

Auditors' Report

To the Shareholder We have audited the accompanying consolidated balance sheet of Bank of Bahrain and Kuwait B.S.C. (the Bank) and its subsidiaries (the Group) as of 31 December 2002, and the related consolidated statements of income, cash flows and changes in equity for the year then ended. These consolidated financial statements are the responsibility of the Bank's Board of Directors. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 31 December 2002, and of the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

We confirm that, in our opinion, proper accounting records have been kept by the Bank and the consolidated financial statements and the contents of the Chairman's statement relating to these consolidated financial statements, are in agreement therewith. We further report, to the best of our knowledge and belief, that no violations of the Bahrain Commercial Companies Law, nor of the Bahrain Monetary Agency Law, nor of the memorandum and articles of association of the Bank, have occurred during the year ended 31 December 2002 that might have had a material adverse effect on the business of the Bank or on its consolidated financial position, and that the Bank has complied with the terms of its banking licence. We obtained all the information and explanations which we required for the purpose of our audit.

Ernst & Young

2 February 2003

Manama, Kingdom of Bahrain

Consolidated Balance Sheet

31 December 2002

	Notes	2002 BD '000	2001 BD '000
Assets			
Cash and balances with central banks	4	64,876	72,057
Treasury bills	5	69,817	37,330
Trading investments		440	-
Deposits and due from banks and other financial institutions		195,461	185,524
Loans and advances to customers	6	536,880	480,790
Non-trading investment securities	7	295,971	253,568
Investment in associated company	8	4,936	4,547
Interest receivable and other assets	9	14,851	18,966
Kuwait Government bond	10	15,331	32,932
Premises and equipment		16,086	15,418
Total Assets		1,214,649	1,101,132
Liabilities, Minority Interest and Equity			
Liabilities			
Deposits and due to banks and other financial institutions		326,136	221,638
Medium term loans	11	84,825	84,825
Customers' current, savings and other deposits		658,400	651,687
Interest payable and other liabilities	12	14,209	15,670
Total Liabilities		1,083,570	973,820
Minority Interest		-	1,546
Shareholders' Equity			
Share capital	13	56,906	56,906
Treasury stock	13	(1,053)	(1,053)
Statutory reserve	14	18,675	16,674
General reserve	14	20,000	20,000
Cumulative changes in fair values	15	(586)	50
Foreign currency translation adjustment		(1,696)	(2,448)
Retained earnings	16	22,852	20,825
Proposed appropriations	17	15,981	14,812
Total Shareholders' Equity		131,079	125,766
Total Liabilities, Minority Interest and Shareholders' Equity		1,214,649	1,101,132

The financial statements were authorised for issue in accordance with a resolution of the directors on 2 February 2003.

Murad Ali Murad
Chairman

Jassem Hasan Ali Zainal
Deputy Chairman

Dr. Farid Ahmed Al Mulla
General Manager

Consolidated Income Statement

Year ended 31 December 2002

	Notes	2002 BD '000	2001 BD '000
Interest income	18	51,291	65,832
Interest expense	19	25,838	42,093
Net interest income		25,453	23,739
Other operating income	20	15,260	13,063
Net interest and other operating Income		40,713	36,802
Net provision for losses on loans and advances to customers	6	(3,272)	(1,465)
Write back of provision for impairment in other assets and contingencies	7	1,696	-
Provision for impairment in the value of non-trading investment securities	7	-	(190)
Net operating Income after provisions		39,137	35,147
Operating Expenses			
Staff costs		11,322	10,549
Other operating expenses		6,483	6,357
Depreciation		2,094	1,981
Total operating expenses		19,899	18,887
Profit from operations		19,238	16,260
Share of profit in associated company		961	471
Profit before taxation and minority interest		20,199	16,731
Taxation - foreign units		(190)	(153)
Minority interest		-	159
Net profit for the year		20,009	16,737
Basic earnings per share (BD)	21	0.035	0.030
Dividend per share (BD)	17	0.027	0.025

Consolidated Statement of Cash Flows

Year ended 31 December 2002

	2002 BD '000	2001 BD '000
Operating activities		
Profit for the year before taxation and minority interest	20,199	16,731
Adjustment for:		
Net provisions (write backs) relating to:		
Loans and advances to customers	3,272	1,465
Non trading investment securities	-	190
Other assets and contingencies	(1,696)	-
Share of profit in associated company	(961)	(471)
Depreciation	2,094	1,981
Negative goodwill amortised	(37)	-
Realised (gains) losses on redemption of managed funds	(464)	257
Net foreign exchange translation adjustments on non trading investment securities	(4,817)	2,781
Taxation of foreign units	(190)	(153)
(Increase) decrease in operating assets:		
Treasury bills maturing after 91 days	(17,581)	12,654
Trading investments	(440)	-
Deposits and due from banks and other financial institutions	5,065	29,297
Loans and advances to customers	(59,362)	10,395
Interest receivable and other assets	3,395	9,057
Kuwait Government bond	17,601	7,650
Increase (decrease) in operating liabilities:		
Deposits and due to banks and other financial institutions	104,498	(17,402)
Borrowings under repurchase agreements	-	(23,338)
Customers' current, savings and other deposits	6,713	67,196
Interest payable and other liabilities	235	(4,063)
Net cash from operating activities	77,524	114,227
In vesting activities		
Purchase of non-trading investment securities	(226,706)	(204,621)
Maturities and redemptions of non-trading investment securities	189,668	215,411
Dividends received from associated company	572	405
Purchase of premises and equipment	(2,762)	(3,899)
Investment in subsidiary	(1,509)	-
Net cash (used in) from in vesting activities	(40,737)	7,296
Financing activities		
Medium term loans	-	9,425
Payment of dividend, directors' remunerations and donations	(14,812)	(10,812)
Net movement in treasury stock	-	(27)
Net cash (used in) financing activities	(14,812)	(1,414)
Foreign exchange translation adjustment	752	(277)
Increase in cash and cash equivalents	22,727	119,832
Cash and cash equivalents at beginning of the year	280,187	160,355
Cash and cash equivalents at end of the year (Note 23)	302,914	280,187

The attached notes 1 to 37 form part of these consolidated financial statements.

