



**Board of Directors' Report and financial statements (Unaudited)
For nine –month period ended 30th September 2012**

Registered office and principal place of business:

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Bank Al Markazi street
Post Box 1507,Ruwi
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Sultanate of Oman

BANKDHOFAR S.A.O.G

Board of Directors' Report and financial statements (Unaudited) for nine -month period ended 30 September 2012

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BANKDHO FAR S.A.O.G.

THE BOARD OF DIRECTORS' REPORT FOR THE NINE MONTH PERIOD ENDED 30th SEPTEMBER 2012

Dear Shareholders,

On behalf of the Board of Directors of BankDhofar S.A.O.G., I am pleased to present to you the Bank's Financial Statements for the period ended 30th September 2012.

The Bank's Financial Performance YTD September 2012:-

The Bank continued its progress through prudent policies during the year-to-date September 2012 with Customer Deposits growing by 17.65% to reach RO 1.60 billion and loans and advances to customers growing by 16.90% to reach RO 1.66 billion. Net interest income earned year-to-date September 2012 was RO 48.02 million showing a growth of 6.69%.

Net profit for the nine-month period ended 30th September 2012, reached RO 28.73 million as against RO 5.74 million achieved during nine-month period ended 30th September 2011. The lower 2011 profit is mainly due to RO 26.12 million charged off on account of the legal case filed by Oman International Bank now HSBC Bank Oman SAOG. We have since obtained Higher Courts judgment in our favour and are following up with the respective authorities to recover this money at the earliest.

Non-Interest income including fees and commissions, foreign exchange profit, investment and other income grew by 7.37% to RO 15.30 million during the nine-month period ended 30th September 2012 as compared to RO 14.25 million achieved during the corresponding period of last year. The above factors helped us grow the Operating Profit by 6.27% to RO 36.29 million for nine-month ended September 2012, from RO 34.15 million earned in the nine-month period ended last year September 2011. The earnings per share (EPS) at the end of September 2012 are RO 0.035 as compared to RO 0.007 at end September 2011.

The Bank is making good progress during the first year of its new 5-year plan, is committed to its goal of best in class customer service and employee development.

Islamic Banking:-

The Bank has made significant progress in its readiness to launch the Islamic Banking Window Operations, subject to Regulatory approval. In the shareholders Extra-Ordinary General Meeting held on 10th October 2012, Sharia Supervisory Board was appointed, subject to regulatory clearances. Implementation of the underlying specialized Islamic core banking platform is in its final stages of testing, and required user-training is completed. The bank is committed to its esteemed customers and has initiated all the necessary steps to offer high quality Islamic Banking Window services to its customers.

Acknowledgment:-

On behalf of the Board, I would like to thank our valuable customers for their patronage and confidence reposed in the Bank. I thank the shareholders for the continuous support and the Bank's staff and management for the good performance in the nine-month ended September 2012.

The Board of Directors also thanks the Central Bank of Oman and the Capital Market Authority for their valuable guidance to the local banking sector and the listed companies.

Finally, the Board of Directors and all staff of the Bank, would like to express our most sincere gratitude to His Majesty Sultan Qaboos Bin Said for his wise leadership and generous support to the private sector.

Eng. Abdul Hafidh Salim Rajab Al-Aujali
Chairman

Statement of financial position (Unaudited)
As at 30th September 2012

	Notes	September 2012 RO'000	September 2011 RO'000	Audited Dec 2011 RO'000
ASSETS				
Cash and balances with Central Bank of Oman	5	188,594	186,406	249,305
Loans and advances to banks	6	54,242	21,845	54,318
Loans and advances to customers	7	1,658,293	1,416,408	1,495,661
Available-for-sale investments	8	11,647	10,183	11,175
Held-to-maturity investments	9	144,715	95,428	106,256
Intangible asset	10	3,290	3,772	3,574
Property and equipment		9,418	8,850	8,505
Other assets		45,141	29,828	31,797
Total assets		2,115,340	1,772,720	1,960,591
LIABILITIES				
Due to banks	11	129,171	99,284	59,038
Deposits from customers	12	1,598,084	1,356,703	1,519,318
Other liabilities		85,917	57,660	64,498
Subordinated loan	13	50,000	38,500	88,500
Total liabilities		1,863,172	1,552,147	1,731,354
SHAREHOLDERS' EQUITY				
Share capital	14	110,012	91,524	91,524
Share premium		40,018	58,506	58,506
Legal reserve	15	21,877	20,479	21,877
Subordinated loans reserve	15	34,617	25,667	34,617
Investment revaluation reserve	15	1,235	202	627
Retained earnings		44,409	24,195	22,086
Total shareholders' equity		252,168	220,573	229,237
Total liabilities and shareholders' equity		2,115,340	1,772,720	1,960,591
Contingent liabilities and commitments	23	346,659	325,844	333,935
Net assets per share (Rials Omani)		0.229	0.241	0.250

The accompanying notes form an integral part of these financial statements.

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Statement of comprehensive income (Unaudited) for nine-month period ended 30 September 2012

		9 Months ended September 2012	9 Months ended September 2011	3 Months ended September 2012	3 Months ended September 2011
	Notes	RO'000	RO'000	RO'000	RO'000
Interest income		69,292	61,174	23,895	21,072
Interest expense		(21,270)	(16,163)	(7,313)	(5,546)
Net interest income	18	48,022	45,011	16,582	15,526
Fees and commission income		5,218	5,099	1,766	1,533
Fees and commission expenses		(614)	(542)	(261)	(193)
Net fees and commission income		4,604	4,557	1,505	1,340
Other income	19	10,691	9,692	2,183	4,093
Operating income		63,317	59,260	20,270	20,959
Staff and administrative costs		(24,796)	(23,005)	(8,395)	(8,016)
Depreciation		(2,231)	(2,107)	(786)	(696)
Operating expenses		(27,027)	(25,112)	(9,181)	(8,712)
Profit from operations		36,290	34,148	11,089	12,247
Provision for loan impairment	7&20	(5,512)	(4,770)	(1,329)	(2,147)
Recoveries from allowance for loan impairment	7&20	2,105	3,654	767	1,093
Bad debts written-off		(4)	(2)	(1)	(1)
Impairment of available-for-sale investments		(287)	(466)	-	(202)
Loss from Legal Case - note	26	-	(26,129)	-	-
Profit/ (Loss) from operations after provision		32,592	6,435	10,526	10,990
Income tax expense		(3,862)	(698)	(1,259)	(698)
Profit / (Loss) for the period		28,730	5,737	9,267	10,292
Profit / (Loss) for the period		28,730	5,737	9,267	10,292
Other comprehensive income:					
Net changes in fair value of available-for-sale investments	15	868	(1,372)	11	(494)
Reclassification adjustment on sale of available-for-sale investments	15	(547)	(589)	(61)	(140)
Total comprehensive income/ (Loss) for the period		29,051	3,776	9,217	9,658
Profit / (Loss) Earnings per share (basic and diluted) – annualized (Rials Omani)	16	0.035	0.007	0.033	0.038

The accompanying notes form an integral part of these financial statements

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Statement of changes in equity (Unaudited) For nine - month period ended 30 September 2012

	Notes	Share capital RO'000	Share premium RO'000	Legal reserve RO'000	Subordinated loans reserve RO'000	Investment revaluation reserve RO'000	Retained earnings RO'000	Total RO'000
1 January 2012		91,524	58,506	21,877	34,617	627	22,086	229,237
Total comprehensive income for the period								
Net profit for the period		-	-	-	-	-	28,730	28,730
Other comprehensive income for the period								
Net change in fair value of available-for-sale investments		-	-	-	-	868	-	868
- Transfer to statement of income on sale of available-for-sale investments	15	-	-	-	-	(547)	-	(547)
Impairment of available-for-sale investments	15	-	-	-	-	287	-	287
Total comprehensive income for the period		-	-	-	-	608	28,730	29,338
Transactions with owners recorded directly in equity								
Dividend paid for 2011		-	-	-	-	-	(6,407)	(6,407)
Bonus shares issued for 2011	14	18,488	(18,488)	-	-	-	-	-
30th September 2012		110,012	40,018	21,877	34,617	1,235	44,409	252,168

The accompanying notes form an integral part of these financial statements.

