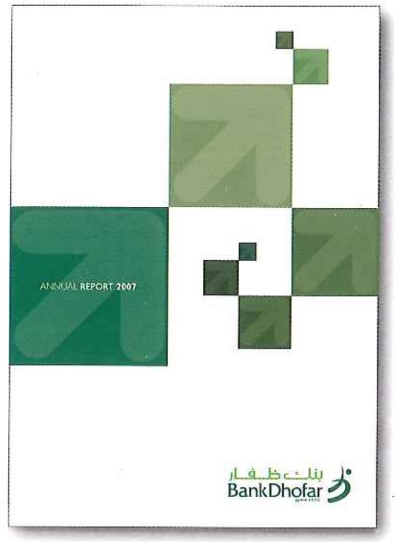
BankDhofar SAOG
PO Box 1507 Ruwi 112
Sultanate of Oman
www.bankdhofar.com

ANNUAL REPORT 2007

بنك ظفار
BankDhofar
ش.م.ع.ع S.A.O.G

His Majesty Sultan Qaboos bin Said

ANNUAL REPORT



Rationale

The graphic of the Arrow is used to signify the entrepreneurial spirit and the growing success behind BankDhofar's drive to reach-out to its customers with a whole range of banking products and services. To create an element of dynamic tension (movement), the arrows are all tilted diagonally and are of different colours. To indicate that the movement across all the bank's initiatives are synchronized the arrows are placed in cubes of differing sizes which are then linked to each other.

Our Philosophy

Since inception, Bank Dhofar with its philosophy of "Customer First" has developed a reputation for commitment, foresight and remarkable, yet solid, growth that has helped rise to industry standards. Bank Dhofar believes in, and is committed to, maintaining relationships by offering a host of personalised services to local and international retail and corporate clients.

Bank Dhofar is committed to new ideas, innovations revisions and fine-tuning of existing practices. The Bank continues to offer innovative high quality products and services and implement creative strategies ahead of market trends to achieve sustained growth and secure and increase local and international market shares.

Bank Dhofar is one of the most efficient banks in Oman, with the reliability as its foundation for service based on advanced technology delivered by professional, competent and approachable staff. The Bank consistently demonstrates good faith and integrity in its dealings with all its stakeholders, providing acceptable returns to shareholders whilst maintaining a strong financial base.

CONTENTS

PAGES

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BOARD OF DIRECTORS' REPORT

BANKDHOFAR S.A.O.G.

THE BOARD OF DIRECTORS' REPORT

Most profitability indicators recorded significant growth, as net interest income increased from RO 26.2 million at the end of 2006 to reach RO 30.4 million at the end of 2007, a growth of 16%. Also other income (fees and commissions, foreign exchange profit, investment income and other income) grew by 57.5% and reached RO 13.7 million at the end of 2007 compared with RO 8.7 million in previous year.

Dear Shareholders,

On behalf of the Board of Directors of BankDhofar S.A.O.G., I am pleased to present to you the Bank's Financial Statements and the Auditors' Report for the financial year ended 31 December 2007.

The Board of Directors would like to thank our shareholders for the valuable trust they have placed in us at the election held in March 2007, and to assure them that we will continue to improve the performance of the Bank that will be reflected positively on the Bank. Also the Board of Directors would like to thanks Mr. Salem Aufiet Al Shanfari and Mr. Saleh Nasser Al Habsy for their valuable contribution during their tenure as members of the Board.

The Bank's Financial Performance in 2007

The Bank has achieved good results as most financial indicators showed remarkable growth. The total assets increased from RO 694.8 million at the end of 2006 to RO 955.1 million in 2007, a growth of 37.5%. The net loans and advances to customers grew by 28.4% and reached RO 704.6 million at the end of the year. Also the customer deposits recorded a growth of 35.7% and increased from RO 497.1 million at the end of 2006 to reach RO 674.5 million at the end of 2007.

The shareholders' equity increased from RO 93.3 million on 31 December 2006 to RO 110.5 million on 31 December 2007. The share capital of the Bank increased in 2007 and reached RO 53.08 million resulting from the issuance of bonus shares on 69.2 million shares with par value of RO 0.100.

Most profitability indicators recorded significant growth, as net interest income increased from RO 26.2 million at the end of 2006 to reach RO 30.4 million at the end of 2007, a growth of 16%. Also other income (fees and commissions, foreign exchange profit, investment income and other income) grew by 57.5% and reached RO 13.7 million at the end of 2007 compared with RO 8.7 million in previous year. The operating expenses grew during 2007 by 24.6% and reached RO 16.96 million resulting in a cost to income ratio of 38.5% compared to 39.0% in 2006.

The net profit for 2007, after providing all required provisions for non-performing loans, reached RO 22.79 million compared with RO 20.13 million in 2006, a growth of 13.2%. The Earning Per Share (EPS) increased from 38 Baisas at the end of 2006 to 43 Baisas in 2007.

Subordinated Long-term Loan

During the third quarter the Bank availed a subordinated Tier II loan of US $ 100 million with a 5 years and 1 month tenor. This loan was arranged by ABN AMRO Bank and Emirates Bank International, as Lead Arrangers and ABN AMRO Bank as the Original Lender. The Bank will utilize this loan for funding its long term, dollar- denominated consortium lending for projects of national importance in Oman. Additionally, the loan shall augment the Bank's capital base, thereby providing additional fund base for accelerating its asset growth. The capital adequacy ratio of the Bank shall also improve further.

Appointment of Senior Management and Other Developments

In our continuous efforts to improve the performance of the Bank, the Board of Directors has appointed a consultancy firm, Booze Allen Hamilton, to formulate a 5-year (2008-2012) strategic plan for the Bank. This plan has been finalized and approved by the Board in January 2008.

Also taking into consideration that human resources is the key factor in driving and achieving our future goals, on 1 October 2007, Mr. Kris Babicci, who has over 30 years of experience in banking was appointed as Chief Operating Officer (all Bank's activities).

Other Achievements

In 2007 the Bank has been awarded the second place in the corporate governance award that was organized by The Hawkmah Institute for Corporate Governance and the Union of Arab Banks in association with MasterCard worldwide. The Hawkmah-UAB Bank Corporate Governance Award is the first of its kind in the Arab world and banks from various countries were invited to apply for this award.

As a result of remarkable performance in 2006, Bank Dhofar ranked No.2 among local banks according to the detailed financial analysis carried out by "Business Today" magazine in coordination with a renowned consultancy firm in 2007.

Social Responsibilities and Local Community Involvement

In addition to the continuous support that the Bank extends to the local community, we contributed an amount of RO one million to the Special Fund that was created by His Majesty Sultan Qaboos Bin Said, to support the relief efforts and to ease the suffering of the people affected by the inclement weather last June.

Corporate Governance

The Bank has fully complied with all directives of the Code of Corporate Governance issued by the Capital Market Authority. Also during 2007 the Bank assessed and reviewed the internal control procedures of the Bank.

In compliance with article (101) of the Commercial Companies Law No. 4/1974 and its amendments, the Board of Directors would like to disclose that the total amount received in 2007 as sitting fees was RO 62,500 and the proposed remuneration for the year is RO 137,500.

Proposed Dividends

The Board of Directors recommends RO 13.27 million in cash dividends, representing 25% of the share capital of the Bank. We will also transfer RO 1.47 million to the subordinated bonds reserve and an amount of RO 2.57 million to subordinated loan reserve as per the requirements of the Bank for International Settlement (BIS) for the purpose of Capital Adequacy calculation.

The amount of dividends distributed in the last five years is as follows:

RO 000

Year	2002	2003	2004	2005	2006
Cash Dividends	6,294	6,294	6,294	4,196	6,924
Bonus Shares	-	-	-	4,196	6,924

On behalf of the Board, I would like to thank our valuable customers for their patronage and confidence they have reposed in the Bank. I thank the shareholders for your continuous support and the Bank's staff and management for the good performance in 2007.

The Board of Directors also wishes to thank the Central Bank of Oman for its valuable guidance to the local banking sector.

Finally, on behalf of the Board of Directors, I would like to express our most sincere gratitude to His Majesty Sultan Qaboos Bin Said for his wise leadership and generous support to the private sector.

Eng. Abdul Hafidh Salim Rajab Al-Aujaili
Chairman

BOARD OF DIRECTORS

Engineer Abdul Hafidh Salim
Rajab Al Aujaili
Chairman

Sheikh Hamoud Bin
Mustahail Ahmed Al Mashani
Vice Chairman

H.E Ahmed Abdullah Moqaibel
Board Member

Saleh Nasser Juma Al Araimi
Board Member

Ahmed Bin Said
Mohammed Al Mahrezi
Board Member

H. H. Sayed Taimoor
Bin Asa'ad Al Said
Board Member

Ali Ahmed Al Mashani
Board Member

Najah Musallim Sulaiman
Al Kiyumi
Board Member

Mohammed Yousuf Alawi
Al Ibrahim
Board Member

MANAGEMENT TEAM

Kris Babicci
Acting Chief Executive Officer

Christopher De'Ath
General Manager Strategy & Planning

Mohammed Redha Ahmed Jawad
General Manager Wholesale Banking

Abdul Hakeem Omar Al Ojaili
Deputy General Manager
Support Services

Ravi Khanna
Assistant General Manager
Information Technology

Mudit Saxena
Assistant General Manager
Consumer Banking

Bashir Said Al Subhi
Head of Treasury and International Banking

Emad Khalid Al Zubi
Chief Financial Officer

Mohammed Yar Mohammed Al Balushi
Acting Head of Human Resources

Ahmed Said Al Ibrahim
Assistant General Manager
Government Relations

Rajesh Kusumwal
Head of Internal Audit

Huwayda Nasser Al Shahimi
Head of Corporate
Communications & Marketing

Mohan Nair
Senior Manager Compliance

P.M. Ranganathan
Head of Risk Management

REPORT ON CORPORATE GOVERNANCE FOR THE YEAR ENDED 31ST DECEMBER 2007

Deloitte.

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Sultanate of Oman

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Tel: +968 24815896
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TO THE SHAREHOLDERS OF
BANK DHOFAR SAOG

We have performed the procedures prescribed in Capital Market Authority (CMA) Circular No. 16/2003 dated 29 December 2003 with respect to the accompanying corporate governance report of **Bank Dhofar SAOG** ("the Bank") and its application of corporate governance practices in accordance with CMA code of corporate governance issued under Circular No. 11/2002 dated 3 June 2002 and CMA Rules and Guidelines on disclosure, issued under CMA administrative decision 5, dated 27 June 2007. Our engagement was undertaken in accordance with the International Standards on Related Services to agreed-upon procedures engagements. The procedures were performed solely to assist you in evaluating the Company's compliance with the code as issued by the CMA.

We report our findings as below:

We found that the Bank's corporate governance report fairly reflects the Bank's application of the provisions of the Code and is free from any material misrepresentation.

Because the above procedures do not constitute either an audit or a review made in accordance with International Standards on Auditing or International Standards on review Engagements, we do not express any assurance on the corporate governance report.

Had we performed additional procedures or had we performed an audit or review of the corporate governance report in accordance with International Standards on Auditing or International Standards on Review Engagements, other matters might have come to our attention that would have been reported to you.

Our report is solely for the purpose set forth in the first paragraph of this report and for your information and is not to be used for any other purpose, This report relates only to the accompanying corporate governance report of **Bank Dhofar SAOG** to be included in its annual report for the year ended 31 December 2007 and does not extend to any financial statements of **Bank Dhofar SAOG**, taken as a whole.

Deloitte & Touche

Deloitte & Touche (M.E.)
Muscat, Sultanate of Oman
28 January 2008

Corporate Governance Report

for the Year Ended 31 December 2007

Part One

1 - Corporate Governance Philosophy:

The Board of Directors of BankDhofar SAOG (the Bank) bears the principal responsibility of fashioning the Corporate Governance code as appropriate to the Bank within the broad framework enunciated by the Central Bank of Oman (CBO) and the Capital Market Authority (CMA). It is also charged with the responsibility of subjecting the code to periodic review to keep it refurbished and contemporary.

Decision-making within the Bank has been broadly divided into two levels. The Board of Directors (the Board) at the apex level, as trustees of the shareholders, bears the responsibility of strategic supervision of the Bank, apart from fulfilling statutory obligations. Some of the major responsibilities of the Board, namely audit, senior management succession, legal and regulatory compliance are discharged through four sub-committees, viz. the Executive Committee, the Audit Committee, the Risk Committee and the Human Resources Strategic Committee. These sub-committees which operate under the Board approved charters have been meeting regularly and have contributed significantly to the effective functioning of the code of corporate governance. The charters of these committees meet with all the requirements as laid down in the Code of Corporate Governance enunciated by the CBO and the CMA. In addition, the Board carries the responsibility of approving the strategic plans of the Bank. The executive management of the Bank comprises the Senior Managers headed by the Chief Executive.

Through this two-tiered interlinked governance process, a wholesome balance has been created between the need for focus and executive freedom, and the need for supervision, control and checks and balances.

The formal Code of Corporate Governance prescribes the highest ethical standards in the conduct of the Bank's business. The Senior Members of the Bank are fully cognisant of their responsibilities in setting personal examples so that the code is internalized within the Bank and becomes part of its culture. In the ultimate analysis, there can be no substitute for the enlightened self-regulation that is expected of every member of the Bank.

2 - The Responsibilities of the Board of Directors

The Board has the full authority to perform all acts required for managing the Bank and protecting and growing the shareholders' interests pursuant to its objectives. Such authority shall not be limited or restricted except as provided by the law, the Articles of Association or resolutions of the General Meetings.

The responsibilities and functions of the Board include the following:

- Charting the overall strategic direction of the Bank and reviewing and approving the business and strategic plan.
- Monitoring the Bank's performance and evaluating whether the business is properly managed in accordance with the Bank's set plans.
- Approving the interim and annual financial statements and providing accurate information at the right time to the shareholders, in accordance with the instructions of the Capital Market Authority.
- Forming various Board sub-committees, approving their charters and reviewing the functions of these committees.
- Reviewing all audit reports submitted by internal and external auditors and statutory agencies.
- Ensuring that the Bank conducts its operations in an ethical and transparent manner.
- Assessing and approving the proper delegation of authorities to executive management.
- Evaluating the functions and the performance of the Chief Executive Officer, Chief Operating Officer and other key employees.

Size and Terms

The Board consists of twelve (12) non-executive directors who are elected by the shareholders at the Annual General Meeting. The term of office of the Board of Directors is three years and each Director can be re-elected for a similar period. The term of the current Board expires in March 2010.

Composition and Selection

Members of the Board of Directors are elected from among the Bank's shareholders or non-shareholders provided that a shareholder candidate owns no less than

50,000 shares of the Bank. The majority of members of the Board of Directors shall be non-executive Directors.

A minimum of one-third of the Board members shall be independent Directors, none of their immediate relatives having held a senior position in the Bank for the last two years, who shall have no relation with the Bank that could result in financial transactions other than contracts and transactions entered through open tendering or done in the ordinary course of business.

The election process is through direct secret ballot whereby each shareholder shall have a number of votes equivalent to the number of shares he/she holds. Every shareholder shall have the right to vote for one candidate or more provided the total number of votes in the voting form is equivalent to the number of shares he/she holds.

At present all the directors of the Board are non-executive and are independent within the scope of the definitions laid down in the Code of Corporate Governance by the CMA.

Board Committees

The Board has the following four permanent Board Committees, whose objectives, powers and procedures are governed by the terms of reference of the respective Committees as enshrined in their Charters, approved by the Board:

- Executive Committee
- Audit Committee
- Risk Committee
- Human Resources Strategic Committee

Additional committees may be established from time to time based on business needs. In 2007 the Board established a special committee called Strategic Plan Committee to monitor the production of the Bank's 5-Years strategic plan. Each committee has access to the information and resources it requires, including direct access to staff and consultants. The Board has selected the committee members based on their professional backgrounds, skills and other qualities they bring to the committees.

Part Two

1. Members of the Board of Directors

The Board of Directors of BankDhofar (SAOG) consists of the following:

S. No.	Name of Director	Basis of Membership			No. of Other Directorships Held
1	Eng. Abdul Hafidh Salim Rajab Al-Aujaili	Chairman Non-executive	Independent	Shareholder Director	1
2	Sheikh Salem Mubarak Al Shanfari	Vice Chairman Non-executive	Independent	Non-shareholder Director	2
3	HH. Sayed Taimoor Bin Assad Al Said	Member Non-executive	Independent	Non-shareholder Director	-
4	HE Ahmed Abdullah Sulaiman Moqaibel	Member Non-executive	Independent	Non-shareholder Director	3
5	Mr. Abul Aziz Ali Al Shanfari	Member Non-executive	Independent	Non-shareholder Director	1
6	Sheikh Hamoud Mustahail Ahmed Al Mashani	Member Non-executive	Independent	Non-shareholder Director	2
7	Mr. Mohammed Yousuf Alawi Al Ibrahim	Member Non-executive	Independent	Non-shareholder Director	2
8	Mr. Ali Ahmed Al Mashani	Member Non-executive	Independent	Non-shareholder Director	1
9	Eng. Saeed Salim Al Shanfari	Member Non-executive	Independent	Non-shareholder Director	2
10	Mr. Ahmed Said Mohammed Al Mahrezi	Member Non-executive	Independent	Non-shareholder Director	2
11	Mr. Saleh Nasser Juma Al Araimi	Member Non-executive	Independent	Non-shareholder Director	2
12	Mrs. Najah Musallim Al Kiyumi	Member Non-executive	Independent	Non-shareholder Director	-

Corporate Governance Report

for the Year Ended 31 December 2007

The Board of Directors held 7 meetings during 2007 as follows:

- 28 February 2007
- 15 April 2007
- 28 March 2007
- 12 June 2007
- 1 April 2007
- 11 September 2007
- 4 October 2007

S. No.	Name of Director	Capacity of Membership	No. of Meetings Attended	Directors' Benefits (Amount in RO)	
				Fees Paid	Remuneration Proposed
1	Eng. Abdul Hafidh Salim Rajab Al-Aujaili	In Personal Capacity	7	10,000	11,458
2	Sheihk Salem Mubarak Al Shanfari	In Personal Capacity	3	1,600	11,458
3	HH. Sayed Taimoor Bin Assad Al Said	In Personal Capacity	4	3,200	11,458
4	HE Ahmed Abdullah Sulaiman Moqaibel	Representative of Dhofar International Development & Investment Holding Company (SAOG)	7	6,700	11,458
5	Mr. Abul Aziz Ali Al Shanfari	In Personal Capacity	5	5,600	11,458
6	Sheikh Hamoud Mustahail Ahmed Al Mashani	In Personal Capacity	3	2,000	11,458
7	Mr. Mohammed Yousuf Al Ibrahim	In Personal Capacity	6	4,800	11,458
8	Mr. Ali Ahmed Al Mashani	In Personal Capacity	5	5,600	11,458
9	Eng. Saeed Salim Al Shanfari	Representative of Dhofar Cattle Feed (SAOG)	6	4,800	11,458
10	Mr. Ahmed Said Mohammed Al Mahrezi	In Personal Capacity	5	5,700	11,458
11	Mr. Saleh Nasser Juma Al Araimi	Representative of Public Authority for Social Insurance	6	5,100	11,458
12	Mrs. Najah Musallim Al Kiyumi *	Representative of Ministry of Defence Pension Fund	6	5,600	8,596
13	Mr. Saleh Nasser Al Habsy **	In Personal Capacity	1	1,800	2,866
TOTAL				62,500	137,500

* Mrs Najah elected as a new Board member on 28 March 2007.
** Mr. Saleh Al Habsy was a member of the Board of Directors up to 27 March 2007.

2. Executive Committee

The Committee consists of five members with proper experience, skills and initiative. The objective of the Executive Committee is to discharge responsibilities on behalf of the Board in deciding on specific policy matters demanding in-depth study and analysis, deliberation and interactive consideration and decisions on micro matters of business beyond the powers delegated to the management, but considered less important to receive the full Board's attention and time.

The Board members of the Executive Committee are:

Name of Director	Designation	No. of Meetings Attended
1. Eng. Abdul Hafidh Salim Rajab Al-Aujaili	Chairman of the Committee	9
2. Mr. Abdul Aziz Ali Al Shanfari	Vice Chairman	8
3. Mrs. Najah Musallim Al Kiyumi	Member	8
4. Mr. Ali Ahmed Al Mashani	Member	8
5. Mr. Ahmed Said Mohammed Al Mahrezi	Member	6

The Executive Committee held 9 meetings during 2007.

3. Audit Committee

The Audit Committee was formed in 2001 by the Board of Directors with the following main objectives and responsibilities:

- To focus the attention of the Board and top management of the Bank on the importance of strong financial reporting and risk management.
- To monitor the adequacy of internal controls in the Bank and to take appropriate steps where required.
- To monitor the Bank's compliance with legal and regulatory provisions, its articles of association, charter, by-laws and rules established by the Board of Directors.
- To identify the risk areas of the Bank's operations to be covered in the scope of the internal and external audits during the year.
- To monitor the effectiveness of the internal audit function and approve the audit plan as well as the availability of adequate resources (personnel and tools).
- To recommend the appointment / change of the external auditors and determine and review their terms of engagement.
- To hear the views of the external auditors before forwarding the annual financial statements to the Board for approval.
- To report and bring to the attention of the Board any matters of concern with regard to the fore-going and any material accounting or auditing concerns identified as a result of the external or internal audits, or examination by supervisory authorities.

The Members of the Audit Committee are:

Name of Director	Designation	No. of Meetings Attended
1. HE Ahmed Abdullah Sulaiman Moqaibel	Chairman of the Committee	5
2. HH. Sayed Taimoor Bin Assad Al Said	Member	2
3. Sheikh Hamoud Mustahail Ahmed Al Mashani	Member	2
4. Mr. Mohammed Yousuf Al Ibrahim	Member	5

The Audit Committee held 5 meetings in 2007.

4. Risk Committee of the Board of Directors:

The Risk Committee of the Board was formed in October 2004 by the Board of Directors with the following main objectives and responsibilities:

The Objective of the Risk Committee of the Board is to focus on issues relating to Risk Management policies and procedures on a Bank-wide basis by arriving at a judicious policy decision collectively.

Roles and Responsibilities:

- To understand the risks undertaken by the Bank and ensure that they are appropriately managed.
- To develop risk policies, limits and procedures after assessment of the Bank's risk bearing capacity.
- To identify, monitor and measure the overall risk profile of the Bank.
- To verify models used for pricing complex products and transfer pricing.
- To review the risk models as development takes place in the markets and also identify new risks.
- To ensure that the risk policies developed clearly spell out the quantitative prudential limits on various segments of Bank's operations.
- To build stress scenarios to measure the impact of unusual market conditions and monitor variance between the actual volatility in portfolio values and those predicted by the risk measures.
- To monitor compliance with various risk parameters by business lines.
- To hold the line management accountable for the risks under their control.
- To oversee and ensure the implementation of CBO's guidelines on risk management systems in Banks.

The members of the Risk Committee are:

Name of Director	Designation	No. of Meetings Attended
1. Mr. Saleh Nasser Juma Al Araimi	Chairman of the Committee	3
2. HH. Sayed Taimoor Bin Assad Al Said	Member	3
3. Sheikh Salem Mubarak Al Shanfari	Member	1
4. Eng. Saeed Salim Al Shanfari	Member	3

The Risk Committee held 3 meetings in 2007.

5. Human Resources Strategic Committee of the Board of Directors:

The Human Resources Strategic Committee of the Board of Directors was formed in March 2005 by the Board to ensure that the overall human resources developments at Bank level are as per the strategic direction of the Bank.

At a strategic level, the Committee is responsible for reviewing and monitoring the following:

- Ensure manpower plans take into account, the strategic and specific resources requirements at the Bank to achieve strategic plans.
- Review the Omanisation plans and ensure certain defined positions are ear-marked for prospective Omanis within a prescribed period of time.
- Review exit interviews and note any dismissals or resignations for middle management and top management.
- Review the recruitment policy adopted by the Human Resources Department.
- Review the qualifications and experience of specific candidates for the positions at the top management levels.
- Review and monitor compensation and reward policy and procedures.
- Review and monitor training and development policy and process.

