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TRANSLATION FROM ORIGINAL ARABIC TEXT

**AUDITOR'S REPORT TO THE SHAREHOLDERS OF
ISLAMIC BANK OF YEMEN FOR FINANCE AND INVESTMENT
SANA'A, REPUBLIC OF YEMEN**

Report on the Financial Statements

We have audited the accompanying financial statements of Islamic Bank of Yemen for Finance and Investment, which comprise the balance sheet as at December 31, 2006, the income statement, cash flow statement, statement of changes in shareholders' equity and statement of sources and uses of Qard Hasan for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the accounting requirements of Central Bank of Yemen and the accounting standards of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and operating in accordance with Islamic Sharia'. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of 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.

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Bank's preparation and fair presentation of the 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 Bank's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.



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

In application of Central Bank of Yemen circulars no. 6 of 1996 and no. 5 of 1998 concerning the classification of assets and contingent liabilities, and making the required provisions, and their impact on the financial statements, there is a shortfall in the provision amount, as explained in note (10) to the financial statements.

Opinion

Except for the effect on the financial statements of the matter referred to in the preceding paragraph, in our opinion, the accompanying financial statements are prepared, in all material respects, in accordance with the accounting requirements of Central Bank of Yemen, Accounting Standards for Islamic Financial Institutions and applicable local laws and regulations.

Report on Other Legal and Regulatory Requirements

We have obtained from management the information and clarifications that we deemed necessary for our audit. The Bank keeps proper books of account, and the accompanying financial statements are in agreement with these books.

M. Zohdi Mejanni
Associated Accountant



Sana'a, April 28, 2007

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**ISLAMIC BANK OF YEMEN FOR FINANCE AND INVESTMENT
SANA'A, REPUBLIC OF YEMEN**

**BALANCE SHEET
AS AT DECEMBER 31, 2006**

	<u>Note</u>	<u>2006 YR 000's</u>	<u>2005 YR 000s</u>
Assets			
Cash on hand & reserve balances with Central Bank	8	2,252,382	3,666,310
Due from banks and financial institutions	9	2,094,751	951,412
Financing Murabaha transactions (net)	3-3,10	6,012,080	6,836,919
Investments in Musharaka contracts (net)	3-4,12	104,801	364,422
Investment in Mudaraba Contracts (net)	3-4,14	491,429	515,155
Available for sale investments	3-5,16	190,543	136,852
Investment property	3-6,17	280,092	276,161
Restricted investments	3-7	-	771,508
Qard Hasan (net)		40,831	17,773
Debit balances & other assets (net)	18	3,946,185	5,355,398
Property and equipment (net)	3-11,20	<u>233,757</u>	<u>287,567</u>
Total assets		<u>15,646,851</u>	<u>19,179,477</u>
Liabilities, investment accounts and shareholders' equity			
Liabilities			
Current accounts and other deposits	21	4,340,439	5,176,353
Due to banks and financial institutions		205,491	2,212,370
Credit balances & other liabilities	22	180,142	1,070,342
Other provisions	24	<u>91,799</u>	<u>142,009</u>
Total liabilities		<u>4,817,871</u>	<u>8,601,074</u>
Unrestricted investment and saving accounts' holders	25	<u>8,674,169</u>	<u>7,689,019</u>
Restricted investment accounts		-	<u>771,508</u>
Total liabilities, unrestricted and restricted accounts		<u>13,492,040</u>	<u>17,061,601</u>
Shareholders' equity			
Paid up capital	26	2,011,232	1,974,297
Reserves	27	142,607	142,607
Retained earnings		<u>972</u>	<u>972</u>
Total shareholders' equity		<u>2,154,811</u>	<u>2,117,876</u>
Total liabilities, investment accounts and shareholders' equity		<u>15,646,851</u>	<u>19,179,477</u>
Contingent liabilities and commitments	3-9,29	<u>7,765,272</u>	<u>12,900,773</u>

(The accompanying notes from 1 to 41 form part of these financial statements)


Chairman

General Manager

Financial Manager



Auditor's report attached.


M. Zohdi Mejanni
(KPMG Mejanni, Hazem Hassan & Co.)



TRANSLATION FROM ORIGINAL ARABIC TEXT

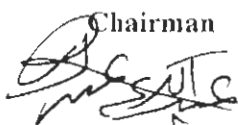
**ISLAMIC BANK OF YEMEN FOR FINANCE AND INVESTMENT
SANA'A, REPUBLIC OF YEMEN**

**INCOME STATEMENT
FOR THE YEAR ENDED DECEMBER 31, 2006**

	<u>Note</u>	<u>2006 YR 000's</u>	<u>2005 YR 000's</u>
Revenues of Murabaha contracts financing		510,957	696,531
Revenues of other joint investments	30	<u>36,547</u>	<u>75,908</u>
		547,504	772,439
Less: Return of unrestricted investment accounts		(720,000)	(643,000)
Add: The bank's share in restricted investments income		-	44,366
Add: Commissions & fees income on banking services	31	573,902	619,449
Add: Gain of foreign currency transactions	32	182,677	261,750
Add: Gain on sale of financial investments evaluation		21,974	-
Less: Losses of financial investments evaluation		(313)	(926)
Add: Other operating income	33	<u>23,297</u>	<u>19,877</u>
Operating profit		629,041	1,073,955
Less: Provisions	34	(21,727)	(413,902)
Less: Commissions & fees expenses on banking services		(18,137)	(16,300)
Less: General & administration expenses and depreciation	35	<u>(589,177)</u>	<u>(643,753)</u>
Net result before tax		<u>-</u>	<u>-</u>

(The accompanying notes from 1 to 41 form part of these financial statements)

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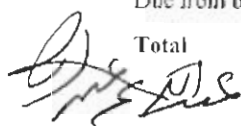
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**ISLAMIC BANK OF YEMEN FOR FINANCE AND INVESTMENT
SANA'A, REPUBLIC OF YEMEN**

