Annual Report

Twenty-Eighth

28

2006

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بيت التمويل الكويتي

Kuwait Finance House

الأمان والإطمئنان

بسم الله الرحمن الرحيم

In the name of Allah the Most Gracious, the Most Merciful Ye who believe! Fear Allah and give up what remains of your demand for usury, if ye are indeed believers. If ye do it not, take notice of war from Allah and his Apostle, but if ye turn back, ye shall have your capital sums deal not unjustly and ye shall not be dealt unjustly.

Al Baqara (278 - 279) Al-Qura'an

H.H. Sheikh Sabah Al Ahmad Al Jaber Al Sabah

The Amir of Kuwait

H.H. Sheikh Nawaf Al Ahmad Al Jaber Al Sabah

Crown Prince

H.H. Sheikh Nasser Mohammad Al Ahmad Al Sabah

The Prime Minister

Contents

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13110 kuwait
Telephone: 2445050
Facsimile: 2455135
Cable: BAITMAL KT
www.kfh.com

Kuwait Finance House

With its strong Islamic values, is a financial institution whose aim is to develop and promote Islamic banking worldwide. Kuwait Finance House offers unique yet competitive products and services directed to target markets for both depositors and shareholders.

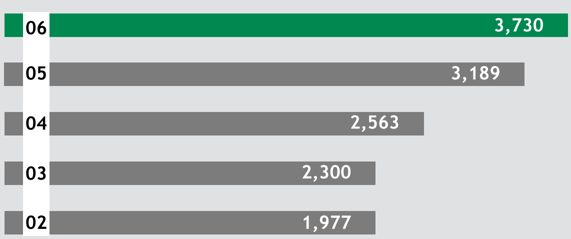
In accordance with the Islamic principles, Kuwait Finance House ensures that while working with the public professionally, the company guarantees an honourable relationship with client base and the Islamic community as a whole.

The values are continually reinforced and adhered to in all aspects of the company's operations. Its integrity and sincerity has maintained a quality service at all times. The employees of Kuwait Finance House are constantly encouraged to be efficient, creative and above all successful. Career enhancement is actively promoted with an ever-changing financial world, creating a healthy professional environment.

Financial Highlights

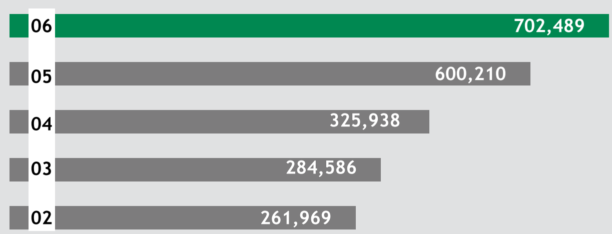
Depositors' Account Growth +17%

(in millions of Kuwaiti Dinars)



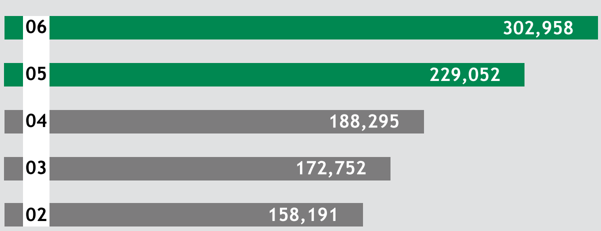
Shareholders' Funds Growth +17%

(in thousands of Kuwaiti Dinars)



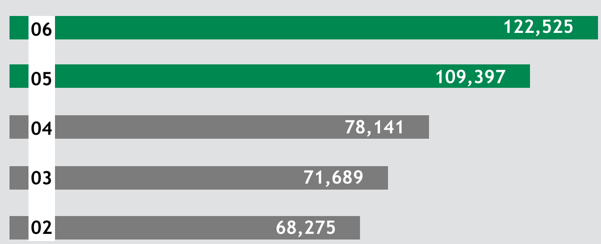
Reserves Growth +32.3%

(in thousands of Kuwaiti Dinars)



Capital Growth +12%

(in thousands of Kuwaiti Dinars)



Your Gateway to Islamic Banking in Kuwait

Board of Directors

Chairman And Managing Director

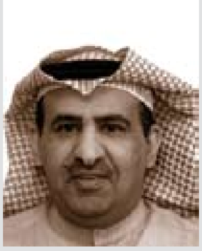
Bader Abdul Muhsen Al-Mukhaizeem

Deputy Chairman

Sameer Yaqoub Al-Nafeesi

Board Member

Saud Abdul Aziz Al-Babtain



Board Member

Essam Saud Al-Rashed

Board Member

Ali Mohammad Al-Elaimi

Board Member

Dr. Mohammad A. Al-Sherif

Board Member

Mohammad Ali Al-Khudairi

Board Member

Meshaal Yousuf Al-Derbas

Board Member

Nasser Abdul Muhsen Al-Merri

Board Member

Adel Abdul Muhsen Al-Subih

KFH the World's Best Islamic Financial Institution

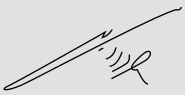
Their Eminences, Members of the Al-Fatwa and Shareea'a Supervisory Board

Report of Al-Fatwa and Shareea'a Supervisory Board

By following up the performance of Kuwait Finance House during the year ended 31 December 2006, we certify confidently that all activities were practiced in compliance with Islamic Shareea'a and no violations have occurred, to the best of our knowledge.