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Statement of changes in equity (Unaudited) for nine-month period ended 30 September 2012

	Notes	Share capital RO'000	Share premium RO'000	Legal reserve RO'000	Subordinated loan reserve RO'000	Investment revaluation reserve RO'000	Retained earnings RO'000	Total RO'000
1 January 2011		81,355	58,506	20,479	25,667	1,697	38,796	226,500
Total Comprehensive income for the period								
Loss for the period		-	-	-	-	-	5,737	5,737
Other comprehensive income for the period								
Net change in fair value of available-for-sale investments		-	-	-	-	(1,372)	-	(1,372)
Transfer to statement of income on sale of available-for-sale investments	15	-	-	-	-	(589)	-	(589)
Impairment of available-for-sale investments	15	-	-	-	-	466	-	466
Total comprehensive income for the period		-	-	-	-	(1,495)	5,737	4,242
Transactions with owners recorded directly in equity								
Dividend paid for 2010		-	-	-	-	-	(10,169)	(10,169)
Bonus shares issued for 2010	14	10,169	-	-	-	-	(10,169)	-
30 September 2011		91,524	58,506	20,479	25,667	202	24,195	220,573

The accompanying notes form an integral part of these financial statements.

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Statement of cash flows (Unaudited) for nine -month period ended 30 September 2012

	2012 RO'000	2011 RO'000
Cash flows from operating activities		
Interest and commission receipts	80,224	74,750
Interest payments	(19,332)	(15,467)
Cash payments to suppliers and employees	(19,588)	(44,067)
	<u>41,304</u>	<u>15,216</u>
(Increase) in operating assets	(224,476)	(144,048)
Increase in operating liabilities	147,494	119,581
Net cash (used in) / from operating activities	(35,678)	(9,251)
Income tax paid	(1,846)	(3,562)
Net cash (used in) / from operating activities	(37,524)	(12,813)
Net cash (used in) / investing activities	265	(420)
Net cash (used in) / financing activities	(44,907)	(10,169)
Net decrease / increase in cash and cash equivalents	(82,166)	(23,402)
Cash and cash equivalents at 1 st January	299,327	226,642
Cash and cash equivalents at 30 September	217,161	203,240
Cash and balances with Central Bank of Oman(Note 5)	188,594	186,406
Capital deposit with Central Bank of Oman	(500)	(500)
Loans and advances to banks due within 90 days	30,803	19,020
Due to banks within 90 days	(1,736)	(1,686)
Cash and cash equivalents for the purpose of the cash flow statement	217,161	203,240

The accompanying notes form an integral part of these financial statements.

**Notes to the financial statements (Unaudited)
for the nine- month period ended 30 September 2012****1. Legal status and principal activities**

BankDhofar SAOG (“the Bank”) is incorporated in the Sultanate of Oman as a public joint stock company and is principally engaged in corporate, retail and investment banking activities. The Bank has a primary listing on the Muscat Securities Market (“MSM”) and its principal place of business is the Head Office, Capital Business District (“CBD”), Muscat, Sultanate of Oman.

2. Basis of Preparation**a) Statement of compliance**

These financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by International Accounting Standards Board (IASB), the requirements of the Commercial Companies Law of 1974, as amended and disclosure requirements of the Capital Market Authority.

b) Basis of measurement

The financial statements have been prepared on the historical cost basis except for derivative financial instruments, financial instruments at fair value through profit and loss and available for sale financial assets which are measured at fair value.

c) Functional and presentation currency

Items included in the Bank’s financial statements are measured using Rials Omani which is the currency of the primary economic environment in which the Bank operates, rounded off to the nearest thousand.

d) Use of estimates and judgements

The preparation of financial statements in conformity with IFRS requires management to make judgements estimates and assumptions that effect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

Information about significant areas of uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements are described in note 4.

e) Accounting policies

The accounting policies set below have been consistently applied in dealing with items that are considered material in relation to the Bank’s financial statements to all the periods presented.

**Notes to the financial statements (Unaudited)
for the nine- month period ended 30 September 2012****3. Principal accounting policies****3.1. Foreign currency translations**

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the statement of comprehensive income. Translation differences on non-monetary items, such as equities held at fair value through profit or loss, are reported as part of the fair value gain or loss. Translation differences on non-monetary items, other than those held at cost, such as equities classified as available-for-sale financial assets, are included in the investment revaluation reserve in equity.

3.2. Financial instruments**3.2.1. Recognition**

The Bank recognises loans and advances, deposits, debt securities and subordinated liabilities on the date at which they originated. Regular way purchases and sales of financial assets are recognised on the trade date at which the Bank commits to purchase and sell of the asset. All other financial assets and liabilities (including assets and liabilities at fair value through profit or loss) are initially recognised on the trade date at which the Bank becomes a party to the contractual provisions of the instrument.

A financial asset or financial liability is measured initially at fair value, plus for an item not at fair value through profit or loss, transaction costs that are directly attributable to its acquisition or issue

3.2.2. Classification

The Bank classifies its financial assets in the following categories: financial assets at fair value through profit or loss; loans and receivables; held-to-maturity investments; and available-for-sale financial assets. Management determines the classification of its investments at initial recognition.

3.2.2.1. Financial assets at fair value through profit or loss

This category has two sub-categories: financial assets held for trading, and those designated at fair value through profit or loss at inception. A financial asset is held in this category if acquired principally for the purpose of short-term profit taking or if so designated by management. Derivatives are also categorised as held for trading unless they are designated as hedges instruments.

Financial assets and financial liabilities are designated at fair value through profit or loss when:

- Doing so significantly reduces measurements inconsistencies that would arise if the related derivatives were treated as held for trading and the underlying financial instruments were carried at amortised costs;

**Notes to the financial statements (Unaudited)
for the nine- month period ended 30 September 2012****3. Principal accounting policies****3.2. Financial instruments (continued)**

3.2.2.2. Classification (continued)

3.2.2.1. *Financial assets at fair value through profit or loss (continued)*

- Certain investments, that are managed and evaluated on a fair value basis in accordance with documented risk management or investments strategy and reported to key management personnel on that basis are designated at fair value through profit or loss; and
- Financial instruments, containing one or more embedded derivatives significantly modify the cash flows, are designated at fair value through profit or loss.

