

BANK MUSCAT SAOG

CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010

Registered office and principal place of business:

Bank Muscat Building
Bank Al Markazi Street
Post Box 134, Ruwi 112
Sultanate of Oman

BANK MUSCAT SAOG

**CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED AT 31 DECEMBER 2010**

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BANK MUSCAT SAOG

CONSOLIDATED STATEMENT OF FINANCIAL POSITION
FOR THE YEAR ENDED 31 DECEMBER 2010

2009 USD'000	2010 USD'000		Notes	2010 RO'000	2009 RO'000
ASSETS					
1,579,478	1,885,857	Cash and balances with Central Banks	5	726,055	608,099
2,638,158	1,429,478	Placements with banks	6	550,349	1,015,691
9,969,379	10,410,197	Loans and advances	7	4,007,926	3,838,211
392,003	441,730	Other assets	8	170,066	150,921
Investment securities:					
311,831	615,857	- Available-for-sale	9	237,105	120,055
63,145	77,719	- Held to maturity	9	29,922	24,311
174,473	142,641	Investment in associates	11	54,917	67,172
68,249	194,255	Property and equipment	12	74,788	26,276
<u>15,196,716</u>	<u>15,197,734</u>			<u>5,851,128</u>	<u>5,850,736</u>
LIABILITIES AND EQUITY					
LIABILITIES					
3,625,317	1,973,730	Deposits from banks	14	759,886	1,395,747
7,969,935	9,160,917	Customers' deposits	15	3,526,953	3,068,425
361,557	401,558	Certificates of deposit	16	154,600	139,200
142,345	142,345	Unsecured bonds	17	54,803	54,803
40,000	40,000	Floating rate notes	18	15,400	15,400
638,356	850,518	Other liabilities	13,20	327,450	245,767
82,021	83,486	Taxation	21	32,142	31,578
489,610	476,623	Subordinated liabilities	22	183,500	188,500
<u>13,349,141</u>	<u>13,129,177</u>			<u>5,054,734</u>	<u>5,139,420</u>
EQUITY					
Capital and reserves attributable to equity holders of the parent company					
279,774	349,717	Share capital	23	134,641	107,713
783,130	783,130	Share premium		301,505	301,505
83,933	83,933	Mandatory convertible bonds	19	32,314	32,314
146,255	159,242	General reserve	24	61,308	56,308
93,260	116,574	Legal reserve	24	44,881	35,905
10,278	10,278	Revaluation reserve	12	3,957	3,957
125,714	208,052	Subordinated loan reserve	25	80,100	48,400
12,527	24,260	Cumulative changes in fair value		9,340	4,823
(2,296)	(1,307)	Foreign currency translation reserve		(503)	(884)
314,450	333,987	Retained profit		128,585	121,063
1,847,025	2,067,866			796,128	711,104
550	691	Non-controlling interests in equity	10	266	212
<u>1,847,575</u>	<u>2,068,557</u>	TOTAL EQUITY		<u>796,394</u>	<u>711,316</u>
<u>15,196,716</u>	<u>15,197,734</u>	TOTAL LIABILITIES AND EQUITY		<u>5,851,128</u>	<u>5,850,736</u>
USD <u>1,715</u>	USD <u>1,536</u>	Net assets per share	27	RO 0,591	RO <u>0,660</u>
<u>2,497,109</u>	<u>3,224,714</u>	Contingent liabilities and commitments	28	<u>1,241,515</u>	<u>961,387</u>

The consolidated financial statements on pages 2 to 72 were approved and authorised for issue by the Board of Directors on and signed on their behalf by:

Chairman

Director

Chief Executive

Report of the Auditors - page 1

BANK MUSCAT SAOG

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2010

2009 USD'000	2010 US D'000		Notes	2010 RO'000	2009 RO'000
726,052	714,792	Interest income	29	275,195	279,530
(273,153)	(228,571)	Interest expense	30	(88,000)	(105,164)
452,899	486,221	Net interest income		187,195	174,366
129,379	135,416	Commission and fees income (net)	31	52,135	49,811
<u>173,683</u>	<u>67,964</u>	Other operating income	32	<u>26,166</u>	<u>66,868</u>
<u>755,961</u>	<u>689,601</u>	OPERATING INCOME		<u>265,496</u>	<u>291,045</u>
		OPERATING EXPENSES			
(196,112)	(244,543)	Other operating expenses	33	(94,149)	(75,503)
(17,200)	(22,738)	Depreciation	12	(8,754)	(6,622)
(213,312)	(267,281)			(102,903)	(82,125)
-	(5,455)	Provision for impairment of placements	6	(2,100)	-
(255,174)	(121,010)	Impairment for credit losses	7	(46,589)	(98,242)
27,504	35,449	Recoveries from provision for credit losses	7	13,648	10,589
(7,636)	(1,706)	Impairment for investments	9	(657)	(2,940)
		Recoveries from impairment for investments	9	137	425
1,104	356	Recoveries from impairment for placements	6	3,405	-
-	8,844				
(52,766)	-	Impairment for associate	11	-	(20,315)
(27,156)	(32,823)	Share of loss from associates	11	(12,637)	(10,455)
(527,436)	(383,626)	OPERATING EXPENSES		(147,696)	(203,063)
228,525	305,975	PROFIT BEFORE TAXATION		117,800	87,982
(37,049)	(42,091)	Tax expense	21	(16,205)	(14,264)
<u>191,476</u>	<u>263,884</u>	PROFIT FOR THE YEAR		<u>101,595</u>	<u>73,718</u>
		OTHER COMPREHENSIVE INCOME			
(2,701)	990	Gain/(loss) from foreign currency translation of investments in associates	11	381	(1,040)
25,005	-	Transfer from foreign currency reserve on derecognition of associate	11	-	9,627
(167,410)	11,732	Change in fair value of investments available-for-sale	21	4,517	(64,453)
(145,106)	12,722	OTHER COMPREHENSIVE INCOME FOR THE YEAR	21	4,898	(55,866)
<u>46,370</u>	<u>276,606</u>	TOTAL COMPREHENSIVE INCOME FOR THE YEAR		<u>106,493</u>	<u>17,852</u>

(continued on page 4)

The notes on pages 8 to 72 form an integral part of these consolidated financial statements.

Report of the Auditors - page 1

BANK MUSCAT SAOG

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2010

	Notes	Share capital RO'000	Share premium RO'000	Mandatory convertible bonds RO'000	General reserve RO'000	Legal reserve RO'000	Revaluation reserve RO'000	Subordinated loan reserve RO'000	Cumulative changes in fair value RO'000	Foreign exchange translation reserve RO'000	Retained profit RO'000	Total before NCI RO'000	Non-Controlling Interest RO'000	Total RO'000
2010														
Balance at 31 December 2009		107,713	301,505	32,314	56,308	35,905	3,957	48,400	4,823	(884)	121,063	711,104	212	711,316
Comprehensive income														
Profit for the year		-	-	-	-	-	-	-	-	-	101,669	101,669	(74)	101,595
Other comprehensive income														
Loss on translation of net investment in associates	11	-	-	-	-	-	-	-	-	381	-	381	-	381
Change in fair value of investment available-for-sale	9	-	-	-	-	-	-	-	4,517	-	-	4,517	-	4,517
Total comprehensive income		-	-	-	-	-	-	-	4,517	381	101,669	106,567	(74)	106,493
Transactions with owners														
Dividends paid - 2009	26	-	-	-	-	-	-	-	-	-	(21,543)	(21,543)	-	(21,543)
Issue of bonus shares 2009	26	26,928	-	-	-	-	-	-	-	-	(26,928)	-	-	-
Transfer to legal reserve	24	-	-	-	-	8,976	-	-	-	-	(8,976)	-	-	-
Transfer from subordinated loan reserve	25	-	-	-	5,000	-	-	(5,000)	-	-	-	-	-	-
Transfer to subordinated loan reserve	25	-	-	-	-	-	-	36,700	-	-	(36,700)	-	-	-
Total contributions by and distributions to owners		26,928	-	-	5,000	8,976	-	31,700	-	-	(94,147)	(21,543)	-	(21,543)
Non-controlling interest		-	-	-	-	-	-	-	-	-	-	-	128	128
Total transactions with owners		26,928	-	-	5,000	8,976	-	31,700	-	-	(94,147)	(21,543)	128	(21,415)
Balance at 31 December 2010		<u>134,641</u>	<u>301,505</u>	<u>32,314</u>	<u>61,308</u>	<u>44,881</u>	<u>3,957</u>	<u>80,100</u>	<u>9,340</u>	<u>(503)</u>	<u>128,585</u>	<u>796,128</u>	<u>266</u>	<u>796,394</u>
Balance at 31 December 2010 (USD'000)		<u>349,717</u>	<u>783,130</u>	<u>83,933</u>	<u>159,242</u>	<u>116,574</u>	<u>10,278</u>	<u>208,052</u>	<u>24,260</u>	<u>(1,307)</u>	<u>333,987</u>	<u>2,067,866</u>	<u>691</u>	<u>2,068,557</u>

(Continued on page 6)

The notes on pages 8 to 72 form an integral part of these consolidated financial statements.
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BANK MUSCAT SAOG

STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)

	Notes	Share capital RO'000	Share premium RO'000	Mandatory convertible bonds RO'000	General reserve RO'000	Legal Reserve RO'000	Revaluation reserve RO'000	Sub-ordinated loan reserve RO'000	Cumulative changes in fair value RO'000	Foreign exchange translation reserve RO'000	Retained earnings RO'000	Total Before NCI RO'000	Non Controlling Interest RO'000	Total RO'000
2009														
Balance at 31 December 2008		107,713	301,505	-	56,308	35,905	3,957	24,200	69,276	(9,471)	125,357	714,750	-	714,750
Comprehensive income														
Profit for the year		-	-	-	-	-	-	-	-	-	73,763	73,763	(45)	73,718
Other comprehensive income														
Loss on translation of net investment in associates	11	-	-	-	-	-	-	-	-	(1,040)	-	(1,040)	-	(1,040)
Transfer to comprehensive income statement on derecognition of associate		-	-	-	-	-	-	-	-	9,627	-	9,627	-	9,627
Change in fair value of investments available-for-sale	9	-	-	-	-	-	-	-	(64,453)	-	-	(64,453)	-	(64,453)
Total comprehensive income		-	-	-	-	-	-	-	(64,453)	8,587	73,763	17,897	(45)	17,852
Transactions with owners														
Dividends paid - 2008		-	-	-	-	-	-	-	-	-	(21,543)	(21,543)	-	(21,543)
Issue of convertible bonds	19	-	-	32,314	-	-	-	-	-	-	(32,314)	-	-	-
Transfer to subordinated loan reserve	25	-	-	-	-	-	-	24,200	-	-	(24,200)	-	-	-
Total contributions by and distributions to owners		-	-	32,314	-	-	-	24,200	-	-	(78,057)	(21,543)	-	(21,543)
Non-controlling interest		-	-	-	-	-	-	-	-	-	-	-	257	257
Total transactions with owners		-	-	32,314	-	-	-	24,200	-	-	(78,057)	(21,543)	257	(21,286)
Balance at 31 December 2009		107,713	301,505	32,314	56,308	35,905	3,957	48,400	4,823	(884)	121,063	711,104	212	711,316
Balance at 31 December 2009 (USD'000)		279,774	783,130	83,933	146,255	93,260	10,278	125,714	12,527	(2,296)	314,450	1,847,025	550	1,847,575

The notes on pages 8 to 72 form an integral part of these consolidated financial statements.

Report of the Auditors - page 1

BANK MUSCAT SAOG**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010****1 LEGAL STATUS AND PRINCIPAL ACTIVITIES**

Bank Muscat SAOG (the Bank or the Parent Company) is a joint stock company incorporated in the Sultanate of Oman and is engaged in commercial and investment banking activities through a network of a hundred and twenty seven branches within the Sultanate of Oman and one branch in Riyadh, Kingdom of Saudi Arabia and one in Kuwait. The Bank has a representative office in Dubai, United Arab Emirates. The Bank (Parent Company) has a 95% owned subsidiary in Riyadh, Kingdom of Saudi Arabia. The Bank operates in Oman under a banking licence issued by the Central Bank of Oman and is covered by its deposit insurance scheme. The Bank has its primary listing on the Muscat Securities Market.

The Bank and its subsidiary (together, the Group) operate in three countries (2009 - three countries) and employed 2,709 employees as of 31 December 2010 (2009: 2,579).

2 BASIS OF PREPARATION**2.1 Statement of compliance**

The consolidated 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 of the Sultanate of Oman.

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements as disclosed in note 4.

These consolidated financial statements were approved by the Board of Directors on 26 January 2011.

2.2 Basis of preparation

The consolidated financial statements have been prepared on the historical cost basis, modified to include the revaluation of freehold land and buildings and the measurement at fair value of derivative financial instruments and available-for-sale investment securities.

The consolidated statement of financial position is presented in descending order of liquidity as this presentation is more appropriate to the Group's operations.

2.3 Functional and presentation currency

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

BANK MUSCAT SAOG**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)****2 BASIS OF PREPARATION (continued)****2.4 (a) Standards, amendments and interpretations effective in 2010 and relevant for the Group's operations**

For the year ended 31 December 2010, the Group has adopted all of the new and revised standards and interpretations issued by the International Accounting Standards Board (IASB) and the International Financial Reporting Interpretations Committee (IFRIC) of the IASB that are relevant to its operations and effective for periods beginning on 1 January 2010.

The adoption of these standards and interpretations has not resulted in changes to the Group's accounting policies and has not affected the amounts reported for the current or prior periods.

2.4 (b) Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Group:

The following standards and amendments to existing standards have been published and are mandatory for the Group's accounting periods beginning on or after 1 January 2010 or later periods, but the Group has not early adopted them:

IFRS 7, 'Financial Instruments' (effective from 1 January 2011);
IFRS 9, 'Financial instruments part 1: Classification and measurement' (effective on or after 1 January 2013);
IAS 1 (amendment), 'Presentation of financial statements' (effective from 1 January 2011);
IAS 24 (revised), 'Related party disclosures' (effective from on or after 1 January 2011);
IAS 32 (Amendment), 'Classification of rights issues' (effective from 1 February 2010);
IFRIC 14 (Amendment), 'Prepayments of a minimum funding requirement' (effective from 1 January 2011); and
IFRIC 19, 'Extinguishing financial liabilities with equity instruments' (effective from 1 July 2011).

2.5 Consolidation**(a) Subsidiaries**

Subsidiaries are all entities (including special purpose entities) over which the Group has the power to govern the financial and operating policies, generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases. The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the statement of comprehensive income.

Inter-company transactions, balances and unrealised gains on transactions between Group companies are eliminated. Unrealised losses are also eliminated. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

BANK MUSCAT SAOG**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)****2 BASIS OF PREPARATION (continued)****2.5 Consolidation (continued)****(b) Transactions and non-controlling interests**

The Group treats transactions with non-controlling interests as transactions with equity owners of the group. For purchases from non-controlling interests, the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary is recorded in equity. Gains or losses on disposals to non-controlling interests are also recorded in equity.

When the Group ceases to have control or significant influence, any retained interest in the entity is remeasured to its fair value, with the change in carrying amount recognised in profit or loss. The fair value is the initial carrying amount for the purposes of subsequently accounting for the retained interest as an associate, joint venture or financial asset. In addition, any amounts previously recognised in other comprehensive income in respect of that entity are accounted for as if the group had directly disposed of the related assets or liabilities. This may mean that amounts previously recognised in other comprehensive income are reclassified to profit or loss.

If the ownership interest in an associate is reduced but significant influence is retained, only a proportionate share of the amounts previously recognised in other comprehensive income are reclassified to profit or loss where appropriate.

(c) Associates

Associates are those entities in which the Parent Company has significant influence, but not control, over the financial and operating policies. Associates are accounted for using the equity method (equity accounted investees). Under the equity method, the investment in the associate is carried in the statement of financial position at cost plus post acquisition changes in the Parent Company's share of net assets of the associate. Goodwill relating to the associate is included in the carrying amount of the investment and is not amortised or separately tested for impairment.

The financial statements include the Parent Company's share of the net profit or loss of equity accounted investees, after adjustments to align the accounting policies with those of the Parent Company, from the date that significant influence commences until the date that significant influence ceases. When the Parent Company's share of losses exceeds its interest in an equity accounted investee, the carrying amount of that interest (including any long term investment) is reduced to nil and recognition of further losses is discontinued except to the extent that the Parent Company has an obligation or has made payments on behalf of the associate.

After application of equity method, the Parent Company determines whether it is necessary to recognise an additional impairment loss on the Parent Company's investment in its associates. The Parent Company determines at each reporting date whether there is any objective evidence that the investment in the associate is impaired. If this is the case, the Parent Company calculates the amount of impairment as the difference between the recoverable amount of the investment in associate and its carrying value and charges the amount in the statement of comprehensive income.

3 SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently by the Group to all periods presented in these financial statements.

3.1 Foreign currency translation

(i) Transactions in foreign currencies are translated into Rial Omani at exchange rates ruling at the value dates of the transactions.

BANK MUSCAT SAOG**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)****3 SIGNIFICANT ACCOUNTING POLICIES (continued)****3.1 Foreign currency translation (continued)**

(ii) Monetary assets and liabilities denominated in foreign currencies are translated into Rial Omani at exchange rates ruling at the reporting date. The foreign currency gain or loss on monetary items is the difference between amortised costs in the Rial Omani at the beginning of the period, adjusted for effective interest and payments during the period and the amortised costs in foreign currency translated at the exchange rate at the end of the period. 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, except when deferred in other comprehensive income as qualifying cash flow hedges and qualifying net investment hedges.

(iii) Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are translated to Rial Omani at the exchange rate at the date that the fair value was determined. Translation differences on non-monetary financial assets and liabilities such as equities held at fair value through profit or loss are recognised in profit or loss as part of the fair value gain or loss. Translation differences on non-monetary financial assets, such as equities classified as available-for-sale, are included in other comprehensive income.

(iv) The financial statements of the overseas branches are translated into Rial Omani for aggregation purposes at the exchange rates ruling at the reporting date. Any translation differences arising from the application of exchange rates ruling at the reporting date to the opening net assets of the overseas branches are taken directly to equity.

(v) Net investment in associates, are translated into Rial Omani at the exchange rates ruling at the reporting date. Any translation differences arising from the application of exchange rates ruling at the reporting date are taken directly to equity.

3.2 Revenue and expense recognition**3.2.1 Interest**

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

Interest income and expense presented in the statement of comprehensive income include:

- Interest on financial assets and liabilities at amortised cost on an effective interest rate basis;
- Interest on available-for-sale investment securities on an effective interest basis;

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

3.2.2 Fees and commission

Fees and commission income and expenses that are integral to the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate. Other fees and commission income, including service charges, advisory fees, processing fees, syndication fees and others are recognised when they are due.

3.2.3 Dividends

Dividend income is recognised in the consolidated statement of comprehensive income in 'Other operating income', when the Group's right to receive income is established.

3.2.4 Provisions

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

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)****3 SIGNIFICANT ACCOUNTING POLICIES (continued)****3.3 Financial assets and liabilities****3.3.1 Classification**

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

(a) Financial assets at fair value through profit or loss

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

(b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

When the Group is the lessor in a lease agreement that transfers substantially all of the risks and rewards incidental to ownership of an asset to the lessee, the arrangement is presented within loans and advances.

Loans and receivables are initially recognised at fair value – which is the cash consideration to originate or purchase the loan including any transaction costs – and measured subsequently at amortised cost using the effective interest rate method. Loans and receivables are reported in the consolidated statement of financial position as loans and advances to banks or customers. Interest on loans is included in the consolidated income statement and is reported as ‘Interest income’. In the case of an impairment, the impairment loss is reported as a deduction from the carrying value of the loan and recognised in the consolidated income statement as ‘Impairment for credit losses’.

