# Arab Insurance Group (B.S.C.)

# Report of the Board of Directors and Consolidated Financial Statements for the year ended 31 December 2006

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# REPORT OF THE BOARD OF DIRECTORS

Dear Shareholders,

The Directors of Arab Insurance Group (B.S.C.) are pleased to present the Company's 26th Annual Report and Consolidated Financial Statements for the year ended 31 December 2006.

In the year under review, the Group recorded net profits of US$ 30.4 million, representing a 10.7% average return on shareholders' equity. The result includes an amount of US$ 10.4 million stemming from the successful settlement of the outstanding warranty claim lodged earlier with the Moroccan Government. The ongoing good performance of the Company places the Board in the position to recommend, subject to regulatory approval, a cash dividend of 10% on paid-up capital (10 cents per share) amounting to US$ 22 million.

Applied underwriting discipline helped Arig to stem the tide of the globally deteriorating terms of trade. Claims loss ratio from reinsurance as well as related operating costs could be reduced to generate underwriting profit of US$ 8.1 million (2005: US$ 8.3 million) from a condensed reinsurance book of US$ 166.3 million (2005: US$ 173.7 million) in Gross Premium Written.

Total investment earnings climbed to US$ 38.4 million for the year (2005: US$ 33.2 million), representing an average rate of return on investments of 5.8% (2005: 5.7%). Invested assets totalled US$ 674.2 million at the end of 2006 (2005: US$ 659.4 million). While the Company's overall asset allocation strategy remained unchanged, a significant portion of the funds allocated to the fixed income portfolio continued to be held in short-term instruments to capture higher money market yields. As in previous years, investment funds were held in high quality liquid assets and managed conservatively in line with the Company's fiduciary obligations towards the policyholders.

During the year, Arig experienced a smooth transition at the helm. The Directors remain highly confident that the Company will continue on its successful course under the leadership of Yassir Albaharna, the able and widely recognized reinsurance professional who was appointed as CEO succeeding his predecessor Udo Krueger in April 2006.

**Market Conditions - Managing the Cycle**

Unlike the preceding year, 2006 spared the reinsurance industry from large event losses. This has provided additional momentum to the soft market conditions already prevalent throughout most Afro-Asian markets in 2005. Please allow me, therefore, to explain how Arig is responding to the challenge:

Soft markets are characterized by an oversupply of reinsurance capacity for customers to choose from. In many cases this means that reinsurers are prepared to offer coverage at terms and conditions, which do not reflect the true quality of the risks they choose to accept. Soft markets are a common sight in times without large catastrophic events, especially while financial markets offer good returns and when abundant capital is looking for investment opportunities. But the temporary equilibrium between inadequate reinsurance pricing and increased investment returns is treacherous. As soon as large market claims hit the industry or investment incomes deteriorate, the financial position of reinsurers will start being compromised until the terms of trade again significantly improve.

To manage this recurring reinsurance cycle remains one of the chief tasks for Arig's management today. The Company has deployed several key strategies to protect shareholders' interest:

Prudent Pricing - the Company will refrain from simply 'following the market'; instead, it is basing its reinsurance acceptances on minimum expected returns. Arig is using an array of IT-based pricing instruments that enable its underwriters to quantify the true economic value of each risk under consideration.

Return On Equity Over Volume Expansion - since 2005, Arig has been critically examining its book of business and has discontinued its involvement in consistently under-performing accounts. The volume effect of this measure has been a 4.2% reduction in Gross Premium Written during 2006, reinforced by general rate reductions yet partially offset by strong organic growth.

Controlled Expansion Into Attractive Lines And Markets - a voluntary reduction in the proportional Treaty accounts has been complemented by pronounced growth in Arig's Facultative book, comprising a form of coverage that provides improved underwriting control and cash flow. In addition, the new Singapore Branch has successfully established itself to generate more desirable business from the Far East in its first full year of operation, thereby assisting in the diversification of the Company's traditionally MENA focused portfolio.

Takaful Re - Arig's most recent investment launched in late 2005, was able to quickly earn its spot in the market place achieving gross contributions from participants of US$ 15.0 million in its first year. It achieved satisfactory returns on invested funds despite unfavorable market conditions and challenges in portfolio construction due to the limited availability of suitable Islamic financial instruments. Operating cost remained well contained by way of outsourcing agreements in place with Arig, saving the new subsidiary from high start-up expenses. Takaful Re contributed net profits of US$ 2.2 million to the results of the Group for the reporting year. Takaful Re was assigned a long-term counterparty credit and insurer financial strength rating of 'BBB' by the rating agency Standard & Poor's.

**Outlook**

In summary, the Board is satisfied that Arig has further consolidated its financial and market position in a testing environment. It has resumed a consistent dividend strategy allowing shareholders to participate in its success. Return targets and appropriate business strategies have been put in place to support attractive future returns.

Organizational changes were effected to increase customer focus and the quality of Arig's book. New reward schemes for key employees are currently being designed to ensure the best possible delivery on the Company's targets. The end result shall be a company that will not only expand on a leading position throughout the Middle East, but be among the best and most professional of its league world-wide to give you, the shareholders, the comfort of knowing that your investment with Arig is well protected.

**Acknowledgements**

The Directors take this opportunity to express their special thanks and appreciation to our business partners, clients, shareholders, and regulators for the strong support and cooperation received from them throughout the year and look forward to further strengthening these relationships in the coming years.

The Directors would like to place on record their sincere thanks to Udo Krueger, the former Chief Executive Officer of the Company, under whose stewardship the Company achieved a remarkable turnaround in its financial, operational and competitive position. The Directors further extend a special word of thanks to Mathews John, former Chief Financial Officer of the Company, for his significant contributions to the Group during his long and dedicated years of service.

The Directors also convey their deepest appreciation to the management team and all the staff of the Company for their continuing commitment, hard work and loyalty.

On behalf of the
**Board of Directors**

Khalid A Al Bustani
Chairman

15 February 2007

## Independent Auditors' Report
## To the Shareholders of Arab Insurance Group (B.S.C.)

We have audited the accompanying consolidated financial statements of Arab Insurance Group B.S.C. ("the Company") and its subsidiaries (together the "Group"), which comprise the consolidated balance sheet as at 31 December 2006, and the consolidated income statement, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

### Responsibility of the Directors for the consolidated financial statements

The Directors of the Company are responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards. 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 misstatements, 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 relevant ethical requirements and plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free of material misstatement.

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

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

### Opinion

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

### Report on other legal and regulatory requirements

In addition, in our opinion, the Company has maintained proper accounting records and the consolidated financial statements are in agreement therewith. We have reviewed the accompanying report of the directors and confirm that the information contained therein is consistent with the consolidated financial statements. We are not aware of any violations of the Bahrain Commercial Companies Law 2001, the Central Bank of Bahrain and Financial Institutions Law 2006, the Insurance Regulations set out in Volume 3 of the Insurance Rulebook issued by the Central Bank of Bahrain or the terms of the Company's memorandum and articles of association having occurred during the year ended 31 December 2006 which might have had a material effect on the business of the Company or its financial position. Satisfactory explanations and information have been provided to us by the management in response to all our requests.

Manama, Bahrain
15 February 2007

# ARAB INSURANCE GROUP (B.S.C.)

## CONSOLIDATED BALANCE SHEET
## AS AT 31 DECEMBER 2006

(In thousands of U.S. Dollars)

| | Note | 2006 | 2005 |
|---|---|---|---|
| **ASSETS** | | | |
| Cash and cash equivalents | 5 | **304,541** | 340,051 |
| Investments | 6 | **360,931** | 316,283 |
| Accrued income | 7 | **43,064** | 42,560 |
| Insurance receivables | 8 | **47,517** | 43,671 |
| Insurance deposits | 9 | **51,372** | 46,677 |
| Deferred policy acquisition costs | | **12,059** | 13,259 |
| Reinsurers' share of technical provisions | 10 | **74,172** | 82,482 |
| Other assets | 11 | **12,101** | 9,521 |
| Takaful participants' assets | 12 | **14,882** | - |
| Investment in associated companies | 13 | **-** | 895 |
| Fixed assets | 14 | **9,537** | 9,743 |
| | | **930,176** | 905,142 |
| **LIABILITIES** | | | |
| Technical provisions | 15 | **435,391** | 429,031 |
| Insurance payables | 18 | **28,353** | 28,391 |
| Borrowings | 19 | **55,929** | 75,926 |
| Other liabilities | 20 | **43,261** | 43,257 |
| Takaful fund and participants' liabilities | 12 | **14,882** | - |
| | | 577,816 | 576,605 |
| **EQUITY** | | | |
| **Shareholders' equity** | 21 | | |
| Share capital | | **220,000** | 200,000 |
| Treasury stock | | **(4,293)** | (2,836) |
| Reserves | | **36,742** | 30,991 |
| Proposed appropriations | | **23,080** | 31,080 |
| Retained earnings | | **17,867** | 13,148 |
| | | **293,396** | 272,383 |
| **Minority interests** | 22 | **58,964** | 56,154 |
| | | **352,360** | 328,537 |
| | | **930,176** | 905,142 |

These consolidated financial statements were approved by the Board of Directors on 15 February 2007 and signed by:

| | | |
|---|---|---|
| Khalid A. Al Bustani | Khalid J. Bin Kalban | Yassir Albaharna |
| Chairman | Vice Chairman | Chief Executive Officer |

The accompanying notes 1 to 39 are an integral part of these consolidated financial statements.

# ARAB INSURANCE GROUP (B.S.C.)

## CONSOLIDATED STATEMENT OF INCOME
## FOR THE YEAR ENDED 31 DECEMBER 2006

(In thousands of U.S. Dollars)

| | Note | | 2006 | 2005 |
|---|---|---|---|---|
| Gross premiums written | | | 166,304 | 173,652 |
| Net earned premiums | | | 145,760 | 134,860 |
| Claims and related expenses | | | (99,901) | (93,073) |
| Policy acquisition costs | | | (38,846) | (32,654) |
| Investment income attributable to insurance funds | 25 | | 15,607 | 15,325 |
| Operating expenses | 26 | | (14,554) | (16,167) |
| **Underwriting result** | 23 | | 8,066 | 8,291 |
| Investment income attributable to shareholders' funds | 25 | | 22,770 | 17,857 |
| Operating expenses - non-underwriting activities | 26 | | (9,634) | (6,697) |
| Other income | 27 | | 20,284 | 6,912 |
| Other expenses and provisions | 28 | | (8,837) | (8,105) |
| **Profit from continuing operations** | | | 32,649 | 18,258 |
| Minority interests | | | (2,283) | 1,080 |
| **Net profit from continuing operations** | | | 30,366 | 19,338 |
| Profit from discontinued operations | | | - | 28,859 |
| **Net profit attributable to shareholders** | | | 30,366 | 48,197 |
| **Earnings per share attributable to shareholders from :** | | | | |
| **- continuing operations** | 29 | US$ | 0.14 | 0.09 |
| **- discontinued operations** | | | - | 0.13 |

The accompanying notes 1 to 39 are an integral part of these consolidated financial statements.

