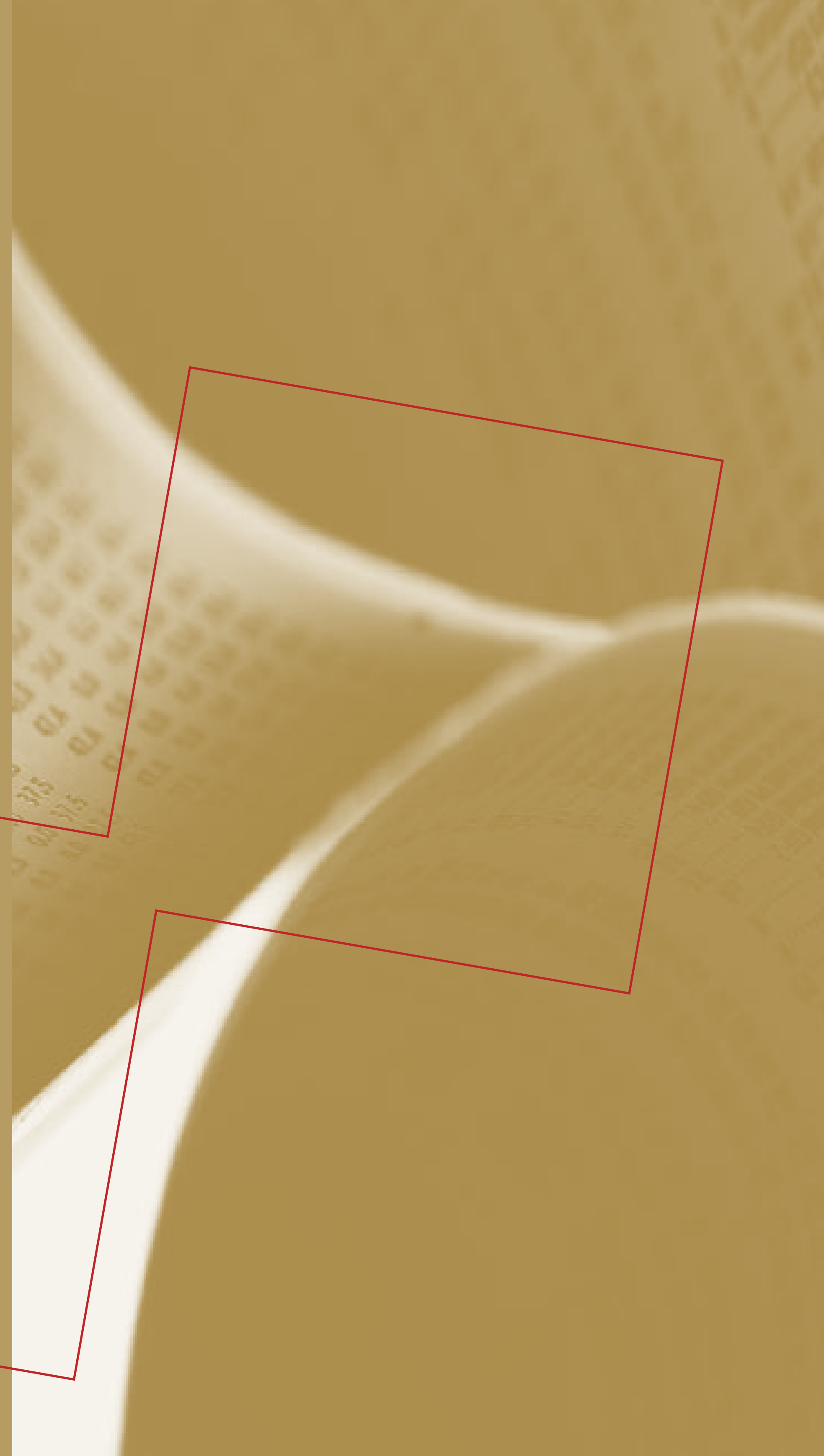

Consolidated Financial Statements

SHARIA'A SUPERVISORY BOARD REPORT ON THE ACTIVITIES OF GULF FINANCE HOUSE B.S.C

FOR THE FINANCIAL YEAR ENDING 31 DECEMBER 2006

In the name of Allah, the Beneficent, the Merciful

Prayers and Peace Upon the Last Apostle and Messenger, Our prophet Mohammed, His Comrades and Relatives.

The Sharia'a Supervisory Board of Gulf Finance House have reviewed the Bank's investment activities and compared them with the previously issued fatwas and rulings during the financial year 31st December 2006 and found them compatible with the already issued fatwas and rulings.

The Board believes that it has expressed its opinion in respect of the activities carried on by the Bank and it is the responsibility of the management to ensure the implementation of such decisions. It is the duty of the Board to express an independent opinion on the basis of its control and review of the Bank's operations and to prepare a report about them.

A representative of the Bank's management explained and clarified the contents of consolidated Balance Sheet, attached notes and Consolidated Income Statement for the financial year ended on 31st December 2006 to our satisfaction. The report of the Board has been prepared based on the contents provided by the Bank.

The Board is further satisfied that any income which is not in compliance with the Glorious Islamic Sharia'a has been dispersed to charitable organizations and that the responsibility of the payment of the Zakat lies with the shareholders in their shares.

The Board is satisfied that the investment activities and banking services are in compliance with the Glorious Islamic Sharia'a.

Praise be to Allah, Lord of the Worlds.

Prayers on Prophet Mohammed (Peace Be Upon Him), all his Family and Companions.

Sh. Abdullah bin Sulaiman Al-Manie

Sh. Nizam Bin Mohammed Saleh Yaquby

Dr. Fareed Mohammed Hadi

Dr. AbdulAziz Khalifa Al-Qassar

REPORT OF THE AUDITORS TO THE SHAREHOLDERS

GULF FINANCE HOUSE BSC
Manama, Kingdom of Bahrain

28 January 2007

Report on the consolidated financial statements

We have audited the accompanying consolidated financial statements of Gulf Finance House B.S.C. ("the Bank") and its subsidiaries (together the "Group"), which comprise the consolidated balance sheet as at 31 December 2006, and the consolidated income statement, the consolidated statement of changes in equity, the consolidated statement of cash flows, the consolidated statement of changes in restricted investment accounts and the consolidated statement of sources and uses of charity and zakah fund for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Responsibility of the directors for the consolidated financial statements

The directors of the Bank are responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Financial Accounting Standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions and International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of the consolidated financial statements that are free from material misstatements, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances. In addition the directors of the Bank are responsible for the Bank's undertaking to operate in accordance with Islamic Shari'a rules and principles.

Auditors' responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with both the Auditing Standards for Islamic Financial Institutions and International Standards on Auditing. Those standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements 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 principles used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2006, and of its consolidated financial performance, its consolidated cash flows, the consolidated changes in its equity, changes in consolidated restricted investment accounts and consolidated sources and uses of charity and zakah fund for the year then ended in accordance with Financial Accounting Standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions and the Shari'a rules and principles as determined by the Shari'a Supervisory Board of the Bank.

In addition, in our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2006 and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards.

Report on other legal and regulatory requirements

In addition, in our opinion, the Bank has maintained proper accounting records and the consolidated financial statements are in agreement therewith. We have reviewed the accompanying report of the chairman and confirm that the information contained therein is consistent with the consolidated financial statements. We are not aware of any violations of the Bahrain Commercial Companies Law 2001, the Central Bank of Bahrain and Financial Institutions Law 2006, the terms of the Bank's license or its memorandum and articles of association having occurred during the year ended 31 December 2006 that might have had a material effect on the business of the Bank or on its financial position. Satisfactory explanations and information have been provided to us by the management in response to all our requests.

KPMG
Manama, Kingdom of Bahrain

The accompanying notes 1 to 38 form an integral part of these consolidated financial statements.

