

# **BANK MUSCAT SAOG**

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

Registered office and principal place of business:

Building No - 120/4  
Block No – 311, Airport Heights, Seeb  
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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## **Independent auditor's report to the shareholders of Bank Muscat SAOG**

We have audited the accompanying consolidated financial statements of **Bank Muscat SAOG** (the bank) and its subsidiary (together, the Group) which comprise the consolidated statement of financial position as at 31 December 2010 and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended and a summary of significant accounting policies and other explanatory notes.

### **Directors' responsibility for the financial statements**

The Directors are responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards and the disclosure requirements of the Capital Market Authority and the Commercial Companies Law of 1974, as amended and for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor's responsibility**

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

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

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

### **Opinion**

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2010, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

### **Other legal and regulatory requirements**

Further, as required by the Rules and Guidelines on Disclosure by Issuers of Securities and Insider Trading (R&G) issued by the Capital Market Authority (CMA) of the Sultanate of Oman, we report that the accompanying consolidated financial statements have been properly prepared, in all material respects, in accordance with the R&G, with the Rules for Disclosure and Proformas issued by the CMA and with the Commercial Companies Law of 1974, as amended.

**PricewaterhouseCoopers LLP**

**2 March 2011  
Muscat, Sultanate of Oman**

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

| 2009<br>USD'000  | 2010<br>USD'000   |  | Notes | 2010<br>RO'000   | 2009<br>RO'000   |
|--|-------------------|--|-------|------------------|------------------|
| <b>ASSETS</b>  |                   |  |       |                  |                  |
| 1,579,478  | <b>1,885,857</b>  | Cash and balances with Central Banks   | 5     | <b>726,055</b>   | 608,099          |
| 2,638,158  | <b>1,429,478</b>  | Placements with banks                  | 6     | <b>550,349</b>   | 1,015,691        |
| 9,969,379  | <b>10,410,197</b> | Loans and advances                     | 7     | <b>4,007,926</b> | 3,838,211        |
| 392,003  | <b>441,730</b>    | Other assets                           | 8     | <b>170,066</b>   | 150,921          |
| Investment securities:   |                   |  |       |                  |                  |
| 311,831  | <b>615,857</b>    | - Available-for-sale                   | 9     | <b>237,105</b>   | 120,055          |
| 63,145   | <b>77,719</b>     | - Held to maturity                     | 9     | <b>29,922</b>    | 24,311           |
| 174,473  | <b>142,641</b>    | Investment in associates               | 11    | <b>54,917</b>    | 67,172           |
| 68,249   | <b>194,255</b>    | Property and equipment                 | 12    | <b>74,788</b>    | 26,276           |
| <u>15,196,716</u>  | <u>15,197,734</u> |  |       | <u>5,851,128</u> | <u>5,850,736</u> |
| <b>LIABILITIES AND EQUITY</b>  |                   |  |       |                  |                  |
| <b>LIABILITIES</b>   |                   |  |       |                  |                  |
| 3,625,317  | <b>1,973,730</b>  | Deposits from banks                    | 14    | <b>759,886</b>   | 1,395,747        |
| 7,969,935  | <b>9,160,917</b>  | Customers' deposits                    | 15    | <b>3,526,953</b> | 3,068,425        |
| 361,557  | <b>401,558</b>    | Certificates of deposit                | 16    | <b>154,600</b>   | 139,200          |
| 142,345  | <b>142,345</b>    | Unsecured bonds                        | 17    | <b>54,803</b>    | 54,803           |
| 40,000   | <b>40,000</b>     | Floating rate notes                    | 18    | <b>15,400</b>    | 15,400           |
| 638,356  | <b>850,518</b>    | Other liabilities                      | 13,20 | <b>327,450</b>   | 245,767          |
| 82,021   | <b>83,486</b>     | Taxation                               | 21    | <b>32,142</b>    | 31,578           |
| 489,610  | <b>476,623</b>    | Subordinated liabilities               | 22    | <b>183,500</b>   | 188,500          |
| <u>13,349,141</u>  | <u>13,129,177</u> |  |       | <u>5,054,734</u> | <u>5,139,420</u> |
| <b>EQUITY</b>  |                   |  |       |                  |                  |
| <b>Capital and reserves attributable to equity holders of the parent company</b> |                   |  |       |                  |                  |
| 279,774  | <b>349,717</b>    | Share capital                          | 23    | <b>134,641</b>   | 107,713          |
| 783,130  | <b>783,130</b>    | Share premium                          |       | <b>301,505</b>   | 301,505          |
| 83,933   | <b>83,933</b>     | Mandatory convertible bonds            | 19    | <b>32,314</b>    | 32,314           |
| 146,255  | <b>159,242</b>    | General reserve                        | 24    | <b>61,308</b>    | 56,308           |
| 93,260   | <b>116,574</b>    | Legal reserve                          | 24    | <b>44,881</b>    | 35,905           |
| 10,278   | <b>10,278</b>     | Revaluation reserve                    | 12    | <b>3,957</b>     | 3,957            |
| 125,714  | <b>208,052</b>    | Subordinated loan reserve              | 25    | <b>80,100</b>    | 48,400           |
| 12,527   | <b>24,260</b>     | Cumulative changes in fair value       |       | <b>9,340</b>     | 4,823            |
| (2,296)  | <b>(1,307)</b>    | Foreign currency translation reserve   |       | <b>(503)</b>     | (884)            |
| 314,450  | <b>333,987</b>    | Retained profit                        |       | <b>128,585</b>   | 121,063          |
| 1,847,025  | <b>2,067,866</b>  |  |       | <b>796,128</b>   | 711,104          |
| 550  | <b>691</b>        | Non-controlling interests in equity    | 10    | <b>266</b>       | 212              |
| <u>1,847,575</u>   | <u>2,068,557</u>  | <b>TOTAL EQUITY</b>                    |       | <u>796,394</u>   | <u>711,316</u>   |
| <u>15,196,716</u>  | <u>15,197,734</u> | <b>TOTAL LIABILITIES AND EQUITY</b>    |       | <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 <u>0,591</u>  | 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 26 January 2011 and signed on their behalf by:

\_\_\_\_\_  
Chairman

\_\_\_\_\_  
Director

\_\_\_\_\_  
Chief Executive

Report of the Auditors - page 1

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

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

(continued on page 4)

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

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**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME  
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)**

| 2009<br>USD'000 | 2010<br>USD'000  |  | Notes | 2010<br>RO'000  | 2009<br>RO'000 |
|-----------------|------------------|--|-------|-----------------|----------------|
|                 |                  | <b>Total comprehensive income attributable to:</b> |       |                 |                |
| 46,487          | <b>276,798</b>   | Equity holders of the parent company               |       | <b>106,567</b>  | 17,897         |
| <u>(117)</u>    | <u>(192)</u>     | Non-controlling interests                          | 10    | <u>(74)</u>     | <u>(45)</u>    |
| <u>46,370</u>   | <u>276,606</u>   |  |       | <u>106,493</u>  | <u>17,852</u>  |
|                 |                  | <b>Profit attributable to:</b>                     |       |                 |                |
| 191,593         | <b>264,076</b>   | Equity holders of the parent company               |       | <b>101,669</b>  | 73,763         |
| <u>(117)</u>    | <u>(192)</u>     | Non-controlling interests                          | 10    | <u>(74)</u>     | <u>(45)</u>    |
| <u>191,476</u>  | <u>263,884</u>   |  |       | <u>101,595</u>  | <u>73,718</u>  |
|                 |                  | <b>Earnings per share:</b>                         |       |                 |                |
| USD 0.178       | <b>USD 0.195</b> | - Basic  | 35    | <b>RO 0.075</b> | RO 0.068       |
| USD 0.174       | <b>USD 0.195</b> | - Diluted  | 35    | <b>RO 0.075</b> | RO 0.067       |

Items in the statement above are disclosed net of tax. The income tax relating to each component of other comprehensive income is disclosed in note 21.

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

# BANK MUSCAT SAOG

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

|   | Notes | Share capital<br>RO'000 | Share premium<br>RO'000 | Mandatory convertible bonds<br>RO'000 | General reserve<br>RO'000 | Legal reserve<br>RO'000 | Revaluation reserve<br>RO'000 | Subordinated loan reserve<br>RO'000 | Cumulative changes in fair value<br>RO'000 | Foreign exchange translation reserve<br>RO'000 | Retained profit<br>RO'000 | Total before NCI<br>RO'000 | Non-Controlling Interest<br>RO'000 | Total<br>RO'000  |
|---|-------|-------------------------|-------------------------|---------------------------------------|---------------------------|-------------------------|-------------------------------|-------------------------------------|--|--|---------------------------|----------------------------|------------------------------------|------------------|
| <b>2010</b>   |       |                         |                         |                                       |                           |                         |                               |                                     |  |  |                           |                            |                                    |                  |
| 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          |
| <b>Comprehensive income</b>                               |       |                         |                         |                                       |                           |                         |                               |                                     |  |  |                           |                            |                                    |                  |
| Profit for the year                                       |       | -                       | -                       | -                                     | -                         | -                       | -                             | -                                   | -  | -  | 101,669                   | 101,669                    | (74)                               | 101,595          |
| <b>Other comprehensive income</b>                         |       |                         |                         |                                       |                           |                         |                               |                                     |  |  |                           |                            |                                    |                  |
| 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            |
| <b>Total comprehensive income</b>                         |       | -                       | -                       | -                                     | -                         | -                       | -                             | -                                   | 4,517                                      | 381  | 101,669                   | 106,567                    | (74)                               | 106,493          |
| <b>Transactions with owners</b>                           |       |                         |                         |                                       |                           |                         |                               |                                     |  |  |                           |                            |                                    |                  |
| 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)                  | -                          | -                                  | -                |
| <b>Total contributions by and distributions to owners</b> |       | 26,928                  | -                       | -                                     | 5,000                     | 8,976                   | -                             | 31,700                              | -  | -  | (94,147)                  | (21,543)                   | -                                  | (21,543)         |
| Non-controlling interest                                  |       | -                       | -                       | -                                     | -                         | -                       | -                             | -                                   | -  | -  | -                         | -                          | 128                                | 128              |
| <b>Total transactions with owners</b>                     |       | 26,928                  | -                       | -                                     | 5,000                     | 8,976                   | -                             | 31,700                              | -  | -  | (94,147)                  | (21,543)                   | 128                                | (21,415)         |
| <b>Balance at 31 December 2010</b>                        |       | <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>   |
| <b>Balance at 31 December 2010 (USD'000)</b>              |       | <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> |