Chairman

Sheikh Ahmad Bazie Al-Yaseen



Shareea'a Board Member

Sheikh Dr. Khalid Mathkour Al-Mathkour

Shareea'a Board Member

Sheikh Dr. Ajeel Jasem Al-Nashmi

Shareea'a Board Member

Sheikh Dr. Anwar Shuaib Abdulsalam

Shareea'a Board Member

Sheikh Dr. Mohammad Fawzi Faidullah

Shareea'a Board Member

Sheikh Dr. Mohammad Abdul Razaq Al-Tabtabae

A

FitchRatings

A

CAPITAL intelligence

Aa3

Moody's

A-

STANDARD & POOR'S

A Leading Islamic Financial Institution Locally and Globally

Management

General manager
Mohammad Sulaiman Al-Omar

Assistant General Manager
Mohammad Naser Al-Fouzan

Assistant General Manager
Salah A. Al-Bassam

Assistant General Manager
Emad A. Al-Thaqeb

Assistant General Manager
Dr. Anwar Ahmad Al-Fuzaie

Assistant General Manager
Fawaz S. Al-Othman

Assistant General Manager
Dr. Waleed Essa Al-Hasawi

Assistant General Manager
Abdul Aziz Al-Jaber

Assistant General Manager
Anwar Mohammad Al-Bader

Outstanding Profits

Chairman and Managing Director's Statement

Bader Abdul Muhsen Al-Mukhaizeem
Chairman and Managing Director

In The Name of Allah, The Merciful, The Compassionate. Praise be to the Almighty God, and Peace and Blessings be upon his apostle, Mohammad, his folks, companions, and followers to the Day of Judgment.

Dear Sirs,

It is my pleasure to welcome you to the 28th General Assembly Meeting. I would like to present Kuwait Finance House's (KFH) Annual Report for the year ended 31 December 2006, covering KFH's Shareea'a Board Report, the major achievements throughout the year, as well as the domestic, regional and global developments. The report also contains the consolidated financial statements of KFH and its subsidiaries, in addition to the Auditors' Report.

The year 2006 marked KFH's continued series of successes and achievements, crowning its historic progress and constant growth, on domestic, regional and global levels. KFH maximized its quantitative and qualitative achievements, while maintaining its position as the world's largest Islamic bank. In the meantime, KFH continued to adhere to the rules and principles of the Islamic Shareea'a. Within the framework of its strategic objectives to provide the best services to its customers and meet their requirements, it continued to develop innovative products, upgrade existing services, and expand regionally and internationally. On the performance side, KFH keenly nourished the stability of its staff members, increasing their knowledge, besides effectively communicating with the community. To this end, KFH increased expenditure on IT infrastructure.

As oil prices maintained their upward trend, coupled with the increasing volume of government and private investments, especially the non-oil sectors, the Kuwaiti economy witnessed a state of growth. State budget surplus had a positive impact on increasing the income, on one part, and increasing the volume of expenditure on infrastructure, construction and development projects, on the other part. Such positive state has reflected on the re-activation of the local real estate market, which appeared to compete with the fluctuating Kuwait Stock Exchange (KSE) during 2006.

The year 2006 was favorable in that KFH was able to register outstanding results in its various operating sectors. KFH clearly focused on total compliance with the Central Bank of Kuwait's (CBK) requirements. The year witnessed the development of new products, expansive innovations, and more accessibility to KFH's services via numerous means, while maximizing benefit from the technological developments. In this context, KFH's sectors and departments showed great interest towards continuing attraction of the large customer base, thus contributing to KFH's positive ratings by the world's major rating agencies, giving an example as the world's best Islamic bank.

Of the major achievements in 2006 is the opening of Kuwait Finance House – Malaysia, with a capital of MR 380 million (USD 100 million). The opening followed finalization of licensing and operating requirements at all levels. It marks a significant stage of the worldwide expansion strategy. The new bank received outstanding response in Malaysia, making it the Gulf region's gate to East Asia, where the latter represents one of the largest growing markets, obviously offering the world's best and largest investment opportunities.

Highest Rating for an Islamic Bank

KFH continued to obtain global and Gulf ratings, which unanimously marked the adequacy, quality and stability of its

A Year of Continued Record Achievements

KFH has been awarded by Euro Money as the best bank in the region, being one of the most distinctive banks in the area of developing the Ijara (lease) product. It has been deservedly awarded ...

assets, being a pioneering bank in the region, and the world's leading Islamic bank. The ratings confirm the successful efforts towards upgrading all activities, and refer to the correlation between the financial adequacy and operation in accordance with the global rules, systems and standards, thus providing the opportunity for evaluation on sound grounds. In a positive addition enhancing KFH's outstanding rating, and marking its numerous success stories, both regionally and globally, Capital Intelligence has upgraded KFH's rating from (A-) to (A). It is the first rating for an Islamic financial institution. Fitch Ratings has also upgraded KFH's long term FC rating to become (A), with stable outlook. In this context, Standard & Poor's has rated KFH (A-) and (A2) for both long and short terms. Moody's has also upgraded the long and short term ratings to (Aa3/P-1). The new assessments reflect the appreciation of KFH's sound position, realized growth, constant progress, innovative products, and stringent IT base.

KFH, the World's Best Islamic Financial Institution

In appreciation of its leading position, numerous successes, and the qualitative and quantitative value it added in the area of Islamic financial transactions, KFH has been awarded by The Banker magazine as the world's best Islamic financial institution.