The members of the Human Resources Committee are:

Name of Director	Designation	No. of Meetings Attended
1. Mr. Ahmed Said Mohammed Al Mahrezi	Chairman of the Committee	1
2. Mr. Mohammed Yousuf Al Ibrahim	Member	1
3. Eng. Saeed Salim Al Shanfari	Member	1

The Human Resources Strategic Committee held one meeting in 2007.

6. Directors' Remuneration and Executives Pay

As all members of the Board are non-executive directors, no fixed salary or performance-linked incentives are applicable. The non-executive directors are paid an annual remuneration and sitting fees for attending the Board / Committee meetings. Directors' proposed remuneration and sitting fees paid during 2007 are as follows:

	Proposed Remuneration RO '000s	Sitting Fees Paid RO '000s	Total RO '000s
Chairman of the Board	11.7	10.0	21.7
Board Members	125.8	52.5	178.3
Total	137.5	62.5	200.0

The Bank's top five executives, namely the Chief Executive, Chief Operating Officer, General Manager – Wholesale Banking, Deputy General Manager- Support Services and Assistant General Manager – Consumer Banking have received the following in 2007:

	Salaries RO '000s	Performance Bonus & Others RO '000s	Total RO '000s
Top five Executives	**373.0**	**185.0**	**558.0**

7. Compliance with Regulatory Requirements

The Bank adhered to and complied with all relevant regulatory requirements in the last three years except one instance in 2007 when the bank penalized for RO 2,500 by one of its regulator. The bank has taken all corrective and necessary measures to avoid similar instance in future.

Also the Bank complied with all provisions of the Code of Corporate Governance issued by the Capital Market Authority.

8. Communication with Shareholders and Investors

The Bank publishes its quarterly interim financial statements and also hosts these and other relevant information at its website (www.bankdhofar.com). The quarterly results are published in two local newspapers in Arabic and English. These results can be obtained by shareholders either from the Bank or Muscat Securities Market (MSM).

The management provides regular updates to the market on the Bank's performance and new developments. The Management Discussion and Analysis Report forms are part of this annual report.

9. Market Price Data

a. Share Price Movements

The high/low share price information of the Bank during the financial year ended 31 December 2007 compared with Muscat Securities Market Index is as follows:

2007	BankDhofar Share Price (RO)			MSM Index
Month	High	Low	Closing	Closing
January	0.425	0.370	0.410	5,769.99
February	0.455	0.410	0.451	5,773.150
March	0.462	0.410	0.460	5,550.470
April	0.429	0.367	0.403	5,795.300
May	0.500	0.396	0.468	6,202.400
June	0.480	0.440	0.471	6,338.960
July	0.490	0.455	0.482	6,426.660
August	0.595	0.480	0.548	6,650.490
September	0.599	0.555	0.594	6,986.640
October	0.660	0.585	0.657	8,021.230
November	0.710	0.650	0.705	8,442.750
December	0.706	0.669	0.672	9,035.460

b. Major Shareholders

The following are the major shareholders who own more than 5% of the outstanding shares as at 31 December 2007:

Shareholder	% of Ownership
Dhofar International Development and Investment Holding Company (SAOG)	30.00%
Civil Service Pension Fund	10.00%
Ministry of Defense Pension Fund	8.57%
Public Authority for Social Insurance	8.15%
Malatan Trading and Contracting LLC	6.39%
Qais Omani Establishment LLC	6.27%

10. Profile of the Statutory Auditors

Deloitte Touche Tohmatsu is an organization of member firms devoted to excellence in providing professional services and advice. Deloitte is focused on client service through a global strategy executed locally in nearly 140 countries. With access to the deep intellectual capital of 150,000 people worldwide, our member firms, including their affiliates, deliver services in four professional areas: audit, tax, consulting, and financial advisory.

Deloitte & Touche in the Middle East is the oldest and largest indigenous professional services firm with more than 1,000 people serving businesses and governments in 14 countries through 25 offices. The Oman Practice currently has three Partners and over 50 professionals.

11. Acknowledgment

The Board of Directors acknowledges confirmation of:

- Its responsibility for the preparation of the financial statements in accordance with the applicable standards and rules.

- Review of the efficiency and adequacy of internal control systems of the bank and that it complies with internal rules and regulations.

- There are no material matters that affect the continuation of the bank and its ability to continue its operations during the next financial year.

12. Other Matters

- During 2007 the bank has fully complied with all directives of the Code of Corporate Governance issued by the CMA.
- The Statutory Auditors of the Bank are Deloitte Touche Tohmatsu. The Audit fees paid or payable to auditors for 2007 is RO 29,000 and other fees paid or payable is RO 7,300.
- The last Annual General Meeting was held on 28 March 2007 and the last Extraordinary General Meeting was held on 30 September 2003.

THE MANAGEMENT DISCUSSION AND ANALYSIS REPORT
FOR THE YEAR ENDED 31ST DECEMBER 2007

The Management Discussion and Analysis

Report for the year ended 31 December 2007

Oman's Economy and Outlook

The buoyant economic growth of the last 3 years continued in 2007 and the nominal Gross Domestic Product (GDP) growth for 2007 is estimated at 11.6 %, underpinned by the growth in the income of oil and natural gas sectors. The growth in oil sector is estimated at 5.5 %, non-oil sector at 17 % and exports at 4 %. Imports increased by 46 %, due to rising commodity prices in the international market and due to the weak dollar. The commodity prices caused a moderate inflationary pressure of around 5 %. The Government expects a budgetary surplus of RO 1.72 billion in 2007. Muscat Securities Market (MSM) achieved a record growth of 62 % in 2007, the best growth in the entire GCC region.

The 2008 government budget estimates a revenue growth of 20% over 2007, an expenditure growth of 19% and a nominal budgetary deficit of 3 % of the GDP. Oil income is estimated to contribute to 67% of the total income, with natural gas revenue accounting for 11% of the total income. Significant thrust has been given to health care and education sectors, with the expenditure allocation accounting for 49% of the total budgeted expenditure. Analysts forecast a real GDP growth of 5.2% in 2008.

Wholesale Banking Group

The Wholesale Banking Group encompasses the Corporate Banking Department, Project Finance & Syndications Department, Small & Medium Enterprises (SME) Department and the Remedial, Trade Finance Sales and Corporate Advisory & Structured Finance Departments.

The metamorphosis of the erstwhile Corporate Banking Division (including the Mid-Sector unit) into the Wholesale Banking Group was a part of a planned strategy evolved by the Bank to focus on different segments of the Corporate market and provide the full range of Corporate services under a single umbrella. The framework for the re-organisation was laid down by the internationally reputed Management Consultants, Booz-Allen Hamilton. During the year staffing of key positions was taken through induction of highly qualified and trained professionals.

In the backdrop of a rapidly changing economic profile of the country, increased competition in the sector and the evolving banking regulatory regime, we believe that the Wholesale Banking Group will be the vehicle of future growth for the Bank. It is our cherished objective to become the 'preferred Bank' for corporate customers in Oman and serve as a 'one-stop shop' for all their banking requirements and services. Towards this objective and to serve promptly and effectively our existing as well as prospective customers, the Bank has streamlined internal procedures and as mentioned earlier, hired experienced professionals committed to deliver corporate banking services of the highest standard. The Bank is also upgrading its technological capabilities in various areas to effectively provide efficient delivery channels to its Corporate customers which, inter-alia, include the provision of internet-based banking facilities.

In 2007, all the lending arms of the Wholesale Banking Group have performed well under challenging circumstances. This was possible due to a leveraging of the existing relationships to increase our exposure to the extent possible, growth in new Corporate/SME lending, growth in the project finance/ syndicated loan portfolio and growth in overseas lending. Also we have been able to lend to companies with larger fund requirements in consortium with regional banks.

Corporate Banking Department

The Corporate Banking Department is staffed by qualified banking professionals with vast and varied experience of Credit delivery and the Omani market. It provides the entire gamut of Corporate Banking products – both funded and non-funded – to the customers and has been instrumental in developing the Bank into a 'Relationship Bank' which endeavors to build a long-lasting and mutually beneficial relationship with its clients. Typical products extended by the department include Term Loans of various maturities both for capital expenditure and working capital requirement, Letters of Credit, Loans against Trust Receipts, Guarantees, etc. The customer base of the Corporate Banking Department spans over a wide range of industry including Trading, Manufacturing, Services and Contracting. Depending on the industry sector, the banking products are suitably devised to effectively cater to the particular requirement of the sector.

Every customer or a group of customers is assigned a specialist relationship executive, who is in constant touch with the customers to understand their requirements and offer suitable services/products on most competitive terms. The emphasis is on the development of tailor-made financial solutions that are suited to the individual needs of the customers. The executive also liaises with other departments of the Bank to facilitate prompt delivery of the required services/products to the satisfaction of the customer. The Bank considers these relationship executives as vital links with its esteemed customers.

As a part of the Bank's increased emphasis on Trade Finance, a special cell is being created to attend to specialized requirements of the Customers in this area. The objective is to have a continuous interaction with the Customers in order to provide effective solutions in the area of Trade Finance.

Project Finance & Syndications Department

The Government of Oman is continuing with its stated policy of wider and larger participation of the private sector in various spheres of economic activities, which were hitherto in its domain. Consequently, a number of large projects of national importance, requiring considerable sums of investments are being implemented at a rapid pace. BankDhofar has taken a conscious decision to actively participate in financing of these projects within its prudential exposure norms. Accordingly, the Project Finance & Syndication team continued to work closely with local and international banks, exploring/ exploiting the lending opportunities to various projects.

Over the years the Bank has participated in several important local projects including the projects of Sohar Refinery LLC, Oman India Fertiliser Company LLC, Sohar Aluminum, Oman LNG, Oman Gas, Salalah Port, Oman Refinery (expansion) and the four power and water projects. The Bank has in place the technical capability to independently lead- arrange funds for mid-cap projects and has a strategic tie-up with a few regional and international banks for the purpose of ensuring full participation. A start in this direction has been made with lead-arranging the funds for various projects taken up by reputed companies. Realising the lending potential across the border the Bank has increased its participation in respect of cross-border deals within the permitted regulatory ceiling. The Bank is also making a foray into the provision of Advisory Services for Projects/Corporates and is in the process of building a suitable team.

Going forward we envisage a host of lending opportunities in the Infrastructure, Oil & Gas, Construction and Tourism sectors taking into account the large Government sponsored projects on the anvil as well as those privately sponsored. The 7th Five Year Plan (2005-2010), which is currently in its third year of implementation, envisages a Governmental & Private investment programme of RO 13.15 billion over the five-year period. Of this, Oil & gas-related investments aggregate RO 7.3 billion while investment in tourism projects is slated at RO 958 M. Investments in other mega-projects and in private sector projects aggregate to RO 2.9 billion. In the Budget for 2008, the Government has increased the spending on development projects by RO 2.4 billion to reach a level of RO 5.4 billion.

SME Department

The SME Department has carved out a niche for itself by catering to the needs of small and medium-sized enterprises. The Department actively interfaces with the small and medium companies to understand their requirements and devise suitable solutions. The focused approach towards this segment has clearly shown impressive results not only in terms of the number of customers and volume of the portfolio but also in terms of profitability to the Bank. Going forward, we envisage widespread growth in this segment taking into account the percolation effect of the sustained increase in the price of oil. In addition there is widespread awareness in the concerned Ministries and Government departments on the need to revitalize this important segment of the Economy.

Consumer Banking Group

Distribution Network

It was an outstanding year for the Consumer Banking Division (CBD) of BankDhofar, as it continued its focus on providing value-added products and services to the customers. The Bank continued its growth and expansion strategy in 2007, strengthening its distribution channels with the addition of more branches, ATMs and Deposit & Bill payment Machines (DBPMs).

The year 2007 saw the addition of 2 new branches at Falaj Qabail (Batinah region) and Al Khuwair Ministries Area (Muscat region), 4 ATMs (2 offsite ATMs in Buraimi and Salalah) and 2 more Deposit & Bill Payment Machines at Ruwi and Jalan Bani Bu Ali. The year ended with 49 branches, 85 ATms and 8 DBPMs.

Products

Al Heson

The year also saw the growth of BankDhofar's flagship scheme Al Heson savings scheme offering bigger and better prizes to its customers. The Al Heson savings scheme is one of the most popular savings schemes in the market with its unique proposition of 'Win Now,' which gives customers the opportunity to open an account and get the chance to win every week.

The Al Heson scheme continued its promise of offering more prizes every week, and draws for various special occasions and festivals like Ramadan, Eid Al Fitr, National Day and Eid Al Adha. All this along with other special prizes and draws for various segments and age groups in the form of gold for Ladies and a Mazen & Mazoon draw for children.

NRI Connect

BankDhofar announced the launch of a joint product offering along with ICICI Bank, making it convenient for the large Non-resident Indian population in Oman to enjoy the services of 2 world-class banks with a single account. NRIs can get a Twin account as well as do online remittances from 49 branches at preferential rates.

Card Centre

The year 2007 saw the introduction of Oman's first and only Chip Credit Card. The Chip Credit Card brings in advanced chip technology that offers unparalleled security to customers by providing them with maximum protection against fraud through theft, or losses through counterfeit transactions.

The new Chip Credit Card has both the magnetic strip as well as chip functionality. The chip functionality offers BankDhofar's Chip credit card users complete security and greatly enhances the procedure of fraud detection at terminals that are chip-enabled. The Chip Credit Card is offered on both Visa and MasterCard platforms.

Along with security the Bank's credit cards come with various benefits and advantages like privileged access to Oman Air Airport lounge at Muscat and Salalah, free travel insurance including accident, baggage and flight delay for cardholder and family, interest-free repayment period up to 52 days, emergency card replacement, etc. Chip Credit Cards can now also be availed by customers without transferring their salary to BankDhofar by offering an undated cheque.

Housing Loans

The Housing loan product was well received by customers. The product was the most competitive in the market as it offered the lowest monthly installment, the lowest processing fees and lowest insurance and it comes along with a free credit card. Housing loans are available to customers to buy, build or renovate their homes, for more than one property, to buy land, and to invest in a residential project.

Outbound Sales

It was a remarkable year for Outbound Sales Department in 2007, which launched the new Home banking service. The service is specially designed to serve customers from the convenience of their homes or offices. All that a customer has to do is to call BankDhofar's toll- free number and request for Home Banking at a location and time convenient to him. A representative from BankDhofar will personally attend to the customer, and look after all their banking needs. This service was recently launched in Muscat and will be taken across the Sultanate in due course of time.

Home Banking Service is an extension of BankDhofar's philosophy of putting the 'customer first.' A highly motivated direct sales team comprising of young and energetic Omanis cater to the customers' banking needs.

The Call Centre services also saw improvement with the increase in the number of Omanis specially trained to provide information on various services and products.

Consumer Marketing

The division is involved with Advertising, Public Relations, Direct Marketing and Events, to promote the Bank's products and improve its image.

Aggressive media strategies were used to generate top of mind awareness with a number of mass media campaigns for the Bank's 'Al Heson' savings products, credit cards, housing loans and electronic channels.

BankDhofar has always believed in celebrating various community activities, and used such platforms to avail the tremendous marketing potential these events offer. The Muscat Festival and Khareef Festival are the perfect avenues for advertising opportunities especially for brand building, as it helps in creating a larger customer-base. Sponsorships and donations have also provided extensive marketing opportunities.

BankDhofar has also placed focus on its Mazen & Mazoon customers by hosting a QaranQashow party at Marah Land during Ramadan as well as initiating a full region-wide colouring competition.

The year 2007 also saw special promotions and offers for the customers of BankDhofar. In November a special promotion was run by BankDhofar where customers were urged to apply for a Chip Credit Card and receive special gift vouchers from Lulu Hypermarket.

Treasury & International Banking Division

The Treasury Division at BankDhofar offers a wide range of treasury-related services to all of our valued corporate, retail and high networth individual customers. The major functions of the Treasury are to control the interest rate risk for reserve holding, exchange rate risk, and liquidity management on daily basis. The Treasury also supports corporate clients for their hedging requirements such as IRS, Options and ICAPs.

We are one of the leading market contributors in USD/OMR spot and swaps. We offer attractive interest rates on deposits in all major currencies to corporate, retail and high networth individual clients. At BankDhofar, we offer highly competitive exchange rates against all currencies. Through the Treasury, we provide services of buying and selling Government securities like Government Development Bonds.

The Treasury and International Division performed better in 2007 in comparison with 2006. Foreign Exchange income grew by 49.86% as compared to the 2006 figures. During 2007, investment in international and regional T-Bills, currency swaps, and corporate relationships with increased business from trade-related activities played a major role in the robust growth.

International Banking Division supports and assists in the areas of trade finance, foreign exchange and building relationships with financial institutions globally. Our Bank has a well-established network of correspondents around the world. With our personalized and professional approach to our customers' varied requirements, BankDhofar has emerged as an important player in the field of Correspondent Banking

2007 proved to be another successful year for International Banking Division. The Bank secured a new long term borrowing of US$ 100 Million for 5 years and one month and a new medium term borrowing of US$ 75 Million for 3 years. US$ 100 Million raised the Tier II capital to strengthen the Bank's net worth and thereby accelerate asset growth. The facility was jointly underwritten by ABN Amro Bank and Emirates Bank International. US$ 75 Million was raised with a view to further improving the balance sheet structure, specifically matching the maturity profile of assets and liabilities. Seventeen international banks from the USA, Europe and the Middle East participated in the facility. The participation of these banks was a reflection of confidence of the international banking community in the country and in our Bank.

During the year, Moody's Investor Service assigned for the first time A3/P-2 local currency rating, A3/P-2 foreign currency deposit rating, and a D+ Bank Financial Strength Rating (BFSR) to our Bank. The outlooks on all ratings are stable. Fitch Ratings affirmed our Bank's rating at long-term issuer debt (IDR) "BBB+" with a stable outlook and short-term IDR "F2", individual "C", support "2" and support rating floor 'BBB+". Cyprus-based "Capital Intelligence (CI) affirmed our Bank's foreign currency long-term and financial strength ratings at "BBB" and the foreign currency short-term rating at "A3". The support rating is unchanged at 3 and the outlook for all the ratings remains "Stable".

Private Clients and Investment Management

Private Clients and Investment Management Division continues to offer a range of investment banking services. Backed by a highly professional and experienced team, institutional, high net worth and retail clients are offered brokerage services in Muscat Securities Market. The Brokerage Services Department plans to broad-base this service to other GCC markets by entering into strategic tie up with brokerage houses in other GCC markets. The research department manned by qualified professionals provides investment research and advisory services covering Oman market. Our asset management team currently manages discretionary investment portfolio. Backed by strong research and asset management capabilities, the team plans to build up the size of funds under management. The private clients department currently provides a very significant support for the resource mobilization and marketing initiatives of the Bank.

Central Operations Division

2007 was another challenging and exciting year for COD. The Division continued to strengthen its capabilities

by continuously looking at ways and means to improve existing processes without compromising quality and control through extensive use of technology and take on additional processes to improve the operational efficiency and accuracy.

The organization restructuring in the last quarter of 2006 saw two crucial operations being merged with COD – Communications in Q4 2006 and Trade Finance in Q1 2007.

Despite the above challenges faced, core COD transaction volume grew by over 30% without any significant increase in staffing. The key reason for this was the continuous focus by the team to effectively utilize technological solutions to automate processes thereby increasing the productivity of the team. This also resulted in the ability of the team to handle the increasing volume of transactions and activities effectively.

Key achievements

- Successfully implemented the online payments for INR through ICICI Bank (Money to India) in 2007 which is a unique service provided to clients in Oman by BankDhofar.
- COD was the first division of the Bank to introduce an Online Electronic Version of Instruction Manual Operations (IMO) which was launched in April 2007.
- Successful implementation of Remote Cheque Deposit System with Bank of New York (BONY RCD)
- All Customers' External Payrolls being transferred electronically through ACH System (Automated Clearing House System), except some formats in Arabic language.
- Centralization of all local currency payments through RTGS.
- Partnered with the IT Department and automated the external standing order function for all clients resulting in timely and accurate processing.

Credit Control

In compliance with the directives of Central Bank of Oman on best risk management practices, the Bank established the Credit Control Department (CCD) during the year under Support Services Group. This new department was formed primarily with the objective of strengthening credit risk management processes through independent reviews of loan portfolio so as to bring about a qualitative improvement in loan administration and control on an ongoing basis.

The department is entrusted with the responsibility of implementation of Loan Review Mechanism (LRM) approved by the Bank's Board. LRM is a comprehensive and independent credit review process, distinct from Risk Management and Internal Audit functions. Under LRM, the Bank's Corporate Loan portfolio is reviewed before management on an ongoing basis by independent evaluation of various credit processes to ensure timely corrective measures. The scope of LRM covers evaluation of credit risk assessment and approval processes, adherence to loan policies/ procedures, sufficiency of loan documentation, overall quality of post-disbursement follow up / loan administration, identification of early warning signals, independent review of risk grading, provisioning etc. In terms of regulatory guidelines, CCD has ensured that at least 30% of the loan portfolio is brought under LRM in 2007 by undertaking timely reviews of large and critical accounts of Corporate Banking and SME departments.

CCD also conducts various portfolio reviews to ensure compliance with various norms on advances as prescribed in the Bank's Credit Risk Policy approved by the Board. Since inception, CCD has taken up various portfolio review exercises to clean up the loan database in the system, to improve the quality of MIS reports by modification of IT programmes, etc. In line with the objectives, CCD would continue to play an important role in reviewing and strengthening various credit risk management processes.

Information Technology

Information Technology (IT) Division of the Bank completed the implementation of Automated Settlements module at all the branches to offer Straight through Processing for Transfer of Funds to the customers of the Bank. The division facilitated the introduction of Asset Liability Manager (ALM) system in the Bank as a part of the Risk Management and Control System. This system would enable the Bank to prudently manage Liquidity and Interest risks.

IT Division upgraded the Trade Finance system of the Bank and enriched the functionality of eZtrade to enhance the service capability of its on-line Trade Finance offering to its corporate customers. The division acquired Business Intelligence tools to track and interpret patterns in its historical data to provide information to the managers to make more knowledgeable business decisions.

The Bank upgraded its Information Security Policies in line with ISO27001 standards.

Human Resources

Human Resources at BankDhofar remain integral to our sustainability and undoubtedly, our continual success has been a resounding testament to the excellence we have within Team BankDhofar. We have always striven and have succeeded in identifying, recruiting and developing the promising young blood of the Sultanate and providing them great careers in banking. We pride ourselves for being able to maintain the Omanisation ratio above the stipulated limit at 91.9% in the year 2007 .This demonstrates amply our commitment towards identifying and grooming the local talent.

The total staff strength of the Bank increased from 636 in the year 2006 to 720 by the end of 2007 to support the rapid expansion of delivery channels. Further, this year almost 35 per cent of our staff advanced up their career ladder to take up higher responsibilities.

In line with the Bank's business plan a number of key initiatives were implemented within HR this year. Competency mapping was one such initiative where HR Department developed competency profiles for all positions in the branch network and mapped out each branch staff against the ideal skills they should possess in discharging their duties effectively. The training needs for the year 2008 were identified after completing the skill mapping exercise across the branch network.

Organizational development is also linked to HR development and we have introduced special programmes which look into this aspect. "Future Managers" programme is one such initiative where 25 potential leaders at supervisory level identified by the management are being groomed to take over managerial positions in the immediate future. The Future Manager programme launched in September 2007 prepares the participants to take over challenging assignments by enhancing their "job mastery" as well as soft skills through regular workshops, special assignments, job enrichment and rotation. Job Mastery programme conducted for the staff members of the "Trade Finance Team" is yet another specialized training launched in 2007.