(c) Held to maturity

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

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

Interest on held to maturity investments is included in the consolidated income statement and reported as ‘Interest income’. In the case of impairment, the impairment loss is been reported as a deduction from the carrying value of the investment and recognised in the consolidated income statement as ‘Impairment for investments’. Held to maturity investments are corporate bonds.

(d) Available-for-sale financial assets

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

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

BANK MUSCAT SAOG

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)**3 SIGNIFICANT ACCOUNTING POLICIES (continued)****3.3 Financial assets and liabilities (continued)****3.3.1 Classification****(d) Available-for-sale financial assets**

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

3.3.2 Derivative financial instruments and hedging activities

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently remeasured at their fair value. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The Group designates certain derivatives as either:

- (i) hedges of the fair value of recognised assets or liabilities or a firm commitment (fair value hedge);
- (ii) hedges of a particular risk associated with a recognised asset or liability or a highly probable forecast transaction (cash flow hedge); or
- (iii) hedges of a net investment in a foreign operation (net investment hedge).

The Group documents at the inception of the transaction the relationship between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking various hedging transactions. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

3.3.3 Recognition

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

3.3.4 Derecognition

The Group derecognises a financial asset when the contractual rights to receive the cash flows from the asset expire or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the Group is recognised as a separate asset or liability.

The Group derecognises a financial liability when its contractual obligations are discharged or cancelled or expire.

3.3.5 Offsetting

Financial assets and financial liabilities are only offset and the net amount reported in the statement of financial position when there is a legally enforceable right to set off the recognised amounts and the Group intends to either settle on a net basis or to realize the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis only when permitted by the accounting standards or for gains and losses arising from a Group of similar transactions.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)****3 SIGNIFICANT ACCOUNTING POLICIES (continued)****3.3 Financial assets and liabilities (continued)****3.3.6 Amortised cost measurement**

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

3.3.7 Fair value measurement

A number of the Group's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on a number of accounting policies and methods. Where applicable, information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability. Refer also to note 43.

3.3.8 Investment in equity and debt securities

For investments traded in organised financial markets, fair value is determined by reference to Stock Exchange quoted market prices at the close of business on the reporting date.

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

For unquoted equity investments fair value is determined by reference to the market value of a similar investment or is based on the expected discounted cash flows.

3.3.9 Fair value measurement of financial assets

The fair value of forward contracts is estimated based on observable market inputs for such contracts as on the reporting date.

The fair value of interest rate swaps is arrived at by discounting estimated future cash flows based on the terms and maturity of each contract and using market interest rates for a similar instrument at the measurement date.

3.3.10 Derivatives at fair value through profit or loss

Certain derivative instruments do not qualify for hedge accounting. Changes in the fair value of any these derivative instruments are recognised immediately in the statement of comprehensive income within 'Other operating income'.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)****3 SIGNIFICANT ACCOUNTING POLICIES (continued)****3.4 Identification and measurement of impairment of financial assets****(a) Assets carried at amortised cost**

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

- significant financial difficulty of the issuer or obligor;
- a breach of contract, such as a default or delinquency in interest or principal payments;
- the Group granting to the borrower, for economic or legal reasons relating to the borrower's financial difficulty, a concession that the lender would not otherwise consider;
- it becoming probable that the borrower will enter bankruptcy or other financial reorganisation;
- the disappearance of an active market for that financial asset because of financial difficulties; or
- observable data indicating that there is a measurable decrease in the estimated future cash flows from a Group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the 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 Group 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 Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a Group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

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

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

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

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

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

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)**3 SIGNIFICANT ACCOUNTING POLICIES (continued)****3.4 Identification and measurement of impairment of financial assets****(a) Assets carried at amortised cost**

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the statement of comprehensive income. Also refer to notes 2.5 associates, 3.3.1 (b) loans and receivables and 3.3.1(c) held-to-maturity investments.

(b) Assets classified as available-for-sale

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

3.5 Cash and cash equivalents

Cash and cash equivalents consist of cash in hand, balances with Group, treasury bills and money market placements and deposits maturing within three months of the date of acquisition. Cash and cash equivalents are carried at amortised cost in the statement of financial position.

3.6 Placements with banks

These are stated at cost, less any amounts written off and provisions for impairment.

3.7 Property and equipment

Items of property and equipment are measured at cost less accumulated depreciation and impairment loss. Cost includes expenditures that are directly attributable to the acquisition of the asset.

When parts of an item of property and equipment have different useful lives, they are accounted for as separate items (major components) of property and equipment.

Revaluations of freehold land and buildings are carried out every five years on an open market value for existing use basis, by an independent valuer. Increases in the carrying amount arising on revaluation are credited to other comprehensive income and shown as other reserves in shareholders' equity. Decreases that offset previous increases of the same asset are charged in other comprehensive income and debited against other reserves directly in equity; all other decreases are charged to the statement of comprehensive income. On disposal the related revaluation surplus is transferred directly to retained earnings. Transfers from revaluation surplus to retained earnings are not made through statement of comprehensive income.

Land is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate their cost or revalued amounts to their residual values over their estimated useful lives, as follows:

	Years
Freehold and leasehold buildings	20 - 50
Leased hold improvements	5 - 10
Furniture, fixtures and equipment	5 - 10
Motor vehicles	3 - 5

BANK MUSCAT SAOG**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)****3 SIGNIFICANT ACCOUNTING POLICIES (continued)****3.7 Property and equipment (continued)**

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

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

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

Repairs and renewals are charged to the statement of comprehensive income 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 statement of comprehensive income as an expense as incurred.

3.8 Collateral pending sale

The Group occasionally acquires real estate in settlement of certain loans and advances. Real estate is stated at the lower of the net realisable value of the related loans and advances and the current fair value of such assets. Gains or losses on disposal and unrealised losses on revaluation are recognised in the statement of comprehensive income.

3.9 Goodwill

Goodwill represents the excess of the cost of the acquisition over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities of the acquiree. Goodwill is measured at cost less any accumulated impairment losses. In respect of equity accounted investees, the carrying amount of goodwill is included in the carrying amount of the investment. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold. Goodwill is allocated to cash-generating units for the purpose of impairment testing. Each of those cash-generating units is represented by each operating segment.

3.10 Deposits

Deposits from banks and customers, debt securities and subordinated liabilities are the Group's sources of funding. These are initially measured at fair value plus transaction costs and subsequently measured at their amortised cost using the effective interest method.

3.11 Income tax

Income tax expense comprises current and deferred tax. Taxation is provided in accordance with Omani fiscal regulations.

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

Income tax is recognised in the statement of comprehensive income except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Deferred tax assets/liabilities are calculated using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. 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 reporting date.

The carrying amount of deferred income tax assets/liabilities is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilised.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)****3 SIGNIFICANT ACCOUNTING POLICIES (continued)****3.12 Fiduciary assets**

The Group provides trustee, corporate administration, investment management and advisory services to third parties, which involve the Group making allocation and purchase and sale decisions in relation to a wide range of financial instruments. Those assets that are held in a fiduciary capacity are not included in these consolidated financial statements.

3.13 Acceptances

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

3.14 Repurchase and resale 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 deposits from banks or deposits from 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 consolidated financial statements.

3.15 Trade and settlement date accounting

All regular way purchases and sales of financial assets are recognised on the trade date, i.e. the date that the entity commits to purchase the asset. Regular way purchase or sales are purchases or sales of financial assets that require delivery of assets within the timeframe generally established by regulation or convention in the market place.

3.16 Leases

Finance leases, which transfer to the Group substantially all the risks and benefits incidental to ownership of the leased item, are capitalised at the inception of the lease at the fair value of the leased asset or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly against income.

Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset or the lease term.

Leases where the lessor retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. Operating lease payments are recognised as an expense in the statement of comprehensive income on a straight-line basis over the lease term.

3.17 Employee terminal benefits

Contributions to a defined contribution retirement plan, for Omani employees, in accordance with the Oman Social Insurance Scheme, are recognised as expense in the statement of comprehensive income when accrued.

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

3.18 Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the executive management team that makes strategic decisions.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)**3 SIGNIFICANT ACCOUNTING POLICIES (continued)****3.19 Earnings per share**

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

4 Critical accounting estimates and judgements

The preparation of consolidated financial statements requires the Management to make judgements, estimates and assumptions that affect the application of accounting policies and reported amounts of assets, liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. The resulting accounting estimates will, by definition, seldom equal the related actual results. Specific fair value estimates are disclosed in note 43.

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

(a) Impairment on placements

The Group reviews its portfolio of Placements with banks on a yearly basis to assess impairment. In determining whether an impairment loss should be recorded in the consolidated statement of comprehensive income, the Group makes judgements as to whether there is any observable data indicating an impairment. For individually impaired placements, the Group considers the necessary impairment loss based on the expected cash flows and borrower's financial position. In addition, the Group assesses the portfolio on a collective basis and estimates the collective impairment loss if any. The judgements and estimates used for impairment assessment depend on a the number of parameters which include the borrower's financial condition, local and international economic conditions and economic outlook.

(b) Impairment losses on loans and advances

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

(c) Fair value of derivatives and other financial instruments

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

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)****4 Critical accounting estimates and judgements (continued)****(d) Impairment of available-for-sale equity investments**

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

(a) Impairment loss on investments in associates

The Group reviews its investments in associates periodically and evaluates the objective evidence of impairment. Objective evidence includes the performance of associate, the future business model, local economic conditions and other relevant factors. Based on the objective evidences, the Group determines the need for impairment loss on investments in associates.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)

5 CASH AND BALANCES WITH CENTRAL BANKS

2009 USD '000	2010 USD'000		2010 RO'000	2009 RO'000
202,426	285,444	Cash	109,896	77,934
5,530	1,299	Capital deposit with Central Banks	500	2,129
4,231	2,821	Insurance deposit with Central Banks	1,086	1,629
<u>1,367,291</u>	<u>1,596,293</u>	Other balances with Central Banks	<u>614,573</u>	<u>526,407</u>
<u>1,579,478</u>	<u>1,885,857</u>		<u>726,055</u>	<u>608,099</u>

The capital deposit with the Central Banks cannot be withdrawn without the approval of the Central Banks. Insurance deposit with Central Bank of Oman is non refundable and the Bank is amortising the same over a period of 3 years ending 31 December 2012.

6 PLACEMENTS WITH BANKS

2009 USD'000	2010 USD'000		2010 RO'000	2009 RO'000
2,325,306	1,022,790	Inter-bank placements	393,774	895,243
<u>325,353</u>	<u>413,182</u>	Nostro balances	<u>159,075</u>	<u>125,261</u>
2,650,659	1,435,972		552,849	1,020,504
(12,501)	(6,494)	Provision for impairment	<u>(2,500)</u>	(4,813)
<u>2,638,158</u>	<u>1,429,478</u>		<u>550,349</u>	<u>1,015,691</u>

The movement in provision for impairment is analysed below:

Provision for placements with Banks

2009 USD'000	2010 USD'000		2010 RO'000	2009 RO'000
12,501	12,501	1 January	4,813	4,813
-	5,455	Provided during the year	2,100	-
-	(8,844)	Released during the year	(3,405)	-
-	(3,657)	Written off during the year	(1,408)	-
-	1,039	Transfer during the year from impairment for credit loss	400	-
<u>12,501</u>	<u>6,494</u>	31 December	<u>2,500</u>	<u>4,813</u>

7 LOANS AND ADVANCES

2009 USD'000	2010 USD'000		2010 RO'000	2009 RO'000
9,271,663	9,623,379	Loans	3,705,001	3,569,590
644,610	586,520	Overdrafts and Credit cards	225,810	248,175
402,016	410,060	Loans against trust receipts	157,873	154,776
80,966	127,810	Bills purchased and discounted	49,207	31,172
<u>125,566</u>	<u>146,236</u>	Other advances	<u>56,301</u>	<u>48,343</u>
10,524,821	10,894,005		4,194,192	4,052,056
(555,442)	(483,808)	Provision for impairment	<u>(186,266)</u>	<u>(213,845)</u>
<u>9,969,379</u>	<u>10,410,197</u>		<u>4,007,926</u>	<u>3,838,211</u>

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)

7 LOANS AND ADVANCES (continued)

The movement in provision for impairment is analysed below:

Provision for loan losses

2009 USD'000	2010 USD'000		2010 RO'000	2009 RO'000
258,694	478,416	1 January	184,190	99,597
255,174	121,010	Provided during the year	46,589	98,242
(23,938)	(32,029)	Released during the year	(12,331)	(9,216)
(11,514)	(157,657)	Written off during the year	(60,698)	(4,433)
-	(1,039)	Transfer during the year to placements provision	(400)	-
<u>478,416</u>	<u>408,701</u>	31 December (a)	<u>157,350</u>	<u>184,190</u>

Recoveries during the year of RO 13.648 million (2009: RO 10.589 million) include RO 1.317 million (2009 - RO 1.373 million) recovered from loans written off earlier. The loans written off during the year include an amount of RO 65.515 million (2009: RO 5.746 million) transferred to memorandum portfolio, which were fully provided by the Group.

Contractual interest not recognised

2009 USD'000	2010 USD'000		2010 RO'000	2009 RO'000
67,473	77,026	1 January	29,655	25,977
(13,792)	(21,587)	Written off during the year	(8,311)	(5,310)
33,800	37,177	Contractual interest not recognised	14,313	13,013
(10,455)	(17,509)	Contractual interest recovered	(6,741)	(4,025)
<u>77,026</u>	<u>75,107</u>	31 December (b)	<u>28,916</u>	<u>29,655</u>
<u>555,442</u>	<u>483,808</u>	Total impairment (a+b)	<u>186,266</u>	<u>213,845</u>

As of 31 December 2010, loans and advances on which contractual interest is not being accrued or has not been recognised amounted to RO 175.888 million (2009: RO 201.671 million).

8 OTHER ASSETS

2009 USD'000	2010 USD'000		2010 RO'000	2009 RO'000
100,026	103,527	Positive fair value of derivatives (Note 38)	39,858	38,510
164,657	240,096	Acceptances	92,437	63,393
33,579	29,426	Accrued interest	11,329	12,928
39,200	27,223	Other debtors and prepaid expenses	10,481	15,092
28,821	28,821	Deferred tax asset (Note 21)	11,096	11,096
3,104	3,104	Collateral pending sale (net of provisions)	1,195	1,195
<u>22,616</u>	<u>9,533</u>	Others	3,670	<u>8,707</u>
<u>392,003</u>	<u>441,730</u>		<u>170,066</u>	<u>150,921</u>

Collateral pending sale includes properties acquired from borrowers as part of settlement agreement of loans and advances.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)

9 INVESTMENT SECURITIES

	Available- for-sale RO'000	Held to maturity RO'000	2010 Total RO'000	2009 Total RO'000
2010				
Quoted investments	218,286	-	218,286	105,782
Unquoted investments				
Treasury bills	-	29,922	29,922	23,009
Bonds/securities	<u>24,195</u>	-	<u>24,195</u>	<u>21,241</u>
Total unquoted	<u>24,195</u>	<u>29,922</u>	<u>54,117</u>	<u>44,250</u>
Total investments	242,481	29,922	272,403	150,032
Impairment losses on investments	<u>(5,376)</u>	-	<u>(5,376)</u>	<u>(5,666)</u>
Net investments	<u>237,105</u>	<u>29,922</u>	<u>267,027</u>	<u>144,366</u>
2009	<u>120,055</u>	<u>24,311</u>	<u>144,366</u>	

	Available- for-sale USD'000	Held to maturity USD'000	2010 Total USD'000	2009 Total USD'000
2010				
Quoted investments	566,977	-	566,977	274,758
Unquoted investments				
Treasury bills	-	77,719	77,719	59,764
Bonds/securities	<u>62,844</u>	-	<u>62,844</u>	<u>55,171</u>
Total unquoted	<u>62,844</u>	<u>77,719</u>	<u>140,563</u>	<u>114,935</u>
Total investments	629,821	77,719	707,540	389,693
Impairment losses on investments	<u>(13,964)</u>	-	<u>(13,964)</u>	<u>(14,717)</u>
Net investments	<u>615,857</u>	<u>77,719</u>	<u>693,576</u>	<u>374,976</u>
2009	<u>311,831</u>	<u>63,145</u>	<u>374,976</u>	

An analysis of available-for-sale investments is set out below:

2009 USD'000	2010 USD'000		2010 RO'000	2009 RO'000
		Quoted investments		
119,366	283,203	Government bonds	109,033	45,956
40,917	42,421	Foreign bonds	16,332	15,753
35,927	92,753	Other services sector	35,710	13,832
24,042	26,691	Investment fund units	10,276	9,256
21,823	53,364	Foreign securities	20,545	8,402
11,335	11,545	Industrial sector	4,445	4,364
10,434	16,509	Financial services sector	6,356	4,017
<u>7,533</u>	<u>40,491</u>	Corporate bonds	<u>15,589</u>	<u>2,900</u>
<u>271,377</u>	<u>566,977</u>	Total	<u>218,286</u>	<u>104,480</u>
		Unquoted investments		
28,296	27,553	Local securities and bonds	10,608	10,894
26,745	35,161	Foreign securities and bonds	13,537	10,297
<u>130</u>	<u>130</u>	Investment fund units	<u>50</u>	<u>50</u>
<u>55,171</u>	<u>62,844</u>	Total	<u>24,195</u>	<u>21,241</u>
<u>326,548</u>	<u>629,821</u>	Total investments	<u>242,481</u>	<u>125,721</u>
<u>(14,717)</u>	<u>(13,964)</u>	Impairment losses on investments	<u>(5,376)</u>	<u>(5,666)</u>
<u>311,831</u>	<u>615,857</u>	Total available-for-sale	<u>237,105</u>	<u>120,055</u>

BANK MUSCAT SAOG

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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9 INVESTMENT SECURITIES (continued)

The movement in impairment of investment securities may be summarised as follows:

2009 USD'000	2010 USD'000		2010 RO'000	2009 RO'000
34,197	14,717	At 1 January	5,666	13,166
7,636	1,706	Provision made during the year	657	2,940
(26,012)	(2,103)	Release during the year for sales	(810)	(10,015)
(1,104)	(356)	Release during the year for recoveries	(137)	(425)
<u>14,717</u>	<u>13,964</u>	At 31 December	<u>5,376</u>	<u>5,666</u>

The movement in investment securities may be summarised as follows:

	Available- for-sale RO'000	Held to maturity RO'000	Total RO'000
At 1 January 2010	120,055	24,311	144,366
Exchange differences on monetary assets	(378)	-	(378)
Additions	129,249	29,922	159,171
Disposals (sale and redemption)	(16,585)	(24,309)	(40,894)
Gain from changes in fair value	4,575	-	4,575
Recoveries from impairment for investments	137	-	137
Impairment losses	(657)	-	(657)
Amortisation	(480)	(2)	(482)
Realised gains on sale	<u>1,189</u>	<u>-</u>	<u>1,189</u>
At 31 December 2010	<u>237,105</u>	<u>29,922</u>	<u>267,027</u>
USD'000	<u>615,857</u>	<u>77,719</u>	<u>693,576</u>

	Available- for-sale RO'000	Held to maturity RO'000	Total RO'000
At 1 January 2009	216,948	161,698	378,646
Exchange differences on monetary assets	157	-	157
Additions	39,244	23,009	62,253
Disposals (sale and redemption)	(123,197)	(160,394)	(283,591)
Losses from changes in fair value	(63,932)	-	(63,932)
Recoveries from impairment for investments	425	-	425
Impairment losses	(2,940)	-	(2,940)
Amortisation	(131)	(2)	(133)
Realised gains on sale	<u>53,481</u>	<u>-</u>	<u>53,481</u>
At 31 December 2009	<u>120,055</u>	<u>24,311</u>	<u>144,366</u>
USD'000	<u>311,831</u>	<u>63,145</u>	<u>374,976</u>

BANK MUSCAT SAOG

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)

10 INVESTMENT IN SUBSIDIARY

Details regarding the Parent Company's subsidiary are set out below.

