

**Ahli United Bank B.S.C.**  
**CONSOLIDATED FINANCIAL STATEMENTS**  
**31 DECEMBER 2002**

## **AUDITORS' REPORT TO THE SHAREHOLDERS OF AHLI UNITED BANK B.S.C.**

We have audited the accompanying consolidated balance sheet of Ahli United Bank 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 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 Report of the Board of Directors 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.



10 March 2003  
Manama, Kingdom of Bahrain

## CONSOLIDATED BALANCE SHEET

31 December 2002

	<i>Note</i>	<i>2002</i> <i>US\$ '000</i>	<i>2001</i> <i>US\$ '000</i>
<b>ASSETS</b>			
Cash and balances with central banks	4	<b>52,350</b>	45,294
Treasury bills	5	<b>21,183</b>	34,531
Trading securities		<b>10,831</b>	355
Deposits with banks and other financial institutions		<b>862,354</b>	925,613
Loans and advances	6	<b>2,168,275</b>	1,882,699
Non-trading investments	7	<b>1,430,483</b>	932,549
Investment in associates	2	<b>438,205</b>	167,664
Premises and equipment		<b>47,323</b>	43,755
Other assets and intangibles	8	<b>104,892</b>	70,259
		<b><u>5,135,896</u></b>	<b><u>4,102,719</u></b>
<b>LIABILITIES, SUBORDINATED LIABILITIES AND EQUITY</b>			
<b>LIABILITIES</b>			
Due to banks and other financial institutions		<b>1,395,614</b>	738,900
Customers' deposits		<b>2,348,983</b>	2,366,086
Certificates of deposits	9	<b>75,293</b>	40,205
Floating rate notes and other term debt	9	<b>233,083</b>	219,718
Other liabilities	10	<b>128,985</b>	85,273
		<b><u>4,181,958</u></b>	<b><u>3,450,182</u></b>
<b>SUBORDINATED LIABILITIES</b>	11	<b><u>123,323</u></b>	<b><u>88,235</u></b>
<b>EQUITY</b>			
Share capital	12	<b>650,000</b>	450,000
Reserves	13	<b>180,615</b>	114,302
		<b><u>830,615</u></b>	<b><u>564,302</u></b>
		<b><u>5,135,896</u></b>	<b><u>4,102,719</u></b>

These consolidated financial statements were authorised for issue in accordance with a resolution of the Board of Directors on 10 March 2003.

Fahad Al-Rajaan  
Chairman

Mohammed Yousuf Jalal  
Deputy Chairman

Adel A. El-Labban  
Group Chief Executive Officer  
& Managing Director

# Ahli United Bank B.S.C.

## CONSOLIDATED STATEMENT OF INCOME

Year ended 31 December 2002

	<i>Note</i>	<i>2002</i> <i>US\$ '000</i>	<i>2001</i> <i>US\$ '000</i>
<b>OPERATING INCOME</b>			
Interest income		<b>211,672</b>	247,035
Interest expense		<b>115,408</b>	160,865
Net interest income		<b>96,264</b>	86,170
Fees and commission - net	14	<b>33,849</b>	30,792
Trading income	15	<b>3,786</b>	5,790
Gain on sale of non-trading investments		<b>8,389</b>	14,223
Share of profit from associates		<b>9,779</b>	6,671
Other operating income		<b>10,965</b>	11,241
		<b>66,768</b>	68,717
<b>NET INTEREST AND OTHER INCOME</b>			
		<b>163,032</b>	154,887
Provision for loan losses - net	6	<b>19,419</b>	17,735
Provision for impairment of non-trading investments, other assets and contingencies	16	<b>4,679</b>	6,920
		<b>24,098</b>	24,655
<b>OPERATING INCOME AFTER PROVISIONS</b>			
		<b>138,934</b>	130,232
<b>OPERATING EXPENSES</b>			
Staff expenses		<b>39,433</b>	38,695
Depreciation and amortisation		<b>6,423</b>	6,635
Other operating expenses		<b>26,145</b>	30,116
		<b>72,001</b>	75,446
<b>PROFIT BEFORE TAXATION</b>			
Taxation	17	<b>7,207</b>	6,426
<b>NET PROFIT FOR THE YEAR</b>			
		<b>59,726</b>	48,360
Basic earnings per share (cents)	18	<b>3.30</b>	3.15
Weighted average number of shares outstanding (in millions)		<b>1,807</b>	1,537

The attached notes 1 to 33 form part of these consolidated financial statements.

# Ahli United Bank B.S.C.

## CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended 31 December 2002

	2002 US\$ '000	2001 US\$ '000
<b>OPERATING ACTIVITIES</b>		
Profit before taxation	66,933	54,786
Adjustments for:		
Depreciation and amortisation	6,423	6,635
Gain on sale of non-trading investments	(8,389)	(14,223)
Provision for loan losses - net	19,419	17,735
Provision for impairment of non-trading investments, other assets and contingencies	4,679	6,920
Share of profit from associates	(9,779)	(6,671)
	<hr/>	<hr/>
Operating profit before changes in operating assets and liabilities	79,286	65,182
Changes in:		
Mandatory reserve deposits with central banks	(2,292)	12,761
Trading securities	(10,476)	261
Deposits with banks and other financial institutions	(26,739)	108,102
Loans and advances	(304,995)	67,556
Other assets and intangibles	(33,259)	9,840
Due to banks and other financial institutions	656,714	(88,294)
Customers' deposits	(17,103)	349,734
Certificates of deposits	35,088	(118,598)
Other liabilities	43,502	3,834
	<hr/>	<hr/>
Cash from operations	419,726	410,378
Tax paid	(9,348)	(13,936)
	<hr/>	<hr/>
Net cash from operating activities	410,378	396,442
	<hr/>	<hr/>
<b>INVESTING ACTIVITIES</b>		
Acquisition of a subsidiary (Note 2)	-	(41,980)
Purchase of non-trading investments	(711,439)	(704,102)
Proceeds from sale of non-trading investments	208,571	237,211
Investment in associates	(260,762)	(154,922)
Redemption of treasury bills over three months	-	19,401
Purchase of premises and equipment	(9,224)	(4,677)
	<hr/>	<hr/>
Net cash (used in) investing activities	(772,854)	(649,069)
	<hr/>	<hr/>
<b>FINANCING ACTIVITIES</b>		
Proceeds from issue of share capital (Note 12,13)	242,971	153,816
Increase in subordinated liabilities	35,088	(855)
Floating rate notes and other term debt	13,365	19,557
Merger expenses	-	(124)
Dividends	(41,400)	(32,350)
	<hr/>	<hr/>
Net cash from financing activities	250,024	140,044
	<hr/>	<hr/>
Foreign currency translation adjustments	13,870	(7,599)
	<hr/>	<hr/>
<b>DECREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(98,582)</b>	<b>(120,182)</b>
Cash and cash equivalents at 1 January	923,120	1,043,302
	<hr/>	<hr/>
<b>CASH AND CASH EQUIVALENTS AT 31 DECEMBER (Note 19)</b>	<b>824,538</b>	<b>923,120</b>
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The attached notes 1 to 33 form part of these consolidated financial statements.

