

**KUWAIT FINANCE HOUSE K.S.C. AND  
SUBSIDIARIES**

**CONSOLIDATED FINANCIAL STATEMENTS**

**31 DECEMBER 2006**

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## **INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF KUWAIT FINANCE HOUSE K.S.C.**

### **Report on the Consolidated Financial Statements**

We have audited the accompanying consolidated financial statements of Kuwait Finance House K.S.C. (the bank) and Subsidiaries (the group), which comprise consolidated balance sheet as of 31 December 2006, the related consolidated statements of income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

#### *Management's Responsibility for the Consolidated Financial Statements*

The bank's management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards adopted for use by the State of Kuwait. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of consolidated financial statements that are 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.

#### *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 International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free from 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 the auditors' judgement, 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, the auditor considers 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 for 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 bank's 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*

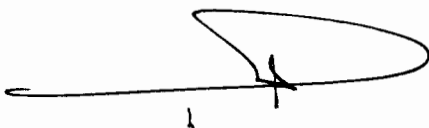
In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the group as of 31 December 2006, and the results of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted for use by the State of Kuwait.

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**Report on Other Legal and Regulatory Requirements**

Furthermore, in our opinion proper books of account have been kept by the bank and the consolidated financial statements, together with the contents of the report of the bank's board of directors relating to these consolidated financial statements, are in accordance therewith. We further report that we obtained all the information and explanations that we required for the purpose of our audit and that the consolidated financial statements incorporate all information that is required by the Commercial Companies Law of 1960, as amended, and by the bank's articles of association, that an inventory was duly carried out and that, to the best of our knowledge and belief, no violations of the Commercial Companies Law of 1960, as amended, nor of the articles of association have occurred during the year ended 31 December 2006 that might have had a material effect on the business of the group or on its financial position.

We further report that, during the course of our audit, we have not become aware of any material violations of the provisions of Law No. 32 of 1968, as amended, concerning currency, the Central Bank of Kuwait and the organisation of banking business, and its related regulations during the year ended 31 December 2006.



WALEED A. AL OSAIMI  
LICENCE NO. 68 A  
ERNST & YOUNG  
AL AIBAN, AL OSAIMI & PARTNERS



JASSIM AHMAD AL-FAHAD  
LICENCE NO. 53 A  
DELOITTE  
AL-FAHAD & CO.

6 January 2007  
Kuwait

Kuwait Finance House K.S.C. and Subsidiaries

CONSOLIDATED INCOME STATEMENT

Year ended 31 December 2006

|  | Note | 2006<br>KD 000's | 2005<br>KD 000's |
|--|------|------------------|------------------|
| <b>INCOME</b>  |      |                  |                  |
| Murabaha, Istisna'a and leasing income   |      | 327,523          | 196,739          |
| Investment income  | 3    | 183,249          | 140,453          |
| Fee and commission income  |      | 44,008           | 33,363           |
| Net gain from dealing in foreign currencies  |      | 3,332            | 6,214            |
| Other income   |      | 20,875           | 13,351           |
|  |      | <u>578,987</u>   | <u>390,120</u>   |
| <b>EXPENSES</b>  |      |                  |                  |
| Staff costs  |      | 72,269           | 43,292           |
| General and administrative expenses  |      | 38,863           | 31,803           |
| Murabaha and ijara costs   |      | 32,041           | 6,792            |
| Depreciation   |      | 33,754           | 15,528           |
| Provision for impairment   | 4    | 27,180           | 37,047           |
|  |      | <u>204,107</u>   | <u>134,462</u>   |
| <b>PROFIT BEFORE DISTRIBUTION TO DEPOSITORS</b>  |      | <b>374,880</b>   | <b>255,658</b>   |
| Distribution to depositors   | 14   | 176,362          | 122,591          |
| <b>PROFIT AFTER DISTRIBUTION</b>   |      | <b>198,518</b>   | <b>133,067</b>   |
| Contribution to Kuwait Foundation for the Advancement of Sciences                          |      | 1,673            | 1,227            |
| National Labour Support tax  |      | 3,465            | 2,612            |
| Directors' fees  | 18   | 150              | 150              |
| <b>PROFIT FOR THE YEAR</b>   |      | <b>193,230</b>   | <b>129,078</b>   |
| <b>Attributable to:</b>  |      |                  |                  |
| Equity holders of the bank   |      | 162,004          | 118,687          |
| Minority interest  |      | 31,226           | 10,391           |
|  |      | <u>193,230</u>   | <u>129,078</u>   |
| <b>BASIC AND DILUTED EARNINGS PER SHARE ATTRIBUTABLE TO THE EQUITY HOLDERS OF THE BANK</b> |      |                  |                  |
|  | 5    | <u>132 fils</u>  | <u>107 fils</u>  |


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

# Kuwait Finance House K.S.C. and Subsidiaries

## CONSOLIDATED BALANCE SHEET

At 31 December 2006

|   | Note | 2006<br>KD 000's | 2005<br>KD 000's |
|---|------|------------------|------------------|
| <b>ASSETS</b>   |      |                  |                  |
| Cash and balances with banks and financial institutions   | 6    | 231,996          | 158,293          |
| Short-term international murabaha   |      | 1,050,599        | 663,848          |
| Receivables   | 7    | 2,778,166        | 2,104,346        |
| Leased assets   | 8    | 647,939          | 603,333          |
| Available for sale investments  | 9    | 583,351          | 555,279          |
| Investment in associates  | 10   | 210,538          | 142,734          |
| Trading properties  |      | 90,463           | 93,009           |
| Investment properties   | 11   | 207,423          | 140,892          |
| Other assets  |      | 128,327          | 68,102           |
| Property and equipment  | 12   | 384,989          | 151,282          |
| <b>TOTAL ASSETS</b>   |      | <b>6,313,791</b> | <b>4,681,118</b> |
| <b>LIABILITIES, DEFERRED REVENUE,<br/>FAIR VALUE RESERVE, FOREIGN EXCHANGE<br/>TRANSLATION RESERVE AND TOTAL EQUITY</b>       |      |                  |                  |
| <b>LIABILITIES</b>  |      |                  |                  |
| Due to banks and financial institutions   | 13   | 1,080,004        | 281,617          |
| Depositors' accounts  | 14   | 3,729,930        | 3,189,344        |
| Other liabilities   |      | 289,325          | 220,795          |
| <b>TOTAL LIABILITIES</b>  |      | <b>5,099,259</b> | <b>3,691,756</b> |
| <b>DEFERRED REVENUE</b>   |      | <b>299,263</b>   | <b>235,239</b>   |
| <b>FAIR VALUE RESERVE</b>   | 15   | <b>66,654</b>    | <b>62,092</b>    |
| <b>FOREIGN EXCHANGE TRANSLATION RESERVE</b>   | 16   | <b>8,683</b>     | <b>11,401</b>    |
| <b>EQUITY ATTRIBUTABLE TO THE EQUITY HOLDERS OF<br/>THE BANK</b>  |      |                  |                  |
| Share capital   | 17   | 122,525          | 109,397          |
| Share premium   |      | 188,788          | 188,465          |
| Proposed issue of bonus shares  | 18   | 18,379           | 13,128           |
| Reserves  | 19   | 302,958          | 229,052          |
| Proposed cash dividend  | 18   | 69,839           | 60,168           |
| <b>TOTAL EQUITY ATTRIBUTABLE TO THE<br/>EQUITY HOLDERS OF THE BANK</b>  |      | <b>702,489</b>   | <b>600,210</b>   |
| Minority interest   |      | 137,443          | 80,420           |
| <b>TOTAL EQUITY</b>   |      | <b>839,932</b>   | <b>680,630</b>   |
| <b>TOTAL LIABILITIES, DEFERRED REVENUE,<br/>FAIR VALUE RESERVE, FOREIGN EXCHANGE<br/>TRANSLATION RESERVE AND TOTAL EQUITY</b> |      | <b>6,313,791</b> | <b>4,681,118</b> |

  
BADER ABDULMOHSEN AL-MUKHAIZEEM  
(CHAIRMAN AND MANAGING DIRECTOR)

  
MOHAMED SULAIMAN AL-OMAR  
(GENERAL MANAGER)

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

Kuwait Finance House K.S.C. and Subsidiaries  
**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY**  
Year ended 31 December 2006