For the third successive year, KFH has been awarded by Euro Money as the best bank in the region, being one of the most distinctive banks in the area of developing the Ijara (lease) product. It has been deservedly awarded as the best Islamic bank in the field of retail banking and credit cards of all types, where it managed to transfer about 75% of these operations into the smart Chip Card, thus ensuring highest degree of safety and quality in the cards issued by KFH. The year witnessed several positive reports, which were published about KFH in the major media, economic and banking institutions around the world.

I: Retail Banking

(Expansion of Local Network)

Retail banking continued to have a substantial foothold in the domestic market, reflecting a strategy set towards upgrading the standards of services, while providing comprehensive and integrated products. In line with such strategy, and in order to cover most parts of Kuwait with KFH branch network, the number of branches rose to 42, where 7 new branches were opened in Adailiya, Mubarak Al-Abdulla, Abdulla Al-Salem, Ahmadi, Kaifan, Abdulla Mubarak, and Liberation Tower. Qaser, Farwaniya, and Qurtoba branches were relocated. The number of ATMs reached 125, out of which 30 ATMs are available with drive-in service. Cash deposit machines were introduced for the first time, allowing direct cash and cheque deposits via special machines, without having to enter the branch.

Product Marketing

In line with the increasing interest in marketing the products and services in the local market, a sales team has been enhanced with additional skillful, efficient staff members. In a unique step, KFH has enhanced relations with all segments under a featured marketing plan.

In collaboration with the human resources department, the banking sector provided the branch employees with training. A number of banking branch managers were awarded with the Accredited Branch Manager Certificate, a globally recognized professional certificate that provides standards for professional know-how and competence in the area of bank branch management.

Online Services

KFH launched a set of products that achieve instant services and enhance its presence with customers everywhere. Islamic share trading services were introduced online. New services were also launched via KFH's website, as a new method of payment of corporate customer salaries, to replace manual statements. Furthermore, KFH concluded an agreement with Kuwait Airways Corporation (KAC) to launch the electronic payment system, which was applied for the first time in the history of KAC.

A series of intensive promotional and awareness campaigns were introduced to encourage customers to use online services. In order to do so, interactive PCs were introduced in a number of branches to support and encourage the use of Tamweel-on-line service, covering over 150 customer services, anytime, anywhere.

Servicing All Customer Segments

Continuing its strategy to target customer segments, KFH completed several significant steps towards classifying the customers into segments, in accordance with the latest global techniques, so as to meet all banking, financing, and investment needs, thus achieving integration between such services.

In this area, KFH focused on the children segment (Baraem), where KFH Junior Club was opened, at Faiha Branch, to provide children with an atmosphere of fun, education and knowledge. The aim was to achieve children's loyalty and confidence towards KFH. Children rooms were provided in most of the Ladies Sections at banking branches.

Several marketing activities were carried out for the "Shabab Al-Deera" account customer segment. The aim was to maintain present customers and provide features and promotions to the youth cardholders, with a view to highlight it as a bank account that meets the requirements and ambitions of youngsters via its numerous features, which make it the best youth account in Kuwait in terms of savings and diversified promotions.

Programs were directed to several segments, such as "Al-Sundus" program for ladies, "Al-Rubban" for men, and "Al-Tamayoz", for both men and women. "Priority" program was introduced in a new format to our high net worth customers.

II: Trade, Real Estate and Corporate Finance

KFH's strategy puts the local market on top of its priorities, as its share witnesses constant growth. In this context, KFH has upgraded its services in the local market in the areas of trade, real estate and corporate finance.

Business Activities

KFH continued to maintain its leading position. It was ranked first in the consumer finance market, where it dominated about one third of the local market. During the year, KFH's spending in the Kuwaiti market amounted to KD 0.5 billion in the form of purchases to meet the customers' requirements, including goods and services. Out of this, trade sector spending registered about KD 300 million, benefiting over 100,000 customers, and 4,000 Kuwaiti corporate entities. These figures emphasize the success of KFH's continuous strategy of supporting the national products, while coordinating with the economic activists to serve the market and boost economic stability. In 2006, Ahmadi Showroom was opened, and Shuwaikh and Used Car showrooms in Farwaniya are under preparations, to provide the area customers with products and services. On the other hand, several products were developed, including the added service product, and supplier sale proxy service.

Continuing its leading position on the retail level, KFH achieved notable growth in the operational lease market sales. The product provides numerous features to customer requirements, including periodic maintenance, vehicle comprehensive insurance, as well as substitute car during the repair period of leased car. Operational lease product allows customers the option of changing the car from time to time. KFH provides over 40 types of vehicles for lease, whether finance or operational, in addition to providing other types of automobiles to customer requirements.

Real Estate Activities

During the year, KFH expanded its residential and investment real estate financing activities, with a special focus on real estate lease-to-own, and Istisna products. In addition, it contributed to the development and construction of a number of commercial and investment complexes, with several construction projects being in progress. The year witnessed a series of major real estate promotional activities that aimed at promoting the sales of real estate Murabaha, material, and constructions works.