# ARAB INSURANCE GROUP (B.S.C.)

## CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
## FOR THE YEAR ENDED 31 DECEMBER 2006

(In thousands of U.S. Dollars)

| | Share capital | Treasury stock | Reserves | | | | Proposed appropriations | Retained earnings | Shareholders' equity | Minority interests | Total equity |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | Legal | Investment revaluation | Property revaluation | Total | | | | | |
| **Balances at 31 December 2005** | 200,000 | (2,836) | 18,344 | 4,422 | 8,225 | 30,991 | 31,080 | 13,148 | 272,383 | 56,154 | 328,537 |
| Changes on remeasurement of available for sale assets | - | - | - | 3,034 | - | 3,034 | - | - | 3,034 | 18 | 3,052 |
| Transfers for recognition of gains/losses on disposal of available for sale assets | - | - | - | - | - | - | - | 8 | 8 | - | 8 |
| Transfer of net depreciation on revalued property | - | - | - | - | (353) | (353) | - | 353 | - | - | - |
| Net income (expense) recognised directly in equity | - | - | - | 3,034 | (353) | 2,681 | - | 361 | 3,042 | 18 | 3,060 |
| Net profit for the year | - | - | - | - | - | - | - | 30,366 | 30,366 | 2,283 | 32,649 |
| **Total recognised income (expense)** | - | - | - | 3,034 | (353) | 2,681 | - | 30,727 | 33,408 | 2,301 | 35,709 |
| Issue of bonus shares | 20,000 | - | - | - | - | - | (20,000) | - | - | - | - |
| Purchase of treasury shares | - | (1,457) | - | - | - | - | - | - | (1,457) | - | (1,457) |
| Dividends payable | - | - | - | - | - | - | (9,858) | - | (9,858) | - | (9,858) |
| Dividend on treasury shares | - | - | - | - | - | - | (142) | 142 | - | - | - |
| Sale of partial interest in subsidiary | - | - | - | - | - | - | - | - | - | 611 | 611 |
| Directors' remuneration paid | - | - | - | - | - | - | (1,080) | - | (1,080) | - | (1,080) |
| Directors' remuneration proposed | - | - | - | - | - | - | 1,080 | (1,080) | - | - | - |
| Proposed dividend @ 10% of paid-up capital | - | - | - | - | - | - | 22,000 | (22,000) | - | - | - |
| Transfer to legal reserves | - | - | 3,070 | - | - | 3,070 | - | (3,070) | - | - | - |
| Share of dividend declared by subsidiary | - | - | - | - | - | - | - | - | - | (102) | (102) |
| **Balances at 31 December 2006** | 220,000 | (4,293) | 21,414 | 7,456 | 7,872 | 36,742 | 23,080 | 17,867 | 293,396 | 58,964 | 352,360 |
| **Parent company balances at 31 December 2006 (note 38)** | 220,000 | (4,293) | 21,381 | 7,436 | 7,872 | 36,689 | 23,080 | 17,920 | 293,396 | - | 293,396 |

The accompanying notes 1 to 39 are an integral part of these consolidated financial statements.

# ARAB INSURANCE GROUP (B.S.C.)

## CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
## FOR THE YEAR ENDED 31 DECEMBER 2005

(In thousands of U.S. Dollars)

| | Share capital | Treasury stock | Reserves | | | | | Proposed appropriations | Retained earnings | Shareholders' equity | Minority interests | Total equity |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | Legal | Investment revaluation | Catastrophe | Property revaluation | Total | | | | | |
| **Balances at 31 December 2004** | 200,000 | (2,836) | 13,860 | (1,892) | 19 | 8,576 | 20,563 | 900 | 4,476 | 223,103 | 17,573 | 240,676 |
| Changes on remeasurement of available for sale assets | - | - | - | 7,274 | - | - | 7,274 | - | - | 7,274 | - | 7,274 |
| Transfers for recognition of gains/losses on disposal of available for sale assets | - | - | - | - | - | - | - | - | 15 | 15 | - | 15 |
| Transfer of net depreciation on revalued property | - | - | - | - | - | (351) | (351) | - | 351 | - | - | - |
| Net income (expense) recognised directly in equity | - | - | - | 7,274 | - | (351) | 6,923 | - | 366 | 7,289 | - | 7,289 |
| Net profit for the year | - | - | - | - | - | - | - | - | 48,197 | 48,197 | (1,444) | 46,753 |
| **Total recognised income (expense)** | - | - | - | 7,274 | - | (351) | 6,923 | - | 48,563 | 55,486 | (1,444) | 54,042 |
| Transfer of balances (including accumulated translation difference) on sale of interest in subsidiary | - | - | (336) | (960) | (19) | - | (1,315) | - | (3,991) | (5,306) | (16,510) | (21,816) |
| Directors' remuneration paid | - | - | - | - | - | - | - | (900) | - | (900) | - | (900) |
| Directors' remuneration proposed | - | - | - | - | - | - | - | 1,080 | (1,080) | - | - | - |
| Proposed bonus shares @ 10% of paid up capital | - | - | - | - | - | - | - | 20,000 | (20,000) | - | - | - |
| Proposed dividend @ 5% of paid up capital | - | - | - | - | - | - | - | 10,000 | (10,000) | - | - | - |
| Transfer to legal reserves | - | - | 4,820 | - | - | - | 4,820 | - | (4,820) | - | - | - |
| Capital contribution by minority in Takaful Re | - | - | - | - | - | - | - | - | - | - | 56,875 | 56,875 |
| Share of dividend declared by subsidiary | - | - | - | - | - | - | - | - | - | - | (340) | (340) |
| **Balances at 31 December 2005** | 200,000 | (2,836) | 18,344 | 4,422 | - | 8,225 | 30,991 | 31,080 | 13,148 | 272,383 | 56,154 | 328,537 |
| **Parent company balances at 31 December 2005 (note 38)** | 200,000 | (2,836) | 18,344 | 4,422 | - | 8,225 | 30,991 | 31,080 | 13,148 | 272,383 | - | 272,383 |

The accompanying notes 1 to 39 are an integral part of these consolidated financial statements.

# ARAB INSURANCE GROUP (B.S.C.)

## CONSOLIDATED STATEMENT OF CASH FLOWS
## FOR THE YEAR ENDED 31 DECEMBER 2006

(In thousands of U.S. Dollars)

| | Note | 2006 | 2005 |
|---|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES:** | | | |
| Premiums received | | 182,590 | 151,509 |
| Reinsurance premiums paid | | (15,975) | (19,701) |
| Claims paid | | (152,334) | (195,463) |
| Reinsurance receipts in respect of claims | | 10,343 | 61,338 |
| Investment income received | | 38,520 | 33,237 |
| Operating expenses paid | | (21,491) | (19,034) |
| Other income/expenses, net | | 7,992 | (8,543) |
| Insurance deposits (paid) received | | (4,579) | 7,668 |
| Purchase of trading investments | | (285,501) | (403,869) |
| Sale of trading investments | | 253,293 | 507,266 |
| Directors' remuneration paid | | (1,080) | (900) |
| **Net cash provided by operating activities** | 34 | 11,778 | 113,508 |
| **CASH FLOWS FROM INVESTING ACTIVITIES:** | | | |
| Acquisition/disposal of subsidiaries, net of cash transferred | | 625 | 80,214 |
| Disposal of associate | | 1,250 | - |
| Maturity/sale of investments | | 69,174 | 36,657 |
| Purchase of investments | | (85,794) | (39,368) |
| Collateralised cash deposits received | | 286 | 1,238 |
| Purchase of fixed assets | | (778) | (732) |
| Purchase of intangible assets | | (597) | (8) |
| **Net cash (used in) provided by investing activities** | | (15,834) | 78,001 |
| **CASH FLOWS FROM FINANCING ACTIVITIES:** | | | |
| Net borrowings | | (19,997) | 25,653 |
| Dividends paid | | (10,000) | - |
| Purchase of treasury stock | | (1,457) | - |
| **Net cash (used in) provided by financing activities** | | (31,454) | 25,653 |
| Net cash provided by discontinued operations | | - | 18,166 |
| **Net (decrease) increase in cash and cash equivalents** | | (35,510) | 235,328 |
| Cash and cash equivalents, beginning of year | | 340,051 | 104,723 |
| **Cash and cash equivalents, end of year** | | 304,541 | 340,051 |

The accompanying notes 1 to 39 are an integral part of these consolidated financial statements.

# ARAB INSURANCE GROUP (B.S.C.)

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006

### 1. INCORPORATION AND PRINCIPAL ACTIVITY

Arab Insurance Group (B.S.C.) (the "Company", "parent company") is an international insurance company registered as a Bahraini Shareholding Company having its registered office at Arig House, Manama, Kingdom of Bahrain. The parent company and its subsidiaries (the "Group") are involved in provision of general (non-life) and life reinsurance and related service activities.

### 2. SIGNIFICANT ACCOUNTING POLICIES

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS), including International Accounting Standards (IAS) and Interpretations issued by the International Accounting Standards Board and are consistent with prevailing practice within the insurance industry.

The Group's financial statements are presented in U.S. Dollars, which is its functional currency as its share capital and a significant proportion of its business, assets and liabilities are denominated in that currency.

The consolidated financial statements are prepared under the historical cost convention as modified by the revaluation of land and building, investment property and certain investment assets.

Comparative figures have been reclassified, where necessary, to conform to the current year's presentation.

During the year the following relevant new/amended IFRS standards and interpretations have been issued, which are not yet mandatory and have not been adopted by the Group in preparing these consolidated financial statements:

- IFRS 7 Financial Instruments: Disclosures - require disclosures about the significance of financial instruments on an entity's financial position
- IAS 1 Presentation of Financial Statements (amended) - requires disclosures regarding management of capital
- IFRIC 10 Interim Financial Reporting and Impairment - Deals with the reversal of impairment provision

The adoption of these standards and interpretations which is effective from 1 January 2007, are not expected to have a material impact on the financial statements

The significant accounting policies of the Group are as follows:

#### BASIS OF CONSOLIDATION

The consolidated financial statements include the accounts of the parent company and all of its subsidiaries made up to 31 December 2006.

