

For the year ended 31 December 2007

I. ACTIVITIES

National Bank of Bahrain BSC, a public shareholding company, was incorporated in the Kingdom of Bahrain by an Amiri decree in January 1957. The Bank operates in Bahrain under a banking licence issued by the Central Bank of Bahrain. The overseas branch in Abu Dhabi, U.A.E. operates under the laws of that country. The Bank is principally engaged in providing retail and wholesale commercial banking services, treasury and capital markets activities, and investment advisory services.

2. SIGNIFICANT ACCOUNTING POLICIES

Statement of Compliance

The financial statements have been prepared in accordance with the International Financial Reporting Standards, the requirements of the Bahrain Commercial Companies Law 2001 and the Central Bank of Bahrain and Financial Institutions Law 2006. The accounting policies have been applied consistently for the periods presented herein.

In preparing these financial statements the Bank adopted IFRS 7 - Financial Instruments: Disclosures and revised IAS 1 - Presentation of Financial Statements – Capital Disclosures on their required application date of 1 January 2007. The adoption of IFRS 7 and the amendment to IAS 1 have impacted the type and amount of disclosures made in these financial statements, but had no impact on the reported profits or financial position of the Bank. In accordance with the transitional requirements of the standards, the Bank has provided full comparative information.

The financial statements of the Bank are presented in Bahraini Dinar (BHD) being the functional currency of the Bank. The US Dollar (US\$) amounts are presented for the convenience of the reader. The Bahraini Dinar has been translated at the rate of BHD 0.376 to US\$ 1 (2006: BHD 0.376 to US\$ 1)

Accounting convention

The financial statements are prepared under the historical cost convention except as modified for the measurement at fair value.

a. Accounting for income and expenses

i) Interest income and expenses are recognised in the income statement on an accrual basis using the effective interest rate method. The effective interest rate method is a method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or interest expense over the expected life of the asset or liability. The effective interest rate is the rate that exactly discounts estimated future cash flows through the expected life of the financial asset or liability or, where appropriate, a shorter period, to the net carrying amount of the financial asset or liability. The application of the effective interest rate method has the effect of recognising interest income and interest expense evenly in proportion to the amount outstanding over the period to maturity or repayment. In calculating the effective interest rate, cash flows are estimated taking into consideration all contractual terms of the financial instrument but excluding future credit losses. Fees, including loan origination fees and early redemption fees, are included in the calculation of the effective interest rate to the extent that they are considered to be an integral part of the effective interest rate.

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.

ii) Fees and commission income are recognised as the related services are performed.

iii) Other expenses are recognised on an accrual basis

iv) Provision for possible loan losses, pertaining to individually significant impaired loans and advances, is determined based on the difference between the net carrying amount and the estimated recoverable amount of the loans and advances, measured at present value of estimated future cash flows from such loans and advances and discounting them based on their original effective interest rate. If a loan has a floating interest rate, the discount rate is the current effective rate determined under the contract.

Impairment and uncollectability is also measured and recognised on a portfolio basis for a group of similar loans and advances, that are not individually identified as impaired, on the basis of estimates of incurred losses that are inherent but not yet specifically identified within the loans and advances portfolio at the balance sheet date. The estimates are based on internal risk ratings, historical default rates, rating migrations, loss

severity, macroeconomic and other relevant factors with historic loss experience being adjusted to reflect the effect of prevailing economic and credit conditions. Loans and advances are written off after all reasonable attempts at restructuring and possible courses of action to achieve recovery have been exhausted and the possibility of any further recovery is considered to be remote.

v) Dividend income is recognised when the right to receive a dividend is established.

b. Use of estimates and management judgement

The preparation of financial statements requires management to make estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses.

The use of considerable judgement and estimates is principally required in the estimation of the amount and timing of future cash flows when determining the level of provisions required for individually significant non-performing loans and advances, estimating incurred losses that are inherent within the loans and advances portfolio and impairment losses for available-for-sale financial assets.