**CASH FLOW STATEMENT
FOR THE YEAR ENDED DECEMBER 31, 2006**

	<u>Note</u>	<u>2006</u> <u>YR 000s</u>	<u>2005</u> <u>YR 000s</u>
<u>Cash flows from operating activities:</u>			
Net result before tax		-	-
Adjustments to reconcile net result to cash flows from operating activities			
Depreciation		67,967	69,267
Provisions	34	21,727	413,902
Provision used		(15,120)	(18,983)
Paid income taxes		-	(6,998)
(Gain) on sale of property and equipment		(3,650)	(421)
Return of unrestricted investment and saving accounts		720,000	643,000
Profit of sale available for sale investments		(21,974)	-
Translation differences of available for sale investments		(1,029)	-
Loss of evaluation of available for sale investments		313	-
<u>Operating profit before changes in assets & liabilities related to operating activities</u>		768,234	1,099,767
Decrease (increase) in reserve balances with CBY		1,312,025	(574,341)
(Increase) in Qard Hasan		(21,916)	(10,636)
Decrease in debit balances and other assets		1,409,213	15,770
(Decrease) increase in credit balances and other liabilities		(842,948)	13,182
Net cash flows provided by operating activities (1)		2,624,608	543,742
<u>Cash flows from investing activities:</u>			
(Increase) in available for sale investments		(31,001)	(124,622)
Decrease (increase) in Murabaha financing contracts		716,766	(363,496)
Decrease in Musharaka contracts		262,243	195,597
Decrease in Mudaraha contracts		23,966	185,778
(Increase) in investment property		(3,931)	(276,161)
Decrease in restricted investments		771,508	411,129
Payments to purchase property and equipment		(14,157)	(42,973)
Proceeds from sale of property and equipment		3,650	50
Net cash flows provided by (used in) investing activities (2)		1,729,044	(14,698)
<u>Cash flows from financing activities:</u>			
Capital cash increase		36,935	504,297
(Decrease) increase in due to banks and financial institutions		(2,006,879)	2,099,410
Increase (decrease) in unrestricted investment and saving accounts		265,150	(871,531)
(Decrease) in current accounts and other deposits		(835,914)	(3,337,059)
(Decrease) in unrestricted investments		(771,508)	(411,129)
Dividends paid		-	(1,450)
Net cash flows (used in) financing activities (3)		(3,312,216)	(2,017,462)
Net change in cash and cash equivalent (1+2+3)		1,041,436	(1,488,418)
Cash and cash equivalent at beginning of the year		1,463,605	2,952,023
Cash and cash equivalent at end of the year		2,505,041	1,463,605
<u>Cash and cash equivalent consist of:</u>			
Cash on hand & current accounts with CBY		1,084,205	661,411
Due from banks and financial institutions		1,420,836	802,194
Total		2,505,041	1,463,605

(The accompanying notes from 1 to 41 form part of these financial statements)

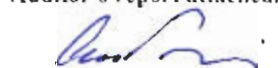


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ISLAMIC BANK OF YEMEN FOR FINANCE AND INVESTMENT
SANA'A, REPUBLIC OF YEMEN

STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
FOR THE YEAR ENDED DECEMBER 31, 2006

	<u>Paid up Capital YR 000s</u>	<u>Statutory Reserve YR 000s</u>	<u>Retained Earnings YR 000s</u>	<u>Total YR 000s</u>	
Year 2006					
Balance at beginning of the year	1,974,297	142,607	972	2,117,876	
Capital increase - cash	<u>36,935</u>	<u>-</u>	<u>-</u>	<u>36,935</u>	
Balance at end of the year	<u>2,011,232</u>	<u>142,607</u>	<u>972</u>	<u>2,154,811</u>	
	<u>Paid up Capital YR 000s</u>	<u>Statutory Reserve YR 000s</u>	<u>General Reserve YR 000s</u>	<u>Retained Earnings YR 000s</u>	<u>Total YR 000s</u>
Year 2005					
Balance at beginning of the year	1,250,000	142,607	209,000	11,972	1,613,579
Capital increase from reserves	220,000	-	(209,000)	(11,000)	-
Capital increase - cash	<u>504,297</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>504,297</u>
Balance at end of the year	<u>1,974,297</u>	<u>142,607</u>	<u>-</u>	<u>972</u>	<u>2,117,876</u>

(The accompanying notes from 1 to 41 form part of these financial statements)


Chairman

General Manager

Financial Manager



Auditor's report attached.


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ISLAMIC BANK OF YEMEN FOR FINANCE AND INVESTMENT
SANA'A, REPUBLIC OF YEMEN

STATEMENT OF SOURCES AND USES OF QARD HASAN
FOR THE YEAR ENDED DECEMBER 31, 2006

	<u>2006</u> <u>YR 000s</u>	<u>2005</u> <u>YR 000s</u>
<u>Opening balance, represented in:</u>		
Outstanding loans	21,169	10,533
<u>Add: Sources of Qard Hasan</u>		
Transfer from customers' current accounts	38,261	17,114
<u>Less: Uses of Qard Hasan</u>		
Payment to customers' current accounts	(16,345)	(6,478)
<u>Ending balance, represented in:</u>		
Outstanding loans	43,085	21,169
Less: provision of Qard Hasan	(2,254)	(3,396)
	<u>40,831</u>	<u>17,773</u>

(The accompanying notes from 1 to 41 form part of these financial statements)

Chairman



General Manager



Financial Manager



Auditor's report attached.



M. Zohdi Mejanni
(KPMG Mejanni, Hazem Hassan & Co.)



TRANSLATION FROM ORIGINAL ARABIC TEXT

**ISLAMIC BANK OF YEMEN FOR FINANCE AND INVESTMENT
SANA'A, REPUBLIC OF YEMEN**

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2006**

1. BACKGROUND INFORMATION

The Islamic Bank of Yemen for Finance and Investment, a Yemeni Joint – Stock Company (Y.S.C.) was incorporated pursuant to the Minister of Trade and Supply Decree No. 137 of 1995. The bank carries out its banking activity in the Republic of Yemen through its Head office and 5 branches in Sana'a, Hodeidah, Taiz and Aden (Crater and Sheikh Othman).