# Ahli United Bank B.S.C.

## CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

31 December 2002

	<i>Share capital US\$ '000</i>	<i>Share premium US\$ '000</i>	<i>Capital reserve US\$ '000</i>	<i>Statutory reserve US\$ '000</i>	<i>Foreign currency translation adjustments US\$ '000</i>	<i>Retained earnings US\$ '000</i>	<i>Proposed appropriations US\$ '000</i>	<i>Cumulative changes in fair values US\$ '000</i>	<i>Total US\$ '000</i>
Balance at 31 December 2000	323,500	53,589	307	4,013	(17,785)	3,730	32,383	-	399,737
Transition adjustment on adoption of IAS 39	-	-	-	-	-	4,482	-	-	4,482
Merger expenses	-	(124)	-	-	-	-	-	-	(124)
Dividends and other appropriations paid	-	-	-	-	-	-	(32,383)	-	(32,383)
Issuance of ordinary shares (Note 13)	126,500	27,316	-	-	-	-	-	-	153,816
Net profit for the year – 2001	-	-	-	-	-	48,360	-	-	48,360
Currency translation adjustments	-	-	-	-	(7,599)	-	-	-	(7,599)
Net gain on sale of available-for-sale investments (previously included in retained earnings on adoption of IAS 39)	-	-	-	-	-	(7,340)	-	-	(7,340)
Net fair value movements during the year	-	-	-	-	-	-	-	5,353	5,353
Transfer to statutory reserve	-	-	-	4,836	-	(4,836)	-	-	-
Proposed dividends	-	-	-	-	-	(41,400)	41,400	-	-
Proposed directors' remuneration	-	-	-	-	-	(210)	210	-	-
<b>Balance at 31 December 2001</b>	<b>450,000</b>	<b>80,781</b>	<b>307</b>	<b>8,849</b>	<b>(25,384)</b>	<b>2,786</b>	<b>41,610</b>	<b>5,353</b>	<b>564,302</b>
Dividends and other appropriations paid	-	-	-	-	-	-	(41,610)	-	(41,610)
Issuance of ordinary shares (Note 13)	200,000	42,971	-	-	-	-	-	-	242,971
Net profit for the year – 2002	-	-	-	-	-	59,726	-	-	59,726
Currency translation adjustments	-	-	-	-	13,870	-	-	-	13,870
Net gain on sale of available-for-sale investments (previously included in retained earnings on adoption of IAS 39)	-	-	-	-	-	(810)	-	-	(810)
Net fair value movements during the year	-	-	-	-	-	-	-	(7,834)	(7,834)
Transfer to statutory reserve	-	-	-	5,973	-	(5,973)	-	-	-
Proposed dividends	-	-	-	-	-	(41,553)	41,553	-	-
Proposed directors' remuneration	-	-	-	-	-	(318)	318	-	-
<b>Balance at 31 December 2002</b>	<b>650,000</b>	<b>123,752</b>	<b>307</b>	<b>14,822</b>	<b>(11,514)</b>	<b>13,858</b>	<b>41,871</b>	<b>(2,481)</b>	<b>830,615</b>

The movements in foreign currency translation adjustments represent differences arising from translating the net investment in a subsidiary into US dollars.

The attached notes 1 to 33 form part of these consolidated financial statements.

## 1 ACTIVITIES

The parent company, Ahli United Bank B.S.C. (the 'Bank') was incorporated in the Kingdom of Bahrain on 31 May 2000 originally as a closed company and changed on 12 July 2000 to a public shareholding company by Amiri Decree no. 16/2000, and is engaged in commercial and investment banking business, global fund management and private banking services through its subsidiaries. The Bank operates under an offshore banking unit licence issued by the Bahrain Monetary Agency. The registered office of Ahli United Bank B.S.C. is located at 120 Government Avenue, P O Box 2424, Manama, Kingdom of Bahrain.

The number of staff employed by the Group as of 31 December 2002 was 534 (31 December 2001: 517).

## 2 CONSOLIDATED FINANCIAL STATEMENTS

The consolidated financial statements comprise the financial statements of Ahli United Bank B.S.C. and its principal subsidiaries (together known as "the Group"). The operating results of principal associates are equity accounted in the consolidated financial statements including the broad concepts underlying the consolidation procedures. The following are the principal subsidiaries and associates:

<u>Name</u>	<u>Country of incorporation</u>	<u>Percentage holding</u>
<i>a) Principal subsidiaries</i>		
Ahli United Bank (Bahrain) B.S.C. (c) [formerly known as Al-Ahli Commercial Bank B.S.C.(c)]	Kingdom of Bahrain	100%
Ahli United Bank (U.K.) PLC [formerly known as The United Bank of Kuwait PLC]	United Kingdom	100%
<i>b) Principal associate</i>		
Bank of Kuwait and Middle East K.S.C.	State of Kuwait	43%

During the year ended 31 December 2001, the Group acquired 100% of the share capital of Commercial Bank of Bahrain B.S.C. (c) [CBB], a Bahrain based commercial bank, with effect from 1 January 2001. On 1 October 2001, the operations of CBB were combined with those of Ahli United Bank (Bahrain) B.S.C. (c) and CBB became dormant. During the year ended 31 December 2002, the Group adjusted the fair values of assets acquired through the business combination which resulted in increasing the goodwill arising on acquisition from US\$18,856 thousand to US\$30,352 thousand.

All material intra-group balances and transactions, including material unrealised gains and losses on transactions, between Group companies have been eliminated on consolidation.

## 3 SIGNIFICANT ACCOUNTING POLICIES

### *Basis of preparation*

The consolidated financial statements of Ahli United Bank B.S.C. are prepared in conformity with the Bahrain Commercial Companies Law and the Bahrain Monetary Agency Law and in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board (IASB), and interpretations issued by the Standing Interpretations Committee of the IASB.

**3 SIGNIFICANT ACCOUNTING POLICIES (continued)**

The significant accounting policies adopted, which are consistent with those used in the previous year, are as follows:

***Accounting convention***

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

The financial statements are presented in US dollars being the currency in which the share capital of the Bank is denominated.

***Trading securities***

Trading securities are initially recognised at cost and subsequently remeasured at fair value with any gains or losses arising from a change in fair value being included in the consolidated statement of income in the period in which it arises.

***Deposits with banks and other financial institutions***

Deposits with banks and other financial institutions are stated net of amounts written off and provision for impairment.

***Loans and advances***

Loans and advances are stated at cost, adjusted for effective fair value hedges, less any amounts written off and provision for impairment.

***Non-trading investments***

These are classified as either held-to-maturity, available-for-sale or originated by the Group. All investments are initially recognised at cost, being the fair value of the consideration given, including acquisition costs associated with the investment. Premiums and discounts are amortised on a systematic basis to maturity using the effective interest method and taken to interest income.

***Available-for-sale***

After initial recognition, available-for-sale investments 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 is included in the consolidated statement of income 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 statement of income 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, adjusted for effective fair value hedges, less provision for impairment.

***Held-to-maturity***

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

Where investments are sold subject to a commitment to repurchase them at a predetermined price, they remain on the balance sheet and the consideration received is classified as "Due to banks and other financial institutions". Conversely, securities purchased under similar commitments to resell are not recognised on the balance sheet and the consideration paid is recorded in "Deposits with banks and other financial institutions".



