

## Arab National Bank – Saudi Joint Stock Company

### BALANCE SHEET

As at December 31, 2006 and 2005

	Notes	2006 SAR' 000	2005 SAR' 000
<b>ASSETS</b>			
Cash and balances with SAMA	3	3,216,007	2,495,186
Due from banks and other financial institutions	4	4,633,337	3,933,675
Investments, net	5	18,291,558	20,422,650
Loans and advances, net	6	49,747,224	38,778,556
Other real estate		155,127	158,865
Property and equipment, net	7	586,251	418,108
Other assets	8	1,405,879	1,285,039
<b>Total assets</b>		<b>78,035,383</b>	<b>67,492,079</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
<b>Liabilities</b>			
Due to banks and other financial institutions	10	3,098,603	8,376,934
Customer deposits	11	61,773,494	48,832,464
Other liabilities	12	1,995,648	2,633,502
Term Loan	13	1,312,500	1,312,500
Debt securities in issue	13	1,875,000	-
<b>Total liabilities</b>		<b>70,055,245</b>	<b>61,155,400</b>
<b>Shareholders' equity</b>			
Share capital	14	3,250,000	2,500,000
Statutory reserve	15	3,150,000	2,500,000
General reserve	15	1,300,000	780,000
Other reserves		19,841	217,690
Retained earnings		260,297	64,242
Proposed dividend	26	-	274,747
<b>Total shareholders' equity</b>		<b>7,980,138</b>	<b>6,336,679</b>
<b>Total liabilities and shareholders' equity</b>		<b>78,035,383</b>	<b>67,492,079</b>

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

## Arab National Bank – Saudi Joint Stock Company

### STATEMENT OF INCOME

For the years ended December 31, 2006 and 2005

	Notes	2006 SAR' 000	2005 SAR' 000
Special commission income	17	4,659,311	3,445,180
Special commission expense	17	<u>2,134,354</u>	<u>1,256,051</u>
Net special commission income		2,524,957	2,189,129
Fees from banking services, net	18	986,501	693,915
Exchange income, net		134,955	113,956
Income from FVIS financial instruments, net	19	29,745	259
Trading income, net	20	2,612	17,614
Dividend income	21	-	2,396
Gains on non-trading investments, net	22	106,033	90,670
Other operating income	23	<u>70,569</u>	<u>33,753</u>
Total operating income		<u>3,855,372</u>	<u>3,141,692</u>
Salaries and employee related expenses		770,468	657,689
Rent and premises related expenses		80,465	62,146
Depreciation and amortization	7	84,107	75,544
Other general and administrative expenses		331,978	251,339
Provision for credit losses	6	82,986	248,390
Impairment of other financial assets		-	18,750
Other operating expenses	24	<u>643</u>	<u>202</u>
Total operating expenses		<u>1,350,647</u>	<u>1,314,060</u>
Net income for the year		<u><u>2,504,725</u></u>	<u><u>1,827,632</u></u>
Basic and fully diluted earnings (in SAR per share)	25	<u><u>7.71</u></u>	<u><u>5.62</u></u>

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

## Arab National Bank – Saudi Joint Stock Company

### STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY For the years ended December 31, 2006 and 2005

<u>2006</u>	Notes	Share capital SAR' 000	Statutory reserve SAR' 000	General reserve SAR' 000	Other reserves SAR' 000	Retained earnings SAR' 000	Proposed dividend SAR' 000	Total SAR' 000
Balance at beginning of the year		2,500,000	2,500,000	780,000	217,690	64,242	274,747	6,336,679
Net changes in fair value of cash flow hedges					1,191	-	-	1,191
Net changes in fair values of available for sale investments					(96,074)	-	-	(96,074)
Transfers to statement of income					(102,966)	-	-	(102,966)
Net expenses recognized directly in equity					(197,849)	-	-	(197,849)
Net income for the year					-	2,504,725	-	2,504,725
Total recognized income for the year					(197,849)	2,504,725	-	2,306,876
Bonus share issue	14	750,000	-	(750,000)	-	-	-	-
Transfer to statutory reserve	15	-	650,000	-	-	(650,000)	-	-
Transfer to general reserve	15	-	-	1,270,000	-	(1,270,000)	-	-
2005 final dividend paid	26	-	-	-	-	-	(274,747)	(274,747)
2006 interim dividend paid	26	-	-	-	-	(358,295)	-	(358,295)
Zakat for second half 2006	26	-	-	-	-	(30,375)	-	(30,375)
<b>Balance at the end of the year</b>		<b>3,250,000</b>	<b>3,150,000</b>	<b>1,300,000</b>	<b>19,841</b>	<b>260,297</b>	<b>-</b>	<b>7,980,138</b>
<u>2005</u>								
Balance at beginning of the year, as adjusted		2,000,000	2,000,000	550,000	226,759	17,659	175,202	4,969,620
Net changes in fair value of cash flow hedges					(25,653)	(3,361)	-	(29,014)
Net changes in fair values of available for sale investments					103,893	-	-	103,893
Transfers to statement of income					(87,309)	-	-	(87,309)
Net expense recognized directly in equity					(9,069)	(3,361)	-	(12,430)
Net income for the year					-	1,827,632	-	1,827,632
Total recognized income for the year					(9,069)	1,824,271	-	1,815,202
Bonus share issue	14	500,000	-	(500,000)	-	-	-	-
Transfer to statutory reserve	15	-	500,000	-	-	(500,000)	-	-
Transfer to general reserve	15	-	-	730,000	-	(730,000)	-	-
2004 final dividend paid		-	-	-	-	-	(175,202)	(175,202)
2005 interim dividend paid	26	-	-	-	-	(272,941)	-	(272,941)
2005 final proposed dividend	26	-	-	-	-	(274,747)	274,747	-
<b>Balance at end of the year</b>		<b>2,500,000</b>	<b>2,500,000</b>	<b>780,000</b>	<b>217,690</b>	<b>64,242</b>	<b>274,747</b>	<b>6,336,679</b>