Subsidiaries are defined as companies that are controlled by the Group, namely companies in which the Group has the power to govern the financial and operating policies so as to obtain benefits from their activities, and thus generally includes all companies in which the Group owns more than 50% of the voting shares. The purchase method is used to account for acquisitions.

## 2. SIGNIFICANT ACCOUNTING POLICIES (Contd.)

All intra-group transactions, balances and unrealised surpluses and deficits on transactions between group companies have been eliminated on consolidation. Where necessary, the accounts of subsidiaries have been restated to ensure consistency with the accounting policies adopted by the Group.

The Company's subsidiary, Takaful Re Limited, is an Operator of Islamic Reinsurance business. In accordance with applicable Shari'a principles, participants' (policyholders') funds are maintained distinct from the Operator's (shareholders') funds. Accordingly, the participants' assets and liabilities including the fund balance are shown separately as 'takaful participants' assets' and 'takaful fund and participants' liabilities' respectively in the consolidated balance sheet. Takaful Participants' Fund Accounts comprising of Balance Sheet and Statement of Participants' Revenue is set out in note 12.

A listing of the principal subsidiaries is set out in note 36. In the parent company, these investments are accounted under IAS 39, Financial Instruments: Recognition and Measurement.

### INVESTMENTS

Investment securities are classified as 'at fair value through profit or loss' which includes financial assets held for trading and those designated at fair value on initial recognition, 'available for sale', 'held to maturity' or 'loans and receivables'. Management determines the appropriate classification of investments at the time of purchase.

Securities are classified as at fair value through profit or loss if they are acquired for the purpose of generating a profit from short-term fluctuations in price or if so designated by management. Investments with fixed or determinable payments and fixed maturity that the management has the intent and ability to hold to maturity are classified as held to maturity. Non-derivative financial instruments with fixed or determinable payments and that are not quoted in an active market are categorised as loans and receivables. Securities intended to be held for an indefinite period of time and those that are not classified as at fair value through profit or loss, held to maturity or loans and receivables, which may be sold in response to needs for liquidity or changes in interest rates, are classified as available for sale.

All purchases and sales of investments are recognised at the settlement date. All investment assets are recognised initially at cost. After initial recognition, investments are valued using principles described below.

Investments at fair value through profit or loss and investments available for sale are carried at fair value. Held to maturity investments and loans and receivables are carried at amortised cost, less any adjustment necessary for impairment.

The fair value of publicly traded investments is based on quoted market values at the balance sheet date. Fair values of other investments are estimated at realisable values. Where it is not possible to estimate the fair value, the asset is carried at cost. Property values are based on recent valuations carried out by qualified professional valuers in accordance with recognised valuation principles.

Investments in non-financial assets such as land and buildings are included in investments if such assets are not for the Group's own use.

### PROVISION FOR IMPAIRMENT OF FINANCIAL ASSETS

A provision is made in respect of a financial asset that is impaired if its carrying amount is greater than its estimated recoverable amount.

## 2. SIGNIFICANT ACCOUNTING POLICIES (Contd.)

Provisions for assets carried at amortised cost are calculated as the difference between the carrying amount of the assets and the present value of expected future cash flows discounted at their original effective interest rate. By comparison, the recoverable amount of an instrument carried at cost is the present value of expected future cash flows discounted at the current market rate of interest for a similar financial asset.

In the case of available for sale financial assets, the Group assesses at each balance sheet date whether there is an objective evidence of impairment of such assets. If any such evidence exists, the impairment is recognised in income. Impairment recognized is not reversed subsequently except in case of debt instruments.

### INVESTMENT IN ASSOCIATED COMPANIES

Investments in associated companies are accounted for using the equity method. Associated companies are defined as those companies over which the Group is able to exercise significant influence, being the power to participate in the financial and operating policy decisions of the company, but not the power to control such policy decisions. Generally, these are companies in which the Group owns 20% to 50% of the voting shares.

### INSURANCE RECEIVABLES

Insurance receivables are carried at anticipated realisable values after provision for impairment. A provision for impairment is established when there is evidence that the Group will not be able to collect all amounts due according to the terms of the receivables. Bad debts are written off during the year in which they are identified.

### INSURANCE DEPOSITS

Insurance deposits comprise premium and claim deposits with cedants in accordance with policy terms and are carried at anticipated realisable values after provision for impairment. A provision for impairment is established when there is evidence that the Group will not be able to collect all amounts due according to the terms of the deposits. Irrecoverable deposits are written off during the year in which they are identified.

### INTANGIBLE ASSETS

Expenditure on software, patents and licenses are capitalised and amortised using the straight line basis over their expected useful lives, not exceeding a period of 5 years.

Costs associated with developing computer software programmes are recognised as an expense when incurred. However, costs that are clearly associated with an identifiable and unique product, which will be controlled by the Group and has a probable benefit exceeding the costs beyond one year, are recognised as intangible assets. Costs include staff costs of the development team and an appropriate portion of relevant overheads.

Expenditure, which enhances and extends the benefits of computer software programmes beyond their original specifications and lives is recognised as a capital improvement and added to the original cost of the software. The carrying amount of intangible assets is reviewed annually and adjusted for impairment where it is considered necessary.

## 2. SIGNIFICANT ACCOUNTING POLICIES (Contd.)

### GOODWILL

Goodwill represents excess of cost of an acquisition over the fair value of the identifiable net assets at the date of acquisition. After initial recognition, goodwill is carried at cost less accumulated impairment. At each balance sheet date the Group performs an analysis to assess whether the carrying amount of goodwill is fully recoverable. A write down is made if the carrying amount exceeds the recoverable amount and the resultant loss is recognised as an expense in the income statement.

### FIXED ASSETS AND RELATED DEPRECIATION

Fixed assets are stated at cost less accumulated depreciation except for land and building which are stated at fair value based on valuation by independent external valuers, less accumulated depreciation on buildings. On revaluation, any increase in the carrying amount of the asset is carried in the shareholders' equity as Property Revaluation Reserve and any decrease is recognized as an expense, except to the extent that they reverse decreases or increases previously recognized through income or shareholders' equity. The balance in the Property Revaluation Reserve is transferred

directly to Retained Earnings on sale of property and realization of surplus. Further, the difference between depreciation based on the revalued carrying amounts and the depreciation based on original cost of the property is transferred directly from Property Revaluation Reserve to Retained Earnings.

The cost of additions and major improvements are capitalised; maintenance and repairs are charged to expense as incurred. Gains or losses on disposal are reflected in other income. Depreciation is provided on straight-line basis over the expected useful lives of the assets, which are as follows:

| | | |
|---|---|---|
| Building | 40 | years |
| Electrical and mechanical | 10 | years |
| Information systems, furniture, equipment and others | 3-5 | years |

### PROVISIONS

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate of the amount of the obligation can be made. Employee entitlements are recognised when they accrue to employees, with a provision being carried for the estimated liability as a result of services rendered upto the balance sheet date.

### POST EMPLOYMENT OBLIGATIONS

The Group operates a number of defined benefit plans for its employees. The assets of the defined benefit plans are managed internally as part of the Group's investment portfolio.

For defined benefit plans, the accounting cost is charged to the income statement so as to spread it over the expected service lives of employees. The accounting costs under these plans are measured as the present value of the estimated future cash outflows using interest rates of government securities, which have terms to maturity approximating the terms of the related liability.

### EMPLOYEE SHARE SCHEME

The Group operates a cash settled, share-based compensation scheme. The fair value of the employee services received in exchange for virtual shares is recognized as an expense.

## 2. SIGNIFICANT ACCOUNTING POLICIES (Contd.)

The total amount to be expensed is spread over the financial year to which the award pertains (Scheme year) and the vesting period of two years from the end of Scheme year in the proportion 60:20:20.

At each balance sheet date, the liability is revalued with reference to the book value of the virtual shares allocated and the impact of the revaluation is recognized in the income statement with a corresponding adjustment to the liability.

### TREASURY STOCK

Treasury stock representing shares purchased by the parent company or its consolidated subsidiaries are carried at cost with the exception of holdings as on the date of capital reduction, 4 July 2002, which are carried at nominal value. All treasury stock is presented as a deduction from shareholders' equity and gains and losses from sale of these shares are presented as a change in shareholders' equity.

### RECOGNITION OF UNDERWRITING RESULT

Insurance business is accounted for in a manner consistent with prevailing practice within the insurance industry, more specifically, on an annual accounting basis. Specific accounting policies relating to individual items of insurance revenues and costs and technical provisions are explained below for each relevant item.

### PREMIUMS

Gross premiums written comprise the total premiums in relation to contracts incepting during the financial year, together with adjustments arising in the financial year to premiums receivable in respect of business written in previous financial years. It includes an estimate of pipeline premiums, being those premiums written but not reported to the Group at the balance sheet date. Pipeline premiums are reported as accrued insurance premiums.

Premiums, net of reinsurance, are taken to income over the terms of the related contracts or policies. Unearned premiums are those proportions of the premiums accounted for, which relate to periods of risk that extend beyond the end of the financial year; they are calculated based on a time apportionment basis. A provision for unexpired risks is made for estimated amounts required over and above provisions for unearned premiums to meet future claims and related expenses on business in force at the balance sheet date. Such provision, where necessary, is made on the basis of an assessment of segments in which policies with similar risk profile are grouped together.

### CLAIMS AND RELATED EXPENSES

Claims and related expenses are accounted for based on reports received and subsequent review on an individual case basis. Provision is made to cover the estimated ultimate cost of settling claims arising out of events, which have occurred by the end of the financial year, including unreported losses, and claims handling expenses. Provision for unreported claims is established based on actuarial analysis and application of underwriting judgment having regard to the range of uncertainty as to the eventual outcome for each category of business.

### POLICY ACQUISITION COSTS

Commissions, taxes, brokerages and other variable underwriting costs directly associated with acquiring business are amortised over the period in which the related premiums are earned. Policy acquisition costs that relate to periods of risk that extend beyond the end of the financial year are reported as deferred policy acquisition costs.

## 2. SIGNIFICANT ACCOUNTING POLICIES (Contd.)

### REINSURANCE ARRANGEMENTS

As part of managing its insurance risks, the Group enters into contracts with other reinsurers for compensation of losses on insurance contracts issued by the Group.