**3 SIGNIFICANT ACCOUNTING POLICIES (continued)**

***Fair values***

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

The fair value of interest-bearing financial assets and liabilities is estimated based on discounted cash flows using current market rates for financial instruments with similar terms and risk characteristics.

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 instrument which is substantially the same, or is based on the net present value of future cash flows.

The fair value of over-the-counter options is determined by using option-pricing models.

***Investment in associates***

Associated companies are companies in which the Group has a long-term interest of between 20% and 50% in the voting capital or over which it exerts significant influence. Investments in associated companies are accounted for using the equity method.

***Goodwill***

Goodwill, representing the excess of the cost of an acquisition over the fair value of the Group's share of identifiable net assets of a subsidiary or an associate at the date of acquisition, is amortised using the straight-line method over its estimated useful life of 40 years. At each balance sheet date, goodwill is reviewed for impairment.

***Premises and equipment***

Premises and equipment is stated at cost, less accumulated depreciation.

The cost of freehold land is not depreciated. Depreciation on other premises and equipment is provided on a straight-line basis over their estimated useful lives.

The estimated useful lives of the assets for the calculation of depreciation are as follows:

Freehold buildings	15 to 20 years
Leasehold buildings	Over the period of lease
Other premises and equipment	2 to 6 years

***Collateral pending sale***

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

***Deposits***

All money market and customer deposits are carried at amortised cost, less amounts repaid.

***Liabilities***

Liabilities that are held for trading are subsequently remeasured at fair value and any gain or loss arising from a change in fair value is included in the consolidated statement of income in the period in which it arises.

***Taxation***

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

Deferred taxation is provided using the liability method on all temporary differences calculated at the rate at which it is expected to be payable. Deferred tax assets are only recognised if recovery is probable.

**3 SIGNIFICANT ACCOUNTING POLICIES (continued)**

***Employee benefits***

*Pension scheme*

Ahli United Bank (U.K.) PLC operates a defined benefits scheme for employees who joined prior to 1 March 2001. The pension costs of the scheme are recognised on a systematic basis so that the costs of providing retirement benefits to employees are evenly matched, so far as possible, to the service lives of the employees concerned. Any excess or deficiency of the actuarial value of assets over the actuarial value of liabilities of the pension scheme is allocated over the average remaining service lives of the scheme members.

*Defined contribution plans*

The Bahraini employees of the parent and its subsidiary Ahli United Bank (Bahrain) BSC (c) are covered under the General Organisation of Social Insurance Scheme (GOSI) and the Group's obligations are limited to the amounts contributed to the Scheme.

Ahli United Bank (UK) PLC employees who joined after 28 February 2001 are not covered by the earlier pension scheme but are subject to a defined contribution scheme, the costs of which are recognized in the period to which they relate.

*Other defined benefit plan*

In accordance with the Bahrain Labour law the parent and its subsidiary Ahli United Bank (Bahrain) B.S.C. (c) provide for end of service benefits for its non-Bahraini employees. The provision is based on accumulated periods of service and estimated salary at the time of leaving.

***Provisions***

Provisions are recognised when the Group has a present obligation arising from a past event, and costs to settle the obligation are both probable and able to be reliably estimated.

***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 at prevailing market rates. 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 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 statement of income. The hedged item is adjusted for fair value changes relating to the risk being hedged and the difference is recognised in the consolidated statement of income.

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

**3 SIGNIFICANT ACCOUNTING POLICIES (continued)**

***Derivatives (continued)***

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. In the case of fair value hedges of interest-bearing financial instruments any adjustment relating to the hedged item is amortised over the remaining term to maturity. In the case of cash flow hedges, the cumulative gain or loss on the hedging instrument recognised in equity remains in equity until the forecasted transaction occurs, unless the hedged transaction is no longer expected to occur, in which case the net cumulative gain or loss recognised in equity is transferred to the consolidated statement of income for the period.

***Fiduciary assets***

Assets held in trust or in a fiduciary capacity are not treated as assets of the Group and, accordingly, are not incorporated in the consolidated 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 is recognised on a time proportion basis, taking account of the principal outstanding and the rate applicable. Loan interest that is 90 days or more overdue is excluded from income. Notional interest is recognised on impaired loans and advances and other financial assets based on the rate used to discount future cash flows to their net present values.

Fees and commission income are recognised when earned. Dividend income is recognised when the right to receive payment is established.

***Foreign currencies***

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

The assets and liabilities of foreign entities are translated into US dollars at the rates of exchange prevailing at the balance sheet date. Income and expense items are translated at average exchange rates prevailing for the period. Any exchange differences (including those which hedge such investments) are taken directly to a "foreign currency translation adjustments" which forms part of equity.

***Cash and cash equivalents***

Cash and cash equivalents comprise cash and balances with central banks, excluding mandatory reserves, plus those deposits with banks and other financial institutions and treasury bills which mature within three months from the balance sheet date.

***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, is recognised in the consolidated statement of income.

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 have been 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.

***Settlement date accounting***

All "regular way" purchases and sales of financial assets are recognised on the settlement date, i.e. the date that the Group receives or delivers 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2002

**4 CASH AND BALANCES WITH CENTRAL BANKS**

	<i>2002</i> <i>US\$ '000</i>	<i>2001</i> <i>US\$ '000</i>
Cash and balances with central banks, excluding mandatory reserve deposits	<b>21,450</b>	16,686
Mandatory reserve deposits with central banks	<b>30,900</b>	28,608
	<b>52,350</b>	45,294

Mandatory reserve deposits are not available for use in the day-to-day operations.

**5 TREASURY BILLS**

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

**6 LOANS AND ADVANCES**

The composition of the loans and advances portfolio, net of provisions, is as follows:

<b>Industry sector</b>	<i>2002</i>				<i>2001</i>	
	<i>Bahrain</i> <i>US\$ '000</i>	<i>Foreign</i> <i>US\$ '000</i>	<i>Total</i> <i>US\$ '000</i>	<i>%</i>	<i>Total</i> <i>US\$ '000</i>	<i>%</i>
Consumer finance	425,824	322,837	748,661	32.4	527,091	26.4
Construction and real estate	70,749	584,216	654,965	28.5	615,140	30.8
Trading and manufacturing	166,034	314,004	480,038	20.9	399,247	20.0
Banks and other financial institutions	34,215	80,442	114,657	5.0	160,684	8.0
Government/public sector	1,682	-	1,682	0.1	4,647	0.2
Others	40,170	261,585	301,755	13.1	290,837	14.6
	<b>738,674</b>	<b>1,563,084</b>	<b>2,301,758</b>	<b>100.0</b>	1,997,646	100.0
Less: Provisions	<b>(101,528)</b>	<b>(31,955)</b>	<b>(133,483)</b>	<b>(5.8)</b>	(114,947)	(5.8)
	<b>637,146</b>	<b>1,531,129</b>	<b>2,168,275</b>	<b>94.2</b>	1,882,699	94.2
<b>Geographic region</b>						
G.C.C. countries			<b>918,691</b>	<b>39.9</b>	772,912	38.7
United Kingdom			<b>831,878</b>	<b>36.1</b>	731,309	36.6
Europe			<b>251,035</b>	<b>10.9</b>	166,145	8.3
United States of America			<b>90,965</b>	<b>4.0</b>	98,408	4.9
Asia			<b>49,903</b>	<b>2.2</b>	64,881	3.2
Others			<b>159,286</b>	<b>6.9</b>	163,991	8.3
			<b>2,301,758</b>	<b>100.0</b>	1,997,646	100.0
Less: Provisions			<b>(133,483)</b>	<b>(5.8)</b>	(114,947)	(5.8)
			<b>2,168,275</b>	<b>94.2</b>	1,882,699	94.2

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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**6 LOANS AND ADVANCES (continued)**

Age analysis of non-performing loans on which interest is not being accrued

	2002			Total US\$ '000	2001
	3 months to 1 year US\$ '000	1 - 3 years US\$ '000	Over 3 years US\$ '000		Total US\$ '000
Gross non-performing loans	72,215	48,706	51,543	172,464	153,698
Less: Provisions				(112,397)	(98,094)
Less: Interest in suspense				(21,086)	(16,853)
Net outstanding				<u>38,981</u>	<u>38,751</u>

During the year ended 31 December 2002, the Group restructured credit facilities amounting to US\$10 million. The restructured facilities have no material impact on the current year's earnings or are expected to have any material adverse effect on future earnings.