The increased staff participation and valuable contribution made by staff at all levels in the "suggestion scheme' launched in the past year is another noteworthy achievement recorded this year. Over 66 staff suggestions were evaluated by the Management and 29 good suggestions were implemented and the respective staff rewarded during the year.

Introduction of e–learning to the branch staff in March 2007 was one of the milestones in the Bank's staff development initiatives. With the availability of brief on-line training modules covering the full product range, the branch staff can now log on to his/her own computer and learn in their own free time at the branch.

Risk Management :

a) Risk Management Structure:

The primary responsibility of understanding the risks assumed by the Bank in its normal course of business and ensuring that these risks are appropriately managed, is vested with the Board of Directors of the Bank.

As required by the Central Bank of Oman (CBO), the impending implementation of the Basel II Accord and in line with the international best practices, an independent Risk Committee of the Board of Directors (RC) of the Bank monitors and controls the overall risk profile of the Bank. The RC reports to the full board, on matters of significance and keeps the board continuously updated on the RC's comfort with the Risk Management Process in the Bank. In this task RC relies on an independent Risk Management Division.

The Bank has a well established Risk Management Division with a team of competent and experienced professionals. The primary responsibility of the RMD is to ensure on a continuous basis that an effective risk management framework exists and the various divisions of the Bank function within this framework. RMD also functions as an interface between the Management and the Board in defining appropriate risk tolerance levels for various business and operating divisions of the Bank and in ensuring that policies and procedures are tailored to the defined tolerance levels.

b) Risk Management Strategy:

The Risk Management strategy of the Bank pivots on the following :

1. A clear understanding of various risks assumed by the business and operating divisions of the Bank;
2. Well-defined and disciplined risk measurement processes and procedures for the divisions by way of well-documented authority levels and limits;
3. Continuous monitoring and control of these limits; and
4. Continuous reporting systems to various authority levels on compliance.

A brief account on the various identifiable risks and their risk management process is given below:

1. Credit Risk

Credit risk is defined as the possibility that a borrower or counterparty will fail to meet its obligation in accordance with agreed terms in relation to lending, trading, hedging, settlement and other financial transactions. This risk is primarily controlled and managed by dealing with customers of good credit standing, a thorough and professional credit assessment, obtaining collaterals and

continuous monitoring of the conduct of the account. The Bank has framed a credit risk policy to establish prudent standards, practices in managing credit risk and setting up prudent benchmarks, limits for management of credit risk. At the portfolio level, the risk is further monitored by various limits established including group exposure limits. The Bank employs experienced and competent staff in the areas of corporate banking, provides them with regular training to upgrades and hones their credit skills. Detailed credit policies and procedures, strict adherence to the segregation of duties principle, elaborate and well-defined authority levels, periodic audit and examination by the internal auditors ensure that the culture of risk permeates through the business divisions supported by a rigorous environment of checks and balances.

2. Liquidity and Interest Rate Risk :

Liquidity Risk is the potential inability of the Bank to meet its maturing obligations to a counter party. Liquidity planning and management are necessary to ensure that the Bank has the ability to fund its operations cost effectively and to meet current and future potential obligations such as loan commitments, contingent liquidity commitments and unexpected deposit outflows.

While the Bank's Asset-Liability Committee (ALCO) is responsible for setting up the broad framework for managing the liquidity risk effectively, the responsibility of managing the liquidity risk of the Bank, within this framework, lies with the Treasury Division which discharges this function with the assistance of other business divisions of the Bank.

The Bank has clearly documented Board and ALCO–approved policy guidelines on critical liquidity and gap ratios and RMD monitors that the Bank operates within these guidelines.

A high level ALCO meeting is held every month to discuss strategic medium and long term liquidity and interest rate issues. Additionally ALCO meets as and when required, to discuss dynamic day-to-day market issues impacting the Bank's liquidity and interest rates. The approach to effective liquidity and interest rate risk management in the Bank is built on diversification of deposit base, reducing dependence on large depositors, maintaining a suitable mix of deposits including low cost deposits and periodic review of asset pricing mechanism. In addition to the above, the Bank maintains a stock of high quality liquid assets which can be liquidated at short notice to raise cash if required and arrangements with several international banks to raise funds, if necessary.

3. Market Risk

Market risk is the risk of loss arising from unexpected changes in financial prices arising out of changes in interest rate, exchange rate, bond, equity and commodity prices. The risks which are important to the Bank are currency and interest rate risk.

The major foreign currency in which the Bank deals on a regular basis is the US Dollar. The established parity between the US Dollar and Rial Omani substantially reduces this risk. However, in order to control currency exposure risk, limits for intra day and overnight positions have been set up in addition to currency-wise stop loss limits. The Central Bank of Oman (CBO) has also set prudential norms for the net open position to restrict banks from taking undue currency exposures.

The Bank manages the interest rate risk by matching the re-pricing of assets and liabilities through various means and operating within the set gap limits. Foreign currency loans are linked to LIBOR (London Inter-bank Offered Rate) and re-priced regularly to reduce the attendant interest rate risk.

4. Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed internal systems, processes, people or from external events. The Bank has detailed policies and procedures that are regularly updated to ensure that a sound internal control environment exists in the Bank. Trained and competent staff oversee the various operational functions of the Bank.

Tested and up-to-date disaster recovery plans exist to provide normal banking services in the event of any unforeseen disruption to business. The Bank has also issued detailed guidelines to the operating units and branches on identifying potential operational risks and to put in place appropriate key controls to mitigate such risks.

Risk Management Division also conducts regular training programmes for staff at various levels to inculcate 'risk awareness' and to spread the general 'risk management culture' in the Bank.

c. Initiatives: For Further Enhancement in the Risk Management Process:

- The Bank has been using the Moody's Risk Advisor (MRA) credit rating model, a globally reputed credit analysis tool to aid in assessing the credit risk in lending proposals. The Bank is reviewing the process of assigning the risk grading of the borrowers based on the score thrown by MRA and also based on the collaterals provided by the borrower. The revised system of grading, which will take into account the collaterals available, can be used in pricing the loan assets. In addition to the risk grading, the corporate credit proposals are reviewed by the RMD whose observations form an important input in the credit risk management process.

- The Bank has put in place a front-end software package for effective management of its assets and liabilities from a risk perspective. The system has been implemented and it is expected that when the system is implemented full fledged, the Bank will not only be able to enhance the quality of the risk management of this important part of its business but also assist the line management to enhance its performance levels.
- A system to conduct stress tests with assumed stress/worst case scenarios of credit risk, interest rate risk, foreign exchange risk and equity price risk on a quarterly basis is put in place to assess the impact on the Bank's profits under these stress scenarios.

d) Basel II

CBO has directed that the banks operating in the Sultanate of Oman are required to compute their capital adequacy under Basel II with effect from 01 January 2007. As per the CBO directives, the Bank has adopted the Standardized Approach for Credit Risk and the Basic Indicator Approach for Operational Risk. The Bank is confident that with the Risk Management Processes established within the Bank and their continued up-gradation, it will move towards adopting more advanced approaches of Basel II for best risk management practices and improve the quality of the assets on its books.

Financial Performance

The total assets of the Bank in 2007 increased by 37.5% and reached RO 955.1 million compared RO 694.8 million at the end of 2006. The net loans and advances to customers also increased from RO 548.8 million at the end of 2006 to RO 704.6 million at the end of 2007, a growth of 28.4%. An analysis of our loans and advances portfolio as at December 31, 2007 along with the comparative figures for the prior period is as follows:

	RO million	
	2007	**2006**
Overdrafts	73.1	75.3
Loans	621.8	471.1
Loans against trust receipts	38.2	33.4
Bills discounted	3.2	1.5
Advance against credit cards	4.7	4.1
Others	9.0	9.3
Gross loans and advances to customers	750.0	594.7
Less: Allowance for impairment	45.4	45.9
Net Loans and Advances	**704.6**	**548.8**

The ratio of total non-performing loans to total loans reduced to 4.9% at the end of 2007 from 7% at the end of 2006.

The total customer deposits increased from RO 497.1 million at the end of 2006 to RO 674.5 million at the end of 2007, a creditable growth of 35.7%. The composition of customer deposits at the end of 2007 along with the corresponding figures for the prior period is as follows:

	RO million	
	2007	**2006**
Current accounts	178.1	123.2
Saving accounts	142.9	86.6
Time deposits	351.4	285.7
Margin accounts	2.1	1.6
Total customer accounts	**674.5**	**497.1**

Shareholders' Equity

The shareholders' equity at the end of 2007 was RO 110.5 million compared with RO 93.3 million at the end of 2006. At the end of 2007 we transferred RO 2.3 million to legal reserve being 10% of net profit, RO 1.47 million to subordinated bonds reserve, RO 2.57 million to subordinated loan reserve and RO 3.2 million to retained earnings.

The analysis of shareholders' funds at the end of 2007 along with the corresponding figures for the prior period is as follows:

	RO million	
	2007	**2006**
Share capital	53.08	46.16
Share premium	5.43	5.43
Legal reserve	12.15	9.87
Subordinated bonds reserve	7.36	5.89
Subordinated loan reserve	2.57	-
Proposed distribution - cash	13.27	6.92
Proposed distribution – bonus shares	-	6.92
Investment reserve revaluation	3.58	2.23
Retained earnings	13.06	9.86
Total Shareholders' Equity	**110.50**	**93.28**

As a result of the increase in shareholders' equity the net assets per share reached RO 0.208 at the end of 2007 compared with RO 0.202 at the end of 2006.

Income Statement

The net interest income increased by 15.7% from RO 26.25 million for the year ended 2006 to RO 30.36 million for the year ended 2007. Other income increased by 57.6% and reached RO 13.86 million at the end of 2007, net fees/commissions, profit from foreign exchange and investment income recorded growths of 37%, 50% and 39% respectively. Although the total operating expenses increased by 24.6% from RO 13.61 million in 2006 to RO 16.96 million in 2007, the cost to income ratio improved to 38.5%

The Bank made all provisions as required for impaired assets. The amount of additional provisions for impaired loans provided in 2007 was RO 3.3 million and the amount recovered from provisions was RO 1.52 million.

The net profit in 2007 grew by 13.2% and reached RO 22.79 million compared with RO 20.13 million in 2006. The earning per share (EPS) increased from RO 0.038 in 2006 to RO 0.043 in 2007.

The Board of Directors proposes to pay 25% cash dividend amounting to RO 13.27 million. Also the Bank will retain RO 1.47 million and RO 2.57 million to be transferred to subordinated bonds and loan reserves respectively and RO 3.2 million to retained earnings. The proposed profit appropriation for 2007 is as follows:

	RO thousands	
	2007	**2006**
Proposed dividends – cash	13,271	6,924
Proposed dividends - bonus shares	-	6,924
To legal reserve	2,279	2,013
To subordinated bonds reserve	1,474	1,472
To subordinated loan reserve	2,567	-
To retained earning	3,199	2,797
Net profit for the year	**22,790**	**20,130**

Future Prospects

The strong financial performance since the inception of the Bank coupled with the expected growth in the local and regional economies give us the confidence of further business growth in 2008.

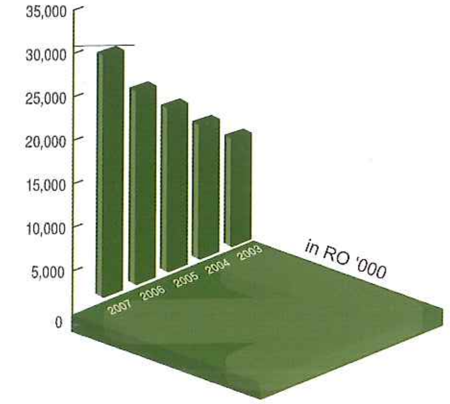
Financial Highlights of Last Five Years

(In RO'000) For the year	2007	2006	2005	2004	2003
NET INTEREST INCOME	**30,356**	26,245	24,396	23,264	21,402
NON INTEREST INCOME	**13,684**	8,675	5,584	5,187	5,040
OPERATING COSTS	**16,964**	13,614	13,170	12,497	11,016
OPERATING PROFIT (before Impairment losses)	**27,076**	21,306	16,810	15,954	15,426
PROFIT FROM OPERATIONS	**25,355**	21,976	16,131	12,600	11,423
NET PROFIT FOR THE YEAR	**22,790**	20,130	14,199	11,078	10,156
At year-end					
TOTAL ASSETS	**955,127**	694,799	618,225	551,293	474,085
NET LOAN PORTFOLIO	**704,643**	548,819	470,937	406,503	367,185
CUSTOMER DEPOSITS	**674,502**	497,142	452,132	421,093	358,397
SHAREHOLDERS' EQUITY	**110,498**	93,281	79,405	67,771	63,127
SHARE CAPITAL	**53,082**	46,158	41,962	41,962	41,962
FULL SERVICE BRANCHES	**49**	48	47	47	45
ATMs	**85**	79	79	66	62
STAFF	**720**	636	598	579	562

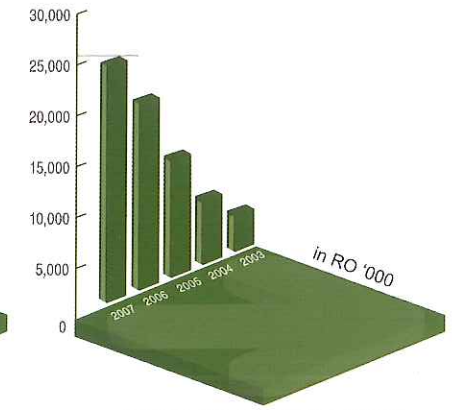
Financial Ratios of Last Five Years

	As at 31 December 2007	As at 31 December 2006	As at 31 December 2005	As at 31 December 2004	As at 31 December 2003
I - PROFITABILITY					
Return on Average Equity	**22.37%**	23.31%	19.30%	16.90%	18.40%
Return on Average Capital	**45.93%**	45.68%	33.80%	26.40%	26.30%
Return on Average Assets	**2.76%**	3.07%	2.40%	2.20%	2.50%
Non Interest Income to Operating Income	**31.07%**	24.84%	18.60%	18.20%	19.10%
Operating Expenses to Operating Income	**38.52%**	38.99%	43.90%	43.90%	41.70%
II - LIQUIDITY					
Net Loans to Total Deposits	**91.75%**	96.61%	91.90%	89.20%	95.40%
Total Customer Deposits to Total Deposits	**87.83%**	87.52%	88.30%	92.40%	93.10%
III - ASSET QUALITY RATIOS					
Loan Loss Provisions to Total Loans	**6.05%**	7.71%	8.60%	9.50%	9.30%
Non Performing Loans to Total Loans	**4.88%**	7.00%	7.70%	8.30%	8.70%
Loan Loss Provisions to Total Non Performing Loans	**124%**	110%	112%	114%	106%
IV - CAPITAL ADEQUACY					
BIS Risk Asset Ratio	**14.87%**	13.10%	15.30%	15.30%	15.60%
BIS Risk Asset Ratio on Tier One Capital	**10.08%**	11.66%	13.10%	13.00%	12.80%
Shareholder's Equity / Total Assets	**11.57%**	13.40%	17.80%	12.30%	13.30%