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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)

|  | Share capital  | Share premium  | Mandatory convertible bonds | General reserve | Legal Reserve | Revaluation reserve | Sub-ordinated loan reserve | Cumulative changes in fair value | Foreign exchange translation reserve | Retained earnings | Total Before NCI | Non Controlling Interest | Total            |
|--|----------------|----------------|-----------------------------|-----------------|---------------|---------------------|----------------------------|----------------------------------|--------------------------------------|-------------------|------------------|--------------------------|------------------|
| Notes  | RO'000         | RO'000         | RO'000                      | RO'000          | RO'000        | RO'000              | RO'000                     | RO'000                           | RO'000                               | RO'000            | RO'000           | RO'000                   | 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  | <u>107,713</u> | <u>301,505</u> | <u>32,314</u>               | <u>56,308</u>   | <u>35,905</u> | <u>3,957</u>        | <u>48,400</u>              | <u>4,823</u>                     | <u>(884)</u>                         | <u>121,063</u>    | <u>711,104</u>   | <u>212</u>               | <u>711,316</u>   |
| Balance at 31 December 2009 (USD'000)                                    | <u>279,774</u> | <u>783,130</u> | <u>83,933</u>               | <u>146,255</u>  | <u>93,260</u> | <u>10,278</u>       | <u>125,714</u>             | <u>12,527</u>                    | <u>(2,296)</u>                       | <u>314,450</u>    | <u>1,847,025</u> | <u>550</u>               | <u>1,847,575</u> |

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

Report of the Auditors - page 1

**CONSOLIDATED STATEMENT OF CASH FLOWS**  
**YEAR ENDED 31 DECEMBER 2010**

| 2009<br>USD'000  | 2010<br>USD'000         | Notes   | 2010<br>RO'000          | 2009<br>RO'000   |
|------------------|-------------------------|---|-------------------------|------------------|
|                  |                         |   |                         |                  |
|                  |                         | <b>CASH FLOWS FROM/(USED IN)</b>                    |                         |                  |
|                  |                         | <b>OPERATING ACTIVITIES</b>                         |                         |                  |
| 228,525          | <b>305,974</b>          | Profit for the year before taxation                 | <b>117,800</b>          | 87,982           |
|                  |                         | Adjustments for:                                    |                         |                  |
| 27,156           | <b>32,823</b>           | Share of net loss from associates                   | <b>12,637</b>           | 10,455           |
| 17,200           | <b>22,738</b>           | Depreciation  | <b>8,754</b>            | 6,622            |
| 7,636            | <b>1,706</b>            | Impairment for investments                          | <b>657</b>              | 2,940            |
| 255,174          | <b>121,010</b>          | Impairment for credit losses                        | <b>46,589</b>           | 98,242           |
| -                | <b>5,455</b>            | Impairment for placements                           | <b>2,100</b>            | -                |
| 52,766           | -                       | Impairment for associate                            | -                       | 20,315           |
| (27,504)         | <b>(35,449)</b>         | Recoveries from impairment for credit losses        | <b>(13,648)</b>         | (10,589)         |
| (1,104)          | <b>(356)</b>            | Recoveries from impairment for investments          | <b>(137)</b>            | (425)            |
| -                | <b>(8,844)</b>          | Recoveries from impairment for placement            | <b>(3,405)</b>          | -                |
| -                | <b>(94)</b>             | Profit on sale of property and equipment            | <b>(36)</b>             | -                |
| (138,912)        | <b>(3,088)</b>          | Profit on sale of investments                       | <b>(1,189)</b>          | (53,481)         |
| <u>(2,714)</u>   | <u><b>(2,784)</b></u>   | Dividends received                                  | <u><b>(1,072)</b></u>   | <u>(1,045)</u>   |
| 418,223          | <b>439,091</b>          |   | <b>169,050</b>          | 161,016          |
| 264,184          | <b>279,182</b>          | Placements with banks                               | <b>107,485</b>          | 101,711          |
| (514,712)        | <b>(526,379)</b>        | Loans and advances                                  | <b>(202,656)</b>        | (198,164)        |
| 345,148          | <b>(45,608)</b>         | Other assets  | <b>(17,559)</b>         | 132,882          |
| (351,055)        | <b>(272,875)</b>        | Deposits from banks                                 | <b>(105,057)</b>        | (135,156)        |
| (271,706)        | <b>1,190,982</b>        | Customers' deposits                                 | <b>458,528</b>          | (104,607)        |
| 201,364          | <b>40,000</b>           | Certificates of deposit                             | <b>15,400</b>           | 77,525           |
| (250,000)        | -                       | Floating rate notes                                 | -                       | (96,250)         |
| (297,073)        | <b>212,010</b>          | Other liabilities                                   | <b>81,624</b>           | (114,373)        |
| (455,627)        | <b>1,316,403</b>        | Cash from/(used in) operations                      | <b>506,815</b>          | (175,416)        |
| (45,473)         | <b>(40,626)</b>         | Income taxes paid                                   | <b>(15,641)</b>         | (17,507)         |
| (501,100)        | <u><b>1,275,777</b></u> | <b>Net cash from/(used in) operating activities</b> | <u><b>491,174</b></u>   | <u>(192,923)</u> |
|                  |                         | <b>CASH FLOWS (USED IN)/FROM</b>                    |                         |                  |
|                  |                         | <b>INVESTING ACTIVITIES</b>                         |                         |                  |
| 2,714            | <b>2,784</b>            | Dividends received                                  | <b>1,072</b>            | 1,045            |
|                  |                         | Net (payments)/proceeds in non-trading              |                         |                  |
| 265,319          | <b>(287,023)</b>        | investments   | <b>(110,504)</b>        | 102,148          |
| 10,052           | -                       | Investment in associates                            | -                       | 3,870            |
| (28,483)         | <b>(148,875)</b>        | Purchase of property and equipment                  | <b>(57,317)</b>         | (10,966)         |
| 42               | <b>226</b>              | Proceeds from sale of property and equipment        | <b>87</b>               | 16               |
| <u>249,644</u>   | <u><b>(432,888)</b></u> | <b>Net cash (used in)/from investing activities</b> | <u><b>(166,662)</b></u> | <u>96,113</u>    |
|                  |                         | <b>CASH FLOWS (USED IN)/FROM</b>                    |                         |                  |
|                  |                         | <b>FINANCING ACTIVITIES</b>                         |                         |                  |
| (55,956)         | <b>(55,956)</b>         | Dividends paid                                      | <b>(21,543)</b>         | (21,543)         |
| 668              | <b>332</b>              | Non controlling interest                            | <b>128</b>              | 257              |
| <u>194,805</u>   | <u><b>(12,987)</b></u>  | Subordinated loan (repaid) /received                | <u><b>(5,000)</b></u>   | <u>75,000</u>    |
| <u>139,517</u>   | <u><b>(68,611)</b></u>  | <b>Net cash (used in)/from financing activities</b> | <u><b>(26,415)</b></u>  | <u>53,714</u>    |
|                  |                         | <b>NET CHANGE IN CASH AND</b>                       |                         |                  |
|                  |                         | <b>CASH EQUIVALENTS</b>                             |                         |                  |
| (111,939)        | <b>774,278</b>          | Cash and cash equivalents at 1 January              | <b>298,097</b>          | (43,096)         |
| <u>1,065,935</u> | <u><b>953,996</b></u>   | <b>CASH AND CASH EQUIVALENTS</b>                    | <u><b>367,289</b></u>   | <u>410,385</u>   |
| <u>953,996</u>   | <u><b>1,728,274</b></u> | <b>AT 31 DECEMBER</b>                               | <u><b>665,386</b></u>   | <u>367,289</u>   |

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

**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.

**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.

**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.

**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.

**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.

**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   |

**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.

**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.

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

**5 CASH AND BALANCES WITH CENTRAL BANKS**

| 2009             | 2010                    |                                      | 2010                  | 2009           |
|------------------|-------------------------|--------------------------------------|-----------------------|----------------|
| USD '000         | USD'000                 |                                      | RO'000                | RO'000         |
| 202,426          | <b>285,444</b>          | Cash                                 | <b>109,896</b>        | 77,934         |
| 5,530            | <b>1,299</b>            | Capital deposit with Central Banks   | <b>500</b>            | 2,129          |
| 4,231            | <b>2,821</b>            | Insurance deposit with Central Banks | <b>1,086</b>          | 1,629          |
| <u>1,367,291</u> | <u><b>1,596,293</b></u> | Other balances with Central Banks    | <u><b>614,573</b></u> | <u>526,407</u> |
| <u>1,579,478</u> | <u><b>1,885,857</b></u> |                                      | <u><b>726,055</b></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             | 2010                    |                          | 2010                  | 2009             |
|------------------|-------------------------|--------------------------|-----------------------|------------------|
| USD'000          | USD'000                 |                          | RO'000                | RO'000           |
| 2,325,306        | <b>1,022,790</b>        | Inter-bank placements    | <b>393,774</b>        | 895,243          |
| <u>325,353</u>   | <u><b>413,182</b></u>   | Nostro balances          | <u><b>159,075</b></u> | <u>125,261</u>   |
| 2,650,659        | <b>1,435,972</b>        |                          | <b>552,849</b>        | 1,020,504        |
| <u>(12,501)</u>  | <u><b>(6,494)</b></u>   | Provision for impairment | <u><b>(2,500)</b></u> | <u>(4,813)</u>   |
| <u>2,638,158</u> | <u><b>1,429,478</b></u> |                          | <u><b>550,349</b></u> | <u>1,015,691</u> |

The movement in provision for impairment is analysed below:

**Provision for placements with Banks**

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

**7 LOANS AND ADVANCES**

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

**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<br>USD'000 | 2010<br>USD'000       |   | 2010<br>RO'000        | 2009<br>RO'000 |
|-----------------|-----------------------|---|-----------------------|----------------|
| 258,694         | <b>478,416</b>        | <b>1 January</b>                                    | <b>184,190</b>        | 99,597         |
| 255,174         | <b>121,010</b>        | Provided during the year                            | <b>46,589</b>         | 98,242         |
| (23,938)        | <b>(32,029)</b>       | Released during the year                            | <b>(12,331)</b>       | (9,216)        |
| (11,514)        | <b>(157,657)</b>      | Written off during the year                         | <b>(60,698)</b>       | (4,433)        |
| -               | <b>(1,039)</b>        | Transfer during the year to placements<br>provision | <b>(400)</b>          | -              |
| <u>478,416</u>  | <u><b>408,701</b></u> | <b>31 December (a)</b>                              | <u><b>157,350</b></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<br>USD'000 | 2010<br>USD'000       |                                     | 2010<br>RO'000        | 2009<br>RO'000 |
|-----------------|-----------------------|-------------------------------------|-----------------------|----------------|
| 67,473          | <b>77,026</b>         | <b>1 January</b>                    | <b>29,655</b>         | 25,977         |
| (13,792)        | <b>(21,587)</b>       | Written off during the year         | <b>(8,311)</b>        | (5,310)        |
| 33,800          | <b>37,177</b>         | Contractual interest not recognised | <b>14,313</b>         | 13,013         |
| (10,455)        | <b>(17,509)</b>       | Contractual interest recovered      | <b>(6,741)</b>        | (4,025)        |
| <u>77,026</u>   | <u><b>75,107</b></u>  | <b>31 December (b)</b>              | <u><b>28,916</b></u>  | <u>29,655</u>  |
| <u>555,442</u>  | <u><b>483,808</b></u> | <b>Total impairment (a+b)</b>       | <u><b>186,266</b></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<br>USD'000 | 2010<br>USD'000       |  | 2010<br>RO'000        | 2009<br>RO'000 |
|-----------------|-----------------------|--|-----------------------|----------------|
| 100,026         | <b>103,527</b>        | Positive fair value of derivatives (Note 38) | <b>39,858</b>         | 38,510         |
| 164,657         | <b>240,096</b>        | Acceptances                                  | <b>92,437</b>         | 63,393         |
| 33,579          | <b>29,426</b>         | Accrued interest                             | <b>11,329</b>         | 12,928         |
| 39,200          | <b>27,223</b>         | Other debtors and prepaid expenses           | <b>10,481</b>         | 15,092         |
| 28,821          | <b>28,821</b>         | Deferred tax asset (Note 21)                 | <b>11,096</b>         | 11,096         |
| 3,104           | <b>3,104</b>          | Collateral pending sale (net of provisions)  | <b>1,195</b>          | 1,195          |
| <u>22,616</u>   | <u><b>9,533</b></u>   | Others                                       | <u><b>3,670</b></u>   | <u>8,707</u>   |
| <u>392,003</u>  | <u><b>441,730</b></u> |  | <u><b>170,066</b></u> | <u>150,921</u> |

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

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

**9 INVESTMENT SECURITIES**

|                                  | Available-<br>for-sale<br>RO'000  | Held to<br>maturity<br>RO'000  | 2010<br>Total<br>RO'000  | 2009<br>Total<br>RO'000  |
|----------------------------------|-----------------------------------|--------------------------------|--------------------------|--------------------------|
| <b>2010</b>                      |                                   |                                |                          |                          |
| 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>           |
| <b>Net investments</b>           | <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-<br>for-sale<br>USD'000 | Held to<br>maturity<br>USD'000 | 2010<br>Total<br>USD'000 | 2009<br>Total<br>USD'000 |
| <b>2010</b>                      |                                   |                                |                          |                          |
| 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>           |
| <b>Total investments</b>         | 629,821                           | 77,719                         | 707,540                  | 389,693                  |
| Impairment losses on investments | <u>(13,964)</u>                   | -                              | <u>(13,964)</u>          | <u>(14,717)</u>          |
| <b>Net investments</b>           | <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<br>USD'000 | 2010<br>USD'000 |                                  | 2010<br>RO'000 | 2009<br>RO'000 |
|-----------------|-----------------|----------------------------------|----------------|----------------|
|                 |                 | <b>Quoted investments</b>        |                |                |
| 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          |
| 7,533           | 40,491          | Corporate bonds                  | 15,589         | 2,900          |
| <u>271,377</u>  | <u>566,977</u>  | Total                            | <u>218,286</u> | <u>104,480</u> |
|                 |                 | <b>Unquoted investments</b>      |                |                |
| 28,296          | 27,553          | Local securities and bonds       | 10,608         | 10,894         |
| 26,745          | 35,161          | Foreign securities and bonds     | 13,537         | 10,297         |
| 130             | 130             | Investment fund units            | 50             | 50             |
| <u>55,171</u>   | <u>62,844</u>   | Total                            | <u>24,195</u>  | <u>21,241</u>  |
| 326,548         | 629,821         | Total investments                | 242,481        | 125,721        |
| (14,717)        | (13,964)        | Impairment losses on investments | (5,376)        | (5,666)        |
| <u>311,831</u>  | <u>615,857</u>  | Total available-for-sale         | <u>237,105</u> | <u>120,055</u> |

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

**9 INVESTMENT SECURITIES (continued)**

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

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

The movement in investment securities may be summarised as follows:

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

|  | Available-<br>for-sale<br>RO'000 | Held to<br>maturity<br>RO'000 | Total<br>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>53,481</u>         |
| At 31 December 2009                        | <u>120,055</u>                   | <u>24,311</u>                 | <u>144,366</u>        |
| <b>USD'000</b>                             | <b><u>311,831</u></b>            | <b><u>63,145</u></b>          | <b><u>374,976</u></b> |

**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.

| <b>Company name</b>  | <b>Country of incorporation</b> | <b>Year end</b>  | <b>Proportion held</b> | <b>Carrying value RO'000</b> |
|--|---------------------------------|------------------|------------------------|------------------------------|
| Muscat Capital LLC   | Kingdom of Saudi Arabia         | 31 December 2010 | 95%                    | <b>5,053</b>                 |
| Muscat Capital LLC<br>(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:

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

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

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

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

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

**11 INVESTMENTS IN ASSOCIATES**

| 2009<br>USD'000 | 2010<br>USD'000       |   | 2010<br>RO'000       | 2009<br>RO'000 |
|-----------------|-----------------------|---|----------------------|----------------|
| 148,904         | <b>114,325</b>        | BMI Bank B.S.C. (c) Kingdom of Bahrain                            | <b>44,016</b>        | 57,328         |
| <u>25,569</u>   | <u><b>28,316</b></u>  | Mangal Keshav Holding Ltd (MKHL), India                           | <u><b>10,901</b></u> | <u>9,844</u>   |
|                 |                       | <b>Carrying value of investments in associates at 31 December</b> | <u><b>54,917</b></u> | <u>67,172</u>  |
| <u>174,473</u>  | <u><b>142,641</b></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<br>USD'000 | 2010<br>USD'000        |                                 | 2010<br>RO'000         | 2009<br>RO'000 |
|-----------------|------------------------|---------------------------------|------------------------|----------------|
| 170,566         | <b>148,904</b>         | Carrying value at 1 January     | <b>57,328</b>          | 65,668         |
| <u>(21,662)</u> | <u><b>(34,579)</b></u> | Add: Share of loss for the year | <u><b>(13,312)</b></u> | <u>(8,340)</u> |
| <u>148,904</u>  | <u><b>114,325</b></u>  | Carrying value at 31 December   | <u><b>44,016</b></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<br>USD'000 | 2010<br>USD'000      |  | 2010<br>RO'000       | 2009<br>RO'000 |
|-----------------|----------------------|--|----------------------|----------------|
| 24,298          | <b>25,569</b>        | Carrying value of investments at 1 January   | <b>9,844</b>         | 9,355          |
|                 |                      | Add: share of profit for the period 1 October 2009 to 30 September 2010 (2009 - 1 October 2008 to 30 September 2009) | <b>676</b>           | 101            |
| 263             | <b>1,756</b>         | Add/less: Translation of foreign currency profit   | <b>381</b>           | 388            |
| <u>1,008</u>    | <u><b>991</b></u>    | Carrying value of investments at 31 December   | <u><b>10,901</b></u> | <u>9,844</u>   |
| <u>25,569</u>   | <u><b>28,316</b></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.

**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<br>USD'000 | 2010<br>USD'000 |  | 2010<br>RO'000 | 2009<br>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)        |
| (10,052)        | -               | Less: Transferred to available for sale investments                  | -              | (3,870)        |
| <u>-</u>        | <u>-</u>        | Carrying value of investments at 31 December                         | <u>-</u>       | <u>-</u>       |

**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<br>January 2009<br>to December<br>2009<br>RO'000 | MKHL<br>April 2009 to<br>September<br>2009<br>RO'000 | SILK BANK<br>January 2009<br>to September<br>2009<br>RO'000 |                   | MKHL<br>April 2010 to<br>September<br>2010<br>RO'000 | BMI<br>January 2010<br>to December<br>2010<br>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<br>December<br>2009                            | At 30<br>September<br>2009                           | At 30<br>September<br>2009                                  |                   | At 30<br>September<br>2010                           | At 31<br>December<br>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<br>January 2009<br>to December<br>2009<br>USD'000 | MKHL<br>April 2009 to<br>September<br>2009<br>USD'000 | SILK BANK<br>January 2009<br>to September<br>2009<br>RO'000 |                   | MKHI<br>April 2010 to<br>September<br>2010<br>USD'000 | BMI<br>January 2010<br>to December<br>2010<br>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<br>September<br>2009                            | At 30<br>September<br>2009                                  |                   | At 30<br>September<br>2009                            | At 31<br>December<br>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<br>buildings<br>RO'000 | Freehold land<br>and buildings<br>RO'000 | Furniture,<br>fixtures and<br>equipment<br>RO'000 | Motor<br>vehicles<br>RO'000 | Total<br>RO'000 |
|-------------------------------|----------------------------------|--|---|-----------------------------|-----------------|
| <b>Cost or valuation</b>      |                                  |  |   |                             |                 |
| 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>  |
| <b>Depreciation</b>           |                                  |  |   |                             |                 |
| 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>   |
| <b>Net book value</b>         |                                  |  |   |                             |                 |
| 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>  |