Consolidated Statement of Changes in Shareholders' Equity

Year ended 31 December 2002

Notes	Share capital BD '000	Treasury stock BD '000	Statutory reserve BD '000	General reserve BD '000	Cumulative changes in fair values BD '000	Foreign currency translation adjustment BD '000	Retained earnings BD '000	Proposed appropriations BD '000	Total BD '000
Balance at 31 December 2000	56,906	(1,026)	15,000	20,000	-	(2,171)	15,361	10,812	114,882
Transition adjustment on adoption of IAS 39	-	-	-	-	-	-	3,860	-	3,860
Payment of dividend, directors' remuneration and donation	-	-	-	-	-	-	-	(10,812)	(10,812)
Net profit for the year – 2001	-	-	-	-	-	-	16,737	-	16,737
Portion of realised gain on sale of investments (previously included in retained earnings on adoption of IAS 39)	-	-	-	-	-	-	1,353	-	1,353
Difference arising on translation of operating assets and liabilities of overseas branches	-	-	-	-	-	(277)	-	-	(277)
Net movement in cumulative changes in fair values	15	-	-	-	50	-	-	-	50
Transfer to statutory reserve	-	-	1,674	-	-	-	(1,674)	-	-
Net movement in treasury stock	13	(27)	-	-	-	-	-	-	(27)
Proposed dividend	17	-	-	-	-	-	(14,117)	14,117	-
Proposed directors' remuneration	17	-	-	-	-	-	(195)	195	-
Proposed donations	17	-	-	-	-	-	(500)	500	-
Balance at 31 December 2001	56,906	(1,053)	16,674	20,000	50	(2,448)	20,825	14,812	125,766
Payment of dividend, directors' remuneration and donations	-	-	-	-	-	-	-	(14,812)	(14,812)
Net profit for the year – 2002	-	-	-	-	-	-	20,009	-	20,009
Difference arising on translation of operating assets and liabilities of overseas branches	-	-	-	-	-	752	-	-	752
Net movement in cumulative changes in fair values	15	-	-	-	(636)	-	-	-	(636)
Transfer to statutory reserve	-	-	2,001	-	-	-	(2,001)	-	-
Net movement in treasury stock	13	-	-	-	-	-	-	-	-
Proposed dividend	17	-	-	-	-	-	(15,247)	15,247	-
Proposed directors' remuneration	17	-	-	-	-	-	(234)	234	-
Proposed donations	17	-	-	-	-	-	(500)	500	-
Balance at 31 December 2002	56,906	(1,053)	18,675	20,000	(586)	(1,696)	22,852	15,981	131,079
Month end average equity – 2002									124,243
Month end average equity – 2001									116,136

The movement in foreign exchange translation adjustment represents the net foreign exchange translation loss arising from translating the financial statements of the bank's foreign entities into Bahraini dinars.

Notes to the Consolidated Financial Statements

31 December 2002

1 Activities

Bank of Bahrain and Kuwait B.S.C., (the Bank) a public shareholding company, was incorporated in the Kingdom of Bahrain by an Amiri Decree in March 1971 and registered with the Ministry of Commerce under Commercial Registration (CR) number 1234 dated 16 March 1971. The Bank operates in Bahrain under a banking licence issued by the Bahrain Monetary Agency. The overseas units operate under the laws of their respective countries. The Bank's registered office is at 43 Government Avenue, P O Box 597, Manama, Kingdom of Bahrain. The total number of employees of the Group as of 31 December 2002 is 706 (31 December 2001:694). During 2002, the Bank increased its shareholding in Al Khaleej Islamic Investment Bank E.C. from 65% to 100%.

2 Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Bank and its subsidiaries (the 'Group') after adjustment for minority interest. All inter company transactions and balances have been eliminated on consolidation.

3 Significant accounting policies

The significant accounting policies adopted in the preparation of consolidated financial statements are set out below:

Basis of preparation

The consolidated financial statements have been prepared in accordance with Standards issued by the International Accounting Standards Board (IASB) and interpretations issued by the International Financial Reporting Interpretations Committee of the IASB and are in conformity with the Bahrain Commercial Companies Law and the Bahrain Monetary Agency Law.

The accounting policies are consistent with those used in the previous year.

Accounting convention

The consolidated financial statements are prepared under the historical cost convention as modified by the measurement at fair value of derivatives and trading and available-for-sale investment securities. In addition, as more fully discussed below, assets and liabilities that are hedged are carried at fair value to the extent of the risk being hedged.

Trading investments

Trading investments are held for a short-term period and are carried at fair value with any gain or loss arising from a change in fair value being included in the consolidated income statement in the period in which it arises.

Deposits and due from banks and other financial institutions

Deposits and due from banks and other financial institutions are stated at cost less any amounts written off and provision for impairment. The carrying values of such assets, which are being effectively hedged for changes in fair value, are adjusted to the extent of the changes in the fair value being hedged. Resultant gains or losses are recognised in the consolidated income statement.

Loans and advances to customers

Loans and advances to customers are stated net of any amounts written off and provision for impairment.

Projections of future cash flows relating to loans and advances to customers are made on the basis of a continuing appraisal of the lending portfolio having regard to the Group's previous experience and current economic conditions. The evaluations consider identified risks and potential impairment in the Group's individual and different portfolios of loans and advances to customers based on historical patterns of losses.

3 Significant accounting policies continued

Non-trading investment securities

These are classified as follows:

- Held-to-maturity
- Available-for-sale
- Originated by the Group

All non-trading investments are initially recognised at cost, being the fair value of the consideration given, including acquisition charges associated with the investment. These include bonds, equities, managed funds and other investments. Investments in managed funds comprise investments in mutual funds, private equity and credit structured products.

Premiums and discounts on non-trading investments are amortised on a systematic basis to maturity, using the effective interest rate method, and taken to interest income.

Held-to-maturity

Investments which have fixed or determinable payments and which are intended to be held to maturity are carried at amortised cost, less provision for impairment in value.

Available-for-sale

After initial recognition, investments which are classified as "available-for-sale" are remeasured at fair value. Unless unrealised gains and losses on remeasurement to fair value are part of an effective hedging relationship, they are reported as a separate component of equity until the investment is sold, collected or otherwise disposed of, or the investment is determined to be impaired, at which time the cumulative gain or loss previously reported in equity along with any transition adjustment to retained earnings arising from the adoption of IAS 39, is included in the consolidated income statement for the period. Any gain or loss arising from a change in fair value of available-for-sale investments, which are part of an effective hedging relationship, is recognised directly in the consolidated income statement to the extent of the changes in fair value being hedged.

Originated by the Group

Investments in debt securities which are funded directly to the issuer are stated at amortised cost, less provision for impairment. An adjustment is made to such investments where effective fair value hedges have been made to adjust the value of the investment for the fair value being hedged, with the resultant gains or losses being recognised in the consolidated income statement.

Fair values

For investments traded in organised financial markets, fair value is determined by reference to quoted market bid prices for assets and quoted market offer prices for liabilities at the close of business on the balance sheet date.

For investments where there is no quoted market price a reasonable estimate of the fair value is determined by reference to the current market value of another similar instrument, or is based on the net present value of future cash flows.

The fair value of options is based on internal pricing models.

Investment in associated company

Associate is a company in which the Group has a long term investment comprising an interest of 20% - 50% in the voting capital or over which it exerts significant influence, and are accounted for using the equity method.

Notes to the Consolidated Financial Statements continued

31 December 2002

3 Significant accounting policies continued

Kuwait Government Bond

Kuwait Government Bond is stated at cost less impairment in value, if any.

Premises and equipment

All items of premises and equipment are initially recorded at cost. Depreciation is provided on a straight-line basis over the estimated useful lives of all premises and equipment, other than freehold land which is deemed to have an indefinite life.

Collateral pending sale

The Group occasionally acquires real estate in settlement of certain loans and advances to customers. Real estate is stated at the lower of the net realisable value of the related loans, advances and overdrafts and the current fair value of such assets, assessed on an individual basis. Gains or losses on disposal, and unrealised losses on revaluation, are recognised in the consolidated income statement.