|  | Attributable to equity holders of the bank |                           |  |                               |                               |   |                             |                                     |                       |                                     |                       | Minority interest<br>KD 000's | Total equity<br>KD 000's |          |
|--|--|---------------------------|--|-------------------------------|-------------------------------|---|-----------------------------|-------------------------------------|-----------------------|-------------------------------------|-----------------------|-------------------------------|--------------------------|----------|
|  | Reserves                                   |                           |  |                               |                               |   |                             |                                     |                       |                                     |                       |                               |                          |          |
|  | Share capital<br>KD 000's                  | Share premium<br>KD 000's | Proposed issue of bonus shares<br>KD 000's | Statutory reserve<br>KD 000's | Voluntary reserve<br>KD 000's | Employee share option reserve<br>KD 000's | Treasury shares<br>KD 000's | Net profit for the year<br>KD 000's | Sub total<br>KD 000's | Proposed cash dividends<br>KD 000's | Sub total<br>KD 000's |                               |                          |          |
| At 31 December 2004                            | 78,141                                     | 12,618                    | 7,814                                      | 157,119                       | 32,192                        | -   | (1,016)                     | -                                   | 188,295               | 286,868                             | 39,070                | 325,938                       | 21,633                   | 347,571  |
| Issue of bonus shares                          | 7,814                                      | -                         | (7,814)                                    | -                             | -                             | -   | -                           | -                                   | -                     | -                                   | -                     | -                             | -                        | -        |
| Issue of shares for cash                       | 23,442                                     | 175,816                   | -  | -                             | -                             | -   | -                           | -                                   | -                     | 199,258                             | -                     | 199,258                       | -                        | 199,258  |
| Cash received on cancellation of share options | -  | 31                        | -  | -                             | -                             | -   | -                           | -                                   | -                     | 31                                  | -                     | 31                            | -                        | 31       |
| Zakat  | -  | -                         | -  | -                             | (4,372)                       | -   | -                           | -                                   | (4,372)               | (4,372)                             | -                     | (4,372)                       | -                        | (4,372)  |
| Cash dividends paid                            | -  | -                         | -  | -                             | -                             | -   | -                           | -                                   | -                     | -                                   | (39,070)              | (39,070)                      | -                        | (39,070) |
| Net profit for the year                        | -  | -                         | -  | -                             | -                             | -   | 118,687                     | 118,687                             | 118,687               | 118,687                             | -                     | 118,687                       | 10,391                   | 129,078  |
| Distribution of net profit:                    |  |                           |  |                               |                               |   |                             |                                     |                       |                                     |                       |                               |                          |          |
| Proposed issue of bonus shares                 | -  | -                         | 13,128                                     | -                             | -                             | -   | (13,128)                    | (13,128)                            | (13,128)              | (13,128)                            | -                     | (13,128)                      | -                        | -        |
| Proposed cash dividends                        | -  | -                         | -  | -                             | -                             | -   | (60,168)                    | (60,168)                            | (60,168)              | (60,168)                            | 60,168                | -                             | -                        | -        |
| Transfer to statutory reserve                  | -  | -                         | -  | 12,267                        | -                             | -   | (12,267)                    | (12,267)                            | (12,267)              | -                                   | -                     | -                             | -                        | -        |
| Transfer to voluntary reserve                  | -  | -                         | -  | -                             | 33,124                        | -   | (33,124)                    | (33,124)                            | (33,124)              | -                                   | -                     | -                             | -                        | -        |
| Net movement in treasury shares                | -  | -                         | -  | -                             | -                             | -   | (262)                       | (262)                               | (262)                 | (262)                               | -                     | (262)                         | -                        | (262)    |
| Net change in minority interest                | -  | -                         | -  | -                             | -                             | -   | -                           | -                                   | -                     | -                                   | -                     | -                             | 48,396                   | 48,396   |
| At 31 December 2005                            | 109,397                                    | 188,465                   | 13,128                                     | 169,386                       | 60,944                        | -   | (1,278)                     | -                                   | 229,052               | 540,042                             | 60,168                | 600,210                       | 80,420                   | 680,630  |
| Issue of bonus shares                          | 13,128                                     | -                         | (13,128)                                   | -                             | -                             | -   | -                           | -                                   | -                     | -                                   | -                     | -                             | -                        | -        |
| Cash received on cancellation of share options | -  | 323                       | -  | -                             | -                             | 4,237                                     | -                           | -                                   | 4,237                 | 4,237                               | -                     | 4,237                         | -                        | 4,237    |
| Cost of employee share option                  | -  | -                         | -  | -                             | (5,091)                       | -   | -                           | -                                   | (5,091)               | (5,091)                             | -                     | (5,091)                       | -                        | (5,091)  |
| Zakat  | -  | -                         | -  | -                             | -                             | -   | -                           | -                                   | -                     | -                                   | (60,168)              | (60,168)                      | -                        | (60,168) |
| Cash dividends paid                            | -  | -                         | -  | -                             | -                             | -   | -                           | -                                   | -                     | -                                   | -                     | -                             | -                        | -        |
| Net profit for the year                        | -  | -                         | -  | -                             | -                             | -   | 162,004                     | 162,004                             | 162,004               | 162,004                             | -                     | 162,004                       | 31,226                   | 193,230  |
| Distribution of net profit:                    |  |                           |  |                               |                               |   |                             |                                     |                       |                                     |                       |                               |                          |          |
| Proposed issue of bonus shares                 | -  | -                         | 18,379                                     | -                             | -                             | -   | (18,379)                    | (18,379)                            | (18,379)              | (18,379)                            | -                     | (18,379)                      | -                        | -        |
| Proposed cash dividends                        | -  | -                         | -  | -                             | -                             | -   | (69,839)                    | (69,839)                            | (69,839)              | (69,839)                            | 69,839                | -                             | -                        | -        |
| Transfer to statutory reserve                  | -  | -                         | -  | 16,729                        | -                             | -   | (16,729)                    | (16,729)                            | -                     | -                                   | -                     | -                             | -                        | -        |
| Transfer to voluntary reserve                  | -  | -                         | -  | -                             | 57,057                        | -   | (57,057)                    | (57,057)                            | -                     | -                                   | -                     | -                             | -                        | -        |
| Net movement in treasury shares                | -  | -                         | -  | -                             | -                             | -   | 974                         | 974                                 | 974                   | 974                                 | -                     | 974                           | -                        | 974      |
| Net change in minority interest                | -  | -                         | -  | -                             | -                             | -   | -                           | -                                   | -                     | -                                   | -                     | -                             | 25,797                   | 25,797   |
| At 31 December 2006                            | 122,525                                    | 188,788                   | 18,379                                     | 186,115                       | 112,910                       | 4,237                                     | (304)                       | -                                   | 302,958               | 632,650                             | 69,839                | 702,489                       | 137,443                  | 839,932  |

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

**Kuwait Finance House K.S.C. and Subsidiaries**  
**CONSOLIDATED STATEMENT OF CASH FLOWS**  
Year ended 31 December 2006

|   | Note     | 2006<br>KD 000's      | 2005<br>KD 000's      |
|---|----------|-----------------------|-----------------------|
| <b>OPERATING ACTIVITIES</b>   |          |                       |                       |
| Net profit for the year   |          | 193,230               | 129,078               |
| Adjustment for:   |          |                       |                       |
| Depreciation  |          | 33,754                | 15,528                |
| Provision for impairment  |          | 27,180                | 37,047                |
| Dividend income   |          | (28,467)              | (20,156)              |
| Gain on part sale of associates and subsidiaries  |          | (11,381)              | (4,179)               |
| Gain on sale of available for sale investment   |          | (49,165)              | (51,217)              |
| Share of the accumulated retained earnings of the newly consolidated subsidiaries as of 1 January |          | (6,025)               | (11,957)              |
| Share of results of associates  |          | (51,085)              | (14,376)              |
| Operating profit before changes in operating assets and liabilities                               |          | 108,041               | 79,768                |
| <i>(Increase) decrease in operating assets:</i>   |          |                       |                       |
| Exchange of deposits  |          | 4,727                 | (4,727)               |
| Receivables   |          | (972,881)             | (289,610)             |
| Leased assets   |          | (44,606)              | (53,124)              |
| Trading properties  |          | 2,546                 | 34,826                |
| Other assets  |          | (71,126)              | 20,285                |
| <i>Increase (decrease) in operating liabilities:</i>  |          |                       |                       |
| Due to banks and financial institutions   |          | 798,387               | 24,769                |
| Depositors' accounts  |          | 540,586               | 313,244               |
| Other liabilities   |          | 96,927                | (13,147)              |
| Deferred revenue  |          | 64,024                | 46,237                |
| Net cash from operating activities  |          | <u>526,625</u>        | <u>158,521</u>        |
| <b>INVESTING ACTIVITIES</b>   |          |                       |                       |
| Net sale of available for sale investments  |          | 38,186                | 120,494               |
| Purchase of investment properties   |          | (70,020)              | (108)                 |
| Purchase of property and equipment  |          | (264,812)             | (31,669)              |
| Net movement in investment in associates  |          | (12,925)              | (60,712)              |
| Dividend income received  |          | 28,467                | 20,156                |
| Net cash (used in) from investing activities  |          | <u>(281,104)</u>      | <u>48,161</u>         |
| <b>FINANCING ACTIVITIES</b>   |          |                       |                       |
| Issue of shares   |          | —                     | 199,258               |
| Cash dividends paid   |          | (60,168)              | (39,070)              |
| Cash received on cancellation of share options  |          | 323                   | 31                    |
| Payment of Zakat  |          | (5,091)               | (4,372)               |
| Net movement in treasury shares   |          | 974                   | (262)                 |
| Net cash (used in) from financing activities  |          | <u>(63,962)</u>       | <u>155,585</u>        |
| <b>INCREASE IN CASH AND CASH EQUIVALENTS</b>  |          | <b>181,559</b>        | <b>362,267</b>        |
| Cash and cash equivalents at 1 January  |          | 701,582               | 339,315               |
| <b>CASH AND CASH EQUIVALENTS AT 31 DECEMBER</b>   | <b>6</b> | <b><u>883,141</u></b> | <b><u>701,582</u></b> |

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

**1 ACTIVITIES**

The consolidated financial statements of the group for the year ended 31 December 2006 were authorised for issue in accordance with a resolution of the banks' board of directors on 6 January 2007 and were approved by the Central Bank of Kuwait. The general assembly of the equity holders of the bank has the power to amend these consolidated financial statements after issuance.

The group comprises Kuwait Finance House K.S.C. (the bank) and its consolidated subsidiaries (the group) as noted in Note 20. The bank is a public shareholding company incorporated in Kuwait on 23 March 1977 and was registered as an Islamic bank with the Central Bank of Kuwait on 24 May 2004. It is engaged principally in providing banking services, the purchase and sale of properties, leasing, project construction for its own account as well as for third parties and other trading activities without practising usury. Trading activities are conducted on the basis of purchasing various goods and selling them on Murabaha at negotiated profit margins which can be settled in cash or on instalment credit basis. The bank's registered head office is at Abdulla Al-Mubarak Street, Murqab, Kuwait.

All activities are conducted in accordance with Islamic Shareea'a, as approved by the bank's Fatwa and Shareea'a Supervisory Board.

The bank operates through 42 local branches (2005: 36) and employed 1,809 employees as of 31 December 2006 (2005: 1,750) of which 973 (2005: 920) are Kuwaiti nationals representing 54% (2005: 53%) of the bank's total work force.

**2 SIGNIFICANT ACCOUNTING POLICIES**

**Basis of preparation**

The consolidated financial statements have been prepared in accordance with the regulations of the Government of Kuwait for financial services institutions regulated by the Central Bank of Kuwait. These regulations require adoption of all International Financial Reporting Standards (IFRS) except for the IAS 39 requirement for collective provision, which has been replaced by the Central Bank of Kuwait's requirement for a minimum general provision as described under the accounting policy for impairment of financial assets.

The application of IFRS 7 "Financial instruments: Disclosures" which will be effective for the year ending 31 December 2007 will result in amended and additional disclosures relating to financial instruments and associated risks.

The consolidated financial statements have been presented in Kuwaiti Dinars.

**Accounting convention**

The consolidated financial statements are prepared under the historical cost convention modified to include the measurement at fair value of available for sale investments.

The accounting policies are consistent with those used in the previous year, except for the newly adopted policy in respect of share based payment.

**IFRS 2 "Share-Based Payment"**

IFRS 2 "Share-Based Payment" requires an expense to be recognised where the group buys goods or services in exchange for shares or rights over shares ("equity-settled transactions"), or in exchange for other assets equivalent in value to a given number of shares or rights over shares ("cash-settled transactions").

*Share-based payment transactions*

Entitled employees (including directors) of the group receive remuneration in the form of share-based payment transactions, whereby entitled employees render services in exchange for shares or rights over shares ("equity-settled transactions").



**2 SIGNIFICANT ACCOUNTING POLICIES (continued)**

**IFRS 2 "Share-Based Payment" (continued)**

*Equity-settled transactions*

The cost of equity-settled transactions with employees is measured under the intrinsic value method. Under this method, the cost is determined by comparing the fair value of the granted shares at each reporting date and the date of final settlement to the exercise price with any change in intrinsic value recognised in the consolidated income statement.

The cost of equity settled transactions is recognised, together with a corresponding increase in equity, over the period in which the performance conditions are fulfilled, ending on the date on which the relevant employees exercise their rights. The cumulative expense recognised for equity-settled transactions at each reporting date until the exercise date reflects the extent to which the exercise period has expired and the number of awards that, in the opinion of the Board of Directors at that date, based on the best available estimate of the number of equity instruments that will ultimately vest.

The bank granted 54,964,233 shares of a subsidiary to certain senior management personnel during the year ended 31 December 2006 which vested immediately. The bank recognised the difference between the exercise price and fair value of the shares granted amounting to KD 4,237 thousand as an expense within staff costs with a corresponding credit to employee share option reserve within equity attributable to equity holders of the bank.

**Basis of consolidation**

The consolidated financial statements incorporate the financial statements of the bank for the year ended 31 December 2006 and its subsidiaries as noted in Note 20. All significant intra-group balances, transactions and unrealised profits are eliminated upon consolidation.