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

**12 PROPERTY AND EQUIPMENT (continued)**

|                               | Freehold land<br>and buildings<br>RO'000 | Furniture,<br>fixtures and<br>equipment<br>RO'000 | Motor<br>vehicles<br>RO'000 | Total<br>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                      | <u>254</u>                               | <u>(254)</u>                                      | -                           | -               |
| 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<br>USD'000 | 2010<br>USD'000  |  | 2010<br>RO'000   | 2009<br>RO'000 |
|-----------------|------------------|--|------------------|----------------|
| -               | (122)            | Current  | (47)             | -              |
| -               | <u>98,823</u>    | Non current  | <u>38,047</u>    | -              |
| -               | <u>98,701</u>    |  | <u>38,000</u>    | -              |
| -               |                  | Represented by:  |                  |                |
| -               | <b>448,790</b>   | Gross finance lease payments due                         | <b>172,784</b>   | -              |
| -               | <b>(350,089)</b> | Less: Future finance charges                             | <b>(134,784)</b> | -              |
| -               | <u>98,701</u>    | Net lease liability/present value recognised as property | <u>38,000</u>    | -              |

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

**13 FINANCE LEASE LIABILITIES (continued)**

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

|                              | Less than<br>1 year<br>RO'000  | Between 1<br>and 2 years<br>RO'000  | Between 2<br>and 5 years<br>RO'000  | More than<br>5 years<br>RO'000  | Total<br>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          | <u>(47)</u>                    | <u>(49)</u>                         | <u>(174)</u>                        | <u>38,270</u>                   | <u>38,000</u>    |
|                              | Less than<br>1 year<br>USD'000 | Between 1<br>and 2 years<br>USD'000 | Between 2<br>and 5 years<br>USD'000 | More than<br>5 years<br>USD'000 | Total<br>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          | <u>(122)</u>                   | <u>(127)</u>                        | <u>(452)</u>                        | <u>99,402</u>                   | <u>98,701</u>    |

**14 DEPOSITS FROM BANKS**

| 2009<br>USD'000  | 2010<br>USD'000  |                             | 2010<br>RO'000 | 2009<br>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<br>USD'000  | 2010<br>USD'000  |                  | 2010<br>RO'000   | 2009<br>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.

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

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

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

**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:

|  | <b>2010</b>          | 2009          |
|--|----------------------|---------------|
|  | <b>RO'000</b>        | RO'000        |
| Tax charge at 12% on accounting profit before tax          | <b>14,136</b>        | 10,558        |
| <b>Add/(less) tax effect of:</b>                           |                      |               |
| Income not taxable   | <b>(166)</b>         | (107)         |
| Expenses not deductible or deferred                        | <b>2,084</b>         | 2,300         |
| Foreign taxes on foreign-sourced income                    | <b>1</b>             | 1,533         |
| Tax relating to subsidiary                                 | <b>92</b>            | 75            |
| Others   | <b>58</b>            | (95)          |
| <b>Tax charge as per statement of comprehensive income</b> | <b><u>16,205</u></b> | <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<br>2010    | Charged/<br>(Credited) to<br>Statement of<br>comprehensive<br>income | 31 December<br>2010  |
|--|----------------------|--|----------------------|
|  | RO'000               | RO'000   | RO'000               |
| <b>Asset</b>                               |                      |  |                      |
| Tax effect of provisions                   | 10,888               | -  | 10,888               |
| <b>Liability</b>                           |                      |  |                      |
| Tax effect of accelerated tax depreciation | <u>208</u>           | <u>-</u>   | <u>208</u>           |
|  | <b><u>11,096</u></b> | <b><u>-</u></b>  | <b><u>11,096</u></b> |

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

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

**21 TAXATION (continued)**

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

|  | 31 December 2010     |                                      |                     | 31 December 2009       |                                      |                        |
|--|----------------------|--------------------------------------|---------------------|------------------------|--------------------------------------|------------------------|
|  | Before tax<br>RO'000 | Tax<br>(charge)/<br>Credit<br>RO'000 | After Tax<br>RO'000 | Before tax<br>RO'000   | Tax<br>(charge)/<br>Credit<br>RO'000 | After Tax<br>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>        |
| <b>Other comprehensive income</b>  | <b><u>4,956</u></b>  | <b><u>(58)</u></b>                   | <b><u>4,898</u></b> | <b><u>(55,345)</u></b> | <b><u>(521)</u></b>                  | <b><u>(55,866)</u></b> |
| 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      |                                       |                      | 31 December 2009        |                                       |                         |
|--|-----------------------|---------------------------------------|----------------------|-------------------------|---------------------------------------|-------------------------|
|  | Before tax<br>USD'000 | Tax<br>(charge)/<br>Credit<br>USD'000 | After Tax<br>USD'000 | Before tax<br>USD'000   | Tax<br>(charge)/<br>Credit<br>USD'000 | After Tax<br>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>        |
| <b>Other comprehensive income</b>  | <b><u>12,873</u></b>  | <b><u>(151)</u></b>                   | <b><u>12,722</u></b> | <b><u>(143,753)</u></b> | <b><u>(1,353)</u></b>                 | <b><u>(145,106)</u></b> |
| 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.

**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<br>USD'000 | 2010<br>USD'000 |  | 2010<br>RO'000 | 2009<br>RO'000 |
|-----------------|-----------------|--|----------------|----------------|
| 389,610         | <b>376,623</b>  | Fixed rate Rial Omani subordinated loans | <b>145,000</b> | 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   | <b>334,422,151</b> | <b>24.84</b> | 267,537,721   | 24.84     |
| Dubai Financial Group | <b>201,962,500</b> | <b>15.00</b> | 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 40%, 25% in the form of cash and 15% in the form of bonus shares. Thus shareholders would receive cash dividend of RO 0.025 per ordinary share of RO 0.100 each aggregating to RO 33.66 million on the Parent company'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.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
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**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<br>USD'000  | 2010<br>USD'000         |                   | 2010<br>RO'000          | 2009<br>RO'000 |
|------------------|-------------------------|-------------------|-------------------------|----------------|
| 686,990          | <b>844,914</b>          | Letters of credit | <b>325,292</b>          | 264,491        |
| <u>1,810,119</u> | <u><b>2,379,800</b></u> | Guarantees        | <u><b>916,223</b></u>   | <u>696,896</u> |
| <u>2,497,109</u> | <u><b>3,224,714</b></u> |                   | <u><b>1,241,515</b></u> | <u>961,387</u> |

**(c) Capital commitments**

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

| 2009<br>USD'000 | 2010<br>USD'000     |                                    | 2010<br>RO'000      | 2009<br>RO'000 |
|-----------------|---------------------|------------------------------------|---------------------|----------------|
| <u>3,873</u>    | <u><b>5,507</b></u> | Purchase of property and equipment | <u><b>2,120</b></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).

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

**29 INTEREST INCOME**

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

Effective annual rates on yielding assets are provided in note 42.4.4

**30 INTEREST EXPENSE**

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

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

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

**33 OTHER OPERATING EXPENSES**

| 2009<br>USD'000 | 2010<br>USD'000       |  | 2010<br>RO'000       | 2009<br>RO'000 |
|-----------------|-----------------------|--|----------------------|----------------|
| 84,128          | <b>97,939</b>         | Employees' salaries                      | <b>37,707</b>        | 32,389         |
| 59,769          | <b>77,338</b>         | Administrative expenses                  | <b>29,775</b>        | 23,011         |
| 29,992          | <b>43,273</b>         | Other staff costs                        | <b>16,660</b>        | 11,547         |
| 16,855          | <b>19,351</b>         | Occupancy costs                          | <b>7,450</b>         | 6,489          |
| 3,722           | <b>4,125</b>          | Contribution to Social Insurance schemes | <b>1,588</b>         | 1,433          |
| 1,335           | <b>2,164</b>          | Employees' end of service benefits       | <b>833</b>           | 514            |
| 311             | <b>353</b>            | Directors' remuneration (note 36)        | <b>136</b>           | 120            |
| <u>196,112</u>  | <u><b>244,543</b></u> |  | <u><b>94,149</b></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<br>USD'000 | 2010<br>USD'000         |                                      | 2010<br>RO'000        | 2009<br>RO'000 |
|-----------------|-------------------------|--------------------------------------|-----------------------|----------------|
| 1,931,468       | <b>998,579</b>          | Placements with banks                | <b>384,453</b>        | 743,615        |
| 1,569,717       | <b>1,880,215</b>        | Cash and balances with Central Banks | <b>723,883</b>        | 604,341        |
| 59,762          | <b>77,719</b>           | Treasury bills                       | <b>29,922</b>         | 23,009         |
| (2,606,951)     | <b>(1,228,239)</b>      | Deposits from banks                  | <b>(472,872)</b>      | (1,003,676)    |
| <u>953,996</u>  | <u><b>1,728,274</b></u> |                                      | <u><b>665,386</b></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) | <u><b>101,595</b></u>   | <u>73,718</u>    |
| Weighted average number of shares outstanding during the year (in '000)                | <u><b>1,346,417</b></u> | <u>1,077,134</u> |
| Basic earnings per share (RO)  | <u><b>0.075</b></u>     | <u>0.068</u>     |
| Basic earnings per share (USD)   | <u><b>0.195</b></u>     | <u>0.178</u>     |