Compensations receivable from reinsurers are estimated in a manner consistent with the corresponding claim liability. The benefits and obligations arising under reinsurance contracts are recognised in income and the related assets and liabilities are recognised as accounts receivable, reinsurers' share of technical reserves and accounts payable.

### LIABILITY ADEQUACY TEST

At each balance sheet date, liability adequacy tests are performed to ensure adequacy of the contractual liabilities net of related deferred acquisition costs. In performing these tests, current best estimates of future contractual cash flows and claims

handling and administrative expenses are considered. The tests are performed on a portfolio basis where policies with similar risk profile are grouped together as a portfolio.

### INVESTMENT INCOME

Investment income comprises interest and dividend receivable for the financial year. Gains and losses arising from changes in the fair value of investments at fair value through profit or loss are included in the income statement in the period in which they arise. Gains and losses arising from changes in the fair value of available for sale investments are recognised in equity. When available for sale investments are disposed of or are impaired, the related fair value adjustments are included in the income statement. Gains and losses arising from changes in the fair value of investment properties are included in the income statement for the period in which they arise.

Investment income arising from insurance business investment assets are allocated to the underwriting results of insurance businesses based on the proportion of their respective insurance funds to shareholders' funds during the financial year.

### FOREIGN CURRENCY TRANSLATION

Transactions denominated in currencies other than U.S. Dollars are recorded at the rates ruling at the date of the transaction. Assets and liabilities denominated in currencies other than U.S. Dollars are translated at year-end exchange rates.

Unrealised gains or losses on translation of investments denominated in foreign currencies are taken to income except in respect of non-monetary available for sale investments, which are taken to equity until they are disposed.

Unrealised gains and losses on translation of financial statements of subsidiaries, net of translation adjustments relating to hedging liabilities, if any, are included in the Retained Earnings. Other foreign currency gains and losses are taken to income.

### DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGING

In the ordinary course of its business, the Group uses forward foreign exchange contracts as fair value hedges to protect its exposures in respect of foreign currency denominated investments and insurance liabilities and these contracts are carried at fair value.

## 2. SIGNIFICANT ACCOUNTING POLICIES (Contd.)

Where a fair value hedge meets the conditions prescribed by International Financial Reporting Standards for qualifying as an effective hedge, gains or losses from remeasuring forward foreign exchange contracts and gains or losses on hedged assets attributable to the hedged risk are recognised in income.

Where the hedge is not effective, gains or losses from remeasuring forward foreign exchange contracts are recognised in income. Gains or losses on hedged assets are recognised in income except in respect of non-monetary available for sale investments, which are taken to equity until they are disposed.

The gain or losses from remeasuring insurance liabilities and related foreign exchange contracts are recognised in income.

Covered call and put options are written and bought by the Group as part of its investment portfolio. The premium received and paid is initially recorded as liability and asset respectively and the changes in fair value of these options are taken to the statement of income and the corresponding asset or liability adjusted.

## 3. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

In the process of applying its accounting policies, the Group makes estimates and judgements that have an impact on the amounts recognised and reported in the financial statements. These estimates and judgements are based on historical experience, observable market data, published information and other information including expectations of future events that are believed to be reasonable under the circumstances. The estimates and judgements that have a significant impact on the recognised amounts in the financial statements and the processes used to determine these estimates and judgements are described below:

### i) Claims and related expenses

The estimate of ultimate losses arising from existing insurance contracts include unreported claims. Provisions for unreported claims are estimated based on actuarial analysis and application of underwriting judgment having regard to the range of uncertainty as to the eventual outcome for each category of business. The ultimate insurance liability also includes the costs to administer the claims.

### ii) Ultimate premiums

The estimate of ultimate premiums is based on premium income estimates provided by cedants which is then adjusted to reflect underwriters' judgement taking into account market conditions and historical data. This estimate is subject to review by underwriters and actuaries.

## 4. MANAGEMENT OF INSURANCE RISKS

Risks under insurance contracts arise from uncertainty regarding the occurrence of the insured event and the amount of the resulting claim. In addition to underwriting risks, the Group is also exposed to other related risks such as credit, currency and liquidity risks.

The following is a summary of policies adopted to mitigate the key insurance risks facing the Group:

### i) Underwriting risks

The group manages its underwriting risks principally through policies and guidelines for accepting risks and reinsurance arrangements.

## 4. MANAGEMENT OF INSURANCE RISKS (Contd.)

Risks are accepted based on an evaluation of pricing and prior underwriting experience in accordance with underwriting guidelines that have been laid out for each line of business. Underwriting guidelines are constantly reviewed and updated to take account of market developments, performance and opportunities. Accumulation limits are set to control exposures to natural hazards and catastrophes. Various approval limits are specified for accepting risks.

Acceptance of risks that do not meet specified minimum criteria are subject to agreement of an Underwriting Review Committee comprising representatives from the Marketing, Underwriting and Actuarial functions.

The reinsurance strategy of the Group is designed to protect exposures to individual and event risks based on current risk exposures through cost effective reinsurance arrangements.

Reserving risks are addressed by ensuring prudent and appropriate reserving for business written by the Group, thus ensuring that sufficient funds are available to cover future claims. Reserving practices involve the use of actuarial analysis and application of underwriting judgement. These are supplemented by periodical independent actuarial reviews for determining the adequacy of reserves.

### ii) Credit risks

Credit risk under insurance contracts is the risk that a counterparty will be unable to pay amounts in full when due.

Credit risk is controlled through terms of trade for receipt of premium and in certain cases enforcement of premium warranty conditions. Most of the counterparties are insurance companies that are generally not rated. However, there are no significant exposures from any one counterparty.

Reinsurance arrangements are effected with reinsurers whose creditworthiness is assessed on the basis of satisfying minimum rating and financial strength criteria. Exposure to any single reinsurer generally does not exceed a maximum of 25% of total exposure and risks are generally placed with counterparties with minimum investment grade rating except for proportional treaty arrangements placed on reciprocal basis.

Credit risks relating to reinsurance arrangements are analysed as follows:

| | US$ '000 | | |
|---|---|---|---|
| | 2006 | | |
| | **Receivables** | **Share of technical provisions** | **Total** |
| **Balance relating to reinsurers:** | | | |
| **- With investment grade rating** | **6,276** | **49,805** | **56,081** |
| **- Other** | **18,066** | **8,945** | **27,011** |
| | **24,342** | **58,750** | **83,092** |

| | US$ '000 | | |
|---|---|---|---|
| | 2005 | | |
| | Receivables | Share of technical provisions | Total |
| Balance relating to reinsurers: | | | |
| - With investment grade rating | 6,946 | 61,189 | 68,135 |
| - Other | 19,517 | 18,379 | 37,896 |
| | 26,463 | 79,568 | 106,031 |

## 4. MANAGEMENT OF INSURANCE RISKS (Contd.)

### iii) Currency risks

Foreign exchange currency risks are hedged where exposures are significant and facility to hedge is available.

### iv) Liquidity risks

Liquidity risk is the risk that cash may not be available to pay obligations when due. Limits have been specified in the investment policy and guidelines that requires a significant portion of investment funds representing insurance liabilities to be held in cash or readily marketable investment securities.

## 5. CASH AND CASH EQUIVALENTS

| | US$ '000 | |
|---|---|---|
| | **2006** | 2005 |
| Cash and bank balances | **58,732** | 94,838 |
| Deposits with short term maturities | **245,809** | 245,213 |
| | **304,541** | 340,051 |

Details of significant terms and conditions, exposures to credit, interest rate and currency risks are as follows:

### i) Credit risk:

Bank balances and deposits with short term maturities are held with leading financial institutions. The Group limits its concentration of time deposits with any one financial institution to a maximum of 10% of shareholders' equity.

### ii) Interest rate risk:

| | **2006** | 2005 |
|---|---|---|
| Interest receivable basis: | | |
| - Bank balances | Daily/Monthly | Daily/Monthly |
| - Deposits with short term maturities | On maturity | On maturity |
| Effective rates | 0.13% to 6.50% | 0.0% to 5.40% |

### iii) Currency risk:

| | US$ '000 | |
|---|---|---|
| | **2006** | 2005 |
| U.S. Dollar | **180,789** | 327,174 |
| Kuwaiti Dinar | **108,758** | 2,615 |
| Euro | **1,141** | 1,352 |
| Pound Sterling | **1,912** | 1,230 |
| Other | **11,941** | 7,680 |
| | **304,541** | 340,051 |

## 6. INVESTMENTS

| | US$ '000 | |
|---|---|---|
| | 2006 | 2005 |
| **At fair value through profit or loss** | | |
| **Held for trading** | | |
| Debt securities | | |
| - Supra-nationals and OECD country governments | - | 3,924 |
| - Other | 6,207 | - |
| Common stock of listed companies | 92,464 | 74,420 |
| | 98,671 | 78,344 |
| **Designated at fair value on initial recognition** | | |
| Debt Securities | | |
| - Investment grade | - | 15,364 |
| - Other | 46,696 | 21,222 |
| | 46,696 | 36,586 |
| **Held to maturity** | | |
| Debt securities | | |
| - Supra-nationals and OECD country governments | 33,002 | 27,172 |
| - Other investment grade | 73,928 | 81,010 |
| | 106,930 | 108,182 |
| **Available for sale** | | |
| Debt securities | | |
| - Supra-nationals and OECD country governments | 42,988 | 34,733 |
| - Other investment grade | 10,986 | 10,852 |
| - Non-OECD country governments | 4,654 | 4,402 |
| - Other | 13,273 | 7,927 |
| Common stock of listed companies | 2,136 | 2,757 |
| Common stock of unlisted companies | 14,289 | 16,162 |
| Other | 20,308 | 16,338 |
| | 108,634 | 93,171 |
| | 360,931 | 316,283 |

Investments available for sale are carried net of impairment provisions amounting to US$ 6.4 million (2005: US$ 5.9 million).

Debt securities amounting to US$ 46.4 million (2005: US$ 48.3 million) have been pledged as security for reinsurance trust agreements, letters of credit and guarantees and US$ 67.9 million (2005: US$ 87.8 million) for borrowings.

Details of significant exposures to credit, interest rate and currency risks on investments are as follows:

**i) Credit risk:**

The Group limits its investment concentration in debt securities in any one investee and in any one industry group to 10% and 20% respectively, of the total debt securities portfolio.