KFH participated in a number of real estate fairs that contributed to the enrichment of real estate market. Utilizing these events, KFH provided customers with access to all new developments and services, including the Real Estate, Building and Investment Exhibition, which was held during the period 3-7 April 2006, Kuwait Real Estate and Investment Exhibition, during the period 8-10 April 2006, and Ramadan Real Estate Exhibition, during 1-4 October 2006. These events covered outstanding offers to our customers wishing to utilize the real estate services and purchase land and houses. In an effort to introduce its future vision to develop the local real estate market, KFH sponsored the First Real Estate Experts Conference over the period 16-18 April 2006.

As a significant addition to the external real estate purchasing services provided by KFH in several countries and cities, such as the United Kingdom, Lebanon, Mecca, Medina and some Gulf states, KFH introduced real estate buying and selling services for housing units in Malaysia. The action reflects its tendency towards expanding into foreign markets, thus meeting the requirements of its Kuwaiti and resident customers, who are willing to purchase housing units abroad.

Corporate Finance and Business Sector Activities

Finance Sector at KFH continued its outstanding performance in the area of corporate finance for all business sectors. The value of financing transactions rose by 42.36%, causing the profit from this activity to soar by 86.48%. Finance Department efforts focused on developing products to customers, which reflect the profound understanding of the customer requirements through direct interaction with them, while intensifying on-site visits to identify their requirements. These actions are taken in full compliance with the Central Bank of Kuwait's (CBK) regulations and guidelines, and in cooperation and coordination with KFH's departments, towards providing integrated customer services.

III: International Investment Activities

Efforts continued towards expanding abroad in line with the pre-set plans, in order to achieve the best level of regional and global coverage. KFH continued to build on its achievements and reputation as a pioneering contributor to Islamic financial industry in many markets, such as Turkey, Malaysia, Gulf markets, in addition to the US and Europe, where a large number of investment portfolios and funds are centered.

Short Term Murabaha Finance

In 2006 international investment activity focused on short term Murabaha transactions for various companies. Finance activity targeted some corporate entities of the GCC countries, which, in turn, witness an economic boom in all sectors.

Sukuk Structuring and Issuance

On the Sukuk structuring and issuance side, participation was renewed in the fresh launching of the Sukuk of the UAE Refrigeration Company, which launched the first Islamic Sukuk in the region in 2004. Participation was made as authorized co-manager in the arrangement of USD 350 million Ijara Sukuk to finance the activities and extensions of the Sharjah Electricity and Water Authority, in a first-time structuring in the history of Islamic action. Domestically, arrangements were made for 5-year participation Sukuk to finance future expansion of National Industries Building Materials Company within Kuwait and abroad. As organizer and lead manager of the issue, KFH listed these Sukuks on Dublin Market – Ireland, as the first Islamic Sukuks to be listed in this major global stock exchange. The Sukuks became tradable, which will provide their investors with liquidity, while creating a secondary Sukuk market. The issue was successful, and over 15 regional and international banks participated, with over 200% coverage, compared to the initial issue amount.

Global Ijara Operations

In cooperation with KFH – Malaysia, KFH expanded its global Ijara operations by organizing the first Islamic Ijara deal to finance the purchase of 6 USD 230 million A320-200 aircraft to the favor of Asian Air. The deal is a lease-to-own transaction for 12 years. It reflects the management's constant efforts to develop globally acceptable, Shari'a compatible products, which are in compliance with the requirements of the Malaysian National Shari'a Council, and KFH's Shari'a Board – Kuwait. It is the first of its kind in the Malaysian market.

Al-Rubban Fund

Of the major achievements realized in 2006 is the sale of KFH's stake in Al-Rubban Ship Finance Fund, giving an internal rate of return (IRR) of about 42% for KFH's shareholders and depositors.

ALAFCO listed on Kuwait Stock Exchange (KSE)

Continuing KFH's strategy towards supporting the national economy by increasing the local investments, ALAFCO capital was increased and the company was listed on Kuwait Stock Exchange in October. The increase was made upon the sale of a share of KFH in ALAFCO through a pre-listing issue in July, as a step to prepare for the listing of the company and expanding its shareholder base. The deal amounted to KD 25.6 million, giving a net profit of about KD 11 million to KFH.

Bahrain Islamic Bank

KFH's full stake in Bahrain Islamic Bank was sold in a public auction at Bahrain Bourse, giving a profit of KD 16 million, in a total deal of KD 21 million.

Liquidity Management Center

Subscription was made to increasing the capital of Liquidity Management Center – Bahrain by USD 30 million. KFH's share was USD 7.5 million. The increase was to receive new shareholders of the center.

Gulf Islamic Investment Company

The capital of Gulf Islamic Investment Company was increased to USD 52,500,000, with KFH's share amounting to 7%.

Ithmar British Real Estate Fund

In the third quarter of the year, KFH sold Ithmar British Real Estate Fund in the UK against Sterling Pounds 178 million (KD 96 million). The fund realized notable appreciation of its assets, i.e. by 40%, compared to the historical value. Profit from the deal amounted to Sterling Pounds 51 million (KD 27.5 million), with KFH's share amounting to Sterling Pounds 24 million (KD 13 million). An average internal rate of return (IRR) of 35% was achieved over the past two years, i.e. 70% as a cumulative return on investment (ROI).

Al-Mumayaz Industrial Real Estate Fund

During the first quarter of the year, KFH launched and marketed the Warehouse Real Estate Fund, which owns assets of about USD 260 million, under long-term contracts, to major US and international companies. The fund has a 5-year investment period and monthly dividends at the rate of 8-9%.