**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.

|   |                         |                  |
|---|-------------------------|------------------|
|   | <b>2010</b>             | 2009             |
| Net profit for the year (RO'000)                                  | <b>101,595</b>          | 73,718           |
| Interest on convertible bonds, net of taxation (RO'000)           | <b>1,991</b>            | 1,563            |
|   | <b><u>103,586</u></b>   | <u>75,281</u>    |
| Weighted average number of shares in issue during the year ('000) | <b><u>1,388,405</u></b> | <u>1,126,095</u> |
| Diluted earnings per share (RO)                                   | <b><u>0.075</u></b>     | <u>0.067</u>     |
| Diluted earnings per share (USD)                                  | <b><u>0.195</u></b>     | <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<br>USD'000 | 2010<br>USD'000       |  | 2010<br>RO'000       | 2009<br>RO'000 |
|-----------------|-----------------------|--|----------------------|----------------|
|                 |                       | <b>Loans and advances</b>  |                      |                |
| 156,842         | <b>100,933</b>        | 1 January  | <b>38,859</b>        | 60,384         |
| 18,671          | <b>103,104</b>        | Disbursed during the year  | <b>39,695</b>        | 7,188          |
| (74,580)        | <b>(4,603)</b>        | Repaid during the year   | <b>(1,772)</b>       | (28,713)       |
| <u>100,933</u>  | <b><u>199,434</u></b> | 31 December  | <b><u>76,782</u></b> | <u>38,859</u>  |
|                 |                       | <b>Current, deposit and other accounts</b>   |                      |                |
| 61,729          | <b>88,599</b>         | 1 January  | <b>34,110</b>        | 23,766         |
| 41,487          | <b>73,249</b>         | Received during the year   | <b>28,201</b>        | 15,972         |
| (14,617)        | <b>(7,364)</b>        | Repaid during the year   | <b>(2,835)</b>       | (5,628)        |
| -               | <b>(135)</b>          | Other decreases  | <b>(52)</b>          | -              |
| <u>88,599</u>   | <b><u>154,349</u></b> | 31 December  | <b><u>59,424</u></b> | <u>34,110</u>  |
| <u>11,408</u>   | <b><u>16,621</u></b>  | Customers' liabilities under documentary credits, guarantees and other liabilities | <b><u>6,399</u></b>  | <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<br>USD'000 | 2010<br>USD'000       |   | 2010<br>RO'000       | 2009<br>RO'000 |
|-----------------|-----------------------|---|----------------------|----------------|
| 10,779          | <b>58,886</b>         | Royal Court Affairs                                     | <b>22,671</b>        | 4,150          |
| 20,000          | <b>20,000</b>         | Dubai Financial Group                                   | <b>7,700</b>         | 7,700          |
| 61,990          | <b>111,912</b>        | HE Sheikh Mustahil Ahmed Al Mashani and Group Companies | <b>43,086</b>        | 23,866         |
| 8,164           | <b>8,636</b>          | Others  | <b>3,325</b>         | 3,143          |
| <u>100,933</u>  | <b><u>199,434</u></b> |   | <b><u>76,782</u></b> | <u>38,859</u>  |

**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<br>USD'000 | 2010<br>USD'000 |                                   | 2010<br>RO'000 | 2009<br>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<br>USD'000 | 2010<br>USD'000 |   | 2010<br>RO'000 | 2009<br>RO'000 |
|-----------------|-----------------|---|----------------|----------------|
| 312             | 36              | Royal Court Affairs   | 14             | 120            |
| 2,044           | 930             | H.E Sheikh Mustahil Ahmed Al Mashani<br>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<br>USD'000 | 2010<br>USD'000 |  | 2010<br>RO'000 | 2009<br>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<br>USD'000 | 2010<br>USD'000 |                        | 2010<br>RO'000 | 2009<br>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:

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

**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<br>fair<br>value<br>RO'000<br>(Note 8) | Negative<br>fair<br>value<br>RO'000<br>(Note 20) | Notional<br>amount<br>total<br>RO'000 | Notional amounts by term to maturity |                            |                               |
|-----------------------------------|---|--|---------------------------------------|--------------------------------------|----------------------------|-------------------------------|
|                                   |   |  |                                       | Within 3<br>months<br>RO'000         | 3 - 12<br>months<br>RO'000 | More than<br>1 year<br>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<br>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                     | -                             |
| <b>Total</b>                      | <b>39,858</b>                                   | <b>53,710</b>                                    | <b>2,732,539</b>                      | <b>1,658,998</b>                     | <b>290,499</b>             | <b>783,042</b>                |
| <b>USD'000</b>                    | <b>103,527</b>                                  | <b>139,506</b>                                   | <b>7,097,504</b>                      | <b>4,309,086</b>                     | <b>754,543</b>             | <b>2,033,875</b>              |

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
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).

**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<br>Oman<br>RO'000 | Other GCC<br>countries<br>RO'000 | Europe<br>RO'000      | United<br>States of<br>America<br>RO'000 | Others<br>RO'000      | Total<br>RO'000         |
|--|--------------------------------|----------------------------------|-----------------------|--|-----------------------|-------------------------|
| <b>31 December 2010</b>                            |                                |                                  |                       |  |                       |                         |
| 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<br>other assets            | <u>240,651</u>                 | <u>4,203</u>                     | <u>-</u>              | <u>-</u>                                 | <u>-</u>              | <u>244,854</u>          |
| <b>Total assets</b>                                | <b><u>4,914,802</u></b>        | <b><u>457,296</u></b>            | <b><u>118,816</u></b> | <b><u>49,708</u></b>                     | <b><u>310,506</u></b> | <b><u>5,851,128</u></b> |
| Deposits from banks                                | 29,286                         | 108,049                          | 185,606               | 6  | 436,939               | 759,886                 |
| Customers' deposits and<br>certificates of deposit | 3,426,448                      | 239,918                          | 4,272                 | 126                                      | 10,789                | 3,681,553               |
| Unsecured bonds and<br>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>          |
| <b>Total liabilities and equity</b>                | <b><u>4,808,463</u></b>        | <b><u>350,519</u></b>            | <b><u>205,786</u></b> | <b><u>38,632</u></b>                     | <b><u>447,728</u></b> | <b><u>5,851,128</u></b> |

|  | Sultanate of<br>Oman<br>RO'000 | Other GCC<br>countries<br>RO'000 | Europe<br>RO'000      | United<br>States of<br>America<br>RO'000 | Others<br>RO'000      | Total<br>RO'000         |
|--|--------------------------------|----------------------------------|-----------------------|--|-----------------------|-------------------------|
| <b>31 December 2009</b>                            |                                |                                  |                       |  |                       |                         |
| 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<br>assets            | <u>173,067</u>                 | <u>4,130</u>                     | <u>-</u>              | <u>-</u>                                 | <u>-</u>              | <u>177,197</u>          |
| <b>Total assets</b>                                | <b><u>4,543,837</u></b>        | <b><u>771,627</u></b>            | <b><u>212,419</u></b> | <b><u>38,969</u></b>                     | <b><u>283,884</u></b> | <b><u>5,850,736</u></b> |
| Deposits from banks                                | 29,900                         | 193,657                          | 214,765               | -  | 957,425               | 1,395,747               |
| Customers' deposits and<br>certificates of deposit | 2,997,575                      | 199,606                          | 3,039                 | 759                                      | 6,646                 | 3,207,625               |
| Unsecured bonds and<br>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>          |
| <b>Total liabilities and equity</b>                | <b><u>4,218,865</u></b>        | <b><u>395,337</u></b>            | <b><u>233,204</u></b> | <b><u>39,259</u></b>                     | <b><u>964,071</u></b> | <b><u>5,850,736</u></b> |

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

**40 GEOGRAPHICAL DISTRIBUTION OF ASSETS AND LIABILITIES (continued)**

|  | Sultanate of<br>Oman<br>USD'000 | Other GCC<br>countries<br>USD'000 | Europe<br>USD'000     | United<br>States of<br>America<br>USD'000 | Others<br>USD'000       | Total<br>USD'000         |
|--|---------------------------------|-----------------------------------|-----------------------|---|-------------------------|--------------------------|
| <b>31 December 2010</b>                            |                                 |                                   |                       |   |                         |                          |
| Cash and balances with<br>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<br>other assets            | <u>625,068</u>                  | <u>10,917</u>                     | <u>-</u>              | <u>-</u>                                  | <u>-</u>                | <u>635,985</u>           |
| <b>Total assets</b>                                | <b><u>12,765,718</u></b>        | <b><u>1,187,782</u></b>           | <b><u>308,613</u></b> | <b><u>129,112</u></b>                     | <b><u>806,509</u></b>   | <b><u>15,197,734</u></b> |
| Deposits from banks                                | 76,067                          | 280,647                           | 482,094               | 16  | 1,134,906               | 1,973,730                |
| Customers' deposits and<br>certificates of deposit | 8,899,865                       | 623,164                           | 11,096                | 327                                       | 28,023                  | 9,562,475                |
| Unsecured bonds and<br>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>         |
| <b>Total liabilities and equity</b>                | <b><u>12,489,513</u></b>        | <b><u>910,440</u></b>             | <b><u>534,509</u></b> | <b><u>100,343</u></b>                     | <b><u>1,162,929</u></b> | <b><u>15,197,734</u></b> |

|  | Sultanate of<br>Oman<br>USD'000 | Other GCC<br>countries<br>USD'000 | Europe<br>USD'000     | United<br>States of<br>America<br>USD'000 | Others<br>USD'000       | Total<br>USD'000         |
|--|---------------------------------|-----------------------------------|-----------------------|---|-------------------------|--------------------------|
| <b>31 December 2009</b>                            |                                 |                                   |                       |   |                         |                          |
| Cash and balances with<br>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<br>other assets            | <u>449,523</u>                  | <u>10,729</u>                     | <u>-</u>              | <u>-</u>                                  | <u>-</u>                | <u>460,252</u>           |
| <b>Total assets</b>                                | <b><u>11,802,171</u></b>        | <b><u>2,004,228</u></b>           | <b><u>551,738</u></b> | <b><u>101,219</u></b>                     | <b><u>737,360</u></b>   | <b><u>15,196,716</u></b> |
| Deposits from banks                                | 77,663                          | 503,005                           | 557,831               | -   | 2,486,818               | 3,625,317                |
| Customers' deposits and<br>certificates of deposit | 7,785,908                       | 518,457                           | 7,894                 | 1,971                                     | 17,262                  | 8,331,492                |
| Unsecured bonds and<br>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>         |
| <b>Total liabilities and equity</b>                | <b><u>10,958,091</u></b>        | <b><u>1,026,849</u></b>           | <b><u>605,725</u></b> | <b><u>101,971</u></b>                     | <b><u>2,504,080</u></b> | <b><u>15,196,716</u></b> |

# BANK MUSCAT SAOG

## 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<br>USD'000 | International<br>USD'000 | Oman<br>USD'000  |   | Oman<br>RO'000   | International<br>RO'000 | Total<br>RO'000  |
|------------------|--------------------------|------------------|---|------------------|-------------------------|------------------|
| <b>714,792</b>   | <b>14,867</b>            | <b>699,925</b>   | <b>Segment revenue</b>                        |                  |                         |                  |
| (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           |
| <b>689,601</b>   | <b>13,027</b>            | <b>676,574</b>   | Other operating income                        | <u>26,061</u>    | <u>105</u>              | <u>26,166</u>    |
|                  |                          |                  | <b>Operating income</b>                       | <b>260,481</b>   | <b>5,015</b>            | <b>265,496</b>   |
|                  |                          |                  | <b>Segment costs</b>                          |                  |                         |                  |
| (244,543)        | (18,013)                 | (226,530)        | Other operating expenses                      | (87,214)         | (6,935)                 | (94,149)         |
| (22,738)         | (2,706)                  | (20,032)         | 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>  |
| <b>(425,717)</b> | <b>(73,951)</b>          | <b>(351,766)</b> | Total costs                                   | <b>(135,430)</b> | <b>(28,471)</b>         | <b>(163,901)</b> |
| <u>263,884</u>   | <u>(60,924)</u>          | <u>324,808</u>   | <b>Segment net profit/(loss) for the year</b> | <b>125,051</b>   | <b>(23,456)</b>         | <b>101,595</b>   |
|                  |                          |                  | <b>Other information</b>                      |                  |                         |                  |
| 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           |