The Bank was established for the purpose of covering the social and economic needs in investment, finance and banking services in conformity with the principles of the Islamic Shari'a. The Bank commenced operations on June 8, 1996. In accordance with Article No. (26) of Law No. (21) for 1996 regarding Islamic Banks, the Bank is entitled to all privileges and exemptions as stated in the Investment Law.

2. PREPARATION BASIS OF THE FINANCIAL STATEMENTS

The financial statements are prepared under the historical cost principle in accordance with Accounting Standards for Islamic Financial Institutions, local prevailing laws and regulations and in the light of rules and instructions issued by Central Bank of Yemen.

3. SIGNIFICANT ACCOUNTING POLICIES

3-1. Translation of foreign currencies

The bank maintains its accounting records in Yemeni Rial. Transactions in other currencies are recorded during the financial year at the prevailing exchange rates at the date of transaction. Balances of monetary assets and liabilities in other currencies at the end of the financial year are translated at the prevailing exchange rates on that date. Gains or losses resulting from translation are taken to the statement of income.

3-2. Revenue recognition

A. Murabaha

- Profits on Murabaha contracts are recorded on the accrual basis as all profits at the completion of Murabaha contract are recorded as deferred revenues and taken to the statement of income, based on the finance percentage, using the straight line method over the term of contract.
- In order to comply with the requirements of CBY, the bank does not accrue the revenues relating to non-performing Murabaha contracts.

TRANSLATION FROM ORIGINAL ARABIC TEXT

**ISLAMIC BANK OF YEMEN FOR FINANCE AND INVESTMENT
SANA'A, REPUBLIC OF YEMEN**

**NOTES TO THE FINANCIAL STATEMENTS (continued)
FOR THE YEAR ENDED DECEMBER 31, 2006**

B. Mudaraba and Musharaka

- Profits on Mudaraba and Musharaka contracts, which initiate and terminate during the financial year, are recorded in the statement of income at the liquidation date of the contract.
- Profits on Mudaraba and Musharaka contracts, which last for more than one financial year, are recorded, based on cash profits distributed on these transactions during the year.

C. Available for sale investments

Income from available for sale investments is recognized when its related dividends are distributed.

3-3. *Valuation of Murabaha financing transactions*

- Debts related to Murabaha financing transactions whether short or long term are recorded at cost in addition to agreed-upon profits in Murabaha contracts. In order to comply with the requirements of CBY, a provision is provided for specific Murabaha contracts and contingent liabilities, in addition to a percentage for general risk calculated on the total of other Murabaha contracts and contingent liabilities after deducting balances secured by deposits and banks' guarantees issued by worthy banks. The provision is determined based on periodical comprehensive reviews of the portfolio and contingent liabilities and made in accordance with the following minimum rates:

<u>Performing debts and special attention</u>	1%
<u>Non-performing debts:</u>	
Substandard debts	15%
Doubtful debts	45%
Bad debts	100%

- Debts relating to financing Murabaha transactions are written off if procedures taken toward their collection prove useless, or if directed by CBY examiners upon review of the portfolio. Proceeds from debts previously written off in prior years are credited to the provision.

TRANSLATION FROM ORIGINAL ARABIC TEXT

**ISLAMIC BANK OF YEMEN FOR FINANCE AND INVESTMENT
SANA'A, REPUBLIC OF YEMEN**

**NOTES TO THE FINANCIAL STATEMENTS (continued)
FOR THE YEAR ENDED DECEMBER 31, 2006**

- Debts relating to financing Murabaha transactions whether short or long term are presented on the balance sheet net provision, (non-performing debts provision and general risk provision on performing debts), deferred revenues and suspense revenues.

3-4. Valuation of Mudaraba and Musharaka contracts

- Investments in cash Mudaraba and Musharaka contracts are recorded on the basis of the amount paid to the capital of Mudaraba or Musharaka, while investments in inkind Mudaraba and Musharaka contracts are recorded based on the agreed-upon value between the bank and the customer or partner. Any differences between this value and the book value are recorded as profits or losses in the income statement.

In order to comply with the requirements of CBY, a provision is provided for specific Mudaraba and Musharaka contracts which recognized losses, in addition to a percentage for general risk calculated on the total of other Mudaraba and Musharaka contracts after deducting balances secured by the deposits and bank's guarantees issued by worthy banks.

The provision is determined based on periodical comprehensive reviews of the portfolio and made in accordance with the following rates:

<u>Performing debts and special attention</u>	1%
<u>Non-performing debts:</u>	
Substandards debts	15%
Doubtful debts	45%
Bad debts	100%

- At the end of each financial year, Mudaraba and Musharaka capitals are reduced by losses incurred. These losses are charged to the income statement.
- Investments in Mudaraba and Musharaka contracts are presented on the balance sheet at carrying value (cost less recognized losses and related provisions).

3.5. Valuation of available for sale investments

Available for sale investments are recorded at acquisition cost. At the financial statements date, they are individually valued at fair value. Valuation differences are charged to the statement of income in accordance with Central Bank of Yemen instructions.

In case that reliable estimate of the fair value of these investments can not be obtained, due to lack of quoted market prices, they are recorded at cost.

TRANSLATION FROM ORIGINAL ARABIC TEXT

**ISLAMIC BANK OF YEMEN FOR FINANCE AND INVESTMENT
SANA'A, REPUBLIC OF YEMEN**

**NOTES TO THE FINANCIAL STATEMENTS (continued)
FOR THE YEAR ENDED DECEMBER 31, 2006**

3.6. Valuation of investment property

Investment property purchased by the bank for trading purposes are recorded at historical cost at financial statement date less impairment losses, if any, according to CBY instructions.

3-7. Valuation of restricted investments

Murabaha transactions and other investments financed by restricted investment accounts are recorded on the same valuation bases mentioned above with related profits (losses) and related provisions are taken to restricted investment accounts net of the bank's share for managing these investments.