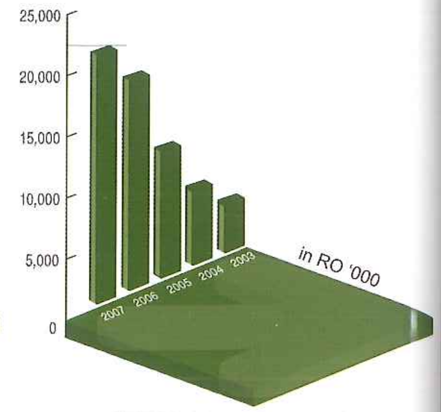
Financial Highlights of Last Five Years



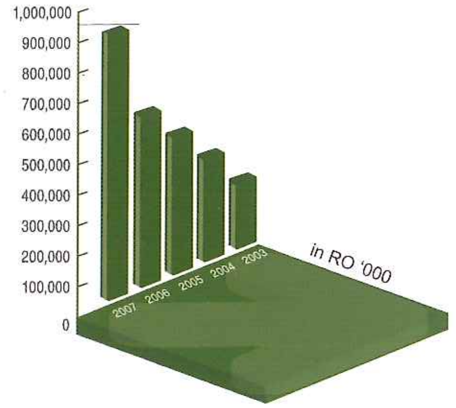
NET INTEREST INCOME



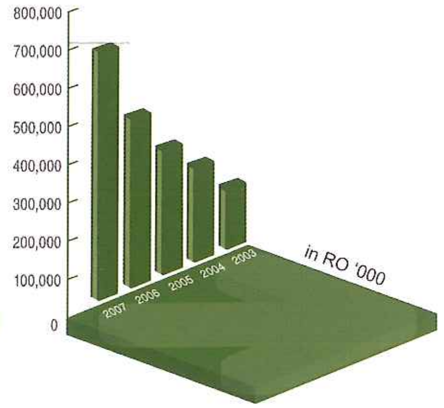
PROFIT FROM OPERATIONS



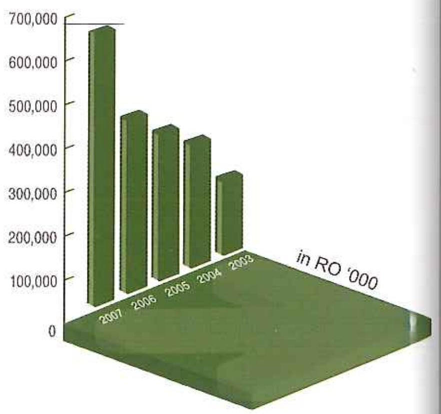
NET PROFIT FOR THE YEAR



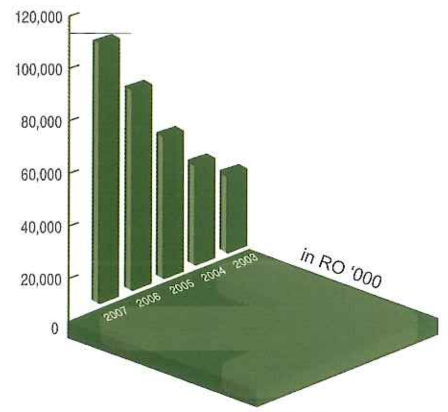
TOTAL ASSETS



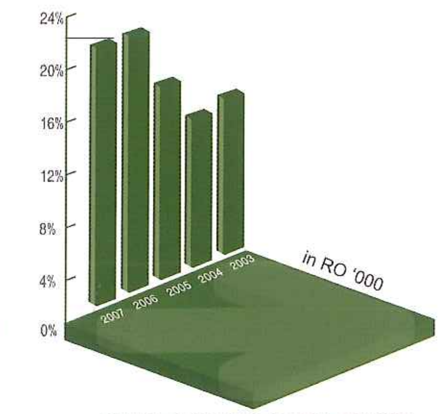
NET LOAN PORTFOLIO



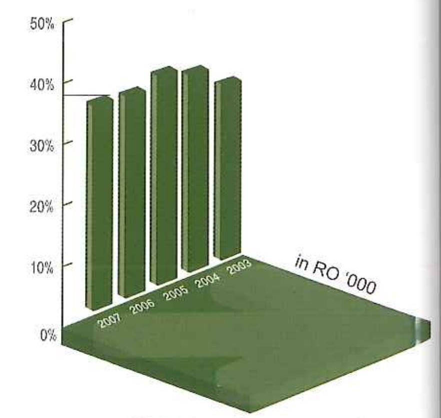
CUSTOMER DEPOSITS



SHAREHOLDERS' EQUITY

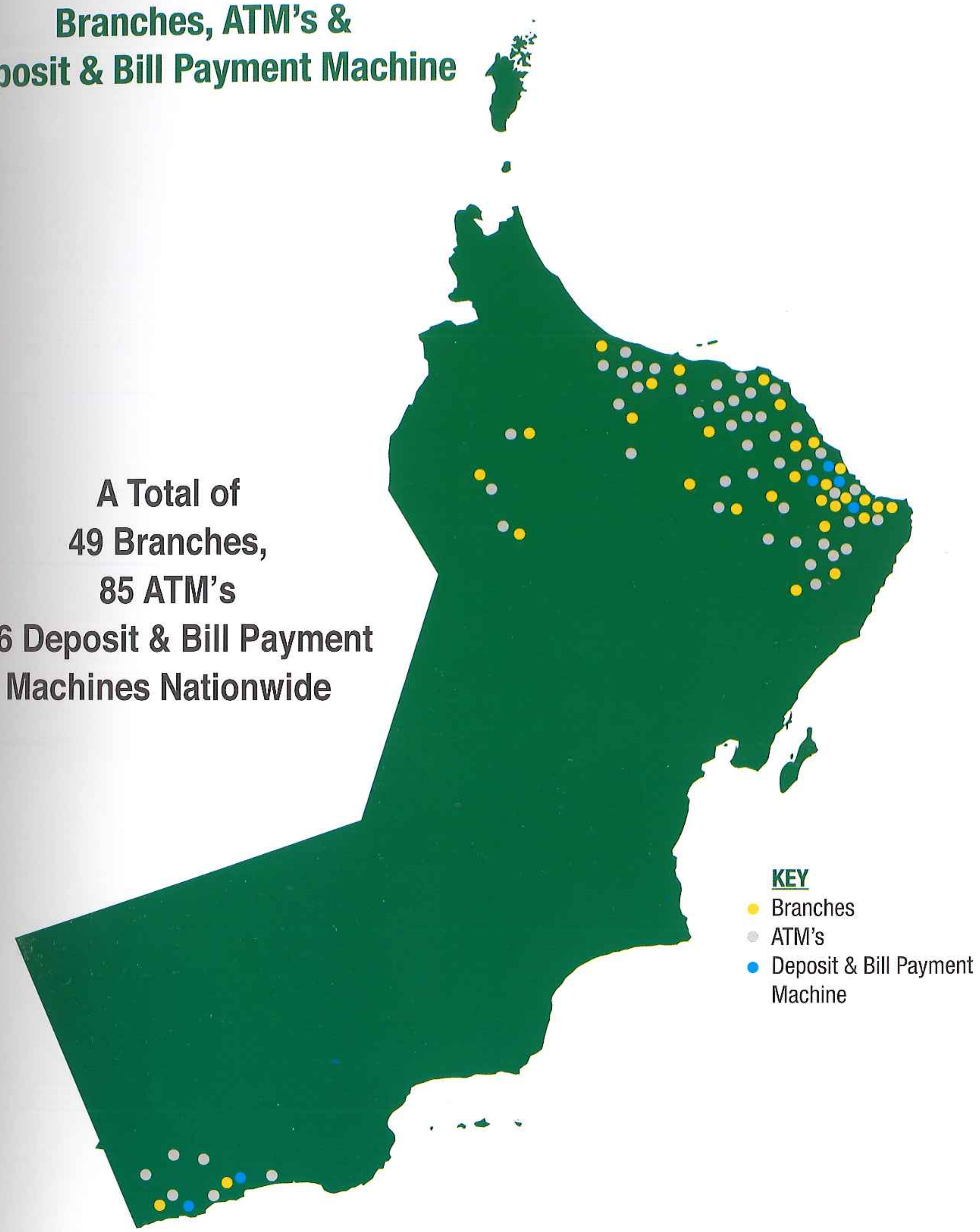


RETURN ON AVERAGE EQUITY



OPERATING EXPENSES
TO OPERATING INCOME

Branches, ATM's & Deposit & Bill Payment Machine



This map cannot be a reference for international borders

BankDhofar Branch Network contact Details

NO	BRANCH	TEL. NO.	FAX NO.	P.O. BOX
R. M. MUSCAT-NORTH				
1	Azaiba	24496811 - 24495075	24495079	378, PC 133
2	Al Khuwar 2	24484880 - 24480008 - 24485554	24483366	2717, PC 112 Ruwi
3	Al Khuwair	24602049 - 24602374 -24603240	24601623	1507, PC 112 Ruwi
4	Al Khuwair Ministry	24694710-24694725-24694715	24694730	1591, PC 130 Aziba
5	Bausher	24502606 - 24596994	24595323	148 PC 130 Azaiba
7	Khoudh	24536132 -24545026 - 24542826	24545268	1507, PC 112 Ruwi
8	Mabellah	2445 1539-2445 1540-2445 1520	24451542	1507, PC 112 Ruwi
7	Seeb Airport	24510101 - 24510537- 24 510102	24510468	56, Pc Seeb PC 111
9	Seeb Town	2442585 1 - 24425852 - 24424434 - 24423373	24425627	347, PC 121 Al-Seeb
R. M. MUSCAT-SOUTH		24750516 - 24790466	24798621	1507, PC 112 Ruwi
1	Amarat	24876580 - 24876120	24875829	346 PC 119 Amerat
2	G.Muttrah	24793297- 24707959 - 24706636	24706103	1831, PC 112 Ruwi
3	Muscat	24 737865 - 24736614 - 24736606 -24 737066	24739166	1613, PC 114 Muttrah
4	Muttrah	24712970 -24714452 -24 714279	24713556	1441, PC 112 Ruwi
5	MBD	24750516 - 24790466	24798621	1507, PC 112 Ruwi
6	Qurum	24568351 - 24567671 - 24567673	24567679	108, PC 114 Muttrah
7	Ruwi	24835854 - 24831090	24831892	1442, PC 112 Ruwi
8	Wadi Kabir	24814127 - 24814126	24814128	1507, PC 112 Ruwi
9	Wattayah	24565137 - 24566731 - 24565208	24566732	1507, PC 112 Ruwi
R.M. BATINAH & BUR		26840794-26840228	26841229	21, PC 311 Sohar
1	Buraimi	25655647 - 25651696 - 25651989	25651115	278, PC 512 Buraimi
2	Barka	26884423 - 26884428	26884451	751, PC 320 Barka
3	Falaj Al Qabail	26750156-26750928-26751378	26750891	209,PC 322 Falaj Al Qabail
4	Hafeet	26817646 - 26817991 - 26817992	26817993	596 PC 319 Saham
5	Khadhra	26714164 - 26714162	26714163	505, PC 315 Al-Suwaiq
6	Khaboura	26801686 - 26801028	26805130	423, PC 326
7	Suwaiq	26862001- 26862010	26862102	585, PC 315 Suwaiq
8	Saham	26854400 - 26856699	26855277	92, PC 319 Saham
9	Sohar	26841712 -26840794 - 26840228	26841229	21, PC 311 Sohar
10	Shinas	26748302-26748306-26748308	26748304	434,PC 324 Shinas
11	Al Ghashab(Rustaq)	26878737 - 26875759	26878797	216, PC 329
12	Muladdah	26868544 - 26868553	26868549	106 PC 341 Muladdah
13	Rustaq	26876039 - 26875117	26875591	25, PC 318 Rustaq
R. M. Dhakhliya & DHAHIRA		25410234 - 25411370	25411234	83, PC 611 Nizwa
1	Araqi	25695071 - 25694126	25695047	90, PC 515 Iraqi
2	B.Al-Mauz	25443466 - 25443460	25443462	97, PC 616 B. Al-Mawz
3	Bahla	25420021 - 25420292 -	25420387	661, PC 612 Bahla
4	Bid Bid	25369254 - 25369044 - 25369033	25369055	307, PC 613 Bid Bid
5	Izki	25340393 - 25340089-25341016	25340204	412, PC 614 Izki
6	Ibri	25692283-25689341 - 25689685	25690341	28, PC 511 Ibri
7	Nizwa	25410234 - 25411370	25411234	83, PC 611 Nizwa
8	Sumail	25351283 - 25351188	25350094	199, PC 620 Samail
R. M.Sharqiya		25571658-25571756	25570253	514, PC 413 Ibra
1	Al Ees Sur	25545867-25544350 - 25541912	25543710	323, PC 411
2	Ibra	25571632 - 25571631	25570646	514, PC 413 Ibra
3	J. B. B. Ali	25553440 - 25553414	25553446	10 PC416 Jalan
4	kamil Al Wafi	25557134 - 25557501	25557962	294, PC 412 Al-Kamil
5	Mintrib	25583853- 25584049	25583510	154, PC 421
6	Sinaw	25524663 - 25524367	25524823	296, PC 418 Sinaw
7	Sur	25546677- 25541255 - 25540256	25540615	75, PC 411 Sur
8	Samad A'Shan	25526736 - 25526529	25526574	123, PC 423 Samad
R.M. DHOFAR		23292299 - 23294863 - 23291631	23293505	2334, PC 211 Salalah
1	Al Wadi	23211130 - 23212185 - 23212180	23210085	2334, PC 211 Salalah
2	Saada	23 225463 - 23225409	23225179	2334, PC 211 Salalah
3	Salalah	23290644 - 23292299 - 23294863 - 23291631	23295291	2334, PC 211 Salalah

ATM & CDM Locations

MUSCAT BRANCH
Muttrah Branch ★
MBD Branch ★■
Greater Muttrah ★
Wadi Kabir Branch ★
Ruwi Branch ★
Amerat Branch ★
Wattaya Branch ★
Qurum Branch ★■
Al Khuwair Branch ★■
Mabellah Branch ★
Al Khuwair Centre Branch ★
Al Khuwair Ministry Branch
Sarooj ●
Al Maha Filling Station-Al Khuwair ●
Al Khuwair - PIC & SAVE ●
Bousher Branch ★
Zein Factory - Bousher ●
Al Ghubra - Round about ●
Azaiba Branch ★
Seeb Airport Branch ★
Seeb International Exhibition ●
Markaz Bahja ●
Al Khoudh Branch ★
Al Khoudh-Omanoil Filling Stat. ●
Al Mawaleh South-Shell Filling Station ●
Seeb Town Branch ★■
Maabela - Al Maha Filling Station ●
Azaiba, Shell Filling Station ●
City Center Lobby ●
Mercure Al Falaj Hotel, Ruwi ●
AL MAHA SOUK -Ruwi (Hamriya R/A) ●
AL MAHA SOUK - Amerat ●
AL MAHA SOUK - Ansab ●
AL MAHA SOUK - Wattaya ●
AL MAHA SOUK - Ghubra ●
AL MAHA SOUK - MSQ ●

BATINAH
Barka Branch ★
Rustaq Branch ★
Al Ghashab Branch ★
Muladah Branch ★
Suwaiq Branch ★
Al Khadhra Branch ★
Khaboura Branch ★
Hafeet Branch ★
Saham Branch ★
Sohar Branch ★
Shinas Branch ★
Falaj Al Qabail Branch
Falaj Al Qabail Drive thru
Sohar University, Sohar ●
AL MAHA SOUK - Batha Hilal Suweiq ●
Al Maqasa (Hafeet) Souk ●
AL MAHA SOUK - Musannah ●
Al Tarif (Sohar) Souk ●
AL MAHA SOUK - Al Hazem (Rustaq) ●
AL MAHA SOUK - Al Waqaiba (Sohar) ●

DHAHIRAH
Ibri Branch ★
Al Iraqi Branch ★
Buraimi Branch ★
Buraimi Drive Through ATM ●

DAKHILIYA
Bid Bid Branch ★
Samail Branch ★
Izki Branch ★
Barkat Al Mauz Branch ★
Al Shafaa - MOD ●
Nizwa Branch ★
Bahla branch ★
AL MAHA SOUK - Falaj Dariz (Nizwa) ●

SHARQIYA
Sinaw Branch ★
Samad A'Shan ★
Ibra Branch ★
Mintrib Branch ★
Al Kamil Al Wafi ★
J.B.B.Ali Branch ★
Al Ees Branch ★
Sur Branch ★
Mudhaibi ●

DHOFAR
Salalah Branch ★■
Salalah Shell Filling Stat.
New Salalah- Al Najaf Street ●
Al Qoaf - Salaam Str. ●
Haffa - Sultan Qaboos St. ●
Saada Branch ★
Dahareez ●
Al Wadi Branch ★■
Shell Filling Station, Al Salam Street ●
Al Awqadain ●
Al Isteqrar Hypermarket ●

LEGENDS

★ **Branch ATM**
● **Off-site ATM**
■ **CDM**

REPORT ON BASEL II- PILLAR III DISCLOSURE REQUIREMENTS
FOR THE YEAR ENDED 31ST DECEMBER 2007

Deloitte.

Deloitte & Touche (M.E.)
Muscat International Centre
Ground Floor
Location: MBD Area
P.O. Box 258, Ruwi
Postal Code 112
Sultanate of Oman

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Tel: +968 24815896
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Report of factual findings to the Board of Directors of Bank Dhofar SAOG in respect of Basel II – Pillar III Disclosures

We have performed the procedures agreed with you and as prescribed in the Central Bank of Oman ("CBO") Circular No BM 1027 dated December 4, 2007 with respect to the Basel II – Pillar III disclosures (the disclosures) of the **Bank Dhofar SAOG** (the bank) set out on pages 40 to 48 as at and for the year ended December 31, 2007. The disclosures were prepared by the management in accordance with the CBO's Circular No. BM 1009 dated September 13, 2006 and Circular No. BM 1027 dated December 4, 2007. Our engagement was undertaken in accordance with the International Standard on Related Services applicable to agreed-upon procedures engagements. The procedures, as set out in Circular No. BM 1027 dated December 4, 2007, were performed solely to assist you in evaluating the bank's compliance with the disclosure requirements set out in CBO's Circular number BM 1009 dated September 13, 2006.

We report our findings as follows:

Based on performance of the procedures detailed above, we found the disclosures free from any material misrepresentation.

Because the above procedures do not constitute either an audit or a review made in accordance with International Standards on Auditing or International Standards of Review Engagements, we do not express any assurance on the disclosers.

Had we performed additional procedures or had we performed an audit or review of the financial statements in accordance with International Standards on Auditing or International Standards on Review Engagements, other matters might have come to our attention that would have been reported to you.

Our report is solely for the purpose set forth in the first paragraph of this report and for your information and is not to be used for any other purpose or to be distributed to any other parties other than Central Bank of Oman. This report relates only to the bank's disclosures and does not extend to any financial statements of the Bank taken as a whole or to any other reports of the Bank.

Deloitte & Touche

Deloitte & Touche (M.E.)
Muscat, Sultanate of Oman
29 January 2008

ديلويت آند توش (الشرق الأوسط)
ص.ب: ٢٥٨ - ر.ب: ١١٢
سلطنة عمان
P.O. Box 258, P.C. 112
Sultanate of Oman
Deloitte & Touche (M.E.)

BankDhofar S.A.O.G

DISCLOSURE REQUIREMENTS FROM CAPITAL ADEQUACY STANDARD (BASEL II)

1. Disclosure Policy:

The following detailed qualitative and quantitative public disclosures are provided in accordance with Central Bank of Oman (CBO) rules and regulations on capital adequacy standard Basel II issued through circular BM 1009 on September 13, 2006.The purpose of these requirements is to complement the capital adequacy requirements and the Pillar II – Supervisory review process.These disclosures are intended for market participants to assess key information about the bank's exposure to risks and provide a consistent and understandable disclosure framework for easy comparison among banks operating in the market. The Bank does not have a disclosure policy separately and the disclosures are made in accordance with the Central Bank of Oman requirements.

The major highlights of the Central Bank of Oman (CBO) regulations are :

a. To maintain capital adequacy ratio (CAR) at a minimum of 10%;
b. Banks have to adopt the standardized approach for implementing Basel II, using national discretion for:
   - Adopting the credit rating agencies as external credit assessment institutions (ECA) for claims on sovereigns and banks;
   - Adopting simple/comprehensive approach for Credit Risk Mitigants (CRM)
   - Treating all corporate exposures as unrated and assign 100% risk weight.
c. Capital Adequacy returns must be submitted to CBO on a quarterly basis; and
d. The bank's external auditors must review capital adequacy returns.

2. Scope of Application:

The Bank has no subsidiaries or significant investments and the Basel II is applied at the Bank level only.

3. Range of Disclosures:

a) Capital Structure:

BankDhofar's capital structure consists of Tier I capital, which includes paid up capital and reserves and Tier II capital, which includes 45% of Investment revaluation reserve and a general provision of 1.25% of total risk weighted assets. There are no innovative or complex capital instruments in the capital structure.

i) Qualitative disclosures:

On 30th August 2007, the Bank raised a subordinated loan of US $ 100 million with a fixed maturity of 5 years and 1 month. The loan is unsecured, subordinated (in respect of both principal and interest) to all other liabilities of the Bank except the share capital and is subject to adequate amortization arrangements by the creation of subordinated debt reserve. The loan is not redeemable at the initiative of the lender or without the consent of the Central Bank of Oman. The loan forms part of the Tier 2 Capital of the Bank.

ii) Quantitative disclosures:

TIER I CAPITAL :	RO'000 Amount
Paid up capital	53,082
Legal reserve	12,149
Share premium	5,429
Subordinated bonds and reserve	9,929
Retained Earnings	13,056
Less Goodwill	(3,971)
TOTAL TIER I CAPITAL	**89,674**
TIER II CAPITAL	
Investment revaluation Reserve (45% only)	1,612
General Provision (Max of 1.25% of total risk weighted assets)	10,209
Subordinated Loan	30,800
TOTAL TIER II CAPITAL	**42,621**
TOTAL ELIGIBLE CAPITAL	**132,295**

b) Capital Adequacy:

i) Qualitative disclosures:

The bank has adopted the Standardized Approach (SA) for computation of capital charge for credit risk and market risk, and Basic Indicator Approach (BIA) for operational risk. For Credit risk, under the Standardized approach, the Bank has adopted the Simple approach for recognizing collaterals in the Banking Book and for risk weighting the claims on sovereign and banks, the Bank has chosen Moody's, S & P or Fitch rating. Assessment of capital adequacy is carried out in conjunction with the capital adequacy reporting to the CBO.

The bank uses a prudential approach as the measurement technique to assess adequacy of its capital to support current and future activities which is compared with the existing eligible capital. Additionally, a detailed evaluation of any strategic initiative necessarily includes appraisal of capital adequacy requirement to carry the initiative further.

The bank's capital management is done in a coordinated and consistent manner with the objective of maximizing it's return on capital while at the same time ensuring adequate cushion to cover any unforeseen losses.

The bank's policy is to manage and maintain it's capital with the objective of maintaining strong capital ratios and high ratings. This, to the bank means, maintaining capital levels that are sufficient to absorb all material risks the bank is exposed to and to provide market returns to the shareholders. The bank also ensures that the capital levels comply with regulatory requirements and satisfy the external rating agencies and other stakeholders including depositors and senior creditors. Consideration is also given to the cost of capital and it's composition in terms of quality and stability. The whole objective of the capital management process in the bank is to ensure that the bank remains adequately capitalized at all times.

The bank has in place a capital adequacy framework by which the bank's annual budget projections and the capital required to achieve the business objectives are linked in a cohesive way. Capital requirements are assessed for credit, market and operational risks. The bank's capital adequacy ratios are periodically assessed and reported to the Risk Committee of the Board of Directors (RC)

The composition of capital in terms of Tier I, II and III are also analysed to ensure capital stability and to reduce volatility in the capital structure.

Strategies for implementing Basel II and for Advanced Approaches:

The bank has implemented Basel II standards issued by the CBO vide its circular BM 1009 dated September 2006, effective January 01, 2007. The capital adequacy calculations and capital charges for various risks are made in accordance with the CBO guidelines.

While the bank has adopted the Standardized Approach for credit risk, Market risk and Basic Indicator Approach for operational risk, to begin with, it is the intention of the bank to prepare itself to graduate to Foundation Internal Rating Based (FIRB) approach for credit risk and Standardized Approach for operational risk within a reasonable time frame.

With this end in view, the bank is in the process of putting in place, a tested and accepted risk rating framework for assessing and pricing credit risk in it's corporate credit portfolio. The Bank shall also develop/put in place required systems for estimation of Probability of Default (PD), Loss Given Default (LGD) and Exposure at Default (EAD). The necessary data requirement shall be identified for adoption of Advanced approaches of Basel II and incorporated in the new core banking system to be implemented. With the availability of the data, a suitable risk based information system shall also be developed. Bank has already started conducting training programmes on risk management practices for the staff and such trainings shall be intensified further to ensure percolation of risk culture across the Bank.

The bank expects to refine the existing risk management systems and practices on an ongoing basis over the next two years and with that experience approach the CBO with a framework and a road map to move to FIRB, for it's approval.

For assessing the Market risk, the Bank shall graduate to more advanced measurement techniques from the present Standardized method adopted by the Bank.

For operational risks, the bank has put in place a system of collecting and collating data on operational risk events in the bank and also initiated the process of implementing best practices for measuring and controlling operational risks in various units of the bank with tools such as Key Risk Indicators and Key Control Standards. The existing data collection system shall be reviewed and refined over a period of time to build a strong loss data base and to move over to the advanced measurement system for operational risk.

ii) Quantitative disclosures:

a) Risk weighted Assets

Sl. No	Details	Gross Balances (Book Value) RO'000	Net Balances (Book Value)* RO'000	Risk Weighted Assets RO'000
1	On balance sheet items	1,016,562	953,235	728,579
2	Off balance sheet items	61,895	59,019	59,019
3	Derivatives	6,275	6,275	4,141
4	**TOTAL**	**1,084,732**	**1,018,529**	**791,739**

* Net of provisions, reserve interest and eligible collaterals

b) Capital

Sl. No	Details	RO'000
1	Tier I Capital	89,674
2	Tier 2 Capital	42,621
3	Tier 3 Capital	-
4	**Total Regulatory Capital**	**132,295**
5	Capital Requirement for Credit Risk	79,174
6	Capital Requirement for Market Risk	2,715
7	Capital Requirement for Operational Risk	7,055
8	**Total Required Capital**	**88,944**
9	Tier I Capital Ratio	10.08%
10	Total Capital Ratio	14.87%

c) Risk exposure and Assessment:

Credit Risk - General Disclosures:

i) Description of the risk management objectives and strategies including:

Strategies and processes:

The risk management division of the bank is an independent and dedicated unit reporting directly to the Risk Committee of the Board. The division's primary responsibility is to assess, monitor and recommend strategies for control of credit, market and operational risk. The absence of any direct or indirect reporting lines and permanent membership in all the bank's committees are among the factors which reflect the independence of the Risk Management Divisions working and the key role it plays within the bank.

The risk management framework is pivoted on a host of committees involving the executive management and board of directors for approval and reporting purposes. The Board has the overall authority for approval of strategies and policies, which it exercises through it's various sub-committees. The Risk Committee of the Board is responsible for reviewing and recommending to the full Board for approval all risk policies and procedures. RC also reviews the risk profile of the bank as presented to it by the RMD and appraises the full Board in it's periodic meetings.

The goal of credit risk management is to minimize the probable losses and maintaining credit risk exposure within acceptable parameters. The Bank's policy is to establish prudent standards, practices in managing credit risk and setting up prudent bench marks, limits for management of credit risks.

Executive Committee of the Board is the final credit approving authority of the bank which is mainly responsible for approving all credit proposals beyond the authority level of the management and also for reviewing and approving credit policies. This committee is also the final authority for approving investments beyond the authority of the management. The Management Credit Committee (MCC) is the management decision making body which is empowered to consider all credit related issues upto certain limits.

Credit risk is managed by the Risk Management Division through a system of independent risk assessment in credit proposals beyond a threshold limit of OR 100,000 before they are considered by the appropriate approving authorities. This facilitates the approving authorities in making their credit decision. In addition RMD assists/ reviews grading of obligors, conducts regular macro analysis of the credit portfolio, and monitors credit concentration limits.

The bank has in place a risk grading system for analyzing the risk associated with credit. The parameters, while risk grading the customers, include financial condition and performance, quality of disclosures and management, facility structure, collateral and country risk assessment where necessary. Maximum counterparty/group exposures are limited to 15% of the bank's capital base as stipulated by CBO and where a higher limit is required for projects of national importance prior CBO approval is obtained.

Retail lending is strictly in accordance with the CBO guidelines. In addition to these, there are also country limits approved by the Board to ensure portfolio diversification in terms of sovereign risk ratings and geographical exposure. All lending decisions are made after giving due consideration to credit policy requirements. Continuous review of the credit policy is done to keep it in line with the business environment and regulatory requirements at all times.

However, in the absence of acceptable external credit rating agency in the Sultanate of Oman, the bank has obtained the approval of the CBO to treat all corporate exposures as unrated and accordingly assign risk weight of 100% for computing capital requirements under Basel II.

Past dues and Impairment:

Past dues and impaired exposures are defined in accordance with the relevant CBO regulations. Specific and general provisions are computed periodically in accordance with the CBO regulations as well as other applicable accounting standards. Past dues and impaired exposures are defined

by CBO as shown in the table below:

Category & Provision reqd.	Past due (Commercial loans)	Past Due (Retail loans)
Special mention	For 60 days or more but less than 90 days	For 60 days or more but less than 90 days
Substandard – 25% provision	For 90 days or more but less than 270 days	For 90 days or more but less than 180 days
Doubtful – 50% provision	For 270 days or more but less than 630 days	For 180 days or more but less than 365 days
Loss – 100%	For 630 days or more	For 365 days or more

In addition to the above, the bank makes a general loan loss provision equivalent to 1% of the loans categorized as Standard and Special Mention for meeting the latent loan losses. However, a general loss provision of 2% of the Standard and Special Mention personal loans is created considering the heightened risk inherent in personal loans.

Quantitative Disclosures:

ii) The gross credit exposures, plus average gross exposure over the period broken down by major types of credit exposure:

Sl. No.	Type of Credit Exposure	Average Gross exposure		Total Gross exposures	
		RO'000	RO'000	RO'000	RO'000
		Current year	Previous year	As at 31.12.2007	As at 31.12.2006
1	Overdrafts	68,968	68,764	73,052	75,278
2	Loans	549,138	442,630	621,846	471,091
3	Loans against trust receipts	36,583	25,887	38,203	33,401
4	Other	10,029	8,535	8,998	9,307
5	Bills purchased /discounted	2,068	2,579	3,224	1,482
6	Advance against credit cards	4,268	4,136	4,717	4,157
7	**TOTAL**	**671,054**	**552,531**	**750,040**	**594,716**

iii) Geographic distribution of exposures, broken down in significant areas by major types of credit exposure.

