

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2006

1. Organisation and activities

Al Ahlia Insurance Company B.S.C. ("the Company") is a public shareholding company registered with the Ministry of Industry and Commerce in the Kingdom of Bahrain and operates under commercial registration number 5091 obtained on 17 August 1976.

The Company is licensed to carry out insurance and reinsurance of all risks.

The registered office of the Company is in the Kingdom of Bahrain.

2. Cash and cash equivalents

	2006 Bahraini Dinars	2005 Bahraini Dinars
Cash and bank balances	669,420	162,211
Overdraft	-	(841,187)
Time deposits	725,547	274,717
Call deposits	93,310	1,750,717
	1,488,277	1,346,458

The bank balances are held in non interest bearing current accounts.

Time deposits and call deposits bare interest rates ranging from 4% to 5.5% per annum (2005: 3% to 4.5% per annum) and have a maturity period of less than 3 months.

3. Statutory deposit

Statutory deposit is placed with the National Bank of Bahrain B.S.C. The deposit is made in accordance with module GR paragraph number 7.1.2 of Central Bank of Bahrain, Rule Book Volume 3 Part A. The deposit is held in the name of the company and for the order of Central Bank of Bahrain, and carries interest at variable commercial rates.

4. Investments

	31 December 2006 Bahraini Dinars	31 December 2005 Bahraini Dinars
At 1 January	14,651,334	6,651,334
Additions during the year	7,402,322	11,266,379
Sale during the year	(3,757,129)	(5,374,893)
Realised fair value gains	(3,401,290)	(819,716)
Impairment losses (Note 17)	(1,884,255)	(493,155)
Unrealised fair value gains recognised in investment fair value reserve	305,854	3,421,385
At 31 December	13,316,836	14,651,334

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4. Investments (continued)

	31 December 2006 Bahraini Dinars	31 December 2005 Bahraini Dinars
Analysis of investments		
Shares listed on Stock Exchanges	11,935,951	13,449,778
Managed funds	395,166	393,672
Bonds	94,257	94,257
Unquoted equity investments	891,462	713,627
	13,316,836	14,651,334

5. Policyholders' receivables

	2006 Bahraini Dinars	2005 Bahraini Dinars
Policyholders' receivables	1,764,869	1,124,563
Less: provision for doubtful receivables	(26,343)	(26,343)
	1,738,526	1,098,220

Policyholders' receivables are generally on 30 to 60 days credit terms.

6. Insurance and reinsurance companies' receivables

Insurance balances receivable consist of balances due from insurance and reinsurance companies domiciled mainly in the Middle East and Europe. Two companies account for 36% (2005: 39%) of the total insurance balances receivable as at 31 December 2006. Arrangements with insurers normally require settlement on a quarterly basis.

7. Other receivables

	2006 Bahraini Dinars	2005 Bahraini Dinars
Accrued interest	5,359	4,825
Other receivables	831,235	208,541
Prepaid expenses	18,556	16,793
	855,150	230,159

8. Outstanding claims recoverable from reinsurer

	2006 Bahraini Dinars	2005 Bahraini Dinars
At 1 January	3,601,079	3,320,625
Additions during the year	1,414,906	1,680,261
Received during the year	(1,382,769)	(1,399,807)
At 31 December	3,633,216	3,601,079

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9. Outstanding claims reserve

Outstanding claims reserve movement during the year ended 31 December 2006:

Bahraini Dinars	Fire, General Accident & Engineering	Marine & Aviation	Life & Medical	Motor	2006 Total	2005 Total
At 1 January	993,987	2,040,168	416,415	3,325,195	6,775,765	6,052,247
Claims incurred	607,875	96,685	1,249,426	1,586,825	3,540,811	3,437,855
Claims paid	(219,122)	(61,627)	(1,459,463)	(1,029,503)	(2,769,715)	(2,714,337)
At 31 December	1,382,740	2,075,226	206,378	3,882,517	7,546,861	6,775,765

Gross outstanding claims reserve at 31 December 2006:

Current year claims	647,219	85,580	152,537	2,717,144	3,602,480	1,846,418
Prior year claims	725,166	1,988,278	48,030	1,036,355	3,797,829	4,790,924
Incurred but not reported	10,355	1,368	5,811	129,018	146,552	138,423
	1,382,740	2,075,226	206,378	3,882,517	7,546,861	6,775,765

10. Unearned premiums

The movement in the unearned premium provision during the year is as follows:

Bahraini Dinars	Fire, General Accident & Engineering	Marine & Aviation	Life & Medical	Motor	2006 Total	2005 Total
At 1 January	156,072	32,652	188,411	909,944	1,287,079	1,060,866
Additions	146,345	25,460	142,876	1,339,550	1,654,231	1,287,079
Releases	(156,072)	(32,652)	(188,411)	(909,944)	(1,287,079)	(1,060,866)
At 31 December	146,345	25,460	142,876	1,339,550	1,654,231	1,287,079

The Company had a policy of calculating unearned premium on the sixth method for marine cargo and twenty-fourth method for other classes of business, subject to minimum of 25% for marine cargo and 40% for other classes of business, as required by the Bahrain Insurance Law. During the year, Bahrain Insurance Law, 1987, was superseded by Central Bank of Bahrain and Financial Institution Law 2006, therefore, unearned premium is calculated on sixth method for marine cargo and twenty-fourth method for other classes of business. This change in the estimates of unearned premium does not have material impact on the financial statements of the Company.

11. Other technical provisions

Represents amounts received from reinsurance companies for settlement of their share of outstanding claims for certain underwriting years, which extinguishes their liabilities in respect of such underwriting years. The amounts received will be utilised for settlement of all claims in respect of those underwriting years.

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12. Other payables

	2006 Bahraini Dinars	2005 Bahraini Dinars
Payables	349,189	391,062
Accrued expenses	171,915	131,257
Provision for leave salary and air passage	44,648	36,742
Unclaimed dividends	104,751	80,676
	<u>670,503</u>	<u>639,737</u>

13. Employees' terminal benefits

Local employees

The contributions made by the Company towards the pension scheme for Bahraini nationals administered by the General Organisation for Social Insurance in the Kingdom of Bahrain for the year ended 31 December 2006 amounted to BD31,677 (2005 : BD29,759).

Expatriate employees

The movement in leaving indemnity liability applicable to expatriate employees was as follows:

	2006 Bahraini Dinars	2005 Bahraini Dinars
At 1 January	93,645	90,598
Accruals for the year	22,730	18,044
Payments during the year	(100)	(14,997)
At 31 December	<u>116,275</u>	<u>93,645</u>

Number of staff

The number of staff employed by the Company at 31 December 2006 was 68 (2005: 65).

14. Share capital

	2006 Bahraini Dinars	2005 Bahraini Dinars
Authorised share capital		
50,000,000 shares of BD0.100 each (2005: 50,000,000 shares of BD0.100 each)	5,000,000	5,000,000
Issued and fully paid-up share capital		
31,500,000 shares of BD0.100 each (2005: 30,000,000 shares of BD0.100 each)	3,150,000	3,000,000
Treasury shares		
23,625 shares of BD0.100 each (2005: 22,500 shares of BD0.100 each)	(3,724)	(3,612)
	<u>3,146,276</u>	<u>2,996,388</u>

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14. Share capital (continued)

Additional information on shareholding pattern

i) The names and nationalities of the major shareholders, and the number of shares held in which they have an interest of 5% or more are as follows:

	Nationality	Number of shares	% holding
Hussain Ali Sajwani	United Arab Emirates	8,500,000	26.98
Damac Invest Co. (LLC)	United Arab Emirates	3,834,064	12.17
Mustafa Ahmed Salman	Oman	2,782,500	8.83
Others	-	16,383,436	52.02
		31,500,000	100.00%

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

iii) The distribution of the Company's equity shares, i.e. the number of holders and their percentage holdings as at 31 December 2006 is set out below:

	Number of shareholders	Number of shares	% of total outstanding shares
Less than 1%	2,332	11,342,804	36.01
1% up to less than 5%	8	5,040,632	16.00
More than 5%	3	15,116,564	47.99
	2,343	31,500,000	100.00%

iv) Details of the Directors' interests in the Company's shares as at 31 December 2006 are as follows:

	2006 Number of shares	2005 Number of shares
Hussain Ali Sajwani	8,500,000	11,746,728
Dr Osama Taqi Al Baharna	364,857	347,484
Adel Hassan Ali Alaali	136,710	130,200
Sharif Mohammed Ahmadi	134,882	128,459
Abdulla Ebrahim Jamsheer	131,250	125,000
Sofyan Adnan Khatib	105,000	100,000
	9,372,699	12,577,871

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15. Statutory reserve

As required by the Bahrain Commercial Companies Law an amount equivalent to 10% of the Company's net profit for the year has been transferred to the statutory reserve. The Company may resolve to discontinue such annual transfers when the reserve equals 100% of the paid up share capital of the Company. The reserve cannot be utilised for the purpose of distribution, except in such circumstances as stipulated in the Bahrain Commercial Companies Law.