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

# Arab National Bank – Saudi Joint Stock Company

## STATEMENT OF CASH FLOWS

For the years ended December 31, 2006 and 2005

	Notes	2006 SAR' 000	2005 SAR' 000
<b>OPERATING ACTIVITIES</b>			
Net income		2,504,725	1,827,632
Adjustments to reconcile net income to net cash used in operating activities:			
Accretion of discounts and amortization of premium on non-trading investments, net		(19,037)	(15,931)
Gains on non-trading investments, net		(106,033)	(90,670)
Depreciation and amortization		84,107	75,544
Gains on disposal of property and equipment, net		(32,414)	(1,151)
Provision for credit losses		82,986	248,390
Impairment of other financial assets		-	18,750
		<u>2,514,334</u>	<u>2,062,564</u>
Net (increase) decrease in operating assets:			
Statutory deposit with SAMA	3	(297,230)	(185,039)
Due from banks and other financial institutions maturing after ninety days		(37,500)	-
Investments held for trading		-	(14,092)
Loans and advances		(11,027,136)	(10,456,303)
Other real estate		3,739	33,034
Other assets		(150,554)	(231,055)
Net increase (decrease) in operating liabilities:			
Due to banks and other financial institutions		(5,278,331)	(1,443,893)
Customer deposits		12,944,675	2,513,257
Other liabilities		(699,425)	564,747
Net cash used in operating activities		<u>(2,027,428)</u>	<u>(7,156,780)</u>
<b>INVESTING ACTIVITIES</b>			
Proceeds from sale of and matured non-trading investments		4,771,633	6,483,432
Purchase of non trading investments		(2,694,463)	(5,607,313)
Purchase of property and equipment		(270,742)	(119,256)
Proceeds from sale of property and equipment		50,906	9,170
Net cash from investing activities		<u>1,857,334</u>	<u>766,033</u>
<b>FINANCING ACTIVITIES</b>			
Term loan	13	-	1,312,500
Debt securities in issue	13	1,875,000	-
Dividends paid		(619,153)	(471,260)
Net cash from financing activities		<u>1,255,847</u>	<u>841,240</u>
Increase (Decrease) in cash and cash equivalents		1,085,753	(5,549,507)
Cash and cash equivalents at the beginning of the year		<u>4,638,190</u>	<u>10,187,697</u>
Cash and cash equivalents at the end of the year	27	<u><u>5,723,943</u></u>	<u><u>4,638,190</u></u>
Special commission received during the year		4,511,198	3,345,105
Special commission paid during the year		<u>1,970,017</u>	<u>1,226,965</u>
<b>Supplemental non-cash information</b>			
Net changes in fair value and transfer to statement of income.		<u>(197,849)</u>	<u>(12,430)</u>

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

# Arab National Bank – Saudi Joint Stock Company

## NOTES TO THE FINANCIAL STATEMENTS

For the years ended December 31, 2006 and 2005

(Saudi Riyals in Thousands)

### 1. General

Arab National Bank (a Saudi Joint Stock Company, the Bank) was formed pursuant to Royal Decree No. M/38 dated Rajab 18,1399H (June 13, 1979). The Bank commenced business on February 2, 1980 by taking over the operations of Arab Bank Limited in the Kingdom of Saudi Arabia. The Bank operates under Commercial Registration No. 1010027912 dated Rabi Awal 1,1400H (January 19, 1980) through 116 branches (2005: 116 branches) in the Kingdom of Saudi Arabia and one branch in the United Kingdom. The address of the Bank's head office is as follows:

Arab National Bank  
P.O. Box 56921  
Riyadh 11564  
Kingdom of Saudi Arabia

The objective of the Bank is to provide a full range of banking services. The also provides its customers non-interest based banking products which are approved and supervised by an independent Shariah Board established by the Bank

### 2. Summary of significant accounting policies

The significant accounting policies adopted in the preparation of these financial statements are set out below.

Except for the changes in accounting policies as detailed in note 2 (b) below, the accounting policies adopted in the preparation of these financial statements are consistent with those used in the previous year.

#### a) Basis of preparation

The financial statements are prepared in accordance with the accounting standards for financial institutions promulgated by the Saudi Arabian Monetary Agency (SAMA) and International Financial Reporting Standards (IFRS). The Bank also prepares its financial statements to comply with the Banking Control Law and the Regulations for Companies in the Kingdom of Saudi Arabia.

The financial statements are prepared under the historical cost convention except for the measurement at fair value of derivatives, financial assets and liabilities held at Fair Value through Income Statement (FVIS) and available for sale. In addition, assets or liabilities that are hedged in a fair value hedging relationship are carried at fair value to the extent of the risk being hedged.