KFH Asian Real Estate Fund

KFH established an Asian real estate fund to invest in the assets comprising Shari'a compatible industrial, office, and commercial properties, in addition to the investment in development projects in vital capitals and areas. The aim of the fund is to diversify and mitigate investment risk levels as these markets have a notable growth in GNP and an increasing demand for investment in the various real estate tools. Invested capital of the fund amounted to USD 100 million, and it is expected to distribute annual cash dividends of 8-10%, with an internal rate of return (IRR) of 15%.

IV:Human Resources

KFH has an ambitious plan to attract and appoint efficient Kuwaiti nationals to take over vacancies in its various sectors and departments. The plan is the outcome of ambitious schemes covering training and incentives, by granting some outstanding employees multiple incentives, resulting in the minimization of redundancy from 6% in 2005 to 2.3% up to mid 2006, which indicates the stability of manpower in KFH. Service Outsourcing project was implemented to provide KFH employees with various services at lower cost and better quality. Kuwaiti manpower accounted for 53%, i.e. higher than the ceiling set by the Central Bank of Kuwait. Meanwhile, Human Resources Department commenced implementation of a new system to appraise employee performance, thus helping develop human resources abilities. Over 380 programs were organized for more than 3,000 seats from the various sectors of KFH. In addition, the management concluded an agreement with local and international recruitment agencies to facilitate obtaining quality recruits in a timely manner.

V:KFH and the Community

During the year, KFH continued effective contribution to social activities. It continued to support the Zakat House by donating KD 1 million for this purpose. The sum of KD 1.250 million was raised for implementing 15 highway first aid centers in Kuwait. Amounts continued to be raised for prisoners solidarity fund. KFH donated USD 1 million to the Red Crescent Society for the Lebanese war victims. Another donation was made to relieve the Iraqi people, which reflects KFH's interaction with the global tragic events.

Financial Performance Review

Dear Sirs,

Financial results for the financial year ended 31 December 2006 showed the following:

Balance Sheet

At year-end assets totaled KD 6.314 billion, an increase of KD 1.633 billion, compared to 2005, or by 34.9%. On the liabilities side, customer account balances amounted to KD 3.730 billion, an increase of KD 541 million, or by 17%, compared to last year. Shareholders' equity accounted for KD 702.5 million, an increase of KD 102.3 million, or by 17%, compared to 2005.

Income

Income realized for the year totaled KD 579 million, an increase of KD 189 million, or by 48.4%. Net of expenses and provisions, profit before distribution amounted to KD 344 million, an increase of KD 98 million, or by 40%, compared to 2005.

Profit for Shareholders

Net profit for shareholders amounted to KD 162 million, an increase of KD 43 million, a growth rate of 36.5%, against 2005.

Dividends

Dividends for the financial year ended 31 December 2006 were distributed to investor depositors as follows:

Type of Account	2006	2005
Unconditional Investment Deposits	8.458%	6.807%
Al-Sedra Investment Deposits	6.578%	5.294%
Investment Savings Accounts	5.639%	4.538%

Economic Review

National Economy

For the fifth consecutive year, Kuwait economy remained active and stringent. Optimistic business environment had a positive impact on consumer and corporate sectors. There are strong indicators to the growth of government and corporate investment, which will, in turn, motivate domestic demand. In 2006 Kuwait economy registered a growth rate of 7.9%, compared to 2005.

The said growth in 2006 reflects the outcome of the developments of oil prices in global markets, and total exports of Kuwaiti oil, compared to the 4th quarter of the same year. On the oil price levels side in global markets, OPEC data refer to an increase of the average spot price of OPEC basket, including 11 standard crude oils, effective 16 June 2005, from about USD 57.68 a barrel in the 1st Q. of 2006 to about USD 64.74 a barrel in the 2nd Q. of the same year. Available estimates indicate that total exports of Kuwaiti crude and refined oil, as well as liquefied gas, during the 2nd Q. of 2006 have dropped by 2%, compared to the level registered in the previous quarter of the same year. State budget and current account continued to achieve surpluses as a result of this trend.

Initial data in the financial statements for the said fiscal year refer to an actual surplus of KD 6,866.1 million, compared to about KD 2,647.2 million achieved during the previous fiscal year, representing an increase of about KD 4,219 million, or by 159.4%, before deducting the provisions of the general reserve and reserve for future generations. The increase reflects a tangible rise in the actual public revenues achieved during the fiscal year in question, to about KD 13,728.1 million.

On 27 December 2006, major indices of Kuwait Stock Exchange (KSE) witnessed a decline, compared to their levels registered in 2005. Price index dropped by 12.04%, registering 10,067 points on 27 December 2006. Meanwhile, trading value slipped by 39.1% for the same period, and traded quantity dropped by 27.8%. During the period, 22 new companies were listed in KSE.

GCC Economy

Oil prices reflected positively on the economic performance of GCC states in terms of growth rates and current account surpluses. Estimates indicate that GCC states are expected to witness continued growth as in 2005. In 2006 GDP for the six countries is expected to register about USD 732.7 billion, and about USD 811.2 billion in 2007, compared to about USD 592.8 billion in 2005.

World Economy

World economy continued to grow in 2006, registering a growth rate of 5.1%. It is expected to drop to 4.9% in 2007, compared to 4.9% in 2005. Such growth rate involves substantial variances between the world's major economic zones. In the US, it may be mentioned that the US economy has entered into a slowdown stage due to the shrinking housing sector, slow growth of exports, as well as public finance restrictions. The trend is due to the higher military expenditure, higher interest, increasing fuel prices, and receding manpower hiring rates.

