

***2007***

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***Financial***

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***Report***

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With the onset of a significantly changed regulatory environment, the adoption of enhanced global compliance frameworks particularly for the prevention of anti-money laundering, and the need to restructure the Bank for another period of sustainable growth, the Board endorsed management's recommendation to implement an extensive strategic infrastructure development program. This program included IT hardware and software, implementation of a new retail banking front-end system, restructuring the Bank to better position for future growth and reviewing our strategy with a view to diversifying our business. I am pleased to advise that this program was completed in 2007 with the launch of our new internet banking system to incorporate business banking, in the first half of the year, and completion of our BASEL II implementation in the latter part of 2007.

One of our key objectives was to ensure that our leadership team was inspired, motivated, and committed, with a 'One Team Can Do' attitude. To that extent, I am very pleased to advise that we have managed to recruit some of the most talented people in the industry to help position the Bank for growth and continue our track record as one of the most successful overseas owned banks operating in Australia. We also have an agile and responsive, cost conscious operation, with a family orientated culture based on strong Core Values.

The shareholder, Arab Bank plc, which is the largest bank from the Middle East, has demonstrated commitment to Australia and this is reflected by the fact that all profits to date have been retained in the Australian operation. Additional support has also been provided by the parent bank in the implementation of IT systems, governance frameworks, compliance and anti-money laundering systems in the Australian operation, which are of the highest world standard.

In 2007 Arab Bank Australia completed its transformation into a mature and sustainable financial institution thanks to the hard work and commitment of our Staff, our Board and the support of our Shareholder.

Our products and service range has increased substantially from those of a few years ago and this will continue to grow and improve with the launch of the new Business Divisions and improved products specifically tailored to our customer needs, which in turn will allow us to cross sell to our existing customers and entice potential customers to bank with us.

In 2007 we began investigating strategically increasing our market share to reach beyond our traditional Arabic customer base, with the value add proposition "we understand your business" and to take full advantage of our wider and better range of distribution channels with particular focus on our new and improved Internet Banking and on our Mobile Lending Managers.

Customer service as always will be at the centre of our focus and a sales and service culture which we have established and are continuing to enhance in 2007, will drive the business through a structured, measurable and accountable sales performance and rewards program. The aim of this being that our frontline staff not only will provide exceptional service but they will cross sell the Bank's range of products and services based on the needs of the customer at the counter.

The Bank's balance sheet is well positioned for growth particularly given the global credit and liquidity crunch. We have achieved a large percentage of retail customer deposits to fund our planned asset growth which is based on an existing high quality loan portfolio. In this regard we will continue to be vigilant and place strong focus on fully understanding the needs of new and existing borrowing customers so that we do not compromise credit quality for asset growth in any circumstance.

## Looking forward

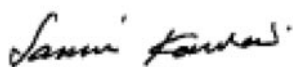
The Board and I are optimistic that with the successful implementation of the infrastructure and compliance projects, and with the restructuring and the recruitment of talented and committed employees, Arab Bank Australia is well positioned to embark on a new growth phase in its balance sheet and P&L footings. My confidence is founded on the strong belief that we have in Arab Bank Australia today, a strong team that understands that the ultimate sustainability to growth for any great company is its ability to attract and keep enough of the right people. To that extent I am confident that our management team will consistently apply rigorous discipline in formulating a “one team can do attitude” with a strong focus on customer intimacy throughout the Bank. We will focus on diversifying our revenue streams and on our market concentration.

Overall, I am confident that Arab Bank Australia has made significant progress in implementing very sound foundations for future growth and achievement of our long term business strategy. We are proud of our brand and the strong good will value that we have fostered in the community through the successful implementation of our customer focused strategy as reflected by our award winning products. In 2007, we have received a host of awards from various industry bodies, including Money magazine “Best of Best” awards and AFR Smart Investor Blue Ribbon awards, reflecting our commitment to delivering only the very best to our customers. We are committed to continued improvement in the Bank’s ability to develop a recognized brand in support of our balance sheet growth.

With the current global liquidity tightening in financial markets, I am pleased to report that Arab Bank Australia Limited has positioned itself very well to weather this issue. We are currently operating at the highest liquidity ratio for some years and our credit loan portfolio is well managed. We have maintained our impeccable record of zero material loan losses for the 13th consecutive year in Australia. Furthermore, the Bank’s capital continues to be at well in excess of our prudential requirements.

Our parent company Arab Bank plc is also well positioned in the current climate with a very strong liquidity and capital position. Our parent is the largest financial institution from the Arab world and has maintained strong profitability and growth during the past several years. Arab Bank plc has not called for any dividend repatriation to date from Arab Bank Australia, preferring to leave all our profits in Australia to be used to increase our capital and further invest in our growth. The strong support of our parent further enhances our strength in Australia as a local Bank.

Arab Bank Australia’s success could only have been possible through the effort of the Board of Directors, our shareholder, our staff and the continuous support of our loyal customers. I take this opportunity to thank them for their ongoing commitment and support.



Samir Kawar  
Chairman

2007 marked the completion of our major infrastructure review and implementation project, which in stages spanned over 3 years. The successful completion means that the Bank is well positioned for sustainable long term growth, with minimal cost increase thus significantly reducing our cost to income ratio, in 2008 and beyond. We are now able to focus our efforts on increasing banking product multiples to our existing customers and to target potential customers within the markets in which we operate.

With our infrastructure review and implementation project behind us we are able to provide even a greater focus on our staff and our customers. Our front line staff received extensive training in 2007 so that their confidence in cross selling the Bank's products and services was at an all time high and their attentiveness to customer service ensures that every customer experience is a positive one.

With the rise of increased competition in the marketplace, we knew that to continue to keep our customers satisfied and wanting to bank with us we needed to offer them more than just good rates and service, hence we developed and nurtured our value add proposition of "understanding your business". These are not mere words but are a result of strong marketing and analytical skills and knowledge of various industries, demonstrated by our Relationship Management team and our Senior Managers. The message which we put to the market and which was well received is that "We're ready to do business".

Strength in the marketplace is always a direct reflection of your internal strength and our greatest asset and strength is our people. Our leadership team is strongly aligned with their "One Team Can Do" attitude and the Arab Bank Australia staff have a strong culture built on dedicated work ethics and the Bank's core values. These values in summation are "treat others the way we would like to be treated". Together these ensure that all staff take genuine ownership of any task at hand and have a real interest in protecting the Bank's brand, its customers and the general community which they serve.

The Bank has an excellent balance sheet structure with strong liquidity and capital. Our parent, Arab Bank plc, support and guidance continues to be a differentiating factor in our long term strength and sustainability. We are very fortunate to have one of the most liquid banks in the world as our shareholder. The strength and brand of Arab Bank plc in the Middle East and North African market provides us with a competitive edge in being able to provide financial support and service to local Australian companies who trade with the Middle East region.

### **Financial Highlights**

Both fierce competition in the market place on interest margins and a slight decrease in lending and deposit volumes resulted in an 11% decline in the retail net interest margin. In addition, total operating costs increased by 7.3%, the primary cause of which was the investment in more experienced bankers recruited into the frontline.

The combined effect caused an increase to the cost to income ratio to 91%. However, management is confident that the cost to income ratio will reduce to a more respectable 81% by the end of 2008 through increased lending, deposit growth, and cost containment, and with the aim of matching the cost to income ratio to that of our peers over time.

### **Customer Intimacy & Relationship Banking**

Achieving true customer intimacy and delivering on our mission of being a relationship bank remained our top strategic priority for 2007.

Consistent with our commitment to these goals, we commenced a number of initiatives to improve our performance in this area. These initiatives included restructuring the retail branch network to introduce a new operating model designed to keep us close to our customers and better align our banking model with our customers' needs. We increased our footprint by increasing the number of business bankers and mobile managers.

In keeping with our commitment to improved customer convenience and accessibility, we responded to customer demand for more flexible opening hours, and extended our operating hours in priority locations to suit the preferred banking hours of our clients.

We have also begun to embed our sales and service culture with our branch network team, and have placed emphasis on both training and programs for our front line people to deepen their understanding of our customers' needs and business referral initiatives. To this extent, we are starting to see an improvement in both new business and customer service.

A customer contact program has also commenced, including a disciplined sales and marketing funnel plan, which has been designed to enhance our ongoing relationship with existing and potential customers, and enhance our business development opportunities.

Whilst we are yet to see these improvements reflected in formal customer satisfaction surveys (due to be conducted in 2008), we are beginning to see evidence of improvements in service levels through feedback from our customers and a substantial reduction in the level of customer complaints to a negligible level.

### **Enhanced Product & Service Offering**

In addition, and in response to our customers' feedback on areas where we can improve our services, we continued to review and refine our product portfolio, and introduced new and improved products to better meet the needs of our customers.

We embarked on a large scale replacement of our internet banking service, which was re-designed to suit our niche customer requirements. Improvements included, offering some of the most up to date technology, such as the provision of SMS banking for those of our customers regularly on the move, business banking services and security at industry best practice levels.

We were also pleased to provide our customers with a broadened product range to include the arrangement of insurance services, enhanced asset financing, additional foreign exchange products and tailored banking packages for our valued corporate customers and their employees. These new and improved products are not only designed to meet the needs of our customers, but we believe will also make us more competitive.

As further proof of our commitment to delivering excellence in our products and services, the Bank received a wide range of 1st place awards in 2007, including:

- Best 3 Year Fixed Home Loan - Money Magazine "Best of the Best" awards 2007
- Best 5 Year Fixed Investment Loan - Money Magazine "Best of the Best" awards 2007
- Best Business Deposit Account for our Premium Business Cheque Account - Money Magazine "Best of the Best" awards 2007
- Best Short Term Deposit - AFR Smart Investor Blue Ribbon awards 2007
- Best Long Term Deposit - AFR Smart Investor Blue Ribbon awards 2007

The improvements made to our retail product range were also evidenced by the awarding of '5 Star Ratings' by Cannex for the following products - Basic Home Loan, Revolving Line of Credit, 2 Year Fixed Loan (Investment), 3 Year Fixed (Investment), and 5 Year Fixed (both Owner Occupied and Investment) - a rating only awarded to a product in the top 5% of all products within that category, recognising we do in fact offer one of the best combinations of features and pricing to our customers.

### **A Robust Risk Management & Compliance Framework**

Over 2007, the Bank has continued to strengthen its risk management practices by completing the implementation of the Basel II regulatory requirements and building its operational risk framework.

Anti-Money Laundering and compliance management remained at the forefront of management's efforts focusing on building a best practice compliance program. This includes the implementation of a best-in-class transaction monitoring system that will assist us in effective monitoring of all banking transactions.

For a good part of the year, focus was placed on Business Continuity Management through testing the Bank's capability to resume its operations and crisis management. The results identified the Bank's ability to effectively manage a crisis and capabilities to successfully recover critical business operations.

The Bank's periodic Fraud and Ethics Survey conducted last year yielded significant improvements in virtually all areas reflecting effective management initiatives been made in the right direction in strengthening fraud control.

### **Credit Risk Management Challenges in 2007**

The 2007-year proved to be a significant challenge in maintaining credit quality and simultaneously growing the portfolio in an increasingly competitive and aggressive lending market.

Property prices have not yet recovered since the value peak of 2003, although we remain comfortable that our exposures are well covered due to our consistently conservative lending philosophy.

Taxi plate lending remained steady throughout the year. Growth however, was nominal due to pay-downs of existing debt. This has been true of the loan portfolio in general. Significant new lending was approved throughout the year, with solid conversion achieved. However new lending was counter balanced by large repayments, as our customers, who have typically remained very liquid in the current environment, continued to sell off assets and reduce their debts.

Default rates remained relatively low throughout 2007, however as interest rates continued on an upward trend, stress on the portfolio increased and a slight growth in arrears was noted.

In line with the Bank's broad strategic objectives, we continued with our unwavering commitment to "understand our customer, their business and the problems we believe we can best solve for them". Unlike most of our competitors, all credit staff become involved as early as possible in the credit proposal process and work hand in hand with the Relationship Managers in structuring loan transactions to suit the customer's needs. In fact, joint credit and front line staff visits to both existing and potential customers have improved our understanding of the client's business, operating cycle and associated risks for improved customer satisfaction and better credit and asset management. This has been further enhanced through the ongoing credit training for field staff, sponsored by the Credit area, and aimed at improving credit and financial analysis skills.

Credit Department was also restructured to better align its constituents and operations with our customer philosophy. This included the recruitment of experienced credit personnel and the formation of new positions, for the purpose of improving responsiveness to customer supporting staff and of course our customers. Most importantly, the relocation of credit resources to our flagship branch, Bankstown, was our most effective initiative in forging workforce and customer connectivity. This scheme yielded successes both in bringing to fruition our "one team can do" value through one on one coaching between the credit and front line team, and bringing us closer to our customers.

## **Capital & Treasury**

We have always placed great importance on our capital position and supporting Treasury operations, and this focus in 2007, more than ever, served to place us in perhaps one of the strongest liquidity and capital positions relative to our peers in the face of the financial market turmoil surrounding the US sub-prime fallout. We continue to remain well capitalised through the support and commitment of our parent and our focus on retail banking for the majority of our liability base. This has ensured that we continue to remain extremely well positioned throughout this very challenging operating environment.

Growth in our retail deposit base, again in the face of an aggressively competitive market for retail funding, has also allowed us to expand our liquidity holdings generating a much improved and stronger liquidity position.

For the first time in January 2007 we were assigned ratings from Standard & Poor's of A-/A2 and we are now rated by all three major international rating agencies with these ratings reflecting our close relationship with Arab Bank plc.

During May 2007 Moody's Investors Service published our rating results as part of the application of its refined joint default analysis (JDA) and updated bank financial strength rating (BFSR) methodologies for banks in Australia. The specific rating changes for us were positive, namely:

- BFSR was upgraded to D+ from D'
- Foreign Currency Deposit Ratings were upgraded to A3/Prime-1 from Baa1/Prime-2;
- Local Currency Deposit Ratings of A3/Prime-1 were assigned; and
- All ratings were assigned a stable outlook

In addition, in August 2007, Fitch Ratings upgraded our Short-Term Issuer Default Rating (IDR) to 'F1' from 'F2'. Fitch also affirmed our other ratings being: Long-Term IDR 'A-', Individual 'C/D' and Support '1'. The outlook for the Bank's Long-Term IDR was assigned as Stable.