The categorisation of securities into fair value through profit or loss, available-for-sale and held-to-maturity is done on the basis of the management intent at the time these securities are acquired and laid down investment policies.

c. Fixed assets

Property and equipment are initially recorded at cost and subsequently stated at cost less accumulated depreciation and impairment losses, as explained in note 'd' below. Land is not depreciated and is stated at its fair value at the date of acquisition. Where an item of fixed asset comprises major components having different useful lives, they are accounted for as separate items of fixed assets. The cost of an item of fixed asset comprises its purchase price and any costs directly attributable to bringing the asset to the location and condition necessary for it to be put to its intended use. Depreciation is charged to the income statement on a straight-line basis over the estimated useful lives of the fixed assets. The estimated useful lives are as follows:

Buildings	20 to 40 years
Furniture and Equipment	3 to 8 years

The residual value and the useful life of fixed assets are reviewed periodically and, if expectations differ from previous estimates, the change is recognised prospectively in the income statement over the remaining estimated useful life of the fixed asset.

d. Impairment

The carrying amount of the Bank's assets is reviewed at each year-end to determine whether there is objective evidence that a specific asset may be impaired. If any such evidence exists, the recoverable amount of the asset is estimated to determine the extent of impairment. An impairment loss is recognised when the carrying amount of an asset exceeds its estimated recoverable amount and all such impairment losses are recognised in the income statement.

e. Other provisions

A provision is recognised if, as a result of a past event, the Bank has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation.

f. Foreign currencies

Foreign currency transactions are initially recorded at rates of exchange prevailing at the value dates of the transactions. Monetary assets and liabilities in foreign currencies are translated at the rates of exchange prevailing at the year-end. Realised and unrealised exchange gains and losses arising on such translation are included in Other Income.

g. Derivative financial instruments

All derivative financial instruments are initially recognised at cost, being the fair value at contract date, and are subsequently re-measured at their fair values. Changes in the fair value of derivative financial instruments that do not qualify for hedge accounting are recognised in Other Income.

For the year ended 31 December 2007

In the case of fair value hedges that meet the criteria for hedge accounting, any gain or loss arising from remeasuring the hedging instruments to fair value as well as the related changes in fair value of the item being hedged are recognised in Other Income.

In the case of cash flow hedges that meet the criteria of hedge accounting, the portion of the gain or loss on that hedging instrument that is determined to be an effective hedge is recognised directly in equity and the ineffective portion, if any, is recognised in the income statement.

All derivative financial instruments are recognised in the balance sheet as either assets (positive fair values) or liabilities (negative fair values).

h. Treasury bills and investment securities

i) Treasury Bills

Treasury bills comprise unquoted short-term treasury bills issued by the Government of Bahrain and denominated in the local currency and unquoted short-term Islamic bills issued by the Government of Bahrain and denominated in United States Dollars. Treasury Bills are Held-to-Maturity and carried at amortised cost.

ii) Available-for-Sale Securities

Securities which are intended to be held for an indefinite period of time and may be sold in response to needs for liquidity, changes in interest rates or concerns with respect to credit deterioration are categorised as available-for-sale securities. Available-for-sale securities which comprise both debt and equity securities are initially recognised at fair value, including transaction costs, and subsequently measured at fair value based on quoted market prices or amounts derived from cash flow models as appropriate. Unquoted and illiquid equity investments for which fair values cannot be reliably measured are stated at cost less provision for impairment. Unrealised gains and losses arising from changes in the fair values of available-for-sale securities are recognised in a separate revaluation reserve in equity. The cumulative fair value adjustments on available-for-sale securities which are sold or otherwise disposed of, or become impaired, and which had previously been recognised in equity are transferred to the income statement.

iii) Fair value through profit or loss investments

a) Fair value through profit or loss investments:

Investment securities which are acquired with an intent to hold for an indefinite period of time, but not as part of a portfolio for trading to generate short term profits or as part of available for sale securities, are upon initial recognition categorised as fair value through profit and loss investments. Fair value through profit or loss investment securities are carried at fair value with any unrealised gains and losses arising from changes in fair value being recognised in the income statement.