CONSOLIDATED BALANCE SHEET

as at 31 December 2006

US$ 000's

	Note	2006	2005
ASSETS			
Cash and bank balances	3	15,050	13,412
Due from financial and non-financial institutions	4	687,765	685,771
Trading properties		2,960	8,660
Islamic financing assets	5	98,927	17,110
Investment in sukuks	6	77,993	61,374
Assets held-for-sale	7	24,196	25,327
Investment securities	8	357,063	189,235
Other assets	9	232,496	97,184
Equipment	10	4,434	1,694
Total assets		**1,500,884**	**1,099,767**
LIABILITIES			
Investors' funds	11	348,553	477,775
Customers' current accounts		7,297	5,090
Due to financial and non-financial institutions	12	340,916	176,145
Other liabilities	13	77,454	52,693
Total liabilities		**774,220**	**711,703**
Unrestricted investment accounts	14	58,920	35,700
EQUITY			
Share capital	15	212,674	149,771
Advance towards share capital		2,708	-
Share premium		178,321	31,487
Treasury shares		(14,127)	-
Subsidiary company share grants	19	1,804	-
Statutory reserve		46,337	24,621
Investments fair value reserve		364	227
Retained earnings		239,663	146,258
Total equity (page 72)		**667,744**	**352,364**
Total liabilities, unrestricted investment accounts and equity		1,500,884	1,099,767
OFF-BALANCE SHEET ITEMS			
Restricted investment accounts (page 74)		**123,393**	**106,393**

The consolidated financial statements, which consist of pages 70 to 102, were approved by the Board of directors on 28 January 2007 and signed on its behalf by:

Fuad Abdulla Al-Omar
Chairman

Hamad A Aziz Al-Shaya
Vice-Chairman

Esam Yousif A. Janahi
Director and Chief Executive Officer

The accompanying notes 1 to 38 form an integral part of these consolidated financial statements.

CONSOLIDATED INCOME STATEMENT

for the year ended 31 December 2006 US$ 000's

	Note	2006	2005
Income from investment advisory services	16	266,647	167,752
Placement, arrangement and management fees		20,337	27,280
Income from investment securities	17	11,982	12,403
Income from short-term murabaha placements		35,357	13,559
Income from investment in sukuks		3,718	1,234
Income from Islamic financing assets		3,783	150
Other income		3,882	548
Total income		**345,706**	**222,926**
Staff costs	18	67,248	40,103
Investment advisory expenses		25,055	29,402
Impairment allowances on available-for-sale investments	8 (i)	6,728	-
Murabaha expense		24,322	8,022
Other expenses		10,767	5,015
Total expenses		**134,120**	**82,542**
PROFIT FOR THE YEAR		**211,586**	**140,384**
Attributable to:			
Shareholders of the parent company		211,586	140,331
Minority interest		-	53
		211,586	**140,384**
Earnings per share (US cents)			
Basic	28	**33.88**	**25.34**

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

for the year ended 31 December 2006

US$ 000's

2006	Attributable to the shareholders of the parent									Minority interest	Total equity
	Share Capital	Advance towards share capital	Share premium	Treasury Shares	Subsidiary company share grants	Statutory reserve	Investments fair value reserve	Retained earnings	Total		
Balance at 1 January 2006	**149,771**	**-**	**31,487**	**-**	**-**	**24,621**	**227**	**146,258**	**352,364**	**-**	**352,364**
Gain on sale of treasury shares	-	-	-	-	-	508	-	-	508	-	508
Net fair value changes during the year	-	-	-	-	-	-	1,223	-	1,223	-	1,223
Transfer to income statement on disposal of AFS investments	-	-	-	-	-	-	(1,086)	-	(1,086)	-	(1,086)
Net income recognised directly in equity	-	-	-	-	-	508	137	-	645	-	645
Net profit for the year	-	-	-	-	-	-	-	211,586	211,586	-	211,586
Total recognised income and expense	**-**	**-**	**-**	**-**	**-**	**508**	**137**	**211,586**	**212,231**	**-**	**212,231**
Issue of bonus shares	17,972	-	-	-	-	-	-	(17,972)	-	-	-
Increase in share capital	44,931	2,708	142,963	-	-	-	-	-	190,602	-	190,602
Share issue expenses	-	-	(129)	-	-	-	-	-	(129)	-	(129)
Fair value of share grants issued (note 19)	-	-	-	-	2,056	-	-	-	2,056	-	2,056
Unvested component of share grants issued (note 19)	-	-	-	-	(252)	-	-	-	(252)	-	(252)
Dividend declared for 2005	-	-	-	-	-	-	-	(71,890)	(71,890)	-	(71,890)
Charity contribution declared for 2005	-	-	-	-	-	-	-	(1,000)	(1,000)	-	(1,000)
Board remuneration declared for 2005	-	-	-	-	-	-	-	(1,050)	(1,050)	-	(1,050)
Zakah contribution declared for 2005	-	-	-	-	-	-	-	(1,061)	(1,061)	-	(1,061)
Purchase of treasury shares	-	-	-	(19,987)	-	-	-	-	(19,987)	-	(19,987)
Sale of treasury shares	-	-	-	5,860	-		-	-	5,860	-	5,860
Transfer from retained earnings to share premium	-	-	4,000	-	-	-	-	(4,000)	-	-	-
Transfer to statutory reserve	-	-	-	-	-	21,208	-	(21,208)	-	-	-
Balance at 31 December 2006	**212,674**	**2,708**	**178,321**	**(14,127)**	**1,804**	**46,337**	**364**	**239,663**	**667,744**	**-**	**667,744**

2005	Attributable to the shareholders of the parent									Minority interest	Total equity
	Share Capital	Advance towards share capital	Share premium	Treasury Shares	Subsidiary company share grants	Statutory reserve	Investments fair value reserve	Retained earnings	Total		
Balance at 1 January 2005	**139,973**	**-**	**31,487**	**-**	**-**	**10,576**	**3,899**	**63,725**	**249,660**	**1,246**	**250,906**
				-	-						
Net fair value changes during the year	-	-	-	-	-	-	12,520	-	12,520	-	12,520
Transfer to income statement on disposal of AFS investments	-	-	-	-	-	-	(16,192)	-	(16,192)	-	(16,192)
Net income recognised directly in equity	-	-	-	-	-	-	(3,672)	-	(3,672)	-	(3,672)
Net profit for the year	-	-	-	-	-	-	-	140,331	140,331	53	140,384
Total recognised income and expense	**-**	**-**	**-**	**-**	**-**	**-**	**(3,672)**	**140,331**	**136,659**	**53**	**136,712**
Issue of bonus shares	9,798	-	-	-	-	-	-	(9,798)	-	-	-
Dividend declared for 2004	-	-	-	-	-	-	-	(32,194)	(32,194)	-	(32,194)
Charity contribution declared for 2004	-	-	-	-	-	-	-	(600)	(600)	-	(600)
Board remuneration declared for 2004	-	-	-	-	-	-	-	(585)	(585)	-	(585)
Zakah contribution declared for 2004	-	-	-	-	-	-		(576)	(576)		(576)
Transfer to statutory reserve	-	-	-	-	-	14,045	-	(14,045)	-	-	-
De-recognition of minority interest on sale of subsidiary	-	-	-	-	-	-	-	-	-	(1,299)	(1,299)
Balance at 31 December 2005	**149,771**	**-**	**31,487**	**-**	**-**	**24,621**	**227**	**146,258**	**352,364**	**-**	**352,364**

The accompanying notes 1 to 38 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

for the year ended 31 December 2006 US$ 000's

	Note	2006	2005
OPERATING ACTIVITIES			
Cash receipts from investment advisory services	9, 16	140,149	101,821
Net increase in customers' current accounts		2,207	5,090
Islamic financing assets, net		(81,817)	(17,110)
Short term financing of projects		(32,091)	(7,393)
Investors' funds (paid)/ received, net		(129,221)	443,556
Placement, arrangement and management fees received		20,337	21,499
Murabaha profits and income from Islamic financing received		39,140	14,551
Murabaha expense paid		(22,655)	(8,625)
Other income received		-	182
Payments for expenses		(68,113)	(32,055)
Cash flows from operating activities		**(132,064)**	**521,516**
INVESTING ACTIVITIES			
Purchase of investment securities	8, 16	(134,407)	(130,518)
Proceeds from sale of investment securities	8, 9	41,179	42,607
Purchase of trading property		(45,409)	(12,279)
Proceeds from sale of trading and investment property		-	5,447
Purchase of sukuks (long term)	6	(40,501)	(15,000)
Income from sukuks received		2,413	995
Purchase of equipment	10	(4,036)	(391)
Dividends received	17	628	2,170
Cash flows from investing activities		**(180,133)**	**(106,969)**
FINANCING ACTIVITIES			
Receipts from financial and non-financial institutions, net		164,771	47,104
Proceeds from issue of ordinary shares		190,602	-
Acquisition of treasury shares, net		(13,619)	-
Net receipts from unrestricted investment accounts		23,220	35,700
Cash paid to charitable organisations		(695)	(1,130)
Board remuneration paid		(1,050)	(585)
Dividends paid		(72,587)	(29,868)
Cash flows from financing activities		**290,642**	**51,221**
Net (decrease)/ increase in cash and cash equivalents		(21,555)	465,768
Cash and cash equivalents at 1 January		745,557	279,789
Cash and cash equivalents at 31 December		**724,002**	**745,557**
Cash and balances with banks	3	15,050	13,412
Due from financial and non-financial institutions	4	687,765	685,771
Investment in sukuks (short-term)	6	21,187	46,374
		724,002	**745,557**