Sl. No	Type of Credit Exposure	Oman	Other GCC Countries	OECD Countries*	India	Pakistan	Other	total
		RO'000	RO'000	RO'000	RO'000	RO'000	RO'000	RO'000
		1	2	3	4	5	6	7
1	Overdrafts	73,052	-	-	-	-	-	73,052
2	Personal Loans	258,976	-	-	-	-	-	258,976
3	Loans against trust Receipts	38,137	66	-	-	-	-	38,203
4	Other Loans	345,495	17,375	-	-	-	-	362,870
5	Bills Purchased/negotiated	3,224	-	-	-	-	-	3,224
6	Any other	13,715	-	-	-	-	-	13,715
7	**Total**	**732,599**	**17,441**	-	-	-	-	**750,040**

Overdraft and others included Personal overdraft and others
*excluding countries included in column 2

iv) Industry or counterparty type distribution of exposures broken down by major types of credit exposures:

Sl. No.	Economic Sector	Overdraft	Loans	Bills purchased	Others	Total	Off balance sheet exposures
		RO'000	RO'000	RO'000	RO'000	RO'000	RO'000
1	Import Trade	8,228	72,168	323	15,862	96,581	27,745
2	Export Trade	406	6,688	-	24	7,118	8,245
3	Wholesale & Retail trade	4,185	9,507	10	1,863	15,565	2,793
4	Mining & Quarrying	418	14,173	91	200	14,882	1,954
5	Construction	10,469	22,411	-	13,714	46,594	58,257
6	Manufacturing	5,613	30,526	2,660	13,520	52,319	22,251
7	Electricity, gas & water	462	22,227	-	309	22,998	5,097
8	Transport & Comm.	1,239	10,980	-	-	12,219	812
9	Fin. Institutions	4,821	34,640	-	-	39,461	455
10	Services	8,836	35,827	140	1,734	46,537	13,417
11	Personal	12,154	258,976	-	4,692	275,822	1,128
12	Agri & Allied activities	-	50	-	-	50	12
13	Government	1,655	-	-	-	1,655	8
14	Non Resident lending	-	17,441	-	-	17,441	94
15	All others *	14,566	86,232	-	-	100,798	25,292
16	Total (1 to 15)	73,052	621,846	3,224	51,918	750,040	167,560

*All Others Included Govt. wholly Owned and Quasi Govt. bodies RO.34,322/=

v) Residual contractual maturity breakdown of the whole portfolio , broken down by major types of credit exposure:

Sl. No.	Time Band	Overdrafts	Loans	Bills purchased/ Discounted	Others	Total	Off-balance sheet exp.
		RO'000	RO'000	RO'000	RO'000	RO'000	RO'000
1	Upto 1 month	3,653	84,210	3,115	47,871	138,849	636
2	1-3 months	3,653	34,208	-	1,047	38,908	34,842
3	3-6 months	3,653	50,151	-	216	54,020	30,540
4	6-9 months	3,653	22,763	-	7	26,423	11,975
5	9 – 12 months	3,653	19,915	-	99	23,667	13,563
6	1-3 years	18,262	143,485	109	383	162,239	52,566
7	3 – 5 years	18,262	107,534	-	73	125,869	13,724
8	Over 5 years	18,263	159,580	-	2,222	180,065	9,714
9	TOTAL	73,052	621,846	3,224	51,918	750,040	167,560

vi) By major industry or counterparty type:

Sl. No.	Economic Sector	Gross loans	Of which NPLs	General provision held	Specific prov. Held	Reserve Interest	Prov. Made during the year	Adv. Written off during year
		RO'000	RO'000	RO'000	RO'000	RO'000	RO'000	RO'000
1	Import Trade	96,580	10,824	858	5,124	5,074	283	1,231
2	Export Trade	7,119	42	71	33	9	22	-
3	Wholesale & Retail	15,565	9,096	65	4,919	4,178	40	5
4	Mining & Quarrying	14,882	-	149	-	-	47	-
5	Construction	46,594	2,242	444	1,415	718	142	342
6	Manufacturing	52,319	1,045	513	722	312	252	290
7	Electricity,gas & water	22,998	-	230	-	-	72	-
8	Transport& Communications	12,219	26	122	7	2	38	-
9	Financial Institutions	39,461	-	303	-	-	123	-
10	Services	46,537	3,867	427	2,126	1,671	179	147
11	Personal	275,822	9,250	5,741	4,264	4,597	1,801	79
12	Agri & Allied	50	-	1	-	-	1	-
13	Government	1,655	-	17	-	-	-	-
14	Non-Resident lending	17,441	-	174	-	-	54	-
15	All Others*	100,798	17	1,094	5	12	209	-
16	TOTAL (1 to 15)	750,040	**36,409	10,209	18,615	16,573	3,263	2,094

*All Others Included Govt. wholly Owned and Quasi Govt. bodies RO.34,322/=

** Represents only on balance sheet NPLs.

vii) Amount of impaired loans separately broken down by significant geographic areas:

Sl. No.	Countries	Gross loans	Of which NPLs	General provision held	Specific prov. Held	Reserve Interest	Provisions Made during the year	Advances Written off during year
		RO'000	RO'000	RO'000	RO'000	RO'000	RO'000	RO'000
1	Oman	732,599	36,409	10,035	18,615	16,573	3,089	2,094
2	Other GCC countries	17,441	-	174	-	-	174	-
3	OECD countries*	-	-	-	-	-	-	-
4	India	-	-	-	-	-	-	-
5	Pakistan	-	-	-	-	-	-	-
6	Others	-	-	-	-	-	-	-
7	TOTAL	750,040	36,409	10,209	18,615	16,573	3,263	2,094

*excluding countries included in row 2

viii) Movement of Gross Loans :

(OR in 000's)

Movement of Gross Loans during the year

Sl No	Details	Performing Loans		Non-performing Loans			
		Standard	S.M.	Substandard	Doubtful	Loss	Total
		RO'000	RO'000	RO'000	RO'000	RO'000	RO'000
1	Opening Balance	523,263	30,177	476	1,910	38,890	594,716
2	Migration/changes (+/-)	(6,615)	6,637	335	(1,524)	1,182	15
3	New Loans	378,526	9,862	15	51	3,247	391,701
4	Recovery Loans	(214,417)	(13,778)	(253)	(80)	(2,978)	(231,506)
5	Loans written off	(24)	-	-	(12)	(4,850)	(4,886)
6	Closing Balance	680,733	32,898	573	345	35,491	750,040
7	Provisions held*	10,221	-	120	144	18,339	28,824
8	Reserve Interest	-	-	104	56	16,413	16,573

*Indicate the general provisions held under performing loans and specific provisions under non performing loans

e) Credit Risk: Disclosures for portfolios subject to the Standardized Approach:

Qualitative Disclosures:

a) The bank has obtained CBO approval vide its letter dated December 11, 2006 to use the ratings of Moody's, Standard & Poor (S&P) or Fitch for risk weighting claims on sovereigns and banks. However, as mentioned earlier, the bank has obtained CBO approval to treat all corporate exposures as unrated and assign 100% risk weight on all of them

Quantitative Disclosures:

b) The Bank is adopting the simplified approach for collateral recognition under the standardized approach, where 0% risk weight is assigned for the exposures covered by cash collateral. The total exposure covered by cash collateral, which attracts 0% risk weight is OR 31.014 million All other credit exposures of Corporate and Retail (except mortgage loans which are assigned 35% risk weight) are assigned 100% risk weight.

f) Credit Risk Mitigation: Disclosures for Standardized approaches:

Qualitative Disclosures:

The Bank has adopted the simple approach for credit risk mitigation and no off setting of the collaterals is done to calculate the capital requirement. However, the main CRM techniques followed by the bank are based on collaterals which the bank endeavours to obtain for it's exposures, as far as commercially practicable. The collaterals mainly consist of real estate properties, shares listed on the Muscat Securities Market (MSM) , government bonds, unlisted shares and bank fixed deposits. However, the bank's predominant form of eligible collateral as defined by CBO in its guidelines and for capital adequacy computation purposes, is in the form of cash, acceptable bank guarantees and shares listed on the MSM main index.

The credit policy of the bank defines the types of collaterals that are acceptable and the minimum collateral coverage ratio for each type of collateral. These various ratios are monitored independently by the Credit Control Department of the bank. The bank has a policy which requires different collaterals to be valued at certain periodic intervals.

Quantitative Disclosures:

As stated above, the Bank has adopted Simple Approach under the Standardized Approach where in the set off of eligible financial collaterals against the exposures is not considered. The exposures which have been assigned 0% risk weight based on eligible cash collaterals amounts to OR 31.014 million.

g) Market risk in Trading Book:

Qualitative disclosure

Trading book includes positions held in financial securities/ commodities /foreign currencies with trading intent for

short term resale and/or for benefiting from actual or expected short term price movements. The bank adopts duration method in measuring interest rate risk in respect of debt securities held in trading book. The bank does not hold any trading position in equities and in commodities necessitating capital charge to cover the market risk. Foreign exchange risk is computed on the average of the sum of net short positions or net long positions, whichever is higher of the foreign currency positions held by the bank.

The capital charge for the entire market risk exposure is computed under the standardized approach using the duration method and in accordance with the guidelines issued by CBO in its circular BM 1009

Quantitative Disclosures:

a) The capital requirements for:

Type of risk	RO'000 Amount
Interest Rate Risk	27
Equity Position Risk	-
Commodities Position risk	-
Foreign Exchange position risk	2,144
TOTAL	**2,171**

h) Interest Rate Risk in the Banking Book (IRRBB):

Interest rate risk on the banking book of the bank arises due to re-pricing mismatches in it's interest rate sensitive assets and liabilities. For the purpose of monitoring such interest rate risk, the bank has in place a system that tracks the re-pricing mismatches in it's interest bearing assets and liabilities. For computation of the mismatches the guidelines of CBO on the general behaviour of deposit liabilities are followed.

Details relating to re-pricing mismatches and the interest rate risk thereon are placed to the ALCO in it's regular meetings and also to the Risk Committee of the Board. In addition, scenario analysis assuming a 200 basis point parallel shift in interest rates in OR, USD and other currencies and their impact on the interest income and net profit of the bank are calculated on a quarterly basis and put up to RC for information with proposals for corrective action if necessary.

Quantitative Disclosure:

Impact on earnings of interest rate risk in the banking book assuming a 200 basis point parallel shift in interest rates in OR, USD and other currencies is as under:

(OR in 000's)

Impact on earnings

	+ or – 1%	+ or – 2%
Omani Riyals	2,342	4,685
US Dollars	1,169	2,339
Other currencies	90	180

i) Liquidity Risk – Qualitative Disclosures:

The bank's Liquidity Risk Management is governed by the Treasury Risk Policy document approved by the Board of Directors as well as the provisions of relevant CBO guidelines on liquidity risk management. The Treasury policy also incorporates contingency plans and measures for the bank so as to be always in a position to meet all it maturing liabilities as well as to fund asset growth and business operations. The contingency plan includes effective monitoring of the cash flows on a day to day basis, holding of tradable high quality liquid assets, which may be readily disposed off in sizeable amount etc.

The bank monitors it's liquidity risk through internally generated Maturity of Assets and Liabilities (MAL) report which captures all the maturing assets and liabilities into various pre-set time buckets ranging from overnight to five years. The Treasury department of the bank controls and monitors the liquidity risk and ensures that the bank is not exposed to undue liquidity risk and at the same time make optimum use of its funds. In this, the bank strictly adheres to the CBO set limit of 15% of cumulative liabilities (outflows) on mismatches in time buckets upto one year. In addition, the bank sets internal limit on mismatches in time buckets beyond one year, which are approved by ALCO. The bank has in place adequate lines of credit from both local and international banks to meet any unforeseen liquidity requirements.

The MAL report of the bank showing the mismatches are reviewed by the ALCO in it's regular meetings and also by the RC in it's quarterly meetings, which also advises corrective action where required.

Quantitative Disclosure

Bank has reconciled the statement of Maturity of Assets and Liabilities with the discussions under IFRS.(Refer item no.28 (a) of the Notes to financial statements)

j) Operational risk:

Qualitative Disclosures:

The bank has adopted the Basic Indicator Approach under

Basel II - Pillar III Disclosure

Basel II for purposes of measuring the capital charge for Operational Risk. The approach requires the bank to provide 15% of the average three years gross annual income as capital charge for operational risk.

While the bank has adopted this approach for capital adequacy calculation purposes, it is the intention of the bank to move to more advanced approach dividing the bank's business into eight business lines and assessing the operational risk in each of them. The bank has put in place a system of collecting and collating data on operational risk events in the bank as required by the CBO guidelines. The bank has also initiated the process of implementing best practices for controlling operational risks in various units of the bank with tools such as Key Risk Indicators and Key Control Standards.

No Major regulatory / supervisory actions taken against the bank during the year.

AUDITED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31ST DECEMBER 2007

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Independent auditor's report to the shareholders of Bank Dhofar SAOG

Report on the financial statements

We have audited the accompanying financial statements of **Bank Dhofar SAOG**, which comprise of the balance sheet as at 31 December 2007, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes as set out in pages 58 to 98.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and the relevant disclosure requirements of the Commercial Companies Law of 1974, as amended and the Rules and Guidelines on disclosure issued by the Capital Market Authority, effective 1 October 2007. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of 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.

Auditor's responsibility

Our responsibility is to express an opinion on these 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 financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Bank's preparation and fair presentation of the 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 management, as well as evaluating the overall presentation of the financial statements.

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

Independent auditor's report to the shareholders of Bank Dhofar SAOG (continued)

Opinion

In our opinion, the financial statements present fairly, in all material respects the financial position of **Bank Dhofar SAOG** as of 31 December 2007, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Report on Other Legal and Regulatory Requirements

In our opinion the financial statements comply, in all material respects, with the relevant disclosure requirements of the Commercial Companies Law of 1974, as amended and the Rules and Guidelines on disclosure issued by the Capital Market Authority, effective 1 October 2007.

Deloitte & Touche (M.E.)
Muscat, Sultanate of Oman
28 January 2008

Balance sheet

at 31 December 2007

2007 USD'000	2006 USD'000		**Notes**	**2007 RO'000**	2006 RO'000
		Assets			
310,203	219,322	Cash and cash equivalents	3	**119,428**	84,439
185,333	-	Held-to-maturity investments	4	**71,353**	-
75,810	76,335	Loans and advances to banks	5	**29,187**	29,389
1,830,242	1,425,504	Loans and advances to customers	6	**704,643**	548,819
6,533	23,631	Financial instruments at fair value through profit or loss	7	**2,515**	9,098
38,078	28,234	Available-for-sale investments	8	**14,660**	10,870
10,314	10,314	Intangible assets	9	**3,971**	3,971
11,462	10,784	Property and equipment	10	**4,413**	4,152
12,875	10,548	Other assets	11	**4,957**	4,061
2,480,850	1,804,672	**Total assets**		**955,127**	694,799
		Liabilities			
242,842	184,101	Due to banks	12	**93,494**	70,879
1,751,953	1,291,278	Deposits from customers	13	**674,502**	497,142
79,925	67,883	Other liabilities	14	**30,771**	26,135
119,122	19,122	Subordinated bonds and Loan	15	**45,862**	7,362
2,193,842	1,562,384	**Total liabilities**		**844,629**	601,518
		Shareholders' equity			
137,875	119,891	Share capital	16	**53,082**	46,158
14,101	14,101	Share premium		**5,429**	5,429
31,556	25,636	Legal reserve	17	**12,149**	9,870
25,790	15,294	Subordinated bonds and loan reserve	17	**9,929**	5,888
9,304	5,795	Investment revaluation reserve	17	**3,582**	2,231
68,382	61,571	Retained earnings		**26,327**	23,705
287,008	242,288	**Total shareholders' equity**		**110,498**	93,281
2,480,850	1,804,672	**Total liabilities and shareholders' equity**		**955,127**	694,799
435,221	291,218	**Contingent liabilities and commitments**	27	**167,560**	112,119
0.54	0.52	**Net assets per share (Rials Omani)**		**0.208**	0.202

Eng. Abdul Hafidh Salim Rajab Al-Aujaili
Chairman

Ahmed Ali Al Shanfari
Chief Executive Officer

The accompanying notes form an integral part of these financial statements.

Income statement

for the year ended 31 December 2007

2007 USD'000	2006 USD'000		Notes	2007 RO'000	2006 RO'000
134,052	109,836	Interest income		51,610	42,287
(55,205)	(41,667)	Interest expense		(21,254)	(16,042)
78,847	68,169	**Net interest income**	20	**30,356**	26,245
35,543	22,533	Other income	21	**13,684**	8,675
114,390	90,702	**Operating income**		**44,040**	34,920
(40,475)	(32,392)	Staff and administrative costs	22	**(15,583)**	(12,471)
(3,587)	(2,969)	Depreciation	10	**(1,381)**	(1,143)
(44,062)	(35,361)	**Operating expenses**		**(16,964)**	(13,614)
70,328	55,341	**Profit from operations before provision**		**27,076**	21,306
(8,475)	(6,873)	Provision for loan impairment	6	**(3,263)**	(2,646)
3,935	9,135	Recoveries from provision for loan impairment	6	**1,515**	3,517
(62)	(410)	Bad debts written-off		**(24)**	(158)
133	(112)	Financial instruments at fair value through profit or loss		**51**	(43)
65,859	57,081	**Profit from operations after provision**		**25,355**	21,976
(6,664)	(4,795)	Income tax expense	24	**(2,565)**	(1,846)
59,195	52,286	**Net profit for the year**		**22,790**	20,130
0.11	0.10	**Earnings per share (Rials Omani)**	18	**0.043**	0.038

The accompanying notes form an integral part of these financial statements.

Statement of changes in equity

for the year ended 31 December 2007

	Notes	Share capital RO'000	Share premium RO'000	Legal reserve RO'000	Subordinated bonds and loan reserve RO'000	Investment revaluation reserve RO'000	Retained earnings RO'000	Total RO'000
1 January 2006		41,962	5,429	7,857	4,416	4,289	15,452	79,405
Profit for the year		-	-	-	-	-	20,130	20,130
Fair value decrease		-	-	-	-	(455)	-	(455)
Total recognised income for 2006						(455)	20,130	19,675
Net transfer to income statement on sale of available-for-sale investments		-	-	-	-	(1,603)	-	(1,603)
Dividend paid for 2005		-	-	-	-	-	(4,196)	(4,196)
Bonus issue for 2005		4,196	-	-	-	-	(4,196)	-
Transfer to legal reserve	17			2,013			(2,013)	-
Transfer to subordinated bond reserve	17	-	-	-	1,472	-	(1,472)	-
31 December 2006		46,158	5,429	9,870	5,888	2,231	23,705	93,281
1 January 2007		**46,158**	**5,429**	**9,870**	**5,888**	**2,231**	**23,705**	**93,281**
Profit for the year		**-**	**-**	**-**	**-**	**-**	**22,790**	**22,790**
Fair value increase		**-**	**-**	**-**	**-**	**3,932**	**-**	**3,932**
Total recognised income for 2007		**-**	**-**	**-**	**-**	**3,932**	**22,790**	**26,722**
Net transfer to income statement on sale of available-for-sale investments		**-**	**-**	**-**	**-**	**(2,581)**	**-**	**(2,581)**
Dividend paid for 2006		**-**	**-**	**-**	**-**	**-**	**(6,924)**	**(6,924)**
Bonus issue for 2006		**6,924**	**-**	**-**	**-**	**-**	**(6,924)**	**-**
Transfer to legal reserve	17	**-**	**-**	**2,279**	**-**	**-**	**(2,279)**	**-**
Transfer to subordinated bond reserve	17	**-**	**-**	**-**	**1,474**	**-**	**(1,474)**	**-**
Transfer to subordinated loan reserve	17	**-**	**-**	**-**	**2,567**	**-**	**(2,567)**	**-**
31 December 2007		**53,082**	**5,429**	**12,149**	**9,929**	**3,582**	**26,327**	**110,498**

The accompanying notes form an integral part of these financial statements.

Statement of changes in equity

for the year ended 31 December 2007

	Notes	Share capital USD'000	Share premium USD'000	Legal reserve USD'000	Subordinated bond and loan reserve USD'000	Investment revaluation reserve USD'000	Retained earnings USD'000	Total USD'000
1 January 2006		108,992	14,101	20,408	11,470	11,140	40,135	206,246
Profit for the year		-	-	-	-	-	52,286	52,286
Fair value decrease		-	-	-	-	(1,182)	-	(1,182)
Total recognised income for 2006		-	-	-	-	(1,182)	52,286	51,104
Net transfer to income statement on sale of available-for-sale investments		-	-	-	-	(4,163)	-	(4,163)
Dividends paid for 2005		-	-	-	-	-	(10,899)	(10,899)
Bonus issue for 2005		10,899	-	-	-	-	(10,899)	-
Transfer to legal reserve	17	-	-	5,228	-	-	(5,228)	-
Transfer to subordinated bond reserve	17	-	-	-	3,824	-	(3,824)	-
31 December 2006		119,891	14,101	25,636	15,294	5,795	61,571	242,288
1 January 2007		**119,891**	**14,101**	**25,636**	**15,294**	**5,795**	**61,571**	**242,288**
Profit for the year		**-**	**-**	**-**	**-**	**-**	**59,195**	**59,195**
Fair value increase		**-**	**-**	**-**	**-**	**10,213**	**-**	**10,213**
Total recognised income for 2007		**-**	**-**	**-**	**-**	**10,213**	**59,195**	**69,408**
Net transfer to income statement on sale of available-for-sale investments		**-**	**-**	**-**	**-**	**(6,704)**	**-**	**(6,704)**
Dividend paid for 2006		**-**	**-**	**-**	**-**	**-**	**(17,984)**	**(17,984)**
Bonus issue for 2006		**17,984**	**-**	**-**	**-**	**-**	**(17,984)**	**-**
Transfer to legal reserve	17	**-**	**-**	**5,920**	**-**	**-**	**(5,920)**	**-**
Transfer to subordinated bond reserve	17	**-**	**-**	**-**	**3,828**	**-**	**(3,828)**	**-**
Transfer to subordinated loan reserve	17	**-**	**-**	**-**	**6,668**	**-**	**(6,668)**	**-**
31 December 2007		**137,875**	**14,101**	**31,556**	**25,790**	**9,304**	**68,382**	**287,008**

The accompanying notes form an integral part of these financial statements.

Cash flow statement

for the year ended 31 December 2007

2007 USD'000	2006 USD'000		2007 RO'000	2006 RO'000
		Cash flows from operating activities		
167,881	129,948	Interest and commission receipts	**64,634**	50,030
(47,382)	(36,255)	Interest payments	**(18,242)**	(13,958)
(41,995)	(13,449)	Cash payments to suppliers and employees	**(16,168)**	(5,178)
78,504	80,244		**30,224**	30,894
		Increase in operating assets		
(400,197)	(204,553)	Loans and advances to customers	**(154,076)**	(78,753)
5,400	5,418	Loans and advances to banks	**2,079**	2,086
(185,333)	-	Purchase of treasury bills and certificates of deposits (net)	**(71,353)**	-
(580,130)	(199,135)		**(223,350)**	(76,667)
		Increase in operating liabilities		
460,675	116,909	Deposits from customers	**177,360**	45,010
59,268	27,826	Due to banks	**22,818**	10,713
519,943	144,735		**200,178**	55,723
18,317	25,844	**Net cash from operating activities**	**7,052**	9,950
(4,457)	(4,493)	Income tax paid	**(1,716)**	(1,730)
13,860	21,351	**Net cash generated from operating activities**	**5,336**	8,220
		Cash flows from investing activities		
823	1,294	Investment income	**317**	498
(22,177)	(10,561)	Purchase of investments	**(8,538)**	(4,066)
25,922	17,052	Proceeds from sale of investments	**9,980**	6,565
(4,743)	(3,855)	Purchase of property and equipment	**(1,826)**	(1,484)
582	262	Proceeds from sale of property and equipment	**224**	101
407	4,192	**Net cash generated from/(used in) investing activities**	**157**	1,614
		Cash flow from financing activities		
100,000	-	Subordinated loan	**38,500**	-
(17,984)	(10,899)	Dividend paid	**(6,924)**	(4,196)
82,016	(10,899)	**Net cash flow from / (used in) financing activities**	**31,576**	(4,196)
96,283	14,644	**Net increase in cash and cash equivalents**	**37,069**	5,638
280,849	266,205	**Cash and cash equivalents at the beginning of the year**	**108,127**	102,489
377,132	280,849	**Cash and cash equivalents at the end of the year**	**145,196**	108,127
310,203	219,322	**Cash and cash equivalents (Note 3)**	**119,428**	84,439
(1,299)	(1,299)	Capital deposit with Central Bank of Oman	**(500)**	(500)
69,210	64,335	Loans and advances to banks due within 90 days	**26,646**	24,769
(982)	(1,509)	Due to banks within 90 days	**(378)**	(581)
377,132	280,849	**Cash and cash equivalents for the purpose of the cash flow statement**	**145,196**	108,127

The accompanying notes form an integral part of these financial statements.

Notes to the financial statements

for the year ended 31 December 2007

1. Legal status and principal activities

BankDhofar SAOG (the Bank) is incorporated in the Sultanate of Oman as a public joint stock company and is principally engaged in corporate, retail and investment banking activities. The Bank has a primary listing on the Muscat Securities Market (MSM) and its principal place of business is the Head Office, Capital Business District (CBD), Muscat, Sultanate of Oman.