b) Trading Securities:

Securities which are either acquired for the purpose of generating a profit from short-term fluctuations in price or are included in a portfolio in which a pattern of short-term profit taking exists are categorised as trading securities. These securities are initially recognised at fair value, including transaction costs, and subsequently measured at fair value based on quoted market prices. Realised and unrealised gains and losses on trading securities are included in the income statement.

iv) Held To Maturity Investments

Held to maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Bank positively intends, and is able, to hold until maturity. Held to maturity investments are initially recorded at fair value plus any directly attributable transaction costs, and are subsequently measured at amortised cost using the effective interest method, less any impairment losses.

v) Where securities are sold subject to a commitment to repurchase them at a specified future date (repo) and at a predetermined price, they are not derecognised and the consideration received is classified as Borrowings under Repurchase Agreements. The difference between the sale and repurchase price is treated as an interest expense and accrued over the life of the repo agreement using the effective yield method. Conversely, securities purchased under a commitment to resell them at a specified future date (reverse repo) and at a predetermined price are not recognised on the balance sheet and the consideration paid is recorded in Placements with Banks and Other Financial Institutions. The difference between the purchase and resale price is treated as an interest income and accrued over the life of the reverse repo agreement using the effective yield method.

i. Fair value measurement

The determination of fair value of financial assets and liabilities is based on quoted market prices or dealer price quotations for financial instruments traded in active markets. For all other financial instruments fair value is determined by using valuation techniques that include net present value techniques, discounted cash flow method, comparison to similar instruments for which market observable prices exist and

valuation models.

j. Off-setting

Financial assets and financial liabilities are only set-off and the net amount reported in the balance sheet when there is a legally enforceable right to set-off the recognised amounts and the Bank intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

k. Settlement date accounting

All "regular way" purchases and sales of financial assets are recognised on the settlement date i.e. the date the Bank receives or delivers the asset. Regular way purchases and sales are those that require delivery of assets within the time frame generally established by regulation or convention in the market place.

l. Cash and cash equivalents

Cash and cash equivalents comprise cash, balances at Central banks, placements with banks and other financial institutions that mature within three months of the date of placement, and short-term highly liquid investments that are convertible to known amounts of cash and which are subject to an insignificant risk of change in value and mature within three months of the date of acquisition.

m. Loans and advances

Loans and advances are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and advances are stated at amortised cost, adjusted for changes in fair value under any effective hedging arrangement, less provision for impairment.

n. Customers' deposits

Customer deposits are initially recognised at their fair value plus transaction costs and subsequently measured at their amortised cost using the effective interest method.

o. Financial guarantees

Financial guarantees are contracts that require the Bank to make specified payments to reimburse the holder for a loss it incurs because a specific debtor fails to make payment when due in accordance with the contractual terms.

Financial guarantees are initially recognised at fair value (which is the premium received on issuance). The premium received is amortised over the life of the financial guarantee. The guarantee liability (the notional amount) is subsequently carried at the higher of this amortised amount and the present value of any expected payment (when a payment under the guarantee has become probable). The premium received on these financial guarantees is included under other liabilities.

p. Proposed appropriations

Dividends and other proposed appropriations are included as part of Equity, and are recognised as a liability in the period in which they are approved by the shareholders.

q. Retirement benefits

The Bank has different retirement benefit schemes for its Bahraini and expatriate employees in Bahrain and Abu Dhabi, which are in accordance with the relevant labour laws of the respective countries. The retirement benefit scheme for Bahraini employees is of 'Defined Contribution Plan' in nature, whereas the retirement benefit scheme for expatriate employees and the Managing Director and Chief Executive is considered as a 'Defined Benefit Plan'.

The cost of providing these retirement benefits is charged to the income statement.

r. Income tax liability

Companies are not liable to income tax in Bahrain.