The accompanying notes 1 to 38 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN RESTRICTED INVESTMENT ACCOUNTS

for the year ended 31 December 2006 US$ 000's

31 December 2006	Balance at 1 January 2006		
Company	No of units (000)	Average value per share US$	Total US$ 000's
Gulf Atlantic Real Estate Company Ltd	500	1.72	860
Gulf Atlantic FZ LLC	0.02	118,440	2,369
Gulf Development Real Estate Company KSCC	10,910	0.34	3,720
Menajet Holding SAL	200	10.00	2,000
Kuwait National Real Estate Investment & Services Co. KSCC	6,250	0.37	2,344
Bayan Holding Company KSCC	18,266	0.34	6,255
Gulf Holding Company	72,749	0.34	24,914
Gulf North Africa Holding Company KSCC	11,500	0.35	4,070
Saudi Real Estate Company	904	13.33	12,049
Al Basha'er Fund	823	10.00	8,232
Pan European Fund	8.70	1,188.65	10,339
Al Hareth French Property Fund	24.65	1,186.25	29,241
			106,393

31 December 2005	Balance at 1 January 2005		
Company	No of units (000)	Average value per share US$	Total US$ 000's
Gulf Atlantic Real Estate Company Ltd	500	1.92	959
Gulf Atlantic FZ LLC	0.02	135,580	2,712
Gulf Development Real Estate Company KSCC	9,784	0.340	3,320
Menajet Holding SAL	200	10	2000
Kuwait National Real Estate Investment & Services Co. KSCC	13,550	0.373	5,059
Bayan Holding Company KSCC	-	-	-
Gulf Holding Company	-	-	-
Gulf North Africa Holding Company KSCC	-	-	-
Saudi Real Estate Company	-	-	-
Al Basha'er Fund	-	-	-
Pan European Fund	-	-	-
Al Hareth French Property Fund	-	-	-
			14,050

The accompanying notes 1 to 38 form an integral part of these consolidated financial statements.

Movements during the year					
Investment US$ 000's	Revalua-tion US$ 000's	Gross income US$ 000's	Dividends paid US$ 000's	Bank's fees as an agent US$ 000's	Administration expenses US$ 000's
(922)	-	62	-	-	-
(2,888)	-	519	-	-	-
-	55	260	(260)	-	-
(2,811)	-	811	-	-	-
32	-	-	-	-	-
-	61	-	-	-	-
(16,722)	79	-	-	-	-
-	(94)	-	-	-	-
420	3	-	-	-	-
(706)	-	(702)	-	(73)	-
35,713	1,103	2,384	(2,384)	-	-
-	3,184	3,242	(3,242)	(124)	-
12,116	**4,391**	**6,576**	**(5,886)**	**(197)**	**-**

Balance 31 December 2006				
No of units (000)	Average value per share US$	Total	US$ 000's	Total % ownership
-	-		-	-
-	-		-	-
10,910	0.35		3,775	7
-	-		-	-
6,870	0.35		2,376	23
18,266	0.35		6,316	2
23,919	0.35		8,271	3
11,500	0.35		3,976	8
936	13.33		12,472	31
753	8.97		6,751	2
35.85	1,315.40		47,155	90
24.65	1,310.40		32,301	100
			123,393	

Movements during the year					
Investment US$ 000's	Revalua-tion US$ 000's	Gross income US$ 000's	Dividends paid US$ 000's	Bank's fees as an agent US$ 000's	Administration expenses US$ 000's
-	(99)	58	(58)	-	-
-	(343)	178	(178)	-	-
386	14	-	-	-	-
-	-	-	-	-	-
(2,736)	21	2,185	(2,185)	-	-
6,255	-	-	-	-	-
24,914	-	-	-	-	-
4,070	-	-	-	-	-
12,049	-	-	-	-	-
8,232	-	-	-	-	-
10,304	-	35	-	-	-
29,195	-	1,412	(1,289)	(77)	-
92,669	**(407)**	**3,868**	**(3,710)**	**(77)**	**-**

Balance 31 December 2005			
No of units (000)	Average value per share US$	Total US$ 000's	Total % ownership
500	1.7208	860	1
0.02	118,430	2,369	3
10,910	0.34	3,720	7
200	10.00	2,000	3
6,250	0.375	2,344	21
18,266	0.341	6,255	2
72,749	0.341	24,914	10
11,500	0.349	4,070	8
904	13.33	12,049	30
823	10.00	8,232	2
9	1,188.65	10,339	90
25	1,186.25	29,241	100
		106,393	

CONSOLIDATED STATEMENT OF SOURCES AND USES OF CHARITY AND ZAKAH FUND

for the year ended 31 December 2006 US$ 000's

	2006	2005
Sources of charity and zakah fund		
Contributions by the Bank	2,061	1,176
Non-Islamic income (note 24)	301	66
Total sources	**2,362**	**1,242**
Uses of charity fund and zakah fund		
Contributions to charitable organisations	(695)	(1,130)
Total uses	**(695)**	**(1,130)**
Excess of sources over uses	1,667	112
Undistributed charity and zakah fund at 1 January	967	855
Undistributed charity and zakah fund at 31 December (note 13)	**2,634**	**967**

The accompanying notes 1 to 38 form an integral part of these consolidated financial statements.

1 INCORPORATION AND PRINCIPAL ACTIVITY

Gulf Finance House BSC ("the Bank") was incorporated in 1999 in the Kingdom of Bahrain under Commercial Registration No. 44136. The Bank's shares are listed on the Bahrain, Kuwait and Dubai Financial Market Stock Exchanges. The Bank operates as an Islamic Investment Bank under a license granted by the Central Bank of Bahrain ("CBB").

The consolidated financial statements for the year ended 31 December 2006 comprise the financial statements of the Bank and its subsidiaries (together referred to as "the Group").

The Bank's activities are regulated by the CBB and supervised by a Religious Supervisory Board whose role is defined in the Bank's Memorandum and Articles of Association.

The principal activities of the Bank include investment advisory services and investment transactions which comply with Islamic rules and principles according to the opinion of the Bank's Shari'a Board.

Khaleeji Commercial Bank BSC (c) [previously know as Gulf Finance House Commercial Bank BSC (c)], a closed company incorporated in Bahrain, is the Bank's principal wholly owned subsidiary specialising in real estate financing. The subsidiary operates under a Islamic retail banking license granted by the CBB.

2 SIGNIFICANT ACCOUNTING POLICIES

The significant accounting polices applied in the preparation of these consolidated financial statements are set out below. These accounting policies have been consistently applied by the Group and are consistent with those used in the previous year.

(a) Statement of compliance

The consolidated financial statements have been prepared in accordance with both the Financial Accounting Standards ('FAS') issued by the Accounting and Auditing Organisation for Islamic Financial Institutions and International Financial Reporting Standards ('IFRS').

(b) Basis of preparation

The financial statements are presented in US Dollars, being the principal currency of the Group's operations. They are prepared on the historical cost basis except for the measurement at fair value of certain available-for-sale investments and investments in associates at fair value through the income statement.

Financial 'assets held for sale' are carried at fair value in accordance with International Accounting Standard ('IAS') 39 'Financial Instruments: Recognition and Measurement'.

The preparation of financial statements in conformity with the IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in note 20.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(c) Basis of consolidation

(i) Subsidiaries

Subsidiaries are those enterprises (including special purpose vehicles) controlled by the Bank. Control exists when the Bank has the power, directly or indirectly, to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities. Subsidiaries are consolidated from the date on which control is transferred to the Group and de-consolidated from the date that control ceases.