3-8. Valuation of assets for which titles have been transferred to the bank as a repayment of loans

Assets for which titles have been transferred to the bank or assets which the bank has otherwise taken possession are included in the balance sheet under "Debt balances and other assets" at the values carried by the bank less any decline in its values at the financial statements date. This decline is charged to the statement of income.

3-9. Contingent liabilities and commitments

Contingent liabilities, in which the bank is a party, are presented off balance sheet under "contingent liabilities and commitments" as they do not represent actual assets or liabilities at the balance sheet date.

3-10. Cash and cash equivalent

For the purpose of preparing the statement of cash flows, cash and cash equivalent consist of cash on hand, cash balances with Central Bank of Yemen, other than reserve balances, and demand deposits with other banks.

3-11. Property, equipment and depreciation

Property and equipment are stated at cost less accumulated depreciation and impairment losses, if any. Depreciation is charged to the statement of income on the straight-line method over the estimated useful life of property and equipment except land at the following rates:

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**ISLAMIC BANK OF YEMEN FOR FINANCE AND INVESTMENT
SANA'A, REPUBLIC OF YEMEN**

**NOTES TO THE FINANCIAL STATEMENTS (continued)
FOR THE YEAR ENDED DECEMBER 31, 2006**

	<u>Estimated useful lives</u>
Buildings	40 years
Equipment	5 - 8 years
Motor vehicles	5 years
Furniture and fixtures	5 - 33 years
Computer equipment	5 years

3.12. Impairment of assets

The Bank reviews the carrying amounts of the assets, according to its materiality, at the balance sheet date to determine whether there is any indication of impairment. If such indication exists, the assets' recoverable amount is estimated and compared with the carrying amount and any excess in the carrying amount is charged to the statement of income.

Any increase in the value of the assets is also recognized in the statement of income provided that the increase does not exceed the original recoverable value of the asset before impairment.

3.13. End of service bonus

End of service bonus is calculated for uninsured bank employees on the basis of one month salary for each year of service. These bonuses are recorded under "other provisions"

3-14. Taxation

- Corporate tax is calculated in accordance with the prevailing laws and regulations in Republic of Yemen.
- Due to the characteristics of the tax accounting in Yemen, provision for tax liabilities relating to deferred taxes is formed. In case of deferred tax assets, these assets are not certain to be realized in the near future. Accordingly, such assets are not recorded.

3-15. Statement of changes in restricted investments

Statement of changes in restricted investments present investments fully financed through funds received by the bank from restricted investment accounts. The bank manages restricted investments, as an agent for fees. The bank does not participate in the investment's outcome and the movement of restricted investments are presented in the statement of changes in restricted investments.

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**ISLAMIC BANK OF YEMEN FOR FINANCE AND INVESTMENT
SANA'A, REPUBLIC OF YEMEN**

**NOTES TO THE FINANCIAL STATEMENTS (continued)
FOR THE YEAR ENDED DECEMBER 31, 2006**

3-16. Prohibited revenues

Revenue prohibited by Islamic Sharia' (CBY interest on reserve balances) are recorded under "Credit balances and other liabilities" on the balance sheet. They are utilized in the areas approved by the bank's Sharia' Board

4. SUPERVISION OF CENTRAL BANK OF YEMEN

The bank's business activities are subject to the supervision of Central Bank of Yemen in accordance with the prevailing laws related to banks and Islamic banks.

5. SHARIA' BOARD

The bank's business activities are subject to the supervision of Sharia' Board consisting of 3 members appointed by the bank's general assembly. Their responsibilities are supervision of the sharia' aspects of the bank's activities according to Islamic sharia' regulations.

6. ZAKAT

Zakat is computed according to the Sharia' Board of the bank and collected from the shareholders. The amount collected is remitted to the related Governmental authority, which decides on the allocation of the Zakat.

7. FINANCIAL INSTRUMENTS AND MANAGING THEIR RELATED RISKS

7.1 Financial instruments

- a. The bank's financial instruments are represented in financial assets and liabilities. Financial assets include cash balances, current accounts, deposits with banks and financing of Murabaha, Mudaraba and Musharaka transactions and related debts. Financial liabilities include current and saving accounts, due to banks and investment accounts. Also, financial instruments include rights and obligations stated in contingent liabilities and commitments.

Note (3) to the financial statements includes significant accounting policies applied for recording and measuring significant financial instruments and their related revenues and expenses.

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**ISLAMIC BANK OF YEMEN FOR FINANCE AND INVESTMENT
SANA'A, REPUBLIC OF YEMEN**

**NOTES TO THE FINANCIAL STATEMENTS (continued)
FOR THE YEAR ENDED DECEMBER 31, 2006**

b. Fair value of financial instruments

Based on valuation bases of the bank's assets and liabilities stated in the notes to the financial statements, the fair value of the financial instruments do not differ fundamentally from their book values at the balance sheet date.

c. Forward contracts

The bank does not engage in forward contracts to meet its obligations in foreign currencies, nor does it engage in foreign exchange contracts to cover the risk of future settlement in foreign currencies.

7.2 *Managing related risks*

a. Return rate risk

Return due on unrestricted investment and saving accounts is determined on the basis of Mudaraba contract, which determines profit (loss) sharing basis during the period. Accordingly, any change in the profitability level will determine the return ratio that the bank could pay to unrestricted investment accounts holders. Therefore, the bank is not exposed, directly, to the risk of change in return rate.

b. Credit risk

Financing of Murabaha, Mudaraba and Musharaka transactions and their related debts, current accounts, deposits with banks and rights and obligations from others are considered financial assets exposed to credit risk. Credit risk represents the inability of these parties to meet their obligations when they fall due. In order to comply with CBY requirements (Circular No. 10 of 1997), the bank adheres to certain minimum standards in order to properly manage its credit risk as follows:

- Preparing credit studies on customers and banks before dealing with them and determining their related credit risk rating.
- Obtaining sufficient collaterals to minimize the credit risk exposure which may result in cases of insolvency of customers and banks.
- Following up and periodical reviews of customers and banks in order to evaluate their financial positions, credit rating and the required provision for non-performing debts.
- Distributing credit portfolio and investments over diversified sectors to minimize concentration or credit risk.