Meanwhile, growth at Euro region, UK and Japan witnessed notable improvement in the liquidity status, coupled with active demand. Euro region GDP grew by 2.4%, mainly due to the growth of family spending, in addition to the higher level of business confidence. Unemployment rate decreased to 7.9%, and the improvement in labor market, especially in Germany and France, contributed to raising the actual family income and to enhancing consumer confidence, which regained its 1991 levels.

Economic activity in Japan continued to be strong. Average GDP rate is expected to register 2.7% for 2006. Industrial production index rose by 1.9% on strong demand in the major export markets, such as the US and China.

Asian countries topped the list of the regions that witnessed higher growth in 2006. Average growth rate of the region registered 8.7%, where China registered 10% and India 8.3%. In Russia, growth rate rose to 6.5%. Middle East also witnessed a higher growth rate of 5.8% in 2006.

In conclusion, we praise the Almighty God and pray to bestow us success to the welfare of our beloved country, and dignified customers, under the leadership of His Highness The Amir, Sheikh Sabah Al-Ahmad Al-Jaber Al-Sabah, His Highness The Crown Prince, Sheikh Nawaf Al-Ahmad Al-Jaber Al-Sabah, and His Highness The Prime Minister, Sheikh Naser Mohammad Al-Ahmad Al-Sabah, may God bless them. I would also like to extend my thanks and appreciation to the competent authorities, our customers, and all KFH employees, who spared no effort to support this grand Islamic edifice.

Consolidated Financial Statements

AUDITORS' REPORT

Year ended 31 December 2006

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 adapted 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, 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.

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

Consolidated Income Statement

Year ended 31 December 2006

	Note	2006 KD 000's	2005 KD 000's
INCOME			
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
		578,987	390,120
EXPENSES			
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
		204,107	134,462
PROFIT BEFORE DISTRIBUTION TO DEPOSITORS		374,880	255,658
Distribution to depositors	14	176,362	122,591
PROFIT AFTER DISTRIBUTION		198,518	133,067
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
PROFIT FOR THE YEAR		193,230	129,078
Attributable to:			
Equity holders of the bank		162,004	118,687
Minority interest		31,226	10,391
		193,230	129,078
BASIC AND DILUTED EARNINGS PER SHARE ATTRIBUTABLE TO THE EQUITY HOLDERS OF THE BANK	5	132 fils	107 fils

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

Consolidated Balance Sheet

At 31 December 2006

	Note	2006 KD 000's	*2005 KD 000' s*
ASSETS			
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
TOTAL ASSETS		6,313,791	4,681,118
LIABILITIES, DEFERRED REVENUE, FAIR VALUE RESERVE, FOREIGN EXCHANGE TRANSLATION RESERVE AND TOTAL EQUITY			
LIABILITIES			
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
TOTAL LIABILITIES		5,099,259	3,691,756
DEFERRED REVENUE		299,263	235,239
FAIR VALUE RESERVE	15	66,654	62,092
FOREIGN EXCHANGE TRANSLATION RESERVE	16	8,683	11,401
EQUITY ATTRIBUTABLE TO THE EQUITY HOLDERS OF THE BANK			
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
		632,650	540,042
Proposed cash dividend	18	69,839	60,168
TOTAL EQUITY ATTRIBUTABLE TO THE EQUITY HOLDERS OF THE BANK		702,489	600,210
Minority interest		137,443	80,420
TOTAL EQUITY		839,932	680,630
TOTAL LIABILITIES, DEFERRED REVENUE, FAIR VALUE RESERVE, FOREIGN EXCHANGE TRANSLATION RESERVE AND TOTAL EQUITY		6,313,791	4,681,118

BADER ABDUL MUHSEN AL-MUKHAIZEEM
(CHAIRMAN AND MANAGING DIRECTOR)

MOHAMMED SULAIMAN AL-OMAR
(GENERAL MANAGER)

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

Consolidated Statement of Changes in Equity

Year ended 31 December 2006

	Attributable to equity holders of the bank													
			Reserves											
	Share capital KD 000's	Share premium KD 000's	Proposed issue of bonus shares KD 000's	Statutory reserve KD 000's	Voluntary reserve KD 000's	Employee share option reserve KD 000's	Treasury shares KD 000's	Net profit for the Year KD 000's	Sub total KD 000's	Sub total KD 000's	Proposed cash dividends KD 000's	Sub total KD 000's	*Minority interest KD 000's*	*Total equity 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	10,391	129,078
Distribution of net profit:														
Proposed issue of bonus shares	-	-	13,128	-	-	-	-	(13,128)	(13,128)	-	-	-	-	-
Proposed cash dividends	-	-	-	-	-	-	-	(60,168)	(60,168)	(60,168)	60,168	-	-	-
Transfer to statutory reserve	-	-	-	12,267	-	-	-	(12,267)	-	-	-	-	-	-
Transfer to voluntary reserve	-	-	-	-	33,124	-	-	(33,124)	-	-	-	-	-	-
Net movement in treasury shares	-	-	-	-	-	-	(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	-	-	-	-	-	-	-	323	-	323	-	323
Cost of employee share option	-	-	-	-	-	4,237	-	-	4,237	4,237	-	4,237	-	4,237
Zakat	-	-	-	-	(5,091)	-	-	-	(5,091)	(5,091)	-	(5,091)	-	(5,091)
Cash dividends paid	-	-	-	-	-	-	-	-	-	-	(60,168)	(60,168)	-	(60,168)
Net profit for the year	-	-	-	-	-	-	-	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)	-	-	-	-	-
Proposed cash dividends	-	-	-	-	-	-	-	(69,839)	(69,839)	(69,839)	69,839	-	-	-
Transfer to statutory reserve	-	-	-	16,729	-	-	-	(16,729)	-	-	-	-	-	-
Transfer to voluntary reserve	-	-	-	-	57,057	-	-	(57,057)	-	-	-	-	-	-
Net movement in treasury shares	-	-	-	-	-	-	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.