(ii) Associates

Associates are those enterprises in which the Bank has significant influence, but not control, over the financial and operating policies. On initial recognition of investment in each associate, the Bank makes an accounting policy election as to whether the associate shall be equity accounted or designated as an investment at fair value through the income statement in the consolidated financial statements. The Bank, being a venture capital organisation, designates certain of its investments in associates, as allowed by IAS 28 'Investments in Associates', as 'investments carried at fair value through the income statement' in accordance with IAS 39 [refer note 2 (e)].

If the equity accounting method is chosen for an associate, the consolidated financial statements include the Group's share of the associate's total recognised gains and losses. When the Group's share of losses exceeds its interest in an associate, the Group's carrying amount is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of an associate.

(iii) Transactions eliminated on consolidation

Intra-group balances and transactions, and any unrealised gains arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Unrealised losses are also eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

(d) Foreign currency transactions

(i) Functional and presentation currency

Items included in the consolidated financial statements of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the functional currency). The consolidated financial statements are presented in US dollars, which is the Bank's functional and presentation currency.

(ii) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement. Translation differences on non-monetary items classified as available-for-sale financial assets are included in investments fair value reserve.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(d) Foreign currency transactions (continued)

(iii) Group companies

The other group companies functional currencies are denominated in Bahraini Dinars, which is effectively pegged to the US Dollar. Hence, the translation of financial statements of the group entities that have a functional currency different from the presentation currency do not result in exchange differences.

(e) Investments

(i) Classification

Investments carried at fair value through the income statement are financial assets that are held for trading or which upon initial recognition are designated by the Bank as at fair value through the income statement. These include investment in certain associates [refer note 2 (c) (ii)].

Held-to-maturity investments are financial assets with fixed or determinable payments and fixed maturity that an entity has the positive intention and ability to hold to maturity. These include investment in sukuks.

Available-for-sale investments are financial assets that are not investments carried at fair value through the income statement or held to maturity. These include investments in quoted and unquoted equity securities.

(ii) Recognition

The Group recognises investments when it becomes entitled to ownership. This is determined based on either payments made to acquire stakes in investments or equity stakes received in kind for services rendered.

(iii) Measurement

Financial instruments are measured initially at cost, which is the fair value of the consideration given (in the case of an asset) or received (in the case of a liability), including transaction costs. Subsequent to initial recognition investments at fair value through the income statement and available-for-sale assets are re-measured to fair value. Held-to-maturity investments are measured at cost less any impairment allowances. Available-for-sale investments which do not have a quoted market price or other appropriate methods from which to derive reliable fair values, are stated cost less impairment allowances.

(iv) Gains and losses on subsequent measurement

Gains and losses arising from a change in the fair value of investments carried at fair value through the income statement are recognised in the income statement in the period in which they arise. Gains and losses arising from a change in the fair value of available-for-sale investments are recognised in a separate fair value reserve and when the investments are sold, impaired, collected or otherwise disposed of, the cumulative gain or loss previously recognised in the fair value reserve is transferred to the income statement.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(v) Fair value measurement principles

Unquoted

I. Investments for which there is no quoted market price or other appropriate methods from which to derive reliable fair values, are stated cost less impairment allowances.

II. For other unquoted investments, fair value is determined either by reference to the price of the most recent transactions in the shares, or based on recognised valuation models, or based on valuations undertaken by independent external valuers. The Group uses proprietary models, which usually are developed from recognised valuation models, for fair valuation of certain available-for-sale investments and investments in associates designated at fair value through the income statement. Some or all of the inputs into these models may not be market observable, but are estimated based on assumptions. The value produced by a model or other valuation technique is adjusted to allow for a number of factors as appropriate, because valuation techniques cannot appropriately reflect all factors market participants take into account when entering into a transaction. Valuation adjustments are recorded to allow for model risks, bid-ask spreads, liquidity risks, as well as other factors. Management believes that these valuation adjustments are necessary and appropriate to fairly state the values of these investments.

Quoted investments

III. Fair value for quoted investments is their market bid price.

(f) Due from financial and non-financial institutions

These comprise placements in the form of Murabaha and Mudaraba contracts which are stated at cost less impairment allowances.

(g) Islamic financing assets

Islamic financing assets comprise shari'a compliant commercial financing provided by the Group. These include Murabaha, Mudaraba and Musharaka financing which are stated at cost less impairment allowances.

(h) Impairment of financial assets

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset is impaired. In the case of available-for-sale equity investments, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the assets are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in the income statement. Impairment losses recognised in the income statement on equity instruments are not subsequently reversed through the income statement.

Impairment losses on Islamic financing assets and investment in sukuks are measured as the difference between the carrying amount of the financial asset and the present value of estimated cash flows discounted at the assets' original effective profit rate. Losses, if any, are recognised in the income statement and reflected in an allowance account against Islamic financing assets and investment in sukuks. When a subsequent event causes the amount of impairment loss to decrease, the impairment loss is reversed through the income statement.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(i) Cash and cash equivalents

For the purpose of statement of cash flows, cash and cash equivalents comprise cash, balances with banks and short-term highly liquid assets (including due from financial institutions and investments in certain short-term sukuks) with maturities of three months or less when acquired.

(j) Equipment

Equipment is stated at cost, net of accumulated depreciation. Depreciation is computed using the straight-line method to write-off the cost of the assets over their estimated useful lives ranging from 1 to 5 years. The assets residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

(k) Trading property

Trading properties are properties held for sale in the ordinary course of business. Trading properties are stated at the lower of cost and net realisable value.

(l) Impairment of other assets

The carrying amount of the Group's assets, other than financial assets (refer note 2 (h)), are reviewed 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. An impairment loss is recognised whenever the carrying amount of an asset exceeds its estimated recoverable amount. Impairment losses are recognised in the income statement. Impairment losses are reversed only if there is an indication that the impairment loss may no longer exist and there has been a change in the estimates used to determine the recoverable amount.

(m) Dividends and board remuneration

Dividends to shareholders and board remuneration are recognised as liabilities in the period in which they are declared.

(n) Statutory reserve

The Bahrain Commercial Companies Law 2001 requires that 10 percent of the annual net profit be appropriated to a statutory reserve which is normally distributable only on dissolution. Appropriations may cease when the reserve reaches 50 percent of the paid up share capital.

(o) Revenue recognition

Income from investment advisory services is recognised when the services for the transaction are provided and income is earned. This is usually when the Group has performed all significant acts in relation to the transaction and it is highly probable that the economic benefits from the transaction will flow to the Group.

Placement, management and arrangement fees are recognised as income when earned.

Income from Murabaha contracts are recognised on a time-apportioned basis over the period of the contract. **Income from Mudaraba financing contracts** that continue for more than one financial period are recognised to the extent such profits are declared by the Mudarib (agent).

Profit from Musharaka contracts that continue for more than one financial period are recognised when a partial or final settlement takes place and its share of the losses are recognised to the extent that such losses are deducted from the Group's share of Musharaka capital.

Income from investment in sukuks is recognised on a time-apportioned basis over the term of the sukuk.

Income from investments **(dividend income)** is recognised when the right to receive is established.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(p) Restricted investment accounts

Restricted investment accounts represents assets acquired by funds provided by holders of restricted investment accounts and their equivalent and managed by the Group as an investment manager based on either a Mudaraba contract or agency contract. The restricted investment accounts are exclusively restricted for investment in specified projects as directed by the investments account holders.

(q) Unrestricted investment accounts

Unrestricted investment accounts are funds held by the Group, which it can invest at its own discretion. The unrestricted investment account holder authorises the Group to invest the account holders' funds in a manner which the Group deems appropriate without laying down any restrictions as to where, how and for what purpose the funds should be invested.

The Group charges management fee (Mudarib fees) to unrestricted investment account holders. Of the total income from unrestricted investment accounts, the income attributable to customers is allocated to investment accounts after setting aside provisions and deducting the Group's share of income.The allocation of income is determined by the management of the Group within the allowed profit shar ing limits as per the terms and conditions of the unrestricted investment accounts.Administrative expenses incurred in connection with the management of the funds are borne directly by the Group and are not charged separately to investment accounts.

(r) Earnings prohibited by Shari'a

The Bank is committed to avoid recognising any income generated from non-Islamic sources. Accordingly, all non-Islamic income is credited to a charity account where the Bank uses these funds for charitable means.