Over the longer term, we will continue to concentrate on retail deposits for our liabilities and we are well positioned to further access the wholesale markets, as and when required.

Consequently, notwithstanding the credit squeeze caused by the sub-debt crisis in the United States and its contagion affect around the globe, our capital position remains untainted by the crisis; this is certainly an attribute we can be proud of.

## **Technology & Operations**

From a technology perspective, we have continued to progressively invest in improving systems and hardware, with the desktop replacement rollout yielding new process efficiencies in terms of response times and consequently improved customer service.

Significant work was also completed in readiness for Basle II such that from January 2008 reporting in terms of the Basle II requirements for the first reporting period (April 2008) will commence ahead of schedule. Process reviews to enhance operational efficiencies and ensuing customer service improvements were also assessed throughout 2007, with the benefits expected to be realised in 2008.

Significant work was completed in the area of Trade Finance and International Banking throughout 2007, including reinforcing the strength and global network of the Arab Bank Group, and the acquisition of a leading edge application, a renewed level of trade finance business development and enriched service levels to Australian companies dealing predominantly in the Middle East, North African and Asian markets.

Our Finance area has been under new leadership since early 2007, and has been an instigator in generating timely management information for both regulatory reporting and enhancing the business decision making process.

## **Our people are our greatest asset**

Our staff, represent the diversity that is Australia. This contributes to the unique banking experience offered by us, and our distinct ability to appreciate and be able to empathise with our unique customer base.

Our core values - Mutual Respect, Trust, Customer Service, Community and Empowerment - are demonstrated and encouraged in each of our daily activities and play an integral role in our recruitment and selection processes.

We recruit to enhance our value add proposition of continuing to understand our customers' needs. We achieve this by attracting and selecting highly motivated staff with a customer-centric focus, high level interpersonal skills, professionalism and an affinity with the communities that we serve.

For the development and growth of our workforce, we foster a strong learning and development culture across the organisation and we have recently implemented a renewed leadership and management development plan to identify, support and advance our future leaders. Our learning and development program will assist in building the commitment and capability of our workforce to meet our strategic intent.

### **Helping Individuals, Supporting Communities**

Being a good financial institution is not only about offering excellent products and superior service it is also about serving and supporting the families, businesses and individuals in the communities we serve.

Every year brings with it an opportunity to do more for the communities we serve. Our success has enabled us to make significant contributions, both physically and financially to charities, non-profit associations, community groups, sporting bodies, medical research and cultural programs. We are passionate about making a difference to the lives of all we serve, and remain committed to supporting the local and greater community in an ever-growing capacity.

### **In Conclusion**

We have worked to build a robust and advanced banking platform through which we can grow in the short to medium term. Our foundations are sound, and will assist us in maintaining the solid brand that we have developed over the past 14 years.

With the continued support of our customers, staff, shareholder and Board, for which we are most grateful, we will move forward with confidence and deliver on our mission, of being a relationship Bank offering superior service and excellence in selected products.



James Wakim  
Managing Director

# *Financials*

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Corporate Governance Statement

31 December 2007

This statement outlines the main Corporate Governance practices that were in place throughout the financial year.

**Corporate Governance**

The Board of Directors has adopted a Corporate Governance Framework, which includes the Board's Charter and the Corporate Governance Guidelines.

The Board Charter sets out the key governance principles adopted by the Board for the management of the Arab Bank Australia Limited ("the Company"), and its controlled entity, being the economic entity.

The Board recognises that corporate governance is fundamental to the effective operation of the economic entity. The principles set forth in the Board Charter are designed to reflect the full force and intent of the Australian Prudential Regulation Authority's Prudential Standard APS 510 Governance.

The Corporate Governance Guidelines reflect the key corporate governance principles as set out and adopted by the Board in the Board Charter. The Corporate Governance Guidelines have been adopted to collate the functions and operating principles under which the Board and its Board Committees operate.

The Corporate Governance Guidelines are intended to serve as a reference in focusing on and evaluating the corporate governance framework and procedures for compliance with the Australian Prudential Regulation Authority's Prudential Standard APS510 Governance. In so doing, the arrangements achieve sound corporate governance, and the generation of value for the shareholder.

**Role of the Board of Directors**

The Board of Directors is responsible to the shareholder, employees and customers for the corporate governance of the economic entity.

The role and responsibilities of the Board of Directors are set out in the Board Charter. The responsibilities include:

- Corporate Governance of the Bank, including the establishment and empowerment of Committees of the Board to assist in its functions;
- overseeing the business and affairs of the Bank by:
  - establishing, with management, the overall direction taking into account shareholder objectives, and approving the strategies and financial objectives set out in the annual budgets to be implemented by management;
  - approving major corporate initiatives;
  - approving capital expenditure in excess of limits delegated to management;
  - ensuring that an appropriate level of capital is maintained commensurate with the level and extent of risks to which the Bank is exposed from its activities;
- overseeing the establishment of systems of risk management by approving accounting policies, financial statements and reports, credit policies and standards, risk management policies and procedures and operational risk policies;
- monitoring the performance of management directly, and through its Committees; and
- carrying out the functions specifically reserved to the Board and its Committees under the policies of the Board and consistent with the charters of those Committees.

**Role of the Board of Directors (continued)**

- approval of documents (including reports and statements to the shareholder) required by the Bank's Constitution, the Corporations Act 2001 and other applicable laws and regulations;
- all aspects of the appointment of the Managing Director, including nomination to the shareholder; and
- approval of the Bank's major human resource policies and overseeing the development strategies for senior and high performing executives including succession planning for the Managing Director and the Chief Managers.

The Board retains the right to alter the matters reserved for its decision.

Beyond the roles and responsibilities of the Board noted above, the Board delegates to the Managing Director authority for the day-to-day management of the Bank.

In carrying out its role, the Board will operate in a manner reflecting the Bank's values and Codes of Conduct, and in accordance with the Board Charter, the Corporate Governance Guidelines, the Bank's Constitution, the Corporations Act 2001 and other applicable laws and regulations.

**Independent professional advice**

To assist the directors in discharging their duties as directors, each director has the right to seek independent professional advice, and with the approval of the Chairman, at the expense of the economic entity. Such advice is to be made available to the entire Board.

The Bank's Constitution specifies the required number of directors as being at least five, and not more than nine directors (or such lower number as the board may determine from time to time), including the managing director but not including any alternate directors.

A majority of non-executive directors. These non-executive directors need not all be independent. They can include Board members or senior management of the parent company or the parent's other subsidiaries, but not executives of the Bank or the Bank's subsidiaries;

A minimum of two independent directors, in addition to an independent chairperson where the Board has up to seven members. Where the Board has more than seven members, the Board will be required to have at least three independent directors, in addition to an independent chairperson; and

At least two of the directors of the Board must be ordinarily resident in Australia, and at least one of those must be independent. The independent directors on the Board of the parent company or its other subsidiaries can also sit as independent directors on the Board of the Bank.

There are currently 7 directors of the Bank, and details of their experience, qualifications, interests in other organisations, special responsibilities, and attendance at meetings are set out in the Directors' Report.

Membership of the Board and Committees is set out below:

Director	Board Membership	Audit, Risk and Compliance	Remuneration	Credit
Samir F Kawar	Chairman Non-Executive, Independent			
Geoffrey C E Wild AM <sup>1</sup>	Deputy Chairman Non-Executive, Independent	Member	Member	Chairman
James Wakim	Managing Director			
Muntaser M S Al-Shashtari <sup>2</sup>	Non Executive			
Samer S H A I Tamimi <sup>3</sup>	Non Executive			Member
Eun-Young Kim <sup>1</sup>	Non Executive	Member	Member	Member
Ian G MacDonald	Non-Executive, Independent	Member	Chairman	Member
Leslie E Taylor	Non-Executive, Independent	Chairman		

<sup>1</sup> Mr Wild and Mr Kim are due to retire, and stand for reappointment at the Annual General Meeting to be held in February 2008.

<sup>2</sup> Mr Al-Shashtari resigned on 01 June 2007.

<sup>3</sup> Mr Al-Tamimi was appointed to the Board with effect from 04 June 2007.

### **Independence**

The Board regularly assess the independence of each director, in accordance with the criteria for independence set out in Prudential Standard APS510. An independent director is a non-executive director who is free from any business or other association including those arising out a substantial shareholding, involvement in past management or as a supplier, customer or adviser that could materially interfere with the exercise of their independent judgment.

In addition to being required to conduct themselves in accordance with the ethical policies of the Bank, directors are required to be meticulous in their disclosure of any material contract or relationship in accordance with the Corporations Act 2001 and related Bank policies, and this disclosure extends to the interests of family companies and spouses.

Directors are required to strictly adhere to the constraints on their participation and voting in relation to matters in which they may have an interest in accordance with the Corporations Act 2001 and the Bank's policies.

Each director may from time to time have personal dealings with the Bank. Each director is involved with other companies or professional firms, which may from time to time have dealings with the Bank. Details of offices held by directors with other organisations are set out in the Directors' Report. Full details of related party dealings are set out in notes to the Bank's accounts as required by law.

All the current non-executive directors of the Bank have been assessed for their independence and their status is set out in the membership table above after taking into account the criteria referred to above.

**Independence (continued)**

Whilst a term of service is a consideration in assessing a director's ability to act in the best interests of the Bank, a term of service on the Board is generally not considered to affect a director's ability to act in the best interests of the Bank. Independence is judged against the ability, integrity and willingness of the director to act. In considering a director's tenure, the Board however ensures that the skills sets of directors remain appropriate.

**Director Appointment and Review**

The Board has agreed on the criteria which form the basis of selecting candidates for Board appointment.

The Board annually assesses the skills base, experience and qualifications of the existing directors to enable identification of attributes required in directors to ensure it has the expertise required to competently discharge the Board's duties, having regard to the strategic direction of the Bank.

The Board compares the skills base and experience of existing directors with that required for the future strategy of the economic entity to enable identification of attributes required in new directors.

After consideration of the results of the performance assessment, the Board will determine its endorsement of the directors to stand for re-appointment at the next Annual General Meeting.

The Board has agreed to adopt a policy whereby a director's appointment is reviewed, with the shareholder, every four years, on a rotation basis, to ensure skills remain appropriate (except where succession planning for the Chairman requires an extended term). In accordance with the requirements of Prudential Standard APS510, the Board has established this policy for review of directors' tenures to ensure that it remains open to new ideas and independent thinking while retaining adequate expertise. The Board gives consideration to whether directors have served on the Board for a period which could, or could reasonably be perceived to, materially interfere with their ability to act in the interests of the Bank.

The Board has in place a process for annually reviewing its performance, policies and practices, with a view to identifying the quality and effectiveness of the Board, its committees and individual directors, and the processes that support them.

In addition to a Director Induction Program, the Board will identify any additional areas where education is required and suggest appropriate development activities for directors after consideration of the results of the annual performance assessment of directors.

(continued)

**Committees**

The Board has established the following Board Committees:

- Board Audit Risk & Compliance Committee (“BARCC”);
- Board Remuneration Committee (“BRC”); and
- Board Credit Committee (“BCC”).

The Board has approved a Charter and Operating Governance Practices for each of the Board Committees, and reviews the Board Committees on an annual basis. In addition, the Board has determined that the terms of reference and operations of the BARCC will reflect the requirements of Prudential Standard APS510.

The Board Audit, Risk and Compliance Committee’s primary responsibility is to assist the Board in fulfilling its fiduciary and statutory responsibilities in relation to the external reporting of financial information, compliance and regulatory issues, internal control framework, risk management systems, and the independence and effectiveness of audit activities, plus any other matters referred to it by the Board.

The Charter of the BARCC incorporates the BARCC’s authority, responsibilities, and a work program to ensure the BARCC can fulfill its purpose and exercise its responsibilities effectively. The Charter of the BARCC also incorporates a number of policies and practices to ensure it remains independent and effective. Among these are:

- Financial accounting and reporting. The Managing Director must not be a member of the BARCC.
- A majority of members must be independent of management and free of any relationship, which could interfere with their independent judgment.
- The Chairman of the BARCC is appointed by the Board and must not be the same person as the Chairman or Deputy Chairman of the Board. The Chairman must be an independent director.
- The Managing Director, the Head of Internal Audit, the Head of Risk Management & Compliance and representatives of the external auditor, and legal advisor will attend meetings by invitation.
- At least once a year, the BARCC meets the external auditor and the Head of Internal Audit independently of management.
- The BARCC is responsible for nominating the external auditor to the Board for appointment by the shareholder. KPMG have been appointed external auditors of the Bank.
- The external auditor must, in accordance with the Corporations Act 2001, comply with the auditor independence requirements and applicable prudential standards (including APS510 and APS520) and codes of professional conduct. The BARCC will assess on at least an annual basis, the independence, fitness and propriety of the external auditors.
- Audit fees are reviewed by the BARCC each year, to determine that an effective, comprehensive and complete audit can be conducted for that fee.
- The scope of the audit is agreed between the BARCC and the external auditor and is subject to the minimum requirements of the Corporations Act 2001 (which regulates audit requirements), accounting standards and other mandatory professional reporting requirements in Australia.

**Committees (continued)**

- The external audit partner attends meetings of the BARCC by invitation and attends the Board meeting when the annual accounts are signed. However, the external auditor may also raise matters directly with the Board.
- The BARCC, in relation to dealing with the independence of the external auditor, inter alia, has adopted the practice of meetings between the BARCC and the Auditors in the absence of management.
- The BARCC discusses and receives assurances from the external auditors on the quality of the Bank's systems, its accounting processes and its financial results. It also receives a report from the Auditors on any significant matters raised by the Auditors with management.
- All material accounting matters requiring exercise of judgment by management are specifically reviewed by the BARCC and reported on by the BARCC to the Board.
- The policy governing the provision of non-audit services by the external auditor is set out in the BARCC Charter and Operational Governance Practices.
- The Bank requires the partner managing the external audit be changed within a period of 5 years.