Deposits

All money market and customer deposits are carried at amortised cost, less amounts repaid. An adjustment is made to these where effective fair value hedges have been made, to adjust the value of the deposit for the fair value being hedged, with the resultant gains or losses being recognised in the consolidated income statement.

Repurchase and resale agreements

Assets sold with a simultaneous commitment to repurchase at a specified future date (repos) continue to be recognised in the balance sheet and are measured in accordance with accounting policies for non-trading investment securities. The liability for amounts received under these agreements is shown as borrowings. The difference between sale and repurchase price is treated as interest expense using the effective interest method. Assets purchased with a corresponding commitment to resell at a specified future date (reverse repos) are not recognised in the balance sheet, as the Group does not obtain control over the assets. Amounts paid under these agreements are included in deposits with banks and other financial institutions or loans and advances to customers, as appropriate. The difference between purchase and resale price is treated as interest income using the effective interest rate method.

Taxation

There is no tax on corporate income in the Kingdom of Bahrain. Taxation on foreign operations is provided in accordance with the fiscal regulations of the respective countries in which the Group operates.

Employees' end of service benefits

Costs relating to employees' end of service benefits are accrued in accordance with actuarial and other valuations as required by regulations applicable in each location.

Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

Treasury stock

Treasury stock is stated at cost adjusted for any gains or losses on sales.

3 Significant accounting policies continued

Derivatives

The Group enters into derivative instruments including futures, forwards, swaps, and options in the foreign exchange and capital markets. 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. Derivatives with positive market values (unrealised gains) are included in other assets and derivatives with negative market values (unrealised losses) are included in other liabilities in the consolidated balance sheet.

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

In relation to fair value hedges, which meet the conditions for hedge accounting, any gain or loss from remeasuring the hedging instrument to fair value is recognised immediately in the consolidated income statement. The hedged item is adjusted for fair value changes and the difference relating to the risk being hedged is recognised in the consolidated income statement.

In relation to cash flow hedges which meet the conditions for hedge accounting the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised initially in equity and the ineffective portion is recognised in the consolidated income statement. The gains or losses on effective cash flow hedges recognised initially in equity are either transferred to the consolidated income statement in the period in which the hedged transaction impacts the consolidated income statement or included in the initial measurement of the cost of the related asset or liability.

For hedges which do not qualify for hedge accounting, any gains or losses arising from changes in the fair value of the hedging instrument are taken directly to the consolidated income statement for the period.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. For fair value hedges of financial instruments with fixed maturities any adjustment arising from hedge accounting is amortised over the remaining term to maturity. For cash flow hedges, any cumulative gain or loss on the hedging instrument recognised in equity remains in equity until the hedged transaction occurs. If the hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the consolidated income statement.

Fiduciary assets

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

Offsetting

Financial assets and financial liabilities are only offset and the net amount reported in the consolidated balance sheet when there is a legally enforceable right to set off the recognised amounts and the Group intends to settle on a net basis.

Revenue recognition

Interest income and loan commitment fees are recognised on a time proportion basis, taking account of the principal outstanding and the rate applicable. An amount is recognised as interest income on impaired loans and advances and other financial assets, through the process of amortisation, based on the rate of interest that was used to discount the anticipated future cash flows relating to these impaired assets.

Other fees receivable are recognised when earned. Dividend income is recognised when the right to receive payment is established.

Notes to the Consolidated Financial Statements continued

31 December 2002

3 Significant accounting policies continued

Foreign currencies

Translation of foreign currency transactions

Monetary assets and liabilities in foreign currencies are translated into Bahraini Dinars at rates of exchange prevailing at the balance sheet date. Any gains or losses are taken to the consolidated income statement.

Translation of financial statements of foreign entities

The operations of overseas units are not deemed an integral part of the head office's operations as each is financially and operationally independent of the head office. The assets and liabilities of foreign entities are translated at rates of exchange ruling at the balance sheet date. Income and expense items are translated at average exchange rates for the period. Any exchange differences (including those on transactions which hedge such investments) are taken directly to foreign currency translation adjustment reserve.

Cash and cash equivalents

Cash and cash equivalents comprise those balances of the following maturing within ninety-one days of the date of acquisition: cash and balances with central banks; treasury bills; deposits and due from banks and other financial institutions.

Impairment and uncollectability of financial assets

An assessment is made at each balance sheet date to determine whether there is objective evidence that a specific financial asset may be impaired. If such evidence exists, the estimated recoverable amount of that asset is determined and any impairment loss, based on the net present value of future anticipated cash flows, including anticipated recoveries from guarantees and collateral, discounted at original effective interest rates, is recognised in the consolidated income statement.

The provision for impairment of loans and advances also covers losses where there is objective evidence that losses may be present in components of the loans and advances portfolio at the balance sheet date. These are estimated based on historical patterns of losses in each component, the credit ratings allotted to the borrowers and reflecting the current economic climate in which the borrowers operate.

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 Group commits to purchase or sell the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place.

4 Cash and balances with central banks

	2002 BD '000	2001 BD '000
Cash	7,623	4,986
Current account with central banks	4,992	5,614
Deposit with central banks	52,261	61,457
	64,876	72,057

5 Treasury bills

These are short term treasury bills issued by the Governments of the Kingdom of Bahrain, the State of Kuwait and the Republic of India and are carried at amortised cost.

6 Loans and advances to customers

	2002 BD '000	2001 BD '000
Commercial loans	390,342	358,239
Consumer loans	79,215	64,032
Overdrafts	102,629	103,536
Credit cards	22,263	22,106
Other	28,964	19,906
	623,413	567,819
Less:provision for impairment	(86,533)	(87,029)
	536,880	480,790

a)The composition of the loans and advances to customers is as follows:

(i) Industry sector

	2002 BD '000	2001 BD '000
Trading and manufacturing	204,345	190,236
Banks and other financial institutions	85,038	73,828
Construction and real estate	88,922	91,863
Government and public sector	43,338	23,269
Consumer	152,834	136,014
Others	48,936	52,609
	623,413	567,819
Less:Provision for impairment	(86,533)	(87,029)
	536,880	480,790

(ii) Geographical region

	2002 BD '000	2001 BD '000
Gulf Co-operation Council countries	557,534	493,997
European Community countries	17,141	14,270
Asia	46,947	57,896
Others	1,791	1,656
	623,413	567,819
Less:Provision for impairment	(86,533)	(87,029)
	536,880	480,790

Notes to the Consolidated Financial Statements continued

31 December 2002

6 Loans and advances to customers continued

b) Movements in provisions for loan losses including interest in suspense are as follows:

	2002	2001
	BD '000	BD '000
At 1 January	87,029	91,070
Adjustment arising from application of IAS 39	-	6,798
Charge for the year	9,233	4,750
Recoveries/write-backs	(5,961)	(3,285)
Interest suspended during the year, net	2,241	5,931
Amounts written off during the year, net	(5,625)	(16,740)
Interest recognised/amortised on impaired loans	(190)	(872)
Other movements	(194)	(623)
Balance at 31 December	86,533	87,029

Other movements include foreign exchange adjustments relating to loans and advances to customers denominated in foreign currencies.

c) As of 31 December 2002, gross loans and advances to customers which were classified as impaired amounted to BD 97,687 thousand (2001:BD 94,983 thousand). The total of provisions carried and the value of securities held for these loans amounted to BD 97,633 thousand (2001:BD 94,658 thousand).

d) As of 31 December 2002, balance of restructured loans amounted to BD 11,944 thousand (2001:BD 21,908 thousand).