Note No. (37) to the financial statements indicates the distribution of assets, liabilities and contingent liabilities and commitments at balance sheet date.

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**ISLAMIC BANK OF YEMEN FOR FINANCE AND INVESTMENT
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**NOTES TO THE FINANCIAL STATEMENTS (continued)
FOR THE YEAR ENDED DECEMBER 31, 2006**

c. Exchange rate risk

Due to the nature of the bank's activity, the bank deals in different foreign currencies, hence it is exposed to exchange rate risk. In order to minimize the exposure to exchange rate risk, the bank is trying to maintain balanced foreign currencies positions in compliance with the Central Bank of Yemen instructions and the requirements of CBY circular No. 6 of 1998 specifying that individual foreign currency position should not exceed 15% of the bank's capital and reserves, and that the aggregate open position for all foreign currencies should not exceed 25% of a bank's capital. Note (38) to the financial statement indicates the significant foreign currencies' positions at the balance sheet date.

8. CASH ON HAND AND RESERVE BALANCES WITH CENTRAL BANK OF YEMEN

	<u>2006</u> <u>YR 000s</u>	<u>2005</u> <u>YR 000s</u>
Cash on hand - local currency	173,453	184,838
Cash on hand - foreign currency	<u>236,837</u>	<u>327,355</u>
	<u>410,290</u>	<u>512,193</u>
Reserve balance with CBY - local currency	605,375	632,318
Reserve balance with CBY - foreign currency	<u>1,236,717</u>	<u>2,521,799</u>
	<u>1,842,092</u>	<u>3,154,117</u>
	<u>2,252,382</u>	<u>3,666,310</u>

The reserve balances with Central Bank of Yemen represent the minimum reserve requirements against customers' accounts in Yemeni Rial and foreign currencies. These funds are not available for the Bank's daily business.

9. DUE FROM BANKS AND FINANCIAL INSTITUTIONS

	<u>2006</u> <u>YR 000s</u>	<u>2005</u> <u>YR 000s</u>
a. Central Bank of Yemen		
Current accounts - local currency	552,592	118,687
Current accounts - foreign currency	<u>121,323</u>	<u>30,531</u>
	<u>673,915</u>	<u>149,218</u>
b. Local banks		
Current accounts	<u>105,838</u>	<u>213</u>
c. Foreign banks		
Current accounts	1,107,498	660,168
Investment deposits	<u>207,500</u>	<u>141,813</u>
	<u>1,314,998</u>	<u>801,981</u>
	<u>2,094,751</u>	<u>951,412</u>

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10. FINANCING MURABAHA TRANSACTIONS (NET)

	<u>Note</u>	<u>2006</u> <u>YR 000s</u>	<u>2005</u> <u>YR 000s</u>
Financing Murabaha transactions - local		8,345,134	9,726,777
Financing Murabaha transactions - foreign		-	175,364
		<u>8,345,134</u>	<u>9,902,141</u>
Less:			
- Murabaha transactions provision	11	(1,609,402)	(1,501,329)
- Suspense revenues		(379,782)	(326,797)
- Deferred revenues		(343,870)	(465,588)
		<u>6,012,080</u>	<u>7,608,427</u>
Less: Transferred to restricted investments		-	(771,508)
		<u>6,012,080</u>	<u>6,836,919</u>

- Non-performing Murabaha transactions installments amounted to YR / 2,862 / Million at 31/12/2006 (YR /2,199/ Million at 31/12/2005).
- The shortfall in Murabaha amounted to YR / 656 / Million in addition to YR / 1,176 / Million being the shortfall in the provision debit balances and other assets at 31/12/2006.

(The shortfall in Murabaha provision amounted to YR /746/ Million in addition to YR /799/ Million being the shortfall in the provision for debit balances and other assets at 31/12/2005.)

11. FINANCING MURABAHA TRANSACTIONS PROVISION (NON-PERFORMING)

	<u>2006</u>			<u>2005</u>		
	<u>Specific</u> <u>YR 000s</u>	<u>General</u> <u>YR 000s</u>	<u>Total</u> <u>YR 000s</u>	<u>Specific</u> <u>YR 000s</u>	<u>General</u> <u>YR 000s</u>	<u>Total</u> <u>YR 000s</u>
Balance at beginning of the year	1,501,329	-	1,501,329	798,700	78,143	876,843
Used during the year	(5,817)	-	(5,817)	(5,982)	-	(5,982)
Provided during the year	11,279	-	11,279	397,616	-	397,616
Transfer from general to specific		-	-	78,143	(78,143)	-
Transfer from Mushraka	2,622	-	2,622	1,956	-	1,956
Transfer from Mudaraba	240	-	240	1,857	-	1,857
Transfer from Qard Hasan	1,142	-	1,142			
Transfer from contingent liabilities	51,355	-	51,355	22,330	-	22,330
Provided during the year (from credit balances)	<u>47,252</u>	<u>-</u>	<u>47,252</u>	<u>206,709</u>	<u>-</u>	<u>206,709</u>
	<u>1,609,402</u>	<u>-</u>	<u>1,609,402</u>	<u>1,501,329</u>	<u>-</u>	<u>1,501,329</u>

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12. INVESTMENTS IN MUSHARAKA CONTRACTS (NET)

	<u>Note</u>	<u>2006</u> <u>YR 000s</u>	<u>2005</u> <u>YR 000s</u>
Taib Bank – external investment		105,860	104,040
Tadhamon International Islamic Bank – internal investment		<u>-</u>	<u>264,063</u>
		105,860	368,103
Less: Musharaka contracts provision	13	<u>(1,059)</u>	<u>(3,681)</u>
		<u>104,801</u>	<u>364,422</u>