Since the subsidiaries' financial statements used in the consolidation are drawn up to different reporting dates, adjustments were made for the effects of significant transactions or other events that occurred between the reporting date of the subsidiaries and the bank's reporting date.

Some of the consolidated subsidiaries use accounting policies other than that adopted in the consolidated financial statements for certain transactions and assets. Hence, appropriate adjustments are made to their financial statements when used in preparing the consolidated financial statements to bring these in line with group accounting policies.

During the year, the bank consolidated ALAFCO – Aviation Lease and Finance Company K.S.C (Closed), a previously immaterial unconsolidated subsidiary carried at cost. On consolidation, the group's share of the accumulated retained earnings of the subsidiary as of 1 October 2005 amounting to KD 6,025 thousand along with results of the period ended 30 September 2006 amounting to KD 5,745 thousand have been included in the consolidated income statement for the year ended 31 December 2006.

Subsidiaries are fully consolidated from the date on which control is transferred to the group. Control is achieved where the group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the date of acquisition or upto the date of disposal, as appropriate.

Minority interests represent the portion of profit or loss and net assets not held by the group and are presented separately in the consolidated income statement and within equity in the consolidated balance sheet, separately from the bank's shareholders' equity. Acquisition of minority interests are accounted for using the parent company extension method, whereby, the difference between the consideration and the book value of the share of the net assets acquired is recognized as goodwill.

Any excess of the cost of acquisition over the fair values of the identifiable net assets acquired is recognised as goodwill. Any deficiency of the cost of acquisition below the fair values of the identifiable net assets acquired (i.e. a discount on acquisition) is recognised directly in the income statement in the year of acquisition.

**2 SIGNIFICANT ACCOUNTING POLICIES (continued)**

**Short-term international murabaha**

Short-term international murabaha are financial assets originated by the group and represent deals with high credit quality international banks and financial institutions maturing within three months of the balance sheet date. These are stated at amortised cost.

**Receivables**

Receivables are financial assets originated by the group and principally comprise Murabaha and Istisna'a receivables. These are stated at amortised cost.

Murabaha is the sale of commodities and real estate at cost plus an agreed profit mark up whereby the seller informs the purchaser of the price at which he purchases the product and also stipulates an amount of profit.

Istisna'a is a sale contract between a contract owner and a contractor whereby the contractor based on an order from the contract owner undertakes to manufacture or otherwise acquire the subject matter of the contract according to specifications, and sells it to the contract owner for an agreed upon price and method of settlement whether that be in advance, by instalments or deferred to a specific future time.

**Impairment of financial assets**

An assessment for a group of financial assets is made at each balance sheet date to determine whether there is an objective evidence that a specific group of financial asset may be impaired. If such an evidence exists, an impairment loss is recognised in the consolidated income statement.

Impairment is determined as follows:

- (a) for assets carried at amortised cost, impairment is based on estimated cash flows discounted at the original effective rate of return;
- (b) for assets carried at fair value, impairment is the difference between cost and fair value; and
- (c) for assets carried at cost, impairment is the difference between cost and present value of future cash flows discounted at the current market rate of return for a similar financial asset.

In addition, in accordance with Central Bank of Kuwait instructions, a minimum general provision of 2% on all finance facilities net of certain categories of collateral, to which CBK instructions are applicable and not subject to specific provision, is made.

Reversal of impairment losses recognised in prior years is recorded when there is an indication that the impairment losses recognised for the financial asset no longer exist or have decreased and the decrease can be related objectively to an event occurring after the impairment was recognised. Except for equity instruments classified as available for sale, reversals of impairment losses are recognised in the consolidated income statement to the extent the carrying value of the asset does not exceed its amortised cost at the reversal date. Reversals in respect of equity instruments classified as available for sale are recognised in the fair value reserve.

**Recognition and derecognition of financial assets and liabilities**

A financial asset or a financial liability is recognised when the group becomes a party to the contractual provisions of the instrument. A financial asset is de-recognised either when the contractual rights to cash flows from the financial asset expire, the group has transferred substantially all the risks and rewards of ownership or when it has neither transferred nor retained substantially all the risks and rewards, but no longer has control over the asset or a proportion of the asset. A financial liability is de-recognised when the obligation specified in the contract is discharged, cancelled or expired.

**Leased assets**

This represents net investment in assets leased for periods which either approximate or cover a major part of the economic lives of such assets. The lease agreements provide a purchase option to lessees at a price equal or expected to be equal or lower than fair value of such assets at the time when such option is exercised.

Leased assets are stated at amounts equal to the net investment outstanding in the leases.

**2 SIGNIFICANT ACCOUNTING POLICIES (continued)**

**Available for sale investments**

Investments are initially recognised at cost (including transaction costs associated with the acquisition of the investment) and are subsequently remeasured to fair value unless fair value cannot be reliably determined. Changes in fair value are reported in the fair value reserve until the investment is sold, collected or otherwise disposed off, or the investment is determined to be impaired, at which time the cumulative gain or loss previously included within the fair value reserve is included within investment income in the consolidated income statement.

**Investments in associates**

An associate is an entity over which the group exerts significant influence. Investments in associates are accounted for under the equity method of accounting. Where an associate is acquired and held exclusively for resale, it is accounted for as a non-current asset held for resale under IFRS 5.

Under the equity method, the investment in associate is initially recognised at cost and adjusted thereafter for the post-acquisition change in the group's share of the associate's equity. Goodwill relating to an associate is included in the carrying amount of the investment and is not amortised. The group recognises in the consolidated income statement its share of the total recognised profit or loss of the associate from the date that influence effectively commenced until the date that it effectively ceases. Distributions received from the associate reduce the carrying amount of the investment. Adjustments to the carrying amount may also be necessary for changes in the group's share in the associate arising from changes in the associate's equity. The group's share of those changes is recognised directly in equity, fair value reserve or foreign exchange translation reserve as appropriate.

Unrealised gains on transactions with associate are eliminated to the extent of the group's share in the associate. Unrealised losses are also eliminated unless the transaction provides evidence of impairment in the asset transferred. An assessment for impairment of investments in associates is performed when there is an indication that the asset has been impaired, or that impairment losses recognised in prior years no longer exist.

The associate's financial statements are prepared either to the bank's reporting date or to a date not earlier than three months of the bank's reporting date using consistent accounting policies. Where practicable, adjustments were made for the effects of significant transactions or other events that occurred between the reporting date of the associates and the bank's reporting date.

**Trading properties**

Trading properties are carried at the lower of cost or market value determined on an individual basis.

**Investment properties**

Investment properties are initially recorded at cost including associated transaction costs. Depreciation is provided on a straight-line basis over the estimated useful lives of all rental properties other than freehold land which is deemed to have an indefinite life.

**Impairment of non-financial assets**

The group assesses at each reporting date whether there is an indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the group makes an estimate of the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit's fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets and then its recoverable amount is assessed as part of the cash-generating unit to which it belongs. Where the carrying amount of an asset (or cash-generating unit) exceeds its recoverable amount, the asset (or cash-generating unit) is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset (or cash-generating unit). In determining fair value less costs to sell an appropriate valuation model is used. These calculations are corroborated by available fair value indicators.

**2 SIGNIFICANT ACCOUNTING POLICIES (continued)**

**Impairment of non-financial assets (continued)**

An assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is asset's recoverable amount since the last impairment loss was recognised. If that is the case, the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in the consolidated income statement. After such a reversal, the depreciation charge is adjusted in future years to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining useful life.

**Property and equipment**

Property and equipment are stated at historical cost less accumulated depreciation and any impairment in value. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the consolidated income statement during the financial period in which they are incurred.

Freehold land is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives, as follows:

- Aircraft and engines 18 years (from the date of original manufacture)
- Buildings 20 years
- Furniture, fixtures and equipment 3-5 years

The asset's residual values, useful lives and methods of depreciation are reviewed, and adjusted if appropriate, at each financial year end.

**Fair values**

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Consequently differences can arise between carrying values and the fair value estimates.

Underlying the definitions of fair value is the presumption that the group is a going concern without any intention or requirement to materially curtail the scale of its operations or to undertake a transaction on adverse terms.

*Investments*

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

For investments where there is no quoted market price, a reasonable estimate of the fair value is determined by reference to recent arm's length transactions, current fair value of another instrument that is substantially the same, an earnings multiple, or an industry specific earnings multiple or is based on the expected cash flows of the investment discounted at current rates applicable for items with similar terms and risk characteristics. Fair value estimates take into account liquidity constraints and assessment for any impairment.

Investments with no reliable measures of their fair values and for which no fair value information could be obtained are carried at their initial cost less impairment in value, if any.

*Investment properties*

For local investment properties, fair value is determined by the group's specialist resources which have relevant experience in the local property market. For overseas investment properties, fair value is determined based on external valuations by independent, registered real estate valuers.

*Other financial assets and liabilities*

For other financial assets and liabilities, fair value is determined based on expected future cash flows and management's estimate of the amount at which these assets could be exchanged for cash on an arm's length basis or a liability settled to the satisfaction of creditors

**2 SIGNIFICANT ACCOUNTING POLICIES (continued)**

**Revenue recognition**

- i) Income from Murabaha and Istisna'a is recognised on a weighted time apportionment basis.
- ii) Income from leased assets is recognised on a pattern reflecting a constant periodic return on the net investment outstanding.
- iii) Operating lease income is recognised on a straight line basis in accordance with the lease agreement.
- iv) Rental income from investment properties is recognised on an accruals basis.
- v) Dividend income, including dividend income on own shares (held on behalf of depositors), is recognised when the right to receive payment is established.
- vi) Fee and commission income is recognised at the time the related services are provided.

**Zakat**

Zakat is calculated at 2.577% on the opening reserves of the bank (excluding proposed distributions) which have remained for one complete fiscal year and is paid under the direction of the bank's Al-Fatwa and Shareea's Supervisory Board. Zakat is charged to voluntary reserve.

**Foreign currency translation**

The consolidated financial statements are presented in Kuwaiti Dinars, which is the bank's functional and presentational currency. Each entity in the group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency.

*Transactions and balances*

Transactions in foreign currencies are initially recorded in the functional currency rate of exchange ruling at the date of the transaction.

Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the balance sheet date. All differences are taken to general and administrative expenses in the consolidated income statement.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined. Any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition are treated as assets and liabilities of the foreign operations and translated at closing rate.

*Group companies*

As at the reporting date, the assets and liabilities of foreign subsidiaries translated into the bank's presentation currency (the Kuwaiti Dinars) at the rate of exchange ruling at the balance sheet date, and their income statements are translated at the weighted average exchange rates for the year except for entities operating in hyper inflationary economies. The results of entities operating in hyper inflationary economies are translated into the bank's presentation currency at period end exchange rates. Exchange differences arising on translation are taken directly to foreign exchange translation reserve. On disposal of a foreign entity, the deferred cumulative amount recognised in equity relating to the particular foreign operation is recognised in the consolidated income statement.

On equity accounting, the carrying value of the associates is translated into the bank's presentation currency at the period end rates of exchange and the results of the associates are translated into Kuwaiti dinars at the average rates of exchange for the year. All foreign exchange translation adjustments are taken to the foreign exchange translation reserve until disposal at which time they are recognised in the consolidated income statement.