7 Non-trading investment securities

	Available- for-sale BD '000	Held-to- maturity BD '000	Originated by the Group BD '000	Total 2002 BD '000	Total 2001 BD '000
Quoted in investments	-	-	-		
Quoted equities	22,232	-	-	22,232	21,772
Quoted bonds	44,977	56,345	34,094	135,416	94,699
Managed funds	1,775	-	-	1,775	5,814
	68,984	56,345	34,094	159,423	122,285
Unquoted in investments					
Government bonds	-	-	71,061	71,061	70,090
Managed funds	41,855	-	-	41,855	34,036
Other investments	6,566	14,708	3,778	25,052	30,535
	117,405	71,053	108,933	297,391	256,946
Provision for impairment	(1,420)	-	-	(1,420)	(3,378)
Balance at 31 December 2002	115,985	71,053	108,933	295,971	
Balance at 31 December 2001	78,949	77,086	97,533		253,568

The movements in provision for impairment of non-trading investment securities and other assets and contingencies were as follows:

	Available- for-sale BD '000	Held-to- maturity BD '000	Originated by the Group BD '000	Total 2002 BD '000	Total 2001 BD '000
Non-trading investment securities					
Balance at 1 January	1,678	1,700	-	3,378	3,188
Charge for the year	-	-	-	-	190
Written off	(258)	(1,700)	-	(1,958)	-
Balance at 31 December	1,420	-	-	1,420	3,378
Other assets and contingencies					
Balance at 1 January				1,696	2,262
Write-back				(1,696)	-
Amount settled				-	(566)
Balance at 31 December				-	1,696

Included under available-for-sale investments are unquoted equity investments with a value of BD 4,395 thousand (2001: BD 4,169 thousand) which are carried at cost. This is due to the unpredictable nature of their future cash flows and the lack of suitable alternate methods for arriving at a reliable fair value.

Notes to the Consolidated Financial Statements continued

31 December 2002

8 Investment in associated company

	2002		2001	
	% of interest held	BD '000	% of interest held	BD '000
Bahrain Commercial Facilities Company B.S.C (Incorporated in the Kingdom of Bahrain)	20.25	4,936	20.25	4,547

9 Interest receivable and other assets

	2002 BD '000	2001 BD '000
Interest receivable	6,359	8,344
Collateral pending sale	1,774	2,197
Accounts receivable	2,328	1,521
Positive fair value of derivatives (Note 25)	1,127	1,670
Other	3,263	5,234
	14,851	18,966

10 Kuwait government bond

The Central Bank of Kuwait purchased resident Kuwaiti customers' debts and resident debts of other Gulf Co-operation Council nationals held by the Kuwait branch of the Bank as of 1 August 1990 and related interest up to 31 December 1991 on behalf of the Government of Kuwait. The purchase value of these debts was settled by the issue of a bond with a value date of 31 December 1991. The bond matures over a maximum period of twenty years from the value date. Interest is payable semi annually in arrears at a rate specified for each six months by the Central Bank of Kuwait. The average interest rate for 2002 was 2.67% (2001: 4.34%). During 2002, there were redemptions of bond, net of foreign exchange adjustments, amounting to BD 17,601,000 (2001: BD 7,650,000).

Under the terms of the purchase agreement with the Central Bank of Kuwait, the amount of the bond will be adjusted, in respect of any differences arising, once the balances of the related debts have been agreed with the customers concerned. The Bank therefore has a contingent liability in this regard. During 1999, the Central Bank of Kuwait reduced the value of the bond by BD 66,000 and accumulated interest income of BD 32,000, and the adjustment relating to this was charged to income. During 2002 and 2001, there were no such reductions in value of the bond.

The Bank is required to manage the debts purchased by the Government of Kuwait without remuneration, in conformity with the regulations and instructions of the Central Bank of Kuwait.

11 Medium term loans

The medium term loans are unsecured facilities obtained for general financing purposes and comprise:

Amount of facility US\$ '000	Rate of interest	Maturity (Year)	Carrying amount	
			2002 BD '000	2001 BD '000
50,000	Libor + 0.55%	2003	18,850	18,850
75,000	Libor + 0.55%	2003	28,275	28,275
100,000	Libor + 0.50%	2004	37,700	37,700
			84,825	84,825

12 Interest payable and other liabilities

	2002 BD '000	2001 BD '000
Interest payable	2,649	4,145
Accounts payable	3,063	3,494
Accrued expenses	2,196	1,867
Taxation	2,843	2,623
Negative fair value of derivatives (Note 25)	2,384	1,017
Provision for contingencies (Note 7)	-	1,696
Other	1,074	828
	14,209	15,670

13 Share capital and treasury stock

	2002 BD '000	2001 BD '000
Share Capital		
Authorised:		
1,000,000,000 shares of BD 0.100 each	100,000	100,000
Issued and fully paid:		
569,062,500 shares of BD 0.100 each	56,906	56,906

Treasury stock

Treasury stock represents the purchase by the Bank, either directly or indirectly, of its own shares. At the end of the year, the Bank held 4,369,666 shares (2001: 4,369,666 shares) of its own shares. The shares are carried at cost adjusted for any gain or loss on sale. Treasury stock does not carry the right to voting or to dividends.

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14 Reserves

Statutory reserve

Annual transfer at the rate of 10% of the net profit for the year of the Bank is made until such time as the reserve equals 50% of the issued share capital of the Bank. The reserve is not distributable but may be utilised as security for the purpose of a distribution except in such circumstances as stipulated in the Bahrain Commercial Companies Law, and following the approval of the Bahrain Monetary Agency.

General reserve

The general reserve has been built up in accordance with the provisions of the Bank's articles of association and underlines the shareholders' commitment to enhance the strong equity base of the Bank. The general reserve is a distributable reserve, subject to the approval of the Bahrain Monetary Agency.

15 Cumulative changes in fair values

	2002 BD '000	2001 BD '000
Available-for-sale investments		
At 1 January	50	-
Realised in the year	(462)	-
Change in unrealised fair values during the year	546	50
At 31 December	134	50
Cash flow hedges		
At 1 January	-	-
Change in unrealised fair values during the year	(720)	-
At 31 December	(720)	-
	(586)	50

16 Retained earnings

Retained earnings include a sum of BD 774 thousand (2001:BD 476 thousand) relating to statutory reserves of subsidiary companies which are non-distributable.

17 Proposed appropriations

	2002 BD '000	2001 BD '000
Dividend	15,247	14,117
Directors' remuneration	234	195
Donations	500	500
	15,981	14,812

The directors have proposed a cash dividend of 27% being BD 0.027 per share (2001:BD 0.025 per share) to be applied to the shares in issue, net of treasury stock, as of the balance sheet date.