Company name	Country of incorporation	Year end	Proportion held	Carrying value RO'000
Muscat Capital LLC	Kingdom of Saudi Arabia	31 December 2010	95%	5,053
Muscat Capital LLC (formerly Muscat Securities House LLC)	Kingdom of Saudi Arabia	31 December 2009	95%	4,022

During the year 2009, the Parent Company incorporated Muscat Securities House LLC with its registered office in Riyadh - Kingdom of Saudi Arabia. During July 2010 the name of the company was changed from Muscat Securities House LLC to Muscat Capital LLC. As at 31 December 2010, the Authorised and issued share capital of the subsidiary is SAR 75 million (2009: SAR 50 million).

Financial information relating to subsidiary is summarised as follows:

31 December 2010	Total RO'000	Share of parent company RO'000	Share of non controlling interest RO'000
Total share capital	7,704	7,319	385
Reserves	(2,385)	(2,266)	(119)
Total net worth	<u>5,319</u>	<u>5,053</u>	<u>266</u>

	Total US'000	Share of parent company US'000	Share of non controlling interest US'000
Total share capital	20,010	19,010	1,000
Reserves	(6,195)	(5,886)	(309)
Total net worth	<u>13,815</u>	<u>13,124</u>	<u>691</u>

31 December 2009	Total RO'000	Share of parent company RO'000	Share of non controlling interest RO'000
Total share capital	5,136	4,879	257
Reserves	(902)	(857)	(45)
Total net worth	<u>4,234</u>	<u>4,022</u>	<u>212</u>

	Total US'000	Share of parent company US'000	Share of non controlling interest US'000
Total share capital	13,340	12,673	667
Reserves	(2,343)	(2,226)	(117)
Total net worth	<u>10,997</u>	<u>10,447</u>	<u>550</u>

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11 INVESTMENTS IN ASSOCIATES

2009 USD'000	2010 USD'000		2010 RO'000	2009 RO'000
148,904	114,325	BMI Bank B.S.C. (c) Kingdom of Bahrain	44,016	57,328
<u>25,569</u>	<u>28,316</u>	Mangal Keshav Holding Ltd (MKHL), India	<u>10,901</u>	<u>9,844</u>
<u>174,473</u>	<u>142,641</u>	Carrying value of investments in associates at 31 December	<u>54,917</u>	<u>67,172</u>

During 2010, share of losses from associates amounted to RO 12.637 million (2009: losses of RO 10.455 million) and translation gains on associate investments amounted to RO 0.381 million (2009: loss of RO 0.72 million). In 2009 translation gain on associate investments of RO 0.320 million was transferred from equity to the consolidated statement of comprehensive income.

Details of investments in associates are given below.

11.1 Investment in BMI Bank B.S.C. (c), Kingdom of Bahrain (BMI)

As at 31 December 2010, the Parent Company held 49% (2009 - 49%) shareholding in BMI, a closely held bank. The carrying value of the investment in BMI as on 31 December 2010 was as follows:

2009 USD'000	2010 USD'000		2010 RO'000	2009 RO'000
170,566	148,904	Carrying value at 1 January	57,328	65,668
<u>(21,662)</u>	<u>(34,579)</u>	Add: Share of loss for the year	<u>(13,312)</u>	<u>(8,340)</u>
<u>148,904</u>	<u>114,325</u>	Carrying value at 31 December	<u>44,016</u>	<u>57,328</u>

11.2 Investment in Mangal Keshav Holdings Limited, India (MKHL)

As at 31 December 2010, the Bank held 42.96% shareholding in MKHL. The carrying value of the investment in MKHL as on 31 December 2010 was as follows:

2009 USD'000	2010 USD'000		2010 RO'000	2009 RO'000
24,298	25,569	Carrying value of investments at 1 January	9,844	9,355
		Add: share of profit for the period 1 October 2009 to 30 September 2010 (2009 - 1 October 2008 to 30 September 2009)		
263	1,756	Add/less: Translation of foreign currency profit	676	101
<u>1,008</u>	<u>991</u>		<u>381</u>	<u>388</u>
<u>25,569</u>	<u>28,316</u>	Carrying value of investments at 31 December	<u>10,901</u>	<u>9,844</u>

The carrying value of investments as reflected above includes an amount of RO 2.408 million (2009: RO - 2.319 million) on account of goodwill related to acquisition.

The Parent Company's share of the total recognised gains and losses of associate are reflected on the basis of reviewed results of MKHL for the period ended 30 September 2010. The financial statements of MKHL for the quarter ended 31 December 2010 were not available at the time of the preparation of these financial statements.

BANK MUSCAT SAOG

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)

11 INVESTMENTS IN ASSOCIATES (continued)

11.2 Investment in Mangal Keshav Holdings Limited, India (MKHL) (continued)

The financial statements of MKHL are prepared as per generally accepted accounting practices prevailing in India (Indian GAAP). The Management of the Parent Company believe that it is not practicable to restate the financial statements of MKHL in order to reflect the position as per International Financial Reporting Standards, as MKHL does not operate under similar circumstances and management considers the impact not to be material to the Group.

11.3 Investment in Silk Bank Limited (SBL) (formerly Saudi Pak Commercial Bank Limited)

In March 2008, the Parent Company acquired 200,899,633 shares representing 40.17% of the issued and paid up share capital of SBL, a public limited company engaged in banking services in Pakistan. The Parent Company invested in SBL along with consortium members comprising of International Finance Corporation, Nomura Group and Sinthos Capital. In June 2008, SBL announced a rights issue where the Bank acquired 114,313,228 shares. The number of shares acquired by the Parent Company was lower than its share of rights issue and as a result the Parent Company's holding diluted to 35.07% at 31 December 2009.

The Parent Company's share of the total recognised losses of associate are reflected on the basis of reviewed results of SBL for the period 1 January 2009 to 30 September 2009.

In December 2009, SBL announced a rights issue of Pakistani Rupee (PKR) 7 billion through issuance of 2.8 billion right shares at the rate of PKR 2.5 per share for every one share held in order to meet the minimum capital requirement of the local regulator.

The Parent Company decided not to participated in this rights issue and its stake in SBL is diluted to around 8.5% and as a result effectively lost significant influence. The SBL investment has been marked-to-market in the Parent Company's books as at 31 December 2010. An impairment loss of RO 20.3 million was recognised in the statement of comprehensive income in 2009 including the loss on depreciation of the Pakistan Rupee amounting to RO 9.6 million which was earlier recognised in equity. The rights issue has been subscribed to the extent of continuing shareholders holding and the remaining is expected to be completed by 31 March 2011. As of the reporting date, the Group's holding SBL is 11.8%.

The financial statements of Silk Bank are prepared as per International Financial Reporting Standards.

The carrying value of the investment in SBL as on 31 December 2009 was as follows:

2009 USD'000	2010 USD'000		2010 RO'000	2009 RO'000
46,442	-	Carrying value of investments at 1 January	-	17,880
(5,756)	-	Less: share of loss for the period 1 April 2009 to 30 September 2009	-	(2,216)
(27,761)	-	Less: Impairment loss	-	(10,688)
(2,873)	-	Less: Translation of foreign currency loss	-	(1,106)
<u>(10,052)</u>	<u>-</u>	Less: Transferred to available for sale investments	<u>-</u>	<u>(3,870)</u>
<u>=====</u>	<u>=====</u>	Carrying value of investments at 31 December	<u>=====</u>	<u>=====</u>

BANK MUSCAT SAOG

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)

11.4 Financial information relating to associates

Financial information relating to associates is summarised as follows:

BMI January 2009 to December 2009 RO'000	MKHL April 2009 to September 2009 RO'000	SILK BANK January 2009 to September 2009 RO'000		MKHL April 2010 to September 2010 RO'000	BMI January 2010 to December 2010 RO'000
20,923	2,871	(4,568)	Total revenue	3,109	18,281
(17,210)	494	(10,705)	Net profit/(loss)	721	(27,156)
At 31 December 2009	At 30 September 2009	At 30 September 2009		At 30 September 2010	At 31 December 2010
689,037	25,055	264,375	Total assets	25,359	603,989
573,847	9,830	245,050	Total liability	7,994	515,870
115,190	15,225	19,325	Net worth	17,365	88,119

BMI January 2009 to December 2009 USD'000	MKHL April 2009 to September 2009 USD'000	SILK BANK January 2009 to September 2009 RO'000		MKHI April 2010 to September 2010 USD'000	BMI January 2010 to December 2010 USD'000
54,344	7,458	(11,865)	Total revenue	8,075	47,483
(44,700)	1,284	(27,805)	Net profit/(loss)	1,873	(70,535)
At 31-12-09	At 30 September 2009	At 30 September 2009		At 30 September 2009	At 31 December 2010
1,789,707	65,078	686,688	Total assets	65,868	1,568,803
1,490,512	25,533	636,493	Total liability	20,764	1,339,922
299,195	39,545	50,195	Net worth	45,104	228,881

12 PROPERTY AND EQUIPMENT

	Leasehold buildings RO'000	Freehold land and buildings RO'000	Furniture, fixtures and equipment RO'000	Motor vehicles RO'000	Total RO'000
Cost or valuation					
At 1 January 2010	-	8,048	64,485	949	73,482
Additions during the year	38,000	1,206	17,991	120	57,317
Disposals	-	-	(28)	(263)	(291)
Transfer	-	1,046	(1,046)	-	-
At 31 December 2010	<u>38,000</u>	<u>10,300</u>	<u>81,402</u>	<u>806</u>	<u>130,508</u>
Depreciation					
At 1 January 2010	-	4,228	42,456	522	47,206
Charge for the year	190	540	7,872	152	8,754
Relating to disposals	-	-	(28)	(212)	(240)
Transfer	-	36	(36)	-	-
At 31 December 2010	<u>190</u>	<u>4,804</u>	<u>50,264</u>	<u>462</u>	<u>55,720</u>
Net book value					
At 31 December 2010	<u>37,810</u>	<u>5,496</u>	<u>31,138</u>	<u>344</u>	<u>74,788</u>
At 31 December 2010 (USD'000)	<u>98,208</u>	<u>14,275</u>	<u>80,878</u>	<u>894</u>	<u>194,255</u>

BANK MUSCAT SAOG

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)

12 PROPERTY AND EQUIPMENT (continued)

	Freehold land and buildings RO'000	Furniture, fixtures and equipment RO'000	Motor vehicles RO'000	Total RO'000
Cost or valuation				
At 1 January 2009	8,028	53,640	902	62,570
Additions during the year	20	10,854	91	10,965
Disposals	-	(9)	(44)	(53)
At 31 December 2009	<u>8,048</u>	<u>64,485</u>	<u>949</u>	<u>73,482</u>
Depreciation				
At 1 January 2009	3,529	36,695	398	40,622
Charge for the year	445	6,015	162	6,622
Relating to disposals	-	-	(38)	(38)
Transfer	254	(254)	-	-
At 31 December 2009	<u>4,228</u>	<u>42,456</u>	<u>522</u>	<u>47,206</u>
Net book value				
At 31 December 2009	<u>3,820</u>	<u>22,029</u>	<u>427</u>	<u>26,276</u>
At 31 December 2009 (USD'000)	<u>9,922</u>	<u>57,218</u>	<u>1,109</u>	<u>68,249</u>

The freehold land and buildings owned by the Parent Company were revalued during the year 2007 by independent professional valuers on an open market basis. The gross carrying amount of the land and buildings was restated so that the net carrying amount of the asset after its revaluation equals its revalued amount; surplus on revaluation was credited to revaluation reserve.

If freehold land and buildings had been carried at cost less depreciation, the carrying amount would have been RO 1,050,680 (2009: RO 1,137,687).

13 FINANCE LEASE LIABILITIES

The Group entered into a lease agreement with a third party (a quasi government entity) to lease a purpose built head office which was constructed for exclusive use of the Group. The construction of building was completed in 2010 and the Group is currently in the process of occupying the building. Total cost of the project was estimated to be around RO 48 million. However, cost split between leased asset (RO 38 million) and own assets (RO 10 million) of the building is based on an initial estimate. Based on the detailed breakup of the project cost, the split between leased assets and own assets will be reviewed and adjusted accordingly in 2011. The lease is for a period of 50 years. On the estimated cost of leased assets, the annual lease payment of building for the initial 25 years is RO 2.9 million. Subsequently, for the subsequent 10 years, the annual rent will increase by 25% to RO 3.7 million. From 36th year onwards, the annual rent will further increase by 10% to RO 4.1 million.

Due to the above lease payment schedule, the minimum lease payments in the first 25 years of the lease period are less than the finance charges payable.

The minimum lease payments and total liability in respect of these leases relating to future periods are as follows:

2009 USD'000	2010 USD'000		2010 RO'000	2009 RO'000
-	(122)	Current	(47)	-
-	<u>98,823</u>	Non current	<u>38,047</u>	-
-	<u>98,701</u>		<u>38,000</u>	-
-	448,790	Represented by:		
-	(350,089)	Gross finance lease payments due	172,784	-
-		Less: Future finance charges	(134,784)	-
-	98,701	Net lease liability/present value recognised as property	38,000	-

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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13 FINANCE LEASE LIABILITIES (continued)

The following table shows the maturity analysis of finance lease payable:

	Less than 1 year RO'000	Between 1 and 2 years RO'000	Between 2 and 5 years RO'000	More than 5 years RO'000	Total RO'000
At 31 December 2010					
Gross finance lease payable	2,973	2,973	8,918	157,920	172,784
Less: Future finance charges	(3,020)	(3,022)	(9,092)	(119,650)	(134,784)
Net lease liability	(47)	(49)	(174)	38,270	38,000

	Less than 1 year USD'000	Between 1 and 2 years USD'000	Between 2 and 5 years USD'000	More than 5 years USD'000	Total USD'000
At 31 December 2010					
Gross finance lease payable	7,722	7,722	23,164	410,182	448,790
Less: Future finance charges	(7,844)	(7,849)	(23,616)	(310,780)	(350,089)
Net lease liability	(122)	(127)	(452)	99,402	98,701

14 DEPOSITS FROM BANKS

2009 USD'000	2010 USD'000		2010 RO'000	2009 RO'000
2,272,884	1,063,790	Inter-bank borrowings	409,559	875,060
802,449	433,013	Vostro balances	166,710	308,943
549,984	476,927	Other money market deposits	183,617	211,744
<u>3,625,317</u>	<u>1,973,730</u>		<u>759,886</u>	<u>1,395,747</u>

15 CUSTOMERS' DEPOSITS

2009 USD'000	2010 USD'000		2010 RO'000	2009 RO'000
3,300,187	3,511,740	Deposit accounts	1,352,020	1,270,572
2,118,468	2,394,595	Savings accounts	921,919	815,610
1,942,203	2,613,403	Current accounts	1,006,160	747,748
561,171	594,029	Call accounts	228,701	216,051
47,906	47,150	Margin accounts	18,153	18,444
<u>7,969,935</u>	<u>9,160,917</u>		<u>3,526,953</u>	<u>3,068,425</u>

As on the reporting date, Deposits from Ministries and other Government organizations represent 27% of the total customer deposits; (2009: 22%).

16 CERTIFICATES OF DEPOSIT

During the year the Parent company issued certificates of deposit of RO 70.1 million (2009: RO 102.3 million) and RO 53.9 million (2009: RO 24.775 million) of certificates of deposits were matured. The certificates of deposits issued by the Parent Company are unsecured and are denominated in Rial Omani. The maturity profile and interest rate of certificates of deposit are disclosed in notes 42.3.2 and 42.4, respectively.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)

17 UNSECURED BONDS

Unsecured bonds are non-convertible, unsecured and listed on the Muscat Securities Market. The bonds have a maturity of 10 years. The maturity profile and interest rate of unsecured bonds are disclosed in notes 42.3.2 and 42.4.4, respectively.

18 FLOATING RATE NOTES

Floating rate notes are issued by the Parent Company under its Euro Medium Term Note Programme and are denominated in US Dollars. The notes carry a floating interest rate. These are non-convertible, unsecured and listed on the Luxemburg stock exchange. During the year 2010, notes amounting to RO Nil matured (2009: RO 96.25 million). The maturity profile and interest rates of floating rate notes are disclosed in notes 42.3.2 and 42.4.4, respectively.

19 MANDATORY CONVERTIBLE BONDS

During the year 2009, the Parent Company issued 32,313,995 mandatory convertible bonds of RO 1 each aggregating to RO 32.31 million as part of dividend for the year 2008. The mandatory convertible bonds carry a coupon rate of 7% per annum. On maturity, the bonds will be converted to ordinary shares of the Parent Company by using a "Conversion price" which will be calculated by applying 20% discount to 3 month average share price of the Parent Company on the Muscat Securities market prior to the conversion. 50% of the bonds issued will be matured after a period of 3 years and the remaining after a period of 5 years from the date of issuance. The bonds are listed on the Muscat Securities Market.

20 OTHER LIABILITIES

2009 USD'000	2010 USD'000		2010 RO'000	2009 RO'000
131,831	139,506	Negative fair value of derivatives (Note 38)	53,710	50,755
164,660	240,096	Acceptances	92,437	63,394
83,652	91,000	Accrued interest	35,035	32,206
9,101	10,197	Unearned discount and interest	3,926	3,504
6,938	8,743	Employee terminal benefits	3,366	2,671
1,353	1,504	Deferred tax liability	579	521
-	98,701	Finance lease liability (note 13)	38,000	-
240,821	260,772	Other liabilities and accrued expenses	100,397	92,716
638,356	850,519		327,450	245,767

The charge for the year and amounts paid in respect of employee terminal benefits were RO 515,004 (2009: RO 427,900) and RO 824,944 (2009: RO 191,072), respectively.

21 TAXATION

2009 USD'000	2010 USD'000		2010 RO'000	2009 RO'000
		Current liability:		
59,675	42,091	Current year	16,205	22,975
22,346	41,395	Prior years	15,937	8,603
82,021	83,486		32,142	31,578
		Statement of comprehensive income		
59,675	42,091	Current year	16,205	22,975
(22,626)	-	Deferred tax liability relating to temporary differences	-	(8,711)
37,049	42,091		16,205	14,264

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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21 TAXATION (continued)

(a) The tax rate applicable to the Parent Company is 12% (2009: 12%). For the purpose of determining the tax expense for the year, the accounting profit has been adjusted for tax purposes. Adjustments for tax purpose include items relating to both income and expense. After giving effect to these adjustments, the average effective tax rate approximates to 13.76% (2009: 16.21%).

The difference between the applicable tax rate of 12% (2009 : 12%) and effective tax rate of 13.76% (2009: 16.21%) arises due to tax effect of income not considered to be taxable and expenses not considered to be deductible. The adjustments are based on the current understanding of the existing tax laws, regulations and practices.

(b) The reconciliation of taxation on the accounting profit before tax for the year at RO 117.8 million (2009: RO 87.982 million) after the basic exemption limit of RO 30,000 and the taxation charge in the financial statements is as follows:

	2010 RO'000	2009 RO'000
Tax charge at 12% on accounting profit before tax	14,136	10,558
Add/(less) tax effect of:		
Income not taxable	(166)	(107)
Expenses not deductible or deferred	2,084	2,300
Foreign taxes on foreign-sourced income	1	1,533
Tax relating to subsidiary	92	75
Others	58	(95)
Tax charge as per statement of comprehensive income	<u>16,205</u>	<u>14,264</u>

(c) The deferred tax asset / liability has been recognised at the effective tax rate of 12%.

Deferred tax asset/(liability) in the statement of financial position and the deferred tax credit/(charge) in the statement of comprehensive income relate to the tax effect of provisions.