Gains and losses arising from changes in the fair value of derivatives that are managed in conjunction with designated financial assets or financial liabilities are included in the statement of comprehensive income.

3.2.2.2. *Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They can be originated or acquired by the bank with no intention of trading the receivable and comprise loans and advances to banks and customers other than bonds purchased at original issuance.

3.2.2.3. *Available-for-sale investments*

Available-for-sale investments are those intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices.

3.2.2.4. *Held-to-maturity investments*

Investments with fixed or determinable payments and fixed maturity dates that the Bank has the positive intention and ability to hold to maturity are classified as held-to-maturity investments. Held-to-maturity are recorded at amortised costs using the effective interest method less any impairment, with revenue recognised on an effective yield basis.

3.2.3. *Derecognition*

The Bank recognises financial assets at fair value through profit or loss and available-for-sale assets on the trade date, the date it commits to purchase or sell the asset. From this date any gains and losses arising from changes in fair value of the assets are recognised. Loans and receivables, deposits and subordinated liabilities are recognised on the date they are originated.

Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Bank has transferred substantially all risks and rewards of ownership. A financial liability is derecognised when it is extinguished.

**Notes to the financial statements (Unaudited)
for the nine- month period ended 30 September 2012****3. Principal accounting policies (continued)****3.2. Financial instruments (continued)***3.2.4. Measurement*

Financial assets are measured initially at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss.

Subsequent to initial recognition all financial assets at fair value through profit or loss and all available-for-sale assets are measured at fair value, except equity instrument that does not have a quoted market price in an active market and whose fair value cannot be reliably measured is stated at cost, including transaction costs, less impairment losses.

All non-trading financial liabilities and loans and receivables are measured at amortised cost less impairment losses. Amortised cost is calculated on the effective interest rate method. Premiums and discounts, including initial transaction costs, are included in the carrying amount of the related instrument and amortised based on the effective interest rate of the instrument.

3.2.5. Fair value measurement principles

The fair values of quoted investments in active markets are based on current bid prices. If the market for a financial asset is not active (and for unlisted securities), the Bank establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, discounted cash flow analysis and other valuation techniques commonly used by market participants.

Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate is a market related rate at the statement of financial position date for an instrument with similar terms and conditions.

The fair value of derivatives that are not exchange-traded is estimated at the amount that the Bank would receive or pay to terminate the contract at the statement of financial position date taking into account current market conditions and the current credit worthiness of the counter-parties.

3.2.6. Gains and losses on subsequent measurement

Gains and losses arising from changes in the fair value of the financial assets at fair value through profit or loss category are included in the statement of comprehensive income in the period in which they arise. Gains and losses arising from changes in the fair value of available-for-sale financial assets are recognised directly in equity, until the financial asset is derecognised or impaired at which time the cumulative gain or loss previously recognised in equity is recognised in the statement of comprehensive income.

**Notes to the financial statements (Unaudited)
for the nine- month period ended 30 September 2012****3. Principal accounting policies (continued)****3.3. Cash and cash equivalents**

For the purpose of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, including: cash on hand, non-restricted cash deposited with the Central Bank of Oman, amounts due to / from other banks and eligible treasury bills and certificate of deposits.

3.4. Treasury bills and certificate of deposits

Treasury bills and certificates of deposit issued for a term longer than three months are classified as available-for-sale or held-to-maturity at the date of acquisition.

3.5. Offsetting

Financial assets and liabilities are offset and the net amount is reported in the statement of financial position when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis only permitted under IFRS's or for gains and losses arising from a group of similar transaction such as in the Banks trading activity.

3.6. Impairment of financial assets

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

- (i) significant financial difficulty of the issuer or obligor;
- (ii) a breach of contract, such as a default or delinquency in interest or principal payments;
- (iii) the Bank granting to the borrower, for economic or legal reasons relating to the borrower's financial difficulty, a concession that the lender would not otherwise consider;
- (iv) it becoming probable that the borrower will enter bankruptcy or other financial reorganisation;
- (v) the disappearance of an active market for that financial asset because of financial difficulties;
or
- (vi) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group, including:
 - adverse changes in the payment status of borrowers in the group; or
 - national or local economic conditions that correlate with defaults on the assets in the group.

**Notes to the financial statements (Unaudited)
for the nine- month period ended 30 September 2012****3. Principal accounting policies (continued)****3.6. *Impairment of financial assets (continued)***

The Bank first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss on loans and receivables carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the statement of comprehensive income. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. As a practical expedient, the Bank may measure impairment on the basis of an instrument's fair value using an observable market price.

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

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics (i.e. on the basis of the Bank's grading process that considers asset type, industry, geographical location, collateral type, past-due status and other relevant factors). Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the Bank and historical loss experience for assets with credit risk characteristics similar to those in the Group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently.

**Notes to the financial statements (Unaudited)
for the nine- month period ended 30 September 2012**

3. Principal accounting policies (continued)

3.6. Impairment of financial assets (continued)

Estimates of changes in future cash flows for groups of assets should reflect and be directionally consistent with changes in related observable data from period to period (for example, changes in unemployment rates, property prices, payment status, or other factors indicative of changes in the probability of losses in the group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Bank to reduce any differences between loss estimates and actual loss experience.

When a loan is known to be uncollectible, all the necessary legal procedures have been completed, and the final loss has been determined, the loan is written off against the related provision for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are included in the statement of comprehensive income.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the statement of comprehensive income.

The Bank assesses at each statement of financial position date whether there is objective evidence that a financial asset or a group of financial assets, other than investments at fair value through profit and loss, is impaired. In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the assets are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in the statement of comprehensive income. Impairment losses recognised in the statement of comprehensive income on equity instruments are not reversed through the statement of comprehensive income. If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through the statement of comprehensive income.

3.7. Property and equipment

Items of property and equipment are stated at cost less accumulated depreciation and impairment loss. Depreciation is calculated so as to write off the cost of property and equipment, other than freehold land and capital work-in-progress, by equal instalments over their estimated economic useful lives from the date the asset is brought into use, as follows :

	Years
Buildings	7 - 25
Furniture and fixtures	3 - 7
Motor vehicles	3 - 5
Computer equipment	4
Core Banking System	10

**Notes to the financial statements (Unaudited)
for the nine- month period ended 30 September 2012****3. Principal accounting policies (continued)****3.7. Property and equipment (continued)**

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each statement of financial position date. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and value in use.

Gains and losses on disposal of property and equipment are determined by reference to their carrying amount and are taken into account in determining operating profit. Repairs and renewals are charged to the statement of comprehensive income when the expense is incurred. Subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the item of property and equipment. All other expenditure is recognised in the statement of comprehensive income as an expense when incurred.

3.8. Intangible assets

Goodwill represents the excess of the cost of an acquisition over the fair value of the net identifiable assets acquired at the date of acquisition. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses.

3.9. Provisions

A provision is recognised in the statement of financial position when the Bank has a legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation and the amount has been reliably estimated. If the effect is material, provisions are determined by discounting the expected future cash flows at a rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

3.10. Dividends

Dividends are recognised as a liability in the year in which they are declared.