The above appropriations will be submitted for formal approval at the Annual General Meeting to be held on March 2003.

18 Interest income

	2002 BD '000	2001 BD '000
Treasury bills	4,630	5,603
Deposits and due from banks and other financial institutions	6,165	8,907
Loans and advances to customers	31,164	39,243
Non trading investment securities	8,682	10,447
Kuwait Government bond	650	1,632
	51,291	65,832

19 Interest expense

	2002 BD '000	2001 BD '000
Deposits and due to banks and other financial institutions	20,810	37,339
Medium term loans	2,168	3,396
Customers' current, savings and other deposits	2,860	1,358
	25,838	42,093

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20 Other operating income

	2002 BD '000	2001 BD '000
Dividend income	1,933	1,922
Realised gain (loss) on redemption of managed funds	464	(257)
Income from managed funds	387	59
Trading income	1,168	868
Gains on foreign exchange	1,630	1,704
Other	(125)	470
	5,457	4,766
Fee and commission income	10,905	9,047
Fees and commission expense	(1,102)	(750)
	9,803	8,297
	15,260	13,063

21 Basic earnings per share

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

	2002	2001
Net profit for the year (BD '000)	20,009	16,737
Weighted average number of shares, net of treasury stock, outstanding during the year	564,692,834	564,721,541
Basic earnings per share (BD)	0.035	0.030

No figure for diluted earnings per share has been presented as the Bank has not issued any instruments which would have an impact on earnings per share when exercised.

22 Segmental information

Primary segment information

For management purposes the Group is organised into four major business segments:

Retail banking	Principally handling individual customer deposits and providing consumer finance type loans, overdrafts, credit facilities and funds transfer facilities, card businesses, foreign exchange and cash collateralised lending.
Corporate banking	Principally handling loans and other credit facilities, deposit and current accounts for corporate and institutional customers in Bahrain.
International banking	Principally handling loans and other credit facilities, deposit and current accounts for international corporate and institutional customers. This also covers the operations of the overseas units.
Investment and other activities	Principally providing money market, trading and treasury services as well as the management of the Group's funding operations. Investment activities involve handling investments in local and international markets, investment advisory services and funds management.

These segments are the basis on which the Group reports its primary segment information.

Segment information for the year ended 31 December 2002 was as follows:

	Retail banking BD '000	Corporate banking BD '000	International banking BD '000	Investment and other activities BD '000	T otal BD '000
Operating income before provisions	10,645	6,761	10,264	13,043	40,713
Segment result	3,902	4,796	5,620	7,320	21,638
Common costs					(1,014)
Income from associate					961
Net provisions					(1,576)
Net profit for the year					20,009
Segment assets	98,942	197,737	540,829	360,974	1,198,482
Common assets					16,167
Total assets					1,214,649
Segment liabilities	244,577	225,423	450,305	157,919	1,078,224
Common liabilities					5,346
Total liabilities					1,083,570

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22 Segmental information continued

Segment information for the year ended 31 December 2001 was as follows:

	Retail banking BD '000	Corporate banking BD '000	International banking BD '000	Investment and other activities BD '000	Total BD '000
Operating income before provisions	9,232	6,377	10,508	10,685	36,802
Segment result	2,683	4,350	6,113	5,558	18,704
Common costs					(942)
Income from associate					471
Minority interest					159
Net provisions					(1,655)
Net profit for the year					16,737
Segment assets	82,317	203,121	432,157	365,652	1,083,247
Common assets					17,885
Total assets					1,101,132
Segment liabilities	218,763	254,952	351,129	145,246	970,090
Common liabilities					3,730
Total liabilities					973,820

Secondary segment information

Although the management of the Group is based primarily on business segments, the Group operates in two geographic markets; Middle East, which is designated as Regional, and North America, European Community countries, Asia and others, which are designated as International. The geographical analysis of operating income, segment results, total assets and total liabilities, is based primarily upon the domicile of the customer or the investment.

Geographical areas:	Regional		International		Total	
	2002 BD '000	2001 BD '000	2002 BD '000	2001 BD '000	2002 BD '000	2001 BD '000
Operating income before provisions	29,263	25,081	11,450	11,721	40,713	36,802
Segment results	15,374	12,016	6,264	6,688	21,638	18,704
Common costs					(1,014)	(942)
Income from associate					961	471
Minority interest					-	159
Net provisions					(1,576)	(1,655)
Net profit for the year					20,009	16,737
Total assets	937,005	838,670	277,644	262,462	1,214,649	1,101,132
Total liabilities	1,010,755	900,707	72,815	73,113	1,083,570	973,820
Capital expenditure	2,682	3,813	80	86	2,762	3,899

23 Cash and cash equivalent

Cash and cash equivalents included in the consolidated statement of cash flows include the following balance sheet amounts:

	2002	2001	Changes in the year
	BD '000	BD '000	BD '000
Cash and balances with central banks	64,876	72,057	(7,181)
Treasury bills maturing within ninety-one days	52,236	37,330	14,906
Deposits and due from banks and other financial institutions maturing within ninety-one days	185,802	170,800	15,002
Cash and cash equivalents	302,914	280,187	22,727

24 Related party transactions

Certain related parties (principally the associated company, directors and senior management of the Group, their families and companies of which they are principal owners) were customers of the Group in the ordinary course of business. Facilities in the personal names of the directors are fully collateralised. The transactions with these parties were made on substantially the same terms, including interest rates, as those prevailing at the same time for comparable transactions with unrelated parties and did not involve more than a normal amount of risk.

Amounts outstanding as of the balance sheet date in respect of transactions entered into with related parties were as follows:

	2002		2001	
	Related companies BD '000	Others BD '000	Related companies BD '000	Others BD '000
Loans and advances to customers	3,013	1,529	5,914	760
Non-trading investment securities	574	-	4,401	-
Deposits	3,437	1,179	7,897	471
Contingent liabilities	5,759	-	4,507	-

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

	2002	2001
	BD '000	BD '000
Interest income on loans and advances to customers	84	84
Gain on managed funds	120	263
Fee and commission	-	2
Interest expense on deposits	407	600

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25 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. Derivative instruments include forwards, futures, swaps and options.

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. The notional amounts indicate the volume of transactions outstanding at year end and are neither indicative of the market risk nor credit risk.