**Trade and settlement date accounting**

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

**Offsetting**

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

**2 SIGNIFICANT ACCOUNTING POLICIES (continued)**

**Cash and cash equivalents**

Cash and cash equivalents comprise cash, tawarruq balances with the Central Bank of Kuwait, balances with banks and financial institutions and international murabaha contracts and exchange of deposits maturing within three months of contract date.

**Fiduciary assets**

Assets held in trust or in a fiduciary capacity are not treated as assets of the group and accordingly are not included in these consolidated financial statements.

**Judgements**

In the process of applying the group's accounting policies, management has made the following judgements, apart from those involving estimations, which have the most significant effect on the amounts recognised in the consolidated financial statements:

*Classification of investments*

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

The group classified all of its investments as available for sale.

*Impairment of investments*

The group treats available for sale equity investments as impaired when there has been a significant or prolonged decline in the fair value below its cost or where other objective evidence of impairment exists. The determination of what is "significant" or "prolonged" requires considerable judgement. In addition, the group evaluates other factors, including normal volatility in share price for quoted equities and the future cash flows and the discount factors for unquoted equities.

**Estimation uncertainty**

The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

*Impairment losses on finance facilities*

The group reviews its problem finance facilities on a quarterly basis to assess whether a provision for impairment should be recorded in the consolidated income statement. In particular, considerable judgement by management is required in the estimation of the amount and timing of future cash flows when determining the level of provisions required. Such estimates are necessarily based on assumptions about several factors involving varying degrees of judgment and uncertainty, and actual results may differ resulting in future changes to such provisions.

*Valuation of unquoted equity investments*

Valuation of unquoted equity investments is normally based on one of the following:

- recent arm's length market transactions;
- current fair value of another instrument that is substantially the same;
- an earnings multiple
- the expected cash flows discounted at current rates applicable for items with similar terms and risk characteristics; or
- other valuation models.

The determination of the cash flows and discount factors for unquoted equity investments requires significant estimation. There are a number of investments where this estimation cannot be reliably determined. As a result, these investments are carried at cost less impairment.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2006

**3 INVESTMENT INCOME**

|   | <i>2006</i><br><i>KD 000's</i> | <i>2005</i><br><i>KD 000's</i> |
|---|--------------------------------|--------------------------------|
| Income from sale of trading properties  | 25,610                         | 26,878                         |
| Rental income   | 11,516                         | 11,690                         |
| Dividend income   | 28,467                         | 20,156                         |
| Gain on part sale of associates and subsidiaries  | 11,381                         | 4,179                          |
| Gain on sale of available for sale investments  | 49,165                         | 51,217                         |
| Share of the accumulated retained earnings of the newly consolidated subsidiaries as of 1 January | 6,025                          | 11,957                         |
| Share of results of associates (Note 10)  | 51,085                         | 14,376                         |
|   | <u>183,249</u>                 | <u>140,453</u>                 |

**4 PROVISION FOR IMPAIRMENT**

|  | <i>2006</i><br><i>KD 000's</i> | <i>2005</i><br><i>KD 000's</i> |
|--|--------------------------------|--------------------------------|
| Provision for impairment of receivables and other assets   | 27,180                         | 28,783                         |
| Provision for impairment of available for sale investments | -                              | 8,264                          |
|  | <u>27,180</u>                  | <u>37,047</u>                  |

**5 EARNINGS PER SHARE ATTRIBUTABLE TO THE EQUITY HOLDERS OF THE BANK**

Basic and diluted earnings per share are based on the profit for the year attributable to equity holders of the bank of KD 162,004 thousand (2005: KD 118,687 thousand) and the weighted average number of ordinary shares outstanding during the year of 1,224,746 thousand (2005: 1,106,673 thousand) excluding the weighted average number of treasury shares held by the group.

The earnings per share of the previous year has been restated for bonus shares issued in 2006.

The distributable earnings per share of the comparative period after adjustment for the impact of the capital increase from 1 January 2005 and bonus shares issued during 2006 was 97 fils per share.

# Kuwait Finance House K.S.C. and Subsidiaries

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2006

### 6 CASH AND CASH EQUIVALENTS

|   | 2006<br>KD 000's | 2005<br>KD 000's |
|---|------------------|------------------|
| Cash  | 45,901           | 42,328           |
| Balances with Central Banks   | 141,942          | 46,875           |
| Balances with banks and financial institutions - current accounts                                 | 42,880           | 67,977           |
| Balances with banks and financial institutions - exchange of deposits                             | 1,273            | 1,113            |
| Cash and balances with banks and financial institutions   | 231,996          | 158,293          |
| Short-term international murabaha – maturing within 3 months of contract date                     | 428,390          | 447,646          |
| Tawarruq balances with Central Bank of Kuwait (included within short-term international murabaha) | 222,755          | 100,370          |
| Exchange of deposits – maturing after 3 months of contract date                                   | -                | (4,727)          |
| Cash and cash equivalents   | <u>883,141</u>   | <u>701,582</u>   |

The group exchanges deposits with high credit quality banks and financial institutions in local and foreign currencies with the legal right reserved to set off such deposits exchanged in the event that a counter party bank or financial institution becomes insolvent. The gross balances of deposits exchanged were as follows:

|   | 2006<br>KD 000's | 2005<br>KD 000's |
|---|------------------|------------------|
| Due from banks and financial institutions | 168,589          | 251,231          |
| Due to banks and financial institutions   | (234,995)        | (304,447)        |
|   | <u>(66,406)</u>  | <u>(53,216)</u>  |

Included in the consolidated balance sheet as net balances:

|  | 2006<br>KD 000's | 2005<br>KD 000's |
|--|------------------|------------------|
| In assets:   |                  |                  |
| Cash and balances with banks and financial institutions – exchange of deposits | 1,273            | 1,113            |
| In liabilities:  |                  |                  |
| Due to banks and financial institutions – exchange of deposits (Note 13)       | (67,679)         | (54,329)         |
|  | <u>(66,406)</u>  | <u>(53,216)</u>  |

The fair values of cash and balances with banks and financial institutions do not differ from their respective book values.

### 7 RECEIVABLES

Receivables principally comprise Murabaha and Istisna'a balances and are stated net of provision for impairment as follows:

|                                 | 2006<br>KD 000's | 2005<br>KD 000's |
|---------------------------------|------------------|------------------|
| International murabahas         | 666,722          | 404,628          |
| Local murabahas                 | 2,023,715        | 1,617,166        |
| Istisna'a and other receivables | 252,184          | 231,568          |
|                                 | <u>2,942,621</u> | <u>2,253,362</u> |
| Less: provision for impairment  | (164,455)        | (149,016)        |
|                                 | <u>2,778,166</u> | <u>2,104,346</u> |



Kuwait Finance House K.S.C. and Subsidiaries

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2006

7 RECEIVABLES (continued)

The distribution of receivables is as follows:

|                                  | 2006<br>KD 000's | 2005<br>KD 000's |
|----------------------------------|------------------|------------------|
| <b>Industry sector</b>           |                  |                  |
| Trading and manufacturing        | 995,848          | 1,037,937        |
| Banks and financial institutions | 1,323,712        | 696,664          |
| Construction and real estate     | 487,938          | 379,352          |
| Other                            | 135,123          | 139,409          |
|                                  | <u>2,942,621</u> | <u>2,253,362</u> |
| Less: provision for impairment   | (164,455)        | (149,016)        |
|                                  | <u>2,778,166</u> | <u>2,104,346</u> |
|                                  |                  |                  |
|                                  | 2006<br>KD 000's | 2005<br>KD 000's |
| <b>Geographic region</b>         |                  |                  |
| Middle East                      | 2,333,842        | 1,828,652        |
| Western Europe                   | 48,666           | 116,786          |
| Other                            | 560,113          | 307,924          |
|                                  | <u>2,942,621</u> | <u>2,253,362</u> |
| Less: provision for impairment   | (164,455)        | (149,016)        |
|                                  | <u>2,778,166</u> | <u>2,104,346</u> |

Provisions for losses on receivables from customers for finance facilities are as follows:

|                               | <i>Specific</i>  |                  | <i>General</i>   |                  | <i>Total</i>     |                  |
|-------------------------------|------------------|------------------|------------------|------------------|------------------|------------------|
|                               | 2006<br>KD 000's | 2005<br>KD 000's | 2006<br>KD 000's | 2005<br>KD 000's | 2006<br>KD 000's | 2005<br>KD 000's |
| Balance at beginning of year  | 90,787           | 87,276           | 58,229           | 47,668           | 149,016          | 134,944          |
| Provided during the year, net | 8,860            | 3,511            | 6,579            | 10,561           | 15,439           | 14,072           |
|                               | <u>99,647</u>    | <u>90,787</u>    | <u>64,808</u>    | <u>58,229</u>    | <u>164,455</u>   | <u>149,016</u>   |

At 31 December 2006, non-performing finance facilities amounted to KD 120,244 thousand (2005: KD 98,926 thousand) and are split between facilities granted pre-invasion and post liberation as follows:

|                    | <i>Pre-invasion</i><br>KD 000's | <i>Post liberation</i><br>KD 000's | <i>Total</i><br>KD 000's |
|--------------------|---------------------------------|------------------------------------|--------------------------|
| <b>2006</b>        |                                 |                                    |                          |
| Finance facilities | 31,693                          | 88,531                             | 120,224                  |
| Provisions         | 31,693                          | 67,954                             | 99,647                   |
| <b>2005</b>        |                                 |                                    |                          |
| Finance facilities | 31,737                          | 67,189                             | 98,926                   |
| Provisions         | 31,737                          | 59,050                             | 90,787                   |

# Kuwait Finance House K.S.C. and Subsidiaries

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2006

### 7 RECEIVABLES (continued)

The provision charge for the year on unfunded facilities is KD 1,362 thousand (2005: KD 1,467 thousand). The available provision on unfunded facilities of KD 6,550 thousand (2005: KD 5,188 thousand) is included under other liabilities.

The analysis of specific and general provisions set out above is based on the requirements of the Central Bank of Kuwait. According to the Central Bank of Kuwait instructions, a general provision of 2% on all credit facilities net of certain categories of collateral, to which Central Bank of Kuwait instructions are applicable and not subject to specific provision, is made.

Provisions include certain amounts purchased by the Central Bank of Kuwait. Such provisions must be ceded to the Central Bank of Kuwait when they are no longer required.

Whenever necessary, murabaha receivables are secured by acceptable forms of collateral to mitigate the related credit risks. Real estate murabaha receivables are secured by mortgage on the underlying property.

Receivables from banks and financial institutions comprise mainly murabaha transactions with high credit quality institutions.

The fair values of receivables do not differ from their respective book values.