3.11. Interest income and expense

Interest income and expense are recognised in the statement of comprehensive income using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of the financial instrument (for example, prepayment options) but does not consider future credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

**Notes to the financial statements (Unaudited)
for the nine- month period ended 30 September 2012****3. Principal accounting policies (continued)****3.11. Interest income and expense (continued)**

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

3.12. Fees and commission income

Fees and commissions are generally recognised on an accrual basis when the service has been provided. Loan commitment fees for loans that are likely to be drawn down are deferred (together with related direct costs) and recognised as an adjustment to the effective interest rate on the loan. Loan syndication fees are recognised as revenue when the syndication has been completed and the Bank retained no part of the loan package for itself or retained a part at the same effective interest rate for the other participants. Commission and fees arising from negotiating, or participating in the negotiation of, a transaction for a third party – such as the arrangement of the acquisition of shares or other securities or the purchase or sale of businesses – are recognised on completion of the underlying transaction. Portfolio and other management advisory and service fees are recognised based on the applicable service contracts, usually on a time-apportionment basis. Asset management fees related to investment funds are recognised rateably over the period the service is provided. The same principle is applied for wealth management, financial planning and custody services that are continuously provided over an extended period of time.

3.13. Taxation

Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the statement of comprehensive income except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the statement of financial position date, and any adjustment to tax payable in respect of previous years.

Deferred income tax is provided in full, using the statement of financial position liability method, on temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes (the tax base). The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantially enacted at the statement of financial position date. The principal temporary differences arise from depreciation of property and equipment and provisions.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

**Notes to the financial statements (Unaudited)
for the nine- month period ended 30 September 2012****3. Principal accounting policies (continued)****3.14. *Employee benefits***

End of service benefits are accrued in accordance with the terms of employment of the Bank's employees at the statement of financial position date, having regard to the requirements of the Oman Labour Law. Employee entitlements to annual leave and leave passage are recognised when they accrue to employees and an accrual is made for the estimated liability arising as a result of services rendered by employees up to the statement of financial position date.

Contributions to a defined contribution retirement plan and occupational hazard insurance for Omani employees in accordance with the Omani Social Insurances Law of 1991 and its subsequent amendments are recognised as an expense in the statement of comprehensive income as incurred.

3.15. *Derivative financial instruments*

Derivatives are stated at fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and valuation techniques, including discounted cash flow models and options pricing models, as appropriate. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

The best evidence of the fair value of a derivative at initial recognition is the transaction price (i.e., the fair value of the consideration given or received) unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e. without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets. When such evidence exists, the Bank recognises profits on the day of the transaction.

The method of recognising the resulting fair value gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. Although the Bank enters into derivative instruments for hedging purposes, certain derivative instruments do not qualify for hedge accounting. Changes in the fair value of any derivative instrument that does not qualify for hedge accounting are recognised immediately in the statement of comprehensive income.

3.15.1 *Embedded derivatives*

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contracts and the host contracts are not measured at fair value with changes in fair value recognised in profit or loss.

**Notes to the financial statements (Unaudited)
for the nine- month period ended 30 September 2012****3. Principal accounting policies (continued)****3.15. Derivative financial instruments (continued)***3.15.2 Hedge accounting*

The Bank designates certain hedging instruments, which include derivatives, embedded derivatives and non-derivatives in respect of foreign currency risk, as either fair value hedges, cash flow hedges, or hedges of net investments in foreign operations. Hedges of foreign exchange risk on firm commitments are accounted for as cash flow hedges.

At the inception of the hedge relationship, the entity documents the relationship between the hedging instrument and the hedged item, along with its risk management objectives and its strategy for undertaking various hedge transactions. Furthermore, at the inception of the hedge and on an ongoing basis, the bank documents whether the hedging instrument that is used in a hedging relationship is highly effective in offsetting changes in fair values or cash flows of the hedged item.

3.15.3 Fair value hedges

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in profit or loss immediately, together with any changes in the fair value of the hedged item that are attributable to the hedged risk. The change in the fair value of the hedging instrument and the change in the hedged item attributable to the hedged risk are recognised in the line of the statement of comprehensive incomes relating to the hedged item.

Hedge accounting is discontinued when the Bank revokes the hedging relationship, the hedging instrument expires or is sold, terminated, or exercised, or no longer qualifies for hedge accounting. The adjustment to the carrying amount of the hedged item arising from the hedged risk is amortised to profit or loss from that date.

3.15.4 Cash flow hedges

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are deferred in equity. The gain or loss relating to the ineffective portion is recognised immediately in profit or loss, and is included in the “other gains and losses” line of the statement of comprehensive income.

Amounts deferred in equity are recycled in profit or loss in the periods when the hedged item is recognised in profit or loss, in the same line of the statement of comprehensive income as the recognised hedged item. However, when the forecast transaction that is hedged results in the recognition of a non-financial asset or a non-financial liability, the gains and losses previously deferred in equity are transferred from equity and included in the initial measurement of the cost of the asset or liability.

**Notes to the financial statements (Unaudited)
for the nine- month period ended 30 September 2012****3. Principal accounting policies (continued)****3.15. Derivative financial instruments (continued)***3.15.4 Cash flow hedges (continued)*

Hedge accounting is discontinued when the Bank revokes the hedging relationship, the hedging instrument expires or is sold, terminated, or exercised, or no longer qualifies for hedge accounting. Any cumulative gain or loss deferred in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in profit or loss. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was deferred in equity is recognised immediately in profit or loss.

3.16. Sale and repurchase agreements

Securities sold subject to repurchase agreements (repos) are reclassified in the financial statements as pledged assets when the transferee has the right by contract or custom to sell or repledge the collateral; the counterparty liability is included in amounts due to other banks, deposits from banks, other deposits or deposits due to customers, as appropriate. Securities purchased under agreements to resell (reverse repos) are recorded as loans and advances to other banks or customers, as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method. Securities lent to counterparties are also retained in the financial statements.

Securities borrowed are not recognised in the financial statements, unless these are sold to third parties, in which case the purchase and sale are recorded with the gain or loss included in trading income.

3.17. Borrowings

Borrowings are recognised initially at fair value, being their issue proceeds (fair value of consideration received) net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between proceeds net of transaction costs and the redemption value is recognised in the statement of comprehensive income over the period of the borrowings using the effective interest method.

3.18. Segment reporting

A segment is a distinguishable component of the Bank that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments. The Bank currently operates only in the Sultanate of Oman. The Bank's primary format for reporting segmental information is business segments, based upon management and internal reporting structure. The Bank's main business segments are corporate and retail banking.

3.19. Fiduciary assets

Assets held in trust or in a fiduciary capacity are not treated as assets of the Bank in the statement of financial position.

**Notes to the financial statements (Unaudited)
for the nine- month period ended 30 September 2012****3. Principal accounting policies (continued)****3.20. Trade and settlement date accounting**

All “regular way” purchases and sales of financial assets are recognised on the trade date, i.e. that date the Bank commits to purchase the assets. Regular way purchase 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.

3.21. Directors’ remuneration

Directors’ remuneration is calculated in accordance with the Commercial Companies Law of 1974.