The movements in provisions during the year were as follows:

	2002 US\$ '000	2001 US\$ '000
At 1 January	114,947	90,907
Adjustment arising from application of IAS 39	-	2,897
Arising from acquisition of a subsidiary	11,495	13,549
Amounts written off during the year	(18,096)	(17,690)
Charge for the year	22,958	21,072
Recoveries	(3,539)	(3,337)
Interest suspended during the year	4,883	7,935
Exchange rate adjustments/ other	835	(386)
At 31 December	<u>133,483</u>	<u>114,947</u>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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## 7 NON-TRADING INVESTMENTS

31 December 2002	2002			2001	
	Available- for-sale US\$'000	Originated by the Group US\$'000	Held-to- maturity US\$'000	Total US\$'000	Total US\$'000
<b>Quoted investments</b>					
Non-Bahrain government bonds and debt securities	192,039	-	-	192,039	71,096
Floating rate notes and certificate of deposits:					
- issued by banks and other financial institutions	384,952	59,397	-	444,349	272,215
- issued by corporate bodies	571,790	4,780	13,705	590,275	345,204
Equity shares	47,498	-	-	47,498	34,615
Other investments	7,202	-	-	7,202	6,801
	<u>1,203,481</u>	<u>64,177</u>	<u>13,705</u>	<u>1,281,363</u>	<u>729,931</u>
<b>Unquoted investments</b>					
Bahrain government bonds and debt securities	22,480	-	-	22,480	20,241
Other government bonds and debt securities	34,774	-	-	34,774	40,914
Floating rate notes and certificate of deposits:					
- issued by banks and other financial institutions	-	64,894	-	64,894	59,476
- issued by corporate bodies	-	3,346	-	3,346	55,833
Equity shares at cost	9,312	-	-	9,312	6,519
Other investments	26,106	-	-	26,106	30,716
	<u>92,672</u>	<u>68,240</u>	<u>-</u>	<u>160,912</u>	<u>213,699</u>
<b>Total</b>	<b>1,296,153</b>	<b>132,417</b>	<b>13,705</b>	<b>1,442,275</b>	<b>943,630</b>
Less : Provision for impairment	(11,792)	-	-	(11,792)	(11,081)
	<u>1,284,361</u>	<u>132,417</u>	<u>13,705</u>	<u>1,430,483</u>	<u>932,549</u>
31 December 2001	576,689	355,860	-		932,549

Non-trading investments include US\$121 million (2001: Nil) investments sold under agreement to repurchase against which the Group had borrowings of US\$109 million (2001: Nil), included under "Due to banks and other financial institutions".

## 8 OTHER ASSETS AND INTANGIBLES

	2002 US\$ '000	2001 US\$ '000
Interest receivable	31,025	25,734
Goodwill	29,114	18,385
Others	44,753	26,140
	<u>104,892</u>	<u>70,259</u>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2002

**9 CERTIFICATES OF DEPOSITS, FLOATING RATE NOTES AND OTHER TERM DEBT**

	<i>Maturity</i>	<i>2002</i> <i>US\$ '000</i>	<i>2001</i> <i>US\$ '000</i>
Certificates of Deposits	<b>2003</b>	<b>75,293</b>	40,205
Floating rate notes	<b>2003 – 2005</b>	<b>100,000</b>	199,718
Other term debt	<b>2003 – 2005</b>	<b>133,083</b>	20,000
		<b>233,083</b>	219,718

Floating rate notes and other term debt are unsecured with interest payable semi-annually.

**10 OTHER LIABILITIES**

	<i>2002</i> <i>US\$ '000</i>	<i>2001</i> <i>US\$ '000</i>
Interest payable	<b>26,194</b>	25,641
Others	<b>102,791</b>	59,632
	<b>128,985</b>	85,273

**11 SUBORDINATED LIABILITIES**

These borrowings are subordinated to the claims of all other creditors of the respective companies.

	<i>2002</i> <i>US\$ '000</i>	<i>2001</i> <i>US\$ '000</i>
<b>(a) Ahli United Bank B.S.C.</b>		
Great Britain Pounds – interest at six months LIBOR plus 1%, repayable 2012	<b>32,255</b>	-
<b>(b) Ahli United Bank (U.K.) PLC</b>		
Kuwaiti Dinars – interest at six months effective KIBID, repayable 2005	<b>10,254</b>	9,982
US Dollars - interest at three months LIBOR plus ¾%, repayable 2007	<b>32,775</b>	32,729
<b>(c) UBK Finance BV</b>		
Great Britain Pounds - interest at six months LIBOR plus ¾%, repayable 2006	<b>11,351</b>	10,213
Great Britain Pounds - interest at six months LIBOR plus ¾%, repayable 2007	<b>1,765</b>	-
US Dollars – interest at three months LIBOR plus ¾%, repayable 2006	<b>9,938</b>	9,923
US Dollars – interest at three months LIBOR plus ¾%, repayable 2007	<b>1,546</b>	-
Great Britain Pounds - interest at six months LIBOR plus ¾%, 5 years and one day notice	<b>10,928</b>	11,420
US Dollars - interest at three months LIBOR plus ¾%, 5 years and one day notice	<b>9,568</b>	11,099
Kuwaiti Dinars - interest at six months KIBID, repayable 2005	<b>2,943</b>	2,869
<b>TOTAL</b>	<b>123,323</b>	88,235

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2002

**12 SHARE CAPITAL**

	<i>2002</i> <i>US\$ '000</i>	<i>2001</i> <i>US\$ '000</i>
Authorised :		
4,000 million shares of US\$ 0.25 each	<u>1,000,000</u>	<u>1,000,000</u>
Issued and fully paid:		
2,600 million (2001: 1,800 million) shares of US\$ 0.25 each	<u>650,000</u>	<u>450,000</u>

Pursuant to a resolution adopted by the shareholders, the Bank issued 800 million ordinary shares of US\$0.25 each at a premium on 29 December 2002 (2001: 506 million ordinary shares of US\$ 0.25 each at a premium).