The Group also limits its investment concentration in common stock of listed companies of any one issue and any one issuer to 5% and 10% respectively, of its total common stock portfolio.

## 6. INVESTMENTS (Contd.)

### ii) Debt securities - interest rate risk:

| | 2006 | | |
|---|---|---|---|
| | **Interest receivable basis** | **Effective rates** | **Coupon rates** |
| Supra-nationals and OECD country government securities | **Semi-annual/Annual** | **4.6% - 6.0%** | **2.3% - 6.5%** |
| Other investment grade debt securities | **Semi-annual/Annual** | **4.9% - 6.7%** | **2.5% - 8.0%** |
| Non-OECD country government securities | **Semi-annual/Annual** | **3.1% - 5.9%** | **3.1% - 5.9%** |
| Other securities | **Monthly/Semi-Annual** | **6.2% - 7.4%** | **6.2% - 7.4%** |

| | 2005 | | |
|---|---|---|---|
| | Interest receivable basis | Effective rates | Coupon rates |
| Supra-nationals and OECD country government securities | **Semi-annual/Annual** | **2.4% - 4.7%** | **2.2% - 6.5%** |
| Other investment grade debt securities | **Semi-annual/Annual** | **2.4% - 5.6%** | **1.8% - 7.8%** |
| Non-OECD country government securities | **Semi-annual/Annual** | **3.0% - 4.5%** | **3.0% - 4.5%** |
| Other securities | **Monthly/Semi-Annual** | **3.0% - 6.4%** | **3.0% - 6.4%** |

### iii) Debt securities - currency risk :

| | **US$ '000** | | |
|---|---|---|---|
| | **2006** | | |
| | **U.S. Dollar** | **Other** | **Total** |
| Supra-nationals and OECD country government securities | **75,990** | **-** | **75,990** |
| Other investment grade debt securities | **83,876** | **1,038** | **84,914** |
| Non-OECD country governments | **1,151** | **3,503** | **4,654** |
| Other debt securities | **66,176** | **-** | **66,176** |
| | **227,193** | **4,541** | **231,734** |

| | US$ '000 | | |
|---|---|---|---|
| | 2005 | | |
| | U.S. Dollar | Other | Total |
| Supra-nationals and OECD country government securities | 65,829 | - | 65,829 |
| Other investment grade debt securities | 106,199 | 1,027 | 107,226 |
| Non-OECD country governments | 910 | 3,492 | 4,402 |
| Other debt securities | 29,149 | - | 29,149 |
| | 202,087 | 4,519 | 206,606 |

## 6. INVESTMENTS (Contd.)

### iv) Debt securities - remaining term to maturity:

The principal amount and book values of debt securities are shown in the table below by contractual maturity.

| | US$ '000 | | | |
|---|---|---|---|---|
| | 2006 | | 2005 | |
| | **Principal amount** | **Book value** | Principal amount | Book value |
| Supra-nationals and OECD country government securities: | | | | |
| - Due in one year or less | **17,000** | **16,972** | 20,000 | 19,936 |
| - One to five years | **57,195** | **56,790** | 42,340 | 41,718 |
| - More than five years | **2,220** | **2,228** | 4,246 | 4,175 |
| | **76,415** | **75,990** | 66,586 | 65,829 |
| Debt securities of other investment grade issuers: | | | | |
| - Due in one year or less | **29,000** | **29,004** | 24,000 | 23,996 |
| - One to five years | **54,028** | **53,869** | 71,028 | 70,862 |
| - More than five years | **2,000** | **2,041** | 12,000 | 12,368 |
| | **85,028** | **84,914** | 107,028 | 107,226 |
| Non-OECD country government securities: | | | | |
| - Due in one year or less | - | - | 310 | 310 |
| - One to five years | **4,749** | **4,654** | 4,199 | 4,092 |
| - More than five years | - | - | - | - |
| | **4,749** | **4,654** | 4,509 | 4,402 |
| Other debt securities : | | | | |
| - Due in one year or less | - | - | 2,000 | 1,974 |
| - One to five years | **15,217** | **15,163** | 4,499 | 4,451 |
| - More than 5 years | **47,586** | **51,013** | 21,502 | 22,724 |
| | **62,803** | **66,176** | 28,001 | 29,149 |
| | **228,995** | **231,734** | 206,124 | 206,606 |

### v) Common stock:

Common stock have no fixed maturity dates and are generally not exposed to interest rate risk. Dividends are generally declared on an annual basis.

The book value of common stock classified by currencies in which they are denominated are as follows:

| | US$ '000 | |
|---|---|---|
| | 2006 | 2005 |
| U.S. Dollar | **60,205** | 52,281 |
| Moroccan Dirham | - | 5,250 |
| Euro | **8,971** | 7,590 |
| Bahraini Dinar | **7,114** | 3,001 |
| Kuwaiti Dinar | **7,579** | 4,762 |
| Pound Sterling | **4,789** | 2,391 |
| Japanese Yen | **5,225** | 3,136 |
| Other | **15,006** | 14,928 |
| | **108,889** | 93,339 |

## 6. INVESTMENTS (Contd.)

### vi) Commitments:

The Group has commitments in respect of uncalled capital in available for sale investments amounting to US$ 8.0 million (2005: US$ 9.6 million).

## 7. ACCRUED INCOME

| | US$ '000 | |
|---|---|---|
| | 2006 | 2005 |
| Accrued insurance premiums | | |
| Expected to be received : | | |
| - Within 12 months | 33,204 | 38,980 |
| - After 12 months | 1,058 | 488 |
| | 34,262 | 39,468 |
| Accrued interest | | |
| - Expected to be received within 12 months | 8,802 | 3,092 |
| | 43,064 | 42,560 |

## 8. INSURANCE RECEIVABLES

| | US$ '000 | |
|---|---|---|
| | 2006 | 2005 |
| Balances due : | | |
| - Within 12 months | 47,398 | 43,513 |
| - After 12 months | 119 | 158 |
| | 47,517 | 43,671 |

## 9. INSURANCE DEPOSITS

| | US$ '000 | |
|---|---|---|
| | 2006 | 2005 |
| Balances due : | | |
| - Within 12 months | 28,914 | 24,198 |
| - After 12 months | 22,458 | 22,479 |
| | 51,372 | 46,677 |

## 10. REINSURERS' SHARE OF TECHNICAL PROVISIONS

| | US$ '000 | |
|---|---|---|
| | 2006 | 2005 |
| **General insurance business** | | |
| - Claims outstanding | 58,750 | 70,757 |
| - Unreported general insurance claims | 10,445 | 7,582 |
| - Deferred retrocession premium reserve | 4,227 | 2,914 |
| | 73,422 | 81,253 |
| **Life insurance business** | | |
| - Life insurance claims outstanding | 356 | 496 |
| - Life insurance unreported losses | 394 | 733 |
| - Life insurance business provision | | - |
| | 750 | 1,229 |
| | 74,172 | 82,482 |

## 11. OTHER ASSETS

| | US$ '000 | |
|---|---|---|
| | 2006 | 2005 |
| Intangible assets : | | |
| - Goodwill | 1,893 | 1,893 |
| - Computer software | 9,175 | 9,066 |
| | 11,068 | 10,959 |
| Less : accumulated amortisation of computer software | (8,500) | (8,735) |
| Net intangible assets | 2,568 | 2,224 |
| Other assets due within 12 months: | | |
| - Collateralised cash deposits | 4,234 | 4,520 |
| - Prepayments and other receivables | 5,299 | 2,777 |
| | 9,533 | 7,297 |
| | 12,101 | 9,521 |

| | US$ '000 | |
|---|---|---|
| | 2006 | 2005 |
| Movement in intangible assets : | | |
| Net book value at 1 January | 2,224 | 3,363 |
| - Additions | 235 | 728 |
| - Disposals | - | (1,317) |
| - Amortisation charge | 109 | (550) |
| Net book value at 31 December | 2,568 | 2,224 |

## 12. TAKAFUL PARTICIPANTS' FUND ACCOUNTS

### i) BALANCE SHEET

| | US$ '000 |
|---|---|
| | 2006 |
| **ASSETS** | |
| Cash & cash equivalents | 272 |
| Accrued income | 8,994 |
| Insurance receivable | 1,085 |
| Insurance deposits | 383 |
| Deferred acquisition costs | 2,233 |
| Deferred wakala fees | 1,793 |
| Other assets | 122 |
| | 14,882 |
| **LIABILITIES** | |
| Accounts payable | 3,009 |
| **TAKAFUL FUND** | |
| Unearned contributions | 8,970 |
| Outstanding claims | 601 |
| Unreported losses | 2,354 |
| | 11,925 |
| Deficit for the period | (52) |
| | 14,882 |

## 12. TAKAFUL PARTICIPANTS' FUND ACCOUNTS (Contd.)

### ii) STATEMENT OF PARTICIPANTS' REVENUE

| | US$ '000 |
|---|---|
| | 2006 |
| Gross contributions | 15,049 |
| Outward reinsurance premiums | (782) |
| Unearned contributions | (8,965) |
| Net earned contributions | 5,302 |
| Reported losses | (291) |
| Provision for unreported losses | (2,355) |
| Claim and related expenses | (2,646) |
| Policy acquisition costs | (3,738) |
| Deferred policy acquisition costs | 2,232 |
| Policy acquisition costs | (1,506) |
| Fee payable to operator (Wakala fee) | (1,216) |
| Other income | 14 |
| Deficit for the period | (52) |

## 13. INVESTMENT IN ASSOCIATED COMPANIES

| | Ownership interest | | | |
|---|---|---|---|---|
| | 2006 | | 2005 | |
| | US$ '000 | % | US$ '000 | % |
| Arab Lebanese Insurance Group S.A.L. | - | - | 895 | 25.0 |
| | - | | 895 | |

In May 2006, the Company disposed its entire holding in Arab Lebanese Insurance Group S.A.L. for a cash contribution of US$ 1,250,000.