4. Critical Accounting judgment and key sources of estimation uncertainty**(a) Classification of investments**

Management decides on acquisition of an investment whether it should be classified as held for trading, carried at fair value through profit or loss, available-for-sale or held-to-maturity investments.

Available-for-sale investments

Management follows the guidance set out in International Accounting Standard (IAS) 39 Financial Instruments: Recognition and Measurement on classifying non-derivative financial assets as available-for-sale. This classification requires management’s judgement based on its intentions to hold such investments.

Held-to-maturity investments

The Bank follows the guidance of IAS 39 on classifying non-derivative financial assets with fixed or determinable payments and fixed maturity as held-to-maturity. This classification requires significant judgements. In making this judgement, the Bank evaluates its intention and ability to hold such investments to maturity. If the Bank fails to keep these investments to maturity other than for the specific circumstances-for example, selling an insignificant amount close to maturity – it will be required to classify the entire class as available-for-sale. The investments would, therefore, be measured at fair value.

(b) Fair value estimation

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

Where discounted cash flow techniques are used, estimated future cash flows are based on management’s best estimates and the discount rate is a market-related rate for a similar instrument at the statement of financial position date.

**Notes to the financial statements (Unaudited)
for the nine- month period ended 30 September 2012****4. Critical Accounting judgment and key sources of estimation uncertainty
(continued)****(c) Impairment***Impairment losses on loans and advances*

The Bank reviews its loan portfolio to assess impairment at least on a quarterly basis. In determining whether an impairment loss should be recorded in the statement of comprehensive income, management makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans and advances before the decrease can be identified with an individual receivable in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Impairment of goodwill

Determining whether goodwill is impaired requires an estimation of the value in use of the cash-generating units to which goodwill has been allocated. The value in use calculation requires the Bank to estimate the future cash flows expected to arise from the cash-generating unit and a suitable discount rate in order to calculate present value.

Impairment of available-for-sale investment

The Bank determines that available-for-sale investments are impaired when there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgement. In making this judgement, management evaluates among other factors, the normal volatility in share price. In addition, impairment may be appropriate when there is evidence of deterioration in the financial health of the investee, industry and sector performance, changes in technology and operational and financing cash flows.

(d) Useful life of property and equipment

Depreciation is charged so as to write off the cost of assets over their estimated useful lives. The calculation of useful lives is based on management's assessment of various factors such as the operating cycles, the maintenance programs, and normal wear and tear using its best estimates

**Notes to the financial statements (Unaudited)
for the nine- month period ended 30 September 2012**

5. Cash and Bank balances

	2012	2011
	RO'000	RO'000
Cash on hand	20,053	11,747
Balances with the Central Bank of Oman	38,541	14,659
Certificate of deposits with maturity of 90 days or less	130,000	160,000
	<hr/> 188,594 <hr/>	<hr/> 186,406 <hr/>

At 30 September 2012, cash and balances with Central bank of Oman included balances with the Central Bank of Oman amounting to RO 500,000 (2011 - RO 500,000) as minimum reserve requirements. These funds are not available for the Bank's daily business.

Outstanding certificate of deposits as of 30 September 2012 were issued by the Central Bank of Oman and carried an average interest rate of 0.09%.

6. Loans and advances to banks

	2012	2011
	RO'000	RO'000
Placements with other banks	42,929	17,120
Current clearing accounts	11,313	4,725
	<hr/> 54,242 <hr/>	<hr/> 21,845 <hr/>

At 30 September 2012, two banks placements represented 20% or more of the Bank's placements (2011 - one).

**Notes to the financial statements (Unaudited)
for the nine- month period ended 30 September 2012**

7. Loans and advances to customers

	2012	2011
	RO'000	RO'000
Overdrafts	123,470	114,480
Loans	1,501,528	1,273,005
Loans against trust receipts	87,585	85,141
Bills discounted	4,643	2,359
Advance against credit cards	7,698	7,936
Others	17,924	8,778
	<hr/>	<hr/>
Gross loans and advances	1,742,848	1,491,699
Less: Impairment allowance	(84,555)	(75,291)
	<hr/>	<hr/>
Net loans and advances	1,658,293	1,416,408
	<hr/> <hr/>	<hr/> <hr/>

As per the CBO requirements, the movements in the impairment allowance is analysed below:

(a) Allowance for loan impairment

1 January	47,548	45,532
Allowance made during the period	5,512	4,770
Released to the statement of comprehensive income during the period	(2,105)	(3,654)
Written off during the period	(140)	(43)
	<hr/>	<hr/>
30 September	50,815	46,605

(b) Reserved interest

1 January	30,006	26,168
Reserved during the period	4,766	4,779
Released to the statement of comprehensive income during the period	(705)	(840)
Written-off during the period	(327)	(1,421)
	<hr/>	<hr/>
30 September	33,740	28,686

Total impairment allowance

84,555	75,291
<hr/> <hr/>	<hr/> <hr/>

As a matter of policy, the Bank considers waiver / write-off or settlement only in such cases where the Bank is satisfied that the recovery of the full outstanding liabilities from the borrower is not possible in the normal course of business or out of the securities realisation or through enforcement of the guarantee (wherever available) and that legal action will not yield higher recoveries after considering the time and costs involved.

Proposals for waivers/write-off are not formula driven and are decided on case by case basis after weighing all pros and cons. The rationale is invariably documented. In all cases, the Bank aims to recover the maximum value through enforcement of collaterals/guarantees of guarantors, etc.

**Notes to the financial statements (Unaudited)
for the nine- month period ended 30 September 2012**

7. Loans and advances to customers (continued)

Interest is reserved by the Bank against loans and advances which are impaired, to comply with the rules, regulations and guidelines issued by the Central Bank of Oman.

Under the Central Bank of Oman's guidelines for provision against classified loans and advances, at 30 September 2012, out of the total provisions of **RO 84,555,000** (2011 RO 75,291,000) a collective provision was made on a general portfolio basis amounting to **RO 23,844,000** (2011 RO 20,611,000).

At 30 September 2012, impaired loans and advances on which interest has been reserved amount to **RO 64,342,957** (2011 - **RO 61,302,440**) and loans and advances on which interest is not being accrued amount to **RO 1,546,801** (2011 - to RO 1,434,630).

8. Available-for-sale investments

	2012	2011
	RO'000	RO'000
Equity instruments		
- Quoted	8,751	7,167
- Unquoted	2,896	3,016
	<hr/> 11,647 <hr/>	<hr/> 10,183 <hr/>
	Cost	Fair value
	RO'000	2012
		2011
		RO'000
Quoted on the Muscat Securities Market		
Banking and investments	1,357	1,423
Services	3,683	4,030
Industrial	2,933	3,298
	<hr/> 7,973 <hr/>	<hr/> 7,167 <hr/>
Unquoted		
Omani companies	2,439	2,896
	<hr/> 10,412 <hr/>	<hr/> 3,016 <hr/>
	<hr/> 11,647 <hr/>	<hr/> 10,183 <hr/>

**Notes to the financial statements (Unaudited)
for the nine- month period ended 30 September 2012**

9. Held-to-maturity investments

	2012 RO'000	2011 RO'000
Treasury bills with maturity of above 90 days	79,764	33,064
Government Development Bonds	64,951	62,364
	<u>144,715</u>	<u>95,428</u>

10. Intangible asset

	2012 RO'000	2011 RO'000
The movement in the goodwill account is as follows:		
1st January	3,574	3,971
Impaired during the period	(284)	(199)
30 September 2012	<u>3,290</u>	<u>3,772</u>

Intangible asset represents goodwill which resulted from the acquisition of branches of the Commercial Bank of Oman in the year 2001 and merger with Majan International Bank in the year 2003. Goodwill is tested for impairment each year.