	1 January 2010 RO'000	Charged/ (Credited) to Statement of comprehensive income RO'000	31 December 2010 RO'000
Asset			
Tax effect of provisions	10,888	-	10,888
Liability			
Tax effect of accelerated tax depreciation	208	-	208
	<u>11,096</u>	<u>-</u>	<u>11,096</u>

	1 January 2009 RO'000	Charged/ (Credited) to Statement of comprehensive income RO'000	31 December 2009 RO'000
Asset			
Tax effect of provisions	2,717	8,171	10,888
Liability			
Undistributed profits of associates	(540)	540	-
Tax effect of accelerated tax depreciation	208	-	208
	<u>2,385</u>	<u>8,711</u>	<u>11,096</u>

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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21 TAXATION (continued)

The tax (charge)/credit relating to components of other comprehensive income is as follows:

31 December 2010	Tax			31 December 2009		
	Before tax RO'000	(charge)/ Credit RO'000	After Tax RO'000	Before tax RO'000	(charge)/ Credit RO'000	After Tax RO'000
Loss on translation of net investments in associates	381	-	381	(1,040)	-	(1,040)
Loss on translation of net investments in associates reversed to profit and loss	-	-	-	9,627	-	9,627
Change in fair value of investments available for sale (note 9)	<u>4,575</u>	<u>(58)</u>	<u>4,517</u>	<u>(63,932)</u>	<u>(521)</u>	<u>(64,453)</u>
Other comprehensive income	<u>4,956</u>	<u>(58)</u>	<u>4,898</u>	<u>(55,345)</u>	<u>(521)</u>	<u>(55,866)</u>
Current tax	-	-	-	-	-	-
Deferred tax	-	(58)	-	-	(521)	-

From the year 2010, the group started recognising deferred tax on other comprehensive income. During the year 2010, the group has recognised a deferred tax liability of RO 58K (2009: RO 521K) relating to fair value changes of investments available for sale, which may be taxable in the future. The deferred tax liability is disclosed under other comprehensive income in the statement of consolidated comprehensive income.

31 December 2010	Tax			31 December 2009		
	Before tax USD'000	(charge)/ Credit USD'000	After Tax USD'000	Before tax USD'000	(charge)/ Credit USD'000	After Tax USD'000
Loss on translation of net investments in associates	990	-	990	(2,701)	-	(2,701)
Loss on translation of net investments in associates reversed to profit and loss	-	-	-	25,005	-	25,005
Change in fair value of investments available for sale (note 9)	<u>11,883</u>	<u>(151)</u>	<u>11,732</u>	<u>(166,057)</u>	<u>(1,353)</u>	<u>(167,410)</u>
Other comprehensive income	<u>12,873</u>	<u>(151)</u>	<u>12,722</u>	<u>(143,753)</u>	<u>(1,353)</u>	<u>(145,106)</u>
Current tax	-	-	-	-	-	-
Deferred tax	-	(151)	-	-	(1,353)	-

The Bank's tax assessments have been completed by the tax authorities up to tax year 2004.

In respect of the assessments of tax years 2000 and 2002, the tax department had made certain adjustments which were not acceptable to the Bank. The Bank has filed an appeal against certain adjustments made in the assessments. The appeals are pending with various appellate institutions.

The assessments of the former banks that have merged with the Bank are completed.

BANK MUSCAT SAOG

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)

22 SUBORDINATED LIABILITIES

In accordance with the Central Bank of Oman's regulations, subordinated loans are included in the calculation of supplementary capital as defined by the Bank for International Settlements (BIS) for capital adequacy purposes. During the year the Bank obtained Tier II capital of RO Nil (2009: RO 75 million). The Parent Company has subordinated liabilities as follows:

2009 USD'000	2010 USD'000		2010 RO'000	2009 RO'000
389,610	376,623	Fixed rate Rial Omani subordinated loans	145,000	150,000
<u>100,000</u>	<u>100,000</u>	Floating rate USD subordinated loans	<u>38,500</u>	<u>38,500</u>
<u>489,610</u>	<u>476,623</u>		<u>183,500</u>	<u>188,500</u>

The maturity profile and interest rate of subordinated liabilities are disclosed in notes 42.3.2 and 42.4.4 respectively.

23 SHARE CAPITAL

Share capital

The authorised share capital of the Parent Company is 2,500,000,000 shares of RO 0.100 each (2009: 1,250,000,000 of RO 0.100 each). At 31 December 2010, 1,346,417,144 shares of RO 0.100 each (2009: 1,077,133,715 shares of RO 0.100 each) have been issued and fully paid. The Bank's shares are listed on Muscat securities market, Bahrain stock exchange and London stock exchange. The bank has secondary listing on London Stock exchange. The Listing in London stock exchange is through Global depository receipts issued by the Bank.

Significant shareholders

The following shareholders held 10% or more of the Parent Company's capital:

	2010		2009	
	No. of shares	% holding	No. of shares	% holding
Royal Court Affairs	334,422,151	24.84	267,537,721	24.84
Dubai Financial Group	201,962,500	15.00	161,570,000	15.00

24 LEGAL AND GENERAL RESERVES

(i) In accordance with the Omani Commercial Companies Law of 1974, the Parent Company is required to transfer 10% of its profit for the year to legal reserve until the accumulated balance of the reserve equals one third of the Parent Company's paid up share capital. During the year RO 8,976K (2009: RO Nil) was transferred from profits to legal reserve. After this transfer the Parent Company's legal reserve are equal to one third of the paid up share capital.

(ii) The general reserve is established to support the operations and the capital structure of the Group.

25 SUBORDINATED LOAN RESERVE

The subordinated loan reserve is created as per the guidelines given by the Bank for International Settlements and the Central Bank of Oman. During the year 2010, the Parent Company transferred RO 36.7 million (2009 - 24.2 million) to subordinated loan reserve from retained earnings.

A subordinated loan of RO 5 million was repaid during the year 2010 (2009: RO Nil). On maturity, the reserve of RO 5 million related to this loan was thus transferred to General Reserve.

26 PROPOSED DIVIDENDS

For the year 2010, the Board of Directors have proposed a dividend of 45%, 30% in the form of cash and 15% in the form of bonus shares. Thus shareholders would receive cash dividend of RO 0.030 per ordinary share of RO 0.100 each aggregating to RO 40.39 million on the Group's existing share capital. In addition, they would receive bonus shares in the proportion of one share for every 6.666 ordinary shares aggregating to 201,962,571 shares of RO 0.100 each amounting to RO 20.196 million. The proposed cash dividend and issuance of bonus shares are subject to formal approval of the shareholders at the Annual General Meeting.

BANK MUSCAT SAOG

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)**26 PROPOSED DIVIDENDS (continued)**

For 2009, a dividend of 45% comprising, 20% in the form of cash and 25% in the form of bonus shares was approved at the Annual General Meeting on 21 March 2010. Thus shareholders received cash dividend of RO 0.020 per ordinary share of RO 0.100 each aggregating to RO 21.543 million on the Parent company's existing share capital. In addition, they received bonus shares in the proportion of one share for every 4 ordinary shares aggregating to 269,283,429 shares of RO 0.100 each amounting to RO 26.93 million.

27 NET ASSETS PER SHARE

The calculation of net assets per share is based on net assets as at 31 December 2010 attributable to ordinary shareholders of RO 796.39 million (2009: RO 711.32 million) and on 1,346,417,144 ordinary shares (2009: 1,077,133,715 ordinary shares) being the number of shares outstanding as at 31 December 2010.

28 CONTINGENT LIABILITIES AND COMMITMENTS**(a) Legal proceedings**

There were a number of legal proceedings outstanding against the Parent Company at 31 December 2010. No provision has been made, as professional advice indicates that it is unlikely that any significant loss will arise.

(b) Credit related commitments

Credit related commitments include commitments to extend credit, standby letters of credit and guarantees which are designed to meet the requirements of the Parent Company's customers.

Commitments to extend credit represent contractual commitments to make loans and revolving credits. Commitments generally have fixed expiration dates or other termination clauses and require the payment of a fee. Since commitments may expire without being drawn upon, the total contract amounts do not necessarily represent future cash obligations.

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

Irrevocable commitments to extend credit at the reporting date amounted to RO 289,440,000 (2009: RO 320,247,000).

As of the reporting date, commitments on behalf of customers, for which there were corresponding customer liabilities, consisted of the following:

2009	2010		2010	2009
USD'000	USD'000		RO'000	RO'000
686,990	844,914	Letters of credit	325,292	264,491
<u>1,810,119</u>	<u>2,379,800</u>	Guarantees	<u>916,223</u>	<u>696,896</u>
<u>2,497,109</u>	<u>3,224,714</u>		<u>1,241,515</u>	<u>961,387</u>

(c) Capital commitments

As of the reporting date, capital commitments were as follows:

2009	2010		2010	2009
USD'000	USD'000		RO'000	RO'000
<u>3,873</u>	<u>5,507</u>	Purchase of property and equipment	<u>2,120</u>	<u>1,491</u>

(d) As of the reporting date, the Group has not pledged any of its assets as security (2009 - no assets pledged).

(e) As of the reporting date, the amount payable on partly paid shares held by the Group was RO 12,165,435 (2009: RO 9,179,503).

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)

28 CONTINGENT LIABILITIES AND COMMITMENTS (continued)

28.1 Concentration of contingent liabilities and commitments

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

2009 USD'000	2010 USD'000		2010 RO'000	2009 RO'000
31,062	49,842	Agriculture and allied activities	19,189	11,959
505,314	746,052	Construction	287,230	194,546
7,283	5,168	Export trade	1,990	2,804
650,501	809,169	Financial institutions	311,530	250,443
241,997	169,964	Government	65,436	93,169
180,499	294,683	Import trade	113,453	69,492
150,696	128,966	Manufacturing	49,652	58,018
105,221	150,332	Mining and quarrying	57,878	40,510
36,883	50,709	Personal and housing loans	19,523	14,200
38,990	67,481	Real estate	25,980	15,011
295,262	338,590	Services	130,357	113,676
13,416	26,891	Transport	10,353	5,165
35,052	194,371	Utilities	74,833	13,495
80,553	71,044	Wholesale and retail trade	27,352	31,013
124,380	121,452	Others	46,759	47,886
<u>2,497,109</u>	<u>3,224,714</u>		<u>1,241,515</u>	<u>961,387</u>

29 INTEREST INCOME

2009 USD'000	2010 USD'000		2010 RO'000	2009 RO'000
663,296	675,847	Interest income on loans and advances	260,201	255,369
53,862	30,722	Interest income on bank placements	11,828	20,737
8,894	8,223	Interest income on investments	3,166	3,424
<u>726,052</u>	<u>714,792</u>		<u>275,195</u>	<u>279,530</u>

Effective annual rates on yielding assets are provided in note 42.4.4

30 INTEREST EXPENSE

2009 USD'000	2010 USD'000		2010 RO'000	2009 RO'000
179,579	147,306	Interest expense on customers deposits	56,713	69,138
30,369	35,761	Interest expense on subordinated liabilities	13,768	11,692
14,145	20,953	Interest expense on certificates of deposits	8,067	5,446
36,855	14,899	Interest expense on bank borrowings	5,736	14,189
9,218	9,384	Interest expense on unsecured bonds	3,613	3,549
2,987	268	Interest expense on floating rate notes	103	1,150
<u>273,153</u>	<u>228,571</u>		<u>88,000</u>	<u>105,164</u>

Effective annual rates on interest bearing liabilities are provided in note 42.4.4

BANK MUSCAT SAOG

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)

31 COMMISSION AND FEES INCOME (NET)

The commission and fee income shown in the statement of consolidated comprehensive income is net of commission and fees paid of RO 693,944 (2009: RO 727,617).

32 OTHER OPERATING INCOME

2009 USD'000	2010 USD'000		2010 RO'000	2009 RO'000
23,940	56,492	Foreign exchange	21,749	9,217
138,912	3,088	Profit on sale of non trading investments	1,189	53,481
2,714	2,784	Dividend income	1,072	1,045
<u>8,117</u>	<u>5,600</u>	Other income	<u>2,156</u>	<u>3,125</u>
<u>173,683</u>	<u>67,964</u>		<u>26,166</u>	<u>66,868</u>

33 OTHER OPERATING EXPENSES

2009 USD'000	2010 USD'000		2010 RO'000	2009 RO'000
84,128	97,939	Employees' salaries	37,707	32,389
59,769	77,338	Administrative expenses	29,775	23,011
29,992	43,273	Other staff costs	16,660	11,547
16,855	19,351	Occupancy costs	7,450	6,489
3,722	4,125	Contribution to Social Insurance schemes	1,588	1,433
1,335	2,164	Employees' end of service benefits	833	514
<u>311</u>	<u>353</u>	Directors' remuneration (note 36)	<u>136</u>	<u>120</u>
<u>196,112</u>	<u>244,543</u>		<u>94,149</u>	<u>75,503</u>

34 CASH AND CASH EQUIVALENTS

Cash and cash equivalents included in the statement of cash flows comprise the following amounts:

2009 USD'000	2010 USD'000		2010 RO'000	2009 RO'000
1,931,468	998,579	Placements with banks	384,453	743,615
1,569,717	1,880,215	Cash and balances with Central Banks	723,883	604,341
59,762	77,719	Treasury bills	29,922	23,009
<u>(2,606,951)</u>	<u>(1,228,239)</u>	Deposits from banks	<u>(472,872)</u>	<u>(1,003,676)</u>
<u>953,996</u>	<u>1,728,274</u>		<u>665,386</u>	<u>367,289</u>

35 EARNINGS PER SHARE

Basic earnings per share is calculated by dividing the net profit for the year by the weighted average number of shares outstanding during the year as follows:

	2010	2009
Net profit attributable to ordinary shareholders for basic earnings per share (RO'000)	101,595	73,718
Weighted average number of shares outstanding during the year (in '000)	1,346,417	1,077,134
Basic earnings per share (RO)	0.075	0.068
Basic earnings per share (USD)	0.195	0.178

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)

35 EARNINGS PER SHARE (continued)

Diluted earnings per share is calculated by dividing the net profit attributable to ordinary shareholders for the period by the weighted average number of ordinary shares including dilutive potential ordinary shares issued on the conversion of convertible bonds.

Net profit for the year (RO'000)	2010 101,595	2009 73,718
Interest on convertible bonds, net of taxation (RO'000)	<u>1,991</u>	<u>1,563</u>
	103,586	75,281
Weighted average number of shares in issue during the year ('000)	1,388,405	1,126,095
Diluted earnings per share (RO)	<u>0.075</u>	<u>0.067</u>
Diluted earnings per share (USD)	<u>0.195</u>	<u>0.174</u>

36 RELATED PARTY TRANSACTIONS

In the ordinary course of business, the Group conducts transactions with certain of its directors, shareholders, senior management and companies in which they have a significant interest. The terms of these transactions are approved by the Bank's Board and Management. As of the reporting date balances and transactions with directors and their related concerns during the year were as follows:

2009 USD'000	2010 USD'000		2010 RO'000	2009 RO'000
		Loans and advances		
156,842	100,933	1 January	38,859	60,384
18,671	103,104	Disbursed during the year	39,695	7,188
(74,580)	(4,603)	Repaid during the year	(1,772)	(28,713)
<u>100,933</u>	<u>199,434</u>	31 December	<u>76,782</u>	<u>38,859</u>
		Current, deposit and other accounts		
61,729	88,599	1 January	34,110	23,766
41,487	73,249	Received during the year	28,201	15,972
(14,617)	(7,364)	Repaid during the year	(2,835)	(5,628)
-	(135)	Other decreases	(52)	-
<u>88,599</u>	<u>154,349</u>	31 December	<u>59,424</u>	<u>34,110</u>
<u>11,408</u>	<u>16,621</u>	Customers' liabilities under documentary credits, guarantees and other liabilities	<u>6,399</u>	<u>4,392</u>

At 31 December 2010 the placements and other receivable balances due from the associates amount to RO 46.95 million (2009: RO 85.5 million) and the deposits due to the associates amount to RO 12.69 million (2009 - RO 47.2 million). For the year ending 31 December 2010, the interest income received from and interest expense paid to the associates amount to RO 1.15 million and RO 6 K respectively.

Loans, advances or receivables due from related parties or holders of 10% or more of the Bank shares, or their family members, less all provisions and write-offs, is further analysed as follows:

2009 USD'000	2010 USD'000		2010 RO'000	2009 RO'000
10,779	58,886	Royal Court Affairs	22,671	4,150
20,000	20,000	Dubai Financial Group	7,700	7,700
61,990	111,912	HE Sheikh Mustahil Ahmed Al Mashani and Group Companies	43,086	23,866
8,164	8,636	Others	3,325	3,143
<u>100,933</u>	<u>199,434</u>		<u>76,782</u>	<u>38,859</u>

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)

36 RELATED PARTY TRANSACTIONS (continued)

The income and expenses in respect of related parties included in the financial statements are as follows:

2009 USD'000	2010 USD'000		2010 RO'000	2009 RO'000
2,459	2,745	Interest income	1,057	947
2,432	982	Interest expense	378	936
33	55	Commission and other income	21	13
311	353	Directors' remuneration (note 33)	136	120
208	166	Directors' sitting fees	64	80

Interest expense incurred on deposits:

Items of expense which were paid to related parties or holders of 10% or more of the Bank's shares, or their family members, during the year can be further analysed as follows:

2009 USD'000	2010 USD'000		2010 RO'000	2009 RO'000
312	36	Royal Court Affairs	14	120
2,044	930	H.E Sheikh Mustahil Ahmed Al Mashani and Group Companies	358	787
76	16	Others	6	29
<u>2,432</u>	<u>982</u>		<u>378</u>	<u>936</u>

Key management compensation

2009 USD'000	2010 USD'000		2010 RO'000	2009 RO'000
5,288	6,857	Salaries and other short-term benefits	2,640	2,036
616	704	Post-employment benefits	271	237
<u>5,904</u>	<u>7,561</u>		<u>2,911</u>	<u>2,273</u>

37 FIDUCIARY ACTIVITIES

The bank's fiduciary activities consist of investment management activities conducted as trustee and manager for a number of investment funds and individuals. The aggregate amounts of funds managed, which are not included in the Group's statement of financial position, are as follows:

2009 USD'000	2010 USD'000		2010 RO'000	2009 RO'000
<u>717,681</u>	<u>963,153</u>	Funds under management	<u>370,814</u>	<u>276,307</u>

38 DERIVATIVES

In the ordinary course of business, the Group enters into various types of transactions that involve derivative financial instruments. A derivative financial instrument is a financial contract between two parties where payments are dependent upon movements in price in one or more underlying financial instrument, reference rate or index. These derivatives are stated at fair value. The fair value of a derivative is the equivalent of the unrealised gain or loss from marking to market the derivative using prevailing market rates or internal pricing models. Unrealised gains or losses are included in the statement of comprehensive income. The Group uses the following derivative financial instruments:

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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38 DERIVATIVES (continued)

Derivative product types

Forwards and futures are contractual agreements to either buy or sell a specified currency, commodity or financial instrument at a specific price and date in the future. Forwards are customised contracts transacted in the over-the-counter market. Forward rate agreements are effectively tailor-made interest rate futures which fix a forward rate of interest on a notional loan, for an agreed period of time starting on a specified future date.

Interest rate swaps are contractual agreements between two parties to exchange interest differentials based on a specific notional amount. Counter parties generally exchange fixed and floating rate interest payments based on a notional value in a single currency.

Options are contractual agreements that convey the right, but not the obligation, to either buy or sell a specific amount of a commodity, foreign currency or financial instrument at a fixed price, either at a fixed future date or at any time within a specified period. The Group transacts only in currency options for its customers. The Group does not engage in writing of options.

Derivatives held or issued for hedging purposes

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

The Group uses forward foreign exchange contracts, currency options and currency swaps to hedge against specifically identified currency risks. In addition, the Group uses interest rate swaps to hedge against the changes in the cash flow arising from certain fixed interest rate loans and deposits.

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

The table below shows the positive and negative fair values of derivative financial instruments, which are equivalent to the market values, together with the notional amounts analysed by the term to maturity. The notional amount is the amount of a derivative's underlying asset, reference rate or index and is the basis upon which changes in the value of derivatives are measured.