(s) Zakah

Pursuant to the decision of the shareholders', the Bank is required to pay Zakah on its undistributed profits. The Bank is also required to calculate and notify, under a separate report, individual shareholders of their pro-rata share of the Zakah payable by them on distributed profits. These calculations are approved by the Bank's Sharia Supervisory Board.

(t) Employees benefits

(i) Bahraini employees

Pensions and other social benefits for Bahraini employees are covered by the General Organisation for Social Insurance scheme, which is a "defined contribution scheme" in nature, and to which employees and employers contribute monthly on a fixed-percentage-of-salaries basis.

(ii) Expatriate employees

Expatriate employees on fixed contracts are entitled to leaving indemnities payable under the Bahraini Labour Law for the Private Sector of 1976, based on length of service and final remuneration. Provision for this unfunded commitment has been made by calculating the notional liability had all employees left at the balance sheet date.

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2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(iii) Employee savings scheme

The Group has a voluntary employees saving scheme. The Bank and the employee contribute monthly on a fixed percentage of salaries basis to the scheme. The scheme is managed and administered by a board of trustees.

(u) Compensation benefits

Eligible employees of each of the Group entities are entitled to bonus in accordance with their respective Employee Incentive Schemes ("the schemes"). The Group operates different schemes for the parent Bank and its subsidiaries. Under the various schemes, employees are entitled to receive bonus in the form of cash and/ or shares in ratios determined by the terms of the respective schemes. The cash settled portion of the bonus is recognised as an expense and is included in staff costs in the income statement, with a corresponding increase in liabilities for any unsettled amounts. The liability is remeasured at each reporting date and at settlement date. Any changes in the value of the liability are recognised as staff costs in the income statement. The equity settled share-based payment component of the bonus is recognised at the fair values of the equity instruments at the grant date and is recognised as an expense rateably over the vesting period with a corresponding increase in equity.

(v) Trade date accounting

All "regular way" purchases and sales of financial assets are recognised on trade date, i.e. the date that the Group contracts to purchase or deliver the asset. Regular way purchases or sale are purchases or sale of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place.

3 CASH AND BANK BALANCES

	2006	2005
Cash	304	8
Balances with banks	7,446	11,905
Current account with Central Bank	5,788	93
Reserve deposit with Central Bank	1,512	1,406
	15,050	**13,412**

4 DUE FROM FINANCIAL AND NON-FINANCIAL INSTITUTIONS

	2006	2005
		-
Gross commodity Murabaha with financial institutions	689,639	642,770
Gross commodity Murabaha with non-financial institutions	-	15,880
Less: Deferred profits	**(1,874)**	**(2,879)**
	687,765	655,771
Investments in Mudaraba	-	30,000
	687,765	**685,771**

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5 ISLAMIC FINANCING ASSETS

	2006	2005
Murabahas	37,912	12,126
Mudaraba	5,127	3,753
Musharaka	55,888	1,231
	98,927	**17,110**

Murabaha financing receivables are net of deferred profits of US$ 4,173 thousand (2005: US$ 151 thousand).

6 INVESTMENT IN SUKUKS

	2006	2005
Investment in sukuks		
- Short-term	21,187	46,374
- Long-term	56,806	15,000
	77,993	**61,374**

7 ASSETS HELD-FOR-SALE

The bank intends to sell certain of its investment securities and is actively seeking a buyer. In accordance with IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations', such investments have been reclassified as assets held for sale. When the investment securities do not continue to satisfy the conditions of classification as assets held for sale, they are reclassified into investment securities. Assets held for sale include:

	2006	2005
Investments in associates at fair value through income statement	24,196	17,945
Available-for-sale investments	-	7,382
	24,196	**25,327**

The carrying amount of investments in associates at fair value through income statement include fair value gain of US$ 7,900 thousand (2005: net fair value loss of US$ 3,825 thousand).

8 INVESTMENT SECURITIES

Investment securities comprise of:

	2006	2005
Available-for-sale investments	320,137	158,025
Investments in Associates:		
- Designated at fair value through the income statement	26,626	20,910
- Equity accounted	10,300	10,300
	357,063	**189,235**

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8 INVESTMENT SECURITIES (continued)

(i) AVAILABLE-FOR-SALE INVESTMENTS

	2006	2005
At 1 January	168,325	84,664
Acquisitions during the year	162,095	142,229
Disposals during the year, at carrying value	(4,778)	(74,006)
Impairment allowances	(6,728)	-
Fair value changes during the year	1,223	12,520
	320,137	165,407
Less: reclassified as assets-held-for sale (note 7)	**-**	**(7,382)**
At 31 December	**320,137**	**158,025**

Investments amounting to US$ 275,310 thousand (2005: US$ 93,173 thousand) in unquoted equity securities are carried at cost less impairment in the absence of a reliable measure of fair value.

(ii) INVESTMENTS IN ASSOCIATES - DESIGNATED AT FAIR VALUE THROUGH THE INCOME STATEMENT

	2006	2005
At 1 January	20,910	30,168
Acquisitions during the year	500	16,718
Disposals during the year, at carrying value	(479)	(4,206)
Fair value changes during the year	3,445	(3,825)
	24,376	38,855
Less: Reclassified as assets-held-for-sale	-	(17,945)
Add: Reclassified from assets-held-for-sale	2,250	-
At 31 December	**26,626**	**20,910**

(iii) INVESTMENTS IN ASSOCIATES – EQUITY ACCOUNTED

There has been no material change in the equity of the associate at the reporting date as the level of activities were insignificant.

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9 OTHER ASSETS

	2006	2005
Project costs recoverable	6,873	1,920
Advisory fees receivable	123,404	46,846
Short-term financing	36,288	8,975
Receivable from sale of investment securities	-	30,105
Receivable from sale of trading properties	51,109	1,337
Prepayments and other receivables	6,638	2,138
Others	8,184	5,863
	232,496	**97,184**

Short-term financing represents amounts advanced to the projects of the Bank recoverable within six months.

10 EQUIPMENT

	Furniture	Fixtures and equipment	Computers	2006 Total	2005 Total
Cost					
At 1 January	1,143	1,127	1,650	3,920	3,577
Additions	156	1,030	2,850	4,036	407
Disposal	-	-	-	-	(64)
At 31 December	1,299	2,157	4,500	7,956	3,920
Depreciation					
At 1 January	533	718	975	2,226	1,488
Disposal	-	-	-	-	(48)
Charge for year	208	307	781	1,296	786
At 31 December	741	1,025	1,756	3,522	2,226
Net book value At 31 December	**558**	**1,132**	**2,744**	**4,434**	**1,694**

11 INVESTORS' FUNDS

These represent funds received from investors to be invested in entities to be set up or promoted by the Group. The funds are invested in Murabaha transactions pending the legal formation of companies for these investments.

12 DUE TO FINANCIAL AND NON-FINANCIAL INSTITUTIONS

These comprise Murabaha payable to financial and non-financial institutions.

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13 OTHER LIABILITIES

	2006	2005
Employee accruals	62,498	43,602
Unclaimed dividends	1,629	2,326
Provision for employees' leaving indemnities	285	187
Charity and zakah fund (refer page 64)	2,634	967
Accounts payable	4,485	3,425
Accrued expenses	5,923	2,186
	77,454	**52,693**

14 UNRESTRICTED INVESTMENT ACCOUNTS

The average gross rate of return in respect of unrestricted investment accounts was 7.53% for 2006 (2005: 4.95%). Approximately 4.73% / USD 1,666 (2005: 4.25% / USD 549) was distributed to investors and the balance was either set aside for provisions and/or retained by the Bank as a Mudarib fee.

Unrestricted investment accounts include profit equalisation reserve of USD 159 thousand (2005: USD 37 thousand) and investment risks reserve of USD 117 thousand (2005: USD 24 thousand).

The funds received from unrestricted investment account holders have been commingled and jointly invested with the Bank in the following assets:

	2006	2005
Due from financial institutions	-	139,000
Investment in sukuks	38,501	15,000
Islamic financing assets	41,525	7,305

15 SHARE CAPITAL

	2006	2005
Authorised:		
909,090,909 ordinary shares of US$ 0.33 each	300,000	300,000
Issued and fully paid up:		
644,467,372 (2005: 453,850,263) shares of US$ 0.33 each	**212,674**	**149,771**

During the year, the paid up capital of the Bank increased from US$ 149,771 thousand to US$ 212,674 thousand due to issue of bonus shares amounting to US$ 17,972 thousand and a rights issue of US$ 44,931 thousands at a premium of US$ 142,963 thousand.