These financial statements are expressed in Saudi Arabian Riyals (SAR) and are rounded off to the nearest thousands.

#### b) Change in accounting policies

The Bank has implemented the amendments to International Accounting Standard (IAS) 39 Financial Instruments: Recognition and Measurement - The Fair Value Option - effective January 1, 2006 with retrospective effect, wherever applicable. As a result of this amendment, the revised IAS 39 requires that the use of the FVIS designation be restricted and shall be used only as permitted by the IAS.

Upon the implementation of the revised IAS 39, the Bank was not required to reclassify any of its assets and liabilities.

#### c) Critical accounting judgements and estimates

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates and assumptions that affect the reported amounts of assets and liabilities. It also requires management to exercise its judgement in the process of applying the Bank's accounting policies. Such estimates, assumptions and judgements are continually evaluated and are based on historical experience and other factors, including obtaining professional advices and expectations of future events that are believed to be reasonable under the circumstances. Significant areas where management has used estimates, assumptions or exercised judgements are as follows:

2. Summary of significant accounting policies (continued)

c) Critical accounting judgements and estimates (continued)

(i) Impairment losses on loans & advances

The Bank reviews its loan portfolios to assess impairment on a quarterly basis. In determining whether an impairment loss should be recorded, the Bank makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group. Management uses estimates based on historical loss experience for loans with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when estimating its cash flows. The methodology and assumptions used for estimating both the amount and the timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

(ii) Fair value of unquoted financial instruments

The fair values of financial instruments that are not quoted in active markets are determined by using valuation techniques. Where valuation techniques (for example, models) are used to determine fair values, they are validated and periodically reviewed by qualified personnel independent of the area that created them. All models are certified before they are used, and models are calibrated to ensure that outputs reflect actual data and comparative market prices. To the extent practical, models use only observable data, however areas such as credit risk (both own and counter party), volatilities and correlations require management to make estimates. Changes in assumptions about these factors could affect reported fair value of financial instruments.

(iii) Impairment of available-for-sale equity investments

The Bank exercises judgement to consider impairment on its available-for-sale equity investments. This includes determination of a significant or prolonged decline in the fair value below its cost. In making this judgement, the Bank evaluates among other factors, the normal volatility in share price. In addition, the Bank considers impairment to be appropriate when there is evidence of deterioration in the financial health of the investee, industry and sector performance, changes in technology, and operational and financing cash flows.

(iv) Classification of held-to-maturity investments

The Bank follows the guidance of IAS 39 on classifying non-derivative financial assets with fixed or determinable payments and fixed maturity as held-to-maturity. In making this judgement, the Bank evaluates its intention and ability to hold such investments to maturity.

d) Trade date accounting

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

e) Derivative financial instruments and hedging

Derivative financial instruments, including forward foreign exchange contracts, commission rate futures, forward rate agreements, currency and commission rate swaps, currency and commission rate options are measured at fair value. All derivatives are carried at their fair value as assets where the fair value is positive and as liabilities where the fair value is negative. Fair values are obtained by reference to quoted market prices, discounted cash flow models and pricing models, as appropriate.

Any changes in the fair value of derivatives that are held for trading purposes are taken directly to income. Derivatives held for trading also include those derivatives, which do not qualify for hedge accounting described below.

## Arab National Bank – Saudi Joint Stock Company

### NOTES TO THE FINANCIAL STATEMENTS

For the years ended December 31, 2006 and 2005

(Saudi Riyals in Thousands)

## 2. Summary of significant accounting policies (continued)

### e) Derivative financial instruments and hedging (continued)

For the purpose of hedge accounting, hedges are classified into two categories: (a) fair value hedges which hedge the exposure to changes in the fair value of a recognized asset or liability and (b) cash flow hedges which hedge exposure to variability in cash flows that is either attributable to a particular risk associated with a recognized asset or liability or to a highly probable forecasted transaction that will affect the reported net gain or loss.

In order to qualify for hedge accounting, the hedge should be expected to be highly effective, i.e. the changes in fair value or cash flows of the hedging instrument should effectively offset corresponding changes in the hedged item, and should be reliably measurable. At inception of the hedge, the risk management objective and strategy is documented including the identification of the hedging instrument, the related hedged item, the nature of risk being hedged, and how the Bank will assess the effectiveness of the hedging relationship. Subsequently, the hedge is required to be assessed and determined to be an effective hedge on an ongoing basis.

In relation to fair value hedges which meet the criteria for hedge accounting, any gain or loss from remeasuring the hedging instruments to fair value is recognized immediately in the statement of income. The corresponding change in fair value of the hedged item is adjusted against the carrying amount of the hedged item and is recognized in the statement of income. Where the fair value hedge of a commission bearing financial instrument ceases to meet the criteria for hedge accounting, the adjustment in the carrying value is amortized to the statement of income over the remaining life of the instrument.

In relation to cash flow hedges which meet the criteria for hedge accounting, the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognized initially in other reserves under shareholders' equity and the ineffective portion, if any, is recognized in the statement of income. For cash flow hedges affecting future transactions, the gains or losses recognized in other reserves, are transferred to the statement of income in the same period in which the hedged transaction affects the statement of income. Where the hedged forecasted transaction results in the recognition of an asset or a liability, then at the time the asset or liability is recognized, the associated gains or losses that had previously been recognized in other reserves are included in the initial measurement of the acquisition and related costs of the asset or liability.