	Notional amounts by term to maturity					
	Positive fair value BD '000	Negative fair value BD '000	Notional Amount Total BD '000	Within 3 months BD '000	3 - 12 months BD '000	1 - 5 years BD '000
31 December 2002:						
Derivatives held for trading:						
Forward rate agreements	5	-	7,540	-	-	7,540
Interest rate swaps	4	-	22,620	7,540	-	15,080
Forward foreign exchange contracts	176	199	96,269	64,568	31,701	-
Options	-	-	5,284	5,284	-	-
Derivatives held as fair value hedges:						
Interest rate swaps	411	667	10,688	-	2,262	8,426
Forward foreign exchange contracts	531	798	88,638	54,856	33,782	-
Derivatives held as cash flow hedges:						
Interest rate swaps	-	720	37,700	-	-	37,700
	1,127	2,384	268,739	132,248	67,745	68,746

	Notional amounts by term to maturity					
	Positive fair value BD '000	Negative fair value BD '000	Notional Amount Total BD '000	Within 3 months BD '000	3 - 12 months BD '000	1 - 5 years BD '000
31 December 2001:						
Derivatives held for trading:						
Interest rate swaps	-	4	15,080	7,540	-	7,540
Forward foreign exchange contracts	866	879	33,555	8,897	5,834	18,824
Options	144	-	9,757	1,762	7,995	-
Derivatives held as fair value hedges:						
Interest rate swaps	3	3	10,688	-	10,688	-
Forward foreign exchange contracts	657	131	92,585	88,156	4,429	-
	1,670	1,017	161,665	106,355	28,946	26,364

25 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. Foreign currency and interest rate futures are transacted in standardised amounts on regulated exchanges and are subject to daily cash margin requirements. 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.

Swaps are contractual agreements between two parties to exchange interest or foreign currency differentials based on a specific notional amount. For interest rate swaps, counterparties generally exchange fixed and floating rate interest payments based on a notional value in a single currency. For currency swaps, fixed or floating interest payments and notional amounts are exchanged in different currencies.

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

Derivative related credit risk

Credit risk in respect of derivative financial instruments arises from the potential for a counterparty to default on its contractual obligations and is limited to the positive fair value of instruments that are favourable to the Group. All of the Group's derivative contracts are entered into with other financial institutions.

Derivatives held or issued for trading purposes

Most of the Group's derivative trading activities relate to position taking and arbitrage. Position taking includes managing positions with the expectation of profiting from favourable movements in prices, rates or indices. Arbitrage involves identifying and profiting from price differentials between markets or products.

Derivatives held or issued for hedging purposes

The Group has adopted a comprehensive system for the measurement and management of risk. Part of the risk management process involves managing the Group's exposure to fluctuations in foreign exchange rates (currency risk) and interest rates through asset and liability management activities. It is the Group's policy to reduce its exposure to currency and interest rate risks to acceptable levels as determined by the Board of Directors. The Board has established levels of currency risk by setting limits on currency position exposures. Positions are monitored on a daily basis and hedging strategies used to ensure positions are maintained within established limits. The Board has established levels of interest rate risk by setting limits on the interest rate gaps for stipulated periods. Assets and liabilities interest rate gaps are reviewed on a weekly basis and hedging strategies used to reduce the interest rate gaps to within the limits established by the Board.

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

The Group uses forward foreign exchange contracts and currency swaps to hedge against specifically identified currency risks. In addition, the Group uses interest rate swaps and interest rate futures to hedge against the interest rate risk arising from specifically identified fixed interest rate loans. The Group also uses interest rate swaps to hedge against the cash flow risks arising on certain floating rate loans. In all such cases the hedging relationship and objective, including details of the hedged item and hedging instrument, are formally documented and the transactions are accounted for as fair value hedges.

Interest rate risk is managed by monitoring the repricing of assets and liabilities and entering into interest rate swaps and futures to hedge a proportion of the interest rate exposure. Since strategic hedging does not qualify for special hedge accounting related derivatives are accounted for as trading instruments.

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26 Commitments and contingent liabilities

Credit-related commitments

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

Commitments to extend credit represents contractual commitments to make loans and revolving credits. Commitments generally have fixed expiration dates or other termination clauses. Since commitments may expire without being drawn upon, the total contracted amounts do not necessarily represent future cash requirements.

Letters of credit, guarantees (including standby letters of credit) and acceptances commit the Group to make payments on behalf of customers contingent upon the failure of the customer to perform under the terms of the contract. Standby letters of credit, which are included under guarantees, would have market risk if issued or extended at a fixed rate of interest. However, these contracts are primarily made at a floating rate.

The Group has the following credit related commitments:

	2002 BD '000	2001 BD '000
Commitments on behalf of customers:		
Letters of credit	29,869	23,026
Guarantees	127,417	116,469
Acceptances	6,036	6,046
	163,322	145,541
Irrevocable commitments		
Undrawn loan commitments	40,655	11,701
Capital commitments	-	434
Commitments in respect of investments	5,703	7,893
	46,358	20,028
	209,680	165,569
Irrecoverable commitments to extend credit:		
Original term to maturity of one year or less	-	20,028
Original term to maturity of more than one year	46,358	-
	46,358	20,028

The Group does not anticipate any significant losses arising from the above.

27 Credit risk and concentration of credit risk

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. Concentrations of credit risk arise when a number of counterparties are engaged in similar business activities, or activities in the same geographical region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations of credit risk indicate the relative sensitivity of the Group's performance to developments affecting a particular industry or geographical location.

The Group attempts to control credit risk by monitoring credit exposures, limiting transactions with specific counterparties, and continually assessing the creditworthiness of counterparties, diversification of lending activities to avoid undue concentrations of risks with individuals or groups of customers in specific locations or businesses, and by obtaining security when appropriate. In addition to monitoring credit limits, the Group manages the credit exposure by entering into master netting agreements and collateral arrangements with counterparties in appropriate circumstances, and limiting the duration of exposure. In certain cases, the Group may close out transactions or assign them to other counterparties to mitigate credit risk.

All policies relating to credit are reviewed and approved by the Board of Directors. An Executive Committee, consisting of six senior members of the Board of Directors, reviews and approves all larger credits. In addition, all larger credits in excess of approval authority of the Executive Committee are approved by the Board of Directors.

Credit limits are established for all customers after a careful assessment of their creditworthiness. The limits for domestic and international borrowers are approved by a three member committee. These limits, depending upon the level of authority required, are approved by the Executive Committee and the Board of Directors respectively and they are subject to the Bahrain Monetary Agency's large exposure limit criteria. Standard procedures, outlined in the Bank's Credit Procedures Manual, require that all credit proposals be subjected to a detailed screening by a designated credit officer, who is also a member of the three member committee referred above.

Details of the composition of the loans, advances and overdrafts portfolio are set out in note 6 to the consolidated financial statements.

Details of the industry sector analysis and the geographical distribution of assets, liabilities and off balance sheet items are set out in note 28 to the consolidated financial statements.

Credit risk in respect of derivative financial instruments is limited to those with positive fair values.