The BARCC is responsible for the oversight of management in the preparation of the Bank's Financial Statements and financial disclosures. The BARCC relies on the information provided by management and the external auditor. The Managing Director, together with the Chief Financial Officer declare in writing to the Board that the financial records of the Company for the financial year have been properly maintained and the Company's financial reports for the financial year comply with accounting standards to allow the directors to declare that the financial report presents a true and fair view of the Company's financial condition and operational results. This statement is required annually

**Board Remuneration Committee ("BRC")**

The purpose of the BRC is to assist the Board in fulfilling its responsibilities relating to remuneration and people matters, and compliance with related employment laws and regulations. It does this by ensuring that the Bank has appropriate remuneration and people systems in place by monitoring their effectiveness.

The policy of the Board is that the BRC will consist of at least three directors. The directors must be entirely non-executive directors. The Managing Director attends meetings by invitation except when matters affect him personally.

The Charter of the BRC incorporates the BRC's authority, responsibilities, a number of policies, practices and a work program to ensure the BRC can fulfil its purpose and exercise its responsibilities effectively.

(continued)

**Board Credit Committee (“BCC”)**

The purpose of the BCC is to assist the Board in the oversight of credit risk assumed by the Bank in the course of carrying on its business. The BCC is to consider the Bank’s credit policies and ensure that management maintains a set of credit standards designed to achieve portfolio outcomes consistent with the Bank’s risk / return expectations. The BCC is to also review the Bank’s credit portfolio and recommendations by management for provisioning of bad debts

The policy of the Board is that the BCC will consist of at least three directors. The directors must be entirely non-executive directors. The Managing Director attends meetings by invitation.

The Charter of the BCC incorporates the BCC’s authority, responsibilities, a number of policies, practices and a work program to ensure the BCC can fulfil its purpose and exercise its responsibilities effectively.

**Internal control framework**

The Board acknowledges that it is responsible for the overall internal control framework but recognises that no cost effective internal control system will preclude all errors and irregularities. The internal control system is based upon well-documented policies and procedures, manuals and guidelines. It is also based upon an organisational structure which provides an appropriate segregation of responsibility given the size of the Company, an internal audit function which provides reasonable assurance to the Managing Director and the board, and the careful selection and training of qualified personnel by Human Resources.

**Risk Management**

The Board recognises that an effective risk management framework is a critical component of an organisation’s overall strategy and performance objectives. The risk management framework articulates and builds a consistent methodology for the identification, assessment, mitigation and monitoring of risks that is inclusive of, but not limited to, operational, business, market, and credit risks. The framework incorporates risk management practices, including reporting, within the business in a formal manner.

The Bank has adopted a structured and disciplined approach to risk management, which includes:

- Board approval and support for the Risk Management Framework;
- Board Audit Risk and Compliance Committee oversight;
- Managing Director direction;
- Business Unit Managers support and adherence;
- Risk management processes and procedures; and
- Audit assurance.

### **Ethical standards**

#### **Code of Conduct**

The Bank has adopted a Code of Conduct, which sets out the basis for a sound, ethical and impeccable business practice, with which all directors and employees undertake to observe.

The Code requires that all employees and directors act with the highest standard of personal and professional integrity. The Code recognises that the Bank is a fiduciary of public funds and therefore has a commitment to protect the interests of its customers as well as complying with all laws and regulations governing the Bank's business. For this purpose, the Code establishes the sets of standard behaviour required of all employees and directors. Among these are the standards for general responsibilities in relation to ethical conduct, information handling, conflicts of interest, due diligence, gifts and entertainment, fraud, dishonesty, criminal conduct, integrity, whistle blowing, advertising, and information security.

In keeping with its responsibility to the shareholder, employees and customers, a set of Core Values has been adopted, which embrace the principles of mutual respect, trust, customer service, community and empowerment. To emphasise the importance of the Core Values, the Core Values are regularly communicated to all personnel throughout the organisation.

#### **Conflict of Interest**

In addition to the requirements of the Corporations Act 2001 and the Bank's Constitution, the Board has adopted the Bank's Conflict of Interest Policy, which describes the potential conflicts that are required to be addressed and managed by the business. This policy applies to all employees, including directors, and requires the completion of an annual Conflict of Interest Policy declaration

The policy requires that all employees, including directors, have an obligation to avoid, and disclose, any financial, business or other relationships, which might conflict with the legitimate business interests of the Bank or the proper performance of their duties. Such a conflict will exist where an employee compromises their ability to act with total objectivity with regard to the Bank's business interests.

(continued)

**Role of the Shareholder**

The shareholder of the Company, Arab Bank plc, is responsible for the appointment of the directors, as well as approval of the remuneration for the provision of their services as directors of the Company.

Further, to ensure that the board of directors fulfil their stewardship responsibilities, directors inform the shareholder of all significant events concerning the Bank through the distribution of the Annual Financial Report. The Annual Financial Report includes all information required by the Corporations Act 2001, including information concerning the operations of the economic entity and changes in the state of affairs.

The managers of the Bank are accountable directly to the Managing Director. As a member of the Arab Bank Group, management personnel will consult with the respective functions of Arab Bank plc to ensure business plans and policies take into account the interests of the group and achieve standardisation where appropriate. In particular, the credit risk policies of the shareholder, are to be adopted by the Bank.

The respective roles that the Board has reserved for itself, and delegated to management, are to be viewed in this context. The Board must ensure that any group policies followed by the Board give appropriate regard to the Bank's business and its specific requirements.

**Subsidiary Board**

Arab Australia Capital Markets Limited, a wholly owned subsidiary of Arab Bank Australia Limited, is comprised of the following directors, Messrs:

Eun-Young Kim

James Wakim

Geoffrey C E Wild AM

The Directors present their report together with the financial report of Arab Bank Australia Limited ("the Company") and the consolidated financial report of the economic entity, being the Company and its controlled entity, for the year ended 31 December 2007 and the auditors' report thereon.

### **Directors**

The directors of the Company at any time during or since the financial year are:

#### **His Excellency Samir F Kawar, Chairman and Non Executive Independent Director**

His Excellency, Mr Kawar, has been a member of the Board, and Chairman, since 23 June 2005.

Chairman: Middle East Insurance Co,  
Modern Agricultural Investments, and  
InsoStrong Insolation Co.

Director: Arab Bank plc

His Excellency, Mr Kawar, holds a Masters in Engineering.

#### **Mr Geoffrey C E Wild AM, Deputy Chairman and Non Executive Independent Director**

Member of the Board since 2 November 1995, and Deputy Chairman since 9 September 2004

Chairman of the Board Credit Committee, and a member of the Board Audit, Risk & Compliance Committee and the Board Remuneration Committee.

Chairman: WPP Holdings Australia and related entities, and  
ComOps Limited.

Director: Network Limited,  
IBISWorld Limited,  
Professional Golf Association (PGA), and  
Wild Family Nominees Pty Limited.

Fellow of the Advertising Institute of Australia (dip), Fellow of the Australian Institute of Company Directors, Associate of the Institute of Business Administration, and a Member of the Order of Australia (AM).

#### **Mr James Wakim, Managing Director**

Mr Wakim was appointed Managing Director with effect from 08 February 2001

Director: Westmead Millennium Foundation for Medical Research

- Member of the Advisory Board of the Westmead Millenium Institute for Medical Research,  
Fellow of the Financial Services Institute of Australasia, and Affiliate of the Australian  
Institute of Company Directors.

Mr Wakim has a Bachelor of Economics (Econometrics) degree.

#### **Mr Eun-Young Kim, Non Executive Director**

- Member of the Board since 01 July 1995.

- Member of the Board Audit, Risk & Compliance Committee, Board Remuneration  
Committee and Board Credit Committee.

- Executive Vice President and Area Executive of Arab Bank plc, Singapore.

Mr Kim has a Bachelor of Arts in Business Administration degree.

**Directors (continued)**

**Mr Ian G MacDonald, Non Executive Independent Director**

- Member of the Board since 01 July 2006.
- Chairman of the Board Remuneration Committee, and a member of the Board Audit, Risk & Compliance Committee and the Board Credit Committee.
- Director: CPT Global Limited,  
Futuris Corporation Limited,  
Elders Financial Services Group Limited,  
Elders Trustees Limited,  
Elders Insurance Limited,  
Elders Insurance Brokers Pty Limited, and  
Elders Rural Bank.

Mr MacDonald is a Senior Fellow of the Financial Services Institute of Australasia, and a Member of the Australian Institute of Company Directors.

**Mr Leslie E Taylor, Non Executive Independent Director**

- Member of the Board since 25 November 2004.
- Chairman of the Board Audit, Risk and Compliance Committee.
- Chairman: Commonwealth Government Safety Rehabilitation and Compensation Commission,  
Whitehouse Institute of Fashion and Design, and  
National Electronic Conveyancing Committee.

Director: Freshtel Holdings Limited

Mr Taylor is a member of the Australian Securities and Investment Commission Business Consultative Panel, and the Australian Public Service Medal Committee.

Mr Taylor is a solicitor and is also a Senior Fellow of the Financial Services Institute of Australasia.

**Mr Samer S H Al Tamimi, Non Executive Director**

- Member of the Board since 04 June 2007.
- Member of the Board Credit Committee.
- Senior Vice President – Global Credit Group, Arab Bank plc.

Mr Al Tamimi has a Master of Science in Professional Accountancy and a Certified Public Accounting CPA qualification.

**Mr Muntaser M S Al-Shashtari, Non Executive Director**

- Member of the Board from 28 January 2007 until his resignation effective 01 June 2007.
- Credit Supervisor, Investment Portfolio/Subsidiaries & Affiliate Affairs, Arab Bank plc

Mr Al Shashtari has a B.S Degree in Computer Science / Minor Banking.

### Directors' Meetings

The number of Directors' meetings held (including meetings of committees of Directors) and number of meetings attended by each of the Directors during the financial year were

Director	Meetings Held <sup>1</sup>	Meetings Attended
Samir F Kawar	5	5
Geoffrey C E Wild AM	5	5
James Wakim	5	5
Muntaser M S Al-Shashtari <sup>2</sup>	2	2
Samer S H Al Tamimi <sup>3</sup>	3	3
EunYoung Kim	5	5
Ian G MacDonald	5	5
Leslie E Taylor	5	5

<sup>1</sup> The number of meetings held during the time the Director was a member of the Board.

<sup>2</sup> Mr Al-Shashtari was appointed effective 28 January 2007, and resigned effective 1 June 2007.

<sup>3</sup> Mr Al-Tamimi was appointed to the Board effective 04 June 2007.

### Committee Meetings

Director	Audit, Risk & Compliance Committee		Remuneration Committee		Credit Committee	
	Meetings Held <sup>1</sup>	Meetings Attended	Meetings Held <sup>1</sup>	Meetings Attended	Meetings Held <sup>1</sup>	Meetings Attended
Geoffrey C E Wild AM	4	4	2	2	1	1
Samer S H Al Tamimi	-	-	-	-	1	1
EunYoung Kim	4	4	2	2	1	1
Ian G MacDonald	4	4	2	2	1	1
Leslie E Taylor	4	4	-	-	-	-

<sup>1</sup> The number of meetings held during the time the Director was a member of the relevant Committee.

### Principal activities

The principal activity of the Company and the economic entity is the provision of general banking services.

### Results

Consolidated profit from ordinary activities before income tax expense was \$2,170,000 (2006: \$4,865,000).

The net profit of the economic entity for the year after income tax expense of \$785,000 (2006: \$1,456,000) was \$1,385,000 (2006: \$3,409,000).

### Auditor's independence

The lead auditor's independence declaration is set out on page 26 and forms part of the Directors' report for the year ended 31 December 2007.

**Indemnification and insurance of officers**

The Company has agreed to indemnify the directors and officers of the Company and its controlled entity against all liabilities to another person (other than the Company or a related body corporate) that may arise from their position as officers of the Company and its controlled entity, except where the liability arises out of conduct involving a lack of good faith. The Company has during the year maintained insurance contracts indemnifying current and former directors and officers of the Company. Disclosure by the Company of the amount of the insurance and the nature of the liabilities covered by the insurance contracts is prohibited under the terms of the contract.

**Dividends**

No dividends have been paid or declared since the start of the financial year.

The directors do not recommend the payment of a final dividend in respect of the financial year ended 31 December 2007 (2006:Nil).

**Review of operations**

In accordance with ASIC Class Order 98/2395, this information is contained in the Managing Director and Chairman's Report.

**Change in state of affairs**

In the opinion of the directors there were no significant changes in the state of affairs of the economic entity that occurred during the financial year under review.

**Environmental regulations**

The company and the economic entity are not subject to any particular or significant environmental regulation under a law of the Commonwealth or of a State or Territory.

**Events subsequent to balance date**

There has not arisen in the interval between the end of the financial year and the date of this report any item, transaction or event of a material and unusual nature likely, in the opinion of the directors of the Company, to affect significantly the operations of the economic entity, the results of those operations, or the state of affairs of the economic entity, in subsequent financial years.

**Likely developments**

The directors believe, on reasonable grounds, that to include in this report further information regarding likely developments in the operations of the economic entity and the expected results of those operations in future financial years would be likely to result in unreasonable prejudice to the economic entity.

**Directors' benefits**

Since the end of the previous financial year no director of the Company has received or become entitled to receive any benefit (other than a benefit included in the aggregate amount of remuneration received or due and receivable by directors shown in the notes to the financial report) because of a contract made by the Company, its controlled entity or a related body corporate with a director or with a firm of which a director is a member, or with an entity in which the director has a substantial interest.

**Rounding off**

The Company is of a kind referred to in ASIC Class Order 98/100 dated July 1998 (as amended by ASIC Class Order 04/667) and in accordance with that Class Order, amounts in the financial report and directors' report have been rounded off to the nearest thousand dollars, unless otherwise stated.

Signed in accordance with a resolution of the directors:



James Wakim  
Director



G Wild  
Director

Dated at Melbourne 12 March 2008

**Independent auditor's report**  
**to the members of Arab Bank Australia Limited**  
**for the year ended 31 December 2007**



**Report on the financial report**

We have audited the accompanying financial report of Arab Bank Australia Limited ("the Company"), which comprises the balance sheets as at 31 December 2007, and the income statements, statements of recognised income and expense and cash flow statements for the year ended on that date, a description of significant accounting policies and other explanatory notes 1 to 29 and the directors' declaration set out on pages 27 to 68 of the Consolidated Entity which comprises the Company and the entity it controlled during that year.