For the year ended 31 December 2007

3. FINANCIAL RISK MANAGEMENT

The Bank has exposure to the following risks from its use of financial instruments:

- credit risk
- liquidity risk
- market risks
- operational risks

Risk management framework

The overall authority for risk management in the Bank is vested in the Board of Directors. The Board authorises appropriate credit, liquidity and market risk policies as well as suitable operational guidelines based on the recommendation of Management. Approval authorities are delegated to different functionaries in the hierarchy depending on the amount, type of risk and collateral security. The Bank has established various committees that decide on all risk issues.

The Audit Committee of the Board is responsible for monitoring compliance with the Bank's policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Bank. The Audit Committee is assisted in these functions by Management Internal Control department which undertakes both regular and adhoc reviews of risk management controls and procedures, the results of which are reported to the Audit committee.

Credit risk

The Bank has well laid out procedures to appraise and regularly monitor credit risk with respect to counterparties for both on-balance sheet assets and off-balance sheet items. The Bank uses credit ratings by established rating agencies for evaluating and reviewing exposures to rated entities. Further, the Bank's internal rating grading system is based on a 10-point scale which takes into account the financial strength as well as qualitative aspects of the borrower. Risk Ratings assigned to each borrower are reviewed at least on an annual basis and regular monitoring of the portfolio enables the Bank to weed out accounts which witness a deterioration in risk profile. The Bank's lending book is principally concentrated in accounts rated 1-5 which are high quality assets. Any risks inherent therein are mitigated in a number of ways which include obtention of collateral viz; mortgages on property, lien on deposits, readily traded equities, counter-guarantees from shareholders and/or third parties. Adequate margins are maintained on the collateral to provide a cushion against any adverse movements in the market price of collaterals.

Liquidity risk

The asset/liabilities management policies of the Bank define the proportion of liquid assets to total assets with the aim of minimising liquidity risk. The Bank maintains adequate liquid assets such as inter-bank placements, treasury bills and other readily marketable securities. The Treasury department also monitors the maturity profile of assets and liabilities so that adequate liquidity is maintained at all times. The Asset and Liability Committee review the liquidity gap profile at least on a bi-monthly basis to address any strategic issues concerning liquidity.

Market risks

The Bank's trading activities are governed by documented policies and procedures, as well as comprehensive limits structures which are closely monitored. Various dimensions of risk are covered through limits on amount, tenor, rating, gapping, product type, interest basis, etc. The Bank uses Value-at-Risk (VaR) to estimate the exposure of the trading portfolio and total currency book to market risk. The Bank also uses back-testing to validate the VaR model and the results confirm that the model adequately captures risk within the Bank's trading portfolio.

Operational risk

The Bank has well laid out procedures and systems that set out the methodologies for carrying out specific tasks and the scope of the Bank's Management Internal Control department encompasses audits and review of all business activities and support functions. The systems and procedures are regularly reviewed and revised to address any potential risks.

Capital Management

The Central Bank of Bahrain sets and monitors capital requirements for the Bank as a whole. The Bank's policy is to maintain sufficient capital to sustain investor, creditor and market confidence and to support future development of the business. The impact of the level of capital on return on shareholder's equity is also recognised and the Bank recognises the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position. The Bank has complied with regulatory capital requirements throughout the period.

4. TREASURY BILLS

Treasury bills comprise unquoted short-term treasury bills issued by the Government of Bahrain and denominated in the local currency and unquoted short-term Islamic bills issued by the Government of Bahrain and denominated in United States Dollars. Treasury bills are held-to-maturity.