Hedge accounting is discontinued when the hedging instrument is expired or sold, terminated or exercised, or no longer qualifies for hedge accounting, or the forecasted transaction is no longer expected to occur or the Bank revokes the designation. At that point of time, any cumulative gain or loss on the cash flow hedging instrument that was recognized in other reserves is retained in shareholders' equity until the forecasted transaction occurs. Where the hedged forecasted transaction is no longer expected to occur, the net cumulative gain or loss recognized in "other reserves" is transferred to the statement of income for the period.

### f) Foreign currencies

The financial statements are denominated and presented in Saudi Arabian Riyals, which is also the functional currency of the Bank.

Transactions in foreign currencies are translated into Saudi Arabian Riyals at the exchange rates prevailing at transaction dates. Monetary assets and liabilities at year end, denominated in foreign currencies, are translated into Saudi Arabian Riyals at the exchange rates prevailing at the balance sheet date. Foreign exchange gains or losses on translation of monetary assets and liabilities denominated in foreign currencies are recognized in the statement of income, except when deferred in equity as qualifying cash flow hedges and qualifying net investment hedges.

Translation gains or losses on non-monetary items carried at fair value are included as part of the fair value adjustment either in the statement of income or in equity depending on the underlying financial asset.

The monetary assets and liabilities of overseas branches are translated at the rate of exchange ruling at the balance sheet date. The statements of income of overseas branches are translated at the average exchange rates for the year

## Arab National Bank – Saudi Joint Stock Company

### NOTES TO THE FINANCIAL STATEMENTS

For the years ended December 31, 2006 and 2005

(Saudi Riyals in Thousands)

#### 2. Summary of significant accounting policies (continued)

##### g) Offsetting

Financial assets and liabilities are offset and reported net in the balance sheet when there is a legally enforceable right to set off the recognized amounts and when the Bank intends to settle on a net basis, or to realize the asset and settle the liability simultaneously.

##### h) Revenue and expense recognition

Special commission income and expense including the fees which are considered an integral part of the effective yield of a financial instrument, are recognized in the statement of income on the effective yield basis and include premiums amortised and discounts accreted during the year. Exchange income is recognized when earned.

Fees and commissions are recognized on an accrual basis when the service has been provided. Loan commitment fees for loans that are likely to be drawn down are deferred and, together with the related direct cost, are recognized as an adjustment to the effective yield on the loan. Portfolio and other management advisory and service fees are recognized based on the applicable service contracts, usually on a time-proportionate basis. Fee received on asset management, wealth management, financial planning, custody services and other similar services that are provided over an extended period of time, are recognized rateably over the period when the service is being provided.

Dividend income is recognized when declared.

##### i) Sale and repurchase agreements

Assets sold with a simultaneous commitment to repurchase at a specified future date (repos) continue to be recognized on the balance sheet and are measured in accordance with related accounting policies for investments held as FVIS, available for sale, held to maturity and other investments held at amortized cost. The counter-party liability for amounts received under these agreements is included in "due to banks and other financial institutions" or "customers' deposits", as appropriate. The difference between sale and repurchase price is treated as special commission expense and accrued over the life of the repo agreement. Assets purchased with a corresponding commitment to resell at a specified future date (reverse repo) are not recognized in the balance sheet, as the bank does not obtain control over the assets. Amounts paid under these agreements are included in "Cash and balances with SAMA", "Due from banks and other financial institutions" or "Loans and advances", as appropriate. The difference between purchase and resale price is treated as special commission income and accrued over the life of the reverse repo agreement.

##### j) Investments

All investment securities are initially recognized at fair value including acquisition charges associated with the investment except for investments held as FVIS. Premiums are amortised and discounts accreted using the effective yield method and are taken to special commission income.

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

For securities where there is no quoted market price, a reasonable estimate of the fair value is determined by reference to the current market value of another instrument which is substantially the same, or is based on the expected cash flows or the underlying net asset base of the security.

Following initial recognition, subsequent transfers between the various classes of investments are not ordinarily permissible. The subsequent period-end reporting values for each class of investment are determined on the basis as set out in the following paragraphs.



## Arab National Bank – Saudi Joint Stock Company

### NOTES TO THE FINANCIAL STATEMENTS

For the years ended December 31, 2006 and 2005

(Saudi Riyals in Thousands)

## 2. Summary of significant accounting policies (continued)

### j) Investments (continued)

#### Held at FVIS

Investments in this category are classified as either investment held for trading or those designated as FVIS. Investments classified as trading are acquired principally for the purpose of selling or repurchasing in short term. An investment may be designated as FVIS by the management if it satisfies the criteria laid down by IAS 39 except for the equity instruments that do not have a quoted market price in an active market and whose fair values cannot be reliably measured.

After initial recognition, investments at FVIS are measured at fair value and any change in the fair value is recognized in the statement of income for the period in which it arises. Transaction costs, if any, are not added to the fair value measurement at initial recognition of FVIS investments. Special commission income and dividend income received on financial assets held as FVIS are reflected as either trading income or income from FVIS financial instruments in the statement of income.