**Directors' responsibility for the financial report**

The directors of the Company are responsible for the preparation and fair presentation of the financial report in accordance with Australian Accounting Standards (including the Australian Accounting Interpretations) and the Corporations Act 2001. This responsibility includes establishing and maintaining internal control relevant to the preparation and fair presentation of the financial report that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances. In note 1, the directors also state, in accordance with Australian Accounting Standard AASB 101 Presentation of Financial Statements, that the financial report, comprising the financial statements and notes, complies with International Financial Reporting Standards.

**Auditor's responsibility**

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. These Auditing Standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement.

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

We performed the procedures to assess whether in all material respects the financial report presents fairly, in accordance with the Corporations Act 2001 and Australian Accounting Standards (including the Australian Accounting Interpretations), a view which is consistent with our understanding of the Company and Consolidated Entity's financial position, and of their performance.

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

**Auditor's opinion**

In our opinion:

- (a) the financial report of Arab Bank Australia Limited is in accordance with the Corporations Act 2001, including:
  - (i) giving a true and fair view of the Company and Consolidated Entity's financial position as at 31 December 2007 and of their performance for the year ended on that date; and
  - (ii) complying with Australian Accounting Standards (including the Australian Accounting Interpretations) and the Corporations Regulations 2001.
- (b) the financial report also complies with International Financial Reporting Standards as disclosed in note 1.

KPMG.

KPMG

Malcolm Ashcroft  
Partner

Sydney

12 March 2008

Lead Auditor's Independence Declaration under  
Section 307C of the Corporations Act 2001



**To: the directors of Arab Bank Australia Limited**

I declare that, to the best of my knowledge and belief, in relation to the audit for the financial year ended 31 December 2007 there have been:

- (i) no contraventions of the auditor independence requirements as set out in the Corporations Act 2001 in relation to the audit; and
- (ii) no contraventions of any applicable code of professional conduct in relation to the audit.

*KPMG.*

KPMG

Sydney  
12 March 2008

A handwritten signature in black ink, appearing to read 'MA Ashcroft', written in a cursive style.

Malcolm Ashcroft  
Partner

Income Statementsfor the year ended 31 December 2007

		<b>Consolidated</b>		<b>The Company</b>	
	Note	2007	2006	2007	2006
		\$'000	\$'000	\$'000	\$'000
Interest income	2	83,918	77,552	83,913	77,548
Interest expense	2	61,664	53,175	61,670	53,180
Net interest income		22,254	24,377	22,243	24,368
Non-interest income		3,974	3,056	3,974	3,056
Operating Income		26,228	27,433	26,217	27,424
Loan impairment charges/(recoveries)	8	133	(225)	133	(225)
Operating expenses	2	23,925	22,793	23,925	22,793
<b>Profit before income tax expense</b>		2,170	4,865	2,159	4,856
Income tax expense	4(a)	785	1,456	782	1,453
<b>Net profit</b>		1,385	3,409	1,377	3,403

The Income Statements are to be read in conjunction with the notes to the financial statements set out on pages 31 to 68.

***Arab Bank Australia Limited and its controlled entity******Balance Sheets******As at 31 December 2007***

	Note	Consolidated		The Company	
		2007 \$'000	2006 \$'000	2007 \$'000	2006 \$'000
<b>Assets</b>					
Cash and liquid assets		1,269	1,648	1,269	1,648
Receivables from other financial institutions	5	11,388	41,844	11,292	41,748
Held to maturity investments	6	122,977	69,436	122,977	69,436
Loans and advances to customers, net	7	722,461	746,620	722,461	746,620
Financial assets at fair value through profit or loss	9	2,057	920	2,057	920
Plant and equipment	10	1,506	2,343	1,506	2,343
Shares in controlled entity	11	-	-	70	70
Current tax assets		1,206	1,275	1,206	1,278
Deferred tax assets	4	1,534	1,642	1,534	1,642
Intangible assets	12	1,790	1,807	1,790	1,807
Other assets	13	5,406	5,916	5,405	5,913
<b>Total assets</b>		<b>871,594</b>	<b>873,451</b>	<b>871,567</b>	<b>873,425</b>
<b>Liabilities</b>					
Payables to other financial institutions	14	4,554	41,650	4,554	41,650
Deposits	15	729,653	697,161	729,753	697,252
Financial liabilities at fair value through profit or loss	9	491	270	491	270
Provision for employee entitlements	16	680	550	680	550
Other liabilities	17	6,637	5,617	6,636	5,618
Subordinated debt	18	25,005	25,014	25,005	25,014
<b>Total liabilities</b>		<b>767,020</b>	<b>770,262</b>	<b>767,119</b>	<b>770,354</b>
<b>Net assets</b>		<b>104,574</b>	<b>103,189</b>	<b>104,448</b>	<b>103,071</b>
<b>Equity</b>					
Share capital	19	55,000	55,000	55,000	55,000
Reserves	20	6,218	7,489	6,218	7,489
Retained profits	21	43,356	40,700	43,230	40,582
<b>Total equity</b>		<b>104,574</b>	<b>103,189</b>	<b>104,448</b>	<b>103,071</b>

The Balance Sheets are to be read in conjunction with the notes to the financial statements set out on pages 31 to 68.

**Arab Bank Australia Limited and its controlled entity**  
**Statements of Recognised Income and Expense**  
**for the year ended 31 December 2007**

		<b>Consolidated</b>		<b>The Company</b>	
	Note	2007	2006	2007	2006
		\$'000	\$'000	\$'000	\$'000
Impact of discontinued hedge accounting transferred to the income statement	20	-	52	-	52
Income tax on items taken directly to or transferred from equity	20	-	(15)	-	(15)
<b>Net income recognised directly in equity</b>	20	-	37	-	37
<b>Profit for the period</b>		1,385	3,409	1,377	3,403
<b>Total recognised income and expense for the period</b>		1,385	3,446	1,377	3,440

The Statement of Recognised Income and Expense are to be read in conjunction with the notes to the financial statements set out on pages 31 to 68.

***Arab Bank Australia Limited and its controlled entity***  
***Cash Flow Statements***  
***for the year ended 31 December 2007***

	Note	Consolidated		The Company	
		2007	2006	2007	2006
		\$'000	\$'000	\$'000	\$'000
<b>Cash flows from operating activities</b>					
Interest received		83,713	80,010	83,707	80,002
Fees and commission received		4,469	3,037	4,469	3,044
Interest payments		(62,910)	(54,866)	(62,916)	(54,873)
Income taxes paid		(608)	(2,009)	(602)	(2,015)
Payments to employees and suppliers		(19,634)	(20,911)	(19,634)	(20,903)
<b>Net cash from operating activities</b>	29(b)	5,030	5,261	5,024	5,255
<b>Cash flows from investing activities</b>					
Proceeds from sales of plant and equipment		-	-	-	-
Purchase of property, plant and equipment		(991)	(499)	(991)	(499)
<b>Net decrease/(increase)</b>					
Loans, advances and bills discounted		21,346	41,820	21,346	41,806
Held to maturity investments		(53,541)	(19,692)	(53,541)	(19,692)
<b>Net cash from/(used in) investing activities</b>		(33,186)	21,629	(33,186)	21,615
<b>Cash flows from financing activities</b>					
<b>Net (decrease)/increase</b>					
Due to other financial institutions		(35,790)	16,218	(35,793)	16,222
Deposits		33,111	(17,536)	33,120	(17,521)
<b>Net cash (used by)/from financing activities</b>		(2,679)	(1,318)	(2,673)	(1,299)
<b>Net increase/(decrease) in cash</b>		(30,835)	25,572	(30,835)	25,571
<b>Cash and cash equivalents at the beginning of the financial year</b>					
		43,492	17,920	43,396	17,825
<b>Cash and cash equivalents at the end of the financial year</b>					
	29(a)	12,657	43,492	12,561	43,396

The Cash Flow Statements are to be read in conjunction with the notes to the financial statements set out on pages 31 to 68.

## 1. Summary of significant accounting policies

### (a) Basis of accounting

In this financial report Arab Bank Australia Limited is referred to as the “Bank” or “Company”, and the “Group” or the “Consolidated Entity” consists of the Bank and its controlled entity.

### (b) Basis of preparation

The financial statements are prepared on the basis of historical costs except for derivative financial instruments, which are stated at their fair value.

In preparing these financial statements the Group has adopted AASB 7 Financial Instruments: Disclosures. The adoption of AASB 7 impacted the type and amount of disclosures made in these financial statements, but had no impact on the reported profits or financial position of the Group. In accordance with the transitional requirements of the standard, the Group has provided full comparative information.

The financial report is a general purpose financial report which has been prepared in accordance with the requirements of the Banking Act, Corporations Act 2001, Australian Accounting Standards (“AASBs”) and other mandatory reporting requirements so far as the requirements are considered appropriate to a banking corporation. The consolidated financial report of the Group also complies with the International Financial Reporting Standards (“IFRS”) and interpretations adopted by the International Accounting Standards Board.

The financial report is presented in Australian dollars, which is the Group’s functional currency.

### (c) Basis of consolidation

The consolidated financial statements include the financial statements of the Bank and all entities where it is determined that there is a capacity to control as defined in AASB 127. All balances and transactions between Group entities have been eliminated on consolidation.

### (d) Foreign currency transactions

Transactions in foreign currencies are translated to Australian Dollars at exchange rates at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated to Australian Dollars using the current exchange rate at balance date. Unrealised gains and losses arising from these revaluations are recognised in the income statement.

### (e) Financial instruments

The Group utilises an extensive range of financial instruments. Financial instruments are classified and measured as follows:

**Loans and advances:** This category includes non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are measured at amortised cost. The carrying value of loans, advances and other receivables is net of accumulated impairment losses and interest/fees received. Refer Note 1(h) Loans, advances for further details.

**Held to maturity investments:** This category includes non-derivative financial assets with fixed or determinable payments and a fixed maturity that the Group has a positive intention and ability to hold to maturity. They are measured at amortised cost.

**(e) Financial instruments (continued)**

**Financial assets at fair value through profit or loss:** Derivatives held for risk management purposes include all derivative assets and liabilities that are not classified as trading assets or liabilities. The Group enters into derivatives that may include foreign exchange contracts, forward rate agreements, futures and interest rate or currency swaps. Derivatives held for risk management purposes are used to economically hedge certain assets or liabilities.

Derivatives held for risk management purposes are measured at fair value in the balance sheet. All changes in their fair value are recognised immediately in profit or loss as a component of net interest income.

**Other Financial Assets:** The carrying values of other financial assets have been estimated using the rates for similar assets with similar maturities. Deferred tax assets and prepayments are not included in other financial assets as these do not constitute a financial instrument.

**Other Financial Liabilities:** These liabilities are measured at amortised cost. Further details on the Group's accounting for other financial liabilities has been included in Note 1(s) other liabilities.

**(f) Cash and cash equivalents**

Cash and cash equivalents includes cash at branches, cash at banks, money at short call and highly liquid investments that are readily convertible to known amounts of cash.

They are brought to account at the face value or the gross value of the outstanding balance where appropriate. Interest is recognised using the effective yield method. The carrying values of cash and liquid assets, receivables due from other financial institutions and bank acceptances of customers approximate their fair value as they are short term in nature or are receivable on demand.

**(g) Receivables due from other financial institutions**

Receivables from other financial institutions includes loans, nostro balances and settlement account balances due from other banks and regulatory deposits. They are brought to account at the gross value of the outstanding balance. Interest on receivables due from other financial institutions is recognised using the effective yield method.

**(h) Loans and advances**

Loans, advances and other receivables include overdrafts, residential lending, commercial lending and term loans.

Loans originated by the Group are recognised when cash is advanced to borrowers. They are initially recorded at fair value, which is the fair value of the cash given to originate the loan, including any transaction costs directly attributable to the acquisition or issue of the loan, and are subsequently measured at amortised cost using the effective interest rate method.

Loans and advances are reported net of allowances to reflect the estimated recoverable amounts (Note 1(i)).

**(i) Provisions for impairment****Non-financial assets**

The carrying amounts of the Group's non-financial assets are assessed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated.

The recoverable amount of other assets is the greater of their fair value less costs to sell and value in use. In assessing value in use, the expected future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. An impairment loss is recognised when the carrying amount of an asset exceeds its recoverable amount. Impairment losses are recognised in the Income Statements.

A previously recognised impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount, however not to an amount higher than the carrying amount would have been determined, net of amortisation or depreciation, if no impairment loss had been recognised in prior years.

**Financial assets**

Financial assets, excluding derivative assets, are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If any such indication exists, the asset's recoverable amount is estimated.

**Loans and advances and held to maturity assets**

The Group assesses at each balance sheet date whether there is any objective evidence that individual loans and advances and held to maturity assets or groups of these financial assets are impaired.

Objective evidence that an individual asset or a group of these assets are impaired includes, but is not limited to, observable data from the following loss events:

- significant financial difficulty of the issuer or obligor;
- a breach of contract, such as a default or delinquency in interest or principal payments;
- the lender, for economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the lender would not otherwise consider;
- it becoming probable that the borrower will enter bankruptcy or other financial reorganisation;
- the disappearance of an active market for that financial asset because of financial difficulties; or
- observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the Group, etc.

If there is objective evidence that an impairment loss on loans and advances or held to maturity investments carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the asset's recoverable amount.

**(i) Provisions for impairment (continued)**

Loans that are not known to be impaired are grouped together according to their risk characteristics and are then assessed for impairment on a collective basis. This is calculated taking into consideration historical loss data, current available information for assets with similar risk characteristics, evidence on indicators of impairment, and a qualitative assessment of changes in the environment. When required the collective impairment provision is recognised through the income statement.

The recoverable amounts of loans and advances and held to maturity assets are calculated as the present value of the expected future cash flows (excluding future credit losses that have not been incurred), discounted at the instrument's original effective interest rate. Short-term balances are not discounted.

**(j) Financial guarantees**

Financial guarantees are contracts that require the Group to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument. Financial guarantee liabilities are initially recognised at their fair value, and the initial fair value is amortised over the life of the financial guarantee. The guarantee liability is subsequently carried at the higher of this amortised amount and the present value of any expected payment (when a payment under the guarantee has become probable). Financial guarantees are included within other liabilities.

**(k) Shares in controlled entities**

These investments are recorded at the lower of cost or recoverable amount.

**(l) Property, plant and equipment**

The Group measures its property assets on a historical cost basis.