In 2003, the shareholders' approved the utilisation of US$ 4,000 thousand from the share premium account to fund the issue of shares towards the employee incentive scheme. The shareholders in their annual general meeting held on 19 February 2006 resolved to restate the share premium account by transferring an equivalent amount from retained earnings.

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15 SHARE CAPITAL (continued)

Additional information on shareholding pattern

(i) Names and nationalities of the major shareholders and the number of equity shares held in which they have an interest of 5% or more of outstanding shares.

	Nationality	No. of shares	% holding
Abdul Latif Al Shaya and Abdul Aziz Al Shaya	Kuwait	35,129,798	5.45%
Bahrain Islamic Bank	Bahrain	32,390,536	5.02%

(ii) The Bank has only one class of equity shares and the holders of these shares have equal voting rights.

(iii) Distribution schedule of equity shares, setting out the number of holders and percentage in the following categories:

Categories*	Number of Shares	Number of Shareholders	% of total outstanding shares
Less than 1%	346,242,608	2,122	53.73
1% up to less than 5%	230,704,430	14	35.80
5% up to less than 10%	67,520,334	2	10.47
	644,467,372	**2,138**	**100**

* Expressed as a percentage of total outstanding shares of the Bank.

16 INCOME FROM INVESTMENT ADVISORY SERVICES

Income from investment advisory services includes US$ 74,426 thousand (2005: US$ 38,729 thousand) which has been received by the Group in kind in exchange for investment advisory services rendered.

17 INCOME FROM INVESTMENT SECURITIES

	2006	2005
Dividend income and income from managed funds	628	1,437
Fair value changes on investments designated at fair value through the income statement	11,354	(3,825)
Gain on disposal of investment securities	-	14,791
	11,982	**12,403**

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18 STAFF COSTS

	2006	2005
Salaries and benefits	65,040	38,623
Social insurance expenses	975	672
Other staff expenses	1,233	808
	67,248	**40,103**

19 EMPLOYEE INCENTIVE SCHEME

Parent Bank

The Bank operates an employee incentive scheme ('the Scheme') for its employees. As per the terms of the Scheme, eligible employees are entitled to receive bonus in the form of cash and/ or shares in ratios determined by the terms of the Scheme and as approved by the Board of Directors. The Group has incorporated a company, Hawafiz BSC (c), to manage the scheme for the beneficial interest of employees. The entire bonus of the Bank is currently cash settled.

Subsidiary company

Khaleeji Commercial Bank B.S.C (c) ['KHCB'], a fully owned subsidiary of the Bank operates an equity settled share-based payment scheme for its employees. Under the terms of the scheme KHCB has issued 500,000 share grants to employees of which 100,000 shares grants have vested during the year. The shares vest to employees based on the terms of the scheme. The share grants have been recognised at their fair values, determined by an independent firm of accountants, using a discounted cash flow based valuation model. The fair value of the equity settled share-based payment component amounted to US$ 464 thousand, of which US$ 212 thousand has been charged to the income statement during the year under staff costs. The unvested component has been shown as a reduction from equity.

20 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

The Group makes estimates and assumptions that effect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectation of future events that are believed to be reasonable under the circumstances.

(i) Fair value of investments

The fair value of investments that are not quoted in active markets are determined by using valuation techniques. Where valuation techniques (for example, models) are used to determine fair values, they are validated and periodically reviewed by qualified personnel independent of the area that created them. Fair value estimates are made at a specific point in time, based on market conditions and information about the investee companies. These estimates are subjective in nature and involve uncertainties and matters of significant judgement and therefore, cannot be determined with precision. There is no certainty about future events (such as continued operating profits and financial strengths). It is reasonably possible, based on existing knowledge, that outcomes within the next financial year that are different from assumptions could require a material adjustment to the carrying amount of the investments.

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20 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES (continued)

(ii) Impairment on available-for-sale investments

The Group determines that available-for-sale investments are impaired when there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgment. Where fair values are not readily available and the investments are carried at cost, the recoverable amount of such investment is estimated to test for impairment. A significant portion of the Group's available-for-sale investments comprise of investments in long-term real estate infrastructure projects. In making a judgment of impairment, the Group evaluates among other factors, evidence of a deterioration in the financial health of the project, impacts of delays in execution, industry and sector performance, changes in technology, and operational and financing cash flows. It is reasonably possible, based on existing knowledge, that the current assessment of impairment could require a material adjustment to the carrying amount of the investments within the next financial year due to significant changes in the assumptions underlying such assessments.

21 ASSETS UNDER MANAGEMENT

The Group provides corporate administration, investment management and advisory services to its project companies, which involve the Group making decisions on behalf of such entities. Assets that are held in such capacity are not included in these consolidated financial statements. At the balance sheet date, the Group had assets under management of US$ 2,111,215 thousand (2005: 2,001,959 thousand).

22 RELATED PARTY TRANSACTIONS

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions. Related parties include entities over which the Group exercises significant influence, major shareholders, directors and executive management of the Group.

A significant portions of the Group's income from investment advisory services and placement and arrangement and management fees from entities over which the Group exercises significant influence. Although these entities are considered related parties, the Group administers and manages these entities on behalf of its clients, who are by and large third parties and are the economic beneficiaries of the underlying investments.

The related party balances included in these consolidated financial statements are as follows:

	2006	2005
Assets		
Cash and bank balances	416	2,683
Due from financial and non-financial institutions	10,007	15,750
Islamic financing assets	67,656	1,231
Investment in sukuks	-	10,000
Assets held for sale	24,196	25,327
Investment securities	249,433	183,305
Other assets	215,702	100,403
Liabilities		
Investors' funds	348,553	477,775
Customers' current account	5,469	3,194
Due to financial and non-financial institutions	180,956	130,975

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22 RELATED PARTY TRANSACTIONS (continued)

	2006	2005
Income		
Income from investment advisory services	266,647	167,752
Placement, arrangement and management fees	11,664	11,320
Income from investment securities	11,354	12,403
Income from short-term murabaha placements	-	450
Income from islamic financing assets	2,940	152
Other income	3,796	439
Expenses		
Investment advisory expenses	-	8,664
Impairment allowances on available-for-sale investments	6,728	-
Murabaha expenses	27,116	6,684
Other expenses	-	636

Details of Directors' interests in the Bank's ordinary shares as at the end of the year were :

Categories*	Number of Shares	Number of Directors
Less than 1%	1,073,407	5
1% up to less than 5%	15,483,187	2

* Expressed as a percentage of total outstanding shares of the Bank.

Details of material contracts involving directors' include:

	2006	2005
Directors' participation in investments promoted by the Group	3,543	6,700

Key management personnel of the Group comprise of the Board of Directors and key members of management having authority and responsibility for planning, directing and controlling the activities of the Group. The key management personnel compensation is as follows:-

	2006	2005
Board remuneration	1,050	585
Board member fees	831	405
Salaries and other short-term benefits	28,648	19,661
Post employment benefits	107	57

The accompanying notes 1 to 38 form an integral part of these consolidated financial statements.

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23 ZAKAH

Based on the computation approved by the Shari'a Board, the Bank has appropriated US$ 1,061 thousand (2005: 576 thousand) from retained earnings towards payment of Zakah which is included in other liabilities.

Zakah is directly borne by the shareholders on distributed profits and investors in restricted investment accounts. The Bank does not collect or pay Zakah on behalf of its shareholders and investors in restricted investment accounts. Zakah payable by the shareholders is computed by the Bank on the basis of the method prescribed by the Bank's Shari'a Supervisory Board and notified to shareholders annually. Zakah payable by the shareholders in respect of the proposed distributable profits (refer note 27) for the year ended 31 December 2006 is US cents 0.54 (2005: US cents 0.41) for every share held.

24 EARNINGS PROHIBITED BY SHARI'A

The Group is committed to avoid recognising any income generated from non-Islamic sources. Accordingly, all non-Islamic income is credited to a charity account where the Group uses these funds for charitable means. Movements in non-Islamic funds are shown in the statement of sources and uses of charity funds.

The Group receives interest from deposits placed with the Central Bank of Bahrain and other incidental or required deposits. These earnings are utilised exclusively for charitable purposes and amounts to US$ 301 thousand (2005: US$ 66 thousand).