11. Due to banks

	2012 RO'000	2011 RO'000
Other borrowings	127,435	97,598
Payable on demand	1,736	1,686
	<u>129,171</u>	<u>99,284</u>

In 2011, the Bank successfully availed fresh bilateral loans amounting to USD 75 million at LIBOR plus a margin from various regional banks which are currently outstanding. In 2012, the bank successfully repaid USD 40 million bilateral loans. However, in 2012, the bank did not raise any new medium to long term facility in foreign currency.

At 30 September 2012, no borrowing with banks individually represented 20% or more of the Bank's borrowings. The Bank has not had any defaults of principal, interest or other breaches during of the period on its borrowed funds (2011 - Nil).

**Notes to the financial statements (Unaudited)
for the nine- month period ended 30 September 2012**

12. Deposits from customers

	2012 RO'000	2011 RO'000
Current accounts	362,956	302,293
Savings accounts	261,635	235,357
Time deposits/Certificate of deposits	969,816	815,664
Margin accounts	3,677	3,389
	<u>1,598,084</u>	<u>1,356,703</u>

Current accounts and time deposits include deposits from the Government of the Sultanate of Oman and its entities amounting to **RO 566,548,000** (2011 - RO 376,795,000).

13. Subordinated loans

	2012 RO'000	2011 RO'000
Subordinated loan - US Dollar	-	38,500
Subordinated loan - RO	50,000	-
	<u>50,000</u>	<u>38,500</u>

In August 2007, the Bank availed an unsecured subordinated loan of US \$ 100 million with a tenor of 5 years and one month. The rate of interest was linked to 3 month LIBOR plus margin, payable quarterly, while principal was payable in lump sum at maturity. In September 2012, the bank successfully repaid the subordinated loan of US \$ 100 million raised in 2007.

In November 2011, the Bank availed RO 50 million unsecured subordinated loan from the major shareholders for a tenor of 5 years and one month. This facility carries a fixed rate of interest payable half yearly, with principal being repaid on maturity.

**Notes to the financial statements (Unaudited)
for the nine- month period ended 30 September 2012**

14. Share capital

The authorised share capital consists of 1,000,000,000 shares of par value RO 0.100 each (2011 - 1,000,000,000 shares of par value RO 0.100 each).

On 28 March 2012 the Shareholders of the Bank in the annual general meeting approved the issuance of 20.20% bonus shares amounting to 184,878,143 shares of par value RO 0.100 each.

At 30 September 2012, the issued and paid up share capital comprise 1,100,116,474 shares of par value RO 0.100 each. (2011 – 915,238,331 shares of par value RO 0.100 each).

Shareholders

The following shareholders of the Bank own 10% or more of the Bank's share capital:

	2012		2011	
	No of shares	%	No of shares	%
Dhofar International Development and Investment Company SAOG	305,402,129	27.76	251,697,133	27.50
Eng. Abdul Hafidh Salim Rajab	229,249,889	20.84	188,348,491	20.58
Al Aujaili and his related Companies	111,462,828	10.13	91,523,811	10.00
Civil Service Employees' Pension Fund				
Total	646,114,846	58.73	531,569,435	58.08
Others	454,001,628	41.27	383,668,896	41.92
	1,100,116,474	100.00	915,238,331	100.00

15. Reserves

(a) Legal reserve

In accordance with Article 106 of the Commercial Companies Law of 1974, annual appropriations of 10% of profit are made to the legal reserve until the accumulated balance of the reserve is equal to one-third of the Bank's paid up share capital. This reserve is not available for distribution.

(b) Subordinated loan reserves

Consistent with the Bank for International Settlement ("BIS") Guidelines on capital adequacy, the Bank transfers an amount equivalent to 20% of the value of the subordinated loan each year to the subordinated loan reserve until the maturity of the loan. The amount of the reserve will be transferred to retained earnings through the statement of changes in equity upon settlement of the subordinated loan.

**Notes to the financial statements (Unaudited)
for the nine- month period ended 30 September 2012**

15. Reserves (continued)

(c) Investment revaluation reserve

The movements in the investments revaluation reserve is analysed below:

	2012	2011
	RO'000	RO'000
1 January	627	1,697
Increase/(decrease) in fair value	868	(1,372)
Impairment of available for sale investment taken to statement of comprehensive income	287	466
Net transfer to statement of comprehensive income on sale of available-for-sale investment	(547)	(589)
	<u>1,235</u>	<u>202</u>
30 September	<u>1,235</u>	<u>202</u>

16. Earnings per share (basic and diluted)

The calculation of basic and diluted earnings per share is based on profit for the nine months period ended 30 September as follows:

	2012	2011
Net Profit for the period (RO)	28,730,000	5,737,000
Weighted average number of shares outstanding during of the period	1,100,116,474	1,100,116,474
Earnings per share basic and diluted - annualized	0.035	0.007

Earnings per share (basic and diluted) has been derived by dividing the profit for the period attributable to the shareholders by the weighted average number of shares outstanding. As there are no dilutive potential shares, the diluted earnings per share is identical to the basic earnings per share.

For the purpose of earning per share calculation, the Bank has restated the previous year weighted average number of shares outstanding to include the 20.20% bonus Shares (184,878,143 shares with RO 0.100 par each) issued in the first quarter of 2012.

**Notes to the financial statements (Unaudited)
for the nine- month period ended 30 September 2012**

17. Capital adequacy

The ratio of equity to risk weighted assets, as formulated by the Basel II, for nine - months period ended 30 September 2012 is 13.91% (2011 – 12.57%).

Capital structure	2012	2011
	RO'000	RO'000
TIER I CAPITAL		
Paid up capital	110,012	91,524
Legal reserve	21,877	20,479
Share premium	40,018	58,506
Subordinated bonds and loans reserve	34,617	25,667
Retained earnings	15,679	18,458
Deferred tax assets	-	-
Less: goodwill	(3,290)	(3,772)
Less: negative investment revaluation reserve	(184)	(675)
Total Tier I capital	218,729	210,187
TIER II CAPITAL		
Investment revaluation reserve	639	395
General provision	23,844	20,611
Subordinated loan	48,750	-
Total Tier II capital	73,233	21,006
Total eligible capital	291,962	231,193
Risk weighted assets		
Banking book	1,935,147	1,676,359
Trading book	20,737	37,340
Operational risk	142,830	126,210
Total	2,098,714	1,839,909
Tier I capital	218,729	210,187
Tier II capital	73,233	21,006
Tier III capital	-	-
Total regulatory capital	291,962	231,193
Tier I capital ratio	10.42%	11.42%
Total capital ratio	13.91%	12.57%