**Depreciation**

Items of plant and equipment are depreciated at appropriate rates so as to recognise the cost of each asset during its effective working life using the straight-line method. The estimated useful lives of property, plant and equipment are as follows:

Plant and Equipment	- 3 to 5 years
Furniture	- 6 years
Motor Vehicles	- 5 years
Leasehold Improvements	- Life of Leasehold

Depreciation rates for property, plant and equipment are reviewed periodically to ensure they appropriately reflect residual values and estimated useful lives.

**(m) Intangibles****Computer software**

The Group capitalises certain computer software costs and recognises them as an intangible asset where they are clearly identifiable, can be reliably measured and will lead to future economic benefits that the Group controls.

The Group carries capitalised software assets at cost less amortisation and any impairment losses. It amortises these assets on a straight-line basis at a rate applicable to the expected useful life of the asset, but usually not exceeding 5 years. Intangibles are assessed annually for impairment in accordance with Note 1(i).

**(n) Deposits and other public borrowings**

Deposits and other public borrowings includes certificates of deposits, term deposits, savings deposits, cheque and other demand deposits. They are brought to account at fair value plus directly attributable transaction costs at inception.

Deposits and other public borrowings are subsequently stated at amortised cost. Interest is charged to the income statement using the effective yield method.

**(o) Payables due to other financial institutions**

Payables due to other financial institutions includes deposits, vostro balances and settlement account balances due to other banks. They are brought to account at fair value plus directly attributable transaction costs at inception. Payables due to other financial institutions are subsequently stated at amortised cost. Interest is charged to the income statement using the effective yield method.

**(p) Income taxes**

Income tax on the profit for the year comprises current and deferred tax. Income tax is recognised in the Income Statements except to the extent that it relates to items recognised directly to 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 balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

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.

**(q) Employee benefits****Long- term employee benefits**

The Group's net obligation in respect of long-term service benefits is the amount of future benefit that employees have earned in return for their service in the current and prior periods. The obligation is calculated using estimated future service costs and is discounted to its present value.

**Wages, salaries, annual leave and non-monetary benefits**

Liabilities for annual leave which are expected to be settled within 12 months of the reporting date represent obligations resulting from employee's services provided to reporting date, are calculated at undiscounted amounts based on remuneration wage and salary rates that the consolidated entity expects to pay as at reporting date including related on-costs such as workers compensation insurance and payroll tax. Non-accumulating non-monetary benefits such as medical care and cars are expensed based on the net marginal cost to the consolidated entity as the benefits are taken by the employees.

**(r) Provisions**

A provision is recognised in the balance sheet when the Group has a legal or constructive obligation as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

**(s) Other liabilities**

Other liabilities includes all other financial liabilities and includes interest, fees and other unrealised expenses payable and securities purchased not delivered. These liabilities are recorded at cost.

**(t) Subordinated debt**

Subordinated debt was provided by Arab Bank Plc. Subordinated debt is initially recorded at fair value plus transaction costs that are directly attributable to the debt. Subsequently the subordinated debt is measured at amortised cost. Interest is recognised using the effective yield method.

**(u) Shareholders' equity**

Ordinary share capital is the amount of paid up capital from the issue of ordinary shares.

**(v) Revenue recognition**

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the group and the revenue can be reliably measured. The principal sources of revenue are interest income, fees and commissions.

**Interest income**

Interest income is recognised on a time proportion basis that takes into account the effective interest rate on the asset. 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 Group 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 commissions 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. There is a presumption that the cash flows and the expected life of a group of similar financial instruments can be estimated reliably.

**Lending fees**

Fees and direct costs relating to loan origination, financing or restructuring and to loan commitments are deferred and amortised to interest income over the expected life of the loan using the effective interest rate method. Fees received for commitments which are not expected to result in a loan are included in credit-related fees and commissions and amortised on a straight-line basis over the commitment period. Where fees are received on an ongoing basis and represent the recoupment of the costs of maintaining and administering existing loans, these fees are taken to income when the service has been provided.

**(v) Revenue recognition (continued)**

**Commission and other fees**

When commission charges and fees relate to specific transactions or events, they are recognised as income in the period in which they are received. However, when they are charged for services provided over a period, they are taken to income on an accrual basis.

**(w) Lease payments**

Payments made under operating leases are recognised in profit or loss on a straight-line basis over the term of the lease.

**(x) Roundings**

The amounts contained in this report and the financial statements are presented in Australian dollars and have been rounded to the nearest thousand dollars unless otherwise stated, according to the option available to the Company under ASIC Class Order 98/100 (as amended by ASIC Class Order 04/667,05/641 and 06/51).

**(y) New standards and interpretations not yet adopted**

The following standards, amendments to standards and interpretations have been identified as those which may affect the Group in the period of initial application. They are available for early adoption at 31 December 2007, but have not been adopted in preparing the financial report.

- AASB 8 Operating Segments replaces the presentation requirements of segment reporting in AASB 114 Segmental Reporting. AASB 8 is applicable for annual reporting periods beginning on or after 1 January 2009 and is not expected to have an impact on the financial results of the Company and the Group as the standard is only concerned with disclosures.
- AASB 2007-2 Amendments to Australian Accounting Standards arising from AASB Interpretation 12 makes amendments to AASB 121 The Effect of Changes in Foreign Exchange Rates and AASB 139 Financial Instruments: Recognition and Measurement. AASB 2007-2 is applicable for annual reporting periods beginning on or after 1 January 2008.

**2. Operating profit**

Profit before income tax has been determined as follows:

	<b>Consolidated</b>		<b>The Company</b>	
	2007 \$'000	2006 \$'000	2007 \$'000	2006 \$'000
<b>Interest income</b>				
Cash and liquid assets	449	427	449	427
Receivables from other financial institutions	679	340	679	340
Held to maturity investments	5,422	3,934	5,422	3,934
Loans and advances to customers	61,219	59,203	61,214	59,199
Other	16,149	13,648	16,149	13,648
	<u>83,918</u>	<u>77,552</u>	<u>83,913</u>	<u>77,548</u>
<b>Interest expense</b>				
Payables to other financial institutions	1,921	824	1,906	824
Deposits	42,428	37,343	42,428	37,348
Loan capital	1,902	1,724	1,902	1,724
Other	15,413	13,284	15,434	13,284
	<u>61,664</u>	<u>53,175</u>	<u>61,670</u>	<u>53,180</u>
<b>Net interest income</b>	<u>22,254</u>	<u>24,377</u>	<u>22,243</u>	<u>24,368</u>
<b>Non-interest income</b>				
Commission and other fees	3,235	2,163	3,235	2,163
Trading income				
Foreign exchange earnings	779	864	779	864
Net profit on sale of property, plant and equipment	(53)	-	(53)	-
Other	13	29	13	29
	<u>3,974</u>	<u>3,056</u>	<u>3,974</u>	<u>3,056</u>
<b>Operating income</b>	<u>26,228</u>	<u>27,433</u>	<u>26,217</u>	<u>27,424</u>

For the year ended 31 December 2006, interest income was incorrectly understated by \$233,000 in the consolidated and company accounts. The error related to accrued interest on certain past due loans which had been provided for as suspended interest. The 2006 comparatives disclosed in the income statement, balance sheet and related notes have been amended to correct the error. The 2006 opening balance sheet and related notes have been amended to correct the error. The 2006 opening retained earnings balance (see note 21) was also understated by \$198,000 and has been amended.

**2. Operating profit (continued)**

	Consolidated		The Company	
	2007 \$'000	2006 \$'000	2007 \$'000	2006 \$'000
<b>Operating expenses</b>				
<b>Staff</b>				
Salaries and wages	10,351	9,393	10,351	9,393
Provision of employee entitlements	27	33	27	33
Superannuation	1,206	1,011	1,206	1,011
Training and education	149	92	149	92
Other	1,012	1,032	1,012	1,032
	12,745	11,561	12,745	11,561
<b>Occupancy</b>				
Rent	2,029	1,832	2,029	1,832
Other	498	492	498	492
	2,527	2,324	2,527	2,324
<b>Depreciation and amortisation</b>				
Computer hardware	343	371	343	371
Furniture, fittings and equipment	612	818	612	818
Amortisation	712	638	712	638
	1,667	1,827	1,667	1,827
<b>Office expenses</b>				
Marketing and communications	689	678	689	678
Business travel	398	260	398	260
Postage and stationery	529	603	529	603
Entertainment	235	196	235	196
Other	613	538	613	538
	2,464	2,275	2,464	2,275
<b>Other</b>				
Information system expenses	2,070	2,419	2,070	2,419
Service and consultation fees	1,842	1,777	1,842	1,777
Parent entity management fees	527	550	527	550
Other	83	60	83	60
	4,522	4,806	4,522	4,806
<b>Total operating expenses</b>	<b>23,925</b>	<b>22,793</b>	<b>23,925</b>	<b>22,793</b>

**3. Average balances and related interest****(a) Average assets and interest income**

The following table shows the daily average balance for each of the major categories of interest-bearing assets, the amount of interest revenue and the average interest rate. The “Other” category consists mainly of interest income on derivative instruments used to hedge cash flows subject to interest rate and foreign exchange rate risks.

	2007			2006		
	Consolidated			Consolidated		
	Average balance \$'000	Interest \$'000	Average rate %	Average balance \$'000	Interest \$'000	Average rate %
Cash and liquid assets	6,778	449	6.6	5,824	427	7.3
Receivables from other financial institutions						
- Local	7,915	520	6.6	4,119	273	6.6
- Overseas	4,388	159	3.6	2,742	68	2.5
Held to maturity investments	83,139	5,422	6.5	68,000	3,934	5.8
Loans and advances to customers, net	755,452	58,994	7.8	735,051	59,254	8.1
Other	-	18,374	N/A	-	13,596	N/A
	857,672	83,918		815,736	77,552	

**(b) Average liabilities and interest expense**

The following table shows the daily average balance for each of the major categories of interest-bearing liabilities, the amount of interest expense and the average interest rate. The “Other” category consists mainly of interest expense on derivative instruments used to hedge cash flows subject to interest rate and foreign exchange rate risks.

	2007			2006		
	Consolidated			Consolidated		
	Average balance \$'000	Interest \$'000	Average rate %	Average balance \$'000	Interest \$'000	Average rate %
Deposits	483,305	28,536	5.9	436,439	23,118	5.3
Payables to other financial institutions						
- Local	34,625	1,865	5.4	15,261	749	4.9
- Overseas	5,440	40	0.7	4,812	76	1.6
Loan capital	24,931	1,902	7.6	25,000	1,724	6.9
Certificates of deposits	210,397	13,886	6.6	237,215	14,222	6.0
Other		15,435	N/A	-	13,286	N/A
	758,698	61,664		718,727	53,175	

#### 4. Income Tax

##### (a) Income Tax Expense

Income tax expense shown in the financial statements differs from the prima facie tax charge calculated at current taxation rates on operating profit.

	Consolidated		The Company	
	2007 \$'000	2006 \$'000	2007 \$'000	2006 \$'000
<b>Profit before income tax</b>	2,170	4,864	2,159	4,856
Prima facie income tax at 30% (2006 : 30%)	651	1,459	648	1,457
<b>Tax effect of expenses that are non-deductible/income non-assessable in determining taxable profit:</b>				
Doubtful debts	-	(130)	-	(130)
Other	134	127	134	126
	134	(3)	134	(4)
<b>Total income tax expense</b>	785	1,456	782	1,453
<b>Recognised in the Income Statements</b>				
Current tax expense				
Current year	558	1,027	555	1,024
Under/(over) provided in prior years	119	41	119	41
	677	1,068	674	1,065
Deferred tax expense				
Current year temporary differences	108	785	108	785
Under/(Over) provisions in prior year	-	(397)	-	(397)
	108	388	108	388
<b>Total income tax expense in the Income Statements</b>	785	1,456	782	1,453

**4. Income Tax (continued)**

	Consolidated		The Company	
	2007 \$'000	2006 \$'000	2007 \$'000	2006 \$'000
<b>(b) Deferred Tax Assets</b>				
Deferred tax assets arising from:				
Provision for employee benefits	131	92	131	92
Property, Plant and Equipment	662	648	662	648
Commission received in advance	657	868	657	868
Derivatives	147	81	147	81
Unrealised exchange gains	111	-	111	-
Other	449	350	449	350
<b>Deferred tax assets</b>	<b>2,157</b>	<b>2,039</b>	<b>2,157</b>	<b>2,039</b>

**(c) Deferred Tax Liabilities**

Deferred tax liabilities arising from:				
Derivatives	617	292	617	292
Unrealised exchange gains	-	102	-	102
Other	6	3	6	3
<b>Total deferred tax liabilities</b>	<b>623</b>	<b>397</b>	<b>623</b>	<b>397</b>

**Movement in temporary differences**

during the year:				
Property, plant and equipment	14	48	14	48
Provision for employee benefits	39	(4)	39	(4)
Other assets	65	3	65	3
Other liabilities	(226)	(832)	(226)	(832)
	<b>(108)</b>	<b>(785)</b>	<b>(108)</b>	<b>(785)</b>

**Deferred tax assets not taken to account**

Capital losses	1,020	1,020	1,020	1,020
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The deductible temporary differences do not expire under current tax legislation. Deferred tax assets have not been taken to account in respect of the above items because it is not probable that future taxable profit (on capital account) will be available against which the Group can utilise the benefits.

**5. Receivables from other financial institutions**

	Consolidated		The Company	
	2007 \$'000	2006 \$'000	2007 \$'000	2006 \$'000
<b>Australia</b>				
Reserve Bank of Australia	7,969	6,787	7,969	6,787
Other	1,022	33,198	926	33,102
<b>Overseas</b>				
Parent entity	2,075	766	2,075	766
Related parties	19	6	19	6
Other parties	303	1,087	303	1,087
	<b>11,388</b>	<b>41,844</b>	<b>11,292</b>	<b>41,748</b>

**6. Held to maturity investments**

Bank acceptances	122,977	69,436	122,977	69,436
	<b>122,977</b>	<b>69,436</b>	<b>122,977</b>	<b>69,436</b>

**7. Loans and advances to customers, net**

Term loans	390,849	482,587	390,849	482,587
Housing loans	269,939	182,981	269,939	182,981
Overdrafts	48,292	37,603	48,292	37,603
Bills discounted	13,708	43,649	13,708	43,649
<b>Gross loans and advances to customers</b>	<b>722,788</b>	<b>746,820</b>	<b>722,788</b>	<b>746,820</b>
Add/(Less):				
Provisions for impairment (Note 8)				
Collective provision	(264)	(200)	(264)	(200)
Specific provision	(63)	-	(63)	-
	<b>(327)</b>	<b>(200)</b>	<b>(327)</b>	<b>(200)</b>
<b>Net loans and advances to customers</b>	<b>722,461</b>	<b>746,620</b>	<b>722,461</b>	<b>746,620</b>

This category includes capitalised lending income of \$2,190,876 (2006: \$2,892,000). An additional \$32,859 (2006: \$175,787) of lending fee income was recognised in the income statement due to changes in accounting estimates detailed in note 1(v).