25 SHARI'A SUPERVISORY BOARD

The Group's Shari'a Supervisory Board consists of four Islamic scholars who review the Group's compliance with general Shari'a principles and specific fatwas, rulings and guidelines issued. Their review includes examination of evidence relating to the documentation and procedures adopted by the Group to ensure that its activities are conducted in accordance with Islamic Shari'a principles.

26 SOCIAL RESPONSIBILITY

The Group discharges its social responsibilities through donations to charitable causes and organisations.

27 PROPOSED APPROPRIATIONS

The Board of Directors of the Bank propose a dividend of 75% (2005: 60%) of the paid-up capital and other appropriations, subject to the approval of the shareholders' at the annual general meeting, as follows:

	2006	2005
Proposed dividend *	159,991	89,862
Charity contribution	1,200	1,000
Directors' remuneration	1,200	1,050
Share premium	-	4,000

* Proposed dividend include bonus shares recommended by the Board of Directors at the rate of twelve share for every hundred shares held (2005: twelve share for every hundred shares held).

28 EARNINGS PER SHARE

Basic earnings per share is calculated by dividing the profit for the year by the weighted average number of equity shares outstanding during the year ended 31 December 2006 as follows:

	2006	2005
Profit for the year (US$ 000's)	211,586	140,331
Weighted average number of equity shares (Nos. in 000's)	624,533	554,062
Basic earnings per share (in US cents)	**33.88**	**25.34**

29 MATURITY PROFILE

2006	Up to 3 months	3 to 6 months	6 months-1 year	1 to 3 years	Over 3 years	Total
Assets						
Cash and bank balances	15,050	-	-	-	-	15,050
Due from financial and non-financial institutions	643,080	15,310	29,375	-	-	687,765
Trading properties	-	-	-	2,960	-	2,960
Islamic financing assets	48,385	2,480	12,085	19,981	15,996	98,927
Investment in sukuks	21,187	-	-	38,308	18,498	77,993
Assets held for sale	24,196	-	-	-	-	24,196
Investment securities	-	-	154,936	202,127	-	357,063
Other assets	226,128	-	3,000	3,368	-	232,496
Equipment	-	-	-	2,281	2,153	4,434
Total assets	**978,026**	**17,790**	**199,396**	**269,025**	**36,647**	**1,500,884**
2005	858,174	11,109	88,430	123,677	18,377	1,099,767
Liabilities						
Investors' funds	348,553	-	-	-	-	348,553
Customers' current account	7,297	-	-	-	-	7,297
Due to financial and non-financial institutions	244,721	91,573	4,622	-	-	340,916
Other liabilities	72,982	1,209	780	2,197	286	77,454
Total liabilities	**673,553**	**92,782**	**5,402**	**2,197**	**286**	**774,220**
2005	581,020	129,082	-	1,414	187	711,703
Unrestricted investment accounts	**39,753**	**-**	**19,167**	**-**	**-**	**58,920**
2005	24,048	11,053	599	-	-	35,700
Restricted investment accounts	**-**	**2,376**	**-**	**114,266**	**6,751**	**123,393**
2005	-	2,343	-	95,818	8,232	106,393

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30 CONCENTRATION OF ASSETS, LIABILITIES, UNRESTRCITED AND RESTRICTED INVESTMENT ACCOUNTS

(a) Industry sector

2006	Trading and manufacturing	Banks and financial institutions	Real estate	Technology	Others	Total
Assets						
Cash and bank balances	-	15,050	-	-	-	15,050
Due from financial institutions and non-financial institutions	-	687,765	-	-	-	687,765
Trading properties	-	-	2,960	-	-	2,960
Islamic financing assets	-	5,676	86,118	-	7,133	98,927
Investment in sukuks	-	21,341	36,003	-	20,649	77,993
Assets held-for-sale	24,196	-	-	-	-	24,196
Investment securities	-	13,250	264,170	15,967	63,676	357,063
Other assets	-	7,389	214,989	423	9,695	232,496
Equipment	-	-	-	-	4,434	4,434
Total assets	**24,196**	**750,471**	**604,240**	**16,390**	**105,587**	**1,500,884**
Liabilities						
Investors' funds	1,582	49,243	47,049	-	250,679	348,553
Customers' current accounts	-	-	7,297	-	-	7,297
Due to financial and non-financial institutions	-	166,852	158,450	-	15,614	340,916
Other liabilities	2	164	4,462	-	72,826	77,454
Total liabilities	**1,584**	**216,259**	**217,258**	**-**	**339,119**	**774,220**
Unrestricted investment accounts	-	13,271	8,393	-	37,256	58,920
Off-Balance sheet items						
Restricted investment accounts	-	-	116,642	-	6,751	123,393

The accompanying notes 1 to 38 form an integral part of these consolidated financial statements.

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30 CONCENTRATION OF ASSETS, LIABILITIES, UNRESTRICTED AND RESTRICTED INVESTMENT ACCOUNTS (continued)

(a) Industry sector (continued)

2005	Trading and manufacturing	Banks and financial institutions	Real estate	Technology	Others	Total
Assets						
Cash and bank balances	-	13,412	-	-	-	13,412
Due from financial and non-financial institutions	-	685,771	-	-	-	685,771
Trading properties	-	-	8,660	-	-	8,660
Islamic financing assets			14,044	-	3,066	17,110
Investment in sukuks	-	46,136	16,469	-	-	61,374
Assets held-for-sale	15,695	2,250	7,382	-	-	25,327
Investment securities	-	1,928	157,858	12,500	16,949	189,235
Other assets	35	87	62,227	19	34,816	97,184
Equipment	-	-	-	-	1,694	1,694
Total assets	**15,730**	**749,584**	**266,640**	**12,519**	**56,525**	**1,099,767**
Liabilities						
Investors' funds	84	32	477,557	-	103	477,775
Customers' current accounts	-	-	-	-	5,090	5,090
Due to financial and non-financial institutions	-	12,058	126,960	-	37,127	176,145
Other liabilities	-	62	-	-	52,631	52,693
Total liabilities	**84**	**12,152**	**604,517**	**-**	**94,951**	**711,703**
Unrestricted investment accounts	11,053	24,048	599	-	-	35,700
Off-Balance sheet items						
Restricted investment accounts	-	-	98,161	-	8,232	106,393

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30 CONCENTRATION OF ASSETS, LIABILITIES, UNRESTRICTED AND RESTRICTED INVESTMENT ACCOUNTS (continued)

(b) Geographic region

2006	GCC countries	Other MENA and Asia	UK	Europe (excluding UK)	USA	Total
Assets						
Cash and balances with financial institutions	11,506	1,941	665	-	938	15,050
Due from financial and non-financial institutions	613,613	-	35,006	39,146	-	687,765
Trading properties	2,960	-	-	-	-	2,960
Islamic financing assets	98,927	-	-	-	-	98,927
Investment in sukuks	77,993	-	-	-	-	77,993
Assets held-for-sale	24,196	-	-	-	-	24,196
Investment securities	322,509	16,186	-	18,368	-	357,063
Other assets	114,787	114,589	186	2,002	932	232,496
Equipment	4,434	-	-	-	-	4,434
Total assets	**1,270,925**	**132,716**	**35,857**	**59,516**	**1,870**	**1,500,884**
Liabilities						
Investors' funds	338,442	1,797	859	7,455	-	348,553
Customers' current accounts	7,297	-	-	-	-	7,297
Due to financial and non-financial institutions	192,327	60,729	87,860	-	-	340,916
Other liabilities	77,454	-	-	-	-	77,454
Total liabilities	**615,520**	**62,526**	**88,719**	**7,455**	**-**	**774,220**
Unrestricted investment accounts	58,920	-	-	-	-	58,920
Off-Balance sheet items						
Restricted investment accounts	25,372	18,563	-	79,458	-	123,393

The accompanying notes 1 to 38 form an integral part of these consolidated financial statements.