## BANK MUSCAT SAOG

### 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<br>USD'000 | International<br>USD'000 | Oman<br>USD'000  |   | Oman<br>RO'000   | International<br>RO'000 | Total<br>RO'000  |
|------------------|--------------------------|------------------|---|------------------|-------------------------|------------------|
|                  |                          |                  | Segment revenue                             |                  |                         |                  |
| 726,052          | 15,047                   | 711,005          | Interest income                             | 273,737          | 5,793                   | 279,530          |
| (273,154)        | (7,894)                  | (265,260)        | Interest expense                            | (102,125)        | (3,039)                 | (105,164)        |
| 129,379          | 2,683                    | 126,696          | Commission and fees income (net)            | 48,778           | 1,033                   | 49,811           |
| <u>173,683</u>   | <u>157,662</u>           | <u>16,021</u>    | Other operating income                      | <u>6,168</u>     | <u>60,700</u>           | <u>66,868</u>    |
| <u>755,960</u>   | <u>167,498</u>           | <u>588,462</u>   | Operating income                            | <u>226,558</u>   | <u>64,487</u>           | <u>291,045</u>   |
|                  |                          |                  | Segment costs                               |                  |                         |                  |
| (196,112)        | (11,184)                 | (184,928)        | 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>(296,637)</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           |

**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<br>banking<br>RO'000 | Consumer<br>banking<br>RO'000 | Wholesale<br>banking<br>RO'000 | International<br>RO'000 | Total<br>RO'000          |
|---|--------------------------------|-------------------------------|--------------------------------|-------------------------|--------------------------|
| Net interest income   | 66,025                         | 80,876                        | 35,950                         | 4,344                   | 187,195                  |
| Commission, fees and other<br>income (net)                  | <u>13,451</u>                  | <u>33,770</u>                 | <u>29,928</u>                  | <u>1,152</u>            | <u>78,301</u>            |
| <b>Operating income</b>                                     | <b><u>79,476</u></b>           | <b><u>114,646</u></b>         | <b><u>65,878</u></b>           | <b><u>5,496</u></b>     | <b><u>265,496</u></b>    |
| <b>Segment costs</b>  |                                |                               |                                |                         |                          |
| Operating expense (including<br>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<br>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>          |
|   | <b><u>(31,766)</u></b>         | <b><u>(84,430)</u></b>        | <b><u>(16,232)</u></b>         | <b><u>(31,473)</u></b>  | <b><u>(163,901)</u></b>  |
| Segment net profit/(loss) for the<br>year                   | <u>47,710</u>                  | <u>30,216</u>                 | <u>49,646</u>                  | <u>(25,977)</u>         | <u>101,595</u>           |
| Segment assets  | <b><u>2,324,686</u></b>        | <b><u>1,997,400</u></b>       | <b><u>1,280,944</u></b>        | <b><u>248,098</u></b>   | <b><u>5,851,128</u></b>  |
| 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)                                    | <b><u>6,038,144</u></b>        | <b><u>5,188,052</u></b>       | <b><u>3,327,128</u></b>        | <b><u>644,410</u></b>   | <b><u>15,197,734</u></b> |

| 31 December 2009                              | Corporate<br>banking<br>RO'000 | Consumer<br>banking<br>RO'000 | Wholesale<br>banking<br>RO'000 | International<br>RO'000 | Total<br>RO'000          |
|---|--------------------------------|-------------------------------|--------------------------------|-------------------------|--------------------------|
| Net interest income                           | 55,103                         | 83,993                        | 32,264                         | 3,006                   | 174,366                  |
| Commission, fees and other<br>income (net)    | <u>12,880</u>                  | <u>31,427</u>                 | <u>10,375</u>                  | <u>61,997</u>           | <u>116,679</u>           |
| <b>Operating income</b>                       | <b>67,983</b>                  | <b>115,420</b>                | <b>42,639</b>                  | <b>65,003</b>           | <b>291,045</b>           |
| <b>Segment costs</b>                          |                                |                               |                                |                         |                          |
| Operating expense (including<br>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<br>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>          |
|   | <b><u>(21,890)</u></b>         | <b><u>(76,225)</u></b>        | <b><u>(14,331)</u></b>         | <b><u>(104,881)</u></b> | <b><u>(217,327)</u></b>  |
| Segment net profit/(loss) for the<br>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                | <b><u>2,192,791</u></b>        | <b><u>1,907,286</u></b>       | <b><u>1,452,502</u></b>        | <b><u>298,157</u></b>   | <b><u>5,850,736</u></b>  |
| 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)                       | <b><u>5,695,561</u></b>        | <b><u>4,953,991</u></b>       | <b><u>3,772,730</u></b>        | <b><u>774,434</u></b>   | <b><u>15,196,716</u></b> |

**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.

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<br>RO'000                  | 2009<br>RO'000          | 2010<br>RO'000          | 2009<br>RO'000          | 2010<br>RO'000         | 2009<br>RO'000         |
| <b>Individually impaired</b>                |                                 |                         |                         |                         |                        |                        |
| 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>-</u>                | <u>-</u>                | <u>1,891</u>           | <u>1,891</u>           |
| <b>Gross amount</b>                         | <b>103,191</b>                  | <b>153,616</b>          | <b>-</b>                | <b>9,626</b>            | <b>15,466</b>          | <b>15,788</b>          |
| Allowance for impairment                    | <u>(68,700)</u>                 | <u>(115,701)</u>        | <u>-</u>                | <u>(4,813)</u>          | <u>(5,376)</u>         | <u>(5,666)</u>         |
| <b>Carrying amount</b>                      | <b><u>34,491</u></b>            | <b><u>37,915</u></b>    | <b><u>-</u></b>         | <b><u>4,813</u></b>     | <b><u>10,090</u></b>   | <b><u>10,122</u></b>   |
| <b>Collectively impaired</b>                |                                 |                         |                         |                         |                        |                        |
| Sub-Standard                                | 13,960                          | 15,339                  | -                       | -                       | -                      | -                      |
| Doubtful                                    | 19,266                          | 19,152                  | -                       | -                       | -                      | -                      |
| Loss  | <u>39,469</u>                   | <u>22,679</u>           | <u>-</u>                | <u>-</u>                | <u>-</u>               | <u>-</u>               |
| <b>Gross amount</b>                         | <b><u>72,695</u></b>            | <b><u>57,170</u></b>    | <b><u>-</u></b>         | <b><u>-</u></b>         | <b><u>-</u></b>        | <b><u>-</u></b>        |
| Allowance for impairment                    | <u>(54,704)</u>                 | <u>(41,900)</u>         | <u>-</u>                | <u>-</u>                | <u>-</u>               | <u>-</u>               |
| <b>Carrying amount</b>                      | <b><u>17,991</u></b>            | <b><u>15,270</u></b>    | <b><u>-</u></b>         | <b><u>-</u></b>         | <b><u>-</u></b>        | <b><u>-</u></b>        |
| <b>Past due but not impaired</b>            |                                 |                         |                         |                         |                        |                        |
| Standard                                    | <u>227,494</u>                  | <u>111,908</u>          | <u>-</u>                | <u>-</u>                | <u>-</u>               | <u>-</u>               |
| <b>Carrying amount</b>                      | <b><u>227,494</u></b>           | <b><u>111,908</u></b>   | <b><u>-</u></b>         | <b><u>-</u></b>         | <b><u>-</u></b>        | <b><u>-</u></b>        |
| <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>-</u>                | <u>-</u>                | <u>-</u>               | <u>-</u>               |
|   | <b><u>227,494</u></b>           | <b><u>111,908</u></b>   | <b><u>-</u></b>         | <b><u>-</u></b>         | <b><u>-</u></b>        | <b><u>-</u></b>        |
| <b>Neither past due nor impaired</b>        |                                 |                         |                         |                         |                        |                        |
| Standard                                    | 3,472,668                       | 3,499,226               | 552,849                 | 1,010,878               | 256,937                | 134,244                |
| Special mention                             | <u>318,144</u>                  | <u>230,136</u>          | <u>-</u>                | <u>-</u>                | <u>-</u>               | <u>-</u>               |
| <b>Gross amount</b>                         | <b><u>3,790,812</u></b>         | <b><u>3,729,362</u></b> | <b><u>552,849</u></b>   | <b><u>1,010,878</u></b> | <b><u>256,937</u></b>  | <b><u>134,244</u></b>  |
| Allowance for impairment                    | <u>(62,862)</u>                 | <u>(56,244)</u>         | <u>(2,500)</u>          | <u>-</u>                | <u>-</u>               | <u>-</u>               |
| <b>Carrying amount</b>                      | <b><u>3,727,950</u></b>         | <b><u>3,673,118</u></b> | <b><u>550,349</u></b>   | <b><u>1,010,878</u></b> | <b><u>256,937</u></b>  | <b><u>134,244</u></b>  |
| <b>Total carrying amount</b>                | <b><u>4,007,926</u></b>         | <b><u>3,838,211</u></b> | <b><u>550,349</u></b>   | <b><u>1,015,691</u></b> | <b><u>267,027</u></b>  | <b><u>144,366</u></b>  |
| <b>Carrying amount in USD'000</b>           | <b><u>10,410,197</u></b>        | <b><u>9,969,379</u></b> | <b><u>1,429,478</u></b> | <b><u>2,638,158</u></b> | <b><u>693,577</u></b>  | <b><u>374,977</u></b>  |
| <b>Total allowances for impairment</b>      | <b><u>(186,266)</u></b>         | <b><u>(213,845)</u></b> | <b><u>(2,500)</u></b>   | <b><u>(4,813)</u></b>   | <b><u>(5,376)</u></b>  | <b><u>(5,666)</u></b>  |
| <b>IN USD'000</b>                           | <b><u>(483,808)</u></b>         | <b><u>(555,442)</u></b> | <b><u>(6,494)</u></b>   | <b><u>(12,501)</u></b>  | <b><u>(13,964)</u></b> | <b><u>(14,717)</u></b> |