2. Principal accounting policies

2.1. Basis of preparation

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS), the requirements of the Commercial Companies Law of 1974, as amended and disclosure requirements of the Capital Market Authority.

The financial statements have been prepared on the historical cost basis except for derivative financial instruments, financial instruments at fair value through profit and loss and available for sale financial assets which are measured at fair value.

These policies have been consistently applied in dealing with items that are considered material in relation to the Bank's financial statements to all the years presented.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Bank's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements, are disclosed in note 32.

At the date of authorisation of these financial statements the following standards were in issue but not yet effective:

	Effective for annual period beginning or after
IFRIC 11 : IFRS 2: Group and Treasury Share Transactions	1 March 2007
IFRIC 12 : Service Concession Arrangements	1 January 2008
IFRIC 13 : Customer Loyalty Programmes	1 July 2008
IFRIC 14: IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction	1 January 2008
IAS 23 : (Revised) Borrowing Costs	1 January 2009
IFRS 8 : Operating Segments	1 January 2009

The management anticipates that the adoption of the standards will have no material impact on the financial statements of the Bank.

2.2. Foreign currency translations

2.2.1. Functional and presentation currency

Items included in the Bank's financial statements are measured using Rials Omani which is the currency of the primary economic environment in which the Bank operates, rounded off to the nearest thousand.

2. Principal accounting policies (continued)

2.2.2. Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement. Translation differences on non-monetary items, such as equities held at fair value through profit or loss, are reported as part of the fair value gain or loss. Translation differences on non-monetary items, such as equities classified as available-for-sale financial assets, are included in the investment revaluation reserve in equity.

2.3. Financial instruments

2.3.1. Classification

The Bank classifies its financial assets in the following categories: financial assets at fair value through profit or loss; loans and receivables; held-to-maturity investments; and available-for-sale financial assets. Management determines the classification of its investments at initial recognition.

2.3.1.1. 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 held in this category if acquired principally for the purpose of short-term profit taking or if so designated by management. Derivatives are also categorised as held for trading unless they are designated as hedges.

2.3.1.2. Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They can be originated or acquired by the bank with no intention of trading the receivable and comprise loans and advances to banks and customers other than bonds purchased at original issuance.

2.3.1.3. Available-for-sale

Available-for-sale investments are those intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices.

2.3.1.4. Held-to-maturity investments

Investments with fixed or determinable payments and fixed maturity dates that the Bank has the positive and ability to hold to maturity are classified as held-to-maturity investments. Held-to-maturity are recorded at amortised costs using the effective interest method less any impairment, with revenue recognised on an effective yield basis..

2.3.2. Recognition and derecognition

The Bank recognises financial assets at fair value through profit or loss and available-for-sale assets on the trade date, the date it commits to purchase or sell the asset. From this date any gains and losses arising from changes in fair value of the assets are recognised. Loans and receivables, deposits and subordinated liabilities are recognised on the date they are originated.

Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Bank has transferred substantially all risks and rewards of ownership. A financial liability is derecognised when it is extinguished.

2. Principal accounting policies (continued)

2.3.3. Measurement

Financial assets are measured initially at cost plus transaction costs for all financial assets not carried at fair value through profit or loss.

Subsequent to initial recognition all financial assets at fair value through profit or loss and all available-for-sale assets are measured at fair value, except equity instrument that does not have a quoted market price in an active market and whose fair value cannot be reliably measured is stated at cost, including transaction costs, less impairment losses.

All non-trading financial liabilities and loans and receivables are measured at amortised cost less impairment losses. Amortised cost is calculated on the effective interest rate method. Premiums and discounts, including initial transaction costs, are included in the carrying amount of the related instrument and amortised based on the effective interest rate of the instrument.

2.3.4. Fair value measurement principles

The fair values of quoted investments in active markets are based on current bid prices. If the market for a financial asset is not active (and for unlisted securities), the Bank establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, discounted cash flow analysis and other valuation techniques commonly used by market participants.

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

The fair value of derivatives that are not exchange-traded is estimated at the amount that the Bank would receive or pay to terminate the contract at the balance sheet date taking into account current market conditions and the current credit worthiness of the counter-parties.

2.3.5. Gains and losses on subsequent measurement

Gains and losses arising from changes in the fair value of the financial assets at fair value through profit or loss category are included in the income statement in the period in which they arise. Gains and losses arising from changes in the fair value of available-for-sale financial assets are recognised directly in equity, until the financial asset is derecognised or impaired at which time the cumulative gain or loss previously recognised in equity is recognised in profit or loss.

2.4. *Cash and cash equivalents*

For the purpose of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, including: cash on hand, non-restricted cash deposited with the Central Bank of Oman, amounts due from other banks and eligible treasury bills and certificate of deposits.

2.5. *Treasury bills and certificate of deposits*

Treasury bills and certificates of deposit issued for a term longer than three months are classified as available-for-sale or held-to-maturity at the date of acquisition..

2.6. *Offsetting*

Financial assets and liabilities are offset and the net amount is reported in the balance sheet when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

2. Principal accounting policies (continued)

2.7. *Impairment of financial assets*

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

(i) significant financial difficulty of the issuer or obligor;

(ii) a breach of contract, such as a default or delinquency in interest or principal payments;

(iii) the Bank granting to the borrower, for economic or legal reasons relating to the borrower's financial difficulty, a concession that the lender would not otherwise consider;

(iv) it becoming probable that the borrower will enter bankruptcy or other financial reorganisation;

(v) the disappearance of an active market for that financial asset because of financial difficulties; or

(vi) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group, including:

- adverse changes in the payment status of borrowers in the group; or
- national or local economic conditions that correlate with defaults on the assets in the group.

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

If there is objective evidence that an impairment loss on loans and receivables carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. As a practical expedient, the Bank may measure impairment on the basis of an instrument's fair value using an observable market price.

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics (i.e. on the basis of the Bank's grading process that considers asset type, industry, geographical location, collateral type, past-due status and other relevant factors). Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.

2. **Principal accounting policies (continued)**

2.7. *Impairment of financial assets (continued)*

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the Bank and historical loss experience for assets with credit risk characteristics similar to those in the Group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently.

Estimates of changes in future cash flows for groups of assets should reflect and be directionally consistent with changes in related observable data from period to period (for example, changes in unemployment rates, property prices, payment status, or other factors indicative of changes in the probability of losses in the group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Bank to reduce any differences between loss estimates and actual loss experience.

When a loan is known to be uncollectible, all the necessary legal procedures have been completed, and the final loss has been determined, the loan is written off against the related provision for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are included in the income statement.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the income statement.

The Bank assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets, other than investments at fair value through profit and loss, is impaired. In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the assets are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in the income statement. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement. If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through the income statement.

2.8. *Property and equipment*

Items of property and equipment are stated at cost less accumulated depreciation and impairment loss. Depreciation is calculated so as to write off the cost of property and equipment, other than freehold land and capital work-in-progress, by equal instalments over their estimated economic useful lives from the date the asset is brought into use, as follows :

	Years
Buildings	7 - 25
Furniture and fixtures	3 - 7
Motor vehicles	3 - 5
Computer equipment	4

2. **Principal accounting policies (continued)**

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and value in use.

Gains and losses on disposal of property and equipment are determined by reference to their carrying amount and are taken into account in determining operating profit. Repairs and renewals are charged to the income statement when the expense is incurred. Subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the item of property and equipment. All other expenditure is recognised in the income statement as an expense when incurred.

2.9. *Intangible assets*

Goodwill represents the excess of the cost of an acquisition over the fair value of the net identifiable assets acquired at the date of acquisition. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses.

2.10. *Provisions*

A provision is recognised in the balance sheet when the Bank has a legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation and the amount has been reliably estimated. If the effect is material, provisions are determined by discounting the expected future cash flows at a rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

2.11. *Dividends*

Dividends are recognised as a liability in the year in which they are declared.

2.12. *Interest income and expense*

Interest income and expense are recognised in the income statement using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of the financial instrument (for example, prepayment options) but does not consider future credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

2. Principal accounting policies (continued)

2.13. Fees and commission income

Fees and commissions are generally recognised on an accrual basis when the service has been provided. Loan commitment fees for loans that are likely to be drawn down are deferred (together with related direct costs) and recognised as an adjustment to the effective interest rate on the loan. Loan syndication fees are recognised as revenue when the syndication has been completed and the Bank retained no part of the loan package for itself or retained a part at the same effective interest rate for the other participants. Commission and fees arising from negotiating, or participating in the negotiation of, a transaction for a third party – such as the arrangement of the acquisition of shares or other securities or the purchase or sale of businesses – are recognised on completion of the underlying transaction. Portfolio and other management advisory and service fees are recognised based on the applicable service contracts, usually on a time-apportionment basis. Asset management fees related to investment funds are recognised rateably over the period the service is provided. The same principle is applied for wealth management, financial planning and custody services that are continuously provided over an extended period of time.

2.14. Taxation

Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

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

Deferred income tax is provided in full, using the balance sheet liability method, on temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes (the tax base). The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantially enacted at the balance sheet date. The principal temporary differences arise from depreciation of property and equipment and provisions.

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 utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

2.15. Employee benefits

End of service benefits are accrued in accordance with the terms of employment of the bank's employees at the balance sheet date, having regard to the requirements of the Oman Labour Law. Employee entitlements to annual leave and leave passage are recognised when they accrue to employees and an accrual is made for the estimated liability arising as a result of services rendered by employees up to the balance sheet date.

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

2.16. Derivative financial instruments

Derivatives are stated at fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and valuation techniques, including discounted cash flow models and options pricing models, as appropriate. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

2. Principal accounting policies (continued)

2.16. Derivative financial instruments (continued)

The best evidence of the fair value of a derivative at initial recognition is the transaction price (i.e., the fair value of the consideration given or received) unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e. without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets. When such evidence exists, the Bank recognises profits on the day of the transaction.

The method of recognising the resulting fair value gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. Although the Bank enters into derivative instruments for hedging purposes, certain derivative instruments do not qualify for hedge accounting. Changes in the fair value of any derivative instrument that does not qualify for hedge accounting are recognised immediately in the income statement.

2.16.1 Embedded derivatives

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contracts and the host contracts are not measured at fair value with changes in fair value recognised in profit or loss.

2.16.2 Hedge accounting

The bank designates certain hedging instruments, which include derivatives, embedded derivatives and non-derivatives in respect of foreign currency risk, as either fair value hedges, cash flow hedges, or hedges of net investments in foreign operations. Hedges of foreign exchange risk on firm commitments are accounted for as cash flow hedges.

At the inception of the hedge relationship, the entity documents the relationship between the hedging instrument and the hedged item, along with its risk management objectives and its strategy for undertaking various hedge transactions. Furthermore, at the inception of the hedge and on an ongoing basis, the bank documents whether the hedging instrument that is used in a hedging relationship is highly effective in offsetting changes in fair values or cash flows of the hedged item.

2.16.3 Fair value hedges

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in profit or loss immediately, together with any changes in the fair value of the hedged item that are attributable to the hedged risk. The change in the fair value of the hedging instrument and the change in the hedged item attributable to the hedged risk are recognised in the line of the income statement relating to the hedged item.

Hedge accounting is discontinued when the bank revokes the hedging relationship, the hedging instrument expires or is sold, terminated, or exercised, or no longer qualifies for hedge accounting. The adjustment to the carrying amount of the hedged item arising from the hedged risk is amortised to profit or loss from that date.

2.16.4 Cash flow hedges

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are deferred in equity. The gain or loss relating to the ineffective portion is recognised immediately in profit or loss, and is included in the "other gains and losses" line of the income statement.

2. Principal accounting policies (continued)

2.16.4 Cash flow hedges (continued)

Amounts deferred in equity are recycled in profit or loss in the periods when the hedged item is recognised in profit or loss, in the same line of the income statement as the recognised hedged item. However, when the forecast transaction that is hedged results in the recognition of a non-financial asset or a non-financial liability, the gains and losses previously deferred in equity are transferred from equity and included in the initial measurement of the cost of the asset or liability.

Hedge accounting is discontinued when the bank revokes the hedging relationship, the hedging instrument expires or is sold, terminated, or exercised, or no longer qualifies for hedge accounting. Any cumulative gain or loss deferred in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in profit or loss. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was deferred in equity is recognised immediately in profit or loss.

2.17. Sale and repurchase agreements

Securities sold subject to repurchase agreements (repos) are reclassified in the financial statements as pledged assets when the transferee has the right by contract or custom to sell or repledge the collateral; the counterparty liability is included in amounts due to other banks, deposits from banks, other deposits or deposits due to customers, as appropriate. Securities purchased under agreements to resell (reverse repos) are recorded as loans and advances to other banks or customers, as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method. Securities lent to counterparties are also retained in the financial statements.

Securities borrowed are not recognised in the financial statements, unless these are sold to third parties, in which case the purchase and sale are recorded with the gain or loss included in trading income.

2.18. Borrowings

Borrowings are recognised initially at fair value, being their issue proceeds (fair value of consideration received) net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between proceeds net of transaction costs and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

2.19. Segment reporting

A segment is a distinguishable component of the Bank that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments. The Bank currently operates only in the Sultanate of Oman. The Bank's primary format for reporting segmental information is business segments, based upon management and internal reporting structure. The Bank's main business segments are corporate and retail banking.

2.20. Directors' remuneration

Directors' remuneration is calculated in accordance with the Commercial Companies Law of Sultanate of Oman.

3. Cash and cash equivalents

	2007 RO'000	2006 RO'000
Cash on hand	**8,635**	7,321
Balances with the Central Bank of Oman	**45,793**	14,465
Certificate of deposits	**65,000**	55,000
Treasury bills	**-**	7,653
	119,428	84,439

At 31 December 2007, cash and cash equivalents included balances with the Central Bank of Oman approximately RO 500,000 (2006 - RO 500,000) as minimum reserve requirements. These funds are not available for the Bank's daily business.

4 Held-to-maturity investments

	2007 RO'000	2006 RO'000
Treasury bills above 90 days	**36,353**	-
Certificates of deposits above 90 days	**35,000**	-
	71,353	-

5. Loans and advances to banks

	2007 RO'000	2006 RO'000
Placements with other banks	**22,859**	27,463
Current clearing accounts & bills discounted	**6,328**	1,926
	29,187	29,389

At 31 December 2007, no placement with any bank individually represented 20% or more of the Bank's placements.

At 31 December 2006, placement with two local banks individually represented 20% or more of the Bank's placements.

Notes to the financial statements

for the year ended 31 December 2007

6. Loans and advances to customers

	2007 RO'000	2006 RO'000
Overdrafts	**73,052**	75,278
Loans	**621,846**	471,091
Loans against trust receipts	**38,203**	33,401
Bills discounted	**3,224**	1,482
Advance against credit cards	**4,717**	4,157
Others	**8,998**	9,307
Gross loans and advances	**750,040**	594,716
Less: Impairment allowance	**(45,397)**	(45,897)
Net loans and advances	**704,643**	548,819

The movement in the impairment allowance is analysed below:

	2007 RO'000	2006 RO'000
(a) Allowance for loan impairment		
1 January	**29,170**	30,106
Allowance made during the year	**3,263**	2,646
Released to the income statement during the year	**(1,515)**	(3,517)
Written off during the year	**(2,094)**	(65)
31 December	**28,824**	29,170
(b) Reserved interest		
1 January	**16,727**	14,258
Reserved during the year	**3,438**	3,406
Released to the income statement during the year	**(824)**	(476)
Written-off during the year	**(2,768)**	(461)
31 December	**16,573**	16,727
Total impairment allowance	**45,397**	45,897

As a matter of policy, the Bank considers waiver / write-off or settlement only in such cases where the Bank is satisfied that the recovery of the full outstanding liabilities from the borrower is not possible in the normal course of business or out of the securities realisation or through enforcement of the guarantee (wherever available) and that legal action will not yield higher recoveries after considering the time and costs involved.

Proposals for waivers/write-off are not formula driven and are decided on case by case basis after weighing all pros and cons.The rationale is invariably documented. In all cases, the Bank aims to recover the maximum value through enforcement of collaterals/guarantees of guarantors, etc.

Interest is reserved by the Bank against loans and advances which are impaired, to comply with the rules, regulations and guidelines issued by the Central Bank of Oman.

Under the Central Bank of Oman's guidelines for provision against classified loans and advances, at 31 December 2007, out of the total provisions of approximately RO 45,397,195 (2006 – RO 45,896,555) provision made on a general portfolio basis for similar assets amounts to approximately RO 10,208,545 (2006 - RO 7,516,000).

At 31 December 2007, impaired loans and advances on which interest has been reserved amount to approximately RO 34,893,000 (2006 - RO 35,285,000) and loans and advances on which interest is not being accrued amount to approximately RO 1,729,189 (2006 - RO 6,338,000).

Notes to the financial statements

for the year ended 31 December 2007 (continued)

6. Loans and advances to customers (continued)

Loan and advances are summarised as follows

	2007		2006	
	Loans and advances to customers RO'000	**Loans and advances to banks RO'000**	Loans and advances to customers RO'000	Loans and advances to banks RO'000
Neither past due nor impaired	**700,585**	**29,187**	541,076	29,389
Past due but not impaired	**13,046**	**-**	12,364	-
Impaired	**36,409**	**-**	41,276	-
Gross loans and advances	**750,040**	**29,187**	594,716	29,389
Less: Impairment allowance	**(45,397)**	**-**	(45,897)	-
Total	**704,643**	**29,187**	548,819	29,389

Loans and advances neither past due nor impaired

The credit quality of the portfolio of loans and advances that were neither past due nor impaired can be assessed by reference to the internal rating system adopted by the Bank.

	Loans and advances to customers RO'000	Loans and advances to banks RO'000
31 December 2007		
Grade 1	**328,066**	29,187
Grade 2	**262,367**	-
Grade 3	**90,300**	-
Grade 4	**19,852**	-
	700,585	29,187
31 December 2006	**RO'000**	RO'000
Grade 1	**275,808**	29,389
Grade 2	**166,695**	-
Grade 3	**80,760**	-
Grade 4	**17,813**	-
	541,076	29,389

Loans and advances past due but not impaired

	2007 RO'000	2006 RO'000
Past due up to 30 days	**8,871**	8,125
Past due 30 – 60 days	**974**	4,177
Past due 60 – 89 days	**3,201**	62
Totals	**13,046**	12,364

Notes to the financial statements
for the year ended 31 December 2007

6. Loans and advances to customers (continued)

Impaired

	2007 RO'000	2006 RO'000
Substandard	**573**	476
Doubtful	**345**	1,910
Loss	**35,491**	38,890
Total	**36,409**	41,276

Fair value of collaterals

Upon initial recognition of loans and advances, the fair value of collateral is based on valuation techniques commonly used for the corresponding assets. In subsequent periods, the fair value is updated by reference to market price or indexes of similar assets.

Loans and advances renegotiated

Restructuring activities include extended payment arrangements, approved external management plans, modification and deferral of payments. Following restructuring, a previously overdue customer account is reset to a normal status and managed together with other similar accounts. Restructuring policies and practices are based on indicators or criteria which, in the judgment of local management, indicate that payment will most likely continue. These policies are kept under continuous review. Restructuring is most commonly applied to term loans, in particular customer finance loans. Renegotiated loans that would otherwise be past due or impaired totalled RO 1,664,000 at 31 December 2007 (2006: RO 1,997,000).

7. Financial instruments at fair value through profit or loss

	Fair value 2007 RO'000	Fair value 2006 RO'000	**Carrying amount 2007 RO'000**	Carrying amount 2006 RO'000
Debts and other fixed income instruments held for trading				
Government Development bonds	**2,515**	9,098	**2,515**	9,098

8. Available-for-sale investments

	2007 RO'000	2006 RO'000
Equity instruments		
- Quoted	**7,552**	7,277
- Unquoted	**7,108**	3,593
	14,660	10,870

8. Available-for-sale investments

		Market value		Carrying amount	
	Cost RO'000	**2007 RO'000**	2006 RO'000	**2007 RO'000**	2006 RO'000
Quoted on the Muscat Securities Market (by sector)					
Investments	**1,335**	**1,670**	2,958	**1,670**	2,958
Insurance	**-**	**-**	727	**-**	727
Services	**3,759**	**4,640**	2,242	**4,640**	2,242
Industrial	**1,071**	**1,442**	1,432	**1,242**	1,350
	6,165	**7,752**	7,359	**7,552**	7,277
Unquoted					
Unquoted Omani company				**3,937**	2,405
Unquoted foreign equities				**3,171**	1,188
				7,108	3,593
				14,660	10,870

At 31 December 2007, the investments are carried at their fair value. The market value in certain cases is higher than the carrying amount. However, the Board of Directors believe that due to the non-liquidity of certain shares, the market value of the quoted securities is not representative of the fair value and hence appropriate adjustments have been made to the market value to reflect the fair value.

9. Intangible asset

	2007 RO'000	2006 RO'000
Goodwill	**3,971**	3,971

Goodwill is carried at cost less accumulated impairment losses and tested annually for impairment.

10. Property and equipment

	Freehold Land RO'000	Buildings RO'000	Furniture and fixtures RO'000	Motor vehicles RO'000	Computer equipment RO'000	Capital Work-in-progress RO'000	Total RO'000
Cost							
1 January 2006	140	1,653	4,039	761	5,119	217	11,929
Additions	-	-	729	131	768	(144)	1,484
Disposals	-	(80)	(230)	(132)	(78)	-	(520)
1 January 2007	**140**	**1,573**	**4,538**	**760**	**5,809**	**73**	**12,893**
Additions	**-**	**-**	**871**	**265**	**588**	**102**	**1,826**
Disposals	**-**	**-**	**(142)**	**(183)**	**(32)**	**(110)**	**(467)**
31 December 2007	**140**	**1,573**	**5,267**	**842**	**6,365**	**65**	**14,252**
Depreciation							
1 January 2006	-	593	3,021	416	4,052	-	8,082
Charge for the year	-	75	379	151	538	-	1,143
Disposals / written-off	-	(81)	(212)	(114)	(77)	-	(484)
1 January 2007	**-**	**587**	**3,188**	**453**	**4,513**	**-**	**8,741**
Charge for the year	**-**	**60**	**534**	**173**	**614**	**-**	**1,381**
Disposals / written-off	**-**	**-**	**(118)**	**(134)**	**(31)**	**-**	**(283)**
31 December 2007	**-**	**647**	**3,604**	**492**	**5,096**		**9,839**
Carrying amount							
31 December 2007	**140**	**926**	**1,663**	**350**	**1,269**	**65**	**4,413**
31 December 2006	140	986	1,350	307	1,296	73	4,152

11. Other assets

	2007 RO'000	2006 RO'000
Interest receivable	**2,154**	1,851
Prepaid expenses	**583**	658
Dividends receivable	**527**	352
Positive fair value of derivatives (note 29)	**197**	81
Other receivables	**1,496**	1,119
	4,957	4,061

12. Due to banks

	2007 RO'000	2006 RO'000
Syndicated borrowings	**67,375**	67,375
Other borrowings	**14,437**	1,293
Payable on demand	**11,682**	2,211
	93,494	70,879

12. Due to banks

During the previous year, the Bank entered into a mid-term syndicated loan agreement for US $ 100,000,000 with three years maturity. The lead arrangers for the loan were Dresdner Bank, Natexis Banque and Standard Chartered Bank. This was the second loan the Bank raised from the international market bringing the total international borrowing to US $ 175,000,000 (2006 : US $ 175,000,000). The rates of interest are linked to three month LIBOR subject to competitive margin.

At 31 December 2007 no borrowing from a bank individually represented 20% or more of the Bank's borrowings (2006 – nil). The Bank has not had any defaults of principal, interest or other breaches during the year on its borrowed funds (2006 - Nil).