### 8 LEASED ASSETS

The net investment in leased assets comprises the following:

|                          | <i>2006</i><br><i>KD 000's</i> | <i>2005</i><br><i>KD 000's</i> |
|--------------------------|--------------------------------|--------------------------------|
| Gross investment         | 695,235                        | 631,013                        |
| Unearned revenue         | (34,210)                       | (16,153)                       |
| Provision for impairment | (13,086)                       | (11,527)                       |
|                          | <u>647,939</u>                 | <u>603,333</u>                 |

The future minimum lease payments receivable in the aggregate are as follows:

|                  | <i>2006</i><br><i>KD 000's</i> | <i>2005</i><br><i>KD 000's</i> |
|------------------|--------------------------------|--------------------------------|
| Within one year  | 355,679                        | 496,139                        |
| One to five year | 267,350                        | 107,030                        |
| After five years | 72,206                         | 27,844                         |
|                  | <u>695,235</u>                 | <u>631,013</u>                 |

The unguaranteed residual value of the leased assets at 31 December 2006 is estimated at KD Nil (2005: KD Nil).

# Kuwait Finance House K.S.C. and Subsidiaries

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2006

### 9 AVAILABLE FOR SALE INVESTMENTS

|   | 2006<br>KD 000's | 2005<br>KD 000's |
|---|------------------|------------------|
| Available for sale investments comprise:                  |                  |                  |
| Quoted equity investments                                 | 68,612           | 55,395           |
| Unquoted equity investments                               | 93,974           | 62,838           |
| Managed portfolios (containing quoted equity investments) | 69,484           | 66,988           |
| Mutual funds  | 150,528          | 198,978          |
| Sukook  | 151,006          | 87,569           |
| Unconsolidated subsidiaries                               | 49,747           | 83,511           |
|   | <b>583,351</b>   | <b>555,279</b>   |
| Investments carried at fair value                         | 300,845          | 230,990          |
| Investments carried at cost less impairment               | 282,506          | 324,289          |
|   | <b>583,351</b>   | <b>555,279</b>   |

Included in managed portfolios is an amount of KD 20,045 thousand (2005: KD 18,594 thousand) which represents the group's investment in 9,280 thousand (2005: 7,559 thousand) of the bank's shares on behalf of depositors, equivalent to 0.76 % of the total issued share capital at 31 December 2006 (2005: 0.69%). The results from activities relating to dealing in these shares are attributed only to the depositors, and hence these shares are classified under investments.

The group's unconsolidated subsidiaries, carried at cost, primarily consist of the following:

|  | <i>Interest in equity %</i> |      | <i>Country of registration</i> | <i>Principal activities</i>                   |
|--|-----------------------------|------|--------------------------------|---|
|  | 2006                        | 2005 |                                |   |
| <i>Direct investments in unconsolidated subsidiaries:</i>  |                             |      |                                |   |
| Development Enterprises Holding Co.  | 100                         | 100  | Kuwait                         | Holding Company                               |
| Gulf International Automobile Trading Company K.S.C. (Closed)                                      | 100                         | 100  | Kuwait                         | Trading in motor vehicles                     |
| International Turnkey Systems Company K.S.C. (Closed)  | 85                          | 85   | Kuwait                         | Development of computer software and hardware |
| Public Services Company K.S.C. (Closed)  | 80                          | 80   | Kuwait                         | Administrative services                       |
| Al Salaam Hospital Company K.S.C. (Closed)   | 52                          | 52   | Kuwait                         | Health care                                   |
| <i>Indirect investments in unconsolidated subsidiaries held through consolidated subsidiaries:</i> |                             |      |                                |   |
| Heglieg Petroleum Services and Investment Company  | 51                          | -    | Sudan                          | Petroleum services                            |

The impact of the non-consolidation of the above subsidiaries is immaterial to the profits, assets and liabilities of the group.

# Kuwait Finance House K.S.C. and Subsidiaries

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2006

### 10 INVESTMENT IN ASSOCIATES

The group's associates primarily consist of the following:

|   | Interest in equity % |      | Country of registration | Principal activities                   | Financial statements reporting date |
|---|----------------------|------|-------------------------|--|-------------------------------------|
|   | 2006                 | 2005 |                         |  |                                     |
| <i>Direct investments in associates:</i>  |                      |      |                         |  |                                     |
| First Takaful Insurance Company K.S.C. (Closed)                                   | 27                   | 27   | Kuwait                  | Islamic Takaful insurance              | 30 September 2006                   |
| Gulf Investment House K.S.C. (Closed)   | 26                   | 26   | Kuwait                  | Islamic investments                    | 30 September 2006                   |
| Liquidity Management Centre Company B.S.C. (Closed)                               | 25                   | 25   | Bahrain                 | Islamic banking and financial services | 30 September 2006                   |
| National Bank of Sharjah PJSC   | 20                   | 20   | United Arab Emirates    | Islamic banking services               | 30 September 2006                   |
| A'ayan Leasing & Investment Company K.S.C. (Closed)                               | 16                   | 16   | Kuwait                  | Leasing and Islamic investments        | 30 September 2006                   |
| <i>Indirect investments in associates held through consolidated subsidiaries:</i> |                      |      |                         |  |                                     |
| Educational Holding Group K.S.C.  | 33                   | 31   | Kuwait                  | Educational services                   | 31 August 2006                      |
| The International Leasing and Investment Company K.S.C. (Closed)                  | 36                   | 35   | Kuwait                  | Leasing and Islamic investments        | 30 September 2006                   |
| Munsha'at Real Estate Projects Co. K.S.C. (Closed)                                | 50                   | 50   | Kuwait                  | Real estate projects management        | 30 September 2006                   |

|   | 2006<br>KD 000's | 2005<br>KD 000's |
|---|------------------|------------------|
| <i>Carrying amount of investment in associates:</i> |                  |                  |
| At 1 January  | 142,734          | 39,288           |
| Additions   | 35,353           | -                |
| Disposals   | (11,642)         | -                |
| Investments in associates arising on consolidation  | -                | 91,716           |
| Share of results of associates (Note 3)             | 51,085           | 14,376           |
| Dividends received                                  | (8,684)          | (2,646)          |
| Share of changes in associates' fair values reserve | 2,773            | -                |
| Foreign exchange translation adjustment             | (1,081)          | -                |
| At 31 December                                      | <b>210,538</b>   | <b>142,734</b>   |

|   | 2006<br>KD 000's | 2005<br>KD 000's |
|---|------------------|------------------|
| <i>Share of associates' assets and liabilities:</i> |                  |                  |
| Assets  | 447,165          | 233,104          |
| Liabilities   | (261,725)        | (104,764)        |
| Net assets  | <b>185,440</b>   | <b>128,340</b>   |

# Kuwait Finance House K.S.C. and Subsidiaries

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2006

### 10 INVESTMENT IN ASSOCIATES (continued)

|  | 2006<br>KD 000's | 2005<br>KD 000's |
|--|------------------|------------------|
| <i>Share of associates' revenue and results:</i> |                  |                  |
| Revenue  | 71,620           | 13,003           |
| Results  | 51,085           | 6,621            |
| Share of associates' capital commitments         | 3,592            | 2,748            |

Investments in associates with a carrying amount of KD 120,913 thousand (2005: KD 103,497 thousand) have a fair value of KD 213,762 at 31 December 2006 (2005: KD 185,898 thousand). The remaining associates with a carrying value of KD 89,625 are unquoted companies and reliable fair values are not available.

Included in the above balance is goodwill of KD 25,098 thousand (2005: KD 14,394 thousand).

### 11 INVESTMENT PROPERTIES

|                                      | 2006<br>KD 000's | 2005<br>KD 000's |
|--------------------------------------|------------------|------------------|
| At 1 January                         | 140,892          | 105,921          |
| Arising on consolidation             | -                | 15,499           |
| Purchases                            | 74,376           | 27,330           |
| Disposals                            | (4,356)          | (5,216)          |
| Depreciation charged for the year    | (2,649)          | (2,743)          |
| Impairment losses (charged) released | (840)            | 101              |
| At 31 December                       | <u>207,423</u>   | <u>140,892</u>   |
| Cost                                 | 240,775          | 170,755          |
| Accumulated depreciation             | (25,923)         | (23,274)         |
| Impairment                           | (7,429)          | (6,589)          |
|                                      | <u>207,423</u>   | <u>140,892</u>   |

Included in investment properties is an investment in Al-Muthana Complex in Kuwait which is constructed on land leased from the Government of Kuwait. The ownership of the building, as well as any results from the activities relating to the investment, are attributed only to the equity holders of the bank.

The purchases during the year include investment properties with a carrying value of KD 35,830 thousand acquired for rental purposes by a subsidiary. These properties and their rental income are mortgaged and assigned against murabaha payable amounting to KD 30,486 thousand.

The fair value of the investment properties at the balance sheet date is KD 253,775 thousand (2005: KD 208,520 thousand).

## Kuwait Finance House K.S.C. and Subsidiaries

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2006

## 12 PROPERTY AND EQUIPMENT

|   | Land<br>KD 000's | Buildings<br>KD 000's | Aircraft<br>and<br>engines<br>KD 000's | Furniture,<br>fixtures and<br>equipment<br>KD 000's | Motor<br>vehicles<br>KD 000's | Properties<br>under<br>development<br>KD 000's | Total<br>KD 000's |
|---|------------------|-----------------------|--|---|-------------------------------|--|-------------------|
| Cost  |                  |                       |  |   |                               |  |                   |
| At 1 January 2006   | 9,974            | 31,240                | -                                      | 46,790  | 38,780                        | 73,292   | 200,076           |
| Arising on consolidation of previously<br>unconsolidated subsidiary | -                | 1,190                 | 109,782                                | 1,215   | 48                            | -  | 112,235           |
| Additions   | -                | 1,880                 | 160,204                                | 7,067   | 32,499                        | 8,523  | 210,173           |
| Disposals   | (240)            | (813)                 | (9,649)                                | (535)   | (30,387)                      | (12,806)                                       | (54,430)          |
| At 31 December 2006   | <u>9,734</u>     | <u>33,497</u>         | <u>260,337</u>                         | <u>54,537</u>                                       | <u>40,940</u>                 | <u>69,009</u>                                  | <u>468,054</u>    |
| Depreciation  |                  |                       |  |   |                               |  |                   |
| At 1 January 2006   | -                | 16,375                | -                                      | 27,872  | 4,547                         | -  | 48,794            |
| Arising on consolidation of previously<br>unconsolidated subsidiary | -                | 314                   | 9,176                                  | 584   | 69                            | -  | 10,143            |
| Depreciation charge for the year                                    | -                | 1,137                 | 17,979                                 | 6,727   | 5,262                         | -  | 31,105            |
| Relating to disposals   | -                | (73)                  | (2,428)                                | (300)   | (4,176)                       | -  | (6,977)           |
| At 31 December 2006   | <u>-</u>         | <u>17,753</u>         | <u>24,727</u>                          | <u>34,883</u>                                       | <u>5,702</u>                  | <u>-</u>                                       | <u>83,065</u>     |
| Net carrying amount   |                  |                       |  |   |                               |  |                   |
| At 31 December 2006   | <u>9,734</u>     | <u>15,744</u>         | <u>235,610</u>                         | <u>19,654</u>                                       | <u>35,238</u>                 | <u>69,009</u>                                  | <u>384,989</u>    |
| At 31 December 2005   | <u>9,974</u>     | <u>14,865</u>         | <u>-</u>                               | <u>18,918</u>                                       | <u>34,233</u>                 | <u>73,292</u>                                  | <u>151,282</u>    |

One of the subsidiaries holds aircraft with carrying value of KD 162,580 thousand acquired under finance leases. The aircraft are secured against the finance leases with the legal title of the aircraft being retained by the lender (Note 13).