**8. Provisions for impairment**

	Consolidated		The Company	
	2007 \$'000	2006 \$'000	2007 \$'000	2006 \$'000
<b>Specific provisions</b>				
Opening balance	-	432	-	432
Specific loan impairment charges/(recoveries)	69 (6)	(225) (207)	69 (6)	(225) (207)
Closing balance	63	-	63	-
<b>Collective provisions</b>				
Opening balance	200	200	200	200
Collective loan impairment charges	64	-	64	-
Closing balance	264	200	264	200
Total provisions for impairment	327	200	327	200

Collective provision is calculated in accordance with Note 1 (i).

The collective provision as at 31 December 2006 has been restated to recognise a \$200,000 provision which was previously incorrectly classified within other liabilities. The impact on the Income Statement for the year ended 31 December 2007 is \$nil (2006: \$nil).

**9. Financial assets and liabilities at fair value through profit or loss**

The Company enters into derivative transactions for the purpose of economically hedging interest rate and foreign exchange rate risks. The Company has not applied hedge accounting for the period commencing 1 January 2007 to 31 December 2007. For the year ended 31 December 2007, the Company has unrealised gains of \$915,328 (2006: \$620,134).

The Company discontinued hedge accounting in 2006. The impact of discontinuing hedge accounting in 2006 resulted in an expense of \$104,909 in the income statement recognised in accordance with the accounting policy outlined in Note 1 (v).

The fair values of derivative instruments held are set out in the following table:

	Notional value \$'000	2007		Notional value \$'000	2006	
		Asset \$'000	Liability \$'000		Asset \$'000	Liability \$'000
Other non-trading derivatives	308,700	2,057	491	276,000	920	270

**10. Plant and equipment**

	Consolidated			The Company		
	Plant & equipment \$'000	Fixtures & fittings \$'000	Total \$'000	Plant & equipment \$'000	Fixtures & fittings \$'000	Total \$'000
<b>Cost</b>						
Balance at 1 January 2006	4,419	6,095	10,514	4,419	6,095	10,514
Acquisitions	183	180	363	183	180	363
Disposals	-	(3)	(3)	-	(3)	(3)
Balance at 31 December 2006	4,602	6,272	10,874	4,602	6,272	10,874
Balance at 1 January 2007	4,602	6,272	10,874	4,602	6,272	10,874
Acquisitions	170	-	170	170	-	170
Disposals	(342)	(361)	(703)	(342)	(361)	(703)
Balance at 31 December 2007	4,430	5,911	10,341	4,430	5,911	10,341
<b>Depreciation</b>						
Balance at 1 January 2006	3,188	4,154	7,342	3,188	4,154	7,342
Depreciation for the year	549	640	1,189	549	640	1,189
Disposals	-	-	-	-	-	-
Balance at 31 December 2006	3,737	4,794	8,531	3,737	4,794	8,531
Balance at 1 January 2007	3,737	4,794	8,531	3,737	4,794	8,531
Depreciation for the year	171	784	955	171	784	955
Disposals	(342)	(309)	(651)	(342)	(309)	(651)
Balance at 31 December 2007	3,566	5,269	8,835	3,566	5,269	8,835
<b>Carrying amount</b>						
31 December 2006	865	1,478	2,343	865	1,478	2,343
31 December 2007	864	642	1,506	864	642	1,506

**11. Shares in controlled entity**

Details of the controlled entity are:

Name	Country of Incorporation	Interest %	Book value of investment		Contribution to consolidated profit	
			2007 \$'000	2006 \$'000	2007 \$'000	2006 \$'000
Arab Australia Capital Markets Limited	Australia	100	70	70	6	9

Total assets: \$204,107 (2006: \$194,840), total liabilities: \$nil (2006: \$nil).

**12. Intangible Assets**

	Consolidated		The Company	
	2007 \$'000	2006 \$'000	2007 \$'000	2006 \$'000
<b>Cost</b>				
Opening balance	5,091	4,952	5,091	4,952
Acquisitions	695	139	695	139
Disposals	-	-	-	-
Closing balance	5,786	5,091	5,786	5,091
<b>Amortisation</b>				
Opening balance	3,284	2,646	3,284	2,646
Amortisation for period	712	638	712	638
Closing balance	3,996	3,284	3,996	3,284
<b>Carrying amounts</b>	1,790	1,807	1,790	1,807

Intangible assets comprises computer software only

**13. Other assets**

Interest receivable	1,870	1,670	1,870	1,670
Other	3,536	4,246	3,535	4,243
	5,406	5,916	5,405	5,913

**14. Payables to other financial institutions**

<i>Australia</i> – Third party	-	34,609	-	34,609
<i>Overseas</i>				
Parent entity	3,758	4,081	3,758	4,081
Related parties	350	1,245	350	1,245
Other	446	1,715	446	1,715
	4,554	41,650	4,554	41,650

**15. Deposits**

	Consolidated		The Company	
	2007 \$'000	2006 \$'000	2007 \$'000	2006 \$'000
Current	19,618	12,198	19,618	12,198
Savings	4,216	4,002	4,216	4,002
At call	264,695	181,279	264,695	181,279
Term	310,514	269,455	310,614	269,546
Negotiable certificates of deposit	130,610	230,227	130,610	230,227
	<u>729,653</u>	<u>697,161</u>	<u>729,753</u>	<u>697,252</u>

**16. Employee benefits**

Liability for long service leave	352	308	352	308
Liability for annual leave	328	242	328	242
	<u>680</u>	<u>550</u>	<u>680</u>	<u>550</u>

**17. Other liabilities**

Interest payable	2,002	1,373	2,002	1,373
Unearned income	74	26	74	26
Other	4,561	4,218	4,560	4,219
	<u>6,637</u>	<u>5,617</u>	<u>6,636</u>	<u>5,618</u>

**18. Subordinated debt**

	<u>25,005</u>	<u>25,014</u>	<u>25,005</u>	<u>25,014</u>
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A subordinated debt facility was entered into with Arab Bank plc in 2002 to issue \$25 million to the Company. The rights of the lender are subordinated to all other unsubordinated creditors. The debt is a perpetual, non-redeemable facility whereby the Company has contractual obligations to pay interest at market rates on a monthly basis to the holder of the instrument, Arab Bank plc. The debt can be convertible to share capital if retained earnings become negative.

**19. Share capital**

55,000,000 ordinary shares fully paid	<u>55,000</u>	<u>55,000</u>	<u>55,000</u>	<u>55,000</u>
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**20. Reserves****Hedging reserve**

The hedging reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions that have not yet occurred.

	Consolidated		The Company	
	2007 \$'000	2006 \$'000	2007 \$'000	2006 \$'000
<b>Hedging reserve</b>				
Opening balance	-	(37)	-	(37)
Impact of discontinued hedge accounting transferred to the income statement	-	52	-	52
Tax on cash flow hedging instruments	-	(15)	-	(15)
Closing balance	-	-	-	-

**General Reserve for Credit Losses**

In accordance with APRA's regulatory requirements this reserve reflects 1% of risk-weighted assets and has been appropriated from retained earnings to a non-distributable general reserve for credit losses.

Opening balance	7,489	7,667	7,489	7,667
Transfer from/(to) retained profits during the year	(1,271)	(178)	(1,271)	(178)
Closing balance	6,218	7,489	6,218	7,489
Total reserves	6,218	7,489	6,218	7,489

**21. Retained profits**

Opening balance	40,700	37,113	40,582	37,001
Transfer (to)/from reserves	1,271	178	1,271	178
Net profit	1,385	3,409	1,377	3,403
Closing balance	43,356	40,700	43,230	40,582

**22. Fair Value of financial instruments****Held to maturity investments**

The fair values for held to maturity investments are determined using quoted market prices or dealer quotes for the same or similar securities or where a market price is not readily available, estimated discount values of future cash flows.

## **22. Fair Value of financial instruments (continued)**

### **Loans, advances and other receivables**

The fair value of impaired loans was calculated by discounting expected cash flows using a rate that includes a premium for the uncertainty of the flows.

For variable rate loans, excluding impaired loans, the carrying amount is a reasonable estimate of fair value. The fair value for fixed rate loans was calculated by utilizing discounted cash flow models (i.e. the net present value of the portfolio future principal and interest cash flows), based on the maturity of the loans. The discount rates applied were based on the current benchmark rate, including an add-on of the existing credit margin of the portfolio, offered for the average remaining term of the portfolio. These rates vary based on the term of the loan offered and interest rate environment during the period.

### **Deposits and other public borrowings**

The fair value of non-interest bearing, call and variable rate deposits, and fixed rate deposits repricing within six months, is the carrying value as at year-end. Discounted cash flow models based upon current market rates for debt with similar characteristics and maturities, were used to calculate the fair value of other term deposits.

### **Short-term liabilities**

The carrying value of payables due to other financial institutions and bank acceptances approximate their fair value as they are short term in nature and reprice frequently

### **Subordinated debt**

The fair values of subordinated debt issues were calculated based on discounted cash flows, utilising a yield curve appropriate to the expected remaining maturity of the instrument.

### **All other financial liabilities**

This category includes interest payable, where the carrying amount is considered to be a reasonable estimate of fair value. For liabilities that are long term, fair values have been estimated using the rates currently offered for similar liabilities with remaining maturities.

Other provisions including provision for employee entitlements and income tax liability are not considered financial instruments.

**22. Fair Value of financial instruments (continued)****Derivatives**

The fair value of derivative contracts (interest rate swaps) were obtained from quoted market prices or discounted cash flow models as appropriate. The fair value of these instruments is disclosed in Note 9.

The carrying amounts and estimated fair values of financial assets and liabilities of the economic entity are as follows:

	2007		2006	
	Consolidated		Consolidated	
	Carrying value	Net Fair value	Carrying value	Net Fair value
	\$'000	\$'000	\$'000	\$'000
<b>Assets</b>				
Cash and liquid assets	1,269	1,269	1,648	1,648
Receivables from other financial institutions	11,388	11,388	41,844	41,844
Held to maturity investments	122,977	122,953	69,436	69,414
Loans, advances and other receivables	722,461	721,327	746,620	745,456
Financial asset at fair value through profit or loss	2,057	2,057	920	920
<b>Liabilities</b>				
Payables to other financial institutions	(4,554)	(4,554)	(41,650)	(41,642)
Deposits	(729,653)	(729,583)	(697,161)	(696,803)
Subordinated debt	(25,005)	(25,000)	(25,014)	(25,000)
Financial liabilities at fair value through profit or loss	(491)	(491)	(270)	(270)

**23. Risk Management****(a) Introduction and overview**

The company is exposed to a number of risks, which it manages at different organisational levels.

The main categories of risk are:

**Credit risk:** The risk that a borrower or counterparty will fail to meet its obligations in accordance with agreed terms.

**Liquidity risk:** The risk that the Group is unable to meet its payment obligations from its financial liabilities when they fall due or will have to do so at excessive cost.

**Operational risks:** The risks of losses owing to deficient or erroneous internal procedures, human or system errors or external events.

This note presents information about the Group's exposure to each of the above risks, the objectives, policies and processes for measuring and managing each of these risks, and management of capital.

## **23. Risk Management (continued)**

### **(a) Introduction and overview (continued)**

#### **Risk management framework**

The Board of Directors have overall responsibility for the establishment and oversight of the Group's risk management framework. The board has established the Asset and Liability (ALCO), Credit and Operational Risk Committees, which are responsible for developing and monitoring the risk management policies in their specified areas. All Board committees report regularly to the Board of Directors on their activities.

The Group's risk management policies are established to identify and analyse the risks faced by the Group to set appropriate risk limits and controls, and to monitor risks and adherence to limits.

Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered. The Group, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment, in which employees understand their roles and obligations.

The Audit Committee is responsible for monitoring compliance with the Group's risk management policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Group. The Audit Committee is assisted in these functions by Internal Audit. Internal Audit undertakes both regular and ad-hoc reviews of risk management controls and procedures, the result of which are reported to the Audit Committee.

### **(b) Credit risk**

Credit risk arises principally from the Group's loans and advances to customers and other banks and investment securities. For risk management reporting purposes, the Group considers and consolidates all elements of credit risk exposure (such as individual obligor default risk, country and sector risk).

For risk management purposes, credit risk arising from trading securities is managed independently, but reported as a component of market risk exposure.

The Board of Directors has delegated responsibility for the management of credit risk to the Board Credit Committee. The Executive Credit Committee reports to the Board Credit Committee and is responsible for:

- formulating credit policies in consultation with business units, covering collateral requirements, credit assessment, risk grading and reporting, documentary and legal procedures, and compliance with regulatory and statutory requirements.
- establishing the authorisation structure for the approval and renewal of credit facilities. Authorisation limits are allocated to credit officers. Larger facilities require approval by Manager Credit ("credit"), Executive Credit Committee, Board Credit Committee or the Board of Directors as appropriate.

**(b) Credit risk (continued)**

- establishing the authorisation structure for the approval and renewal of credit facilities. Authorisation limits are allocated to credit officers. Larger facilities require approval by Manager Credit, Executive Credit Committee, Board Credit Committee or the Board of Directors as appropriate.
- reviewing and assessing credit risk. Credit assesses all credit exposures in excess of designated limits, prior to facilities being committed to customers by the business unit concerned. Renewals and reviews of facilities are subject to the same review process.
- limiting concentrations of exposure to counterparties, geographies and industries (for loans and advances), and by issuer, credit rating band, market liquidity and country (for investment securities).
- developing and maintaining the Company's risk gradings in order to categorise exposures to the degree of risk of financial loss faced and to focus management on the attendant risks. The risk grading system is used in determining where impairment provisions may be required against specific credit exposures. The current risk grading framework consists of nine grades reflecting varying degrees of risk of default and the availability of collateral or other credit risk mitigators. The responsibility for setting risk grades lies with the final approving executive/committee as appropriate. Risk grades are subject to regular reviews by Credit and are reported to the Executive Credit Committee.
- reviewing compliance of business units with agreed exposure limits, including those for selected industries, country risk and product types. Regular reports are provided to Credit on the credit quality of portfolios and appropriate corrective action is taken.
- providing advice, guidance and specialist skills to business units to promote best practice throughout the Group in the management of credit risk.