## 14. FIXED ASSETS

| | US$ '000 | |
|---|---|---|
| | 2006 | 2005 |
| Land | 909 | 909 |
| Building | 8,841 | 8,841 |
| Information systems, furniture, equipment and other | 12,446 | 12,218 |
| | 22,196 | 21,968 |
| Less: accumulated depreciation | (12,659) | (12,225) |
| | 9,537 | 9,743 |
| Movements in fixed assets : | | |
| Net book value at 1 January | 9,743 | 10,096 |
| - Additions | 551 | 1,357 |
| - Disposals | - | (27) |
| - Depreciation charge | (757) | (1,683) |
| Net book value at 31 December | 9,537 | 9,743 |

## 15. TECHNICAL PROVISIONS

**Technical provisions comprise:**

| | US$ '000 | |
|---|---|---|
| | 2006 | 2005 |
| **General insurance business** | | |
| Claims outstanding | 275,177 | 286,622 |
| Unreported losses | 89,516 | 76,827 |
| Unearned premiums | 65,989 | 60,195 |
| | 430,682 | 423,644 |
| **Life insurance business** | | |
| Claims outstanding | 2,972 | 2,309 |
| Unreported losses | 1,366 | 2,925 |
| Unearned premiums | 371 | 153 |
| | 4,709 | 5,387 |
| | 435,391 | 429,031 |

## 16. CLAIMS DEVELOPMENT

The table below shows the incurred gross and net claims including unreported losses computed with reference to earned premiums, compared with previous estimates for the last 5 years:

| | US$ '000 | | | | | |
|---|---|---|---|---|---|---|
| | Underwriting year | | | | | |
| | 2002 | 2003 | 2004 | 2005 | 2006 | Total |
| **Gross** | | | | | | |
| Estimate of incurred claims costs: | | | | | | |
| - At end of underwriting year | 41,955 | 46,851 | 46,409 | 60,230 | 61,939 | |
| - One year later | 68,011 | 82,605 | 81,670 | 98,619 | - | |
| - Two years later | 74,514 | 86,084 | 88,069 | - | - | |
| - Three years later | 81,203 | 91,770 | - | - | - | |
| - Four years later | 80,575 | - | - | - | - | |
| Current estimate of incurred claims | 80,575 | 91,770 | 88,069 | 98,619 | 61,939 | 420,972 |
| Cumulative payments to date | (64,602) | (70,270) | (55,226) | (48,385) | (1,672) | (240,155) |
| Liability recognized | 15,973 | 21,500 | 32,843 | 50,234 | 60,267 | 180,817 |
| Liability in respect of prior years | | | | | | 188,214 |
| Total liability included in the balance sheet | | | | | | 369,031 |

| | | | | | | |
|---|---|---|---|---|---|---|
| **Net** | | | | | | |
| Estimate of incurred claims costs: | | | | | | |
| - At end of underwriting year | 35,742 | 38,925 | 45,985 | 55,843 | 56,934 | |
| - One year later | 56,961 | 67,143 | 76,236 | 91,271 | - | |
| - Two years later | 61,782 | 69,210 | 81,510 | - | - | |
| - Three years later | 67,529 | 74,500 | - | - | - | |
| - Four years later | 67,324 | - | - | - | - | |
| Current estimate of incurred claims | 67,324 | 74,500 | 81,510 | 91,271 | 56,934 | 371,539 |
| Cumulative payments to date | (53,151) | (54,820) | (51,147) | (45,223) | (1,834) | (206,175) |
| Liability recognized | 14,173 | 19,680 | 30,363 | 46,048 | 55,100 | 165,364 |
| Liability in respect of prior years | | | | | | 133,722 |
| Total liability included in the balance sheet | | | | | | 299,086 |

## 17. MOVEMENTS IN INSURANCE LIABILITIES AND ASSETS

| 2006 | US$ '000 | | |
|---|---|---|---|
| | Gross | Reinsurance | Net |
| **Claims** | | | |
| Claims outstanding | 289,059 | 71,240 | 217,819 |
| Unreported losses | 79,624 | 8,328 | 71,296 |
| Total at beginning of year | 368,683 | 79,568 | 289,115 |
| Increase in provision during the year | 107,972 | 519 | 107,453 |
| Claims settled during the year | (107,624) | (10,142) | (97,482) |
| Balance at end of year | 369,031 | 69,945 | 299,086 |
| **Unearned premium** | | | |
| At beginning of year | 60,348 | 2,914 | 57,434 |
| Increase in provision during the year | 6,012 | 1,313 | 4,699 |
| Balance at end of year | 66,360 | 4,227 | 62,133 |
| **Deferred policy acquisitions costs** | | | |
| At beginning of year | 14,576 | 1,317 | 13,259 |
| Increase during the year | (984) | 216 | (1,200) |
| Balance at end of year | 13,592 | 1,533 | 12,059 |

| 2005 | US$ '000 | | |
|---|---|---|---|
| | Gross | Reinsurance | Net |
| **Claims** | | | |
| Claims outstanding | 283,982 | 71,770 | 212,212 |
| Unreported losses | 85,945 | 7,956 | 77,989 |
| Total at beginning of year | 369,927 | 79,726 | 290,201 |
| Increase in provision during the year | 107,244 | 58,054 | 49,190 |
| Claims settled during the year | (108,488) | (58,212) | (50,276) |
| Balance at end of year | 368,683 | 79,568 | 289,115 |
| **Unearned premium** | | | |
| At beginning of year | 40,087 | 1,908 | 38,179 |
| Increase in provision during the year | 20,261 | 1,006 | 19,255 |
| Balance at end of year | 60,348 | 2,914 | 57,434 |
| **Deferred policy acquisitions costs** | | | |
| At beginning of year | 12,354 | 1,050 | 11,304 |
| Increase during the year | 2,222 | 267 | 1,955 |
| Balance at end of year | 14,576 | 1,317 | 13,259 |

## 18. INSURANCE PAYABLES

| | US$ '000 | |
|---|---|---|
| | 2006 | 2005 |
| Balances due: | | |
| - Within 12 months | 28,353 | 28,391 |
| | 28,353 | 28,391 |

## 19. BORROWINGS

| | US$ '000 | |
|---|---|---|
| | 2006 | 2005 |
| Due within 12 months | 55,929 | 75,926 |
| | 55,929 | 75,926 |

Borrowings amounting to US$ 55.9 million (2005: US$ 75.9 million) are secured by debt securities. The effective interest rate on the borrowings was 5.2% (2005: 3.6%).

## 20. OTHER LIABILITIES

| | US$ '000 | |
|---|---|---|
| | 2006 | 2005 |
| Accrued expenses | 2,520 | 2,859 |
| Post employment benefits (note 31) | 11,782 | 9,919 |
| Accrual for scheme of arrangement fees | 4,043 | 5,774 |
| Reinsurance premiums accrued | 10,892 | 12,229 |
| Covered option premium | 40 | 457 |
| Employee share scheme | 577 | 5,025 |
| Other | 13,407 | 6,994 |
| | 43,261 | 43,257 |
| Balances due: | | |
| - Within 12 months | 31,479 | 33,150 |
| - After 12 months | 11,782 | 10,107 |
| | 43,261 | 43,257 |

## 21. SHAREHOLDERS' EQUITY

### i) Share capital:

#### a) Composition:

| | US$ '000 | |
|---|---|---|
| | 2006 | 2005 |
| Authorized | | |
| 500 million ordinary shares of US$ 1 each | 500,000 | 500,000 |
| Issued, Subscribed & Fully Paid-up | | |
| 220 million (2005: 200 million) ordinary shares of US$ 1 each | 220,000 | 200,000 |

## 21. SHAREHOLDERS' EQUITY (Contd.)

At the annual general assembly held on 29 March 2006, shareholders of the Company resolved to issue 20 million shares fully paid for distribution as bonus shares in the proportion of 1 share for every 10 shares held. As a result, the issued, subscribed and fully paid up capital now stands at 220 million ordinary shares of US$ 1 each.

### b) Major Shareholders

Shareholders who have an interest of 5% or more of the outstanding shares are as shown below:

| Name | Nationality | No. of shares (in millions) | | % of total outstanding shares | |
|---|---|---|---|---|---|
| | | 2006 | 2005 | 2006 | 2005 |
| General Pension & Social Security Authority | UAE | 27.5 | 25.0 | 12.8 | 12.7 |
| Ministry of Finance & Industry | UAE | 27.2 | 24.7 | 12.6 | 12.5 |
| Central Bank of Libya | Libya | 27.2 | 24.7 | 12.6 | 12.5 |
| Kuwait Investment Authority | Kuwait | 27.2 | 24.7 | 12.6 | 12.5 |
| Real Estate Bank | UAE | 11.0 | 10.0 | 5.1 | 5.1 |

### c) Shareholding pattern

The shareholding pattern in the outstanding shares of the Company is as follows:

| Shares | No. of shares (in millions) | | No. of shareholders | | % of total outstanding shares | |
|---|---|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 | 2006 | 2005 |
| Less than 1% | 67.1 | 51.1 | 5,618 | 5,947 | 31.2 | 25.9 |
| 1% to 5% | 28.2 | 37.0 | 6 | 7 | 13.1 | 18.8 |
| 5% to 10% | 11.0 | 10.0 | 1 | 1 | 5.1 | 5.1 |
| 10% and above | 109.0 | 99.1 | 4 | 4 | 50.6 | 50.2 |

### ii) Treasury stock:

The company held 4,730,771 of its own shares at 31 December 2006 (2005: 2,838,525 shares).

### iii) Legal reserve:

In accordance with applicable legal provisions, the Group is required to set aside 10% of net profits each year to build a Legal Reserve up to a maximum of 100% of the paid up value of its share capital.

### iv) General reserve:

General Reserve represents unrestricted reserves created by appropriation from net profits of the parent or subsidiary companies.

## 21. SHAREHOLDERS' EQUITY (Contd.)

### v) Investment revaluation reserve:

Investment Revaluation Reserve comprises gains or losses arising from remeasurement of available for sale investment assets. These gains or losses are carried in the reserve until the assets are disposed of, at which time the gains or losses are included in income.

### vi) Property revaluation reserve:

Property Revaluation Reserve represents the difference between the cost of buildings less accumulated depreciation and their fair values. Further, the difference between depreciation based on the revalued carrying amounts and the depreciation based on original cost of the property is transferred directly from Property Revaluation Reserve to Retained Earnings.