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30 CONCENTRATION OF ASSETS, LIABILITIES, UNRESTRICTED AND RESTRICTED INVESTMENT ACCOUNTS (continued)

(b) Geographic region (continued)

2005	GCC countries	Other MENA and Asia	UK	Europe (excluding UK)	USA	Total
Assets						
Cash and bank balances	12,329	584	255	-	244	13,412
Due from financial and non-financial institutions	424,678	-	106,053	155,040	-	685,771
Trading properties	8,660	-	-	-	-	8,660
Islamic financing assets	17,110					17,110
Investment in sukuks	61,374	-	-	-	-	61,374
Assets held for sale	17,945	-	7,382	-	-	25,327
Investment securities	159,494	20,530	-	9,100	111	189,235
Other assets	65,810	31,364	-	10	-	97,184
Equipment	1,694	-	-	-	-	1,694
Total assets	**769,094**	**52,478**	**113,690**	**164,150**	**355**	**1,099,767**
Liabilities						
Investors' funds	380,216	3	79,308	18,248	-	477,775
Customers' current accounts	5,090	-	-	-	-	5,090
Due to financial and non-financial institutions	57,852	118,293	-	-	-	176,145
Other liabilities	52,693	-	-	-	-	52,693
Total liabilities	**495,851**	**118,296**	**79,308**	**18,248**	**-**	**711,703**
Unrestricted investment accounts	24,048	11,053	599	-	-	35,700
Off-Balance sheet items						
Restricted investment accounts	25,780	41,033	-	39,580	-	106,393

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31 CURRENCY RISK

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates.
The Group had the following significant net exposures denominated in foreign currency as of 31 December:

	2006 US$ Equivalent	2005 US$ Equivalent
Sterling Pounds	1,111	10,875
Euros	4,297	8,211
Lebanese Pounds	-	-
Jordanian Dinar	1,944	584
Kuwaiti Dinars	73,163	53,990
Other GCC Currencies (*)	345,448	110,928

(*) These currencies are pegged to the US Dollar.

32 LARGE EXPOSURES

Exposures to Banks and non-Banks which exceed 15% of the Bank's capital and reserves are as follows:

Bank exposures	% of Tier I capital	2006	% of Tier I capital	2005
National Bank of Kuwait	26	173,314		-
Calyon Corporate Investment Bank	18	119,946		-
HSBC		-	30	106,703
BNP Paribas	17	115,819	34	120,261
Citibank N.A.		-	15	53,911

The above exposures are in relation to commodity Murabahas with these banks.

33 COMMITMENTS AND CONTINGENCIES

The commitments contracted in the normal course of business of the Group:

	2006	2005
Commitments to invest	136,226	507
Undrawn commitments to extend finance	8,050	2,573

The Group has exited one of its investment projects during 2005 and has issued a corporate guarantee of upto £ 57 million, securing the buyer against any general indemnity, tax claim or liability that might arise under the terms of the agreement. In the opinion of the management, the possibility of the guarantee being invoked is negligible.

33 COMMITMENTS AND CONTINGENCIES (continued)

The Group has issued a guarantee to a financial institution to secure credit facility arrangement of US$ 3,440 thousand (2005: US$ 12,200 thousand) for a project promoted by the Group.

34 FAIR VALUE

Fair value is an amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Other than certain available-for-sale investments (note 8), investment in sukuks and islamic financing assets that are carried at cost, the estimated fair values of the Group's other financial instruments are not significantly different from their book values.

35 RISK MANAGEMENT

The Group's exposure to risks and its approach to managing these risks are discussed below.

a) Credit risk

Credit risk is the risk that a counterparty to a financial transaction does not discharge its obligations on due dates and cause the other party to incur a financial loss. The Group's credit risk arises mainly from the advisory fee and other receivables, short-term financing, due from financial and non-financial institutions, islamic financing assets and investment in sukuks.

The Group has well defined policies for managing credit risks that ensure that risks are accurately assessed, properly approved and regularly monitored. Formal credit limits are applied at counterparty and single obligor level. Overall exposures are also evaluated to ensure a broad diversification of risk by setting concentration limits by geography and industry.

b) Concentration risk

Concentration risk arises when a number of counterparties are engaged in similar economic activities or activities in the same geographic region or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. The group seeks to manage its concentration risk by establishing and constantly monitoring geographic and industry wise concentration limits.

The geographical and industry wise distribution of assets and liabilities are set out in note 30.

c) Liquidity risk

Liquidity risk is defined as the risk that the Group will not have funds will not be available to meet liabilities as they fall due. The Group uses a maturity ladder approach for managing and monitoring the liquidity risk. It is the Group's policy to keep a significant part of its assets in highly liquid assets such as short term Murabahas and Sukuks.

The maturity profile of assets and liabilities is set out in note 29.

d) Currency risk

The Group is exposed to currency risks on certain Murabaha receivables and available-for-sale investments. The Group seeks to manage currency risk by continually monitoring exchange rates.

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35 Risk management (continued)

e) Profit rate risk

Profit rate risk arises due to different timing of re-pricing of the Group's assets and liabilities. The Group's profit rate sensitive assets are mainly due from financial and non-financial institutions, Islamic financing assets and investment in sukuks. The profit rate sensitive liabilities include investors' funds, due to financial and non-financial institutions and unrestricted investment accounts. Profit rate risk is managed principally through monitoring profit rate gaps and by having pre-approved limits for repricing bands. The effective profit rates on these assets, liabilities and unrestricted investment accounts are as follows:

	2006	2005
Due from financial and non-financial institutions	4.98%	3.36%
Islamic financing assets	5.69%	3.51%
Investment in sukuks	6.69%	3.86%
Investors' funds	3.02%	2.04%
Due to financial and non-financial institutions	4.60%	3.25%
Unrestricted investments	4.73%	4.25%

36 NEW INTERNATIONAL FINANCIAL REPORTING STANDARDS AND INTERPRETATIONS NOT YET ADOPTED

During the year the following new/ amended IFRS's standards and interpretations have been issued which are not yet mandatory for adoption by the Group:

- IFRS 7 Financial instruments: Disclosures
- IAS 1 Presentation of Financial Statements (amended)
- IFRIC 8 Scope of IFRS 2 Share-based Payment
- IFRIC 9 Reassessment of Embedded Derivatives
- IFRIC 10 Interim Financial Reporting and Impairment

The adoption of these standards and interpretations are not expected to have a material impact on the consolidated financial statements.

37 COMPARATIVES

Certain prior year amounts have been reclassified to conform to the current year's presentation. Such reclassifications do not affect previously reported net profit or equity.

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38 SEPARATE SUMMARISED FINANCIAL STATEMENTS OF GULF FINANCE HOUSE BSC, THE PARENT COMPANY

(i) Balance sheet

	2006	2005
ASSETS		
Cash and bank balances	6,336	11,616
Due from financial and non-financial institutions	687,749	685,754
Islamic financing assets	57,402	9,805
Investment in sukuks	39,492	46,136
Assets held-for-sale	24,196	25,327
Investment securities	319,233	175,508
Investments in subsidiaries, at cost	80,003	80,003
Other assets	196,598	94,302
Equipment	2,153	1,694
Total assets	**1,413,162**	**1,130,145**
LIABILITIES		
Investors' funds	334,715	420,717
Due to financial and non-financial institutions	368,999	315,145
Other liabilities	74,152	51,874
Total liabilities	**777,866**	**787,736**
EQUITY		
Share capital	212,674	149,771
Advance towards share capital	2,708	-
Share premium	178,321	31,487
Treasury shares	(14,127)	-
Statutory reserve	24,135	23,626
Investments fair value reserve	364	227
Retained earnings	231,221	137,298
Total equity	**635,296**	**342,409**
Total liabilities and equity	**1,413,162**	**1,130,145**
OFF-BALANCE SHEET ITEMS		
Restricted investment accounts	91,092	77,152

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38 SEPARATE SUMMARISED FINANCIAL STATEMENTS OF GULF FINANCE HOUSE BSC, THE PARENT COMPANY (continued)

(ii) Income statement

	2006	2005
Income from investment advisory services	243,191	157,691
Placement, arrangement and management fees	19,509	25,590
Income from investment securities, net	11,982	12,403
Income from short-term murabaha placements	35,680	12,989
Income from investment in sukuks	1,986	839
Income from Islamic financing assets	2,502	6
Other income	1,840	2,994
Total income	**316,690**	**212,512**
Staff costs	61,068	38,950
Investment advisory expenses	23,278	28,647
Impairment allowances on available-for-sale investments	6,728	-
Murabaha expense	25,034	9,926
Other expenses	9,688	4,490
Total expenses	**125,796**	**82,013**
PROFIT FOR THE YEAR	**190,894**	**130,499**

Earnings per share (US cents)		
Basic	**30.57**	**23.55**

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