Consolidated Statement of Cash Flows

Year ended 31 December 2006

	Note	2006 KD 000's	2005 KD 000's
OPERATING ACTIVITIES			
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
(Increase) decrease in operating assets:			
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
Increase (decrease) in operating liabilities:			
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		526,625	158,521
INVESTING ACTIVITIES			
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		(281,104)	48,161
FINANCING ACTIVITIES			
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		(63,962)	155,585
INCREASE IN CASH AND CASH EQUIVALENTS		181,559	362,267
Cash and cash equivalents at 1 January		701,582	339,315
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	6	883,141	701,582

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 Abdullah 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").

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.

Notes to the Consolidated Financial Statements

At 31 December 2006

2- SIGNIFICANT ACCOUNTING POLICIES (continued)

Basis of consolidation (continued)
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.

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.

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.

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

Notes to the Consolidated Financial Statements

At 31 December 2006

2- SIGNIFICANT ACCOUNTING POLICIES (continued)

Impairment of non-financial assets (continued)
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.

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'a 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.

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.

Notes to the Consolidated Financial Statements

At 31 December 2006

2- SIGNIFICANT ACCOUNTING POLICIES (continued)

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.

3- INVESTMENT INCOME

	2006 KD 000's	2005 KD 000's
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
	183,249	140,453

4 - PROVISION FOR IMPAIRMENT

	2006 KD 000's	2005 KD 000's
Provision for impairment of receivables and other assets	27,180	28,783
Provision for impairment of available for sale investments	-	8,264
	27,180	37,047

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 have 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.

6 -CASH AND CASH EQUIVALENTS

	2006 KD 000's	2005 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	883,141	701,582

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 KD 000's	2005 KD 000's
Due from banks and financial institutions	168,589	251,231
Due to banks and financial institutions	(234,995)	(304,447)
	(66,406)	(53,216)

Included in the consolidated balance sheet as net balances:

	2006 KD 000's	2005 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)
	(66,406)	(53,216)

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

Notes to the Consolidated Financial Statements

At 31 December 2006

7 -RECEIVABLES

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

	2006 KD 000's	2005 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
	2,942,621	2,253,362
Less: provision for impairment	(164,455)	(149,016)
	2,778,166	2,104,346

The distribution of receivables is as follows:

	2006 KD 000's	2005 KD 000's
Industry sector		
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
	2,942,621	2,253,362
Less: provision for impairment	(164,455)	(149,016)
	2,778,166	2,104,346

	2006 KD 000's	2005 KD 000's
Geographic region		
Middle East	2,333,842	1,828,652
Western Europe	48,666	116,786
Other	560,113	307,924
	2,942,621	2,253,362
Less: provision for impairment	(164,455)	(149,016)
	2,778,166	2,104,346

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

	Specific		General		Total	
	2006 KD 000's	*2005 KD 000's*	**2006 KD 000's**	*2005 KD 000's*	**2006 KD 000's**	*2005 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
Balance at end of year	**99,647**	90,787	**64,808**	58,229	**164,455**	149,016

7 -RECEIVABLES (continued)

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:

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

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:

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

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

	2006 KD 000's	2005 KD 000's
Within one year	355,679	496,139
One to five year	267,350	107,030
After five years	72,206	27,844
	695,235	631,013

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

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At 31 December 2006

9 -AVAILABLE FOR SALE INVESTMENTS

	2006 KD 000's	2005 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
	583,351	555,279
Investments carried at fair value	300,845	230,990
Investments carried at cost less impairment	282,506	324,289
	583,351	555,279

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:

	Interest in equity %		*Country of registration*	*Principal activities*
	2006	2005		
Direct investments in unconsolidated subsidiaries:				
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
Indirect investments in unconsolidated subsidiaries held through consolidated subsidiaries:				
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.

10 - INVESTMENT IN ASSOCIATES

The group's associates primarily consist of the following:

	Interest in equity % 2006	2005	*Country of registration*	*Principal activities*	*Financial statements reporting date*
Direct investments in associates:					
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
Indirect investments in associates held through consolidated subsidiaries:					
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

Carrying amount of investment in associates:	2006 KD 000's	2005 KD 000's
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	210,538	142,734

	2006 KD 000's	2005 KD 000's
Share of associates' assets and liabilities:		
Assets	447,165	233,104
Liabilities	(261,725)	(104,764)
Net assets	185,440	128,340

Share of associates' revenue and results:	2006	2005
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).