#### (ii) Available for sale

Investments which are classified as "available for sale" are measured at fair value. For an available-for-sale investment where the fair value has not been hedged, any gain or loss arising from a change in its fair value is recognized directly in "Other reserves" under Shareholders' equity. On derecognition, any cumulative gain or loss previously recognized in shareholders' equity is included in the statement of income for the period.

#### (iii) Held to maturity

Investments having fixed or determinable payments and fixed maturity that the Bank has the positive intention and ability to hold to maturity, other than those that meet the definition of "Other investments held at amortised cost" are classified as held to maturity. Held to maturity investments are subsequently measured at amortised cost, less provision for impairment in value. Amortised cost is calculated by taking into account any discount or premium on acquisition. Any gain or loss on such investments is recognized in the statement of income when the investment is derecognized or impaired.

Investments classified as held to maturity cannot ordinarily be sold or reclassified without impacting the Bank's ability to use this classification and cannot be designated as a hedged item with respect to special commission rate or prepayment risk, reflecting the longer-term nature of these investments.

#### (iv) Other investments held at amortized cost

Investment securities with fixed or determinable payments that are not quoted in an active market are classified as "Other investments held at amortised cost". Such investments whose fair values have not been hedged are stated at amortised cost, less provision for impairment. Any gain or loss is recognized in the statement of income when the investment is derecognized or impaired.

## Arab National Bank – Saudi Joint Stock Company

### NOTES TO THE FINANCIAL STATEMENTS

For the years ended December 31, 2006 and 2005

(Saudi Riyals in Thousands)

#### 2. Summary of significant accounting policies (continued)

##### k) Loans and advances

Loans and advances are non-derivative financial assets originated or acquired by the Bank with fixed or determinable payments.

All loans and advances are initially measured at fair value, including acquisition charges associated with the loans and advances.

Loans and advances originated or acquired by the Bank that are not quoted in an active market and for which fair value has not been hedged are classified as loan and advances held at amortized cost and are stated at cost less any amount written off and provisions for impairment. For loans and advances which are hedged, the related portion of the hedged fair value is adjusted against the carrying amount.

For presentation purposes, provision for credit losses is deducted from loans and advances.

##### l) Impairment of financial assets

An assessment is made at each balance sheet date to determine whether there is objective evidence that a financial asset or group of financial assets may be impaired. If such evidence exists, the estimated recoverable amount of that asset is determined and any impairment loss, based on the net present value of future anticipated cash flows, is recognized for changes in its carrying amounts as follows:

Financial assets are written off only in circumstances where effectively all possible means of recovery have been exhausted.

Once a financial asset has been written down to its estimated recoverable amount, special commission income is thereafter recognized based on the rate of special commission that was used to discount the future cash flows for the purpose of measuring the recoverable amount.

##### Impairment of financial assets held at amortized cost

A financial asset is classified as impaired when there is an objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset and that a loss event(s) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

A specific provision for credit losses due to impairment of a loan or any other financial asset held at amortized costs is established if there is objective evidence that the Bank will not be able to collect all amounts due. The amount of the specific provision is the difference between the carrying amount and the estimated recoverable amount. The estimated recoverable amount is the present value of expected cash flows, including amounts estimated to be recoverable from guarantees and collateral, discounted based on the original effective commission rate.

In addition to specific provision for credit losses, provision for collective impairment is made on a portfolio basis for credit losses where there is an objective evidence that unidentified losses exist at the reporting date. This provision is estimated based on various factors including credit ratings allocated to a borrower or group of borrowers, the current economic conditions, the experience the Bank has had in dealing with a borrower or group of borrowers and available historical default information.

For financial assets at amortised cost, the carrying amount of the asset is adjusted either directly or through the use of an allowance account and the amount of the adjustment is included in the statement of income.

# Arab National Bank – Saudi Joint Stock Company

## NOTES TO THE FINANCIAL STATEMENTS

For the years ended December 31, 2006 and 2005

(Saudi Riyals in Thousands)

### 2. Summary of significant accounting policies (continued)

#### Impairment of financial assets held at fair value

For financial assets at fair value, where a loss has been recognized directly under shareholders' equity, the cumulative net loss recognized in shareholders' equity is transferred to the statement of income when the asset is considered to be impaired.

For equity investments held as available-for-sale, a significant or prolonged decline in fair value below its cost represents objective evidence of impairment. The impairment loss cannot be reversed through the statement of income as long as the asset continues to be recognized i.e. any increase in fair value after impairment has been recorded can only be recognized in equity. On derecognition, any cumulative gain or loss previously recognized in shareholders' equity is included in the statement of income for the period.

#### m) Other real estate

The Bank, in the ordinary course of business, acquires certain real estate against settlement of due loans and advances. Such real estate are considered as assets held for sale and are initially stated at the lower of net realisable value of due loans and advances and the current fair value of the related properties, less any costs to sell (if material).

Subsequent to the initial recognition, such real estate are revalued on a periodic basis. Any unrealized losses on revaluation, realized losses or gains on disposal and rental income are recognized in the statement of income.

#### n) Property and equipment

Property and equipment are stated at cost and presented net of accumulated depreciation and amortization. Freehold land is not depreciated.