13. Deposits from customers

	2007 RO'000	2006 RO'000
Current accounts	**178,137**	123,234
Savings accounts	**142,907**	86,550
Time deposits	**351,393**	285,706
Margin accounts	**2,065**	1,652
	674,502	497,142

Current accounts and time deposits include deposits from the Government of the Sultanate of Oman amounting to RO 125,797,000 (2006 - RO 108,821,000).

14. Other liabilities

	2007 RO'000	2006 RO'000
Interest payable	**8,807**	5,795
Creditors and accruals	**19,087**	12,073
IPO subscriptions	**-**	6,166
Income tax provision	**2,523**	1,626
Deferred tax liability (note 24)	**80**	128
Negative fair value of derivatives (note 29)	**-**	77
Staff terminal benefits	**274**	270
31 December	**30,771**	26,135

Employee terminal benefits

The Bank's net liability and the movement in the employee terminal benefits during the year are as follows:

	2007 RO'000	2006 RO'000
1 January	**270**	277
Expense recognised in the income statement	**88**	79
Cash paid to employees	**(84)**	(86)
31 December	**274**	270

Notes to the financial statements
for the year ended 31 December 2007

15. Subordinated bonds and loan

	2007 RO'000	2006 RO'000
Subordinated bonds (a)	7,362	7,362
Subordinated loan (b)	38,500	-
31 December	45,862	7,362

(a) Subordinated bonds

Pursuant to a 'merger agreement' between the Bank and Majan International Bank SAOC (MIB) dated 28 December 2002, on 31 March 2003 the Bank issued 7,361,767 subordinated bonds of RO 1 each with a tenure of 5 years and 1 day to the former shareholders of MIB. These bonds carry a coupon rate of 7% per annum payable annually. The bonds are listed at Muscat Securities Market.

(b) Subordinated Loan

In August 2007, the Bank availed an unsecured subordinated loan of USD 100 million with a tenor of 5 years and one month. The rate of interest is linked to 3 month LIBOR plus margin, payable quarterly, while principal is payable in lumpsum at maturity.

16. Share capital

The authorised share capital consists of 1000,000,000 shares of RO 0.100 each (2006 – 1,000,000,000 shares of RO 0.100 each). At 31 December 2007, the issued and paid up share capital comprise 530,817,000 shares of RO 0.100 each. (2006 – 461,579,998 shares of RO 0.100 each)

Shareholders

The following shareholders of the Bank own 10% or more of the Bank's share capital :

	2007 No of shares	%	2006 No of shares	%
Dhofar International Development and Investment Company SAOG	159,245,096	30	138,773,997	30
Civil Service Employees' Pension Fund	53,081,689	10	46,157,991	10
Total	212,326,785	40	184,931,988	40
Others	318,490,215	60	276,648,012	60
	530,817,000	100	461,580,000	100

17. Reserves

(a) Legal reserve

	2007 RO'000	2006 RO'000
1 January	9,870	7,857
Appropriation for the year	2,279	2,013
31 December	12,149	9,870

In accordance with Article 106 of the Commercial Companies Law of 1974, annual appropriations of 10% of profit are made to the legal reserve until the accumulated balance of the reserve is equal to one-third of the Bank's paid up share capital. This reserve is not available for distribution.

Notes to the financial statements
for the year ended 31 December 2007 (continued)

17. Reserves (continued)

Subordinated bonds and loan reserves

	2007 RO'000	2006 RO'000
1 January	5,888	4,416
Appropriation for the year		
Subordinated bonds reserve (b)	1,474	1,472
Subordinated loan reserve (c)	2,567	-
31 December	9,929	5,888

(b) Subordinated bonds reserve

Consistent with Bank for Interantional Settlement (BIS) Guidelines on capital adequacy, the Bank transfers an amount equivalent to 20% of the value of the subordinated bonds each year to the subordinated bond reserve until the bonds mature. The bonds are maturing in April 2008. The amount of the reserve will be transferred to retained earnings through statement of changes in equity upon settlement of the subordinated bonds.

(c) Subordinated loan reserve

Consistent with Bank for Interantional Settlement (BIS) Guidelines on capital adequacy, the Bank transfers an amount equivalent to 20% of the value of the subordinated loan each year to the subordinated loan reserve until the maturity of the loan. Since the loan was obtained at the end of August 2007, the bank transferred 6.67% of the value of the subordinated loan being the period the loan was outstanding in 2007. The amount of the reserve will be transferred to retained earnings through statement of changes in equity upon settlement of the subordinated loan.

(d) Investment revaluation reserve

	2007 RO'000	2006 RO'000
1 January	2,231	4,289
Increase/ (decrease) in fair value	3,932	(455)
Net transfer to income statement on sale of available-for-sale investment	(2,581)	(1,603)
31 December	3,582	2,231

18. Earnings per share (basic and diluted)

The calculation of basic and diluted earnings per share is based on profit for the year attributable to ordinary shareholders as follows:

	2007	2006
Profit for the year (RO)	22,790,000	20,130,000
Weighted average number of shares outstanding during the year	530,817,000	530,817,000
Earnings per share basic and diluted	0.043	0.038

For the purpose of earning per share calculation, the Bank has restated the previous year weighted average number of shares outstanding to include the 15% bonus shares (69,237,000 shares) issued in first quarter of 2007 and par value share is taken as RO 0.100.

Notes to the financial statements
for the year ended 31 December 2007

19. Capital adequacy

The ratio of equity to risk weighted assets, as formulated by the Basel II, for the year ended 31 December 2007 is 14.87% (2006 – 13.10%).

Capital structure	2007 RO'000	2006 RO'000
TIER I CAPITAL		
Paid up capital	**53,082**	53,082
Legal reserve	**12,149**	9,870
Share premium	**5,429**	5,429
Subordinated bonds and loan reserve	**9,929**	5,888
Retained earnings	**13,056**	9,857
Less Goodwill	**(3,971)**	(3,971)
Total Tier I capital	**89,674**	80,155
TIER II CAPITAL		
Investment revaluation reserve	**1,612**	1,004
General provision	**10,209**	7,436
Subordinated loan	**30,800**	1,474
Total Tier II capital	**42,621**	9,914
Total eligible capital	**132,295**	90,069
Risk weighted assets		
Banking book	**791,739**	594,854
Trading book	**27,149**	27,822
Operational risk	**70,552**	64,616
Total	**889,440**	687,292
Tier I capital	**89,674**	80,155
Tier II capital	**42,621**	9,914
Tier III capital	**-**	-
Total regulatory capital	**132,295**	90,069
Tier I capital ratio	**10.08%**	11.66%
Total capital ratio	**14.87%**	13.10%

20. Net interest income

	2007 RO'000	2006 RO'000
Loans and advances to customers	**46,772**	38,295
Debt investments	**3,472**	1,931
Money market placements	**1,209**	1,946
Others	**157**	115
Total interest income	**51,610**	42,287
Deposits from customers	**(15,962)**	(12,422)
Money market deposits	**(5,292)**	(3,620)
Total interest expense	**(21,254)**	(16,042)
Net interest income	**30,356**	26,245

Included in interest income from debt investments an amount of RO 1,913,962 (2006 : RO 816,599) being interest income from held-to-maturity investments.

21. Other income

	2007 RO'000	2006 RO'000
Fees and commissions (net)	**2,952**	2,159
Foreign exchange	**1,128**	752
Investment income (a)	**4,662**	3,551
Miscellaneous income	**4,942**	2,213
	13,684	8,675
(a) Investment income		
Dividend income- available-for-sale investments	**406**	1,027
Gain / (loss) of disposal of available-for-sale investments	**3,939**	2,026
Interest income on financial instruments at fair value through profit or loss	**317**	498
	4,662	3,551

The fees and commissions shown above are net of fees and commissions paid of RO 463,000 (2006 - RO 447,000).

Notes to the financial statements
for the year ended 31 December 2007

22. Staff and administrative costs

(a) Staff costs

	2007 RO '000	2006 RO'000
Salaries and allowances	**7,422**	6,521
Other personnel costs	**625**	589
Scheme costs - Note (b)	**353**	286
Non-Omani employees terminal benefit - Note (c)	**88**	79
	8,488	7,475
Administrative costs		
Advertising and promotion	**2,092**	1,699
Occupancy costs	**1,175**	1,006
Donation	**1,004**	18
Data processing	**779**	601
Fees and subscriptions	**446**	354
Correspondent charges	**50**	36
Communication costs	**298**	238
Printing and stationery	**219**	191
Professional charges	**373**	252
Insurance	**88**	90
Others	**571**	511
	7,095	4,996
	15,583	12,471

At 31 December 2007, the Bank had 720 employees (2006 - 636).

(b) Oman Social Insurance Scheme (the Scheme)

The Bank contributes to the Scheme for all Omani employees. The Scheme, which is a defined contributions retirement plan, is administered by the Government of Oman. The Bank and Omani employees are required to make monthly contributions to the Scheme based on fixed percentages of basic salaries.

(c) Non-Omani employee terminal benefits

The provision for end of service benefits for non-Omani employees is made in accordance with the requirements of the Omani Labour Law. Employees are entitled to benefits based on length of service and final remuneration. Accrued staff terminal benefits are payable on termination of employment.

23. Impairment of financial assets

	2007 RO'000	2006 RO'000
Financial instruments at fair value through profit or loss	**(51)**	43
Provision for loan impairment	**3,263**	2,646
Bad debts and dues written-off	**24**	158
	3,236	2,847
Recoveries from provision for loan impairment	**(1,515)**	(3,517)
Net impairment change of financial assets	**1,721**	(670)

24. Income tax

(a) Income tax expense:

	2007 RO '000	2006 RO'000
Current year tax charge		
Current year	**2,517**	2,194
Under/ (over) provision of tax in prior year	**96**	(444)
	2,613	1,750
Deferred tax expense - Current year	**(48)**	96
	2,565	1,846

The Bank is liable to income tax for the year 2007 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. The following is a reconciliation of income taxes calculated at the applicable tax rate with the income tax expense:

Current year	2007 RO'000	2006 RO'000
Accounting profit for the year	**25,355**	21,976
Tax expense as provided at the rate above mentioned	**3,039**	2,634
Tax exempt revenue	**(468)**	(357)
Prior year tax	**97**	(444)
Deferred tax	**(106)**	-
Others	**3**	13
Tax expense	**2,565**	1,846

(b) Temporary timing differences which give rise to deferred tax liabilities are as follows:

	2007 RO'000	2006 RO'000
Depreciation of property and equipment	**82**	(44)
Intangible assets	**(162)**	(84)
	(80)	(128)

(c) Status of the tax assessments

The Bank's tax assessments for the years 2003 to 2006 have not yet been finalised with the Department of Taxation Affairs at the Ministry of Finance. The Board of Directors believe that additional taxes, if any, in respect of open tax assessments would not be material to the Bank's results and financial position.

Notes to the financial statements
for the year ended 31 December 2007

25. Related parties transactions

In the ordinary course of business, the Bank conducts transactions with certain of its Directors, shareholders and companies over which they are able to exert significant influence. The aggregate amount of balances with such related parties are as follows:

	2007 RO'000	2006 RO'000
Loans and advances		
Directors and shareholders holding less than 10% interest in the Bank	**21,938**	21,990
Directors and shareholders holding 10% or more interest in the Bank	**13,186**	6,574
	35,124	28,564
Deposits and other accounts		
Directors and shareholders holding less than 10% interest in the Bank	**38,586**	60,373
Directors and shareholders holding 10% or more interest	**28,940**	15,103
	67,526	75,476

	2007 RO'000	2006 RO'000
Contingent liabilities and commitments		
Directors and shareholders holding less than 10% interest in the Bank	**1,308**	806
Directors and shareholders holding 10% or more interest in the Bank	**83**	69
	1,391	875
Remuneration paid to Directors		
Chairman		
– remuneration proposed	**11**	9
– sitting fees paid	**10**	10
Other Directors		
– remuneration proposed	**127**	94
– sitting fees paid	**52**	87
	200	200
Other transactions		
Rental payment to a related party	**59**	42
Other transactions	**22**	20
Key management compensation		
Salaries and other short-term benefits	**373**	634
Other related costs – performance bonus	**185**	251
Dues written off	**-**	134
	558	1,019

26. Single borrower and senior members

(a) Single borrower

	2007 RO'000	2006 RO'000
Total exposure:		
Direct	**7,883**	17,387
Indirect (off-balance sheet items)	**-**	9,740
	7,883	27,127
Number of members	**2**	2

26. Single borrower and senior members (continued)

(b) Senior member

	2007 RO'000	2006 RO'000
Total exposure:		
Direct	**35,775**	29,112
Indirect	**1,391**	875
	37,166	29,987
Number of members	**23**	11

Excess over limits as specified by the Central Bank of Oman for Single Borrower and Senior Members are secured by cash collaterals, pledge of Government Development Bonds or risk participation arrangements with other commercial banks.

27. Contingent liabilities and commitments

(a) Credit related contingent items

Letters of credit, guarantees and other commitments for which there are corresponding customer liabilities:

	2007 RO'000	2006 RO'000
Letters of credit	**47,222**	33,520
Acceptances	**14,748**	15,400
Guarantees and performance bonds	**51,955**	27,711
Advance payment guarantees	**28,476**	20,428
Payment guarantees	**23,118**	12,824
Others	**2,041**	2,236
	167,560	112,119

At 31 December 2007, letters of credit, guarantees and other commitments amounting to RO 1,180,000 (2006 -RO 8,844,000) are counter guaranteed by other banks.

(b) Capital and investment commitments

	2007 RO,000	2006 RO'000
Contractual commitments for property and equipment	**860**	855

(c) Other contingent liabilities and commitments

There are no significant contingencies or commitments which have materialised after the balance sheet date nor are there any acknowledged material claims against the Bank.

Notes to the financial statements

for the year ended 31 December 2007

28. Analysis of significant assets and liabilities

(a) Maturity profile of assets and liabilities

	Due on demand and up to 30 days RO'000	2 months to 6 months RO'000	7 months to 12 months RO'000	More than 1 year to 5 years RO'000	Over 5 years RO'000	Total RO'000
31 December 2007						
Cash and cash Equivalents	118,928	-	-	-	500	119,428
Held-to-maturity investments	5,764	65,589	-	-	-	71,353
Loans and advances to banks	24,664	4,523	-	-	-	29,187
Loans and advances to customers	138,849	92,929	38,741	288,108	146,016	704,643
Financial instruments at fair value through profit or loss	-	-	-	2,515	-	2,515
Available-for-sale Investments	-	-	11,638	-	3,022	14,660
Intangible asset	-	-	-	-	3,971	3,971
Property and equipment	-	-	-	-	4,413	4,413
Other assets	1,443	15	77	137	3,285	4,957
Total assets	289,648	163,056	50,456	290,760	161,207	955,127
Due to banks	26,119	-	-	67,375	-	93,494
Deposits from customers	106,377	244,640	145,421	97,757	80,307	674,502
Other liabilities	13,025	5,299	6,090	6,357	-	30,771
Subordinate bonds and loan	-	7,362	-	38,500	-	45,862
Shareholders' equity	-	13,271	-	-	97,227	110,498
Total liabilities and shareholders' equity	145,521	270,572	151,511	209,989	177,534	955,127

	Due on demand and up to 30 days RO'000	2 months to 6 months RO'000	7 months to 12 months RO'000	More than 1 year to 5 years RO'000	Over 5 years RO'000	Total RO'000
31 December 2006						
Cash and cash equivalents	80,113	3,826	-	-	500	84,439
Loans and advances to banks	22,844	6,545	-	-	-	29,389
Loans and advances to customers	95,703	76,995	39,830	242,387	93,904	548,819
Financial instruments at fair value through profit or loss	1,282	-	5,520	2,296	-	9,098
Available-for-sale investments	-	-	8,683	-	2,187	10,870
Intangible asset	-	-	-	-	3,971	3,971
Property and equipment	-	-	-	-	4,152	4,152
Other assets	997	179	15	61	2,809	4,061
Total assets	200,939	87,545	54,048	244,744	107,523	694,799
Due to banks	3,366	-	-	67,513	-	70,879
Deposits from customers	112,801	138,597	105,701	87,549	52,494	497,142
Other liabilities	10,768	6,770	3,037	4,404	1,156	26,135
Subordinate bonds	-	-	-	7,362	-	7,362
Shareholders' equity	-	6,924	-	-	86,357	93,281
Total liabilities and shareholders' equity	126,935	152,291	108,738	166,828	140,007	694,799

28. Analysis of significant assets and liabilities (continued)

(b) Interest sensitivity gap

Sensitivity to interest rates arises from mismatches in the period to repricing of assets and that of the corresponding liability funding. The Bank manages these mismatches by following policy guidelines and reduces risk by matching the repricing of assets and liabilities through various means including monitoring by the Asset Liability Committee. Significant changes in gap positions can be made to adjust the profile as market outlooks change.

	Effective average interest rate %	Due on demand and within 30 days RO'000	Due within 1 to 6 months RO'000	Due within 7 to 12 months RO'000	Due within 1 to 5 years RO'000	Due after 5 years RO'000	Non-interest bearing RO'000	Total RO'000
31 December 2007								
Cash and cash equivalents	3.4	65,000	-	-	-	500	53,928	119,428
Held-to-maturity investments	4.7	5,764	65,589	-	-	-	-	71,353
Loans and advances to banks	5.4	24,664	4,523	-	-	-	-	29,187
Loans and advances to customers	7.6	202,671	85,623	31,435	251,584	127,754	5,576	704,643
Financial assets at fair value through profit or loss		-	-	-	2,515	-	-	2,515
Available-for-sale Investments		-	-	-	3,022	-	11,638	14,660
Intangible asset		-	-	-	-	-	3,971	3,971
Property and equipment		-	-	-	-	-	4,413	4,413
Other assets		-	-	-	-	-	4,957	4,957
Total assets		298,099	155,735	31,435	257,121	128,254	84,483	955,127
Due to banks	5.4	25,783	67,375				336	93,494
Deposits from customers	2.7	157,456	168,003	95,503	26,302	48	227,190	674,502
Other liabilities		-	-	-	-	-	30,771	30,771
Subordinate bonds and loan	7.0	-	45,862	-	-	-	-	45,862
Shareholders' equity		-	-	-	-	-	110,498	110,498
Total liabilities and shareholders' equity		183,239	281,240	95,503	26,302	48	368,795	955,127
On-balance sheet gap		114,860	(125,505)	(64,068)	230,819	128,206	(284,312)	
Cumulative interest sensitivity gap		114,860	(10,645)	(74,713)	156,106	284,312	-	

Notes to the financial statements

for the year ended 31 December 2007

28. Analysis of significant assets and liabilities (continued)

(b) Interest sensitivity gap (continued)

	Effective average interest rate %	Due on demand and within 30 days RO'000	Due within 1 to 6 months RO'000	Due within 7 to 12 months RO'000	Due within 1 to 5 years RO'000	Due after 5 years RO'000	Non-interest bearing RO'000	Total RO'000
31 December 2006								
Cash and cash equivalents	3.7	58,326	3,826	-	-	500	21,787	84,439
Loans and advances to banks	4.9	22,844	1,925	4,620	-	-	-	29,389
Loans and advances to customers	7.8	162,826	69,466	42,648	217,009	52,481	4,389	548,819
Financial assets at fair value through profit or loss	4.3	1,282	-	5,520	2,296	-	-	9,098
Available-for-sale investments		-	-	-	2,187	-	8,683	10,870
Intangible asset		-	-	-	-	-	3,971	3,971
Property and equipment		-	-	-	-	-	4,152	4,152
Other assets		-	-	-	-	-	4,061	4,061
Total assets		245,278	75,217	52,788	221,492	52,981	47,043	694,799
Due to banks	5.4	2,937	67,513	-	-	-	429	70,879
Deposits from customers	2.6	149,664	86,811	72,399	44,275	48	143,945	497,142
Other liabilities	7.0	-	-	-	-	-	26,135	26,135
Subordinate bonds		-	-	-	7,362	-	-	7,362
Shareholders' equity		-	-	-	-	-	93,281	93,281
Total liabilities and shareholders' equity		152,601	154,324	72,399	51,637	48	263,790	694,799
On-balance sheet gap		92,677	(79,107)	(19,611)	169,855	52,933	(216,747)	
Cumulative interest sensitivity gap		92,677	13,570	(6,041)	163,814	216,747	-	

Notes to the financial statements

for the year ended 31 December 2007 (continued)

28. Analysis of significant assets and liabilities (continued)

(c) Geographical concentrations

	Assets			Liabilities		
	Loans and Advances to banks RO'000	Gross loans and advances RO'000	Investment Securities RO'000	Deposits from customers RO'000	Deposits from banks RO'000	Contingent liabilities RO'000
31 December 2007						
Sultanate of Oman	**-**	**732,599**	**49,004**	**669,765**	**22,854**	**88,735**
Other GCC countries	**12,959**	**17,441**	**30,589**	**4,737**	**1,317**	**38,190**
Europe and North America	**14,622**	**-**	**8,180**	**-**	**67,687**	**11,478**
Africa and Asia	**1,606**	**-**	**755**	**-**	**1,636**	**29,157**
	29,187	**750,040**	**88,528**	**674,502**	**93,494**	**167,560**
31 December 2006						
Sultanate of Oman	14,700	590,385	18,780	492,753	1,768	59,310
Other GCC countries	5,072	4,331	-	4,389	4,892	30,804
Europe and North America	4,997	-	1,188	-	60,754	7,190
Africa and Asia	4,620	-	-	-	3,465	14,815
	29,389	594,716	19,968	497,142	70,879	112,119

(d) Customer concentrations

	Assets			Liabilities		
	Loans and Advances to banks RO'000	Gross loans and advances RO'000	Investment Securities RO'000	Deposits from customers RO'000	Deposits from banks RO'000	Contingent liabilities RO'000
31 December 2007						
Personal	**-**	**275,822**	**-**	**267,551**	**-**	**1,128**
Corporate	**29,187**	**438,241**	**51,013**	**281,154**	**93,494**	**166,424**
Government	**-**	**35,977**	**37,515**	**125,797**	**-**	**8**
	29,187	**750,040**	**88,528**	**674,502**	**93,494**	**167,560**
31 December 2006						
Personal	-	229,611	-	169,851	-	524
Corporate	29,389	321,288	10,870	218,470	70,879	111,036
Government	-	43,817	9,098	108,821	-	559
	29,389	594,716	19,968	497,142	70,879	112,119

28. Analysis of assets and liabilities (continued)

(e) Economic sector concentrations

	Assets	Liabilities	
	Gross loans and advances RO'000	Deposits from customers RO'000	Contingent liabilities RO'000
31 December 2007			
Personal	**275,822**	**267,551**	**1,128**
International trade	**103,699**	**24,107**	**35,990**
Construction	**46,594**	**12,891**	**58,257**
Manufacturing	**52,319**	**12,577**	**22,251**
Wholesale and retail trade	**15,565**	**2,983**	**2,793**
Communication and utilities	**35,217**	**1,323**	**5,909**
Financial services	**39,461**	**15,561**	**455**
Government	**35,977**	**125,797**	**8**
Other services	**46,537**	**58,058**	**13,417**
Others	**98,849**	**153,654**	**27,352**
	750,040	**674,502**	**167,560**
31 December 2006			
Personal	229,611	169,851	524
International trade	67,026	29,488	20,974
Construction	48,777	10,979	45,672
Manufacturing	39,349	23,992	21,786
Wholesale and retail trade	14,878	2,161	3,079
Communication and utilities	28,773	1,956	688
Financial services	31,146	18,314	422
Government	43,817	108,821	559
Other services	41,093	64,370	13,150
Others	50,246	67,210	5,265
	594,716	497,142	112,119

29. Derivative financial instruments

The Bank uses the following derivative instruments for both hedging and non-hedging purposes:

Currency forwards represent commitments to purchase foreign and domestic currency, including undelivered spot transactions. Currency swaps are commitments to exchange one set of cash flows for another. Swaps result in an economic exchange of currencies. No exchange of principal takes place, except for certain currency swaps. The Bank's credit risk represents the potential cost to replace the swap contracts if counterparties fail to perform their obligation. This risk is monitored on an ongoing basis with reference to the current fair value, a proportion of the notional amount of the contracts and the liquidity of the market. To control the level of credit risk taken, the Bank assesses counterparties using the same techniques as for its lending activities.