Periodically, audits of credit processes are undertaken by Internal Audit.

The following table presents the maximum exposure to credit risk of balance sheet items (excluding trading assets) combined with the credit quality for each class of financial asset as at the reporting date.

**(b) Credit risk (continued)**

	Loans and advances to customers		Loans and advances to banks		Investment securities	
	2007 \$'000	2006 \$'000	2007 \$'000	2006 \$'000	2007 \$'000	2006 \$'000
<b>Carrying amount</b>	722,461	746,620	11,388	41,844	122,977	69,436
<b>Individually impaired</b>						
Grade H: Non Performing	347	-	-	-	-	-
Individually impaired comprises						
Over 180 days	347	-	-	-	-	-
<b>Past due but not impaired</b>						
Grade A-E: Low risk	17,400	8,083	-	-	-	-
Grade F-G: Watch list	13,803	11,831	-	-	-	-
Grade H: Non Performing	5,555	17,055	-	-	-	-
Carrying Amount	36,758	36,969	-	-	-	-
Past due comprises						
30-60 days	13,615	5,675	-	-	-	-
60-90 days	1,350	3,311	-	-	-	-
90-180 days	2,545	12,993	-	-	-	-
Over 180 days	19,248	14,990	-	-	-	-
Carrying Amount	36,758	36,969	-	-	-	-
<b>Neither past due nor impaired</b>						
Grade A-E: Low risk	665,886	665,105	11,388	41,844	122,977	69,436
Grade F-G: Watch list	19,470	44,546	-	-	-	-
Grade H: Non Performing	-	-	-	-	-	-
Carrying Amount	685,356	709,651	11,388	41,844	122,977	69,436
<b>Total carrying amount</b>	<b>722,461</b>	<b>746,620</b>	<b>11,388</b>	<b>41,844</b>	<b>122,977</b>	<b>69,436</b>

**23. Risk Management (continued)****(b) Credit risk (continued)****Impaired loans and securities**

Impaired loans and securities are loans and securities for which the Company determines that it is probable that it will be unable to collect all principle and interest due according to the contractual terms of the loan/securities agreement(s). The Company has no material unsecured exposure to any individual or external parties. Refer note 1(i) for further detail on factors taken into consideration when assessing for evidence of impairment.

**Past due but not impaired loans**

Loans and securities where contractual interest or principal payments are past due but the Company believes that impairment is not appropriate on the basis of the level of security / collateral available and / or the stage of collection of amounts owed to the Company are considered to be past due but not impaired.

**Loans with renegotiated terms**

Loans with renegotiated terms are loans that have been restructured due to deterioration in the borrower's financial position and where the Company has made concessions that it would not otherwise consider. Once the loan is restructured it remains in this category independent of satisfactory performance after restructuring.

**Allowances for impairment**

The Company establishes an allowance for impairment losses that represents its estimate of incurred losses in its loan portfolio. The main components of this allowance are a specific loss component that relates to individually significant exposures and a collective loan provision. The collective provision is calculated in accordance with note 1 (i).

**Write off policy**

The Group writes off a loan / security balance when credit determines that the loans / securities are uncollectible. This determination is reached after considering information such as the occurrence of significant changes in the borrower / issuer's financial position such that the borrower / issuer can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure. For smaller balance standardised loans, charge off decisions generally are based on a product specific past due status.

The Group holds collateral against loans and advances to customers in the form of mortgage interests over property, other registered security over assets, and guarantees. Estimates of fair value are based on the value of collateral assessed as impaired. Collateral generally is not held over loans and advances to banks, except when securities are held as part of reverse repurchase and securities borrowing activity. Collateral usually is not held against investment securities, and no such collateral was held at 31 December 2007 or 2006.

**23. Risk Management (continued)****(b) Credit risk (continued)**

An estimate of the fair value of collateral and other security enhancements held against loans and advances to customers is shown below:

	<b>Loans and advances</b>	
	2007	2006
	\$'000	\$'000
<b>Against individually impaired</b>		
Property	340	-
Other	60	-
<b>Against past due but not impaired</b>		
Property	33,942	29,918
Other	15,975	5,667

The fair value of financial assets accepted as collateral in the event of customer default and have been subsequently sold during the year is \$3,984,000 (2006: \$nil).

The Company monitors concentrations of credit risk by industry. An analysis of concentration of credit risk at the reporting date is shown below:

Carrying amount	722,461	746,620
Concentration by economic sector:		
Construction	174,095	188,889
Cultural, recreational, personal and other services	23,109	25,670
Finance and insurance	11,371	10,489
Health and community services	18,591	19,909
Manufacturing	19,443	14,888
Property and business services	142,473	154,134
Retail and wholesale trade	109,548	124,795
Transport and storage	62,488	62,748
Other commercial and industrial	161,343	145,098
	722,461	746,620

The above analysis complies with the Australian and New Zealand standard industrial classification codes.

**23. Risk Management (continued)****(c) Liquidity risk**

Treasury maintain information regarding the liquidity profile of financial assets and liabilities and details of other projected cash flows from projected future business. Treasury then maintain a portfolio of short-term liquid assets, largely made up of short term liquid investment securities, loans and advances to banks and other inter-bank facilities, to ensure that sufficient liquidity is maintained within the Company to manage business needs.

The liquidity position is monitored daily and regular liquidity stress testing is conducted under a variety of scenarios covering both predictable and more severe market conditions. All liquidity policies and procedures are subject to review and approval by ALCO. Daily reports cover the liquidity position of the Company. A summary report including any exceptions and remedial action taken is submitted regularly to ALCO.

The table below for 2007 and 2006 breaks down the financial assets and liabilities of the Group by contractual maturity. The companies' expected cash flows on these instruments vary significantly from this analysis. For example demand deposits from customers are expected to remain a stable or increasing balance.

\$'000's	Less than 1 month	1-3 months	3 months to 1 year	1-3 years	More than 3 years	Not tied to maturity
<b>31 December 2007</b>						
<b>Assets</b>						
Cash and liquid assets	-	-	-	-	-	1,269
Receivables from other financial institutions	1,773	-	95	-	-	9,520
Held to maturity investments	33,720	-	89,257	-	-	-
Loans and advances to customers, net	49,126	93,363	105,512	178,916	295,544	-
Financial assets at fair value through profit or loss	365	720	499	429	44	-
<b>Total financial assets</b>	<b>84,984</b>	<b>94,083</b>	<b>195,363</b>	<b>179,345</b>	<b>295,588</b>	<b>10,789</b>
<b>Liabilities</b>						
Payables to other financial institutions	-	-	-	-	-	4,554
Deposits	310,524	331,641	77,113	10,370	5	-
Financial liabilities at fair value through profit or loss	2	1	38	398	52	-
Subordinated debt	-	-	-	-	-	25,005
<b>Total financial liabilities</b>	<b>310,526</b>	<b>331,642</b>	<b>77,151</b>	<b>10,768</b>	<b>57</b>	<b>29,559</b>

**23. Risk Management (continued)****(c) Liquidity risk (continued)**

\$'000's	Less than 1 month	1-3 months	3 months to 1 year	1-3 years	More than 3 years	Not tied to maturity
<b>31 December 2006</b>						
<b>Assets</b>						
Cash and liquid assets	-	-	-	-	-	1,648
Receivables from other financial institutions	33,388	-	95	-	-	8,361
Held to maturity investments	19,839	49,597	-	-	-	-
Loans and advances to customers, net	41,521	140,126	108,275	166,963	289,735	-
Financial assets at fair value through profit or loss	28	6	93	573	220	-
<b>Total financial assets</b>	<b>94,776</b>	<b>189,729</b>	<b>108,463</b>	<b>167,536</b>	<b>289,955</b>	<b>10,009</b>
<b>Liabilities</b>						
Payables to other financial institutions	-	-	-	-	-	41,650
Deposits	266,963	259,866	113,124	56,902	306	-
Financial liabilities at fair value through profit or loss	38	213	19	-	-	-
Subordinated debt	-	-	-	-	-	25,014
<b>Total financial liabilities</b>	<b>267,001</b>	<b>260,079</b>	<b>113,143</b>	<b>56,902</b>	<b>306</b>	<b>66,664</b>

**23. Risk Management (continued)****(d) Market risk**

Market risk is the risk that changes in market prices, such as interest rate and foreign exchange rates will affect the Group's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

**Management of market risks**

The Company separates exposure to market risk into either trading or non-trading portfolios. Trading portfolios include those positions arising from transactions entered into in order to profit from market movements.

Non-trading portfolios arise primarily from the interest rate management of the Group's retail and commercial banking assets and liabilities.

All foreign exchange risk within the Group is managed centrally by Treasury. The foreign exchange position is treated as part of the Companies trading portfolios for risk management purposes.

**Management of market risks (continued)**

Overall authority for market risk is vested in ALCO. Treasury is responsible for the development of detailed risk management policies (subject to the review and approval of ALCO and the Board) and for the day-to-day review of the implementation.

The management of market risk is principally undertaken using risk limits approved by ALCO and the Board. Limits are set for portfolios, products and risk types, with market liquidity being a principal factor in determining the level of limits set.

**Interest Rate Risk**

The principal risk to which non-trading portfolios are exposed is the risk of loss from fluctuations in the future cash flows of fair values of financial instrument because of a change in market interest rates. A principal part of management of interest rate risk is to monitor the sensitivity of projected net interest income.

The following tables represents the earlier of contractual repricing or maturity date as at 31 December 2007 and the prior year. The table is illustrative only and is based on simplified scenarios. Actions that would have been taken to mitigate the impact of this interest rate risk are not incorporated. In reality the Group seeks proactively to change the interest rate risk profile to minimise losses and optimise net revenues. This analysis also makes simplifying projections, including that all positions run to maturity.

An increase in the interest rate of 10% above the average interest rate at 31 December 2007 would result in additional income of \$1,350,000 (2006: \$1,555,000).

**23. Risk Management (continued)****(d) Market risk (continued)****Interest rate risk**

\$'000's	Carrying amount	Less than 1 month	1-3 months	3 months to 1 year	1-3 years	More than 3 years	Not tied to maturity
<b>31 December 2007</b>							
<b>Assets</b>							
Cash and liquid assets	1,269	-	-	-	-	-	1,269
Receivables from other financial institutions	11,388	1,773	-	95	-	-	9,520
Held to maturity investments	122,977	33,720	-	89,257	-	-	-
Loans and advances to customers, net	722,461	546,557	40,262	33,282	55,364	46,996	-
Financial assets at fair value through profit or loss	2,057	-	1,590	467	-	-	-
Plant and equipment	1,506	-	-	-	-	-	1,506
Current tax assets	1,206	-	-	-	-	-	1,206
Deferred tax assets	1,534	-	-	-	-	-	1,534
Intangible assets	1,790	-	-	-	-	-	1,790
Other assets	5,406	-	-	-	-	-	5,406
<b>Total assets</b>	<b>871,594</b>	<b>582,050</b>	<b>41,852</b>	<b>123,101</b>	<b>55,364</b>	<b>46,996</b>	<b>22,231</b>
<b>Liabilities</b>							
Payables to other financial institutions	4,554	-	-	-	-	-	4,554
Deposits	729,653	310,524	331,641	77,113	10,370	5	-
Current tax liability	-	-	-	-	-	-	-
Financial liabilities at fair value through profit or loss	491	370	74	47	-	-	-
Provision for employee entitlements	680	-	-	-	-	-	680
Other liabilities	6,637	-	-	-	-	-	6,637
Subordinated debt	25,005	25,005	-	-	-	-	-
<b>Total liabilities</b>	<b>767,020</b>	<b>335,899</b>	<b>331,715</b>	<b>77,160</b>	<b>10,370</b>	<b>5</b>	<b>11,871</b>

## 23. Risk Management (continued)

## (d) Market risk (continued)

## Interest rate risk

\$'000's	Carrying amount	Less than 1 month	1-3 months	3 months to 1 year	1-3 years	More than 3 years	Not tied to maturity
<b>31 December 2006</b>							
<b>Assets</b>							
Cash and liquid assets	1,648	-	-	-	-	-	1,648
Receivables from other financial institutions	41,844	33,388	-	95	-	-	8,361
Held to maturity investments	69,436	19,839	49,597	-	-	-	-
Loans and advances to customers, net	746,620	536,460	66,727	47,673	69,409	26,351	-
Financial assets at fair value through profit or loss	920	-	686	234	-	-	-
Plant and equipment	2,343	-	-	-	-	-	2,343
Current tax assets	1,275	-	-	-	-	-	1,275
Deferred tax assets	1,642	-	-	-	-	-	1,642
Intangible assets	1,807	-	-	-	-	-	1,807
Other assets	5,916	-	-	-	-	-	5,916
<b>Total assets</b>	<b>873,451</b>	<b>589,687</b>	<b>117,010</b>	<b>48,002</b>	<b>69,409</b>	<b>26,351</b>	<b>22,992</b>
<b>Liabilities</b>							
Payables to other financial institutions	41,650	-	-	-	-	-	41,650
Deposits	697,161	265,098	261,344	113,499	56,912	308	-
Financial liabilities at fair value through profit or loss	270	199	52	19	-	-	-
Provision for employee entitlements	550	-	-	-	-	-	550
Other liabilities	5,617	-	-	-	-	-	5,617
Subordinated debt	25,014	25,014	-	-	-	-	-
<b>Total liabilities</b>	<b>770,262</b>	<b>290,311</b>	<b>261,396</b>	<b>113,518</b>	<b>56,912</b>	<b>308</b>	<b>47,817</b>

**23. Risk Management (continued)****(d) Market risk (continued)****Foreign Exchange risk - trading portfolios**

The principal risk to which trading portfolios are exposed is the risk of loss from fluctuations in the future cash flows of fair values of financial instruments because of a change in the foreign exchange rates. A valuation of the trading book is undertaken on a daily basis and breaches of limits are notified to ALCO.