31 December 2010	Positive fair value RO'000 (Note 8)	Negative fair value RO'000 (Note 20)	Notional amount total RO'000	Notional amounts by term to maturity		
				Within 3 months RO'000	3 - 12 months RO'000	More than 1 year RO'000
Derivatives held for trading:						
Interest rate swaps	33,313	33,313	676,302	23,100	5,228	647,974
Interest rate cap	55	55	36,489	-	-	36,489
Cross currency swap	-	7,796	89,712	-	-	89,712
Forward rate agreement	7	-	19,250	-	19,250	-
Credit derivative swaps	32	-	26,950	19,250	-	7,700
Currency options - bought	405	-	110,533	68,543	41,990	-
Currency options - sold	-	405	110,533	68,543	41,990	-
Commodity derivatives bought	964	-	11,999	5,999	6,000	-
Commodity derivatives sold	-	964	11,999	5,999	6,000	-
Commodities purchase contracts	2,192	204	43,611	39,359	3,669	583
Commodities sale contracts	224	2,165	43,659	39,403	3,672	584
Forward purchase contracts	744	5,924	775,776	694,587	81,189	-
Forward sales contracts	1,922	2,884	775,726	694,215	81,511	-
Total	39,858	53,710	2,732,539	1,658,998	290,499	783,042
USD'000	103,527	139,506	7,097,504	4,309,086	754,543	2,033,875

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FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)

38 DERIVATIVES (continued)

31 December 2009	Positive fair value RO'000 (Note 8)	Negative fair value RO'000 (Note 20)	Notional amount Total RO'000	Notional amounts by term to maturity		
				Within 3 months RO'000	3 - 12 months RO'000	More than 1 year RO'000
Derivatives held for trading						
Interest rate swaps	29,117	29,117	817,567	2,884	63,005	751,678
Interest rate cap	187	187	39,663	-	-	39,663
Cross currency swap	389	5,083	110,849	-	-	110,849
Forward rate agreement	43	-	38,500	38,500	-	-
Credit derivative swaps	167	-	26,950	-	-	26,950
Currency options bought	-	-	74,728	43,447	31,281	-
Currency options sold	-	-	74,728	43,447	31,281	-
Commodities purchase	1,286	32	9,628	6,199	1,070	2,359
Commodities sales contracts	33	1,279	9,637	6,204	1,071	2,362
Forward purchase contracts	3,698	13,667	1,520,877	1,171,257	349,307	313
Forward sales contracts	<u>3,590</u>	<u>1,390</u>	<u>1,520,857</u>	<u>1,170,546</u>	<u>349,998</u>	<u>313</u>
Total	<u>38,510</u>	<u>50,755</u>	<u>4,243,984</u>	<u>2,482,484</u>	<u>827,013</u>	<u>934,487</u>
Total USD'000	<u>100,026</u>	<u>131,831</u>	<u>11,023,336</u>	<u>6,448,011</u>	<u>2,148,086</u>	<u>2,427,239</u>

The terms of the currency options entered on behalf of customers have been negotiated with the counter party banks to match the terms of commitments. The aggregate fair value of the respective rights and obligations in respect of the currency options at 31 December 2010 was not significant and has not been recorded in the financial statements (2009 - not significant and not recorded).

39 REPURCHASE AGREEMENTS

The Group did not have any repurchase transactions outstanding as of the reporting date (2009: RO nil).

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)

40 GEOGRAPHICAL DISTRIBUTION OF ASSETS AND LIABILITIES

The geographical distribution of assets and liabilities was as follows:

	Sultanate of Oman RO'000	Other GCC countries RO'000	Europe RO'000	United States of America RO'000	Others RO'000	Total RO'000
31 December 2010						
Cash and balances with Central Banks	671,160	54,895	-	-	-	726,055
Placements with banks	11,701	150,017	106,496	44,208	237,927	550,349
Loans and advances	3,792,135	165,465	2,668	-	47,658	4,007,926
Investments	199,155	82,716	9,652	5,500	24,921	321,944
Property, equipment and other assets	<u>240,651</u>	<u>4,203</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>244,854</u>
Total assets	<u>4,914,802</u>	<u>457,296</u>	<u>118,816</u>	<u>49,708</u>	<u>310,506</u>	<u>5,851,128</u>
Deposits from banks	29,286	108,049	185,606	6	436,939	759,886
Customers' deposits and certificates of deposit	3,426,448	239,918	4,272	126	10,789	3,681,553
Unsecured bonds and floating rate notes	54,803	-	15,400	-	-	70,203
Other liabilities and taxation	356,532	2,552	508	-	-	359,592
Subordinated liabilities	145,000	-	-	38,500	-	183,500
Shareholders' funds	<u>796,394</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>796,394</u>
Total liabilities and equity	<u>4,808,463</u>	<u>350,519</u>	<u>205,786</u>	<u>38,632</u>	<u>447,728</u>	<u>5,851,128</u>

	Sultanate of Oman RO'000	Other GCC countries RO'000	Europe RO'000	United States of America RO'000	Others RO'000	Total RO'000
31 December 2009						
Cash and balances with Central Banks	598,295	9,804	-	-	-	608,099
Placements with banks	61,523	480,493	203,657	32,937	237,081	1,015,691
Loans and advances	3,621,646	185,978	4,628	-	25,959	3,838,211
Investments	89,306	91,222	4,134	6,032	20,844	211,538
Property, equipment and other assets	<u>173,067</u>	<u>4,130</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>177,197</u>
Total assets	<u>4,543,837</u>	<u>771,627</u>	<u>212,419</u>	<u>38,969</u>	<u>283,884</u>	<u>5,850,736</u>
Deposits from banks	29,900	193,657	214,765	-	957,425	1,395,747
Customers' deposits and certificates of deposit	2,997,575	199,606	3,039	759	6,646	3,207,625
Unsecured bonds and floating rate notes	54,803	-	15,400	-	-	70,203
Other liabilities and taxation	275,271	2,074	-	-	-	277,345
Subordinated liabilities	150,000	-	-	38,500	-	188,500
Shareholders' funds	<u>711,316</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>711,316</u>
Total liabilities and equity	<u>4,218,865</u>	<u>395,337</u>	<u>233,204</u>	<u>39,259</u>	<u>964,071</u>	<u>5,850,736</u>

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)

40 GEOGRAPHICAL DISTRIBUTION OF ASSETS AND LIABILITIES (continued)

	Sultanate of Oman USD'000	Other GCC countries USD'000	Europe USD'000	United States of America USD'000	Others USD'000	Total USD'000
31 December 2010						
Cash and balances with Central Banks	1,743,273	142,584	-	-	-	1,885,857
Placements with banks	30,392	389,655	276,613	114,826	617,992	1,429,478
Loans and advances	9,849,701	429,779	6,930	-	123,787	10,410,197
Investments	517,284	214,847	25,070	14,286	64,730	836,217
Property, equipment and other assets	<u>625,068</u>	<u>10,917</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>635,985</u>
Total assets	<u>12,765,718</u>	<u>1,187,782</u>	<u>308,613</u>	<u>129,112</u>	<u>806,509</u>	<u>15,197,734</u>
Deposits from banks	76,067	280,647	482,094	16	1,134,906	1,973,730
Customers' deposits and certificates of deposit	8,899,865	623,164	11,096	327	28,023	9,562,475
Unsecured bonds and floating rate notes	142,345	-	40,000	-	-	182,345
Other liabilities and taxation	926,056	6,629	1,319	-	-	934,004
Subordinated liabilities	376,623	-	-	100,000	-	476,623
Shareholders' funds	<u>2,068,557</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>2,068,557</u>
Total liabilities and equity	<u>12,489,513</u>	<u>910,440</u>	<u>534,509</u>	<u>100,343</u>	<u>1,162,929</u>	<u>15,197,734</u>

	Sultanate of Oman USD'000	Other GCC countries USD'000	Europe USD'000	United States of America USD'000	Others USD'000	Total USD'000
31 December 2009						
Cash and balances with Central Banks	1,554,013	25,465	-	-	-	1,579,478
Placements with banks	159,799	1,248,034	528,979	85,551	615,795	2,638,158
Loans and advances	9,406,873	483,060	12,021	-	67,425	9,969,379
Investments	231,963	236,940	10,738	15,668	54,140	549,449
Property, equipment and other assets	<u>449,523</u>	<u>10,729</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>460,252</u>
Total assets	<u>11,802,171</u>	<u>2,004,228</u>	<u>551,738</u>	<u>101,219</u>	<u>737,360</u>	<u>15,196,716</u>
Deposits from banks	77,663	503,005	557,831	-	2,486,818	3,625,317
Customers' deposits and certificates of deposit	7,785,908	518,457	7,894	1,971	17,262	8,331,492
Unsecured bonds and floating rate notes	142,345	-	40,000	-	-	182,345
Other liabilities and taxation	714,990	5,387	-	-	-	720,377
Subordinated liabilities	389,610	-	-	100,000	-	489,610
Shareholders' funds	<u>1,847,575</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,847,575</u>
Total liabilities and equity	<u>10,958,091</u>	<u>1,026,849</u>	<u>605,725</u>	<u>101,971</u>	<u>2,504,080</u>	<u>15,196,716</u>

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)

41 SEGMENTAL INFORMATION

Management has determined the operating segments based on the reports reviewed by the executive committee that are used to make strategic decisions. The committee considers the business from both a geographic and product perspective. Geographically, management considers the performance of whole bank in Oman and International markets. The Oman market is further segregated into corporate, consumer and wholesale, as all of these business lines are located in Oman.

Segment information in respect of geographical locations is as follows:

For the year ended 31 December 2010

Total USD'000	International USD'000	Oman USD'000		Oman RO'000	International RO'000	Total RO'000
714,792	14,867	699,925	Segment revenue			
(228,571)	(4,989)	(223,582)	Interest income	269,471	5,724	275,195
135,416	2,876	132,540	Interest expense	(86,079)	(1,921)	(88,000)
<u>67,964</u>	<u>273</u>	<u>67,691</u>	Commission and fees income (net)	51,028	1,107	52,135
689,601	13,027	676,574	Other operating income	<u>26,061</u>	<u>105</u>	<u>26,166</u>
			Operating income	260,481	5,015	265,496
			Segment costs			
(244,543)	(18,013)	(226,530)	Other operating expenses	(87,214)	(6,935)	(94,149)
(22,738)	(2,706)	(20,031)	Depreciation	(7,712)	(1,042)	(8,754)
(121,010)	(20,634)	(100,376)	Impairment for credit losses	(38,645)	(7,944)	(46,589)
35,449	467	34,982	Recoveries from provision for credit losses	13,468	180	13,648
(1,706)	-	(1,706)	Impairment for investments	(657)	-	(657)
356	-	356	Recoveries from impairment for investments	137	-	137
(5,455)	-	(5,455)	Impairment of placements	(2,100)	-	(2,100)
8,844	-	8,844	Recoveries from placements	3,405	-	3,405
(32,823)	(32,823)	-	Share of losses from associates	-	(12,637)	(12,637)
<u>(42,091)</u>	<u>(242)</u>	<u>(41,849)</u>	Tax expense	<u>(16,112)</u>	<u>(93)</u>	<u>(16,205)</u>
(425,717)	(73,951)	(351,766)	Total costs	(135,430)	(28,471)	(163,901)
263,884	(60,924)	324,808	Segment net profit/(loss) for the year	125,051	(23,456)	101,595
			Other information			
15,197,734	644,410	14,553,324	Segment assets and liabilities	5,603,030	248,098	5,851,128
148,875	3,187	145,688	Segment capital expenses	56,090	1,227	57,317

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)

41 SEGMENTAL INFORMATION (continued)

For the year ended 31 December 2009

Total USD'000	International USD'000	Oman USD'000		Oman RO'000	International RO'000	Total RO'000
726,052	15,047	711,005	Segment revenue			
(273,154)	(7,894)	(265,260)	Interest income	273,737	5,793	279,530
129,379	2,683	126,696	Interest expense	(102,125)	(3,039)	(105,164)
<u>173,683</u>	<u>157,662</u>	<u>16,021</u>	Commission and fees income (net)	48,778	1,033	49,811
<u>755,960</u>	<u>167,498</u>	<u>588,462</u>	Other operating income	<u>6,168</u>	<u>60,700</u>	<u>66,868</u>
			Operating income	<u>226,558</u>	<u>64,487</u>	<u>291,045</u>
			Segment costs			
(196,111)	(11,184)	(184,927)	Other operating expenses	(71,197)	(4,306)	(75,503)
(17,200)	(2,153)	(15,047)	Depreciation	(5,793)	(829)	(6,622)
(255,174)	(155,340)	(99,834)	Impairment for credit losses	(38,436)	(59,806)	(98,242)
27,504	-	27,504	Recoveries from provision for credit losses	10,589	-	10,589
(7,636)	-	(7,636)	Impairment for investments	(2,940)	-	(2,940)
1,104	-	1,104	Recoveries from impairment for investments	425	-	425
(52,766)	(52,766)	-	Impairment for associates	-	(20,315)	(20,315)
(27,156)	(27,156)	-	Share of losses from associates	-	(10,455)	(10,455)
<u>(37,049)</u>	<u>(19,249)</u>	<u>(17,800)</u>	Tax expense	<u>(6,853)</u>	<u>(7,411)</u>	<u>(14,264)</u>
<u>(564,485)</u>	<u>(267,848)</u>	<u>(296,636)</u>	Total costs	<u>(114,205)</u>	<u>(103,122)</u>	<u>(217,327)</u>
<u>191,476</u>	<u>(100,350)</u>	<u>291,826</u>	Segment net profit/(loss) for the year	<u>112,353</u>	<u>(38,635)</u>	<u>73,718</u>
			Other information			
15,196,716	774,434	14,422,282	Segment assets and liabilities	5,552,579	298,157	5,850,736
28,483	3,093	25,389	Segment capital expenses	9,775	1,191	10,966

BANK MUSCAT SAOG

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)

41 SEGMENTAL INFORMATION (continued)

The Group reports the segment information by the following business segments corporate, consumer, wholesale and international. The following table shows the distribution of the Group's operating income, net profit and total assets by business segments:

31 December 2010

	Corporate banking RO'000	Consumer banking RO'000	Wholesale banking RO'000	International RO'000	Total RO'000
Net interest income	66,025	80,876	35,950	4,344	187,195
Commission, fees and other income (net)	<u>13,451</u>	<u>33,770</u>	<u>29,928</u>	<u>1,152</u>	<u>78,301</u>
Operating income	<u>79,476</u>	<u>114,646</u>	<u>65,878</u>	<u>5,496</u>	<u>265,496</u>
Segment costs					
Operating expense (including depreciation)	(17,656)	(63,532)	(10,743)	(10,972)	(102,903)
Impairment for credit losses (net)	(8,086)	(17,084)	-	(7,771)	(32,941)
Reversal of impairments for placements/Investments (net)	-	-	785	-	785
Share of loss from associates (net)	-	-	-	(12,637)	(12,637)
Tax expenses	<u>(6,024)</u>	<u>(3,814)</u>	<u>(6,274)</u>	<u>(93)</u>	<u>(16,205)</u>
	<u>(31,766)</u>	<u>(84,430)</u>	<u>(16,232)</u>	<u>(31,473)</u>	<u>(163,901)</u>
Segment net profit/(loss) for the year	<u>47,710</u>	<u>30,216</u>	<u>49,646</u>	<u>(25,977)</u>	<u>101,595</u>
Segment assets	<u>2,324,686</u>	<u>1,997,400</u>	<u>1,280,944</u>	<u>248,098</u>	<u>5,851,128</u>
Operating income (USD'000)	<u>206,432</u>	<u>297,782</u>	<u>171,112</u>	<u>14,275</u>	<u>689,601</u>
Net profit (USD'000)	<u>123,922</u>	<u>78,484</u>	<u>128,951</u>	<u>(67,473)</u>	<u>263,884</u>
Segment assets (US '000)	<u>6,038,144</u>	<u>5,188,052</u>	<u>3,327,128</u>	<u>644,410</u>	<u>15,197,734</u>

31 December 2009

	Corporate banking RO'000	Consumer banking RO'000	Wholesale banking RO'000	International RO'000	Total RO'000
Net interest income	55,103	83,993	32,264	3,006	174,366
Commission, fees and other income (net)	<u>12,880</u>	<u>31,427</u>	<u>10,375</u>	<u>61,997</u>	<u>116,679</u>
Operating income	67,983	115,420	42,639	65,003	291,045
Segment costs					
Operating expense (including depreciation)	(14,106)	(51,420)	(9,708)	(6,891)	(82,125)
Impairment for credit losses (net)	(5,003)	(22,441)	(400)	(59,809)	(87,653)
Other impairments (net)	-	-	(2,515)	(20,315)	(22,830)
Share of profit/(loss) from associates	-	-	-	(10,455)	(10,455)
Tax expenses	<u>(2,781)</u>	<u>(2,364)</u>	<u>(1,708)</u>	<u>(7,411)</u>	<u>(14,264)</u>
	<u>(21,890)</u>	<u>(76,225)</u>	<u>(14,331)</u>	<u>(104,881)</u>	<u>(217,327)</u>
Segment net profit/(loss) for the year	<u>46,093</u>	<u>39,195</u>	<u>28,308</u>	<u>(39,878)</u>	<u>73,718</u>
Segment assets and liabilities	<u>2,192,791</u>	<u>1,907,286</u>	<u>1,452,502</u>	<u>298,157</u>	<u>5,850,736</u>
Operating income (USD'000)	<u>176,579</u>	<u>299,792</u>	<u>110,751</u>	<u>168,839</u>	<u>755,961</u>
Net profit (USD'000)	<u>119,722</u>	<u>101,805</u>	<u>73,528</u>	<u>(103,579)</u>	<u>191,476</u>
Segment assets (US'000)	<u>5,695,561</u>	<u>4,953,991</u>	<u>3,772,730</u>	<u>774,434</u>	<u>15,196,716</u>

BANK MUSCAT SAOG**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)****42 FINANCIAL RISK MANAGEMENT****42.1 Introduction and overview**

Risk Management is the process by which the Group identifies key risks, obtains consistent, understandable risk measures and chooses which risks to reduce and which to increase and by what means and establishes procedures to monitor the resulting risk position. The objective of risk management is to ensure that the Group operates within the risk levels set by the Group's Board of Directors while the various business functions pursue their objective of maximizing the risk adjusted returns. The Group has exposure to the following core risks from its use of financial instruments:

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

Risk management is the overall responsibility of the Group's Board of Directors and is managed by the Board Risk Committee (BRC). The Board reviews and approves the risk management strategy of the Group and defines its risk appetite. The board approved strategy is implemented at management level through management committees and executive management. For the purpose of day-to-day management of risks, the Group has created an independent Risk Management department. Risk Management department objectively reviews and ensures that the various functions of the Group operate in compliance with the risk parameters as set by the Board of Directors. Risk Management has a direct reporting line to the Board of Directors of the Group and for operational convenience a dotted line reporting to the Deputy Chief Executive independent of business lines.

The risk appetite of the Group in various business areas is defined and communicated through an enterprise-wide risk policy. The Group's risk policy, approved by its Board of Directors, analyses and sets risk limits for core risks - Credit risk, Liquidity risk, Market risk and Operational risk. The risk levels of each of these categories is measured and monitored on a continuous basis and compliance to prescribed risk levels reported to Board of Directors on a quarterly basis. It ensures prudent management of the risks assumed by the Group in its normal course of business. The risk policy is updated regularly, based on an analysis of the economic trends and the operating environment in the countries where the Group operates.

42.2 Credit risk**42.2.1 Management of credit risk**

Credit risk is the potential loss resulting from the failure of a borrower or counter party to honour its financial or contractual obligations in accordance with the agreed terms. The function of credit risk management is to maximise the Group's risk-adjusted rate of return by maintaining credit risk exposure within acceptable parameters. Credit risk makes up the largest part of the Group's risk exposure. Credit Risk Management process of the Group begins with the risk policy, updated regularly, which clearly defines parameters for each type of risks assumed by the Group.

The Group has set for itself clear and well defined limits to address different dimensions of credit risk including concentration risk. Compliance with the various parameters set in the risk policy is reviewed on a quarterly basis and variances from the norms are reported to the Board of Directors and Management to enable remedial actions.