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28 Concentration of assets, liabilities and off balance sheet items

The distribution of assets, liabilities and off-balance sheet items by geographic region and industry sector was as follows:

	2002			2001		
	Assets BD '000	Liabilities BD '000	Off balance sheet items BD '000	Assets BD '000	Liabilities BD '000	Off balance sheet items BD '000
Geographical region:						
Gulf Co-operation Council Countries	937,005	1,010,755	216,588	838,670	900,707	198,087
North America	70,220	8,566	20,193	47,535	2,831	37,590
European Community Countries	88,668	34,461	172,942	95,860	33,347	44,934
Asia	86,698	26,632	68,524	92,070	32,863	44,944
Others	32,058	3,156	172	26,997	4,072	1,679
	1,214,649	1,083,570	478,419	1,101,132	973,820	327,234
Industry sector :						
Trading and manufacturing	239,520	47,815	73,111	193,855	50,332	40,143
Banks and other financial Institutions	444,215	426,961	341,690	336,576	227,021	228,899
Construction and real estate	192,518	7,483	29,650	77,509	8,706	32,445
Government and public sector	76,882	131,279	837	241,187	173,600	2,419
Consumer	149,720	39,681	3	87,968	116,575	-
Others	111,794	430,351	33,128	164,037	397,586	23,328
	1,214,649	1,083,570	478,419	1,101,132	973,820	327,234
Month end average	1,204,782	1,079,964	396,116	1,117,913	1,001,777	340,618

29 Market Risk

Market risk is defined as the risk of losses in the Group's on or off balance sheet positions arising from movements in the interest rates, foreign exchange rates and equity prices.

The Group has clearly defined policies for conducting investment (including trading investments) and foreign exchange business which stipulates limits for these activities. Investments are made strictly in accordance with investment acceptance criteria, which ensures that the investments are qualitative and liquid. The Group does not undertake any commodity trading activities.

The Bank uses Kondor Plus Value at Risk for measuring general market risk. This model uses a Value at Risk (VaR) approach for calculation of general market risk. VaR is calculated on a variance and covariance approach using exponentially weighted historical method from Risk Metrics. The model is approved by the Bahrain Monetary Agency. The Bank uses VaR model (approved by the Bahrain Monetary Agency) for determining the capital risk. The Bank uses a 99 percent confidence level for a 10-day holding period. This implies a one percent possibility of the loss exceeding the VaR amount as calculated by the model.

Risk management department conducts back testing in accordance with the Market Risk Capital Adequacy Regulations issued by the Bahrain Monetary Agency. Back testing involves daily comparison of the one day daily VaR with the average daily profit and loss (i.e., average of the opening and closing profit and loss). The objective is to ensure that the assumptions used for computing VaR are reasonable and result in a VaR number that is a reliable indicator of worst possible losses.

The Bank conducts stress testing to identify events or influences that could greatly impact material trading positions taken by the Bank.

30 Interest rate risk management

Interest rate risk arises from the possibility that changes in interest rates will affect future profitability or the value of financial instruments. The Group is exposed to interest rate risk as a result of mismatches or gaps in the amounts of assets and liabilities and off balance sheet instruments that mature or reprice in a given period. The Group manages this risk by reviewing the repricing of assets and liabilities on a weekly basis.

Positions are monitored on a daily basis and hedging strategies used to ensure positions are maintained within established limits.

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

	Less than one month BD '000	One month to one year BD '000	Over one year BD '000	Not exposed to interest rate risk BD '000	Total BD '000
As of 31 December 2002					
Cash and balances with central banks	37,146	-	-	27,730	64,876
Treasury bills	17,747	52,070	-	-	69,817
Trading investments	440	-	-	-	440
Deposits and due from banks and other financial institutions	61,590	103,603	-	30,268	195,461
Loans and advances to customers	71,042	193,859	260,373	11,606	536,880
Non-trading investment securities	6,512	115,975	134,291	39,193	295,971
Investment in associated company	-	-	-	4,936	4,936
Interest receivable and other assets	-	-	-	14,851	14,851
Kuwait Government bond	-	15,331	-	-	15,331
Premises and equipment	-	-	-	16,086	16,086
Total assets	194,477	480,838	394,664	144,670	1,214,649
Deposits and due to banks and other financial institutions	217,595	69,191	9,757	29,593	326,136
Medium term loans	-	84,825	-	-	84,825
Customers' current, savings and other deposits	448,274	167,550	4,406	38,170	658,400
Interest payable and other liabilities	-	-	-	14,209	14,209
Equity	-	-	-	131,079	131,079
Total liabilities, minority interest and equity	665,869	321,566	14,163	213,051	1,214,649
On-balance sheet gap (a)	(471,392)	159,272	380,501		
Off-balance sheet gap (b)	-	(40,584)	40,584		
Total interest rate sensitivity gap	(471,392)	118,688	421,085		
Cumulative interest rate sensitivity gap	(471,392)	(352,704)	68,381		

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30 Interest rate risk management continued

As of 31 December 2001	Less than one month BD '000	One month to one year BD '000	Over one year BD '000	Not exposed to interest rate risk BD '000	Total BD '000
Cash and balances with central banks	48,113	-	-	23,944	72,057
Treasury bills	30,695	6,635	-	-	37,330
Deposits and due from banks and other financial institutions	45,849	128,920	-	10,755	185,524
Loans and advances to customer's	27,148	157,265	288,892	7,485	480,790
Non-trading investment securities	7,071	84,374	118,663	43,460	253,568
Investment in associated company	-	-	-	4,547	4,547
Interest receivable and other assets	-	-	-	18,966	18,966
Kuwait Government bond	-	32,932	-	-	32,932
Premises and equipment	-	-	-	15,418	15,418
Total assets	158,876	410,126	407,555	124,575	1,101,132
Deposits and due to banks and other financial institutions	79,833	106,749	7,756	27,300	221,638
Medium term loans	-	84,825	-	-	84,825
Customers' current, savings and other deposits	211,018	364,184	6,390	70,095	651,687
Interest payable and other liabilities	-	-	-	15,670	15,670
Minority interest	-	-	-	1,546	1,546
Equity	-	-	-	125,766	125,766
Total liabilities, minority interest and equity	290,851	555,758	14,146	240,377	1,101,132
On-balance sheet gap (a)	(131,975)	(145,632)	393,409		
Off-balance sheet gap (b)	-	622	(622)		
Total interest rate sensitivity gap	(131,975)	(145,010)	392,787		
Cumulative interest rate sensitivity gap	(131,975)	(276,985)	115,802		

(a) The on-balance sheet gap represents the net amounts of on-balance sheet items.

(b) The off-balance sheet gap represents the net notional amounts of off balance sheet financial instruments such as interest rate swaps, which are used to manage interest rate risk.

The effective interest rate (effective yield) of a monetary financial instrument is the rate that, when used in a present value calculation, results in the carrying amount of the instrument. The rate is a historical rate for a fixed rate instrument carried at amortised cost and a current market rate for a floating rate instrument or an instrument carried at fair value. The effective interest rates by major currencies for each of the monetary financial instruments are as follows:

	31 December 2002			31 December 2001		
	Effective interest rate %			Effective interest rate %		
	BD	KD	US\$	BD	KD	US\$
Assets						
Treasury bills	1.8	2.0	-	4.7	4.7	-
Deposits and due from banks and financial institutions	2.1	2.9	1.9	4.5	5.8	3.8
Loans and advances to customers(c)	6.2	8.5	2.5	8.8	6.7	5.7
Non-trading investment securities	2.4	3.8	4.9	-	-	6.4
Kuwait Government bond	-	2.3	-	-	3.8	-
Liabilities						
Deposits and due to banks and other financial institutions	1.7	2.7	2.5	4.1	4.8	4.6
Medium term loans	-	-	1.8	-	-	4.9
Customers'current,savings and other deposits(d)	1.2	2.5	2.1	3.5	4.4	4.5

(c)The effective interest rate for loans and advances to customers has been computed by excluding non performing loans.