16. Expenses

	Year ended 31 December 2006 Bahraini Dinars	Year ended 31 December 2005 Bahraini Dinars
Management expenses	421,172	395,427
General and administrative expenses	577,972	503,093
	<u>999,144</u>	<u>898,520</u>
Comprising of:		
Employee related costs	740,003	648,744
Administrative and other costs	229,490	211,011
Depreciation	29,651	38,765
	<u>999,144</u>	<u>898,520</u>

17. Investment income

	Year ended 31 December 2006 Bahraini Dinars	Year ended 31 December 2005 Bahraini Dinars
Realised gains on sale of available-for-sale securities	3,508,312	2,182,631
Dividends income	430,137	344,947
Interest income	31,480	51,892
Impairment loss on available-for-sale investments (Note 4)	(1,884,255)	(493,155)
Interest expenses	(11,041)	(5,238)
	<u>2,074,633</u>	<u>2,081,077</u>

18. Other (expenses)/income

	Year ended 31 December 2006 Bahraini Dinars	Year ended 31 December 2005 Bahraini Dinars
Interest expense	(4,836)	(4,565)
Exchange (loss)/gain	32,273	(30,590)
Other income	(28)	8,290
	<u>27,409</u>	<u>(26,865)</u>

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19. Proposed appropriations

The directors propose a dividend of 20 fils (2005: 20fils) per 100 fils share from the 2006 profits. These and other appropriations mentioned below are subject to the shareholders' approval at the annual general meeting:

	2006 Bahraini Dinars	2005 Bahraini Dinars
Statutory reserve	255,477	232,024
Proposed dividend	630,000	600,000
Proposed bonus shares	157,500	150,000
Directors' remuneration	214,000	193,822
	1,256,977	1,175,846

The Board of Directors in their meeting dated 26 February 2007 proposes that the Chairman be paid remuneration of BD 124,000 in consideration of efforts put by him in advising the Committee and his personal involvement in managing the investment portfolio and remaining BD 90,000 be paid to the other six directors equally for the year ended 31 December 2006.

20. Earnings per share

	2006	2005
Net profit for the period	BD 2,554,770	BD 2,320,243
Weighted average number of shares outstanding	31,476,375	31,476,375
Earnings per 100 fils share	81.2 fils	73.7 fils

The earnings per share have been computed on the basis of net profit for the year divided by the weighted average number of shares outstanding for the year.

21. Segmental underwriting results

The Company's insurance business is organised into four main business segments as follows:

Fire and General Accident	: Fire, General Accidents and Engineering
Marine and Aviation	: Marine Cargo, Marine Hull and Aviation
Medical and Life	: Medical Expense Cover and Life
Motor	: Third Party Liability and Motor Comprehensive

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21. Segmental underwriting results (continued)

Bahraini Dinars					2006
	Fire and General Accident	Marine and Aviation	Medical and Life	Motor	Total
Gross premiums	2,492,689	1,733,593	2,022,392	2,786,880	9,035,554
Reinsurance ceded	(2,164,367)	(1,672,042)	(1,610,748)	(156,231)	(5,603,388)
Retained premiums	328,322	61,551	411,644	2,630,649	3,432,166
Unearned premium adjustment	9,727	7,192	45,535	(429,606)	(367,152)
Net premiums earned	338,049	68,743	457,179	2,201,043	3,065,014
Net earned commission income/(expense)	317,106	120,708	136,225	(61,276)	512,763
Net claims incurred	(134,604)	(15,929)	(298,143)	(1,677,229)	(2,125,905)
Management expenses	(108,719)	(48,329)	(80,943)	(183,181)	(421,172)
Underwriting profit	411,832	125,193	214,318	279,357	1,030,700
Loss ratios	39.82%	23.17%	65.21%	76.20%	69.36%

Bahraini Dinars					2005
	Fire and General Accident	Marine and Aviation	Medical and Life	Motor	Total
Gross premiums	2,057,516	1,308,906	1,715,587	2,028,986	7,110,995
Reinsurance ceded	(1,755,916)	(1,247,528)	(1,363,432)	(162,169)	(4,529,045)
Retained premiums	301,600	61,378	352,155	1,866,817	2,581,950
Unearned premium adjustment	(87,460)	(17,629)	(58,690)	(62,434)	(226,213)
Net premiums earned	214,140	43,749	293,465	1,804,383	2,355,737
Net earned commission income/(expense)	354,723	115,071	129,321	(32,705)	566,410
Net claims incurred	(17,891)	(23,462)	(315,843)	(1,400,400)	(1,757,596)
Management expenses	(110,740)	(49,229)	(65,976)	(169,482)	(395,427)
Underwriting profit	440,232	86,129	40,967	201,796	769,124
Loss ratios	8.35%	53.63%	107.63%	77.61%	74.61%

As the company's activities are performed on an integrated basis, a segmental analysis of assets and liabilities between these segments will not be meaningful.