Risk limit control and mitigation policies

The Group addresses credit risk through the following process:

- All credit processes – Approval, disbursal, administration, classification, recoveries and write-offs - are governed by the Group's Credit manual which is reviewed by Risk Management. The credit policy stipulates clear guidelines for each of these functions and the lending authority at various levels as stipulated in appropriate 'Lending Authority Limits'.
- All Corporate lending proposals, where the proposed credit limit for a borrower or related group exceeds a threshold, are submitted for approval/renewal to the appropriate authority after an independent review by the Risk Management Department whose comments are incorporated into the proposal.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)****42 FINANCIAL RISK MANAGEMENT (continued)****42.2 Credit risk (continued)****42.2.1 Management of credit risk (continued)**

- All corporate lending accounts are reviewed at least once a year. The consumer-lending portfolio, including credit cards, is reviewed on a portfolio basis at least once a year.
- Concentration of exposure to counterparties, geographies and sector are governed and monitored according to regulatory norms and limits prescribed in the Group's risk policy.
- The corporate borrowers are risk rated to provide support for credit decisions. The portfolio is analyzed based on risk grades and risk grade migration to focus on management of prevalent credit risk.

The Group employs a range of policies and practices to mitigate credit risk. The most traditional approach consists in taking of security for funds advances, which is common practice. The Group implements guidelines on the acceptability of specific classes of collateral or credit risk mitigation. The principal collateral types for loans and advances are:

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

Longer-term finance and lending to corporate entities are generally secured; revolving individual credit facilities are generally unsecured. In addition, in order to minimise the credit loss, the Group will seek additional collateral from the counterparty as soon as impairment indicators are noticed for the relevant individual loans and advances. Collateral held as security for financial assets other than loans and advances, is determined by the nature of the instrument. Debt securities, treasury and other eligible bills are generally unsecured.

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

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)

42 FINANCIAL RISK MANAGEMENT (continued)

42.2.2 Exposure to credit risk – Statement of financial position items

	Loans and advances to customers		Placements with banks		Investment securities	
	2010 RO'000	2009 RO'000	2010 RO'000	2009 RO'000	2010 RO'000	2009 RO'000
Individually impaired						
Sub-Standard	17,312	15,614	-	-	-	-
Doubtful	11,610	20,768	-	9,626	13,575	13,897
Loss	<u>74,269</u>	<u>117,234</u>	-	-	<u>1,891</u>	<u>1,891</u>
Gross amount	103,191	153,616	-	9,626	15,466	15,788
Allowance for impairment	(68,700)	(115,701)	-	(4,813)	(5,376)	(5,666)
Carrying amount	<u>34,491</u>	<u>37,915</u>	<u>-</u>	<u>4,813</u>	<u>10,090</u>	<u>10,122</u>
Collectively impaired						
Sub-Standard	13,960	15,339	-	-	-	-
Doubtful	19,266	19,152	-	-	-	-
Loss	<u>39,469</u>	<u>22,679</u>	-	-	-	-
Gross amount	<u>72,695</u>	<u>57,170</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Allowance for impairment	(54,704)	(41,900)	-	-	-	-
Carrying amount	<u>17,991</u>	<u>15,270</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Past due but not impaired						
Standard	<u>227,494</u>	<u>111,908</u>	-	-	-	-
Carrying amount	<u>227,494</u>	<u>111,908</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
<i>Past due but not impaired comprises:</i>						
1-30 days	92,063	56,549	-	-	-	-
30-60 days	88,531	38,397	-	-	-	-
60-90 days	<u>46,900</u>	<u>16,962</u>	-	-	-	-
	<u>227,494</u>	<u>111,908</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Neither past due nor impaired						
Standard	3,473,041	3,499,226	552,849	1,010,878	256,937	134,244
Special mention	<u>317,771</u>	<u>230,136</u>	-	-	-	-
Gross amount	<u>3,790,812</u>	<u>3,729,362</u>	<u>552,849</u>	<u>1,010,878</u>	<u>256,937</u>	<u>134,244</u>
Allowance for impairment	(62,862)	(56,244)	(2,500)	-	-	-
Carrying amount	<u>3,727,950</u>	<u>3,673,118</u>	<u>550,349</u>	<u>1,010,878</u>	<u>256,937</u>	<u>134,244</u>
Total carrying amount	<u>4,007,926</u>	<u>3,838,211</u>	<u>550,349</u>	<u>1,015,691</u>	<u>267,027</u>	<u>144,366</u>
Carrying amount in USD'000	<u>10,410,197</u>	<u>9,969,379</u>	<u>1,429,478</u>	<u>2,638,158</u>	<u>693,577</u>	<u>374,977</u>
Total allowances for impairment	<u>(186,266)</u>	<u>(213,845)</u>	<u>(2,500)</u>	<u>(4,813)</u>	<u>(5,376)</u>	<u>(5,666)</u>
IN USD'000	<u>(483,808)</u>	<u>(555,442)</u>	<u>(6,494)</u>	<u>(12,501)</u>	<u>(13,964)</u>	<u>(14,717)</u>

Total impairment above includes impairment for off-balance sheet exposures as well.

Restructured and rescheduled loans during the year on standard portfolio amounted to RO 106 K (2009: RO 98K) and on classified portfolio it amounted to RO 25K (2009: RO 18K)

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)

42 FINANCIAL RISK MANAGEMENT (continued)

42.2.2 Exposure to credit risk - Statement of financial position items (continued)

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

The maximum credit risk exposures relating to off-balance sheet items calculated as per Basel II guidelines are as follows:

2009	2010		2010	2009
USD'000	USD'000		RO'000	RO'000
397,722	561,888	Financial guarantees	216,327	153,123
741,174	980,372	Other credit related liabilities	377,443	285,352
388,042	383,234	Loan commitments	147,545	149,396
<u>1,526,938</u>	<u>1,925,494</u>		<u>741,315</u>	<u>587,871</u>

The above table represents a worse case scenario of credit risk exposure as of 31 December 2009 and 2010, without taking into account of any collateral held or other credit enhancements attached.

Management is confident in its ability to continue to control and sustain minimal exposure of credit risk resulting from the Group's loan and advances portfolio based on the following:

- Regular review of the loans and advances portfolio to identify any potential risk;
- 93% of the loans and advances portfolio are considered to be neither past due nor impaired (2009: 92%);
- Of the RO 2,536 million (2009: RO 2,489 million) loans and advances assessed on an individual basis, less than 4.1% (2009: 6.2%) is impaired;
- Personal and housing loans represent 39.5% (2009: 39%) of total loans and advances which are backed by salary assignment and/or by collaterals;
- Well diversified loans and advances portfolio to avoid concentration risk in segment, sector, geographies and counterparty.

42.2.3 Impaired loans and securities

Impaired loans and securities are loans and securities for which the Group determines that it is probable that it will be unable to collect all principal and interest due according to the contractual terms of the loan and security agreements. Those loans are categorised either as Sub-standard, Doubtful or Loss in the internal credit risk system.

42.2.4 Past due but not impaired loans

Loans and securities where contractual interest or principal payments are past due but the Group believes that impairment is not appropriate on the basis of the stage of collection of amounts owed to the Group.

42.2.5 Allowances for impairment

The Group establishes an allowance for impairment losses that represents its estimate of incurred losses in its loan portfolio. The main components of this allowance are a specific loss component that relates to individually significant exposures. A collective loan loss allowance is established for Groups of homogeneous assets in respect of losses that have been incurred but have not been identified on loans subject to individual assessment for impairment. The Group makes provision for bad and doubtful debts promptly when required in line with the conservative provisioning norms it has set for itself.

42.2.6 Write-off policy

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

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)

42 FINANCIAL RISK MANAGEMENT (continued)

42.2.6 Write-off policy (continued)

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

	Loans and Advances to customers		Placements with banks		Investment Securities	
	Gross RO'000	Net RO'000	Gross RO'000	Net RO'000	Gross RO'000	Net RO'000
2010						
Sub-Standard	17,312	12,686	-	-	-	-
Doubtful	11,610	5,474	-	-	13,575	10,090
Loss	<u>74,269</u>	<u>16,331</u>	-	-	<u>1,891</u>	-
Total amount	<u>103,191</u>	<u>34,491</u>	<u>-</u>	<u>-</u>	<u>15,466</u>	<u>10,090</u>
Total in USD'000	<u>268,029</u>	<u>89,587</u>	<u>-</u>	<u>-</u>	<u>40,171</u>	<u>26,208</u>
2009						
Sub-Standard	15,614	11,389	-	-	-	-
Doubtful	20,768	11,173	9,626	4,813	13,897	10,122
Loss	<u>117,234</u>	<u>15,353</u>	-	-	<u>1,891</u>	-
Total amount	<u>153,616</u>	<u>37,915</u>	<u>9,626</u>	<u>4,813</u>	<u>15,788</u>	<u>10,122</u>
Total in USD'000	<u>399,003</u>	<u>98,481</u>	<u>25,003</u>	<u>12,501</u>	<u>41,008</u>	<u>26,291</u>

The Group holds collateral against credit exposures to customers in the form of cash on deposits, bank guarantees, quoted securities, mortgage interest over property, other registered securities over assets and other guarantees. Estimates of fair value are based on the value of collateral assessed at the time of borrowing and are updated regularly.

42.2.7 Analysis of impairment and collaterals

(a) An estimate of the fair value of collateral and other security enhancements held against financial assets is shown below:

Loans and Advances			Loans and Advances	
2009	2010		2010	2009
USD'000	USD'000		RO'000	RO'000
		Against individually impaired		
134,797	96,891	Property	37,303	51,897
1,060	1,153	Equities	444	408
<u>59,844</u>	<u>28,525</u>	Others	<u>10,982</u>	<u>23,040</u>
<u>195,701</u>	<u>126,569</u>		<u>48,729</u>	<u>75,345</u>
		Against past due but not impaired		
39,353	100,203	Property	38,578	15,151
19,203	148,478	Equities	57,164	7,393
<u>37,535</u>	<u>6,210</u>	Others	<u>2,391</u>	<u>14,451</u>
<u>96,091</u>	<u>254,891</u>		<u>98,133</u>	<u>36,995</u>
		Against neither past due nor impaired		
1,181,390	1,283,374	Property	494,099	454,835
988,356	881,060	Equities	339,208	380,517
<u>317,602</u>	<u>279,174</u>	Others	<u>107,482</u>	<u>122,277</u>
<u>2,487,348</u>	<u>2,443,608</u>		<u>940,789</u>	<u>957,629</u>
<u>2,779,140</u>	<u>2,825,068</u>	Total	<u>1,087,651</u>	<u>1,069,969</u>

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42 FINANCIAL RISK MANAGEMENT (continued)

42.2.7 Analysis of impairment and collaterals (continued)

(b) Repossessed collateral

The Group obtains assets by taking possession of collateral held as security. The carrying value of collateral held for sale as at 31 December 2010 is as follows:

Nature of assets	Carrying amount	
	2010 RO'000	2009 RO'000
Residential/commercial property	<u>1,195</u>	<u>1,195</u>
USD'000	<u>3,104</u>	<u>3,104</u>

Repossessed properties are sold as soon as practicable, with the proceeds used to reduce the outstanding indebtedness. Repossessed property is classified in the statement of financial position within other assets.

42.2.8 Credit rating analysis

The table below presents an analysis of debt securities, treasury bills and other eligible bills by rating agency designation at 31 December 2010, based on Moody's ratings or their equivalent:

31 December 2010

	2010 RO'000	2009 RO'000
Banks rated:		
Aaa to Aa3	142,137	72,714
A1 to A3	6,044	5,324
Baa1 to Baa3	6,203	5,208
Banks unrated	<u>4,016</u>	<u>3,144</u>
	158,400	86,390
Equity	<u>114,003</u>	<u>63,642</u>
Total investment securities	<u>272,403</u>	<u>150,032</u>

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

	2010 RO'000	2009 RO'000
Banks rated:		
Aaa to Aa3	99,452	134,016
A1 to A3	69,275	278,979
Baa1 to Baa3	47,099	85,611
Ba1 to Ba3	201,904	247,487
B1 to B3	9	2,772
Banks unrated	<u>135,110</u>	<u>266,826</u>
Total	<u>552,849</u>	<u>1,015,691</u>

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

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42 FINANCIAL RISK MANAGEMENT (continued)

42.2.9 Concentration of credit risk

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

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

Concentration by location for loans and advances is measured based on the location of the Group holding the asset, which has a high co-relation with the location of the borrower. Concentration by location for investment securities is measured based on the location of the issuer of the security.

An analysis of concentrations of credit risk as the reporting date is shown below.

Carrying amount	Gross loans and advances to customers		Gross loans and advances to banks		Gross investment in securities	
	2010 RO'000	2009 RO'000	2010 RO'000	2009 RO'000	2010 RO'000	2009 RO'000
Concentration by Sector						
Corporate	2,327,837	2,330,291	-	-	127,092	75,748
Sovereign	36,443	17,973	-	-	138,955	70,267
Financial institution	172,102	140,613	552,849	1,020,504	6,356	4,017
Retail	1,657,810	1,563,179	-	-	-	-
Total	4,194,192	4,052,056	552,849	1,020,504	272,403	150,032
USD'000	10,894,005	10,524,821	1,435,971	2,650,660	707,540	389,694

The table below analyses the concentration of gross loans and advances to customers by various sectors.

2009 USD'000	2010 USD'000		2010 RO'000	2009 RO'000
		Corporate and other loans		
1,243,730	1,346,571	Services	518,430	478,836
906,865	841,234	Mining and quarrying	323,875	349,143
685,205	615,268	Manufacture	236,878	263,804
667,335	785,031	Real estate	302,237	256,924
593,008	459,582	Wholesale and retail trade	176,939	228,308
487,255	567,644	Import trade	218,543	187,593
365,229	447,018	Financial institutions	172,102	140,613
362,130	309,932	Utilities	119,324	139,420
292,340	430,735	Transport	165,833	112,551
256,060	237,909	Construction	91,595	98,583
46,683	94,657	Government	36,443	17,973
26,525	29,722	Agriculture and allied activities	11,443	10,212
4,885	5,221	Export trade	2,010	1,881
527,366	417,481	Others	160,730	203,036
6,464,616	6,588,005		2,536,382	2,488,877
4,060,205	4,306,000	Personal and Housing loans	1,657,810	1,563,179
<u>10,524,821</u>	<u>10,894,005</u>		<u>4,194,192</u>	<u>4,052,056</u>

The Group monitors concentrations of credit risk by sector and by geographic location.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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42 FINANCIAL RISK MANAGEMENT (continued)

42.2.9 Concentration of credit risk (continued)

An analysis of concentrations of credit risk by location at the reporting date is shown below.

	Gross Loans and Advances to customers		Gross Loans and Advances to banks		Investment securities	
	2010 RO'000	2009 RO'000	2010 RO'000	2009 RO'000	2010 RO'000	2009 RO'000
Concentration by location						
Sultanate of Oman	3,960,279	3,774,148	14,201	61,523	149,614	92,574
Other GCC countries	183,587	247,321	150,017	480,493	82,716	34,040
Europe	2,668	4,628	106,496	208,470	9,652	4,258
United States of America	-	-	44,208	32,937	5,500	6,469
Others	47,658	25,959	237,927	237,081	24,921	12,691
	<u>4,194,192</u>	<u>4,052,056</u>	<u>552,849</u>	<u>1,020,504</u>	<u>272,403</u>	<u>150,032</u>
USD'000	<u>10,894,005</u>	<u>10,524,821</u>	<u>1,435,971</u>	<u>2,650,659</u>	<u>707,540</u>	<u>389,693</u>

42.2.10 Settlement risk

The Group's activities may give rise to risk at the time of settlement of transactions and trades. Settlement risk is the risk of loss due to the failure of counterparty to honour its obligation to deliver cash, securities or other assets as contractually agreed.

The Group mitigates settlement risk by conducting settlements through a settlement / clearing agent or having bilateral payment netting agreements. Settlement limits form part of the credit approval or limit monitoring process of the risk management system.

42.3 Liquidity risk

Liquidity risk is the potential inability of the Group to meet its maturing obligations to a counter party.

42.3.1 Management of liquidity risk

In order to ensure that the Group can meet its financial obligations as and when they fall due, there is close monitoring of the assets/liabilities position. Liquidity risk management ensures that the Group has the ability under varying scenarios to fund increase in assets and meet maturing obligations as they arise. Parent Company Asset - Liability Committee (ALCO) monitors its liquidity position. In addition, it is also responsible for funding strategy and foreign exchange risk review.

The Parent Company's treasury division is responsible for the day-to-day liquidity management under the guidance and supervision of Asset and Liability Management Committee (ALCO). Its risk policy stipulates broad guidelines in respect of liquidity risk management such as gap limits, minimum liquidity ratio and limit on illiquid assets.

The Group manages its liquidity to ensure payment obligations are met in time both under normal conditions as well as stressed conditions.

A diversified funding base has evolved to include deposits raised from interbank placements, certificates of deposits, customer deposits, bonds and medium term funds raised through floating rate notes and subordinated liabilities. These together with the strength of the Group's equity and asset quality ensure that funds are made available at competitive rates.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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42 FINANCIAL RISK MANAGEMENT (continued)

42.3.1 Management of liquidity risk (continued)

The sources and maturities of assets and liabilities are closely monitored to avoid any undue concentration and ensure a robust management of liquidity risks. The deposits source is widespread, has maintained a stable profile during the year and is within the limits prescribed by the risk policy to manage concentration of deposits. A substantial portion of the Group's deposits is made up of retail current, savings and fixed deposit accounts, which, though payable on demand or at short notice, have traditionally formed part of a stable deposit base and a key source of funds for the Group.

The Group undertakes structural profiling based on the actual behavioural patterns of customers to study the structural liquidity position and initiate measures to fund gaps. The structural profiling helps the bank in understanding the behaviour pattern in the current and savings accounts where though the balances are payable on demand, they exhibit stable behaviour.

42.3.2 Exposure to liquidity risk

The key measure used by the Group for managing liquidity risk is the ratio of liquid assets to total deposits and liquid assets to total assets. For this purpose the liquid assets include cash and balances with Central Banks, government securities, treasury bills and placements with banks. The table below provides the ratio of liquid assets to deposits from customers and liquid assets to total assets at the reporting date and during the reporting period.

	Liquid assets to total assets ratio		Liquid assets to total deposits ratio	
	2010	2009	2010	2009
As at 31 December	24.22%	29.13%	31.41%	36.24%
Average for the period	30.41%	28.86%	38.41%	36.17%
Maximum for the period	31.92%	32.57%	41.30%	40.64%
Minimum for the period	24.22%	25.73%	31.41%	32.54%

The table below analyses the Group's non-derivative financial liabilities and net-settled derivative financial liabilities into relevant maturity groupings based on the remaining period at the reporting date to the contractual maturity date. Derivative financial liabilities are included in the analysis if their contractual maturities are essential for an understanding of the timing of the cash flows. The amounts disclosed in the table are the contractual undiscounted cash flows.