Agreed maturity dates by remaining maturity	2007		2006	2006
	BD'000	US\$'000	BD'000	US\$'000
As at 31 December				
Up to 1 month	3,230	8,590	28,384	75,489
1 to 3 months	1,840	4,894	26,597	70,737
3 to 6 months	11,816	31,426	19,441	51,705
Total	16,886	44,910	74,422	197,931

5. PLACEMENTS WITH BANKS AND OTHER FINANCIAL INSTITUTIONS

Placements with banks and other financial institutions is part of the Bank's money market activities and comprises short-term lending to banks and other financial institutions. The Bank uses external ratings as part of credit appraisal process for exposures to banks and financial institutions within established country limits.

a) As at 31 December	2007		2006	2006
	BD'000	US\$'000	BD'000	US\$'000
Placements with banks	475,880	1,265,638	307,732	818,436
Placements with other financial institutions	24,265	64,535	29,696	78,979
Total	500,145	1,330,173	337,428	897,415

b) As at 31 December	2007		2006	2006
	BD'000	US\$'000	BD'000	US\$'000
Current and call accounts	13,471	35,827	15,086	40,122
Placement - Term	482,901	1,284,311	311,474	828,389
Reverse Repos	3,773	10,035	10,868	28,904
Total	500,145	1,330,173	337,428	897,415

c) Agreed maturity dates by remaining maturity	2007		2006	2006
	BD'000	US\$'000	BD'000	US\$'000
As at 31 December				
Up to 1 month	357,444	950,649	158,492	421,521
1 to 3 months	54,272	144,340	110,881	294,896
3 to 6 months	88,429	235,184	43,905	116,769
6 to 12 months	-	-	18,650	49,601
1 to 2 years	-	-	5,500	14,628
Total	500,145	1,330,173	337,428	897,415

6. LOANS AND ADVANCES

a) As at 31 December	2007		2006	2006
	BD'000	US\$'000	BD'000	US\$'000
Loans and advances to non-banks	871,393	2,317,535	692,767	1,842,466
Loans and advances to banks	89,119	237,019	106,403	282,987
Less: Provision for impairment	(14,545)	(38,684)	(14,865)	(39,535)
Total	945,967	2,515,870	784,305	2,085,918

For the year ended 31 December 2007

6. LOANS AND ADVANCES (continued)
b) Agreed maturity dates by remaining maturity

	2007	2007	2006	2006
As at 31 December	BD'000	US\$'000	BD'000	US\$'000
Up to 3 months	298,663	794,317	166,167	441,934
3 months to 1 year	72,759	193,508	131,393	349,449
1 to 3 years	215,021	571,864	184,551	490,827
3 to 5 years	211,014	561,207	120,749	321,141
5 to 10 years	105,880	281,596	141,527	376,402
10 to 20 years	42,630	113,378	39,918	106,165
Total	945,967	2,515,870	784,305	2,085,918

c) Loans and advances are of a floating rate nature, since as per the Bank's loan agreements, the Bank reserves the right to change the rate of interest at any time in the event of money market fluctuations and/or other credit/banking considerations which may be set out from time to time by the Bank and/or any governmental or regulatory authority.

d) As at 31 December 2007, the amount of floating rate loans for which interest is being reset by the Bank on agreed dates and based on an agreed fixed margin over a benchmark interest rate, amounted to BD 366.66 million (US\$ 975.0 million) [2006: BD 372.0 million (US\$ 989.4 million)].

e) The Bank holds collateral in the form of mortgage on properties, cash deposits and counter-guarantees from shareholders and/or third parties etc. against its credit exposures.

f) In accordance with the Bank's policy and the Central Bank of Bahrain guidelines, loans on which payments of interest or repayments of principal are 90 days past due, are defined as non-performing. The following is the ageing schedule of non-performing and other impaired and past due loans and advances. The table shows the time period since the date of last repayment of principal or interest by the customer:

	2007	2007	2006	2006
As at 31 December	BD'000	US\$'000	BD'000	US\$'000
Over 3 months to 1 year	4,196	11,160	3,710	9,867
1 to 3 years	1,595	4,242	1,722	4,580
Over 3 years	3,099	8,242	3,134	8,335
Total	8,890	23,644	8,566	22,782

Loans on which payments of interest or repayments of principal are overdue upto less than 90 days amounted to BD 2.58 million (US\$ 6.86 million) [2006: BD 1.98 million (US\$ 5.26 million)].