**Notes to the financial statements (Unaudited)
for the nine- month period ended 30 September 2012**

18. Net interest income

	2012	2011
	RO'000	RO'000
Loans and advances to customers	68,930	61,021
Debt investments	147	97
Money market placements	207	46
Others	8	10
Total interest income	69,292	61,174
Deposits from customers	(19,950)	(14,666)
Money market deposits	(1,320)	(1,497)
Total interest expense	(21,270)	(16,163)
Net interest income	48,022	45,011

19. Other income

	2012	2011
	RO'000	RO'000
Foreign exchange	896	903
Investment income (a)	2,230	2,225
Miscellaneous income	7,565	6,564
	10,691	9,692

(a) Investment income

	2012	2011
	RO'000	RO'000
Investment income		
Dividend income- available-for-sale investments	375	584
Gain of disposal of available-for-sale investments	604	599
Interest income on Government Development Bonds (HTM)	1,251	1,042
	2,230	2,225

20. Impairment of financial assets

	2012	2011
	RO'000	RO'000
Impairment of available-for-sale investments	287	466
Provision for loan impairment	5,512	4,770
Loans written-off	4	2
	5,803	5,238
Recoveries from provision for loan impairment	(2,105)	(3,654)
Net impairment change of financial assets	3,698	1,584

**Notes to the financial statements (Unaudited)
for the nine- month period ended 30 September 2012**

21. Related parties transactions

In the ordinary course of business, the Bank conducts transactions with certain of its Directors, shareholders and companies over which they are able to exert significant influence. The aggregate amounts of balances with such related parties are as follows:

	2012	2011
	RO'000	RO'000
Loans and advances		
Directors and shareholders holding less than 10% interest in the Bank	16,769	17,460
Directors and shareholders holding 10% or more interest in the Bank	24,400	22,408
	41,169	39,868
Subordinated Loans		
Directors and shareholders holding less than 10% interest in the Bank	23,000	-
Directors and shareholders holding 10% or more interest in the Bank	27,000	-
	50,000	-
Deposits and other accounts		
Directors and shareholders holding less than 10% interest in the Bank	112,897	107,224
Directors and shareholders holding 10% or more interest in the Bank	216,664	181,477
	329,561	288,701
Contingent liabilities and commitments		
Directors and shareholders holding less than 10% interest in the Bank	2,285	1,445
Directors and shareholders holding 10% or more interest in the Bank	16,051	11,750
	18,336	13,195
Remuneration paid to Directors		
Chairman		
– remuneration paid	15	16
– sitting fees paid	10	10
Other Directors		
– remuneration paid	101	113
– sitting fees paid	68	63
	194	202
Other transactions		
Rental payment to related parties	281	249
Other transactions	48	41

**Notes to the financial statements (Unaudited)
for the nine- month period ended 30 September 2012**

22. Senior member borrowing

Senior member

	2012	2011
	RO'000	RO'000
Total exposure:		
Direct	43,747	42,179
Indirect	18,336	13,195
	<u>62,083</u>	<u>55,374</u>
Number of members	<u>22</u>	<u>23</u>

23. Contingent liabilities and commitments

Letters of credit, guarantees and other commitments for which there are corresponding customer liabilities:

	2012	2011
	RO'000	RO'000
Letters of credit	71,019	81,485
Guarantees and performance bonds	128,859	109,850
Advance payment guarantees	75,446	81,399
Payment guarantees	70,292	52,344
Others	1,043	766
	<u>346,659</u>	<u>325,844</u>

24. Amount due to brokerage customers

The amount due to brokerage customers as at 30 September 2012 RO 2,906.
(2011: RO 7,741.)

**Notes to the financial statements (Unaudited)
for the nine- month period ended 30 September 2012**

25. Risk Management

(i) Liquidity risk

Maturity profile of assets and liabilities

	Due on demand and up to 30 days RO'000	More than 1 month to 6 months RO'000	More than 6 months to 12 months RO'000	More than 1 year to 5 years RO'000	Over 5 years RO'000	Total RO'000
30 September 2012						
Cash and balances with Central Bank of Oman	188,094	-	-	-	500	188,594
Loans and advances to banks	31,503	7,531	15,208	-	-	54,242
Loans and advances to customers	149,314	290,803	131,548	644,393	442,235	1,658,293
Available-for-sale Investments	-	-	11,647	-	-	11,647
Held-to-maturity investments	19,713	60,051	-	54,475	10,476	144,715
Intangible asset	-	-	-	-	3,290	3,290
Property and equipment	-	-	-	-	9,418	9,418
Other assets	8,043	32,839	4,227	32	-	45,141
Total assets	396,667	391,224	162,630	698,900	465,919	2,115,340
Due to banks	56,021	44,275	5,775	23,100	-	129,171
Deposits from customers	158,084	411,923	313,001	558,928	156,148	1,598,084
Other liabilities	14,314	38,364	10,357	20,417	2,465	85,917
Subordinated loan	-	-	-	50,000	-	50,000
Shareholders' equity	-	-	28,730	-	223,438	252,168
Total liabilities and shareholders' equity	228,419	494,562	357,863	652,445	382,051	2,115,340

**Notes to the financial statements (Unaudited)
for the nine- month period ended 30 September 2012**

25. Risk Management (continued)

(i) Liquidity risk (continued)

Maturity profile of assets and liabilities (continued)

	Due on demand and up to 30 days RO'000	More than 1 month to 6 months RO'000	More than 6 months to 12 months RO'000	More than 1 year to 5 years RO'000	Over 5 years RO'000	Total RO'000
30 September 2011						
Cash and balances with Central Bank of Oman	185,906	-	-	-	500	186,406
Loans and advances to banks	19,920	-	1,925	-	-	21,845
Loans and advances to customers	183,463	197,915	92,178	619,150	323,702	1,416,408
Available-for-sale Investments	16,635	16,430	15,591	46,772	-	95,428
Held-to-maturity investments	-	-	10,183	-	-	10,183
Intangible asset	-	-	-	-	3,772	3,772
Property and equipment	-	-	-	-	8,850	8,850
Other assets	2,753	23,703	-	-	3,372	29,828
Total assets	408,677	238,048	119,877	665,922	340,196	1,772,720
Due to banks	49,234	21,175	5,775	23,100	-	99,284
Deposits from customers	191,663	304,340	391,464	334,823	134,413	1,356,703
Other liabilities	11,068	25,327	2,322	16,913	2,030	57,660
Subordinated loan	-	-	38,500	-	-	38,500
Shareholders' equity	-	-	5,737	-	214,836	220,573
Total liabilities and shareholders' equity	251,965	350,842	443,798	374,836	351,279	1,772,720

**Notes to the financial statements (Unaudited)
for the nine- month period ended 30 September 2012**

25. Risk Management (continued)

(ii) Market risk

(a) Interest rate risk

Interest rate sensitivity gap

Sensitivity to interest rates arises from mismatches in the period to re pricing of assets and that of the corresponding liability. The Bank manages these mismatches by following policy guidelines and reduces risk by matching the re pricing of assets and liabilities.