The cost of property and equipment is depreciated and amortized on the straight-line method over the estimated useful lives of the assets as follows:

Buildings	33 years
Leasehold improvements	over lease period or 10 years, whichever is shorter
Furniture, equipment and vehicles	4 to 10 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

Gains and losses on disposals are determined by comparing proceeds with the carrying amount. These are included in the statement of income.

All assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Any carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

#### o) Liabilities

All money market deposits, customer deposits, term loans subordinated debts issued are initially recognized at cost, being the fair value of the consideration received less transaction costs.

Subsequently all commission-bearing financial liabilities, other than those where fair values have been hedged, are measured at amortized cost. Amortized cost is calculated by taking into account any discount or premium. Premiums are amortized and discounts accreted on an effective yield basis to maturity and taken to special commission expense.

Financial liabilities in a fair value hedge relationship are adjusted for fair value changes to the extent of the risk being hedged. The resultant gain or loss is recognized in the statement of income. For financial liabilities carried at amortized cost, any gain or loss is recognized in the statement of income when derecognized or impaired.

## Arab National Bank – Saudi Joint Stock Company

### NOTES TO THE FINANCIAL STATEMENTS

For the years ended December 31, 2006 and 2005

(Saudi Riyals in Thousands)

#### 2. Summary of significant accounting policies (continued)

##### p) Provisions

Provisions are recognized when a reliable estimate can be made by the Bank for a present legal or constructive obligation as a result of past events and it is more likely than not that an outflow of resources will be required to settle the obligation.

##### q) Accounting for leases

###### i) Where the Bank is the lessee

Leases entered into by the Bank are all operating leases. Payments made under operating leases are charged to the statement of income on a straight-line basis over the period of the lease.

When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognized as an expense in the period in which termination takes place.

###### ii) Where the Bank is the lessor

When assets are sold under a finance lease, including assets under Islamic lease, the present value of the lease payments is recognized as a receivable and disclosed under "loans and advances". The difference between the gross receivable and the present value of the receivable is recognized as unearned finance income. Lease income is recognized over the term of the lease using the net investment method, which reflects a constant periodic rate of return.

##### r) Cash and cash equivalents

For the purpose of the statement of cash flows, "cash and cash equivalents" are defined as those amounts included in cash, balances with SAMA excluding statutory deposit, and due from banks and other financial institutions maturing within ninety days.

##### s) Derecognition of financial instruments

A financial asset (or a part of a financial asset, or a part of a group of similar financial assets) is derecognized, when the contractual rights to the cash flows from the financial asset expires.

In instances where the bank is assessed to have transferred a financial asset, the asset is derecognized if the Bank has transferred substantially all the risks and rewards of ownership. Where the Bank has neither transferred nor retained substantially all the risks and rewards of ownership, the financial asset is derecognized only if the Bank has not retained control of the financial asset. The Bank recognizes separately as assets or liabilities any rights and obligations created or retained in the process.

A financial liability (or a part of a financial liability) can only be derecognized when it is extinguished, that is when the obligation specified in the contract is either discharged, cancelled or expires.

##### t) Zakat and income taxes

Under Saudi Arabian Zakat and Income tax laws, zakat and income taxes are the liabilities of Saudi and foreign shareholders, respectively. Zakat is computed on the Saudi shareholders' share of equity or net income using the basis defined under the zakat regulations. Income taxes are computed on the foreign shareholders share of net income for the year.

Zakat and income taxes are not charged to the Bank's statement of income as they are payable by the shareholders.

## Arab National Bank – Saudi Joint Stock Company

### NOTES TO THE FINANCIAL STATEMENTS

For the years ended December 31, 2006 and 2005

(Saudi Riyals in Thousands)

#### 2. Summary of significant accounting policies (continued)

##### u) Non interest based banking products

In addition to the conventional banking, the Bank offers its customers certain non-interest based banking products, which are approved by its Shariah Board.

All non-interest based banking products are accounted for using IFRS and are in conformity with the accounting policies described in these financial statements.

##### v) Prospective changes in accounting policies

Certain new IFRS and amendments and interpretations to existing IFRS, have been published and are mandatory for the Bank's accounting period beginning on or after January 1, 2007 These include:

###### Amendments to IAS 1 – Capital Disclosures

Amendments to IAS 1 Presentation of Financial Statements were issued by the IASB as Capital Disclosures in August 2005. They are required to be applied for periods beginning on or after 1 January 2007. When effective, these amendments will require disclosure of information enabling evaluation of the bank's objectives, policies and processes for managing capital.

###### IFRS 7 Financial Instruments - Disclosures

IFRS 7 Financial Instruments: Disclosures were issued by the IASB in August 2005, becoming effective for the periods beginning on or after 1 January 2007. The new standard will require additional disclosures of the significance of financial instruments for the bank's financial position and performance and information about exposure to risks arising from financial instruments.

###### IFRS 8 Operating segments

IFRS 8 Operating segments was issued by the IASB in November 2006, becoming effective for periods commencing on or after January 2009. The new standard may require changes in the way the bank discloses information about its operating segments.

###### IFRIC Interpretation

During 2006 IFRIC issued the following interpretations:

- IFRIC Interpretation 8 Scope of IFRS 2
- IFRIC Interpretation 9 Reassessment of Embedded Derivatives
- IFRIC Interpretation 11 IFRS 2 – Group and Treasury Share Transactions

Management do not expect these interpretations to have a significant impact on the bank's financial statements when implemented in 2007.