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)

**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.

**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           |
| <b>2010</b>             |                                 |                      |                       |                      |                       |                      |
| 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>-</u>              | <u>-</u>             | <u>1,891</u>          | <u>-</u>             |
| <b>Total amount</b>     | <b><u>103,191</u></b>           | <b><u>34,491</u></b> | <b><u>-</u></b>       | <b><u>-</u></b>      | <b><u>15,466</u></b>  | <b><u>10,090</u></b> |
| <b>Total in USD'000</b> | <b><u>268,029</u></b>           | <b><u>89,587</u></b> | <b><u>-</u></b>       | <b><u>-</u></b>      | <b><u>40,171</u></b>  | <b><u>26,208</u></b> |
| <b>2009</b>             |                                 |                      |                       |                      |                       |                      |
| 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>-</u>              | <u>-</u>             | <u>1,891</u>          | <u>-</u>             |
| <b>Total amount</b>     | <b><u>153,616</u></b>           | <b><u>37,915</u></b> | <b><u>9,626</u></b>   | <b><u>4,813</u></b>  | <b><u>15,788</u></b>  | <b><u>10,122</u></b> |
| <b>Total in USD'000</b> | <b><u>399,003</u></b>           | <b><u>98,481</u></b> | <b><u>25,003</u></b>  | <b><u>12,501</u></b> | <b><u>41,008</u></b>  | <b><u>26,291</u></b> |

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

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

**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<br>RO'000  | 2009<br>RO'000 |
| Residential/commercial property<br>USD'000 | <u>1,195</u>    | <u>1,195</u>   |
|  | <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<br>RO'000 | 2009<br>RO'000 |
|-----------------------------|----------------|----------------|
| <b>Banks rated:</b>         |                |                |
| Aaa to Aa3                  | 142,137        | 72,714         |
| A1 to A3                    | 6,044          | 5,324          |
| Baa1 to Baa3                | 6,203          | 5,208          |
| <b>Banks unrated</b>        | <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<br>RO'000 | 2009<br>RO'000   |
|----------------------|----------------|------------------|
| <b>Banks rated:</b>  |                |                  |
| 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            |
| <b>Banks unrated</b> | <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.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
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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<br>to customers |                   | Gross loans and advances<br>to banks |                  | Gross investment in<br>securities |                |
|--------------------------------|--|-------------------|--------------------------------------|------------------|-----------------------------------|----------------|
|                                | 2010<br>RO'000                           | 2009<br>RO'000    | 2010<br>RO'000                       | 2009<br>RO'000   | 2010<br>RO'000                    | 2009<br>RO'000 |
| <b>Concentration by Sector</b> |  |                   |                                      |                  |                                   |                |
| 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         | -                                    | -                | -                                 | -              |
| <b>Total</b>                   | <b>4,194,192</b>                         | <b>4,052,056</b>  | <b>552,849</b>                       | <b>1,020,504</b> | <b>272,403</b>                    | <b>150,032</b> |
| <b>USD'000</b>                 | <b>10,894,005</b>                        | <b>10,524,821</b> | <b>1,435,971</b>                     | <b>2,650,660</b> | <b>707,540</b>                    | <b>389,694</b> |

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

| 2009<br>USD'000 | 2010<br>USD'000 |                                   | 2010<br>RO'000 | 2009<br>RO'000 |
|-----------------|-----------------|-----------------------------------|----------------|----------------|
|                 |                 | <b>Corporate and other loans</b>  |                |                |
| 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      |
| 10,524,821      | 10,894,005      |                                   | 4,194,192      | 4,052,056      |

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

**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.

| Concentration by location | Gross Loans and Advances to customers |                          | Gross Loans and Advances to banks |                         | Investment securities |                       |
|---------------------------|---------------------------------------|--------------------------|-----------------------------------|-------------------------|-----------------------|-----------------------|
|                           | 2010<br>RO'000                        | 2009<br>RO'000           | 2010<br>RO'000                    | 2009<br>RO'000          | 2010<br>RO'000        | 2009<br>RO'000        |
| 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>        |
| <b>USD'000</b>            | <b><u>10,894,005</u></b>              | <b><u>10,524,821</u></b> | <b><u>1,435,971</u></b>           | <b><u>2,650,659</u></b> | <b><u>707,540</u></b> | <b><u>389,693</u></b> |

**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  
FOR THE YEAR ENDED 31 DECEMBER 2010 (continued)**

**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<br>assets ratio |        | Liquid assets to total<br>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.

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

**42 FINANCIAL RISK MANAGEMENT (continued)**

**42.3.2 Exposure to liquidity risk**

The asset and liability maturity profile was as follows:

|  | <b>On demand or<br/>within three<br/>months<br/>RO'000</b> | <b>Four months to<br/>12 months<br/>RO'000</b> | <b>One to five<br/>years<br/>RO'000</b> | <b>More than<br/>five years<br/>RO'000</b> | <b>Total<br/>RO'000</b> |
|--|--|--|---|--|-------------------------|
| <b>31 December 2010</b>                            |  |  |   |  |                         |
| <b>Assets</b>                                      |  |  |   |  |                         |
| Cash and balances with Central<br>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<br>other assets         | 87,297   | 70,901   | 13,583                                  | 73,073                                     | 244,854                 |
| <b>Total assets</b>                                | <b><u>1,827,032</u></b>                                    | <b><u>605,405</u></b>                          | <b><u>1,289,950</u></b>                 | <b><u>2,128,741</u></b>                    | <b><u>5,851,128</u></b> |
| <b>Liabilities and equity</b>                      |  |  |   |  |                         |
| Deposits from banks                                | 472,872  | 204,539  | 40,877                                  | 41,598                                     | 759,886                 |
| Customers' deposits and<br>certificates of deposit | 1,005,489  | 764,936  | 1,191,481                               | 719,647                                    | 3,681,553               |
| Unsecured bonds and<br>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                 |
| <b>Total liabilities and equity</b>                | <b><u>1,597,817</u></b>                                    | <b><u>1,114,685</u></b>                        | <b><u>1,442,234</u></b>                 | <b><u>1,696,392</u></b>                    | <b><u>5,851,128</u></b> |
| <b>Assets off balance sheet</b>                    |  |  |   |  |                         |
| 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>        |
| <b>Liabilities off balance sheet</b>               |  |  |   |  |                         |
| Future interest cash flows                         | <u>13,396</u>  | <u>43,702</u>                                  | <u>169,641</u>                          | <u>142,079</u>                             | <u>368,818</u>          |

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

**42 FINANCIAL RISK MANAGEMENT (continued)**

**42.3.2 Exposure to liquidity risk (continued)**

|  | On demand or<br>within three<br>months<br>RO'000 | Four months to<br>12 months<br>RO'000 | One to five<br>years<br>RO'000 | More than<br>five years<br>RO'000 | Total<br>RO'000  |
|--|--|---------------------------------------|--------------------------------|-----------------------------------|------------------|
| 31 December 2009                                   |  |                                       |                                |                                   |                  |
| Assets   |  |                                       |                                |                                   |                  |
| Cash and balances with Central<br>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<br>assets         | <u>77,931</u>                                    | <u>69,419</u>                         | <u>633</u>                     | <u>29,214</u>                     | <u>177,197</u>   |
| 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<br>certificates of deposit | 809,541  | 812,574                               | 991,347                        | 594,163                           | 3,207,625        |
| Unsecured bonds and<br>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                                | -  | -                                     | -                              | <u>711,316</u>                    | <u>711,316</u>   |
| 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>   |

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

**42 FINANCIAL RISK MANAGEMENT (continued)**

**42.3.2 Exposure to liquidity risk (continued)**

|  | On demand or<br>within three<br>months<br>USD'000 | Four months to<br>12 months<br>USD'000 | One to five<br>years<br>USD'000 | More than<br>five years<br>USD'000 | Total<br>USD'000         |
|--|---|--|---------------------------------|------------------------------------|--------------------------|
| <b>31 December 2010</b>                            |   |  |                                 |                                    |                          |
| <b>Assets</b>                                      |   |  |                                 |                                    |                          |
| Cash and balances with Central<br>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<br>assets         | <u>226,745</u>                                    | <u>184,158</u>                         | <u>35,281</u>                   | <u>189,801</u>                     | <u>635,985</u>           |
| <b>Total assets</b>                                | <b><u>4,745,538</u></b>                           | <b><u>1,572,480</u></b>                | <b><u>3,350,520</u></b>         | <b><u>5,529,196</u></b>            | <b><u>15,197,734</u></b> |
| <b>Liabilities and equity</b>                      |   |  |                                 |                                    |                          |
| Deposits from banks                                | 1,228,239   | 531,270                                | 106,174                         | 108,047                            | 1,973,730                |
| Customers' deposits and<br>certificates of deposit | 2,611,660   | 1,986,847                              | 3,094,756                       | 1,869,212                          | 9,562,475                |
| Unsecured bonds and<br>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>         |
| <b>Total liabilities and equity</b>                | <b><u>4,150,174</u></b>                           | <b><u>2,895,286</u></b>                | <b><u>3,746,062</u></b>         | <b><u>4,406,212</u></b>            | <b><u>15,197,734</u></b> |
| <b>Assets off balance sheet</b>                    |   |  |                                 |                                    |                          |
| 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>         |
| <b>Liabilities off balance sheet</b>               |   |  |                                 |                                    |                          |
| Future interest cash flows                         | <u>34,795</u>                                     | <u>113,512</u>                         | <u>440,626</u>                  | <u>369,036</u>                     | <u>957,969</u>           |

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

**42 FINANCIAL RISK MANAGEMENT (continued)**

**42.3.2 Exposure to liquidity risk (continued)**

|  | On demand or<br>within three<br>months<br>USD'000 | Four months to 12<br>months<br>USD'000 | One to five<br>years<br>USD'000 | More than<br>five years<br>USD'000 | Total<br>USD'000  |
|--|---|--|---------------------------------|------------------------------------|-------------------|
| 31 December 2009                                   |   |  |                                 |                                    |                   |
| Assets   |   |  |                                 |                                    |                   |
| Cash and balances with Central<br>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<br>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<br>certificates of deposit | 2,102,703   | 2,110,582                              | 2,574,927                       | 1,543,280                          | 8,331,492         |
| Unsecured bonds and floating<br>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.