29. Derivative financial instruments (continued)

The notional amounts of certain types of financial instruments provide a basis for comparison with instruments recognised on the balance sheet but do not necessarily indicate the amounts of future cash flows involved or the current fair value of the instruments and, therefore, do not indicate the Bank's exposure to credit or price risks. The derivative instruments become favourable (assets) or unfavourable (liabilities) as a result of fluctuations in market interest rates or foreign exchange rates relative to their terms. The aggregate contractual or notional amount of derivative financial instruments on hand, the extent to which instruments are favourable or unfavourable, and thus the aggregate fair values of derivative financial assets and liabilities shown within other assets and other liabilities, can fluctuate significantly from time to time. The fair values of derivative instruments held are set out below:

At 31 December 2007	Contract / notional amount RO'000	Fair value increase Assets RO'000	Liabilities RO'000
Foreign exchange derivatives			
Currency forwards - purchase contracts	**62,747**	**173**	**-**
Currency forwards - sales contracts	**62,483**	**24**	**-**

At 31 December 2006	Contract / notional amount RO'000	Fair value increase/ decrease Assets RO'000	Liabilities RO'000
Foreign exchange derivatives			
Currency forwards - purchase contracts	3,589	-	77
Currency forwards - sales contracts	3,585	81	-

The following table indicates the periods in which the cash flows associated with derivatives that are expected to impact profit or loss.

	Assets		Liabilities	
	2007 RO'000	2006 RO'000	**2007 RO'000**	2006 RO'000
Carrying amount				
Expected cash flow				
Less than 6 months	**197**	4	**-**	-
6 – 12 months	**-**	-	**-**	-
Total	**197**	4	**-**	-

30. Fair value information

Based on the valuation methodology outlined below, the fair values of all on and off-balance sheet financial instruments at 31 December 2007 are considered by the Directors not to be materially different to their book values.

Estimation of fair values

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

Notes to the financial statements

for the year ended 31 December 2007

30. Fair value information (continued)

Loans and advances

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

Investments and derivatives

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

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

Bank and customer deposits

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

Other on-balance sheet financial instruments

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

Off-balance sheet financial instruments

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

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

Notes to the financial statements

for the year ended 31 December 2007 (continued)

30. Fair value information (continued)

Fair value versus carrying amounts

	2007 Carrying amount RO'000	2007 Fair value RO'000	2006 Carrying amount RO'000	2006 Fair value RO'000
Assets				
Cash and cash equivalents	**119,428**	**119,428**	84,439	84,439
Held-to-maturity investments	**71,353**	**71,353**	-	-
Loans and advances to banks	**29,187**	**29,187**	29,389	29,389
Loans and advances to customers	**704,643**	**704,643**	548,819	548,819
Financial instruments at fair value through profit or loss	**2,515**	**2,515**	9,098	9,098
Available-for-sale investments	**14,660**	**14,660**	10,870	10,870
Other assets	**4,957**	**4,957**	4,061	4,061
Liabilities				
Due to banks	**93,494**	**93,494**	70,879	70,879
Deposits from customers	**674,502**	**674,502**	497,142	497,142
Other liabilities	**30,771**	**30,771**	26,135	26,135
Subordinated bonds and loan	**45,862**	**45,862**	7,362	7,362

31. Risk Management

The important types of financial risks to which the Bank is exposed are credit risk, liquidity and market risk. The risk management division of the bank is an independent and dedicated unit reporting directly to the Risk Committee (RC) of the Board. The division's primary responsibility is to assess, monitor and recommend strategies for control of credit, market and operational risk. The absence of any direct or indirect reporting lines and permanent membership in all the bank's committees are among the factors which reflect the independence of the Risk Management Divisions working and the key role it plays within the bank.

The risk management framework is pivoted on a host of committees involving the executive management and board of directors for approval and reporting purposes. The Board has the overall authority for approval of strategies and policies, which it exercises through it's various sub-committees. The Risk Committee of the Board is responsible for reviewing and recommending to the full Board for approval all risk policies and procedures. RC also reviews the risk profile of the bank as presented to it by the RMD and appraises the full Board in it's periodic meetings.

A. Credit risk

The most important risk to which the Bank is exposed to is credit risk. To manage the level of credit risk, the Bank deals with counter-parties of good credit standing and when appropriate, obtains collateral.

Executive Committee of the Board is the final credit approving authority of the bank which is mainly responsible for approving all credit proposals beyond the authority level of the management and also for reviewing and approving credit policies. This committee is also the final authority for approving investments beyond the authority of the management. The Management Credit Committee (MCC) is the management decision making body which is empowered to consider all credit related issues upto certain limits.

31. Risk Management (continued)

Credit risk is managed by the Risk Management Division through a system of independent risk assessment in credit proposals beyond a threshold limit of OR 100,000 before they are considered by the appropriate approving authorities. The bank has in place a risk grading system for analyzing the risk associated with credit. This facilitates the approving authorities in making their credit decision. In addition RMD assists/ reviews grading of obligors, conducts regular macro analysis of the credit portfolio, and monitors credit concentration limits. Maximum counterparty/ group exposures are limited to 15% of the bank's capital base as stipulated by CBO and where a higher limit is required for projects of national importance prior CBO approval is obtained. Individual country limits using Moody's, S & P and Fitch ratings have also been set up to ensure portfolio diversification in terms of sovereign risk ratings and geographical exposure. These limits are approved by the Board. Retail lending is strictly in accordance with the CBO guidelines. The analysis of credit are given below:

Gross credit exposure

	Total Gross Exposure		Monthly average Gross Exposure	
	2007 RO'000	2006 RO'000	**2007 RO'000**	2006 RO'000
Overdrafts	**73,052**	75,278	**68,968**	68,764
Loans	**621,846**	471,091	**549,138**	442,630
Loans against trust receipts	**38,203**	33,401	**36,583**	25,887
Bills discounted	**3,224**	1,482	**2,068**	2,579
Advance against credit cards	**4,717**	4,157	**4,268**	4,136
Others	**8,998**	9,307	**10,029**	8,535
Total	**750,040**	**594,716**	**671,054**	**552,531**

Geographical distribution of exposures

	Sultanate of Oman RO'000	Gulf Council Countries RO'000	Total RO'000
31 December 2007			
Overdrafts	**73,052**	**-**	**73,052**
Loans	**604,471**	**17,375**	**621,846**
Loans against trust receipts	**38,137**	**66**	**38,203**
Bills discounted	**3,224**	**-**	**3,224**
Advance against credit cards	**4,717**	**-**	**4,717**
Others	**8,998**	**-**	**8,998**
	732,599	**17,441**	**750,040**
31 December 2006			
Overdrafts	75,278	-	75,278
Loans	466,760	4,331	471,091
Loans against trust receipts	33,401	-	33,401
Bills discounted	1,482	-	1,482
Advance against credit cards	4,157	-	4,157
Others	9,307	-	9,307
	590,385	4,331	594,716

31. Risk Management (continued)

Industry type distribution of exposures by major types of credit exposures

	Over-drafts RO'000	Loans RO'000	Bills dis-counted RO'000	Others RO'000	Total RO'000	Off balance sheet exposures RO'000
31 December 2007						
Import trade	**8,228**	**72,168**	**323**	**15,862**	**96,581**	**27,745**
Export trade	**406**	**6,688**	**-**	**24**	**7,118**	**8,245**
Wholesale/retail trade	**4,185**	**9,507**	**10**	**1,863**	**15,565**	**2,793**
Mining and quarrying	**418**	**14,173**	**91**	**200**	**14,882**	**1,954**
Construction	**10,469**	**22,411**	**-**	**13,714**	**46,594**	**58,257**
Manufacturing	**5,613**	**30,526**	**2,660**	**13,520**	**52,319**	**22,251**
Electricity, gas and water	**462**	**22,227**	**-**	**309**	**22,998**	**5,097**
Transport and communication	**1,239**	**10,980**	**-**	**-**	**12,219**	**812**
Financial institutions	**4,821**	**34,640**	**-**	**-**	**39,461**	**455**
Services	**8,836**	**35,827**	**140**	**1,734**	**46,537**	**13,417**
Personal loans	**12,154**	**258,976**	**-**	**4,692**	**275,822**	**1,128**
Agriculture and allied activities	**-**	**50**	**-**	**-**	**50**	**12**
Government	**1,656**	**34,321**	**-**	**-**	**35,977**	**8**
Non resident lending	**-**	**17,441**	**-**	**-**	**17,441**	**94**
Others	**14,565**	**51,911**	**-**	**-**	**66,476**	**25,292**
	73,052	**621,846**	**3,224**	**51,918**	**750,040**	**167,560**
31 December 2006						
Import trade	10,532	41,091	494	13,473	65,590	17,547
Export trade	270	1,166	-	-	1,436	5,120
Wholesale/retail trade	4,420	8,869	-	1,589	14,878	3,079
Mining and quarrying	236	10,715	-	305	11,256	384
Construction	10,751	24,502	-	13,524	48,777	46,061
Manufacturing	6,310	21,903	987	10,149	39,349	23,115
Electricity, gas and water	140	16,084	-	247	16,471	29
Transport and communication	311	11,566	-	425	12,302	659
Financial institutions	6,046	24,204	-	-	30,250	422
Services	12,721	25,402	-	2,970	41,093	13,612
Personal loans	19,862	205,620	-	4,129	229,611	524
Agriculture and allied activities	2	52	-	-	54	5
Government	2,086	41,731	-	-	43,817	559
Non resident lending	-	4,331	-	-	4,331	-
Others	1,591	33,855	1	54	35,501	1,003
	75,278	471,091	1,482	46,865	594,716	112,119

31. Risk Management (continued)

Residual contractual maturities of the portfolio by major types of credit exposures

	Over-drafts RO'000	Loans RO'000	Bills discounted RO'000	Others RO'000	Total RO'000	Off balance sheet exposures RO'000
31 December 2007						
Upto 1 month	**3,653**	**84,210**	**3,115**	**47,871**	**138,849**	**636**
1 - 3 months	**3,653**	**34,208**	**-**	**1,047**	**38,908**	**34,842**
3 - 6 months	**3,653**	**50,151**	**-**	**216**	**54,020**	**30,540**
6 - 9 months	**3,653**	**22,763**	**-**	**7**	**26,423**	**11,975**
9 - 12 months	**3,653**	**19,915**	**-**	**99**	**23,667**	**13,563**
1 - 3 years	**18,262**	**143,485**	**109**	**383**	**162,239**	**52,566**
3 – 5 years	**18,262**	**107,534**	**-**	**73**	**125,869**	**13,724**
Over 5 years	**18,263**	**159,580**	**-**	**2,222**	**180,065**	**9,714**
	73,052	**621,846**	**3,224**	**51,918**	**750,040**	**167,560**
31 December 2006						
Upto 1 month	3,764	46,944	1,199	43,796	95,703	426
1 - 3 months	3,764	41,307	-	766	45,837	23,314
3 - 6 months	3,764	27,137	173	84	31,158	20,435
6 - 9 months	3,763	21,189	-	-	24,952	8,013
9 - 12 months	3,763	21,460	-	-	25,223	9,075
1 - 3 years	18,820	113,051	110	80	132,061	35,173
3 – 5 years	18,820	114,905	-	334	134,059	9,183
Over 5 years	18,820	85,098	-	1,805	105,723	6,500
	75,278	471,091	1,482	46,865	594,716	112,119

31. Risk Management (continued)

Distribution of impaired loans and past due loans by type of Industry

	Performing loans RO'000	Non performing loans RO'000	General provisions held RO'000	Specific provisions held RO'000	Interest reserve RO'000	Provision made during the year RO'000	Advances written off during the year RO'000
31 December 2007							
Import trade	**85,756**	**10,824**	**858**	**5,124**	**5,074**	**283**	**1,231**
Export trade	**7,077**	**42**	**71**	**33**	**9**	**22**	**-**
Wholesale/retail trade	**6,469**	**9,096**	**65**	**4,919**	**4,178**	**40**	**5**
Mining and quarrying	**14,882**	**-**	**149**	**-**	**-**	**47**	**-**
Construction	**44,352**	**2,242**	**444**	**1,415**	**718**	**142**	**342**
Manufacturing	**51,274**	**1,045**	**513**	**722**	**312**	**252**	**290**
Electricity, gas and water	**22,998**	**-**	**230**	**-**	**-**	**72**	**-**
Transport and communication	**12,193**	**26**	**122**	**7**	**2**	**38**	**-**
Financial institutions	**39,461**	**-**	**303**	**-**	**-**	**123**	**-**
Services	**42,670**	**3,867**	**427**	**2,126**	**1,671**	**179**	**147**
Personal loans	**266,572**	**9,250**	**5,741**	**4,264**	**4,597**	**1,801**	**79**
Agriculture and allied activities	**50**	**-**	**1**	**-**	**-**	**1**	**-**
Government	**35,977**	**-**	**360**	**-**	**-**	**-**	**-**
Non resident lending	**17,441**	**-**	**174**	**-**	**-**	**54**	**-**
Others	**66,459**	**17**	**751**	**5**	**12**	**209**	**-**
	713,631	**36,409**	**10,209**	**18,615**	**16,573**	**3,263**	**2,094**
31 December 2006							
Import trade	53,335	12,255	533	5,999	5,611	206	-
Export trade	1,395	41	14	36	5	16	-
Wholesale/retail trade	6,522	8,356	65	4,925	3,431	30	-
Mining and quarrying	11,256	-	113	-	-	-	-
Construction	46,088	2,689	461	1,661	918	1,110	14
Manufacturing	35,290	4,059	353	1,756	743	389	-
Electricity, gas and water	16,471	-	165	-	-	-	-
Transport and communication	12,276	26	123	7	2	6	-
Financial institutions	30,250	-	303	-	-	-	-
Services	36,762	4,331	368	2,259	1,746	9	-
Personal loans	220,107	9,504	4330	5,006	4,261	752	47
Agriculture and allied activities	54	-	1	-	-		-
Government	43,817	-	21	-	-	-	-
Non resident lending	4,331	-	43	-	-	-	-
Others	35,486	15	623	5	10	128	4
	553,440	41,276	7,516	21,654	16,727	2,646	65

31. Risk Management (continued)

Distribution of impaired loans and past due loans by geographical distribution

	Gross loans RO'000	Non performing loans RO'000	General provisions held RO'000	Specific provisions held RO'000	Interest reserve RO'000	Provision made during the year RO'000	Advances written off during the year RO'000
31 December 2007							
Sultanate of Oman	**732,599**	**36,409**	**10,035**	**18,615**	**16,573**	**3,089**	**2,094**
Gulf Council Countries	**17,441**	**-**	**174**	**-**	**-**	**174**	**-**
	750,040	**36,409**	**10,209**	**18,615**	**16,573**	**3,263**	**2,094**
31 December 2006							
Sultanate of Oman	590,385	41,276	7,473	21,654	16,727	2,603	65
Gulf Council Countries	4,331	-	43	-	-	43	-
	594,716	41,276	7,516	21,654	16,727	2,646	65

Maximum exposure to credit risk without consideration of collateral held

	2007 RO' 000	2006 RO' 000
On-Balance sheet items		
Certificate of Deposit	**100,000**	55,000
Treasury bills	**36,353**	7,653
Loans and advances to banks	**29,187**	29,387
Loans and advances to customers	**704,643**	548,819
Government Development Bonds	**2,515**	9,098
	872,698	649,957
Off-Balance sheet items		
Financial Guarantees	**103,549**	60,963
	976,247	710,920

B. Liquidity risk

Liquidity risk arises in the general funding of the Bank's activities and in the management of its positions. It includes both the risk of being unable to fund assets at appropriate maturities and rates and the risk of being unable to liquidate an asset at a reasonable price and in an appropriate time frame.

The Bank's Liquidity Risk Management is governed by the Treasury Risk Policy document approved by the Board of Directors as well as the provisions of relevant CBO guidelines on liquidity risk management. The Treasury policy also incorporates contingency plans and measures for the Bank so as to be always in a position to meet all its maturing liabilities as well as to fund asset growth and business operations. The contingency plan includes effective monitoring of the cash flows on a day-to-day basis, holding of tradable high quality liquid assets, which may be readily disposed off in sizeable amount etc.

31. Risk Management (continued)

The Bank monitors it's liquidity risk through internally generated Maturities of Assets and Liabilities (MAL) report which captures all the maturing assets and liabilities into various pre-set time buckets ranging from overnight to five years. The Treasury department of the Bank controls and monitors the liquidity risk and ensures that the Bank is not exposed to undue liquidity risk and at the same time make optimum use of its funds. In this, the Bank strictly adheres to the CBO set limit of 15% of cumulative liabilities (outflows) on mismatches in time buckets upto one year. In addition, the Bank sets internal limit on mismatches in time buckets beyond one year which are approved by ALCO. The Bank has in place adequate lines of credit from both local and international banks to meet any unforeseen liquidity requirements.

C. Market risk

Market risk includes currency risk, interest rate risk and price risk.

C.1 Currency risk

The Bank is exposed to currency risk through its transactions in foreign currencies. The major foreign currency to which the Bank is exposed is the US Dollar. The currency in which the Bank presents its financial statements is Rial Omani, the Bank's financial statements are affected by movements in the exchange rates between U.S Dollar and the Rial Omani. The Bank finances a significant portion of its financial assets in the same currencies as the relevant measurement currencies to mitigate its foreign currency risk.

The Bank's transactional exposures give rise to foreign currency gains and losses that are recognised in the income statement. The Bank ensures that its net exposure is kept to an acceptable level by buying and selling foreign currencies at spot rates when considered appropriate. Foreign exchange risk is computed on the average of the sum of net short positions or net long positions, whichever is higher of the foreign currency positions held by the bank. The foreign currency exposure are given below:

Foreign currency exposures

	2007 RO'000	2006 RO'000
Net assets denominated in US Dollars	**20,558**	3,624
Net assets denominated in other foreign currencies	**3,146**	497
	23,704	4,121

C.2 Interest rate risk

The Bank's operations are subject to the risk of interest rate fluctuations to the extent that interest-earning assets and interest-bearing liabilities mature at different times or in different amounts. Risk management activities are aimed at optimising net interest income, given market interest rate levels, consistent with the Bank's business strategies. The Bank manages mismatches by following policy guidelines and reduces risk by matching the repricing of assets and liabilities. Details relating to re-pricing mismatches and the interest rate risk thereon are placed to the ALCO in its regular meetings and also to the Risk Committee of the Board. Impact on earnings of interest rate risk in the banking book is as follows:

Impact on earnings of interest rate risk in the banking book

	+ or – 1%		+ or – 2%	
	2007 RO'000	2006 RO'000	**2007 RO'000**	2006 RO'000
Omani Riyals	**2,342**	1,975	**4,685**	3,949
US Dollars	**1,169**	786	**2,339**	1,572
Others currencies	**90**	36	**180**	71
Total	**3,601**	2,797	**7,204**	5,592

31. Risk Management (continued)

C.3 Price risks

The Bank is exposed to equity price risks arising from equity investments. Equity investments are held for strategic rather than trading purposes. The Bank does not actively trade these investments.

Equity price sensitivity analysis

The sensitivity analyses below have been determined based on the exposure to equity price risks at the reporting date.

If equity prices had been 5% higher/lower:

Net profit for the year ended 31 December 2007 would have been unaffected as the equity investments are classified as available-for-sale and no investments were impaired; and investment revaluation reserve would increase / decrease by RO 732,983 (2006: increase/decrease by RO 543,521 for the Bank as a result of the changes in fair value of available-for-sale shares.

The Bank's sensitivity to equity prices has not changed significantly from the prior year.

D. Operational Risk:

The Bank has adopted the Basic Indicator Approach under Basel II for purposes of measuring the capital charge for Operational Risk. The approach requires the Bank to provide 15% of the average three years gross annual income as capital charge for operational risk.

E. Capital risk management

The Bank manages its capital to ensure that it will be able to continue as a going concern while maximising the return to shareholders through the optimisation of the debt and equity balance. The Bank's overall strategy remains unchanged from 2006.

The capital of the Bank consists of debt, which includes borrowings disclosed in note 15 and equity attributable to shareholders of the Bank comprising issued capital, share premium, reserves and retained earnings as disclosed in notes 16 and 17.

32. Segmental information

The Bank is organised into three main business segments:

1) Retail banking – incorporating, private customer current accounts, savings, deposits, investment savings products, custody, credit and debit cards, consumer loans and mortgages;
2) Corporate banking – incorporating direct debit facilities, current accounts, deposits, overdrafts, loan and other credit facilities, foreign currency and derivative products; and
3) Treasury and investments

Other operations comprise investment management and institutional finance neither of which constitutes a separately reportable segment.

Transactions between the business segments are on normal commercial terms and conditions. Funds are ordinarily allocated between segments, resulting in funding cost transfers disclosed in operating income. Interest charged for these funds is based on the Bank's cost of capital. There are no other material items of income or expense between the business segments.

32. Segmental information (continued)

Segment assets and liabilities comprise operating assets and liabilities, being the majority of the balance sheet, but exclude items such as taxation and borrowings.

Internal charges and transfer pricing adjustments have been reflected in the performance of each business. Revenue sharing agreements are used to allocate external customer revenues to a business segment on a reasonable basis.

At 31 December 2007	**Retail banking RO'000**	**Corporate banking RO'000**	**Treasury and Investments RO'000**	**Total RO'000**
Interest revenues	**21,080**	**25,692**	**4,838**	**51,610**
Segment Operating Income	**20,458**	**17,020**	**6,562**	**44,040**
Segment assets	**280,827**	**469,213**	**182,715**	**932,755**
Less: Impairment allowance				**(45,397)**
				887,358
Unallocated assets				**67,769**
Total assets				**955,127**
Segment liabilities	**277,730**	**396,772**	**131,994**	**806,496**
Unallocated liabilities				**38,133**
Total liabilities				**844,629**

At 31 December 2006	**Retail banking RO'000**	**Corporate banking RO'000**	**Treasury and Investments RO'000**	**Total RO'000**
Interest revenues	19,507	18,788	3,992	42,287
Segment Operating Income	17,237	11,941	5,742	34,920
Segment assets	228,370	366,346	112,010	706,726
Less: Impairment allowance				(45,897)
				660,829
Unallocated assets				33,970
Total assets				694,799
Segment liabilities	167,020	330,122	70,879	568,021
Unallocated liabilities				33,497
Total liabilities				601,518

Notes to the financial statements
for the year ended 31 December 2007

33. Use of estimates

(a) Impairment losses on loans and advances

The Bank reviews its loan portfolio to assess impairment at least on a quarterly basis. In determining whether an impairment loss should be recorded in the income statement, management makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans and advances before the decrease can be identified with an individual receivable in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

(b) Impairment of available-for-sale equity instruments

The Bank determines that available-for-sale equity investments are impaired when there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgement. In making this judgement, management evaluates among other factors, the normal volatility in share price. In addition, impairment may be appropriate when there is evidence of deterioration in the financial health of the investee, industry and sector performance, changes in technology and operational and financing cash flows.

34. Proposed dividend

The Board of Directors in their meeting held on 28 January 2008 proposed a cash dividend of 25% for the year ended 31 December 2007 amounting to RO 13.27 million (2006 - RO 6.9 million). A resolution to approve these dividends will be presented to the shareholders at the Annual General Meeting.

During the year, unclaimed dividend amounting to RO 7,170 (2006 - RO 2,717) was transferred to the Investor's Trust Fund account as per the guidelines issued by the Capital Market Authority of Oman.

35. Approval of financial statements

The financial statements were approved by the Board of Directors and authorized for issue on 28 January 2008.

36. Comparative figures

Certain amounts of the prior year financial statement have been reclassified to conform with the current year's presentation.