Included in property and equipment are the head office building and all branches of the bank constructed on land leased from the Government of Kuwait. The ownership of the buildings as well as the net rental income from these buildings are attributable only to the equity holders of the bank.

The residual value of the aircraft fleet of a subsidiary is estimated at approximately 30% (in aggregate) of the purchase cost of the aircraft fleet.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2006

**12 PROPERTY AND EQUIPMENT (continued)**

The future minimum lease rent receivable on the operating lease of motor vehicles, aircraft and engines is KD 174,611 thousand (2005: KD 6,309 thousand) and is receivable as follows:

|   | 2006<br>KD 000's | 2005<br>KD 000's |
|---|------------------|------------------|
| Income receivable within one year               | 31,233           | 4,994            |
| Income receivable within one year to five years | 86,552           | 1,315            |
| Income receivable after five years              | 56,826           | -                |
|   | <u>174,611</u>   | <u>6,309</u>     |

**13 DUE TO BANKS AND FINANCIAL INSTITUTIONS**

|  | 2006<br>KD 000's | 2005<br>KD 000's |
|--|------------------|------------------|
| Current accounts                           | 3,831            | 70,865           |
| Murabaha payable                           | 890,518          | 156,423          |
| Exchange of deposits (Note 6)              | 67,679           | 54,329           |
| Obligations under finance leases (Note 12) | 117,976          | -                |
|  | <u>1,080,004</u> | <u>281,617</u>   |

The fair values of balances due to banks and financial institutions do not differ from their respective book values.

Property and equipment include 14 aircraft acquired by a subsidiary under finance leases denominated in US Dollars with maturities varying between 5 – 12 years. The finance leases bear effective finance costs of 4.6% - 6.6% per annum and are secured by the aircraft (Note 12). The instalments payable within one to five years are KD 48,194 thousand and instalments payable after five years are KD 65,814 thousand.

**14 DEPOSITORS' ACCOUNTS**

a) The depositors' accounts of the bank comprise the following:

- i) Non-investment deposits in the form of current accounts. These deposits are not entitled to any profits nor do they bear any risk of loss as the bank guarantees to pay the related balances on demand. Accordingly, these deposits are considered Qard Hasan from depositors to the bank on the grounds of Islamic Shareea'a.
- ii) Investment deposits comprise Mustamera and Al-Sedra deposits for unlimited periods and Tawfeer savings accounts. Unlimited investment deposits are initially valid for one year and are automatically renewable for the same period unless notified to the contrary in writing by the depositor. Investment savings accounts are valid for an unlimited period.

In all cases, the investment deposits receive a proportion of the profit as the board of directors of the bank determines, or bear a share of loss based on the results of the financial year.

The bank generally invests approximately 90% of investment deposits for an unlimited period ("Mustamera"), 70% of investment deposits for an unlimited period ("Al-Sedra") and 60% of investment savings accounts ("Tawfeer"). The bank guarantees to pay the remaining uninvested portion of these investment deposits. Accordingly, this portion is considered Qard Hasan from depositors to the bank, on the grounds of Islamic Shareea'a. Investing such Qard Hasan is made at the discretion of the board of directors of the bank, the results of which are attributable to the equity holders of the bank.

# Kuwait Finance House K.S.C. and Subsidiaries

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2006

### 14 DEPOSITORS' ACCOUNTS (continued)

- b) On the basis of the results for the year, the board of directors of the bank determined the depositors' share of profit at the following rates:

|   | 2006<br>% per annum | 2005<br>% per annum |
|---|---------------------|---------------------|
| Investment deposits - ("Mustamera")     | 8.458               | 6.807               |
| Investment deposits - ("Al-Sedra")      | 6.578               | 5.294               |
| Investment savings accounts ("Tawfeer") | 5.639               | 4.538               |

- c) The fair values of depositors' accounts do not differ from their carrying book values.

### 15 FAIR VALUE RESERVE

Changes in the fair value of available for sale investments are reported in the fair value reserve. Management of the bank is of the opinion that this reserve is attributable to both the depositors and equity holders. As a result, the reporting of this reserve as a separate item on the consolidated balance sheet enables a fairer presentation than its inclusion under equity.

The movement on the fair value reserve is analysed as follows:

|   | 2006<br>KD 000's | 2005<br>KD 000's |
|---|------------------|------------------|
| Balance at 1 January  | 62,092           | 31,680           |
| Change in fair value during the year                          | 9,486            | 49,480           |
| Gain realised during the year                                 | (7,697)          | (19,068)         |
| Share of changes in associates' fair value reserves (Note 10) | 2,773            | -                |
| Balance at 31 December  | <u>66,654</u>    | <u>62,092</u>    |

Unrealised gains on revaluation of available for sale investments recognised directly in fair value reserve include KD 497 thousand (31 December 2005: KD 450 thousand) relating to unquoted equity investments resulting from the use of acceptable valuation techniques.

### 16 FOREIGN EXCHANGE TRANSLATION RESERVE

The foreign exchange translation reserve arises on the consolidation of foreign subsidiaries and equity accounting of foreign associates. Management of the bank is of the opinion that this reserve is attributable to both the depositors and equity holders. As a result, the reporting of this reserve as a separate item on the consolidated balance sheet enables a fairer presentation than its inclusion under equity.



**17 SHARE CAPITAL**

The ordinary and extraordinary general assembly meeting of the equity holders of the bank held on 6 March 2006 approved an increase in the authorised share capital from KD 109,397 thousand to KD 122,525 thousand by way of an issuance of 12% bonus shares amounting to KD 13,128 thousand. Accordingly, the authorised, issued and fully paid-up share capital at 31 December 2006 comprises 1,225,244 thousand (2005: 1,093,968 thousand) shares of 100 fils each.

**18 PROPOSED CASH DIVIDEND, ISSUE OF BONUS SHARES AND DIRECTORS' FEES**

The board of directors of the bank have proposed a cash dividend of 57% for the year ended 31 December 2006 (2005: 55%) and issuance of bonus shares of 15% (2005: 12%) of paid up share capital. This proposal is subject to the approval of the ordinary and extraordinary general assembly of the equity holders of the bank and completion of legal formalities. Proposed dividends are shown separately within equity.

Directors' fees of KD 150 thousand (2005: KD 150 thousand) are within the amount permissible under local regulations and is subject to approval by the annual general assembly of the equity holders of the bank.

**19 RESERVES**

In the Ordinary and Extraordinary General Assembly meeting of the equity holders of the bank held on 14 March 2005, the Ordinary General Assembly resolved to suspend transfers to statutory reserve in excess of 10%. The Extraordinary General Assembly of the bank held on 18 March 1996 approved an amendment to article 58 of its articles of association, in which the Ordinary General Assembly can approve an increase in the transfer of 10% each of the net profit for the year to statutory and voluntary reserves, as appropriate, if proposed by the board of directors of the bank. As a result, an amount of KD 16,729 thousand equivalent to approximately 10% (2005: KD 12,267 thousand equivalent to approximately 10%), of the profit for the year before contribution to Kuwait Foundation for the Advancement of Sciences, National Labour Support tax and Directors' fees has been transferred to statutory reserve.

Only that part of the statutory reserve in excess of 50% of paid-up share capital is freely distributable and usable at the discretion of the Ordinary General Assembly in ways that may be deemed beneficial to the bank. Distribution of the balance of the statutory reserve is limited to the amount required to enable the payment of a dividend of 5% of paid-up share capital to be made in years when accumulated profits are not sufficient for the payment of a dividend of that amount.

34% (2005: 27%) of the profit for the year before contribution to Kuwait Foundation for the Advancement of Sciences, Directors' fees and National Labour Support tax has been transferred to voluntary reserve.

The share premium account is not available for distribution.

# Kuwait Finance House K.S.C. and Subsidiaries

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2006

### 20 CONSOLIDATED SUBSIDIARIES

Details of consolidated subsidiaries are set out below:

| <i>Name</i>   | <i>Country of registration</i> | <i>Interest in equity %</i> |             | <i>Principal activities</i>                     | <i>Financial statements reporting date</i> |
|---|--------------------------------|-----------------------------|-------------|---|--|
|   |                                | <i>2006</i>                 | <i>2005</i> |   |  |
| Kuwait Finance House B.S.C.                                 | Bahrain                        | 100                         | 100         | Islamic banking services                        | 30 November 2006                           |
| Al Muthana Investment Company K.S.C. (Closed)               | Kuwait                         | 100                         | 100         | Islamic investments                             | 30 September 2006                          |
| Al-Nakheel United Real Estate Company K.S.C. (Closed)       | Kuwait                         | 100                         | 100         | Real estate investment and trading              | 31 October 2006                            |
| Kuwait Finance House (Malaysia) Berhad                      | Malaysia                       | 100                         | 100         | Islamic banking services                        | 30 November 2006                           |
| Kuwait Turkish Evkaf Finance House                          | Turkey                         | 62                          | 62          | Islamic banking services                        | 30 September 2006                          |
| Aref Investment Group K.S.C. (Closed)                       | Kuwait                         | 52                          | 52          | Islamic investments                             | 30 September 2006                          |
| Al Enma'a Real Estate Company K.S.C. (Closed)               | Kuwait                         | 51                          | 51          | Real estate, investment, trading and management | 31 October 2006                            |
| ALAFCO – Aviation Lease and Finance Company K.S.C. (Closed) | Kuwait                         | 52                          | 85          | Aircraft leasing and financing services         | 30 September 2006                          |

During the year, the bank disposed of a 21% equity interest in a subsidiary, ALAFCO –Aviation Lease and Finance Company K.S.C. (Closed) for total consideration of KD 23,399 thousand and realised a gain of KD 9,289 thousand.