13. MUSHRAKA CONTRACTS PROVISION (PERFORMING)

	<u>2006</u>			<u>2005</u>		
	<u>Specific</u> <u>YR 000s</u>	<u>General</u> <u>YR 000s</u>	<u>Total</u> <u>YR 000s</u>	<u>Specific</u> <u>YR 000s</u>	<u>General</u> <u>YR 000s</u>	<u>Total</u> <u>YR 000s</u>
Balance at beginning of the year	-	3,681	3,681	-	5,637	5,637
Transfer to Murabaha	<u>-</u>	<u>(2,622)</u>	<u>(2,622)</u>	<u>-</u>	<u>(1,956)</u>	<u>(1,956)</u>
Balance at end of the year	<u>-</u>	<u>1,059</u>	<u>1,059</u>	<u>-</u>	<u>3,681</u>	<u>3,681</u>

14. INVESTMENTS IN MUDARABA CONTRACTS (NET)

	<u>Note</u>	<u>2006</u> <u>YR 000s</u>	<u>2005</u> <u>YR 000s</u>
Dallah Albaraka – external investment		496,393	487,845
Qatar Islamic Bank – external investment		<u>-</u>	<u>32,514</u>
		496,393	520,359
Less: Mudaraba contracts provision	15	<u>(4,964)</u>	<u>(5,204)</u>
		<u>491,429</u>	<u>515,155</u>

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15. MUDARABA CONTRACTS PROVISION (PERFORMING)

	2006			2005		
	Specific YR 000s	General YR 000s	Total YR 000s	Specific YR 000s	General YR 000s	Total YR 000s
Balance at beginning of the year	-	5,204	5,204	-	7,061	7,061
Transfer to Murabaha	-	(240)	(240)	-	(1,857)	(1,857)
Balance at end of the year	-	<u>4,964</u>	<u>4,964</u>	-	<u>5,204</u>	<u>5,204</u>

16. AVAILABLE FOR SALE INVESTMENTS

	2006 YR 000s	2005 YR 000s
Yemeni Center for Conciliation & Arbitration	230	230
Yemen Islamic Insurance Company	10,760	11,073
Financial Services Company	59,553	58,524
The Yemen Islamic Co. for Foam Manufacturing	-	67,025
Yemen Mobile	<u>120,000</u>	<u>-</u>
	<u>190,543</u>	<u>136,852</u>

All available for sale investments are local investments.

17. INVESTMENT PROPERTY

	2006 YR 000s	2005 YR 000s
Artel Region Land	<u>280,092</u>	<u>276,161</u>

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18. DEBIT BALANCES AND OTHER ASSETS (NET)

	<u>Note</u>	<u>2006</u> <u>YR 000s</u>	<u>2005</u> <u>YR 000s</u>
Overdraft		1,068,653	1,595,111
Unpaid L/Cs		2,187,841	3,235,674
Assets which titles have been transferred to the Bank's ownership	3/8	244,090	86,756
Employees advances		33,180	32,748
Accrued income		44,316	43,643
Prepaid expenses		35,704	24,721
Stationary inventory		21,672	20,373
Others		<u>751,414</u>	<u>757,057</u>
		4,386,870	5,796,083
Less: provision for debit balance	19	(<u>440,685</u>)	(<u>440,685</u>)
		<u>3,946,185</u>	<u>5,355,398</u>

19. PROVISION FOR DEBIT BALANCES AND OTHER ASSETS

	<u>2006</u> <u>YR 000s</u>	<u>2005</u> <u>YR 000s</u>
Balance at beginning of the year	440,685	444,814
Provision used during the year	<u>-</u>	(<u>4,129</u>)
Balance at the end of the year	<u>440,685</u>	<u>440,685</u>

20. PROPERTY AND EQUIPMENT (NET)

	<u>2006</u>			<u>2005</u>
	<u>Cost</u> <u>YR 000s</u>	<u>Accumulated</u> <u>Depreciation</u> <u>YR 000s</u>	<u>Net</u> <u>YR 000s</u>	<u>Net</u> <u>YR 000s</u>
Buildings	66,518	946	65,572	78,729
Equipment and machinery	125,638	81,771	43,867	53,442
Motor vehicles	53,182	39,453	13,729	20,035
Furniture and fixtures	160,127	102,365	57,762	67,081
Computers	<u>255,952</u>	<u>203,125</u>	<u>52,827</u>	<u>68,280</u>
Total	<u>661,417</u>	<u>427,660</u>	<u>233,757</u>	<u>287,567</u>

Depreciation for the year 2006 is YR / 67,967 / thousand (YR / 69,267 / thousand for the year 2005).

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21. CURRENT ACCOUNTS AND OTHER DEPOSITS

	<u>2006</u> <u>YR 000s</u>	<u>2005</u> <u>YR 000s</u>
Current accounts – local currency	956,640	737,720
Current accounts – foreign currency	<u>1,306,069</u>	<u>2,492,559</u>
	<u>2,262,709</u>	<u>3,230,279</u>
Cash margin – local currency	375,153	301,393
Cash margin – foreign currency	1,646,874	1,614,376
Other deposits	<u>55,703</u>	<u>30,305</u>
	<u>2,077,730</u>	<u>1,946,074</u>
	<u>4,340,439</u>	<u>5,176,353</u>

22. CREDIT BALANCES AND OTHER LIABILITIES

	<u>Note</u>	<u>2006</u> <u>YR 000s</u>	<u>2005</u> <u>YR 000s</u>
Accrued expenses		63,617	95,720
Prohibited revenues by Islamic Shari'a	23	-	27,065
Other credit balances		<u>116,525</u>	<u>947,557</u>
		<u>180,142</u>	<u>1,070,342</u>

23. PROHIBITED REVENUES BY ISLAMIC SHARI'A

The following represent revenues from transactions prohibited by the Islamic Shaira' during the year, mainly interest on reserve balances with CBY, and its disbursement channels:

	<u>2006</u> <u>YR 000s</u>	<u>2005</u> <u>YR 000s</u>
Balance at the beginning of the year		
Donations	27,065	-
Resources		
Prohibited revenues by Islamic Sharia'a	61,262	334,788
Uses		
Donation	(41,075)	(101,014)
Provided provision during the year	<u>(47,252)</u>	<u>(206,709)</u>
Balance at the end of the year	<u>-</u>	<u>27,065</u>

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24. OTHER PROVISIONS

	2006				Balance at end of the year YR 000s
	Balance at beginning of the year YR 000s	Provided during the year YR 000s	Used during the year YR 000s	Transfer to Murabaha YR 000s	
Provision for contingent liabilities	129,008	-	-	(51,355)	77,653
Provision for end of service compensation	<u>13,001</u>	<u>10,448</u>	<u>(9,303)</u>	<u>-</u>	<u>14,146</u>
	<u>142,009</u>	<u>10,448</u>	<u>(9,303)</u>	<u>(51,335)</u>	<u>91,799</u>

	2005				Balance at end of the year YR 000s
	Balance at beginning of the year YR 000s	Provided during the year YR 000s	Used during the year YR 000s	Transfer to Murabaha YR 000s	
Provision for contingent liabilities	151,338	-	-	(22,330)	129,008
Provision for end of service compensation	<u>8,057</u>	<u>13,816</u>	<u>(8,872)</u>	<u>-</u>	<u>13,001</u>
	<u>159,395</u>	<u>13,816</u>	<u>(8,872)</u>	<u>(22,330)</u>	<u>142,009</u>

25. UNRESTRICTED INVESTMENT AND SAVING ACCOUNTS' HOLDERS

	2006 YR 000s	2005 YR 000s
Unrestricted investment deposits – local currency	3,509,322	3,278,837
Unrestricted investment deposits – foreign currency	<u>2,708,103</u>	<u>1,919,498</u>
	<u>6,217,425</u>	<u>5,198,335</u>
Saving deposits – local currency	1,111,341	1,071,430
Saving deposits – foreign currency	<u>625,403</u>	<u>776,254</u>
	<u>1,736,744</u>	<u>1,847,684</u>
Return of unrestricted investment and savings accounts	<u>720,000</u>	<u>643,000</u>
	<u>8,674,169</u>	<u>7,689,019</u>

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**NOTES TO THE FINANCIAL STATEMENTS (continued)
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26. CAPITAL

The capital of the Bank is YR / 3.15 /Billion represented in / 3.15 /Million shares of a nominal value of YR /1,000/ each as required by Central Bank of Yemen board of directors decision no. 12 of 2004. The following is paid-up capital:

	<u>YR 000s</u>
Capital	3,150,000
Less: Unpaid amounts	(1,138,768)
Paid-up capital	<u>2,011,232</u>

27. RESERVES

According to the Law and the Bank's Articles of Association, 15% of net profit for the year is transferred to statutory reserve till it equals two times paid-up capital.

28. RETURN OF UNRESTRICTED INVESTMENT AND SAVING ACCOUNTS HOLDERS

The share of unrestricted investment and saving accounts holders is determined by distributing total return between shareholders and customers based on the percentage of their contributions weighted by numbers. This calculation is proposed by the budget committee and approved by the Board of Directors. The investment return is as follows:

	<u>2006</u>		<u>2005</u>	
	Yemeni Rial	Foreign Currency	Yemeni Rial	Foreign Currency
	%	%	%	%
Unrestricted deposits	15.17	5.66	13.65	4.55
Deposits for one year	14.22	5.30	12.80	4.26
Deposits for 9 months	13.27	4.95	11.94	3.98
Deposits for 6 months	11.38	4.24	10.24	3.41
Deposits for 3 months	10.43	3.89	9.38	3.13
Saving accounts	9.48	3.54	8.53	2.84

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29. CONTINGENT LIABILITIES AND COMMITMENTS

	<u>2006</u> <u>YR 000s</u>	<u>2005</u> <u>YR 000s</u>
Letters of credit	5,218,662	8,709,069
Letters of guarantee	4,260,069	5,672,206
Other	<u>308,567</u>	<u>434,876</u>
	9,787,298	14,816,151
Less: Margin held	<u>(2,022,026)</u>	<u>(1,915,378)</u>
	<u><u>7,765,272</u></u>	<u><u>12,900,773</u></u>

30. REVENUES OF OTHER JOINT INVESTMENTS

	<u>2006</u> <u>YR 000s</u>	<u>2005</u> <u>YR 000s</u>
Revenues of investments in Musharka contracts	17,689	75,908
Revenues of investment Mudaraba contracts	9,459	-
Revenues of investment deposits	<u>9,399</u>	<u>-</u>
	<u><u>36,547</u></u>	<u><u>75,908</u></u>

31. COMMISSIONS AND FEES INCOME ON BANKING SERVICES

	<u>2006</u> <u>YR 000s</u>	<u>2005</u> <u>YR 000s</u>
Commissions on documentary credits	273,664	375,334
Commissions on letters of guarantee	92,690	91,540
Commissions on transfer of funds	13,979	41,356
Customers services charges	<u>193,569</u>	<u>111,219</u>
	<u><u>573,902</u></u>	<u><u>619,449</u></u>

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32. GAINS OF FOREIGN CURRENCY TRANSACTIONS

	<u>2006</u> <u>YR 000s</u>	<u>2005</u> <u>YR 000s</u>
Profit of dealing in foreign currencies	130,224	112,475
Gain from revaluation of foreign currencies	<u>52,453</u>	<u>149,275</u>
	<u><u>182,677</u></u>	<u><u>261,750</u></u>

33. OTHER OPERATING INCOME

	<u>2006</u> <u>YR 000s</u>	<u>2005</u> <u>YR 000s</u>
Profit (loss) of disposal of property	3,650	421
Others	<u>19,647</u>	<u>19,456</u>
	<u><u>23,297</u></u>	<u><u>19,877</u></u>