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42 FINANCIAL RISK MANAGEMENT (continued)

42.3.2 Exposure to liquidity risk

The asset and liability maturity profile was as follows:

	On demand or within three months RO'000	Four months to 12 months RO'000	One to five years RO'000	More than five years RO'000	Total RO'000
31 December 2010					
Assets					
Cash and balances with Central Banks	551,212	48,168	78,085	48,590	726,055
Placements with banks	384,453	93,316	32,651	39,929	550,349
Loans and advances	599,754	380,239	1,125,589	1,902,344	4,007,926
Investments	204,316	12,781	40,042	64,805	321,944
Property and equipment and other assets	87,297	70,901	13,583	73,073	244,854
Total assets	<u>1,827,032</u>	<u>605,405</u>	<u>1,289,950</u>	<u>2,128,741</u>	<u>5,851,128</u>
Liabilities and equity					
Deposits from banks	472,872	204,539	40,877	41,598	759,886
Customers' deposits and certificates of deposit	1,005,489	764,936	1,191,481	719,647	3,681,553
Unsecured bonds and floating rate notes	-	9,625	60,578	-	70,203
Other liabilities and taxation	119,456	135,585	40,798	63,753	359,592
Subordinated liabilities	-	-	108,500	75,000	183,500
Shareholders' funds	-	-	-	796,394	796,394
Total liabilities and equity	<u>1,597,817</u>	<u>1,114,685</u>	<u>1,442,234</u>	<u>1,696,392</u>	<u>5,851,128</u>
Assets off balance sheet					
Future interest cash flows	<u>57,339</u>	<u>159,063</u>	<u>561,611</u>	<u>361,374</u>	<u>1,139,387</u>
Liabilities off balance sheet					
Future interest cash flows	<u>13,396</u>	<u>43,702</u>	<u>169,641</u>	<u>142,079</u>	<u>368,818</u>

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42 FINANCIAL RISK MANAGEMENT (continued)

42.3.2 Exposure to liquidity risk (continued)

	On demand or within three months RO'000	Four months to 12 months RO'000	One to five years RO'000	More than five years RO'000	Total RO'000
31 December 2009					
Assets					
Cash and balances with Central Banks	567,230	12,427	16,447	11,995	608,099
Placements with banks	743,615	208,574	32,261	31,241	1,015,691
Loans and advances	371,237	417,489	1,227,153	1,822,332	3,838,211
Investments	83,488	7,768	32,538	87,744	211,538
Property and equipment and other assets	77,931	69,419	633	29,214	177,197
Total assets	<u>1,843,501</u>	<u>715,677</u>	<u>1,309,032</u>	<u>1,982,526</u>	<u>5,850,736</u>
Liabilities and equity					
Deposits from banks	1,003,676	130,215	186,719	75,137	1,395,747
Customers' deposits and certificates of deposit	809,541	812,574	991,347	594,163	3,207,625
Unsecured bonds and floating rate notes	-	-	70,203	-	70,203
Other liabilities and taxation	72,038	133,824	34,636	36,847	277,345
Subordinated liabilities	-	5,000	108,500	75,000	188,500
Shareholders' funds	-	-	-	711,316	711,316
Total liabilities and equity	<u>1,885,255</u>	<u>1,081,613</u>	<u>1,391,405</u>	<u>1,492,463</u>	<u>5,850,736</u>
Assets off balance sheet					
Future interest cash flows	<u>58,580</u>	<u>156,664</u>	<u>536,979</u>	<u>325,396</u>	<u>1,077,619</u>
Liabilities off balance sheet					
Future interest cash flows	<u>15,266</u>	<u>42,494</u>	<u>146,284</u>	<u>23,174</u>	<u>227,218</u>

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42 FINANCIAL RISK MANAGEMENT (continued)

42.3.2 Exposure to liquidity risk (continued)

	On demand or within three months USD'000	Four months to 12 months USD'000	One to five years USD'000	More than five years USD'000	Total USD'000
31 December 2010					
Assets					
Cash and balances with Central Banks	1,431,720	125,112	202,818	126,207	1,885,857
Placements with banks	998,579	242,379	84,808	103,712	1,429,478
Loans and advances	1,557,803	987,634	2,923,608	4,941,152	10,410,197
Investments	530,691	33,197	104,005	168,324	836,217
Property and equipment and other assets	<u>226,745</u>	<u>184,158</u>	<u>35,281</u>	<u>189,801</u>	<u>635,985</u>
Total assets	<u>4,745,538</u>	<u>1,572,480</u>	<u>3,350,520</u>	<u>5,529,196</u>	<u>15,197,734</u>
Liabilities and equity					
Deposits from banks	1,228,239	531,270	106,174	108,047	1,973,730
Customers' deposits and certificates of deposit	2,611,660	1,986,847	3,094,756	1,869,212	9,562,475
Unsecured bonds and floating rate notes	-	25,000	157,345	-	182,345
Other liabilities and taxation	310,275	352,169	105,969	165,591	934,004
Subordinated liabilities	-	-	281,818	194,805	476,623
Shareholders' funds	-	-	-	<u>2,068,557</u>	<u>2,068,557</u>
Total liabilities and equity	<u>4,150,174</u>	<u>2,895,286</u>	<u>3,746,062</u>	<u>4,406,212</u>	<u>15,197,734</u>
Assets off balance sheet					
Future interest cash flows	<u>148,932</u>	<u>413,151</u>	<u>1,458,730</u>	<u>938,634</u>	<u>2,959,447</u>
Liabilities off balance sheet					
Future interest cash flows	<u>34,795</u>	<u>113,512</u>	<u>440,626</u>	<u>369,036</u>	<u>957,969</u>

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42 FINANCIAL RISK MANAGEMENT (continued)

42.3.2 Exposure to liquidity risk (continued)

	On demand or within three months USD'000	Four months to 12 months USD'000	One to five years USD'000	More than five years USD'000	Total USD'000
31 December 2009					
Assets					
Cash and balances with Central Banks	1,473,325	32,278	42,719	31,156	1,579,478
Placements with banks	1,931,468	541,751	83,795	81,144	2,638,158
Loans and advances	964,252	1,084,387	3,187,410	4,733,330	9,969,379
Investments	216,852	20,177	84,514	227,906	549,449
Property and equipment and other assets	<u>202,418</u>	<u>180,309</u>	<u>1,644</u>	<u>75,881</u>	<u>460,252</u>
Total assets	<u>4,788,315</u>	<u>1,858,902</u>	<u>3,400,082</u>	<u>5,149,417</u>	<u>15,196,716</u>
Liabilities and equity					
Deposits from banks	2,606,951	338,221	484,984	195,161	3,625,317
Customers' deposits and certificates of deposit	2,102,703	2,110,582	2,574,927	1,543,280	8,331,492
Unsecured bonds and floating rate notes	-	-	182,345	-	182,345
Other liabilities and taxation	187,112	347,595	89,964	95,706	720,377
Subordinated liabilities	-	12,987	281,818	194,805	489,610
Shareholders' funds	-	-	-	<u>1,847,575</u>	<u>1,847,575</u>
Total liabilities and equity	<u>4,896,766</u>	<u>2,809,385</u>	<u>3,614,038</u>	<u>3,876,527</u>	<u>15,196,716</u>
Assets off balance sheet					
Future interest cash flows	<u>152,156</u>	<u>406,919</u>	<u>1,394,751</u>	<u>845,184</u>	<u>2,799,010</u>
Liabilities off balance sheet					
Future interest cash flows	<u>39,652</u>	<u>110,374</u>	<u>379,958</u>	<u>60,192</u>	<u>590,176</u>

Interest cash flows shown in the above table represent inflows and outflows up to the contractual maturity of financial assets and liabilities. Mismatch in interest cash flows arise as contractual maturity of financial assets is longer than contractual maturity of financial liabilities. Historically, financial liabilities are rolled over on contractual maturity which is not considered in the future interest cash flow calculations. Furthermore, the interest cash flows do not factor in the stable nature of unambiguous maturity financial liabilities such as demand and savings accounts.

42.4 Market risk

Market risk is the risk of a change in the actual or effective market value and earnings of a portfolio due to the adverse movements in market variables. The market variables inter-alia include Equity prices, Bond price, Commodity price, Foreign Exchange rates, Interest Rates. The objective of Market risk management is to facilitate business growth operating at the optimal risk levels.

Market risk measurement techniques

Market risk measurement at the Group involves both statistical and non-statistical measures. As one single measure could not reflect various aspects of market risk, Group uses various methods to measure market risk. State of the art systems are used to measure Net interest income at risk, Economic value of equity at risk, Re-pricing risk. Non-statistical measures include net open position, market values, position concentration, stop-loss limits for investments price risk etc.

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FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)

42 FINANCIAL RISK MANAGEMENT (continued)

42.4.1 Management of market risks

The Group sets limits for each product and risk type in order to ensure that the Group's market risk is managed well within the overall regulatory requirements set by the Central Bank of Oman and internal regulations contained in the Risk Policy. The Group does not trade in commodities. Limits and all internal/external guidelines are strictly adhered to, deviations, if any, are immediately escalated and action taken wherever necessary.

The principal categories of market risk faced by Bank Muscat are set out below:

- Foreign exchange risk
- Investment price risk
- Interest rate risk
- Commodity price risk

42.4.2 Foreign Exchange Risk

Foreign exchange risk is the risk of loss due to volatility in the exchange rates. Foreign exchange risk management in the Bank is ensured through regular measurement and monitoring of open foreign exchange positions against approved limits. Majority of the foreign exchange transactions carried out by the division are on behalf of corporate customers and are on a back-to-back basis. The treasury ensures that positions with customers are covered in the interbank market.

The Group conservatively restricts its open currency position at below 35% of its net worth as against the regulatory limit of 40% of net worth.

It also stipulates that exposure on any single non parity currency should be restricted to the extent of 3% of Parent Company's net worth and restricted to the extent of 10% of the Parent Company's net worth for all non parity currencies taken together. As at the reporting date, the Group had the following net exposures denominated in foreign currencies:

2009	2010		2010	2009
USD'000	USD'000		RO'000	RO'000
188,371	173,509	UAE Dirhams	66,801	72,523
82,062	138,540	US Dollar	53,338	31,594
71,951	125,587	Saudi Riyal	48,351	27,701
76,338	15,179	Qatari Riyal	5,844	29,390
36,218	10,231	Pakistani Rupee	3,939	13,944
28,319	30,890	Indian Rupee	11,893	10,903
2,221	56,691	Kuwait Dinar	21,826	855
166,486	125,076	Bahraini Dinar	48,154	64,097
<u>9,535</u>	<u>13,270</u>	Others	<u>5,109</u>	<u>3,671</u>
<u>661,501</u>	<u>688,973</u>		<u>265,255</u>	<u>254,678</u>

Positions are monitored on a monthly basis to ensure positions are maintained within the limits approved by the Central Bank of Oman.

Exposure and sensitivity analysis:

The net exposure in foreign currencies includes foreign currency exposure on investment in overseas associates and branches of equivalent RO 110 million (2009: RO 113 million) which are exempted from regulatory limit on foreign exchange exposure.

The Group's significant portion of foreign exchange exposure is in USD and other GCC currencies which have fixed parity with Omani Rial.

BANK MUSCAT SAOG

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)

42 FINANCIAL RISK MANAGEMENT (continued)

42.4.2 Foreign Exchange Risk

The table below indicates the sensitivity analysis of foreign exchange exposure of the Group to changes in the non parity foreign currency prices as at 31 December 2010 with all other variables held constant:

Non parity foreign currency assets	At 31 December 2010		At 31 December 2009	
	% of change in the currency price (+/-)	Change in the fair value (+/-) RO'000	% of change in the currency price (+/-)	Change in the fair value (+/-) RO'000
Indian Rupee	10%	1,189	10%	1,090
Pakistani Rupee	10%	394	10%	1,394
Others	10%	511	10%	367

42.4.3 Investment Price Risk

Investment price risk is the risk of reduction in the market value of the Group's portfolio as a result of diminishment in the market value of individual investment. The responsibility for management of investment price risk rests with the Investment Banking division under the supervision and guidance from the Investment Committee of the Parent Company. The Group's investments are governed by an investment policy and risk policy approved by the Board of Directors and are subject to rigorous due diligence. All the investments are subject to a stop loss limits. If this limit is triggered then investments are disposed off immediately or exceptionally retained only with the approval of the Investment Committee based on due justification. The rating and price of the instruments are monitored on a regular basis and necessary actions are taken to reduce exposure if needed. The entire portfolio is regularly revalued at closing market price to ensure that unrealised losses, if any, on account of reduction in the market value of the investments over its cost remains within the acceptable parameters defined in the Group's investment policy.

Exposure and sensitivity analysis

The Group analyses price sensitivity of the equity portfolio as follows:

- For the local quoted equity portfolio, based on the beta factor of the portfolio performance to the MSM30 Index performance.
- For the international quoted equity portfolio, based on the individual security market price movement.

The Group's market risk is affected mainly by changes to the actual market price of financial assets. Actual performance of the Group's local equity portfolio has a correlation to the performance of MSM30 Index.

The beta of the Group's quoted local equity portfolio against the MSM30 Index for 2010 was 1.63. Thus, a +/- 5% change in the value of MSM30 index may result in 8.15% change in the value of Group's quoted local equity portfolio, amounting to RO 4.83 million increase or decrease in the unrealised gain recognised in the statement of other comprehensive income for the year.

Since the beta of the Group's quoted local equity portfolio against the MSM30 Index for 2009 was negative at 1.14, sensitivity analysis of investment portfolio to MSM Index was not relevant for the year 2009. However, a +/- 5% change in the market price of the respective securities held as at 31 December 2009 would have resulted in change in value of the portfolio of +/- RO 1.44 million and increased or decreased in the unrealised gain recognised in the statement of other comprehensive income for the year 2009.

International quoted equity portfolio of the Group comprises of shares listed in GCC stock markets, Indian Stock markets and other international markets. A +/-5% change in the market price of the respective securities, have resulted in change in value of the portfolio of +/- RO 1.3 million (2009: +/-RO 400k) and consequently increased or decreased in the unrealised gain recognised in the statement of other comprehensive income.

42.4.4 Interest Rate Risk

Group's Interest Rate Risk arises from the re-pricing gap between the Group's interest sensitive assets and liabilities. Managing the market risk exposure of the banking book involves managing the potential adverse effects of rate movements on Net Interest Income (NII) and the Economic Value of Equity (EVE). The short term impact of interest rate risk is measured by studying the impact on the NII of the Bank while the long term impact is measured through the study of the impact on the Economic Value of Equity.

The responsibility for interest rate risk management rests with the Parent Company's Treasury under the supervision of the Asset Liability Management Committee (ALCO).

BANK MUSCAT SAOG

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)

42 FINANCIAL RISK MANAGEMENT (continued)

42.4.4 Interest rate risk (continued)

The Group's interest rate sensitivity position of assets and liabilities, based on the contractual repricing or maturity dates, whichever dates are earlier, is as follows:

31 December 2010	Effective annual interest rate %	Floating rate or within 3 months RO'000	Months 4 to 12 RO'000	Years 1 to 5 RO'000	Over 5 years RO'000	Non interest sensitive RO'000	Total RO'000
Cash and balances with Central Banks	0 to 2	245,045	-	-	-	481,010	726,055
Placements with banks	0.85	430,562	76,408	1,694	39,929	1,756	550,349
Loans and advances	6.44	1,104,660	708,691	1,350,295	842,040	2,240	4,007,926
Investments	3.61	16,334	25,265	125,572	5,853	148,920	321,944
Property and equipment and other assets	None	-	-	-	-	244,854	244,854
Total assets		<u>1,796,601</u>	<u>810,364</u>	<u>1,477,561</u>	<u>887,822</u>	<u>878,780</u>	<u>5,851,128</u>
Deposits from banks	0.53	546,066	3,849	40,877	-	169,094	759,886
Customers' deposits and Certificates of deposit	1.98	631,318	1,755,365	492,311	208,219	594,340	3,681,553
Unsecured bonds and floating rate notes	5.3	15,400	-	54,803	-	-	70,203
Other liabilities and taxation	None	(12)	(35)	(223)	38,270	321,592	359,592
Subordinated liabilities	6.32	38,500	-	70,000	75,000	-	183,500
Shareholders' funds	None	-	-	-	-	796,394	796,394
		<u>1,231,272</u>	<u>1,759,179</u>	<u>657,768</u>	<u>321,489</u>	<u>1,881,420</u>	<u>5,851,128</u>
Total interest rate sensitivity gap		<u>565,329</u>	<u>(948,815)</u>	<u>819,793</u>	<u>566,333</u>	<u>(1,002,640)</u>	<u>-</u>
Cumulative interest rate sensitivity gap		<u>565,329</u>	<u>(383,486)</u>	<u>436,307</u>	<u>1,002,640</u>	<u>-</u>	<u>-</u>
In USD'000		<u>1,468,387</u>	<u>(996,068)</u>	<u>1,133,265</u>	<u>2,604,260</u>	<u>-</u>	<u>-</u>

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)

42 FINANCIAL RISK MANAGEMENT (continued)

42.4.4 Interest rate risk (continued)

31 December 2009	Effective annual Interest rate %	Floating rate or within 3 months RO'000	Months 4 to 12 RO'000	Years 1 to 5 RO'000	Over 5 years RO'000	Non interest sensitive RO'000	Total RO'000
Cash and balances with Central Banks	0 to 2	475,000	45	-	-	133,054	608,099
Placements with banks	2.03	814,108	170,046	-	31,241	296	1,015,691
Loans and advances	6.64	1,148,218	627,946	1,326,227	735,820	-	3,838,211
Investments	0.42 to 4.02	39,616	4,184	61,418	931	105,389	211,538
Property and equipment and other assets	None	-	-	-	33,384	143,813	177,197
Total assets		<u>2,476,942</u>	<u>802,221</u>	<u>1,387,645</u>	<u>801,376</u>	<u>382,552</u>	<u>5,850,736</u>
Deposits from banks	1.70	1,162,754	105,190	44,269	75,137	8,397	1,395,747
Customers' deposits and certificates of deposit	2.4	505,175	1,639,847	396,094	181,222	485,287	3,207,625
Unsecured bonds and floating rate notes	6.2	15,400	-	54,803	-	-	70,203
Other liabilities and taxation	None	-	-	-	-	277,345	277,345
Subordinated liabilities	6.28	38,500	5,000	70,000	75,000	-	188,500
Shareholders' funds	None	-	-	-	-	711,316	711,316
Total liabilities and shareholders' funds		<u>1,721,829</u>	<u>1,750,037</u>	<u>565,166</u>	<u>331,359</u>	<u>1,482,345</u>	<u>5,850,736</u>
Total interest rate sensitivity gap		<u>755,113</u>	<u>(947,816)</u>	<u>822,479</u>	<u>470,017</u>	<u>(1,099,793)</u>	<u>-</u>
Cumulative interest rate sensitivity gap		<u>755,113</u>	<u>(192,703)</u>	<u>629,776</u>	<u>1,099,793</u>	<u>-</u>	<u>-</u>
In USD'000		<u>1,961,332</u>	<u>(500,527)</u>	<u>1,635,782</u>	<u>2,856,605</u>	<u>-</u>	<u>-</u>

BANK MUSCAT SAOG

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)

42 FINANCIAL RISK MANAGEMENT (continued)

42.4.4 Interest rate risk (continued)

(i) The off-balance sheet gap represents the net notional amount of off-balance sheet financial instruments, including interest rate swaps which are used to manage interest rate risk.

(ii) The repricing profile is based on the remaining period to the next interest repricing date.

(iii) An asset (or positive) gap position exists when assets reprice more quickly or in greater proportion than liabilities during a given period and tends to benefit net interest income in a rising interest rate environment. A liability (or negative) gap position exists when liabilities reprice more quickly or in greater proportion than assets during a given period and tends to benefit net interest income in a declining interest rate environment.

Re-pricing gap is the difference between interest rate sensitive assets and liabilities spread over distinct maturity bands based on residual maturity or re-pricing dates. The Parent Company uses currency-wise and consolidated re-pricing gaps to quantify interest rate risk exposure over distinct maturities and analyze the magnitude of portfolio changes necessary to alter existing risk profile. The distribution of assets and liabilities over these time bands is done based on the actual repricing schedules. The schedules are used as a guideline to assess interest rate risk sensitivity and to focus the efforts towards reducing the mismatch in the repricing pattern of assets and liabilities.

The Parent Company uses simulation reports as an effective tool for understanding risk exposure under variety of interest rate scenarios. These reports help ALCO to understand the direction of interest rate risk in the Parent Company and decide on the appropriate strategy and hedging mechanism for managing it. The Parent Company's current on- and off-balance sheet exposures are evaluated under static environment to quantify potential effect of external interest rate shocks on the earnings and economic value of equity (EVE) at risk, using assumptions about future course of interest rates and changes in Parent Company's business profile. The impact of interest rate changes on EVE is monitored by recognising the changes in the value of assets and liabilities for a given change in the market interest rate. The maximum impact on the EVE for a 200 basis points shift in yield curve is to be contained to 20% of the Group's Capital and Reserves. The simulation report analyses seven possible different scenarios.