# Arab National Bank – Saudi Joint Stock Company

## NOTES TO THE FINANCIAL STATEMENTS

For the years ended December 31, 2006 and 2005

(Saudi Riyals in Thousands)

### 3. Cash and balances with SAMA

	2006	2005
Cash in hand	1,115,144	680,372
Statutory deposit	2,087,901	1,790,671
Special deposit with SAMA	999	-
Other balances	11,963	24,143
<b>Total</b>	<b>3,216,007</b>	<b>2,495,186</b>

In accordance with the Banking Control Law and regulations issued by Saudi Arabian Monetary Agency (SAMA), the Bank is required to maintain a statutory deposit with SAMA at stipulated percentages of its demand, savings, time and other deposits, calculated at the end of each month.

### 4. Due from banks and other financial institutions

	2006	2005
Current accounts	436,945	476,498
Money market placements	4,196,392	3,457,177
<b>Total</b>	<b>4,633,337</b>	<b>3,933,675</b>

### 5. Investments, net

a) Investment securities are classified as follows:

	Domestic		International		Total	
	2006	2005	2006	2005	2006	2005
i) Held at fair value through income statement						
Other ( funds)	-	-	599,403	307,159	599,403	307,159
Held as fair value through income statement	-	-	599,403	307,159	599,403	307,159
ii) Available for sale						
Fixed rate securities	113,758	317,296	3,055,366	3,507,115	3,169,124	3,824,411
Floating rate notes	60,036	59,999	231,119	147,032	291,155	207,031
Equities	283,380	4,516	-	-	283,380	4,516
Other	326,650	169,433	816,931	940,474	1,143,581	1,109,907
<b>Available for sale</b>	<b>783,824</b>	<b>551,244</b>	<b>4,103,416</b>	<b>4,594,621</b>	<b>4,887,240</b>	<b>5,145,865</b>

# Arab National Bank – Saudi Joint Stock Company

## NOTES TO THE FINANCIAL STATEMENTS

For the years ended December 31, 2006 and 2005

(Saudi Riyals in Thousands)

### 5. Investments, net (continued)

	Domestic		International		Total	
	2006	2005	2006	2005	2006	2005
iii) Held to maturity						
Fixed rate securities	433,875	998,977	-	-	433,875	998,977
Held to maturity	433,875	998,977	-	-	433,875	998,977
iv) Other investments held at amortized cost						
Fixed rate securities	8,208,058	8,974,464	244,648	123,464	8,452,706	9,097,928
Floating rate notes	465,000	2,165,000	2,666,762	2,014,275	3,131,762	4,179,275
Other	-	-	805,322	712,196	805,322	712,196
Held at amortized cost, gross	8,673,058	11,139,464	3,716,732	2,849,935	12,389,790	13,989,399
Accumulated provision for impairment	-	-	(18,750)	(18,750)	(18,750)	(18,750)
Held at amortized cost, net	8,673,058	11,139,464	3,697,982	2,831,185	12,371,040	13,970,649
Investments, net	9,890,757	12,689,685	8,400,801	7,732,965	18,291,558	20,422,650

b) The analysis of the composition of investments is as follows:

	2006			2005		
	Quoted	Unquoted	Total	Quoted	Unquoted	Total
Fixed rate securities	1,645,165	10,410,538	12,055,703	1,838,783	12,082,533	13,921,316
Floating rate notes	246,994	3,175,924	3,422,918	83,933	5,014,569	5,098,502
Equities	282,380	1,000	283,380	-	4,516	4,516
Other	653,582	1,894,725	2,548,307	19,880	1,397,186	1,417,066
Accumulated provision for impairment	-	(18,750)	(18,750)	-	(18,750)	(18,750)
Investments, net	2,828,121	15,463,437	18,291,558	1,942,596	18,480,054	20,422,650

Unquoted fixed and floating rate investments are mainly Saudi Government Bonds.

c) The analysis of unrealized gains and losses and fair values of other investments held at amortized cost, and held-to-maturity investments are as follows:

	2006				2005			
	Carrying value	Gross unrealized gains	Gross unrealized losses	Fair value	Carrying value	Gross unrealized gains	Gross unrealized losses	Fair value
i) Held to maturity								
Fixed rate securities	433,875	24,820	-	458,695	998,977	42,157	28	1,041,106
Total	433,875	24,820	-	458,695	998,977	42,157	28	1,041,106
ii) Other investments held at amortized cost								
Fixed rate securities	8,452,706	61,705	58,300	8,456,111	9,097,928	117,555	69,989	9,145,494
Floating rate notes	3,131,762	866	53,897	3,078,731	4,179,275	5,747	34,717	4,150,305
Other	805,322	-	-	805,322	712,196	-	-	712,196
Accumulated provision for impairment	(18,750)	-	-	(18,750)	(18,750)	-	-	(18,750)
Total	12,371,040	62,571	112,197	12,321,414	13,970,649	123,302	104,706	13,989,245

# Arab National Bank – Saudi Joint Stock Company

## NOTES TO THE FINANCIAL STATEMENTS

For the years ended December 31, 2006 and 2005

(Saudi Riyals in Thousands)

### 5. Investments, net (continued)

d) The analysis of investments by counterparty is as follows:

	<u>2006</u>	<u>2005</u>
Government and quasi government	12,420,738	16,043,916
Corporate	678,663	222,708
Banks and other financial institutions	4,788,296	3,982,077
Other	403,861	173,949
<b>Total</b>	<b><u>18,291,558</u></b>	<b><u>20,422,650</u></b>

Investments include SAR 5,333 million (2005: SAR 6,140 million), which have been pledged under repurchase agreements with other banks and customers. The market value of such investments is SAR 5,355 million (2005: SAR 6,113 million).