(d)The effective interest rates have been computed by excluding non-interest bearing accounts which form a small proportion of such deposits.

31 Currency risk

The functional currency of the Group is the Bahraini dinar.

The Group had the following net exposures denominated in foreign currencies as of the balance sheet date:

	2002 BD '000 equivalent long (short)	2001 BD '000 equivalent long (short)
US dollar	73,047	39,140
Japanese Yen	38	(19)
Pound Sterling	94	(50)
Kuwaiti Dinar	21	49
Omani Riyal	169	79
Saudi Riyal	(514)	(531)
Others	140	342

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32 Liquidity risk

Liquidity risk is the risk that the Group will be unable to meet its funding requirements. Liquidity risk can be caused by market disruptions or a credit downgrade which may cause certain sources of funding to dry up immediately. To guard against this risk, management have diversified funding sources and assets are managed with liquidity in mind, maintaining a healthy balance of cash, cash equivalents, and readily marketable securities.

The table below summarises the maturity profile of the Group's assets and liabilities based on contractual repayment arrangements, and do not take into account the effective maturities as indicated by the Group's deposit retention history.

The maturity profile of the assets and liabilities at 31 December 2002 is as follows:

As of 31 December 2002	Less than 1 month	1 month to 1 year	1 - 5 years	5 - 10 years	10 - 20 years	More than 20 years	Undated	Total
Assets								
Cash and balances with central banks	63,238	1,638	-	-	-	-	-	64,876
Treasury bills	17,747	52,070	-	-	-	-	-	69,817
Trading investments	440	-	-	-	-	-	-	440
Deposits and due from banks and other financial institutions	81,635	113,826	-	-	-	-	-	195,461
Loans and advances to customers	41,160	185,218	194,452	116,050	-	-	-	536,880
Non-trading investment securities	9,121	117,321	66,054	47,093	-	2,153	54,229	295,971
Investment in associated company	-	-	-	-	-	-	4,936	4,936
Interest receivable and other assets	10,633	358	3,253	52	81	474	-	14,851
Kuwait Government bond	-	-	-	15,331	-	-	-	15,331
Premises and equipment	-	-	-	-	-	-	16,086	16,086
Total assets	223,974	470,431	263,759	178,526	81	2,627	75,251	1,214,649
Liabilities								
Deposits and due to banks and other financial institutions	239,434	76,945	9,757	-	-	-	-	326,136
Medium term loans	-	47,125	37,700	-	-	-	-	84,825
Customers' current, savings and other deposits	484,925	166,260	7,215	-	-	-	-	658,400
Interest payable and other liabilities	10,348	15	2,937	361	-	548	-	14,209
Total liabilities	734,707	290,345	57,609	361	-	548	-	1,083,570

32 Liquidity risk continued

As of 31 December 2001	Less than 1 month	1 month to 1 year	1 - 5 years	5 - 10 years	10 -20 years	More than 20 years	Undated	Total
Assets								
Cash and balances with central banks	70,332	1,725	-	-	-	-	-	72,057
Treasury bills	30,695	6,635	-	-	-	-	-	37,330
Deposits and due from banks and other financial institutions	56,593	120,328	8,603	-	-	-	-	185,524
Loans and advances to customers	34,633	157,265	223,314	65,578	-	-	-	480,790
Non-trading investment securities	7,071	84,374	54,111	53,451	2,045	1,745	50,771	253,568
Investment in associated company	-	-	-	-	-	-	4,547	4,547
Interest receivable and other assets	14,870	381	3,417	240	58	-	-	18,966
Kuwait Government bond	-	-	-	32,932	-	-	-	32,932
Premises and equipment	-	-	-	-	-	-	15,418	15,418
Total assets	214,194	370,708	289,445	152,201	2,103	1,745	70,736	1,101,132
Liabilities								
Deposits and due to banks and other financial institutions	107,133	106,749	7,756	-	-	-	-	221,638
Medium term loans	-	-	84,825	-	-	-	-	84,825
Customers' current, savings and other deposits	280,155	356,301	15,231	-	-	-	-	651,687
Interest payable and other liabilities	11,158	739	2,744	376	-	653	-	15,670
Total liabilities	398,446	463,789	110,556	376	-	653	-	973,820

33 Legal risk

Legal risk is the risk relating to losses due to legal or regulatory action that invalidates or otherwise precludes performance by the end user or its counterparty under the terms of the contract or related netting agreements.

The Group has developed sufficient preventive controls and formalised and well laid out executive reactions to identify legal risks so that potential losses arising from non-adherence to laws and regulations, negative publicity, etc. are avoided. The Group has well established legal procedures to vet product offerings and manage risks arising out of its transactions.

34 Funds under management

At 31 December 2002, clients' funds managed in a fiduciary capacity, without risk or recourse to the Bank, amounted to BD 24,291 thousand (31 December 2001: BD 12,448 thousand).

35 Subsidiaries

The subsidiaries of the Bank, all of which have 31 December as their financial year end, are as follows:

Ownership		Country of incorporation	Activity
BBK Financial Services W.L.L. [dormant]	100%	Bahrain	Brokerage
Al Khaleej Islamic Investment Bank E.C. [dormant]	100%	Bahrain	Islamic banking
Credimax B.S.C. (c)	100%	Bahrain	Credit card operations

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36 Fair value of financial instruments

The table below sets out the estimated carrying values and fair values of those on- and off balance sheet financial instruments where fair values are materially different from carrying amounts in the consolidated financial statements:

	31 December 2002			31 December 2001		
	Carrying	Fair	Difference	Carrying	Fair	Difference
	value	value		value	value	
BD '000	BD '000	BD '000	BD '000	BD '000	BD '000	
Financial assets						
Non-trading investment securities	295,971	298,342	2,371	253,568	255,387	1,819

As explained in note 7, included under non-trading investments are unquoted equity investments with a value of BD 4,395 thousand for which fair value cannot be reliably determined.

- a) Loans and advances to customers: Due to time and cost constraints and the lack of a secondary market, it is not practicable to determine the fair value of loans and advances to customers.
- b) Kuwait Government bond: It is not practicable to determine the fair value of Kuwait Government bond with sufficient accuracy, as the future cash flows are not determinable.

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37 Capital Adequacy

The risk asset ratio calculated in accordance with the capital adequacy guidelines approved by the Bahrain Monetary Agency, for the Group is as follows:

	2002 BD '000	2001 BD '000
Capital base:		
Tier 1 capital	101,297	100,506
Tier 2 capital	26,342	21,866
Total capital base (a)	127,639	122,372
Credit risk weighted exposure:		
On-balance sheet	675,251	597,618
Off-balance sheet	74,720	110,242
Total	749,971	707,860
Market risk weighted exposure:		
On-balance sheet	-	-
Off-balance sheet	9,600	6,750
Total	9,600	6,750
Total risk weighted exposure (b)	759,571	714,610
Capital adequacy (a/b * 100)	16.80%	17.12%
Minimum requirement	12%	12%