### vii) Retained earnings:

Retained Earnings includes unrealised gains and losses on translation of financial statements of subsidiaries and gains or losses on remeasurement of available for sale investment assets held at 1 January 2000, being the date of adoption of IAS 39. Movements during the year are follows:

| | US$ '000 | |
|---|---|---|
| | **2006** | 2005 |
| Gains or losses on translation of subsidiaries: | | |
| Balance at 1 January | - | 3,880 |
| Translation difference transferred to income on disposal of subsidiary | - | (3,880) |
| Currency translation differences arising during the year | - | - |
| Balance at 31 December | - | - |
| Gains or losses on remeasurement of investment assets: | | |
| Balance at 1 January | **423** | 876 |
| Transfer on sale of subsidiary | - | (468) |
| Transfers on disposal | **8** | 15 |
| Balance at 31 December | **431** | 423 |

## 22. MINORITY INTERESTS

| | US$ '000 | |
|---|---|---|
| | **2006** | 2005 |
| At 1 January | **56,154** | 17,573 |
| Share of profit and movement in equity of subsidiaries | **2,301** | (1,784) |
| Change arising from sale of interest in subsidiaries, net | **611** | (16,510) |
| Capital contribution in subsidiary | - | 56,875 |
| Dividend declared by subsidiary | **(102)** | - |
| At 31 December | **58,964** | 56,154 |

## 23. SEGMENT INFORMATION

### i) Analysis of revenue by primary business segment:

The Group's reinsurance business consists of three main business segments, non-life treaty, non-life facultative mainly involving underwriting of property and marine classes and life mainly involving short term group life policies.

| | US$ '000 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Year ended 31 December 2006 | | | | Year ended 31 December 2005 | | | |
| | Treaty | Facultative | Life | Total | Treaty | Facultative | Life | Total |
| **REVENUES :** | | | | | | | | |
| Gross premiums written | 130,877 | 29,554 | 5,873 | 166,304 | 144,984 | 23,105 | 5,563 | 173,652 |
| Outward reinsurance premiums | (14,739) | (1,154) | (81) | (15,974) | (15,877) | (3,406) | (394) | (19,677) |
| Change in unearned premiums - gross | (574) | (5,077) | (219) | (5,870) | (17,220) | (3,174) | 272 | (20,122) |
| Change in unearned premiums - reinsurance | 1,286 | 14 | - | 1,300 | 1,041 | (34) | - | 1,007 |
| **Net earned premiums** | 116,850 | 23,337 | 5,573 | 145,760 | 112,928 | 16,491 | 5,441 | 134,860 |
| Investment income attributable to insurance funds | 9,494 | 6,010 | 103 | 15,607 | 8,334 | 6,772 | 219 | 15,325 |
| | 126,344 | 29,347 | 5,676 | 161,367 | 121,262 | 23,263 | 5,660 | 150,185 |
| **COSTS AND EXPENSES :** | | | | | | | | |
| Gross claims paid | (74,709) | (29,193) | (5,121) | (109,023) | (68,743) | (41,529) | (3,566) | (113,838) |
| Claims recovered from reinsurers | 5,698 | 4,283 | - | 9,981 | 6,022 | 51,193 | 580 | 57,795 |
| Change in provision for outstanding claims - gross | (6,895) | 26,613 | (820) | 18,898 | (21,954) | 15,592 | (661) | (7,023) |
| Change in provision for outstanding claims - reinsurance | 979 | (12,267) | 76 | (11,212) | 710 | (38,977) | 62 | (38,205) |
| Change in provision for unreported losses - gross | (10,975) | (1,647) | 1,554 | (11,068) | 1,096 | 7,569 | (526) | 8,139 |
| Change in provision for unreported losses - reinsurance | 1,872 | 991 | (340) | 2,523 | 680 | (741) | 120 | 59 |
| **Claims and related expenses** | (84,030) | (11,220) | (4,651) | (99,901) | (82,189) | (6,893) | (3,991) | (93,073) |
| Policy acquisition costs | (36,447) | (6,491) | (456) | (43,394) | (35,169) | (4,538) | (502) | (40,209) |
| Policy acquisition costs recovered from reinsurers | 5,740 | 85 | - | 5,825 | 5,408 | 174 | - | 5,582 |
| Change in deferred policy acquisition costs - gross | (2,249) | 1,182 | - | (1,067) | 1,640 | 601 | - | 2,241 |
| Change in deferred policy acquisition costs - reinsurance | (211) | - | 1 | (210) | (269) | 1 | - | (268) |
| **Policy acquisition costs** | (33,167) | (5,224) | (455) | (38,846) | (28,390) | (3,762) | (502) | (32,654) |
| Operating expenses | (9,829) | (2,528) | (717) | (13,074) | (11,163) | (2,251) | (736) | (14,150) |
| **Segment underwriting result** | (682) | 10,375 | (147) | 9,546 | (480) | 10,357 | 431 | 10,308 |
| Operating expenses - unallocated # | | | | (1,480) | | | | (2,017) |
| **Underwriting result** | | | | 8,066 | | | | 8,291 |

*# Unallocated operating expenses represent corporate expenses.*

## 23. SEGMENT INFORMATION (Contd.)

### ii) Analysis of premiums by secondary business segment - geographical location of the risk insured:

| | US$ '000 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2006 | | | | 2005 | | | |
| | Treaty | Facultative | Life | Total | Treaty | Facultative | Life | Total |
| Gross premiums from: | | | | | | | | |
| - Middle East & North Africa | 80,602 | 18,034 | 5,870 | 104,506 | 88,147 | 17,329 | 5,563 | 111,039 |
| - Africa | 8,090 | 1,525 | - | 9,615 | 9,047 | 878 | - | 9,925 |
| - Asia | 42,183 | 9,976 | 3 | 52,162 | 47,149 | 4,898 | - | 52,047 |
| - Europe | 2 | 19 | - | 21 | 641 | - | - | 641 |
| | 130,877 | 29,554 | 5,873 | 166,304 | 144,984 | 23,105 | 5,563 | 173,652 |

### iii) Analysis of segment assets and liabilities of continuing operations:

| | US$ '000 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2006 | | | | 2005 | | | |
| | Treaty | Facultative | Life | Total | Treaty | Facultative | Life | Total |
| Segment assets | 127,353 | 91,068 | 2,062 | 220,483 | 112,984 | 114,863 | 1,981 | 229,828 |
| Segment liabilities | 279,860 | 189,252 | 7,740 | 476,852 | 257,881 | 213,313 | 5,748 | 476,942 |

## 24. OUTWARD REINSURANCE PREMIUMS

| | US$ '000 | | | |
|---|---|---|---|---|
| | 2006 | | | |
| | Treaty | Facultative | Life | Total |
| Proportional retrocession premium | 12,593 | 546 | - | 13,139 |
| Protection premium | 2,151 | 1,583 | 81 | 3,815 |
| Reinstatement premium | (5) | (975) | - | (980) |
| | 14,739 | 1,154 | 81 | 15,974 |

| | US$ '000 | | | |
|---|---|---|---|---|
| | 2005 | | | |
| | Treaty | Facultative | Life | Total |
| Proportional retrocession premium | 13,424 | 2,316 | - | 15,740 |
| Protection premium | 2,450 | 179 | 394 | 3,023 |
| Reinstatement premium | 3 | 911 | - | 914 |
| | 15,877 | 3,406 | 394 | 19,677 |

## 25. INVESTMENT INCOME

| | US$ '000 | | | |
|---|---|---|---|---|
| | 2006 | | | |
| | Insurance funds | Shareholders' funds | Total | 2005 |
| Interest income | 8,728 | 14,815 | 23,543 | 16,004 |
| Dividends | 866 | 1,223 | 2,089 | 1,997 |
| Realised gains | 7,535 | 8,452 | 15,987 | 24,694 |
| Loss on remeasurement of investments at fair value through profit or loss | (1,528) | (1,711) | (3,239) | (6,412) |
| Impairment loss | (236) | (274) | (510) | (1,523) |
| Other | 242 | 265 | 507 | (1,578) |
| | 15,607 | 22,770 | 38,377 | 33,182 |

## 26. OPERATING EXPENSES

| | US$ '000 | | | |
|---|---|---|---|---|
| | 2006 | | | |
| | Underwriting | Non-Underwriting | Total | 2005 |
| Salaries and benefits | 11,464 | 6,458 | 17,922 | 18,299 |
| General and administration | 3,090 | 3,176 | 6,266 | 4,565 |
| | 14,554 | 9,634 | 24,188 | 22,864 |

## 27. OTHER INCOME

| | US$ '000 | |
|---|---|---|
| | 2006 | 2005 |
| Warranty claims | 10,414 | - |
| Third party administration services | 6,704 | 4,656 |
| Fees on managing Islamic reinsurance operations | 1,216 | - |
| Software sales and related services | 848 | 366 |
| Interest on cash balances | 210 | 252 |
| Gain on sale of interest in associate | 459 | - |
| Other | 433 | 1,638 |
| | 20,284 | 6,912 |

Warranty claims relates to the settlement reached with the Government of the Kingdom of Morocco on a claim lodged under the Warranty Agreement entered into between the Moroccan Government and the Company in July 1997 on the acquisition of the erstwhile subsidiary, CNIA Assurance S.A., Morocco.

## 28. OTHER EXPENSES AND PROVISIONS

| | US$ '000 | |
|---|---|---|
| | 2006 | 2005 |
| Provision for doubtful receivables and deposits | 1,624 | 5,272 |
| Scheme of arrangement fee | 379 | 947 |
| Foreign exchange loss | 2,748 | (1,339) |
| Interest on borrowing | 3,604 | 2,553 |
| Other | 482 | 672 |
| | 8,837 | 8,105 |

## 29. EARNINGS PER SHARE ATTRIBUTABLE TO SHAREHOLDERS

Basic earnings per share has been computed as follows:

| | | For the year ended 31 December 2006 | For the year ended 31 December 2005 |
|---|---|---|---|
| Weighted average number of shares outstanding | '000 | 216,392 | 216,878 |
| Continuing operations: | | | |
| Net profit | US$'000 | 30,366 | 19,338 |
| Earnings per share | US$ | 0.14 | 0.09 |
| Discontinued operations: | | | |
| Net profit | US$'000 | - | 28,859 |
| Earnings per share | US$ | - | 0.13 |
| Total earnings per share | US$ | 0.14 | 0.22 |

The weighted number of shares for prior periods have been adjusted to reflect the effect of stock dividend in 2006.

## 30. EMPLOYEE SHARE SCHEME

The Group operates a cash-settled, share based compensation scheme. Awards under the scheme are subject to the Company achieving specified minimum rates of return to shareholders and are determined based on an evaluation of employee performance against objectives agreed in advance. Virtual shares are allocated at the end of the financial year, being the allotment date, based on the book value of the Company's shares at the beginning of the financial year. These virtual shares will vest in the employees after two years from the allotment date.