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22. Financial assets and liabilities and risk management

Financial instruments consist of financial assets and financial liabilities.

Financial assets of the company include cash and cash equivalents, deposits, available-for-sale investments and receivables (from policy holders, insurance and reinsurance companies).

Financial liabilities of the company include payable and accrued liabilities (to policyholders, insurance and reinsurance companies and other parties).

The company does not use derivative financial instruments.

Accounting policies for financial assets and liabilities are set out on pages 16 to 18.

The risks involved with financial instruments and the company's approach to managing such risks are discussed below:

Insurance risk

Insurance risk comprises the possibility that an insured event occurs, and the uncertainty of the amount of the resulting claim. By the very nature of an insurance contract, this risk is random and therefore unpredictable. The primary risk that the Company faces under such contracts is that the actual claims and benefits payments exceed the carrying amount of insurance liabilities.

The primary risk control measure in respect of insurance risk is the cession of the risk to third parties via reinsurance, including excess of loss protection programme. Reinsurance business ceded is to a number of international reputable third party insurers on a proportional basis with retention limits, varying by lines of business and geographical areas. The Company is not dependent on a single reinsurer or a reinsurance contract.

In addition, insurance risk is mitigated by:

- i) The Company's diverse portfolio of insurance contracts. Accordingly the Company is less likely to be adversely affected by a single unexpected event.
- ii) Binding underwriting and retention guidelines and limits, and clear underwriting authorities control over who is authorized and accountable for concluding insurance and reinsurance contracts. Compliance with these guidelines is closely monitored by management. Developments in the global and local markets are also monitored closely and where necessary appropriate changes are made to the Company's policy and guidelines to reflect current best practice.
- iii) All the Company's insurance contracts contain specific liability limits.

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22. Financial assets and liabilities and risk management (continued)

Claims Development

The development of gross insurance liabilities provides a measure of Company's ability to estimate the ultimate value of claims. The following table illustrates the Company's estimate of total claims outstanding for the years 2001 to 2006:

Underwriting years

	2001 Bahraini Dinars	2002 Bahraini Dinars	2003 Bahraini Dinars	2004 Bahraini Dinars	2005 Bahraini Dinars	2006 Bahraini Dinars	Total Bahraini Dinars
Estimate of ultimate claims:							
At end of each reporting year	1,284,396	1,697,086	2,997,639	2,957,960	4,510,128	5,280,296	18,727,505
One year later	1,206,936	1,630,478	2,930,801	2,729,409	4,427,982	-	12,925,605
Two years later	1,208,646	1,659,191	2,884,414	2,740,206	-	-	8,492,457
Three years later	1,185,137	1,627,713	2,923,317	-	-	-	5,736,167
Four years later	1,172,794	1,633,674	-	-	-	-	2,806,468
Five years later	1,103,843	-	-	-	-	-	1,103,843
Estimate of cumulative claims	1,103,843	1,633,674	2,923,317	2,740,206	4,427,982	5,280,296	18,109,318
Less: Cumulative payments to date	(955,681)	(1,307,766)	(2,378,095)	(2,172,908)	(3,529,840)	(2,884,697)	(13,228,987)
Liability recognized in the balance sheet	148,162	325,908	545,222	567,298	898,142	2,395,599	4,880,331
Add: Claims in respect of years prior to 2001							2,666,530
At 31 December 2006							7,546,861

Claims in respect of prior to 2001 are pending completion subject to receipt of all the necessary documentation. These claims are substantially reinsured at 31 December 2006.

Re-insurance risk

Although the Company has reinsurance arrangements, it is not relieved of its direct obligations to its policyholders and thus a credit risk exposure remains with respect to reinsurance ceded to the extent that any reinsurer is unable to meet its obligations under such reinsurance arrangements. The Company reinsures business only with parties that have good credit ratings, such credit ratings are reviewed on a regular basis. A geographical analysis of the Company's reinsurance exposure at 31 December 2006 is provided below:

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22. Financial assets and liabilities and risk management (continued)

Geographical region

	2006 Bahraini Dinars	2005 Bahraini Dinars
Middle East	2,042,514	1,646,954
Europe	1,092,385	1,175,583
Rest of the World	40,243	14,953
	3,175,142	2,837,490

The five largest reinsurers account for 54% of the maximum credit exposure at 31 December 2006 (2005: 59%).