**Sensitivity analysis**

The sensitivity analysis shows the effect on the Income Statement if there was a movement of 10% in foreign exchange rates from the rates at the reporting date.

	Increase of 10%	Decrease of 10%
	\$	\$
31 December 2007	3,525	5,287
31 December 2006	12,259	14,984

The foreign currency sensitivities set out in the table above are illustrative only and are based on simplified scenarios. The figures represent the effect of the pro forma movements in foreign exchange rates and the Groups current foreign exchange risk profile. The projection above also assumes that foreign exchange rates all move by the same amount and, therefore, do not reflect the potential impact of some rates changing whilst others remain unchanged. This effect does not incorporate actions that would have been taken to mitigate the impact of this foreign exchange risk. In reality, the Group seeks to proactively to change the foreign exchange risk profile to minimise losses and optimise net revenues.

**(e) Operational risk**

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Group's processes, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risks such as those arising from legal and regulatory requirements and generally accepted standards of corporate behaviour. Operational risks arise from all the Group's operations and are faced by all business entities.

The Group's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the Group's reputation with overall cost effectiveness and to avoid control procedures that restrict initiative and creativity.

The primary responsibility for the development and implementation of controls to address operational risk is assigned to senior management. This responsibility is supported by the development of overall Group standards for the management of operational risk in the following areas:

- requirement for appropriate segregation of duties, including independent authorisation of transactions
- requirements for the reconciliation and monitoring of transactions
- compliance with regulatory and other legal requirements
- documentation of controls and procedures

**(e) Operational risk (continued)**

- requirement for the periodic assessment of operational risks faced, and adequacy of controls and procedures to address the risks identified.
- requirements for the reporting of operational losses and proposed remedial actions
- development of contingency plans
- training and professional development
- ethical and business standards
- risk mitigation, including insurance where this is effective

Compliance with Group standards is supported by a programme of periodic reviews undertaken by Internal Audit. The results of Internal Audit reviews are discussed with the management of the business unit to which they relate, with summaries submitted to the Audit Committee and senior management of the Group.

**(f) Capital Management****Regulatory capital**

The Group's lead regulator, Australian Prudential Regulation Authority (APRA) sets and monitors capital requirements for the Group.

In implementing current capital requirements APRA requires the Group to maintain a prescribed ratio of total capital to risk weighted assets. The risk weighting used for assets are as prescribed by APRA.

The Group's regulatory capital is analysed into two tiers:

Tier 1 capital, which includes ordinary share capital, retained earnings and any other regulatory adjustments related to items that are included in equity but are treated differently for capital adequacy purposes.

Tier 2 capital, which includes qualifying subordinated liabilities and collective impairment allowances.

Various limits are applied to elements of the capital base. The amount of innovative tier 1 securities cannot exceed 15 percent of total tier 1 capital; qualifying tier 2 capital cannot exceed tier 1 capital; and qualifying term subordinated loan capital may not exceed 50 percent of tier 1 capital. There are also restrictions on the amount of collective impairment allowances that may be included as part of tier 2 capital. Other deductions from capital include carrying amounts of investments in subsidiaries that are not included in the regulatory consolidation.

The Group's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business.

The Group has complied with all external imposed capital requirements throughout the period.

There have been no material changes to the Group's management of capital during the period.

**23. Risk Management (continued)****(f) Capital Management (continued)**

The Group's regulatory capital position at 31 December was as follows:

	2007	2006
	\$'000	\$'000
<b>Tier 1 capital</b>		
Ordinary share capital	55,000	55,000
Retained earnings	43,356	40,700
Less intangible assets	(1,790)	(1,807)
Other regulatory adjustments	7,500	6,800
<b>Total</b>	<b>104,066</b>	<b>100,693</b>
<b>Tier 2 capital</b>		
Collective allowances for impairment	6,218	7,489
Qualifying subordinated liabilities	25,000	25,000
<b>Total</b>	<b>31,218</b>	<b>32,489</b>
<b>Total regulatory capital</b>	<b>135,285</b>	<b>133,182</b>
<b>Risk-weighted assets</b>	<b>719,100</b>	<b>710,100</b>
<b>Capital ratios</b>		
Total regulatory capital expressed as a percentage of risk weighted assets	18.8%	18.6%
Total tier 1 capital expressed as a percentage of risk-weighted assets	14.5%	14.2%

**Capital allocation**

The allocation of capital between specific operations and activities is, to a large extent, driven by optimisation of the return achieved on the capital allocated. The amount of capital allocated to each operation or activity is based primarily upon the regulatory capital.

Although maximisation of the return on risk-adjusted capital is the principal basis used in determining how capital is allocated within the Group to particular operations or activities, it is not the sole basis used for decision making. Account also is taken of synergies with other operations and activities, the availability of management and other resources, and the fit of the activity with the Group's longer term strategic objectives. The Group's policies in respect of capital management and allocation are reviewed regularly by the Board of Directors.

**24. Commitments for expenditure****Operating leases**

	<b>Consolidated</b>		<b>The Company</b>	
	2007 \$'000	2006 \$'000	2007 \$'000	2006 \$'000
Future operating lease rentals not provided for and payable:				
Later than one year but not later than two years	3,063	2,318	3,063	2,318
Later than two years but not later than five years	2,647	2,249	2,647	2,249
Later than five years	3,666	3,834	3,666	3,834
	1,512	1,463	1,512	1,463
	<b>10,888</b>	<b>9,864</b>	<b>10,888</b>	<b>9,864</b>

The consolidated entity leases branches, head office building, plant and equipment  
During the financial year ended 31 December 2007 \$2,196,000 was recognised as an  
expense in the income statement in respect of operating leases (2006: \$2,200,000).

**25. Auditors' remuneration****Audit services**

Audit of the financial report	151,750	111,750	151,750	111,750
Other regulatory audit services	55,050	50,150	55,050	50,150
	<b>206,800</b>	<b>161,900</b>	<b>206,800</b>	<b>161,900</b>

**Non-audit services**

Taxation services	28,600	25,100	28,600	25,100
Other services	19,500	47,296	19,500	47,296
	<b>48,100</b>	<b>72,396</b>	<b>48,100</b>	<b>72,396</b>
	<b>254,900</b>	<b>234,296</b>	<b>254,900</b>	<b>234,296</b>

The Board Audit Committee has considered the non-audit services provided by KPMG  
and is satisfied that the services and the level of fees are compatible with maintaining  
auditors' independence.

**26. Related Parties****Key management personnel disclosures for non-disclosing entities**

The following were key management personnel of the consolidated entity at any time during the reporting period, unless otherwise indicated were directors for the entire period:

<b>Non-executive directors</b>	<b>Executives</b>	
Mr S Kawar	Mr J Rizk	Chief Banking Officer
Mr G Wild AM	Mr B Buncl	Chief Financial Officer
Mr E-Y Kim	Mr R Withey	Chief Operating Officer
Mr I MacDonald	Ms H Michael	Head of Research and Development and Company Secretary
Mr L Taylor		

**Executive director**

Mr J Wakim (Managing Director)

**Transactions with key management personnel**

In addition to their salaries, the consolidated entity also provides non-cash benefits to directors and executive officers, and contributes to a superannuation fund on their behalf.

The key management personnel compensation included in “staff expenses” (see Note 2) are as follows:

	<b>Consolidated</b>		<b>The Company</b>	
	2007	2006	2007	2006
	\$'000	\$'000	\$'000	\$'000
Short-term employee benefits	1,361,438	1,087,148	1,361,438	1,087,148
Other long-term benefits	49,107	57,000	49,107	57,000
Post-employment benefits	114,698	70,113	114,698	70,113
	<u>1,525,243</u>	<u>1,214,261</u>	<u>1,525,243</u>	<u>1,214,261</u>

**Non-key management personnel disclosures****(a) Directors**

Apart from the details disclosed in this note, no director has entered into a material contract with the Company or its subsidiary since the end of the previous financial year and there are no material contracts involving directors' interests existing at year end

**Loans to directors**

Loan balances	-	300,000	-	300,000
Loans made during the year	-	-	-	-
Repayments during the year	-	(300,000)	-	(300,000)
Interest received during the year	-	10,000	-	10,000

**26. Related Parties (continued)****(b) Transactions within the wholly-owned group**

During the financial year the Company engaged in banking transactions with Arab Bank plc, and its wholly owned subsidiaries. All transactions were on normal terms and conditions. The Company also paid Arab Bank plc a management fee for corporate services; these services are also provided on normal commercial terms and conditions.

**(c) Transactions with other related parties**

During the year the Company engaged in banking transactions with associated companies of Arab Bank plc. All transactions were on normal commercial terms and conditions. Balances with these companies are disclosed in the notes to the financial statements.

**(d) Parent entity**

The parent entity of Arab Bank Australia Limited is Arab Bank plc, a company incorporated in Jordan.

**27. Contingent liabilities**

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business.

Details of financial instruments with off-balance sheet risk are as follows:

	<b>Consolidated</b>		<b>The Company</b>	
	2007 \$'000	2006 \$'000	2007 \$'000	2006 \$'000
	Face value		Face value	
<b>Credit risk related instruments</b>				
Letters of credit issued in the normal course of business	450	232	450	232
Letters of credit confirmed in the normal course of business	8,391	3,881	8,391	3,881
Letters of Guarantee given in the normal course of business	12,508	12,222	12,508	12,222
Commitments to extend credit	107,057	99,683	107,057	99,683

**28. Financial reporting by segments**

The Company operates within one segment, the Australian Banking and Financial Services industry, providing a range of retail banking and trade finance products to customers.

**29. Notes to the Cash Flow Statements****(a) Reconciliation of cash**

For the purposes of the Cash Flow Statements, cash includes cash on hand, cash at bank and short term deposits at call, net of outstanding bank overdrafts. Cash as at the end of the financial year as shown in the Cash Flow Statements is reconciled to the related items in the Balance Sheets as follows:

	Consolidated		The Company	
	2007	2006	2007	2006
	\$'000	\$'000	\$'000	\$'000
Cash	1,269	1,648	1,269	1,648
Short term deposits	11,388	41,844	11,292	41,748
Total cash at end of year	12,657	43,492	12,561	43,396

**(b) Reconciliation of net profit to net cash (used in)/ provided by operating activities**

Net profit	1,385	3,409	1,377	3,403
Add/(less) items classified as investing/financing activities:				
(Profit)/loss on sale of non-current assets	53	-	53	-
Add/(less) non-cash items:				
Depreciation of non-current assets	955	1,189	955	1,189
Amortisation of intangibles	712	638	712	638
Amortisation of establishment expenses	701		701	
Unrealised FX (gain)/loss	657	(340)	657	(340)
Increase in provisions for doubtful debts	127	(432)	127	(432)
Unrealised gain on hedging revaluations	(916)	(621)	(916)	(621)
Add/(less) changes in assets and liabilities:				
(Increase)/Decrease in other assets	-	574	-	573
(Increase)/Decrease in prepayments	(52)	10	(52)	10
(Increase)/Decrease in interest receivable	(824)	3,222	(824)	3,219
Increase/(Decrease) in interest payable	(628)	(1,458)	(628)	(1,460)
Increase/(Decrease) in other liabilities	2,553	(478)	2,552	(470)
Increase/(Decrease) in income tax payable	69	(1,500)	72	(1,502)
(Increase)/Decrease in future tax benefit	108	800	108	800
Increase/(Decrease) in employee provisions	130	248	130	248
Net cash (used in)/provided by operating activities	5,030	5,261	5,024	5,255

**29. Notes to the Cash Flow Statements (continued)****(c) Net reporting of certain cash flows**

Cash flows arising from the following activities have been presented on a net basis in the Cash Flow Statements:

- (i) money market trading activities and retail lending activities;
- (ii) customer deposits to and withdrawals from savings, money market and other deposit accounts;
- (iii) balances due to and from other financial institutions;
- (iv) statutory deposits; and
- (v) investment securities.

**(d) Financing facilities**

	<b>Consolidated</b>		<b>The Company</b>	
	2007 \$'000	2006 \$'000	2007 \$'000	2006 \$'000
Financing arrangements which are available to the group:				
Standby credit facilities with parent	20,000	20,000	20,000	20,000

At year-end the above facilities were unutilised.

Directors' declaration

In the opinion of the directors of Arab Bank Australia Limited:

- 1 The financial statements and notes, set out on pages 27 to 68, are in accordance with the Corporations Act 2001, including:
  - (a) giving a true and fair view of the financial position of the Company and consolidated entity as at 31 December 2007 and of their performance, as represented by the results of their operations and their cash flows, for the year ended on that date; and
  - (b) complying with Accounting Standards and the Corporations Regulations 2001; and
- 2 There are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.

Signed in accordance with a resolution of the directors:



J Wakim  
Director



G Wild  
Director

Dated at Melbourne 12 March 2008.

**Sydney**

Suite 1a, 200 George St Sydney NSW 2000

Lending (02) 9377 8940

Customer Service (02) 9377 8942

**Auburn**

19 Auburn Rd Auburn NSW 2144

Lending (02) 9749 9950

Customer Service (02) 9749 9400

**Bankstown**

Cnr Restwell St and South Terrace Bankstown NSW 2200

Lending (02) 9707 3955

Customer Service (02) 9707 3755

**Campsie**

206 Beamish St Campsie NSW 2194

Lending (02) 9787 5042

Customer Service (02) 9787 2133

**Liverpool**

236 Macquarie Street Liverpool NSW 2170

Lending (02) 8706 0330

Customer Service (02) 8706 0300

**Parramatta**

74 Macquarie St Parramatta NSW 2150

Lending (02) 9689 3500

Customer Service (02) 9893 7633

**Rockdale**

506 Princes Hwy Rockdale NSW 2216

Lending (02) 9599 9633

Customer Service (02) 9597 1122

**Coburg**

492 Sydney Rd Coburg VIC 3058

Lending (03) 9355 8862

Customer Service (03) 9355 7740

**Sunshine**

259 Hampshire Rd Sunshine VIC 3020

Lending (03) 9364 7894

Customer Service (03) 9364 7664

**Freecall**

1800 64 64 84

[www.arabbank.com.au](http://www.arabbank.com.au)