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

**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<br>currency assets | At 31 December 2010                        |   | At 31 December 2009                        |   |
|---------------------------------------|--|---|--|---|
|                                       | % of change in the<br>currency price (+/-) | Change in the<br>fair value (+/-)<br>RO'000 | % of change in the<br>currency price (+/-) | Change in the<br>fair value (+/-)<br>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                 |
| <b>Total assets</b>                             |                                  | <b><u>1,796,601</u></b>                 | <b><u>810,364</u></b>   | <b><u>1,477,561</u></b> | <b><u>887,822</u></b>   | <b><u>878,780</u></b>         | <b><u>5,851,128</u></b> |
| 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                 |
|   |                                  | <b><u>1,231,272</u></b>                 | <b><u>1,759,179</u></b> | <b><u>657,768</u></b>   | <b><u>321,489</u></b>   | <b><u>1,881,420</u></b>       | <b><u>5,851,128</u></b> |
| Total interest rate sensitivity gap             |                                  | <b><u>565,329</u></b>                   | <b><u>(948,815)</u></b> | <b><u>819,793</u></b>   | <b><u>566,333</u></b>   | <b><u>(1,002,640)</u></b>     | <b><u>-</u></b>         |
| Cumulative interest rate sensitivity gap        |                                  | <b><u>565,329</u></b>                   | <b><u>(383,486)</u></b> | <b><u>436,307</u></b>   | <b><u>1,002,640</u></b> | <b><u>-</u></b>               | <b><u>-</u></b>         |
| In USD'000                                      |                                  | <b><u>1,468,387</u></b>                 | <b><u>(996,068)</u></b> | <b><u>1,133,265</u></b> | <b><u>2,604,260</u></b> | <b><u>-</u></b>               | <b><u>-</u></b>         |

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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<br>Interest<br>rate % | Floating rate or<br>within<br>3 months<br>RO'000 | Months<br>4 to 12<br>RO'000 | Years<br>1 to 5<br>RO'000 | Over<br>5 years<br>RO'000 | Non interest<br>sensitive<br>RO'000 | Total<br>RO'000  |
|--|--|--|-----------------------------|---------------------------|---------------------------|-------------------------------------|------------------|
| Cash and balances with<br>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                                   | -  | -                           | -                         | <u>33,384</u>             | <u>143,813</u>                      | <u>177,197</u>   |
| 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<br>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                                   | -  | -                           | -                         | -                         | <u>711,316</u>                      | <u>711,316</u>   |
| 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>         |

**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:

| <b>Impact on Net Interest income</b> | <b>+200 bps<br/>RO'000</b> | <b>-200 bps<br/>RO'000</b> | <b>+100 bps<br/>RO'000</b> | <b>-100 bps<br/>RO'000</b> | <b>+50 bps<br/>RO'000</b> | <b>-50 bps<br/>RO'000</b> |
|--------------------------------------|----------------------------|----------------------------|----------------------------|----------------------------|---------------------------|---------------------------|
| <b>2010</b>                          |                            |                            |                            |                            |                           |                           |
| 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)                   |
| <b>2009</b>                          |                            |                            |                            |                            |                           |                           |
| 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                       |
| <b>Impact on Economic value</b>      |                            |                            |                            |                            |                           |                           |
| <b>2010</b>                          |                            |                            |                            |                            |                           |                           |
| 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                    |
| <b>2009</b>                          |                            |                            |                            |                            |                           |                           |
| 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                    |

**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)**

| <b>Impact on Net Interest income</b> | <b>+200 bps<br/>USD'000</b> | <b>-200 bps<br/>USD'000</b> | <b>+100 bps<br/>USD'000</b> | <b>-100 bps<br/>USD'000</b> | <b>+50 bps<br/>USD'000</b> | <b>-50 bps<br/>USD'000</b> |
|--------------------------------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|----------------------------|----------------------------|
| <b>2010</b>                          |                             |                             |                             |                             |                            |                            |
| 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)                    |
| <b>2009</b>                          |                             |                             |                             |                             |                            |                            |
| 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**

|                        |           |         |           |         |          |        |
|------------------------|-----------|---------|-----------|---------|----------|--------|
| <b>2010</b>            |           |         |           |         |          |        |
| 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 |
| <b>2009</b>            |           |         |           |         |          |        |
| 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.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
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.

**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<br>USD'000   | 2010<br>USD'000          |   | 2010<br>RO'000          | 2009<br>RO'000   |
|-------------------|--------------------------|---|-------------------------|------------------|
| 279,774           | <b>349,717</b>           | Share Capital   | <b>134,641</b>          | 107,713          |
| 783,130           | <b>783,129</b>           | Share Premium   | <b>301,505</b>          | 301,505          |
| 93,260            | <b>116,574</b>           | Legal reserve   | <b>44,881</b>           | 35,905           |
| 146,255           | <b>159,242</b>           | General reserve   | <b>61,308</b>           | 56,308           |
| 125,714           | <b>208,052</b>           | Subordinated loan reserve   | <b>80,100</b>           | 48,400           |
| 258,494           | <b>246,558</b>           | Retained Profit *   | <b>94,925</b>           | 99,520           |
| <u>1,686,627</u>  | <u><b>1,863,272</b></u>  | <b>Total</b>  | <u><b>717,360</b></u>   | <u>649,351</u>   |
|                   |                          | Less:   |                         |                  |
| (6,024)           | <b>(6,256)</b>           | Goodwill  | <b>(2,408)</b>          | (2,319)          |
| (28,821)          | <b>(28,821)</b>          | Deferred tax assets   | <b>(11,096)</b>         | (11,096)         |
| (2,296)           | <b>(1,309)</b>           | Foreign currency translation reserve                                    | <b>(504)</b>            | (884)            |
| -                 | <b>(4,925)</b>           | Non strategic investment in Banks (50%)                                 | <b>(1,896)</b>          | -                |
| <u>(84,226)</u>   | <u><b>(68,196)</b></u>   | Investment in associates (50%)  | <u><b>(26,255)</b></u>  | <u>(32,427)</u>  |
| <u>1,565,262</u>  | <u><b>1,753,767</b></u>  | <b>Tier I Capital</b>   | <u><b>675,201</b></u>   | <u>602,625</u>   |
| 4,990             | <b>7,862</b>             | Cumulative change in fair value (45%)                                   | <b>3,027</b>            | 1,921            |
| 139,156           | <b>145,727</b>           | General loan loss impairment  | <b>56,105</b>           | 53,575           |
| 363,896           | <b>268,572</b>           | Subordinated liabilities (net of reserves)                              | <b>103,400</b>          | 140,100          |
| 83,932            | <b>83,933</b>            | Mandatory convertible bonds   | <b>32,314</b>           | 32,314           |
| <u>591,974</u>    | <u><b>506,094</b></u>    | <b>Total</b>  | <u><b>194,846</b></u>   | <u>227,910</u>   |
|                   |                          | Less:   |                         |                  |
| -                 | <b>(4,925)</b>           | Non strategic investment in Banks (50%)                                 | <b>(1,896)</b>          | -                |
| <u>(84,226)</u>   | <u><b>(68,195)</b></u>   | Investment in associates (50%)  | <u><b>(26,255)</b></u>  | <u>(32,427)</u>  |
| <u>507,748</u>    | <u><b>432,974</b></u>    | <b>Tier II Capital</b>  | <u><b>166,695</b></u>   | <u>195,483</u>   |
| -                 | <b>-</b>                 | <b>Tier III Capital (Net of Reserve)</b>                                | <b>-</b>                | -                |
| <u>2,073,010</u>  | <u><b>2,186,741</b></u>  | <b>Total Regulatory Capital</b>   | <u><b>841,896</b></u>   | <u>798,108</u>   |
|                   |                          | <b>Risk weighted assets</b>   |                         |                  |
| 12,429,883        | <b>12,993,013</b>        | Credit risk   | <b>5,002,310</b>        | 4,785,505        |
| 551,413           | <b>623,112</b>           | Market risk   | <b>239,898</b>          | 212,294          |
| 1,028,605         | <b>1,179,252</b>         | Operational risk  | <b>454,012</b>          | 396,013          |
| <u>14,009,901</u> | <u><b>14,795,377</b></u> | <b>Total risk weighted assets</b>                                       | <u><b>5,696,220</b></u> | <u>5,393,812</u> |
|                   |                          | <b>Capital Ratios</b>   |                         |                  |
| 14.80%            | <b>14.78%</b>            | Total regulatory capital expressed as a % of total risk weighted assets | <b>14.78%</b>           | 14.80%           |
| 11.17%            | <b>11.85%</b>            | Total Tier I capital expressed as a % of total risk weighted assets     | <b>11.85%</b>           | 11.17%           |

\* Retained profit excludes proposed cash dividend of RO 33.66 million for the year 2010 (2009: RO 21.54 mn) in line with the local regulatory disclosure requirement. Proposed cash dividend for the year 2010 is subject to approval by the shareholders in Annual General Meeting scheduled on 21 March 2011.

**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.

## BANK MUSCAT SAOG

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

#### 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<br>RO'000 | Available-for-sale<br>RO'000 | Held-to-maturity<br>RO'000 | Other amortised cost<br>RO'000 | Total carrying value<br>RO'000 | Fair value<br>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     | -                            | <u>237,105</u>               | <u>29,922</u>              | -                              | <u>267,027</u>                 | <u>267,027</u>       |
|                                     |       | <u>5,284,330</u>             | <u>237,105</u>               | <u>29,922</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    | -                            | -                            | -                          | <u>183,500</u>                 | <u>183,500</u>                 | <u>183,500</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     | -                            | <u>120,055</u>               | <u>24,311</u>              | -                              | <u>144,366</u>                 | <u>144,366</u>       |
|                                     |       | <u>5,462,001</u>             | <u>120,055</u>               | <u>24,311</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    | -                            | -                            | -                          | <u>188,500</u>                 | <u>188,500</u>                 | <u>188,500</u>       |
|                                     |       | -                            | -                            | -                          | <u>4,862,075</u>               | <u>4,862,075</u>               | <u>4,862,075</u>     |

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

**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.

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

**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.

**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.