Currency risk

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

The Bahraini Dinar is effectively pegged to the United States dollar, thus currency risk occurs only in respect of other currencies. The company does not have significant exposure in other currencies. The company does not hedge against such currency risks.

The table below summarises the exposure to currency risk excluding assets and liabilities arising from insurance and reinsurance contracts.

Net open positions (in Bahraini Dinar equivalent)

	2006 Bahraini Dinars	2005 Bahraini Dinars
United States Dollars	3,482,592	3,309,795
Egyptian Pound	2,555,672	1,973,236
Australian Dollars	-	452,464
Euro	-	155,842
Other GCC currencies	7,044,349	7,634,083
	13,082,613	13,525,420

Interest rate risk

Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates.

The company invests in bonds and has deposits that are subject to interest rate risk. Interest rate risk to the company is the risk of changes in market interest rates reducing the overall return on its interest bearing securities. The company limits interest rate risk by monitoring changes in interest rates in the currencies in which its cash and investments are denominated.

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22. Financial assets and liabilities and risk management (continued)

Interest rate risk(continued)

Details of maturities of the major classes of interest bearing financial instruments as at 31 December are as follows:

Bahraini Dinars	Less than 6 months	6 months to 1 year	1 year to 3 years	Over 3 years	Non-interest bearing	Total
2006						
Cash and bank balances	-	-	-	-	669,420	669,420
Time deposits	725,547	-	-	125,000	-	850,547
Call deposits	-	-	-	-	93,310	93,310
Investments	-	-	94,257	-	13,222,579	13,316,836
	725,547	-	94,257	125,000	13,985,309	14,930,113
2005						
Cash and bank balances	-	-	-	-	162,211	162,211
Bank overdraft	(841,187)	-	-	-	-	(841,187)
Time deposits	274,717	-	-	125,000	-	399,717
Call deposits	-	-	-	-	1,750,717	1,750,717
Investments	-	-	94,257	-	14,557,077	14,651,334
	(566,470)	-	94,257	125,000	16,470,005	16,122,792

There is no significant difference between contractual repricing or maturity dates. The effective interest rates of the time deposits and investments which are principally denominated in US Dollars and Bahraini Dinars ranges from 4.00% to 5.5% (2005: 3.22% to 5.3%).

Market risk

Market risk is the risk that the value of a financial instrument will fluctuate as a result of changes in market prices, whether those changes are caused by factors specific to the individual security, or its issuer, or factors affecting all securities traded in the market.

The company is exposed to market risk with respect to its investments in equities, managed funds and bonds.

The company limits market risk by maintaining a diversified portfolio and by continuous monitoring of developments in international equity and bond markets. In addition, the company actively monitors the key factors that affect stock market movements, including analysis of the operational and financial performance of investees.

Geographical concentration of investments

	2006 Bahraini Dinars	2005 Bahraini Dinars
Bahrain	813,457	2,151,253
Middle east	7,373,447	7,634,083
North Africa	4,562,504	3,681,235
Rest of the world	567,428	1,184,763
	13,316,836	14,651,334

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22. Financial assets and liabilities and risk management (continued)

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. The company adopts policies and procedures in order to maintain credit risk exposures within limits. These limits have been set on the basis of the types of exposures and the credit rating of the counter party and hence the company is of the opinion that no credit loss will occur. Substantially all of the company's underwriting activities are carried out in the Kingdom of Bahrain.

Substantially all of the company's cash and bank balances, time deposits and investments are placed with institutions in the Kingdom of Bahrain and Middle East. Credit risk on premiums receivable is limited to policyholders in Bahrain. Credit risk on insurance balances receivable is substantially on major reinsurance companies located in the Arabian Gulf States and Europe.

For all classes of financial instruments held by the company, other than those relating to reinsurance contracts as described above, the maximum credit risk exposure to the company is the carrying value as disclosed in the financial statements at the balance sheet date.

Liquidity risk

Liquidity risk is the risk that an enterprise will encounter difficulty in raising funds to meet commitments associated with financial liabilities. Liquidity requirements are monitored on a regular basis and management ensures that sufficient funds are available to meet any commitments as they arise.

Fair values

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

Other than certain available-for-sale investments carried at cost of BD266,519 (2005: BD432,884), the estimated fair values of the Company's other financial instruments are not significantly different from their carrying values.

23. Contingent liabilities

The Company is a defendant in a number of cases brought by policyholders in respect of claims which the Company disputes. While it is not possible to predict the eventual outcome of such legal actions, the directors' have made provision which, in their opinion, is adequate.