**13 RESERVES**

a) **Share premium**

During the year the Bank increased its issued share capital at a premium of US\$42,971 thousand (2001: US\$27,316 thousand) net of retrocession and share issue expenses.

b) **Capital reserve**

As required by the Bahrain Commercial Companies Law, any profit on sale of premises and equipment or on sale of treasury stock is transferred to capital reserve. The reserve is not distributable except in such circumstances as stipulated in the Bahrain Commercial Companies Law and following the approval of the Bahrain Monetary Agency.

c) **Statutory reserve**

As required by the Bahrain Commercial Companies Law and the Bank's articles of association, 10% of the consolidated net profit for the year has been transferred to a statutory reserve. The Bank may resolve to discontinue such transfers when the reserve totals 50% of the paid up capital. The reserve is not distributable except in such circumstances as stipulated in the Bahrain Commercial Companies Law and following the approval of the Bahrain Monetary Agency.

d) **Proposed dividend**

The directors have proposed a cash dividend of US\$41,553 thousand (2001: US\$ 41,400 thousand) being US cents 2.3 per share (2001: US cents 2.3 per share), which will be submitted for formal approval at the Annual General Meeting. The shares issued during the year will be subject to prorata dividend from the date of issue, as per the resolution of the Extraordinary General Assembly held on 14 October 2002.



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2002

**13 RESERVES (continued)****e) Cumulative changes in fair value**

	<i>2002</i> <i>US\$'000</i>	<i>2001</i> <i>US\$'000</i>
<i>Available for sale investments</i>		
At 1 January	5,931	(912)
Realised during the year	(8,182)	(6,060)
Changes in fair values during the year	3,113	12,903
	<u>862</u>	<u>5,931</u>
 <i>Cash flow hedges</i>		
At 1 January	(578)	-
Transferred to income statement	193	(72)
Changes in fair values during the year	(2,958)	(506)
	<u>(3,343)</u>	<u>(578)</u>

**14 FEES AND COMMISSION - NET**

	<i>2002</i> <i>US\$'000</i>	<i>2001</i> <i>US\$'000</i>
Fee and commission income	34,868	31,894
Fee and commission expense	(1,019)	(1,102)
	<u>33,849</u>	<u>30,792</u>

**15 TRADING INCOME**

	<i>2002</i> <i>US\$'000</i>	<i>2001</i> <i>US\$'000</i>
Foreign exchange	4,412	4,813
Derivatives	(626)	977
	<u>3,786</u>	<u>5,790</u>

**16 PROVISION FOR IMPAIRMENT OF NON-TRADING INVESTMENTS, OTHER ASSETS AND CONTINGENCIES**

	<i>2002</i> <i>US\$ '000</i>	<i>2001</i> <i>US\$ '000</i>
Provision for non-trading investments and other assets	4,679	5,647
Provision for contingencies	-	1,273
	<u>4,679</u>	<u>6,920</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2002

17 TAXATION

	<i>2002</i> <i>US\$ '000</i>	<i>2001</i> <i>US\$ '000</i>
Balance sheet:		
Current liability	<b>(1,032)</b>	522
Deferred asset	<b>(1,994)</b>	(2,230)
	<u><b>(3,026)</b></u>	<u>(1,708)</u>
Income statement:		
Current tax on foreign operations	<b>6,971</b>	6,295
Deferred tax on foreign operations	<b>236</b>	131
	<u><b>7,207</b></u>	<u>6,426</u>

There is no tax on corporate income in the Kingdom of Bahrain. As of 31 December 2002, only Ahli United Bank (U.K.) PLC was subject to taxation.

The effective tax rate Ahli United Bank (U.K.) PLC for the year ended 31 December 2002 was 29.87% (2001: 30.51%). Since there is no income tax in the Kingdom of Bahrain, reconciliation between the accounting profit and the taxable profit has not been presented.

18 BASIC EARNINGS PER SHARE

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

	<i>2002</i>	<i>2001</i>
Net profit for the year (US\$ '000)	<u><b>59,726</b></u>	<u>48,360</u>
Weighted average number of shares outstanding during the year (million) *	<u><b>1,807</b></u>	<u>1,537</u>
Basic earnings per share (US cents)	<u><b>3.30</b></u>	<u>3.15</u>

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

19 CASH AND CASH EQUIVALENTS

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

	<i>2002</i> <i>US\$ '000</i>	<i>2001</i> <i>US\$ '000</i>
Cash and balances with central banks (Note 4)	<b>21,450</b>	16,686
Deposits with banks and other financial institutions - maturing within three months	<b>781,905</b>	871,903
Treasury bills maturing within three months	<b>21,183</b>	34,531
	<u><b>824,538</b></u>	<u>923,120</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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**20 RELATED PARTY TRANSACTIONS**

The Group enters into transactions with major shareholders, directors, senior management and companies of which they are principal owners in the ordinary course of business at arms length. All the loans and advances to related parties are performing and are free of any provision for possible loan losses. The Group has sufficient unutilised lines of credit as a back up for related party deposits.

The year-end balances in respect of related parties included in the consolidated balance sheet are as follows:

	<i>2002</i>	<i>2001</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>
Deposits with banks and other financial institutions	<b>29,594</b>	5,076
Loans and advances	<b>41,053</b>	20,175
Non-trading investments	<b>16,652</b>	13,454
Due to banks and other financial institutions	<b>52,524</b>	6,124
Customers' deposits	<b>394,055</b>	700,391
Subordinated liabilities	<b>49,505</b>	30,459

The income and expenses in respect of related party transactions included in the consolidated statement of income are as follows:

	<i>2002</i>	<i>2001</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>
Interest income	<b>5,204</b>	6,101
Interest expense	<b>25,981</b>	20,845
Fees and commission	<b>1,559</b>	1,493

**21 EMPLOYEE BENEFITS**

**Pension scheme**

The total pension costs of the Group relating to Ahli United Bank (U.K.) PLC pension plan were US\$2,007 thousand (2001: US\$ 1,627 thousand).

The most recent actuarial valuation as at 1 July 2001 reflected an actuarial surplus of assets of US\$ 5,011 thousand. The main assumptions used in the valuation were a future investment return of 8% per annum, a future rate of salary progression of 6% per annum and a current contribution rate by the employer of 14.2% of the pensionable earnings.

**Defined contribution plans**

The contribution during the year for Bahraini and U.K. employees on this account amounted to US\$693 thousand (2001: US\$908 thousand) and US\$310 thousand (2001: US\$131 thousand) respectively.

**Other defined benefit plans**

The charge to the consolidated statement of income on account of end of service benefits to non-Bahraini employees of the parent and its subsidiary Ahli United Bank (Bahrain) B.S.C. (c) for the year amounted to US\$248 thousand (2001: US\$257 thousand). There are no material differences between the carrying amount of the provision for end of service benefits and the amount arising from an actuarial computation thereof.

**22 MANAGED FUNDS**

Funds administrated on behalf of customers to which the Group does not have legal title are not included in the consolidated balance sheet. The total market value of all such funds at 31 December 2002 was US\$1,513 million (2001 : US\$1,606 million). Effective 1 January 2002, the fund administration function has been outsourced to external fund managers and as such the group does not have significant fiduciary risk at 31 December 2002.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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## 23 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.

The table below shows the net 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.