Notes to the Consolidated Financial Statements

At 31 December 2006

11- INVESTMENT PROPERTIES

	2006 KD 000's	2005 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	207,423	140,892
Cost	240,775	170,755
Accumulated depreciation	(25,923)	(23,274)
Impairment	(7,429)	(6,589)
	207,423	140,892

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).

12- PROPERTY AND EQUIPMENT

	Land KD 000's	*Buildings* KD 000's	*Aircraft and engines* KD 000's	*Furniture, fixtures and equipment* KD 000's	*Motor vehicles* KD 000's	*Properties under development* KD 000's	*Total* 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 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	**9,734**	**33,497**	**260,337**	**54,537**	**40,940**	**69,009**	**468,054**
Depreciation							
At 1 January 2006	-	16,375	-	27,872	4,547	-	48,794
Arising on consolidation of previously 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	-	17,753	24,727	34,883	5,702	-	83,065
Net carrying amount							
At 31 December 2006	**9,734**	**15,744**	**235,610**	**19,654**	**35,238**	**69,009**	**384,989**
At 31 December 2005	9,974	14,865	-	18,918	34,233	73,292	151,282

12- PROPERTY AND EQUIPMENT (continued)

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.

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 KD 000's	2005 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	-
	174,611	6,309

13 - DUE TO BANKS AND FINANCIAL INSTITUTIONS

	2006 KD 000's	2005 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	-
	1,080,004	281,617

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.

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 % per annum	2005 % 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 KD 000's	2005 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	66,654	62,092

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.

20- CONSOLIDATED SUBSIDIARIES

Details of consolidated subsidiaries are set out below:

Name	Country of registration	Interest in equity %		Principal activities	Financial statements reporting date
		2006	2005		
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.

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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:

	2006 KD 000's	2005 KD 000's
Acceptances and letters of credit	147,975	43,002
Guarantees	414,056	197,760
	562,031	240,762
Capital commitments	667,406	103,865

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:

	Major shareholders KD 000's	*Associates KD 000's*	*Board Members and Executive Officers KD 000's*	*Other related parties KD 000's*	***Total 2006 KD 000's***	*Total 2005 KD 000's*
Related parties						
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:

	The number of Board Members or Executive Officers		The number of related parties			
	2006	2005	**2006**	2005	**2006 KD 000's**	2005 KD 000's
Board Members						
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**	-
Executive officers						
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:

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

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					
Assets	**Treasury KD 000's**	**Investment KD 000's**	**Retail and corporate banking KD 000's**	**Other KD 000's**	**Total KD 000's**
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
	1,872,942	1,346,752	2,749,495	344,602	6,313,791
Liabilities, deferred revenue, fair value reserve, foreign exchange translation reserve and total equity					
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
	1,081,440	85,123	4,181,206	966,022	6,313,791
Year ended 31 December 2006					
Income	33,019	156,071	371,531	18,366	578,987
Profit before distribution to depositors	21,379	101,052	240,557	11,892	374,880

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At 31 December 2006

23- SEGMENTAL ANALYSIS (continued)

31 December 2005	Treasury	Investment	Retail and corporate banking	Other	Total
Assets	KD 000's	KD 000's	KD 000's	KD 000's	KD 000's
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
	936,196	1,084,513	2,616,039	44,370	4,681,118
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
	281,683	130,465	3,506,622	762,348	4,681,118
Year ended 31 December 2005					
Income	19,359	134,100	223,309	13,352	390,120
Profit before distribution to depositors	12,911	84,907	148,935	8,905	255,658

23- SEGMENTAL ANALYSIS (continued)
Secondary segment information

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

	Assets		Liabilities, deferred revenue, fair value reserve, foreign exchange translation reserve and total equity		Contingencies and commitments under letters of credit and guarantees	
	2006	2005	**2006**	2005	**2006**	2005
	KD 000's	KD 000's	**KD 000's**	KD 000's	**KD 000's**	KD 000's
Geographical areas:						
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
	6,313,791	4,681,118	**6,313,791**	4,681,118	**562,031**	240,762

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

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:

	2006 KD 000's	2005 KD 000's
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	775,477	595,109
	6,313,791	4,681,118

See Note 23 for distribution of assets by geographical areas.

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24- CONCENTRATION OF ASSETS AND LIABILITIES (continued)

(b) The distribution of liabilities was as follows:

	2006 KD 000's	2005 KD 000's
Geographic region		
The Middle East	4,346,227	3,340,685
North America	108,299	40
Western Europe	22,048	5,079
Other	622,685	345,952
	5,099,259	3,691,756
Industry sector		
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	2,475,198	2,615,019
	5,099,259	3,691,756

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:

	2006 KD 000's Equivalent Long (short)	2005 KD 000's equivalent Long (short)
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.

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:

	Within 3 months KD 000's	*3 to 6 months* KD 000's	*6 to 12 months* KD 000's	*After one year* KD 000's	**Total KD 000's**
Assets					
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**
	2,058,731	**577,006**	**717,609**	**2,960,445**	**6,313,791**
Liabilities					
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**
	3,053,348	**129,378**	**89,139**	**1,827,394**	**5,099,259**

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

	Within 3 months KD 000's	*3 to 6 months KD 000's*	*6 to 12 months KD 000's*	*After one year KD 000's*	*Total KD 000's*
Assets					
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
	1,499,998	539,849	641,013	2,000,258	4,681,118
Liabilities					
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
	2,255,718	56,574	79,433	1,300,031	3,691,756

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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.

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).