,011,158	-	-	2,207,998
Certificates of deposit	-	22,436	-	-	22,436
Other liabilities	76,228	-	-	-	76,228
<b>Total liabilities</b>	<b>1,459,272</b>	<b>1,182,791</b>	<b>-</b>	<b>-</b>	<b>2,642,063</b>

# Notes to the Consolidated Financial Statements

31 December 2008

## 24 RISK MANAGEMENT (continued)

### C. MARKET RISK

#### C.1 INTEREST RATE RISK

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments. The Board has established limits on the interest rate gaps for stipulated periods. Positions are monitored on a daily basis and hedging strategies are used to ensure positions are maintained within the established limits. The financial instruments exposed to these risks, the objectives, policies and procedures for managing and measuring these risks are explained in the Risk Management section of the annual report.

The sensitivity of interest rate variability on the Group's consolidated income statement is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate non-trading financial assets and financial liabilities held at 31 December 2008 including the effect of hedging instruments. The sensitivity of interest rate variability on the Group's equity is calculated by revaluing fixed rate investments available for sale, including the effect of any associated hedges as at 31 December 2008 for the effects of the assumed changes in interest rates. The sensitivity of equity is analysed by maturity of the asset or swap.

The following table reflects the effect of 25 basis points change in interest rates, with all other variables held constant.

	Effect (%)			
	2008		2007	
	Income	Equity	Income	Equity
Kuwaiti Dinar	2.044	0.0004	1.990	0.0004
US Dollars	0.026	-	0.060	0.0041

#### C.2 CURRENCY RISK

Currency risk is the risk that the value of financial instruments will fluctuate due to changes in foreign exchange rates. The Board of Directors has set limits on positions by currency. Positions are monitored on a daily basis and hedging strategies are used to ensure positions are maintained within established limits. The financial instruments exposed to these risks, the objectives, policies and procedures for managing and measuring these risks are explained in the Risk Management section of the annual report.

The effect on net profit for the year, as a result of 5 per cent change in currency rate, with all other variables held constant is shown below:

	Effect (%)	
	2008	2007
<b>Currency</b>		
US Dollars	0.1238	(0.2770)
UAE Dirhams	0.1064	0.2670
Japanese Yen	0.0022	0.0013
Others	0.0239	0.0316

# Notes to the Consolidated Financial Statements

31 December 2008

## 24 RISK MANAGEMENT (continued)

### C. MARKET RISK (continued)

#### C.3 EQUITY PRICE RISK

Equity price risk is the risk that the fair values of equities decrease as the result of changes in the levels of equity indices and the value of individual stocks. The non-trading equity price risk exposure arises from the Bank's investment portfolio. The financial instruments exposed to these risks, the objectives, policies and procedures for managing and measuring these risks are explained in the Risk Management section of the annual report.

The equity price risk on investments at fair value through profit & loss is immaterial. The effect on the consolidated income statement (as a result of further impairment on impaired financial assets) and on equity (as a result of a change in the fair value of available for sale equity investments), as at 31 December 2008, due to a 5 per cent change in equity indices, with all other variables held constant is as follows:

	Effect (%)			
	2008		2007	
	Income	Equity	Income	Equity
GCC Stock Exchanges	(1.52)	0.98	-	2.63

#### C.4 PREPAYMENT RISK

Prepayment risk is the risk that the Group will incur a financial loss because its customers and counterparties repay or request repayment earlier or later than expected, such as fixed rate mortgages when interest rates fall. Majority of the Group's interests bearing financial assets are at floating rates. Also, the interest-bearing financial liabilities have a maturity of less than 1 year and accordingly, the Group is not exposed to significant prepayment risk. The financial instruments exposed to these risks, the objectives, policies and procedures for managing and measuring these risks are explained in the Risk Management section of the annual report.

### D OPERATIONAL RISK

Operational risk is the risk of loss arising from systems failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Bank cannot expect to eliminate all operational risks, but through a control framework and by monitoring and responding to potential risks, the Bank is able to manage the risks. Controls include effective segregation of duties, access, authorisation and reconciliation procedures, staff education and assessment processes, including the use of internal audit. The financial instruments exposed to these risks, the objectives, policies and procedures for managing and measuring these risks are explained in the Risk Management section of the annual report.

The Risk Management Division manages operational risks in line with the Central Bank of Kuwait instructions dated 14 November 1996, concerning the general guidelines for internal controls and the instructions dated 13 October 2003, regarding the sound practices for managing and supervising operational risks in banks.

## 25 CAPITAL MANAGEMENT

The disclosures relating to the Capital Adequacy Regulations issued by Central Bank of Kuwait as stipulated in CBK Circular number 2/BS/184/2005 dated 21 December 2005 are included under the Risk Management section of the annual report.