	<i>Net fair value</i>	<i>Notional amount Total</i>	<i>Notional amounts by term to maturity</i>			
			<i>Within 3 months</i>	<i>3 – 12 months</i>	<i>1 – 5 years</i>	<i>Over 5 years</i>
	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>	<i>US\$ '000</i>
<b>31 December 2002:</b>						
<i>Derivatives held for trading:</i>						
Interest rate swaps	(1,981)	219,186	20,000	30,000	169,186	-
Foreign exchange – swaps	(10,555)	987,622	940,269	47,269	-	84
Options	(301)	74,282	33,893	6,000	34,389	-
Interest rate futures	374	811,193	304,865	506,328	-	-
<i>Derivatives held as fair value hedges:</i>						
Interest rate swaps	(19,284)	817,816	7,032	128,952	462,073	219,759
Currency swaps	(32)	110,000	-	-	110,000	-
<i>Derivatives held as cash flow hedges:</i>						
Interest rate swaps	(2,878)	150,000	-	-	150,000	-
	<u>(34,657)</u>	<u>3,170,099</u>	<u>1,306,059</u>	<u>718,549</u>	<u>925,648</u>	<u>219,843</u>
<b>31 December 2001:</b>						
<i>Derivatives held for trading:</i>						
Interest rate swaps	(43)	497,256	63,433	209,703	107,347	116,773
Foreign exchange – swaps	(1,309)	848,834	795,880	52,954	-	-
Options	(271)	567,883	553,087	4,589	10,207	-
Interest rate futures	(266)	1,191,587	663,490	250,168	277,929	-
<i>Derivatives held as fair value hedges:</i>						
Interest rate swaps	(1,528)	929,904	214,092	113,572	304,901	297,339
Currency swaps	1,189	9,986	-	-	9,986	-
<i>Derivatives held as cash flow hedges:</i>						
Interest rate swaps	(1,354)	74,158	14,158	60,000	-	-
	<u>(3,582)</u>	<u>4,119,608</u>	<u>2,304,140</u>	<u>690,986</u>	<u>710,370</u>	<u>414,112</u>

**23 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 and floating interest payments as well as 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.

***Derivatives held for trading purposes***

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

***Derivatives held for hedging purposes***

The Group has adopted a comprehensive system for the measurement and management of risk.

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

The Group uses forward foreign exchange contracts, options 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 investments and loans. The Group also uses interest rate swaps to hedge against the cash flow risks arising on certain floating rate deposits. 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.

For strategic interest rate risk, hedging is carried out by monitoring the duration 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 the same way as trading instruments.

**24 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 and generally have fixed expiration dates or other termination clauses. Since commitments may expire without being drawn upon, the total contract amounts do not necessarily represent future cash requirements.

Standby letters of credit, guarantees and acceptances (standbys) commit the Group to make payments on behalf of customers contingent upon their failure to perform under the terms of the contract. Standbys 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:

	<i>2002</i> <i>US\$ '000</i>	<i>2001</i> <i>US\$ '000</i>
Commitments on behalf of customers:		
Guarantees	251,471	250,461
Acceptances	10,790	14,041
Letters of credit	99,272	71,122
	<u>361,533</u>	<u>335,624</u>
Irrevocable commitments:		
Undrawn irrevocable loan commitments	434,698	442,742
Capital expenditure commitments	13,124	80
	<u>447,822</u>	<u>442,822</u>

The concentration of commitments on behalf of customers by types of customers is as follows:

<b>Industry sector</b>	<i>2002</i>			<i>2001</i>
	<i>Bahrain</i> <i>US\$ '000</i>	<i>Foreign</i> <i>US\$ '000</i>	<i>Total</i> <i>US\$ '000</i>	<i>Total</i> <i>US\$ '000</i>
Banks and other financial institutions	187,285	24,670	211,955	202,493
Corporates	91,011	10,628	101,639	92,402
Others	47,202	737	47,939	40,729
	<u>325,498</u>	<u>36,035</u>	<u>361,533</u>	<u>335,624</u>

***Operating lease commitments***

At 31 December 2002 the Group had commitments under non-cancellable operating leases amounting to US\$ 2,736 thousand (2001: US\$ 3,439 thousand).

**25 SEGMENT INFORMATION**

**Primary segment information**

For management purposes the Group is recognised into three major business segments:

- Retail banking - principally handling individual customers' deposits, and providing consumer type loans, overdrafts, credit cards and fund transfer facilities.
- Corporate banking, treasury and investments - principally handling loans and other credit facilities, and deposit and current accounts for corporate and institutional customers and providing money market, trading and treasury services, as well as management of the Group's funding.
- Private banking and wealth management - principally servicing the high net worth clients through a range of investment products, funds, credit facilities, trusts and alternative investments.

These segments are the basis on which the Group reports its primary segment information. Transactions between segments are conducted at estimated market rates on an arm's length basis. Interest is charged/credited to business segments based on a pool rate which approximates the cost of funds.

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

	<i>Retail banking US\$ '000</i>	<i>Corporate banking, treasury and investments US\$ '000</i>	<i>Private banking and wealth management US\$ '000</i>	<i>Total US\$ '000</i>
Operating income before provisions	<u>34,958</u>	<u>98,905</u>	<u>19,390</u>	<u>153,253</u>
Segment result	<u>18,444</u>	<u>53,041</u>	<u>9,767</u>	<u>81,252</u>
Share of profit from associates				<u>9,779</u>
Profit for the year before provisions				<u>91,031</u>
Provisions				<u>24,098</u>
Net profit for the year before tax				<u>66,933</u>
Taxation				<u>7,207</u>
Net profit for the year				<u>59,726</u>
<b>Other Information</b>				
Segment assets	<u>471,234</u>	<u>4,012,168</u>	<u>62,074</u>	<u>4,545,476</u>
Investment in associates				<u>438,205</u>
Unallocated assets				<u>152,215</u>
Total assets				<u>5,135,896</u>
Segment liabilities	<u>846,451</u>	<u>2,512,396</u>	<u>523,298</u>	<u>3,882,145</u>
Unallocated liabilities				<u>423,136</u>
Total liabilities				<u>4,305,281</u>

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**25 SEGMENT INFORMATION (continued)**Segment information for the year ended **31 December 2001** was as follows:

	<i>Retail banking</i> US\$ '000	<i>Corporate banking, treasury and investments</i> US\$ '000	<i>Private banking and wealth management</i> US\$ '000	<i>Total</i> US\$ '000
Operating income before provisions	28,017	102,949	17,250	148,216
Segment result	12,993	55,666	4,111	72,770
Profit from operations				72,770
Share of profit from associates				6,671
Profit for the year before provisions				79,441
Provisions				24,655
Net profit for the year before tax				54,786
Taxation				6,426
Net profit for the year				48,360
<b>Other Information</b>				
Segment assets	271,414	3,466,397	38,899	3,776,710
Investment in associates				167,664
Unallocated assets				158,345
Total assets				4,102,719
Segment liabilities	853,378	1,919,024	391,865	3,164,267
Unallocated liabilities				374,150
Total liabilities				3,538,417

**Secondary segment information**

Although the management of the Group is based primarily on business segments, the Group operates in two geographic markets; Gulf Co-operation Council (Kingdom of Bahrain, State of Kuwait, Sultanate of Oman, State of Qatar, Kingdom of Saudi Arabia and United Arab Emirates) is designated as regional, and the remainder (Europe, U.S.A., Far East and the rest of the world) is designated as international. The following table shows the distribution of the Group's operating income and total assets by geographical segment:

	<i>Regional</i>		<i>International</i>		<i>Total</i>	
	<i>2002</i> US\$ '000	<i>2001</i> US\$ '000	<i>2002</i> US\$ '000	<i>2001</i> US\$ '000	<i>2002</i> US\$ '000	<i>2001</i> US\$ '000
Operating income	76,162	83,559	86,870	71,328	163,032	154,887
Total assets	1,827,883	1,398,222	3,308,013	2,704,497	5,135,896	4,102,719



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**26 CREDIT RISK**

Credit risk is the risk that one party to a financial instrument will fail to discharge a financial obligation and cause the other party to incur a financial loss. In case of derivatives this is limited to positive fair values. The Group attempts to control credit risk by monitoring credit exposures, limiting transactions with specific counterparties, and continually assessing the creditworthiness of counterparties.