	Due on demand and within 30 days RO'000	Due within 1 to 6 months RO'000	Due within 7 to 12 months RO'000	Due within 1 to 5 years RO'000	Due after 5 years RO'000	Non- interest bearing RO'000	Total RO'000
30 September 2012							
Cash and balances with Central Bank of Oman	160,000	-	-	-	500	28,094	188,594
Loans and advances to banks	31,503	7,531	15,208	-	-	-	54,242
Loans and advances to customers	149,314	290,803	131,548	644,393	442,235	-	1,658,293
Available-for-sale investments	-	-	-	-	-	11,647	11,647
Held-to-maturity investments	19,713	60,051	-	54,475	10,476	-	144,715
Intangible asset	-	-	-	-	-	3,290	3,290
Property and equipment	-	-	-	-	-	9,418	9,418
Other assets	-	-	-	-	-	45,141	45,141
Total assets	360,530	358,385	146,756	698,868	453,211	97,590	2,115,340
Due to banks	55,643	44,275	5,775	-	23,100	378	129,171
Deposits from customers	291,250	258,725	214,246	428,110	-	405,753	1,598,084
Other liabilities	-	-	-	-	-	85,917	85,917
Subordinated loan	-	-	-	50,000	-	-	50,000
Shareholders' equity	-	-	-	-	-	252,168	252,168
Total liabilities and shareholders' equity	346,893	303,000	220,021	478,110	23,100	744,216	2,115,340
On-balance sheet gap	13,637	55,385	(73,265)	220,758	430,111	(646,626)	
Cumulative interest sensitivity gap	13,637	69,022	(4,243)	216,515	646,626		

**Notes to the financial statements (Unaudited)
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25. Risk Management (continued)

(ii) Market risk (continued)

(a) Interest rate risk (continued)

Interest rate sensitivity gap (continued)

	Due on demand and within 30 days RO'000	Due within 1 to 6 months RO'000	Due within 7 to 12 months RO'000	Due within 1 to 5 years RO'000	Due after 5 years RO'000	Non- interest bearing RO'000	Total RO'000
30 September 2011							
Cash and balances with Central Bank of Oman	160,000	-	-	-	500	25,906	186,406
Loans and advances to banks	19,920	1,925	-	-	-	-	21,845
Loans and advances to customers	183,463	197,915	92,178	619,150	323,702	-	1,416,408
Available-for-sale investments	-	-	-	-	-	10,183	10,183
Held-to-maturity investments	16,635	16,430	15,591	46,772	-	-	95,428
Intangible asset	-	-	-	-	-	3,772	3,772
Property and equipment	-	-	-	-	-	8,850	8,850
Other assets	-	-	-	-	-	29,828	29,828
Total assets	380,018	216,270	107,769	665,922	324,202	78,539	1,772,720
Due to banks	48,577	50,050	-	-	-	657	99,284
Deposits from customers	291,581	175,002	307,469	217,145	-	365,506	1,356,703
Other liabilities	-	-	-	-	-	57,660	57,660
Subordinated loan	-	38,500	-	-	-	-	38,500
Shareholders' equity	-	-	5,737	-	-	214,836	220,573
Total liabilities and shareholders' equity	340,158	263,552	313,206	217,145	0	638,659	1,772,720
On-balance sheet gap	39,860	(47,282)	(205,437)	448,777	324,202	(560,120)	
Cumulative interest sensitivity gap	39,860	(7,422)	(212,859)	235,918	560,120		

(b) Foreign currency exposures

	2012 RO'000	2011 RO'000
Net assets denominated in US Dollars	50,846	61,470
Net assets denominated in other foreign currencies	944	837
	51,790	62,307

**Notes to the financial statements (Unaudited)
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25. Risk Management (continued)

(iii) Credit Risk

Customer concentrations

	Assets			Liabilities		
	Loans and advances to banks RO'000	Gross loans and advances RO'000	Investment Securities RO'000	Deposits from customers RO'000	Deposits from banks RO'000	Contingent liabilities RO'000
30 September 2012						
Personal	-	780,192	-	384,721	-	10,601
Corporate	54,242	821,969	91,411	646,815	129,171	331,324
Government	-	140,687	64,951	566,548	-	4,734
	54,242	1,742,848	156,362	1,598,084	129,171	346,659
30 September 2011						
Personal	-	665,208	-	360,300	-	231
Corporate	21,845	711,409	43,247	619,608	99,284	323,840
Government	-	115,082	62,364	376,795	-	1,773
	21,845	1,491,699	105,611	1,356,703	99,284	325,844

26. The Current Status of legal Cases

A) The Legal Case (RO 26.1M)

In connection with the lawsuit which was filed by Oman International Bank (OIB) (currently HSBC Bank Oman) against Mr. Ali Redha al Lawati, Ali Redha Trading Co., Mutrah Holding LLC and Bank Dhofar, the Enforcement Court on 25th June 2011 imposed an attachment of RO 26.1 million and ordered the same to be transferred from Bank Dhofar's account held with CBO to the Court account. The dispute, inter alia, involves 1.925 million shares of BankDhofar claimed to be held by Ali Redha Trading Co. and pledged to OIB (currently HSBC Bank Oman). BankDhofar filed a grievance to the Primary Court against the attachment of the RO 26.1 million. The Court on 24th July 2011 ruled in favour of BankDhofar and considered the attachment as Null and Void. This judgment was appealed by OIB (currently HSBC Bank Oman), Ali Redha and Ali Redha Group Companies. The Appeal Court on 12th March 2012 rejected the appeal and upheld the primary judgment. BankDhofar is taking all necessary legal action to get the RO 26.1 million back. It is noteworthy to mention that the disputed shares were basically held in Majan International Bank (MIB) and the case primarily filed against MIB in 2001. The relationship of BankDhofar to this case was established in 2003 wherein MIB had been merged with Bank Dhofar.

B) Other Legal Cases:

i) Ali Redha and Ali Redha Trading Co. in 2006 filed a lawsuit against the Bank claiming compensation for alleged reputational damages incurred to them as a result of BankDhofar filing

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unjustified claims against Ali Redha and the Company. On 12th April 2008 the Primary Court ordered BankDhofar to pay RO 5 million as compensation to the Claimants. BankDhofar appealed the judgment and the Appeal Court on 15th February 2010 revoked the primary judgment and dismissed the case. Subsequently, the Claimants submitted a Cassation to the Supreme Court against the decision which had been passed by the Appeal Court. The case is still under review by the Supreme Court.

It may also be noted that BankDhofar in another three different lawsuits filed by the Bank against the Claimants, has received final judgments in its favour ordering Ali Redha Al-Lawati and his companies (Ali Redha Trading and Muttrah Holding) to pay off the dues amounting to RO 11.9 million to Bank Dhofar.

ii) Another Claimant; Assage Addahabi Trading Co. LLC, in 2007 filed a lawsuit against the Bank claiming compensation amounting to RO 1,037,550 - for commercial and moral damages. A judgment was issued obliging BankDhofar to pay the Claimant RO 400,000 - This judgment was challenged by the Bank up to the Supreme Court. On 23rd May 2012 the Supreme Court revoked the Court of Appeal confirmation of the primary judgment. Further, the Supreme Court directed the Court of Appeal to review the primary judgment, and the same is pending review by the Court of Appeal.

It should be noted that in 2004 BankDhofar received in its favour a final judgment obliging the same Claimant to pay to the Bank an amount of RO 381,203 - in addition to 10.5% interest counts up to the date of final payment.