The effect of the Scheme on the consolidated financial statements is presented below:

| | US$ '000 | |
|---|---|---|
| | 2006 | 2005 |
| Liability | 577 | 5,025 |
| Expense | 577 | 2,504 |

## 31. POST EMPLOYMENT BENEFITS

The Group operates a number of post employment plans on defined benefit basis. Eligibility for participation in the defined benefit plans is based on completion of a specified period of continuous service or date of hire. Benefits are based on the employee's years of service.

The principal actuarial assumptions used for accounting purposes were:

| | 2006 | 2005 |
|---|---|---|
| Discount rate | 5.1% | 4.3% |
| Expected return on plan assets | 5.1% | 4.3% |
| Future salary increases | 3.3% | 3.3% |

The movements in the liability recognised in the balance sheet are:

| | US$ '000 | |
|---|---|---|
| | 2006 | 2005 |
| Balance at 1 January | 9,919 | 9,292 |
| Accruals for the year | 3,216 | 1,571 |
| Payments during the year | (1,353) | (944) |
| Balance at 31 December | 11,782 | 9,919 |

## 32. FORWARD FOREIGN EXCHANGE CONTRACTS

In the ordinary course of its business, the Group uses forward foreign exchange contracts to hedge its exposure in respect of foreign currency denominated investments and insurance liabilities. In the event that the item being hedged is sold or settled prior to maturity of the forward foreign exchange contract, it is generally the Group's policy to enter into another offsetting forward foreign exchange contract of the same amount and maturity date. The notional amounts of these financial instruments are not recognised in the Group's consolidated financial statements but their fair values are recognised as assets or liabilities, as appropriate, with changes in

## 32. FORWARD FOREIGN EXCHANGE CONTRACTS (Contd.)

fair value being taken to the statement of income. The contracts oblige the Group to exchange cash flows to be received in the future from foreign currency denominated investments for U.S. Dollars at predetermined exchange rates. The counter parties in respect of these transactions are leading financial institutions.

### i. Forward foreign exchange contracts - by currency:

| | US$ '000 | | | |
|---|---|---|---|---|
| | 2006 | | 2005 | |
| | **Notional amount purchases** | **Notional amount sales** | Notional amount purchases | Notional amount sales |
| Euro | **10,094** | **7,787** | 26,465 | 24,018 |
| Pound Sterling | **1,497** | **3,992** | 618 | 2,107 |
| Japanese yen | **-** | **4,391** | - | 3,393 |
| Other | **2,442** | **3,948** | 1,179 | 3,511 |
| | **14,033** | **20,118** | 28,262 | 33,029 |

Notional amounts are the contract amounts used to calculate the cash flows to be exchanged. They are a common measure of the volume of outstanding transactions, but do not represent credit or market risk exposures.

### ii. Forward foreign exchange contracts - remaining term to maturity:

All of the forward foreign exchange contracts outstanding are due in one year or less.

### iii. Forward foreign exchange contracts - unrealised gains and losses:

The following table summarises the fair value of the Group's hedging portfolio of forward foreign exchange contracts at the balance sheet date, segregating the items between those that are in an unrealised gain position from those that are in an unrealised loss position.

| | US$ '000 | | | |
|---|---|---|---|---|
| | 2006 | | 2005 | |
| | **Purchases** | **Sales** | Purchases | Sales |
| Unrealised gains | **235** | **124** | 111 | 126 |
| Unrealised losses | **(85)** | **(262)** | (4) | (143) |
| | **150** | **(138)** | 107 | (17) |

## 33. COVERED OPTIONS

The Group writes and buys quoted covered call and put options as part of its investment portfolio. The notional amounts of these options are not recognised in the Group's consolidated financial statements. The premium received and paid is initially recorded as liability and asset respectively and the changes in fair value of these options are taken to the statement of income and the corresponding asset or liability adjusted. The liability relating to these options amounted to US$ 39,750 (2005: US$ 457,284). All options are denominated in US Dollars and are due to expire in less than one year. The counter parties in respect of these transactions are leading financial institutions.

## 33. COVERED OPTIONS (Contd.)

The notional amount and fair value of covered call and put options outstanding at the balance sheet date are as follows:

| | US$ '000 | | | |
|---|---|---|---|---|
| | Notional amount | | Fair value of notional amount | |
| | 2006 | 2005 | 2006 | 2005 |
| Call options written | 2,438 | 13,509 | 2,354 | 13,652 |

## 34. RECONCILIATION OF NET RESULT TO CASH FLOWS FROM OPERATING ACTIVITIES

| | US$ '000 | |
|---|---|---|
| | 2006 | 2005 |
| Profit from continuing operations before minority interests | 32,649 | 18,258 |
| Increase in insurance funds | 11,175 | 21,994 |
| Change in insurance receivable/payable, net | (3,884) | (11,487) |
| Change in accrued income | (504) | (22,324) |
| Change in other assets/liabilities, net | (27,658) | 107,067 |
| Net cash provided by operating activities | 11,778 | 113,508 |

## 35. FAIR VALUE DISCLOSURE

The following table presents the fair values of the Group's financial instruments:

| | US$ '000 | | | |
|---|---|---|---|---|
| | 2006 | | 2005 | |
| | Book value | Fair value | Book value | Fair value |
| **ASSETS** | | | | |
| Cash and cash equivalents | 304,541 | 304,541 | 340,051 | 340,051 |
| Investments | 360,931 | 360,767 | 316,283 | 315,705 |
| Accrued income | 43,064 | 43,064 | 42,560 | 42,560 |
| Insurance receivables | 47,517 | 47,517 | 43,671 | 43,671 |
| Insurance deposits | 51,372 | 51,372 | 46,677 | 46,677 |
| Other assets | 8,658 | 8,658 | 6,371 | 6,371 |
| **LIABILITIES** | | | | |
| Insurance payables | 28,353 | 28,353 | 28,391 | 28,391 |
| Borrowings | 55,929 | 55,929 | 75,926 | 75,926 |
| Other liabilities | 43,261 | 43,261 | 43,257 | 43,257 |

The information disclosed in the table above is not indicative of the net worth of the Group.

The following methods and assumptions were used to estimate the fair value of the financial instruments:

### i. General:

The book values of the Group's financial instruments except investments and forward foreign exchange contracts were deemed to approximate fair value due to the immediate or short term maturity of these financial instruments.

## 35. FAIR VALUE DISCLOSURE (Contd.)

### ii. Investments:

The fair value of debt securities, common stock of listed companies and other investments, where applicable, is based on quoted market prices. For certain other investments, which are not listed, a reasonable estimate of fair value has been made based on available financial data relating to these investments.

### iii. Forward foreign exchange contracts:

The fair value of forward foreign exchange contracts, used for hedging purposes, is based on quoted market prices.

### iv) Covered options:

The fair value of covered options is based on their quoted market prices.

### v) Fair value less than carrying amounts:

The fair value of fixed interest debt securities fluctuates with changes in market interest rates. The book value of financial assets held to maturity has not been reduced to fair value where lower, because such market rate variations are considered temporary in nature and management intends, and has the financial resources and capacity, to generally hold such investments to maturity.

## 36. PRINCIPAL SUBSIDIARIES

At 31 December 2006, the principal subsidiaries of the Company were:

| | Country of incorporation | Ownership |
|---|---|---|
| Arig Insurance Company Limited | United Kingdom | 100.0% |
| Arima Insurance Software W.L.L. | Kingdom of Bahrain | 100.0% |
| Gulf Warranties W.L.L. | Kingdom of Bahrain | 66.0% |
| Takaful Re Limited | United Arab Emirates | 54.0% |

All holdings are in the ordinary share capital of the subsidiaries concerned and are unchanged from 31 December 2005 except for the sale of 0.5% holdings in Takaful Re Limited for a net cash consideration of US$ 625,000. The sale was effected at par as part of the initial private placement of the subsidiary's shares.

## 37. RELATED PARTY DISCLOSURES

Related parties represent the Company's major shareholders, subsidiary and associated companies, directors and key management personnel.

The consolidated financial statements include the effect of the following transactions with related parties.

| | US$ '000 | |
|---|---|---|
| | 2006 | 2005 |
| **i) Directors** | | |
| - Remuneration paid | **1,080** | 900 |
| - Allowances | **108** | 106 |
| **ii) Key management compensation** | | |
| - Salaries and other short-term employee benefits | **1,088** | 1,617 |
| - Post-employment benefits | **943** | 310 |
| - Share-based payments | **131** | 1,235 |
| **iii) Balances due from associates** | - | 233 |

All transactions with related parties are conducted on an arm's length basis. All outstanding balances from related parties are expected to be settled within 12 months. No provisions have been required in 2006 and 2005 for any outstanding amounts due from related parties.

## 38. PARENT COMPANY

The unconsolidated balance sheet of the parent company, Arab Insurance Group (B.S.C.), is presented below.

| | US$ '000 | |
|---|---|---|
| | 2006 | 2005 |
| **ASSETS** | | |
| Cash and cash equivalents | 207,084 | 205,201 |
| Investments | 319,053 | 313,629 |
| Accrued income | 42,221 | 42,469 |
| Insurance receivables | 46,265 | 42,596 |
| Insurance deposits | 51,177 | 46,488 |
| Deferred policy acquisition costs | 12,059 | 13,259 |
| Reinsurers' share of technical provisions | 74,172 | 82,482 |
| Other assets | 11,140 | 11,264 |
| Investment in subsidiaries | 74,870 | 75,961 |
| Investment in associated companies | - | 895 |
| Fixed assets | 9,148 | 9,633 |
| | 847,189 | 843,877 |
| **LIABILITIES** | | |
| Technical provisions | 435,391 | 429,031 |
| Insurance payables | 28,267 | 28,364 |
| Borrowings | 55,929 | 75,926 |
| Other liabilities | 34,206 | 38,173 |
| | 553,793 | 571,494 |
| **SHAREHOLDERS' EQUITY** (note 21): | | |
| Share capital | 220,000 | 200,000 |
| Treasury stock | (4,293) | (2,836) |
| Reserves | 36,689 | 30,991 |
| Proposed appropriations | 23,080 | 31,080 |
| Retained earnings | 17,920 | 13,148 |
| | 293,396 | 272,383 |
| | 847,189 | 843,877 |

## 39. EVENTS AFTER THE BALANCE SHEET DATE

The directors propose to recommend the following appropriations for approval of shareholders at the Annual General Assembly meeting to be held on 29 March 2007:

| | US$ '000 |
|---|---|
| Cash dividend of US$ 0.10 per share of US$ 1 each | 22,000 |
| Directors' remuneration | 1,080 |
| | 23,080 |