### 21 CONTINGENCIES AND COMMITMENTS

At the balance sheet date, there were outstanding contingencies and commitments entered into in the ordinary course of business in respect of the following:

|                                   | <i>2006<br/>KD 000's</i> | <i>2005<br/>KD 000's</i> |
|-----------------------------------|--------------------------|--------------------------|
| Acceptances and letters of credit | <b>147,975</b>           | 43,002                   |
| Guarantees                        | <b>414,056</b>           | 197,760                  |
|                                   | <b>562,031</b>           | 240,762                  |
| Capital commitments               | <b>667,406</b>           | 103,865                  |

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2006

**22 RELATED PARTY TRANSACTIONS**

Certain related parties (directors and executive employees, officers of the group, their families, associated companies and companies of which they are the principal owners) were depositors and financing facilities customers of the bank, in the ordinary course of business. Such transactions were made on substantially the same terms, including profit rates and collateral, as those prevailing at the same time for comparable transactions with unrelated parties and did not involve more than a normal amount of risk. These transactions are approved by the Ordinary General Assembly of the equity holders of the bank. The balances included in the consolidated financial statements are as follows:

|   | <i>Major<br/>shareholders<br/>KD 000's</i> | <i>Associates<br/>KD 000's</i> | <i>Board<br/>Members<br/>and<br/>Executive<br/>Officers<br/>KD 000's</i> | <i>Other<br/>related<br/>parties<br/>KD 000's</i> | <i>Total<br/>2006<br/>KD 000's</i> | <i>Total<br/>2005<br/>KD 000's</i> |
|---|--|--------------------------------|--|---|------------------------------------|------------------------------------|
| <b>Related parties</b>                  |  |                                |  |   |                                    |                                    |
| Receivables                             | -  | 32,689                         | 315  | 475   | 33,479                             | 20,385                             |
| Due to banks and financial institutions | 5,925                                      | -                              | -  | 4,014   | 9,939                              | -                                  |
| Depositors accounts                     | 52,638                                     | 37,318                         | 1,551  | 2,534   | 94,041                             | 102,173                            |
| Commitments and contingencies           | 1,699                                      | 17,469                         | -  | -   | 19,168                             | 3,993                              |

Details of the interests of Board Members and Executive Officers are as follows:

|   | <i>The number of<br/>Board Members or<br/>Executive Officers</i> |             | <i>The number of<br/>related parties</i> |             | <i>2006<br/>KD 000's</i> | <i>2005<br/>KD 000's</i> |
|---|--|-------------|--|-------------|--------------------------|--------------------------|
|   | <i>2006</i>  | <i>2005</i> | <i>2006</i>                              | <i>2005</i> |                          |                          |
| <b>Board Members</b>                    |  |             |  |             |                          |                          |
| Finance facilities                      | 10   | 6           | 9  | 4           | 6,946                    | 137                      |
| Credit cards                            | 9  | 13          | 12                                       | 18          | 79                       | 17                       |
| Deposits                                | 17   | 16          | 66                                       | 475         | 21,264                   | 3,762                    |
| Collateral against financing facilities | 11   | -           | -  | -           | 202                      | -                        |
| <b>Executive officers</b>               |  |             |  |             |                          |                          |
| Finance facilities                      | 23   | 21          | 12                                       | 40          | 1,612                    | 479                      |
| Credit cards                            | 15   | 30          | 28                                       | 43          | 50                       | 37                       |
| Deposits                                | 21   | 34          | 104                                      | 123         | 3,450                    | 617                      |
| Collateral against finance facilities   | 16   | 7           | 1  | 17          | 2,195                    | 754                      |

Compensation of key management personnel is as follows:

|                              | <i>2006<br/>KD 000's</i> | <i>2005<br/>KD 000's</i> |
|------------------------------|--------------------------|--------------------------|
| Short-term employee benefits | 3,965                    | 2,982                    |
| Termination benefits         | 4,403                    | 3,883                    |
| Share options                | 1,013                    | -                        |
|                              | <u>9,381</u>             | <u>6,865</u>             |

# Kuwait Finance House K.S.C. and Subsidiaries

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2006

### 23 SEGMENTAL ANALYSIS

#### Primary segment information

For management purposes, the group is organised into three major business segments. The principal activities and services under these segments are as follows:

**Treasury:** Liquidity management, international murabaha investments, exchange of deposits with banks and financial institutions and international banking relationships.

**Investment:** Managing direct investments, investments in subsidiaries and associates, and international leasing.

**Retail and corporate banking:** Providing a range of banking services and investment products to corporate and individual customers, providing commodity and real estate murabaha finance, local leasing, wakala and Istisna'a facilities.

| 31 December 2006  | <i>Treasury</i><br><i>KD 000's</i> | <i>Investment</i><br><i>KD 000's</i> | <i>Retail and<br/>corporate<br/>banking</i><br><i>KD 000's</i> | <i>Other</i><br><i>KD 000's</i> | <i>Total</i><br><i>KD 000's</i> |
|---|------------------------------------|--------------------------------------|--|---------------------------------|---------------------------------|
| <b>Assets</b>   |                                    |                                      |  |                                 |                                 |
| Cash and balances with banks and financial institutions   | 231,996                            | -                                    | -  | -                               | 231,996                         |
| Short-term international murabaha   | 1,025,224                          | 25,375                               | -  | -                               | 1,050,599                       |
| Receivables   | 599,626                            | 19,150                               | 2,087,277  | 72,113                          | 2,778,166                       |
| Leased assets   | -                                  | 102,156                              | 545,783  | -                               | 647,939                         |
| Available for sale investments  | -                                  | 583,351                              | -  | -                               | 583,351                         |
| Investment in associates  | -                                  | 210,538                              | -  | -                               | 210,538                         |
| Trading properties  | -                                  | 90,463                               | -  | -                               | 90,463                          |
| Investment properties   | -                                  | 207,423                              | -  | -                               | 207,423                         |
| Other assets  | 15,082                             | 73,399                               | 34,482   | 5,364                           | 128,327                         |
| Property and equipment  | 1,014                              | 34,897                               | 81,953   | 267,125                         | 384,989                         |
|   | <u>1,872,942</u>                   | <u>1,346,752</u>                     | <u>2,749,495</u>   | <u>344,602</u>                  | <u>6,313,791</u>                |
| <b>Liabilities, deferred revenue, fair value reserve, foreign exchange translation reserve and total equity</b> |                                    |                                      |  |                                 |                                 |
| Due to banks and financial institutions   | 1,080,004                          | -                                    | -  | -                               | 1,080,004                       |
| Depositors' accounts  | -                                  | -                                    | 3,729,930  | -                               | 3,729,930                       |
| Other liabilities   | 1,436                              | 9,786                                | 152,013  | 126,090                         | 289,325                         |
| Deferred revenue  | -                                  | -                                    | 299,263  | -                               | 299,263                         |
| Fair value reserve  | -                                  | 66,654                               | -  | -                               | 66,654                          |
| Foreign exchange translation reserve  | -                                  | 8,683                                | -  | -                               | 8,683                           |
| Total equity  | -                                  | -                                    | -  | 839,932                         | 839,932                         |
|   | <u>1,081,440</u>                   | <u>85,123</u>                        | <u>4,181,206</u>   | <u>966,022</u>                  | <u>6,313,791</u>                |
| <b>Year ended 31 December 2006</b>  |                                    |                                      |  |                                 |                                 |
| Income  | <u>33,019</u>                      | <u>156,071</u>                       | <u>371,531</u>   | <u>18,366</u>                   | <u>578,987</u>                  |
| <b>Profit before distribution to depositors</b>   | <u>21,379</u>                      | <u>101,052</u>                       | <u>240,557</u>   | <u>11,892</u>                   | <u>374,880</u>                  |

Kuwait Finance House K.S.C. and Subsidiaries

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2006

23 SEGMENTAL ANALYSIS (continued)

| 31 December 2005   | <i>Treasury</i><br><i>KD 000's</i> | <i>Investment</i><br><i>KD 000's</i> | <i>Retail and</i><br><i>corporate</i><br><i>banking</i><br><i>KD 000's</i> | <i>Other</i><br><i>groups</i><br><i>KD 000's</i> | <i>Total</i><br><i>KD 000's</i> |
|--|------------------------------------|--------------------------------------|--|--|---------------------------------|
| Assets   |                                    |                                      |  |  |                                 |
| Cash and balances with banks and financial institutions  | 158,293                            | -                                    | -  | -  | 158,293                         |
| Short-term international murabaha  | 658,153                            | 5,695                                | -  | -  | 663,848                         |
| Receivables  | 116,786                            | 11,301                               | 1,957,493  | 18,766   | 2,104,346                       |
| Leased assets  | -                                  | 79,423                               | 523,910  | -  | 603,333                         |
| Available for sale investments   | -                                  | 555,279                              | -  | -  | 555,279                         |
| Investment in associates   | -                                  | 142,734                              | -  | -  | 142,734                         |
| Trading properties   | -                                  | 93,009                               | -  | -  | 93,009                          |
| Investment properties  | -                                  | 140,892                              | -  | -  | 140,892                         |
| Other assets   | 1,921                              | 10,347                               | 52,170   | 3,664  | 68,102                          |
| Property and equipment   | 1,043                              | 45,833                               | 82,466   | 21,940   | 151,282                         |
|  | <u>936,196</u>                     | <u>1,084,513</u>                     | <u>2,616,039</u>   | <u>44,370</u>                                    | <u>4,681,118</u>                |
| Liabilities, deferred revenue, fair value reserve, foreign exchange translation reserve and total equity |                                    |                                      |  |  |                                 |
| Due to banks and financial institutions  | 281,617                            | -                                    | -  | -  | 281,617                         |
| Depositors' accounts   | -                                  | 50,352                               | 3,138,992  | -  | 3,189,344                       |
| Other liabilities  | 66                                 | 6,620                                | 132,391  | 81,718   | 220,795                         |
| Deferred revenue   | -                                  | -                                    | 235,239  | -  | 235,239                         |
| Fair value reserve   | -                                  | 62,092                               | -  | -  | 62,092                          |
| Foreign exchange translation reserve   | -                                  | 11,401                               | -  | -  | 11,401                          |
| Total equity   | -                                  | -                                    | -  | 680,630  | 680,630                         |
|  | <u>281,683</u>                     | <u>130,465</u>                       | <u>3,506,622</u>   | <u>762,348</u>                                   | <u>4,681,118</u>                |
| Year ended 31 December 2005  |                                    |                                      |  |  |                                 |
| Income   | <u>19,359</u>                      | <u>134,100</u>                       | <u>223,309</u>   | <u>13,352</u>                                    | <u>390,120</u>                  |
| Profit before distribution to depositors   | <u>12,911</u>                      | <u>84,907</u>                        | <u>148,935</u>   | <u>8,905</u>                                     | <u>255,658</u>                  |

*Secondary segment information*

The group operates in different geographical areas. A geographical analysis is as follows:

|                            | <i>Assets</i>                  |                                | <i>Liabilities, deferred revenue, fair value reserve, foreign exchange translation reserve and total equity</i> |                                | <i>Contingencies and commitments under letters of credit and guarantees</i> |                                |
|----------------------------|--------------------------------|--------------------------------|---|--------------------------------|---|--------------------------------|
|                            | <i>2006</i><br><i>KD 000's</i> | <i>2005</i><br><i>KD 000's</i> | <i>2006</i><br><i>KD 000's</i>  | <i>2005</i><br><i>KD 000's</i> | <i>2006</i><br><i>KD 000's</i>  | <i>2005</i><br><i>KD 000's</i> |
| <b>Geographical areas:</b> |                                |                                |   |                                |   |                                |
| The Middle East            | 4,860,983                      | 3,868,116                      | 5,486,966   | 4,263,022                      | 233,917   | 171,413                        |
| North America              | 80,927                         | 111,041                        | 122,701   | 11,933                         | 2,661   | 2,312                          |
| Western Europe             | 346,192                        | 186,946                        | 37,311  | 12,363                         | 14,797  | 11,558                         |
| Other                      | 1,025,689                      | 515,015                        | 666,813   | 393,800                        | 310,656   | 55,479                         |
|                            | <u>6,313,791</u>               | <u>4,681,118</u>               | <u>6,313,791</u>  | <u>4,681,118</u>               | <u>562,031</u>  | <u>240,762</u>                 |

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2006

## 23 SEGMENTAL ANALYSIS (continued)

|   | <i>Local</i>    |                 | <i>International</i> |                 | <i>Total</i>    |                 |
|---|-----------------|-----------------|----------------------|-----------------|-----------------|-----------------|
|   | <i>2006</i>     | <i>2005</i>     | <i>2006</i>          | <i>2005</i>     | <i>2006</i>     | <i>2005</i>     |
|   | <i>KD 000's</i> | <i>KD 000's</i> | <i>KD 000's</i>      | <i>KD 000's</i> | <i>KD 000's</i> | <i>KD 000's</i> |
| <i>Income</i>                                   | <u>366,950</u>  | <u>304,448</u>  | <u>212,037</u>       | <u>85,672</u>   | <u>578,987</u>  | <u>390,120</u>  |
| <i>Profit before distribution to depositors</i> | <u>248,104</u>  | <u>198,520</u>  | <u>126,776</u>       | <u>57,138</u>   | <u>374,880</u>  | <u>255,658</u>  |

## 24 CONCENTRATION OF ASSETS AND LIABILITIES

Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the group's performance to developments affecting a particular industry or geographic location.