An analysis of the Group's sensitivity to an increase or decrease in market interest rates is as follows:

Impact on Net Interest income	+200 bps RO'000	-200 bps RO'000	+100 bps RO'000	-100 bps RO'000	+50 bps RO'000	-50 bps RO'000
2010						
As at 31 December	(5,402)	2,769	(3,848)	1,170	(3,071)	476
Average for the period	(1,991)	4,207	(2,054)	1,488	(2,086)	(63)
Maximum for the period	(5,402)	11,268	(3,848)	6,157	(3,071)	1,053
Minimum for the period	3,855	(853)	853	(1,540)	(648)	(1,259)
2009						
As at 31 December	(6,581)	11,619	(4,260)	6,341	(3,100)	1,436
Average for the period	(4,106)	5,746	(2,733)	2,857	(2,044)	867
Maximum for the period	(6,581)	11,619	(4,260)	6,341	(3,100)	2,711
Minimum for the period	(951)	1,602	183	922	744	190
Impact on Economic value						
2010						
As at 31 December	(105,799)	127,051	(55,116)	57,272	(28,365)	28,472
Average for the period	(91,323)	111,470	(47,595)	50,745	(24,527)	24,934
Maximum for the period	(105,799)	127,051	(55,116)	57,272	(28,365)	28,472
Minimum for the period	(83,519)	100,650	(43,273)	47,647	(22,029)	23,257
2009						
As at 31 December	(93,655)	116,574	(48,803)	50,599	(25,237)	24,998
Average for the period	(105,931)	125,252	(55,238)	57,796	(28,590)	28,482
Maximum for the period	(119,138)	136,134	(62,164)	65,498	(32,201)	32,172
Minimum for the period	(93,063)	116,574	(48,641)	50,599	(25,237)	24,998

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FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)

42 FINANCIAL RISK MANAGEMENT (continued)

42.4.4 Interest rate risk (continued)

Impact on Net Interest income	+200 bps USD'000	-200 bps USD'000	+100 bps USD'000	-100 bps USD'000	+50 bps USD'000	-50 bps USD'000
2010						
As at 31 December	(14,030)	7,193	(9,995)	3,040	(7,977)	1,235
Average for the period	(5,173)	10,927	(5,336)	3,864	(5,417)	(164)
Maximum for the period	(14,030)	29,268	(9,995)	15,992	(7,977)	2,735
Minimum for the period	10,012	(2,216)	2,216	(4,000)	(1,682)	(3,270)
2009						
As at 31 December	(17,093)	30,179	(11,066)	16,469	(8,052)	3,731
Average for the period	(10,664)	14,924	(7,098)	7,420	(5,309)	2,253
Maximum for the period	(17,093)	30,179	(11,066)	16,470	(8,052)	7,042
Minimum for the period	(2,470)	4,161	474	2,395	1,933	494

Impact on Economic value

2010						
As at 31 December	(274,803)	330,004	(143,158)	148,759	(73,675)	73,954
Average for the period	(237,203)	289,532	(123,624)	131,806	(63,707)	64,763
Maximum for the period	(274,803)	330,004	(143,158)	148,759	(73,675)	73,954
Minimum for the period	(216,932)	261,428	(112,397)	123,758	(57,219)	60,409
2009						
As at 31 December	(243,260)	302,790	(126,761)	131,426	(65,551)	64,930
Average for the period	(275,146)	325,329	(143,475)	150,120	(74,260)	73,978
Maximum for the period	(309,450)	353,595	(161,465)	170,124	(83,639)	83,563
Minimum for the period	(241,723)	302,790	(126,339)	131,426	(65,551)	64,930

42.5 Commodity Price Risk

As part of its Treasury operations, the Group offers commodities hedging facility to its clients. Customers of the Bank who are exposed to commodities like Copper, Aluminium and also Jewellers with exposure to gold prices cover their commodity exposures through Parent Company. The Group operates in the commodities market purely as a provider of hedging facilities. It does not trade in commodities/bullion or maintain positions in commodities. Customers of the Bank are sanctioned a transaction volume limit and a variation margin limit as risk management measures. The transaction volume limit is to restrict the total outstanding contracts value to the business requirement of the customer and the Variation margin limit is to protect the Group from excessive credit risk due to adverse price movement in the commodities prices. The customers' positions in commodities are monitored on a daily basis with frequent MTM valuations done independently and margin calls are made thereon based on such valuations.

42.6 Operational risks

Operational risk is the deficiencies in information systems/internal controls or uncontrollable external events will result in loss. The risk is associated with human error, systems failure and inadequate procedures or control and external causes.

Losses from external events such as a natural disaster that has a potential to damage the Group's physical assets or electrical or telecommunications failures that disrupt business are relatively easier to define than losses from internal problems such as employee fraud and product flaws. The risks from internal problems are more closely tied to the Group's specific products and business lines; they are more specific to the Group's operations than the risks due to external events. Operational risks faced by the Group include IT Security, telecom failure, fraud, and operational errors.

As a part of continuous improvement in the risk management process, the Group has developed its own Operational Risk Management Software, "FORTE" OpRisk Monitor". The Software aids assessment of operational risks as well as collection and analysis of operational losses.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)****42 FINANCIAL RISK MANAGEMENT (continued)****42.6 Operational risks (continued)**

The Group's risk policy provides the framework to identify, assess, monitor, control and report operational risks in a consistent and comprehensive manner across the Group. A distinct Operational Risk Management function is in place since 2003 to independently support business units in the management of operational risks. The objectives of Operational Risk Management are as follows:

- To achieve strong risk control by harnessing the latest risk management technologies and techniques, resulting in a distinctive risk management capability, enabling business units to meet their performance and growth objectives.
- To enable adequate capital allocation in respect of potential impact of operational risks.
- To minimize the impact of operational risks through means like a fully functional Business Continuity Plans, up-to-date documentation and by developing general operational risk awareness within the Group.

Executive management defines the operational risk appetite at the business unit and Group's level. This operational risk appetite supports effective decision making and is central to embedding risk management in business decisions and reporting. Business units have the primary responsibility for identifying, measuring and managing the operational risks that are inherent in their respective operations. Operational risk is controlled through a series of strong internal controls and audits, well-defined segregation of duties and reporting lines, detailed operational manuals and standards. The Operational Risk Unit oversees the range of operational risk across the Group in accordance with the Operational Risk Management Framework. Internal Audit independently reviews effectiveness of the Group's internal control and its ability to minimize the impact of operational risks.

Insurance is used as a tool to hedge against operational risks at the Group. The Group has obtained insurance against operational risks which comes in a variety of forms, such as Bankers' Blanket Bond, Electronic and Computer Crimes, Professional Indemnity, etc. While insurance cannot alter the probability of risks, it allows partial transfer of the financial impact of risks. The insurance is primarily aimed at protecting the Group from high-severity low-frequency risks.

Business Continuity Planning (BCP)

The Group ensures that its systems and procedures are resilient to ensure business continuity through potential situations of failure. The Group has put in place contingency plans to ensure that its business runs effectively in the event of most unforeseen disasters. The Group continuously strengthens its existing plans by implementing a robust business continuity plan to ensure that its systems and procedures are resilient and ready to meet 'emergency preparedness'. The BCP committee is entrusted with the responsibility of formulating, adopting, implementing, testing and maintaining a robust BCP for the Group. BCP Committee continuously review and agree the strategic Business Continuity assessment and planning information to ensure Business Continuity Management, planning and maintenance responsibilities are assigned and understood across the business areas.

The Bank has made significant strides in enhancing its business continuity framework. The existing Business Continuity Management (BCM) was reviewed in view of relocating of operations to the new Parent Company's Head Office and to bring the Group's recovery capabilities in line with the current requirements.

Some of the major developments in line with the objective of the continuous evolution of the Group's BCM framework were:

- fresh Business Impact Analysis (BIA) conducted, new BCM policy, revised Crisis Management Structure, Crisis Management Plan and gap analysis were established;
- state-of-the-art BCP software was implemented and trainings conducted;
- training and awareness sessions and workshops were conducted for Crisis Management Team and regions;
- conduct of Fire evacuation drill; and
- Disaster Recovery Strategy (DRS) solution tested successfully at low load levels. IT department has taken initiatives and is confident that the Group can operate successfully out of DRS for core banking system in case of a major disaster.

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FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)

• 42 FINANCIAL RISK MANAGEMENT (continued)

42.7 Capital management

42.7.1 Regulatory capital

The Parent Company's regulator, Central Bank of Oman (CBO), sets and monitors capital requirements for the Parent Company as a whole. In implementing Basel II's capital requirement, the CBO requires the Parent Company to maintain a minimum of 10% ratio of total capital to total risk-weighted assets.

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

- Tier I capital, which includes ordinary share capital, share premium, distributable and non-distributable reserves and retained earnings (net of proposed dividend) after deductions for goodwill and fifty percent of carrying value of investment in associates as per the regulatory adjustments that are included in equity but are treated differently for capital adequacy purposes;
- Tier II capital, which includes qualifying subordinated liabilities, collective impairment allowances and the element of the fair value reserve relating to unrealised gains on equity instruments classified as available-for-sale after deductions for fifty percent of carrying value of investments in associates;
- Tier III capital which includes qualifying subordinated liabilities (net of reserves).

Various limits are applied to elements of the capital base. The qualifying Tier II and Tier III capital cannot exceed Tier I capital; qualifying subordinated liabilities may not exceed fifty percent of Tier I capital; and amount of collective impairment allowances that may be included as part of Tier II capital is limited to 1.25 percent of the total risk-weighted assets.

42.7.2 Capital Adequacy

Capital adequacy indicates the ability of the Group in meeting any contingency without compromising the interest of the depositors and to provide credit across the business cycles. Sufficient capital in relation to the risk profile of the Group's assets helps promote financial stability and the confidence of the stakeholders. The Group aims to maximise the shareholder's value through an optimal capital structure that protects the stakeholders interests under most extreme stress situations, provides sufficient room for growth while meeting the regulatory requirements and at the same time gives a reasonable return to the shareholders.

While risk coverage is the prime factor influencing capital retention, the Group is conscious of the fact that as a business entity, its capital needs to be serviced and a comfortable rate of return needs to be provided to the shareholders. Excessive capital will dilute the return on capital and this in turn can exert pressure for profitability propelling business asset growth resulting in the Group assuming higher levels of risk. With regard to the retention of capital, the Group's policy is governed by the need for adequately providing for associated risk and the needs for servicing the capital retained. The Group makes good use of subordinated loans as Tier II Capital and raises share capital as and when the need arises. The Group's strong and diverse shareholder profile gives the Group the necessary confidence in its ability to raise capital when it is needed.

Management of the Group is well aware of the need to move to more advanced approaches for measuring credit risk and operational risk. In this regard the Group has a 'building block' approach and has made progress in certain areas. Gaps have been identified and road map has been laid down for each area and progress measured at regular intervals.

BANK MUSCAT SAOG

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)

42 FINANCIAL RISK MANAGEMENT (continued)

42.7.2 Capital Adequacy (continued)

The following table sets out the capital adequacy position of the Group.

2009 USD'000	2010 USD'000		2010 RO'000	2009 RO'000
279,774	349,717	Share Capital	134,641	107,713
783,130	783,129	Share Premium	301,505	301,505
93,260	116,574	Legal reserve	44,881	35,905
146,255	159,242	General reserve	61,308	56,308
125,714	208,052	Subordinated loan reserve	80,100	48,400
314,449	333,987	Retained Profit *	128,585	121,063
<u>1,742,582</u>	<u>1,950,701</u>	Total	<u>751,020</u>	<u>670,894</u>
		Less:		
(6,023)	(6,255)	Goodwill	(2,408)	(2,319)
(28,821)	(28,821)	Deferred tax assets	(11,096)	(11,096)
(2,296)	(1,309)	Foreign currency translation reserve	(504)	(884)
-	(4,925)	Non strategic investment in Banks (50%)	(1,896)	-
(84,226)	(68,196)	Investment in associates (50%)	(26,255)	(32,427)
<u>1,621,216</u>	<u>1,841,197</u>	Tier I Capital	<u>708,861</u>	<u>624,168</u>
4,990	7,862	Cumulative change in fair value (45%)	3,027	1,921
139,156	145,727	General loan loss impairment	56,105	53,575
363,896	268,572	Subordinated liabilities (net of reserves)	103,400	140,100
83,932	83,933	Mandatory convertible bonds	32,314	32,314
<u>591,974</u>	<u>506,094</u>	Total	<u>194,846</u>	<u>227,910</u>
		Less:		
-	(4,925)	Non strategic investment in Banks (50%)	(1,896)	-
(84,226)	(68,195)	Investment in associates (50%)	(26,255)	(32,427)
<u>507,748</u>	<u>432,974</u>	Tier II Capital	<u>166,695</u>	<u>195,483</u>
-	-	Tier III Capital (Net of Reserve)	-	-
<u>2,128,964</u>	<u>2,274,171</u>	Total Regulatory Capital	<u>875,556</u>	<u>819,651</u>
		Risk weighted assets		
12,429,883	12,993,013	Credit risk	5,002,310	4,785,505
551,413	623,112	Market risk	239,898	212,294
1,028,605	1,179,252	Operational risk	454,012	396,013
<u>14,009,901</u>	<u>14,795,377</u>	Total risk weighted assets	<u>5,696,220</u>	<u>5,393,812</u>
		Capital Ratios		
15.20%	15.37%	Total regulatory capital expressed as a % of total risk weighted assets	15.37%	15.20%
11.57%	12.44%	Total Tier I capital expressed as a % of total risk weighted assets	12.44%	11.57%

* Retained profit for the year 2010 include proposed cash dividend of RO 40.39 million.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)****42 FINANCIAL RISK MANAGEMENT (continued)****42.7.3 Internal Capital Adequacy Assessment Process (ICAAP):**

The Parent Company prepared an Internal Capital Adequacy Assessment Process (ICAAP) which provides an assessment of the Bank's actual capital adequacy on an advanced Economic Capital measure. ICAAP incorporates the impact of residual risk including business risk, concentration risk, correlation risk, Interest rate risk on banking book. The purpose of the ICAAP is not only to provide a detailed assessment of its current capital adequacy, but also to project future capital adequacy ratios in line with approved business plans in order to evaluate their validity from a risk perspective. The process covers a forward looking plan for the next 5 years. The overall framework has introduced a structured methodology for a comprehensive forward-looking assessment of the Bank's risk profile. It is also expected that the establishment of the ICAAP will facilitate the awareness for risk sensitive topics when it comes to strategic decisions like acquisitions, launch of new products or organic growth targets. It will scrutinise the current business model of the Bank and may lead to corresponding adjustments if the inherent risk goes beyond its risk appetite. ICAAP was approved by the Board of Directors through Board Risk Committee and the same has been submitted to the regulators. The Bank believes that its current and foreseen capital endowment is suitable to support its business strategy in a soothing market environment. The present plan will be updated at least annually for a rolling, forward-looking planning period of 5 years.

In order to determine the Bank's capability to withstand adverse conditions, in addition to the base case, a stress scenario has also been examined. This scenario assumes a prolonged recession and specifically incorporates a deterioration of credit quality, increased IRRBB and Market Risk as well as a decrease in retained profits.

42.7.4 Capital allocation

The allocation of capital between specific business units and activities is, to large extent, driven by optimisation of the return on capital allocated. Although maximisation of the return on risk-adjusted capital is the principal basis used in determining how capital is allocated within the Group to particular business units or activities, it is not the sole basis used for decision making. Other factors such as synergies between the units or activities, the availability of management and other resources, and the fit of the activity with the Group's longer term strategic objectives are taken in to account while allocating capital.

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43 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 2010 are considered by the Board and Management not to be materially different to their book values:

31 December 2010	Notes	Loans and advances RO'000	Available-for-sale RO'000	Held-to-maturity RO'000	Other amortised cost RO'000	Total carrying value RO'000	Fair value RO'000
Cash and balances with Central Bank	5	726,055	-	-	-	726,055	726,055
Placements with banks	6	550,349	-	-	-	550,349	550,349
Loans and advances	7	4,007,926	-	-	-	4,007,926	4,007,926
Investment securities	9	-	237,105	29,922	-	267,027	267,027
		<u>5,284,330</u>	<u>237,105</u>	<u>29,922</u>	<u>-</u>	<u>5,551,357</u>	<u>5,551,357</u>
Deposits from banks	12	-	-	-	759,886	759,886	759,886
Customers' deposits	13	-	-	-	3,526,953	3,526,953	3,526,953
Certificates of deposit	14	-	-	-	154,600	154,600	154,600
Unsecured bonds	15	-	-	-	54,803	54,803	54,803
Floating rate notes	16	-	-	-	15,400	15,400	15,400
Subordinated liabilities	19	-	-	-	183,500	183,500	183,500
		<u>-</u>	<u>-</u>	<u>-</u>	<u>4,695,142</u>	<u>4,695,142</u>	<u>4,695,142</u>
31 December 2009							
Cash and balances with Central Bank	5	608,099	-	-	-	608,099	608,099
Placements with banks	6	1,015,691	-	-	-	1,015,691	1,015,691
Loans and advances	7	3,838,211	-	-	-	3,838,211	3,838,211
Investment securities	9	-	120,055	24,311	-	144,366	144,366
		<u>5,462,001</u>	<u>120,055</u>	<u>24,311</u>	<u>-</u>	<u>5,606,367</u>	<u>5,606,367</u>
Deposits from banks	12	-	-	-	1,395,747	1,395,747	1,395,747
Customers' deposits	13	-	-	-	3,068,425	3,068,425	3,068,425
Certificates of deposit	14	-	-	-	139,200	139,200	139,200
Unsecured bonds	15	-	-	-	54,803	54,803	54,803
Floating rate notes	16	-	-	-	15,400	15,400	15,400
Subordinated liability	19	-	-	-	188,500	188,500	188,500
		<u>-</u>	<u>-</u>	<u>-</u>	<u>4,862,075</u>	<u>4,862,075</u>	<u>4,862,075</u>

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43 FAIR VALUE INFORMATION (continued)

Effective 1 January 2010, the Group adopted the amendment to IFRS 7 for financial instruments that are measured in the statement of financial position at fair value; this requires disclosure of fair value measurements by level of the following fair value measurement hierarchy:

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

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

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

The following table presents the Group's assets and liabilities that are measured at fair value at 31 December 2010.

2010	Level 1 RO'000	Level 2 RO'000	Level 3 RO'000	Total RO'000
Assets				
Trading derivatives	39,858	-	-	39,858
Available-for-sale financial assets:				
Equity securities	71,956	-	21,714	93,670
Debt investments	140,954	-	2,481	143,435
Total Assets	252,768	-	24,195	276,963
Liabilities				
Trading derivatives	53,710	-	-	53,710
2009				
	Level 1 RO'000	Level 2 RO'000	Level 3 RO'000	Total RO'000
Assets				
Trading derivatives	38,510	-	-	38,510
Available-for-sale financial assets:				
Equity securities	34,205	-	16,339	50,544
Debt investments	64,609	-	4,902	69,511
Total Assets	137,324	-	21,241	158,565
Liabilities				
Trading derivatives	50,755	-	-	50,755

43.1 Estimation of fair values

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

43.1.1 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.

BANK MUSCAT SAOG**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)****43 FAIR VALUE INFORMATION (continued)****43.1.2 Investments carried at cost and derivatives**

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

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

43.1.3 Bank and customer deposits

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

43.1.4 Other on-balance sheet financial instruments

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

43.1.5 Off-balance sheet financial instruments

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

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

44 COMPARATIVE FIGURES

The corresponding figures for 2009 included for comparative purposes have been reclassified to conform with the presentation in the current year.