As at 31 December 2007, the principal outstanding of the non-performing loans portfolio on which interest is not being accrued amounted to BD 8.06 million (US \$ 21.44 million) [2006: BD 7.63 million (US \$ 20.29 million)].

Management estimates the fair value of collaterals held against individually impaired loans and advances to reasonably approximate BD 3.55 million (US\$ 9.44 million) [2006: BD 3.86 million (US\$ 10.27 million)] as at the reporting date.

g) During 2007, credit facilities amounting to BD 3.30 million (US \$ 8.78 million) were restructured [2006: BD 8.35 million (US\$ 22.21 million)]. Restructuring concessions mainly related to deferral of loans instalments to assist customers overcome temporary cash crunch situations or to realign the repayment with the borrowers'/projects' revised cash flow projections. Due to the minor nature of concessions, there was no significant impact on the Bank's provisions for loans and advances impairment and present and future earnings.

6. LOANS AND ADVANCES (continued)

h) Exposure to credit risk	2007		2006	
	BD '000	US\$ '000	BD '000	US\$ '000
As at 31 December				
Total carrying amount	945,967	2,515,870	784,305	2,085,918
I. Individually impaired				
Substandard	831	2,210	934	2,484
Doubtful	242	644	477	1,269
Loss	12,188	32,415	11,387	30,284
Gross amount	13,261	35,269	12,798	34,037
Interest in suspense	(4,371)	(11,625)	(4,232)	(11,255)
Specific allowance for impairment	(8,054)	(21,420)	(7,627)	(20,285)
Individually impaired carrying amount	836	2,224	939	2,497
2. Past due but not impaired carrying amount below 90 days				
Gross amount	2,578	6,856	1,978	5,261
Collective impairment provision	(18)	(47)	(18)	(48)
Past due but not impaired carrying amount	2,560	6,809	1,960	5,213
3. Neither past due nor impaired by internal rating				
Rated 1	78,986	210,069	65,635	174,561
Rated 2	79,812	212,266	66,321	176,386
Rated 3	233,923	622,136	194,383	516,975
Rated 4	268,495	714,082	223,111	593,380
Rated 5	64,487	171,508	53,587	142,518
Not rated *	223,341	593,993	185,589	493,590
Gross amount	949,044	2,524,054	788,626	2,097,410
Collective impairment provision	(6,473)	(17,217)	(7,220)	(19,202)
Carrying amount of neither past due nor impaired	942,571	2,506,837	781,406	2,078,208
Total carrying amount	945,967	2,515,870	784,305	2,085,918

* Includes mainly consumer loans and other facilities, which are not assigned any ratings at inception when exposures are individually below BD 0.25 million.

i) Provisions for loans and advances impairment

Movements during the year	Specific provision		Collective impairment provision		Total provisions		Interest in suspense	
	2007	2006	2007	2006	2007	2006	2007	2006
Amounts in BD 000's								
At 1 January	7,627	7,315	7,238	7,818	14,865	15,133	4,232	3,833
Charge against profits	1,055	740	-	-	1,055	740	796	762
Amounts written off	(302)	(237)	(18)	(31)	(320)	(268)	(478)	(60)
Recoveries & write backs								
credited to profits	(326)	(191)	(729)	(549)	(1,055)	(740)	(179)	(303)
At 31 December	8,054	7,627	6,491	7,238	14,545	14,865	4,371	4,232

In accordance with current IAS 39, provision for impairment of loans and advances that are measured and recognized on a portfolio basis are collectively evaluated for impairment based on an incurred loss model.

The provisions and interest in suspense relate to loans and advances to non-banks.

In accordance with the Bank's policy and the Central Bank of Bahrain guidelines, interest on non-performing loans is reversed from income and is accounted for on a cash basis. During 2007, the suspension of interest income relating to such non-performing loans had an insignificant impact on the Banks' net income.