Concentrations of credit risk arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be 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 geographic location.

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

Details of the composition of the loans and advances are set out in note 6.

Details of the industry sector analysis and the geographical distribution of assets, liabilities and off balance sheet items are set out in note 27.

**27 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		
	<i>Assets</i> US\$ '000	<i>Liabilities</i> US\$ '000	<i>Off balance sheet items</i> US\$ '000	<i>Assets</i> US\$ '000	<i>Liabilities</i> US\$ '000	<i>Off balance sheet items</i> US\$ '000
<b>Geographic region:</b>						
G.C.C. countries	1,785,105	2,918,021	822,925	1,398,222	2,290,812	883,103
United Kingdom	1,655,291	1,002,315	2,702,466	1,390,642	816,096	1,638,436
Europe	804,974	253,778	362,580	647,521	273,192	1,570,209
United States of America	465,625	22,517	13,067	290,677	5,811	643,182
Asia	64,841	3,149	24,582	89,672	3,793	15,304
Rest of the world	360,060	105,501	56,570	285,985	148,713	151,259
	<u>5,135,896</u>	<u>4,305,281</u>	<u>3,982,190</u>	<u>4,102,719</u>	<u>3,538,417</u>	<u>4,901,493</u>
<b>Industry sector:</b>						
Banks and other financial institutions	2,259,414	2,029,355	3,395,479	2,078,819	1,261,116	4,264,469
Construction and real estate	676,962	68,539	89,890	609,416	125,762	133,728
Trading and manufacturing	611,438	95,414	340,701	329,395	101,412	334,538
Government/public sector	216,700	500,840	-	110,572	649,286	2,513
Others	1,371,382	1,611,133	156,120	974,517	1,400,841	166,245
	<u>5,135,896</u>	<u>4,305,281</u>	<u>3,982,190</u>	<u>4,102,719</u>	<u>3,538,417</u>	<u>4,901,493</u>
Month end average	<u>3,491,019</u>	<u>3,156,629</u>	<u>3,979,724</u>	<u>4,299,357</u>	<u>3,529,611</u>	<u>4,695,832</u>

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## 28 INTEREST RATE RISK

The Group's interest sensitivity position based on contractual repricing arrangements or maturity, whichever is earlier, at **31 December 2002** was as follows:

	<i>US\$ '000</i>				<i>Total</i>
	<i>Less than three months</i>	<i>Three months to one year</i>	<i>Over one year</i>	<i>Not exposed to interest rate risk</i>	
<b>ASSETS</b>					
Cash and balances with central banks	2,660	-	-	49,690	52,350
Treasury bills	21,183	-	-	-	21,183
Trading securities	8,980	1,851	-	-	10,831
Deposits with banks and other financial institutions	830,188	6,117	10,252	15,797	862,354
Loans and advances	1,166,658	439,012	529,651	32,954	2,168,275
Non-trading investments	566,226	102,196	677,662	84,399	1,430,483
Investment in associates	-	-	-	438,205	438,205
Premises and equipment	-	-	-	47,323	47,323
Other assets and intangibles	-	-	-	104,892	104,892
<b>Total</b>	<b>2,595,895</b>	<b>549,176</b>	<b>1,217,565</b>	<b>773,260</b>	<b>5,135,896</b>
<b>LIABILITIES AND EQUITY</b>					
Due to banks and other financial institutions	1,247,725	139,526	7,000	1,363	1,395,614
Customers' deposits	1,908,883	192,742	107,123	140,235	2,348,983
Certificates of deposits	55,293	20,000	-	-	75,293
Floating rate notes and other term debt	203,083	30,000	-	-	233,083
Other liabilities	2,900	27,909	-	98,176	128,985
Subordinated liabilities	80,816	32,255	10,252	-	123,323
Equity	-	-	-	830,615	830,615
<b>Total</b>	<b>3,498,700</b>	<b>442,432</b>	<b>124,375</b>	<b>1,070,389</b>	<b>5,135,896</b>
On-balance sheet gap	(902,805)	106,744	1,093,190		
Off-balance sheet gap	133,492	595,591	(729,083)		
<b>Total interest rate sensitivity gap</b>	<b>(769,313)</b>	<b>702,335</b>	<b>364,107</b>		
Cumulative interest rate sensitivity gap	(769,313)	(66,978)	297,129		

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28 INTEREST RATE RISK (continued)

The Group's interest sensitivity position based on contractual repricing arrangements or maturity, whichever is earlier, at 31 December 2001 was as follows:

	<i>US\$ '000</i>				
	<i>Less than three months</i>	<i>Three months to one year</i>	<i>Over one year</i>	<i>Not exposed to interest rate risk</i>	<i>Total</i>
<b>ASSETS</b>					
Cash and balances with central banks	1,946	-	-	43,348	45,294
Treasury bills	34,531	-	-	-	34,531
Trading securities	-	-	-	355	355
Deposits with banks and other financial institutions	861,561	43,728	9,982	10,342	925,613
Loans and advances	1,203,337	445,235	201,873	32,254	1,882,699
Non-trading investments	433,080	40,797	383,618	75,054	932,549
Investment in associates	-	-	-	167,664	167,664
Premises and equipment	-	-	-	43,755	43,755
Other assets and intangibles	-	-	-	70,259	70,259
<b>Total</b>	<b>2,534,455</b>	<b>529,760</b>	<b>595,473</b>	<b>443,031</b>	<b>4,102,719</b>
<b>LIABILITIES AND EQUITY</b>					
Due to banks and other financial institutions	670,097	67,765	-	1,038	738,900
Customers' deposits	2,029,727	188,575	57,614	90,170	2,366,086
Certificates of deposits	40,205	-	-	-	40,205
Floating rate notes and other term debt	219,718	-	-	-	219,718
Other liabilities	-	-	-	85,273	85,273
Subordinated liabilities	78,253	-	9,982	-	88,235
Equity	-	-	-	564,302	564,302
<b>Total</b>	<b>3,038,000</b>	<b>256,340</b>	<b>67,596</b>	<b>740,783</b>	<b>4,102,719</b>
On-balance sheet gap	(503,545)	273,420	527,877		
Off-balance sheet gap	197,460	(119,636)	(77,824)		
<b>Total interest rate sensitivity gap</b>	<b>(306,085)</b>	<b>153,784</b>	<b>450,053</b>		
Cumulative interest rate sensitivity gap	(306,085)	(152,301)	297,752		

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.

Interest rate risk arises from the possibility that changes in interest rates will affect 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 Board measures and manages interest rate risk by establishing 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.