34. PROVISIONS CHARGED TO STATEMENT OF INCOME

	Note	<u>2006</u> <u>YR 000s</u>	<u>2005</u> <u>YR 000s</u>
Murabaha provision	11	11,279	397,616
End of service compensation provision	24	10,448	13,816
Qard Hasan provision		<u>-</u>	<u>2,470</u>
		<u><u>21,727</u></u>	<u><u>413,902</u></u>

35. GENERAL AND ADMINISTRATIVE EXPENSES AND DEPRECIATION

	Note	<u>2006</u> <u>YR 000s</u>	<u>2005</u> <u>YR 000s</u>
Wages and salaries		273,988	258,830
Depreciation of property & equipment	20	67,967	69,267
Insurance		8,585	16,360
Stationary		9,712	14,012
Communication		18,897	24,211
Water and electricity		8,824	9,092
Rent		24,521	20,507
Advertising		17,751	11,312
Transportation		19,071	48,426
Maintenance and fuel		18,284	22,636
Entertainment expenses		13,895	15,071
Taxes and duties		32,141	63,585
Professional fees		3,766	3,353
Zakat		53,317	45,809
Others		<u>18,458</u>	<u>21,282</u>
		<u><u>589,177</u></u>	<u><u>643,753</u></u>

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36. MATURITIES OF ASSETS AND LIABILITIES

	Due within 3 months <u>YR Million</u>	Due within 6 months <u>YR Million</u>	Due within 9 months <u>YR Million</u>	Due within one year <u>YR Million</u>	Due within more than one year <u>YR Million</u>	Total <u>YR Million</u>
a. <u>Assets</u>						
Cash on hand and reserve balances with CBY	2,252	-	-	-	-	2,252
Due from banks and fin'l. institution	2,095	-	-	-	-	2,095
Murabaha financing contracts	4,120	2,095	426	750	954	8,345
Investments in Musharaka contracts	62	44	-	-	-	106
Investments in Mudaraba contracts	320	176	-	-	-	496
Available for sale investments	-	-	-	-	191	191
Investment property	-	-	-	-	280	280
Overdraft	1,069	-	-	-	-	1,069
Unpaid L/Cs	520	490	480	697	-	2,187
	10,438	2,805	906	1,447	1,425	17,021
b. <u>Liabilities</u>						
Current accounts and other deposits	4,340	-	-	-	-	4,340
Due to banks and fin'l. institution	205	-	-	-	-	205
Unrestricted investments	4,960	340	154	75	3,145	8,674
	9,505	340	154	75	3,145	13,219

**37. DISTRIBUTION OF ASSETS, LIABILITIES, AND CONTINGENT LIABILITIES
AND COMMITMENTS**

	Manufac- turing <u>YR Million</u>	Trade <u>YR Million</u>	Agricultural and Fishing <u>YR Million</u>	Financial <u>YR Million</u>	Individual and Others <u>YR Million</u>	Total <u>YR Million</u>
<u>Assets</u>						
Murabaha financing contracts	1,670	5,450	691	-	534	8,345
Investments in Musharaka contracts	-	-	-	106	-	106
Investments in Mudaraba contracts	-	-	-	496	-	496
Available for sale investments	-	-	-	191	-	191
Investment property	-	280	-	-	-	280
<u>Liabilities</u>						
Current accounts	505	1,647	240	-	1,948	4,340
Othe deposits	-	-	-	-	-	-
Due to banks and fin'l. instituion	-	-	-	205	-	205
Unrestricted investments	-	5,350	1,834	-	1,490	8,674
<u>Contingent liabilities</u>						
L/Gs	545	3,715	-	-	-	4,260
L/Cs	-	-	5,219	-	-	5,219
Others	-	140	77	-	92	309

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38. SIGNIFICANT FOREIGN CURRENCIES' POSITIONS

To comply with CBY circular No. 6 of 1998, the bank establishes limits for positions in individual foreign currencies as well as an aggregate limitation for all currencies. These limits are 15% and 25% of capital and reserves respectively. The following schedule reflects the bank's significant foreign currencies positions at balance sheet date.

	<u>2006</u>		<u>2005</u>	
	<u>Surplus (deficit) YR 000's</u>	<u>% of capital & reserves</u>	<u>Surplus (deficit) YR 000's</u>	<u>% of capital & reserves</u>
US Dollar	144,064	7%	526,937	25%
EURO	(11,018)	(1%)	(118,321)	(6%)
Sterling Pound	(6,324)	-	(11,098)	(1%)
Saudi Arabia Rial	(93,301)	(4%)	1,430	-
Other	(620)	-	616	-
Surplus (deficit)	<u>32,801</u>	<u>2%</u>	<u>399,564</u>	<u>19%</u>

39. TRANSACTIONS WITH RELATED PARTIES

The bank in its ordinary activity deals with some companies owned by shareholders of the bank or the board of directors. These transactions represent Murabaha financing and other transactions. The balances of these transactions with related parties at the balance sheet date are as follows:

	<u>2006 YR Millions</u>	<u>2005 YR Millions</u>
Murabaha financing contracts	165	234
Debit balances and other assets	11	52
Unrestricted investment accounts	993	131
Current and saving accounts	148	1,053
Credit balances	197	181

40. TAXATION

- There is a legal dispute with the Tax Authority which was not settled until the financial statements preparation date regarding the Bank's profits (as well as all Islamic banks operating in Yemen) during the exemption period, ended on June 7, 2003, being subject to tax. The Bank's management believes that there is no liability on the Bank due to the strong position of the Bank and his tax exemption according to the prevailing laws.

TRANSLATION FROM ORIGINAL ARABIC TEXT

**ISLAMIC BANK OF YEMEN FOR FINANCE AND INVESTMENT
SANA'A, REPUBLIC OF YEMEN**

**NOTES TO THE FINANCIAL STATEMENTS (continued)
FOR THE YEAR ENDED DECEMBER 31, 2006**

- The Bank submitted his voluntary tax declaration for the year 2004 in time and remitted the amount due.

41. ZAKAT POSITION

The Bank has submitted his zakat declaration for the year 2005 in time and remitted the amount due.