(a) The distribution of assets by industry sector was as follows:

|                                  | <i>2006</i>      | <i>2005</i>      |
|----------------------------------|------------------|------------------|
|                                  | <i>KD 000's</i>  | <i>KD 000's</i>  |
| Trading and manufacturing        | 1,987,213        | 1,425,500        |
| Banks and financial institutions | 1,864,658        | 1,363,962        |
| Construction and real estate     | 1,686,443        | 1,296,547        |
| Other                            | <u>775,477</u>   | <u>595,109</u>   |
|                                  | <u>6,313,791</u> | <u>4,681,118</u> |

See Note 23 for distribution of assets by geographical areas.

(b) The distribution of liabilities was as follows:

|                                  | <i>2006</i>      | <i>2005</i>      |
|----------------------------------|------------------|------------------|
|                                  | <i>KD 000's</i>  | <i>KD 000's</i>  |
| <b>Geographic region</b>         |                  |                  |
| The Middle East                  | 4,346,227        | 3,340,685        |
| North America                    | 108,299          | 40               |
| Western Europe                   | 22,048           | 5,079            |
| Other                            | <u>622,685</u>   | <u>345,952</u>   |
|                                  | <u>5,099,259</u> | <u>3,691,756</u> |
| <b>Industry sector</b>           |                  |                  |
| Trading and manufacturing        | 725,857          | 600,039          |
| Banks and financial institutions | 1,804,020        | 445,386          |
| Construction and real estate     | 94,184           | 31,312           |
| Other                            | <u>2,475,198</u> | <u>2,615,019</u> |
|                                  | <u>5,099,259</u> | <u>3,691,756</u> |

At 31 December 2006

**25 CURRENCY RISK**

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates.

Currency risk is managed on the basis of limits determined by the bank's board of directors and a continuous assessment of the group's open positions, and current and expected exchange rate movements. The group, where necessary, matches currency exposures inherent in certain assets with liabilities in the same or a correlated currency.

The group had the following significant net exposures denominated in foreign currencies as of 31 December:

|                                     | <i>2006</i><br><i>KD 000's</i><br><i>Equivalent</i><br><i>Long (short)</i> | <i>2005</i><br><i>KD 000's</i><br><i>equivalent</i><br><i>Long (short)</i> |
|-------------------------------------|--|--|
| U.S. Dollars                        | (92,593)   | (7,850)  |
| Sterling Pounds                     | 26,167   | 664  |
| Japanese Yen                        | 39   | (4)  |
| Euros                               | 19,464   | (9,109)  |
| Gulf Cooperation Council currencies | 20,792   | (6,101)  |
| Others                              | 24,857   | 299  |

**26 CREDIT RISK**

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss.

All policies relating to credit including the determination of approval limits are approved by the bank's board of directors.

The group manages credit risk on both an individual counterparty and portfolio or product line basis together with geographical and business diversification to avoid undue concentration of risk. Credit limits or individual transactions resulting in credit risk are approved in accordance with appropriately defined procedures for the assessment of creditworthiness, collateral requirements and approval limits by the group's management and executive credit committees. Security is obtained when considered appropriate and is considered by management in the determination of provisions. The group's credit granting process including the subsequent monitoring, timely identification of defaults and determination of provisions are subject to periodic independent internal reviews.

The credit risk concentrations within receivables, which form a significant portion of assets subject to credit risk, are given in Note 7.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2006

## 27 LIQUIDITY RISK

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

The table below summarises the maturity profile of the group's assets and liabilities. The contractual maturities of assets and liabilities have been determined on the basis of the remaining period at the balance sheet date to the contractual maturity date and do not take account of the effective maturities as indicated by the group's deposit retention history and the availability of liquid funds. The maturity profile is monitored by management to ensure adequate liquidity is maintained. The maturity profile of the assets and liabilities at the year end are based on contractual repayment arrangement with the exception of available for sale investments and investment properties which are based on planned exit dates.

The maturity profile of assets and liabilities at 31 December 2006 is as follows:

|   | <i>Within<br/>3 months<br/>KD 000's</i> | <i>3 to 6<br/>months<br/>KD 000's</i> | <i>6 to 12<br/>months<br/>KD 000's</i> | <i>After<br/>one year<br/>KD 000's</i> | <i>Total<br/>KD 000's</i> |
|---|---|---------------------------------------|--|--|---------------------------|
| <b>Assets</b>   |   |                                       |  |  |                           |
| Cash and balances with banks and financial institutions | 231,996                                 | -                                     | -                                      | -                                      | 231,996                   |
| Short-term international murabaha                       | 1,050,599                               | -                                     | -                                      | -                                      | 1,050,599                 |
| Receivables   | 522,359                                 | 347,080                               | 503,789                                | 1,404,938                              | 2,778,166                 |
| Leased assets   | 181,423                                 | 136,067                               | 213,820                                | 116,629                                | 647,939                   |
| Available for sale investments                          | -                                       | -                                     | -                                      | 583,351                                | 583,351                   |
| Investment in associates                                | -                                       | -                                     | -                                      | 210,538                                | 210,538                   |
| Trading properties                                      | -                                       | 90,463                                | -                                      | -                                      | 90,463                    |
| Investment properties                                   | -                                       | -                                     | -                                      | 207,423                                | 207,423                   |
| Other assets  | 72,354                                  | 3,396                                 | -                                      | 52,577                                 | 128,327                   |
| Property and equipment                                  | -                                       | -                                     | -                                      | 384,989                                | 384,989                   |
|   | <u>2,058,731</u>                        | <u>577,006</u>                        | <u>717,609</u>                         | <u>2,960,445</u>                       | <u>6,313,791</u>          |
| <b>Liabilities</b>                                      |   |                                       |  |  |                           |
| Due to banks and financial institutions                 | 705,644                                 | -                                     | -                                      | 374,360                                | 1,080,004                 |
| Depositors' accounts                                    | 2,301,688                               | 49,693                                | 32,404                                 | 1,346,145                              | 3,729,930                 |
| Other liabilities                                       | 46,016                                  | 79,685                                | 56,735                                 | 106,889                                | 289,325                   |
|   | <u>3,053,348</u>                        | <u>129,378</u>                        | <u>89,139</u>                          | <u>1,827,394</u>                       | <u>5,099,259</u>          |



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2006

**27 LIQUIDITY RISK (continued)**

The maturity profile of assets and liabilities at 31 December 2005 is as follows:

|   | <i>Within<br/>3 months<br/>KD 000's</i> | <i>3 to 6<br/>months<br/>KD 000's</i> | <i>6 to 12<br/>months<br/>KD 000's</i> | <i>After<br/>one year<br/>KD 000's</i> | <i>Total<br/>KD 000's</i> |
|---|---|---------------------------------------|--|--|---------------------------|
| <b>Assets</b>   |   |                                       |  |  |                           |
| Cash and balances with banks and financial institutions | 158,293                                 | -                                     | -                                      | -                                      | 158,293                   |
| Short-term international murabaha                       | 663,848                                 | -                                     | -                                      | -                                      | 663,848                   |
| Receivables   | 462,956                                 | 315,652                               | 441,913                                | 883,825                                | 2,104,346                 |
| Leased assets   | 168,933                                 | 126,700                               | 199,100                                | 108,600                                | 603,333                   |
| Available for sale investments                          | -                                       | -                                     | -                                      | 555,279                                | 555,279                   |
| Investment in associates                                | -                                       | -                                     | -                                      | 142,734                                | 142,734                   |
| Trading properties                                      | -                                       | 93,009                                | -                                      | -                                      | 93,009                    |
| Investment properties                                   | -                                       | -                                     | -                                      | 140,892                                | 140,892                   |
| Other assets  | 45,968                                  | 4,488                                 | -                                      | 17,646                                 | 68,102                    |
| Property and equipment                                  | -                                       | -                                     | -                                      | 151,282                                | 151,282                   |
|   | <u>1,499,998</u>                        | <u>539,849</u>                        | <u>641,013</u>                         | <u>2,000,258</u>                       | <u>4,681,118</u>          |
| <b>Liabilities</b>                                      |   |                                       |  |  |                           |
| Due to banks and financial institutions                 | 281,617                                 | -                                     | -                                      | -                                      | 281,617                   |
| Depositors' accounts                                    | 1,945,073                               | 11,120                                | 33,663                                 | 1,199,488                              | 3,189,344                 |
| Other liabilities                                       | 29,028                                  | 45,454                                | 45,770                                 | 100,543                                | 220,795                   |
|   | <u>2,255,718</u>                        | <u>56,574</u>                         | <u>79,433</u>                          | <u>1,300,031</u>                       | <u>3,691,756</u>          |

**28 MARKET RISK**

Market risk is the risk that the value of an asset will fluctuate as a result of changes in market prices.

Market risk is managed on the basis of pre-determined asset allocations across various asset categories, a continuous appraisal of market conditions and trends and management's estimate of long and short term changes in fair value.

The group is not exposed to any risk in terms of the repricing of its liabilities since the group does not provide contractual rates of return to its depositors in accordance with Islamic Shareea'a.

**29 EQUITY PRICE RISK**

Equity price risk arises from the change in the fair values of equity investments. The group manages this risk through diversification of investments in terms of geographical distribution and industry concentrations.

**30 OPERATIONAL RISK**

The bank has a set of policies and procedures, which is approved by its board of directors and are applied to identify, assess and supervise operational risk in addition to other types of risks relating to the banking and financial activities of the bank. Operational risk is managed by the operational risk function, which ensures compliance with policies and procedures and monitors operational risk as part of overall global risk management.

The operational risk function of the bank is in line with the CBK instructions concerning the general guidelines for internal controls and the sound practices for managing and supervising operational risks in banks.

At 31 December 2006

**31 MANAGEMENT OF PURCHASED DEBTS**

In accordance with Decree 32/92 and Law 41/93 in respect of the financial and banking sector, the bank is required to manage the purchased debts without remuneration in conformity with the terms of the debt purchase agreement.

**32 FINANCIAL INSTRUMENTS**

In the ordinary course of business, the group uses primary financial instruments such as cash and balances with or due to banks and other financial institutions, investments, receivables and payables. The group does not make use of derivative financial instruments. Information about fair values of financial assets and liabilities are disclosed in the respective notes to the consolidated financial statements.

**33 FIDUCIARY ASSETS**

The aggregate value of assets held in a trust or fiduciary capacity by the group at 31 December 2006 amounted to KD 467,356 thousand (2005: KD 274,239 thousand).