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**28 INTEREST RATE RISK (continued)**

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 range of effective interest rates for each of the monetary financial instruments is as follows:

	<b>2002</b> <i>% range</i>	<b>2001</b> <i>% range</i>
<i>Assets</i>		
Treasury bills	<b>1.61 - 2.06</b>	2.26 – 6.34
Deposits with banks and other financial institutions	<b>1.53 – 4.79</b>	1.78 – 6.18
Loans and advances <sup>(a)</sup>	<b>3.24 – 7.28</b>	4.78 – 9.42
Non-trading investments	<b>2.46 – 6.08</b>	4.80 – 7.82
<i>Liabilities</i>		
Due to banks and other financial institutions	<b>1.36 – 4.06</b>	2.48 – 6.03
Customers' deposits <sup>(b)</sup>	<b>1.61 – 3.90</b>	2.46 – 5.93
Floating rate notes and other term debt	<b>1.90 – 3.93</b>	2.47 – 5.00
Certificates of deposits	<b>2.00 – 4.03</b>	2.50 – 6.00
Subordinated liabilities	<b>3.19 – 5.25</b>	3.23 – 6.70

(a) The effective interest rate for loans and advances has been computed including impaired loans [Note 6].

(b) The effective interest rate for customers' deposits has been computed excluding non-interest bearing accounts.

**29 CURRENCY RISK**

The Group views United States dollars as its measurement currency and had the following significant net exposures denominated in foreign currencies as of 31 December:

	<b>2002</b> <i>US\$ '000</i> <i>long (short)</i>	<b>2001</b> <i>US\$ '000</i> <i>long (short)</i>
Great Britain Pound	<b>212,168</b>	169,564
Bahraini Dinar	<b>53,931</b>	(31,257)
Kuwaiti Dinar	<b>43,306</b>	152,843
Euro	<b>190,796</b>	80,841
Others	<b>11,269</b>	(8,620)

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.

**30 EQUITY PRICE RISK**

Equity price risk arises from fluctuations in equity prices. The Board has set limits on the amount and type of investments that may be accepted. This is monitored on an ongoing basis by the Group Investment Committee.

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**31 LIQUIDITY RISK**

Liquidity risk is the risk that an institution 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 Group Asset and Liability Committee (GALCO) monitors the maturity profile on an overall basis with ongoing liquidity monitoring by the Group treasury.

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

	<i>US\$ '000</i>			<i>Total</i>
	<i>Less than one month</i>	<i>One month to one year</i>	<i>Over one year</i>	
<b>ASSETS</b>				
Cash and balances with central banks	36,080	16,270	-	52,350
Treasury bills	7,956	13,227	-	21,183
Trading securities	-	2,037	8,794	10,831
Deposits with banks and other financial institutions	768,908	83,194	10,252	862,354
Loans and advances	192,347	295,298	1,680,630	2,168,275
Non-trading investments	-	142,548	1,287,935	1,430,483
Investment in associates	-	6,186	432,019	438,205
Premises and equipment	-	-	47,323	47,323
Other assets and intangibles	19,238	26,831	58,823	104,892
<b>Total</b>	<b>1,024,529</b>	<b>585,591</b>	<b>3,525,776</b>	<b>5,135,896</b>
<b>LIABILITIES AND EQUITY</b>				
Due to banks and other financial institutions	975,111	420,503	-	1,395,614
Customers' deposits	1,666,549	543,850	138,584	2,348,983
Certificates of deposits	-	75,293	-	75,293
Floating rate notes and other term debt	-	130,000	103,083	233,083
Other liabilities	21,975	54,128	52,882	128,985
Subordinated liabilities	-	-	123,323	123,323
Equity	-	-	830,615	830,615
<b>Total</b>	<b>2,663,635</b>	<b>1,223,774</b>	<b>1,248,487</b>	<b>5,135,896</b>

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**31 LIQUIDITY RISK (continued)**

The maturity profile of the assets and liabilities at 31 December 2001 is as follows:

	<i>US\$ '000</i>			<i>Total</i>
	<i>Less than one month</i>	<i>One month to one year</i>	<i>Over one year</i>	
<b>ASSETS</b>				
Cash and balances with central banks	35,918	9,376	-	45,294
Treasury bills	13,828	20,703	-	34,531
Trading securities	355	-	-	355
Deposits with banks and other financial institutions	819,813	95,818	9,982	925,613
Loans and advances	285,029	594,050	1,003,620	1,882,699
Non-trading investments	71,762	43,208	817,579	932,549
Investment in associates	-	-	167,664	167,664
Premises and equipment	-	-	43,755	43,755
Other assets and intangibles	6,038	38,797	25,424	70,259
<b>Total</b>	<u>1,232,743</u>	<u>801,952</u>	<u>2,068,024</u>	<u>4,102,719</u>
<b>LIABILITIES AND EQUITY</b>				
Due to banks and other financial institutions	372,736	366,164	-	738,900
Customers' deposits	1,661,956	646,504	57,626	2,366,086
Certificates of deposits	2,996	37,209	-	40,205
Floating rate notes and other term debt	-	119,860	99,858	219,718
Other liabilities	11,101	30,003	44,169	85,273
Subordinated liabilities	-	-	88,235	88,235
Equity	-	42,878	521,424	564,302
<b>Total</b>	<u>2,048,789</u>	<u>1,242,618</u>	<u>811,312</u>	<u>4,102,719</u>

The above reflects the contractual maturities of assets and liabilities that have been determined on the basis of the remaining period at the balance sheet date to the contractual maturity date and does not take account of the effective maturities as indicated by the Group's deposit retention history and the availability of liquid funds.

**32 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 their carrying values in the financial statements.

	<i>2002</i>			<i>2001</i>		
	<i>Carrying value US\$ '000</i>	<i>Fair value US\$ '000</i>	<i>Difference US\$ '000</i>	<i>Carrying value US\$ '000</i>	<i>Fair value US\$ '000</i>	<i>Difference US\$ '000</i>
Non-trading investments	1,430,483	1,422,933	(7,550)	932,549	928,258	(4,291)

Non-trading investments include unquoted equity investments at cost of US\$9,312 thousand (2001: US\$6,519 thousand) with a net carrying value of US\$7,530 thousand (2001: US\$4,811 thousand) after impairment provision of US\$1,782 thousand (2001: US\$1,708 thousand).

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**33 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:

	<i>2002</i> <i>US\$ '000</i>	<i>2001</i> <i>US\$ '000</i>
Capital base:		
Tier 1 capital	<b>806,610</b>	542,313
Tier 2 capital	<b>26,129</b>	9,803
- Eligible subordinated debts	<b>113,787</b>	85,665
	<u><b>946,526</b></u>	<u>637,781</u>
Less: Investments in/loans to funds and subsidiaries	<b>(4,005)</b>	(7,600)
Total capital base (a)	<u><b>942,521</b></u>	<u>630,181</u>
Risk weighted assets:		
Credit risk	<b>3,716,009</b>	2,878,716
Market risk	<b>130,490</b>	133,138
Total risk weighted assets (b)	<u><b>3,846,499</b></u>	<u>3,011,854</u>
Capital adequacy (a/b * 100)	<u><b>24%</b></u>	<u>21%</u>
Minimum requirement	<u><b>12%</b></u>	<u>12%</u>