During 2005, an impairment charge of SAR 18.8 million was computed on securities classified as "Held at amortized cost, other".

### 6. Loans and advances, net

a) Loans and advances comprise of the following:

	<u>2006</u>	<u>2005</u>
Performing:		
Overdrafts	4,781,203	4,122,916
Credit cards	1,523,680	440,869
Commercial loans	27,805,356	19,795,679
Consumer loans	16,444,098	15,260,444
Other	8,234	10,671
Performing loans and advances, gross	<u>50,562,571</u>	<u>39,630,579</u>
Non-performing loans and advances, net	369,724	846,626
<b>Total</b>	<b><u>50,932,295</u></b>	<b><u>40,477,205</u></b>
Provision for credit losses	(1,185,071)	(1,698,649)
<b>Loans and advances, net</b>	<b><u>49,747,224</u></b>	<b><u>38,778,556</u></b>

b) Movements in provision for credit losses are as follows:

	<u>2006</u>	<u>2005</u>
Balance at beginning of the year	1,698,649	1,617,768
Provided during the year	82,986	248,390
Bad debts written off	(596,564)	(167,509)
<b>Balance at end of the year</b>	<b><u>1,185,071</u></b>	<b><u>1,698,649</u></b>

Recoveries of loans and advances previously written off are included in other operating income (note 23).



# Arab National Bank – Saudi Joint Stock Company

## NOTES TO THE FINANCIAL STATEMENTS

For the years ended December 31, 2006 and 2005

(Saudi Riyals in Thousands)

### 6. Loans and advances, net (continued)

c) Economic sector risk concentrations for the loans and advances and Provision for credit losses are as follows:

	Performing gross	Non performing, net	Credit loss provision	Loans and advances, net
<u>2006</u>				
1. Government and quasi government	60,642	-	-	60,642
2. Banks and other financial institutions	4,191,378	-	-	4,191,378
3. Agriculture and fishing	510,813	7,774	(26,722)	491,865
4. Manufacturing	5,706,244	157,094	(259,654)	5,603,684
5. Mining and quarrying	285,181	-	(9)	285,172
6. Electricity, water, gas and health services	1,715,551	-	-	1,715,551
7. Building and construction	4,060,579	71,359	(117,510)	4,014,428
8. Commerce	5,925,995	24,672	(63,253)	5,887,414
9. Transportation and communication	1,648,687	-	(3,316)	1,645,371
10. Services	769,115	16,850	(11,582)	774,383
11. Consumer loans and credit cards	17,777,416	47,544	(39,352)	17,785,608
12. Other	7,910,970	44,431	(47,902)	7,907,499
	<u>50,562,571</u>	<u>369,724</u>	<u>(569,300)</u>	<u>50,362,995</u>
13. Portfolio provision	-	-	(615,771)	(615,771)
Total	<u>50,562,571</u>	<u>369,724</u>	<u>(1,185,071)</u>	<u>49,747,224</u>
<u>2005</u>				
1. Government and quasi government	69,643	-	-	69,643
2. Banks and other financial institutions	2,726,815	-	-	2,726,815
3. Agriculture and fishing	425,362	7,371	(12,718)	420,015
4. Manufacturing	4,910,616	227,400	(335,482)	4,802,534
5. Mining and quarrying	40,140	29	(201)	39,968
6. Electricity, water, gas and health services	1,409,553	-	-	1,409,553
7. Building and construction	2,387,471	298,993	(234,547)	2,451,917
8. Commerce	4,541,275	172,758	(321,811)	4,392,222
9. Transportation and communication	917,271	7,148	(10,724)	913,695
10. Services	639,921	21,990	(24,080)	637,831
11. Consumer loans and credit cards	15,686,689	34,460	(32,467)	15,688,682
12. Other	5,875,823	76,477	(80,848)	5,871,452
	<u>39,630,579</u>	<u>846,626</u>	<u>(1,052,878)</u>	<u>39,424,327</u>
13. Portfolio provision	-	-	(645,771)	(645,771)
Total	<u>39,630,579</u>	<u>846,626</u>	<u>(1,698,649)</u>	<u>38,778,556</u>

### 7. Property and equipment, net

	Land and Buildings	Leasehold improvements	Equipment, furniture and vehicles	Total 2006	Total 2005
<b>Cost</b>					
Balance at beginning of the year	353,363	224,917	442,239	1,020,519	946,035
Additions	94,900	74,990	100,852	270,742	119,256
Disposals	(20,927)	(154)	(69)	(21,150)	(44,772)
Balance at end of the year	<u>427,336</u>	<u>299,753</u>	<u>543,022</u>	<u>1,270,111</u>	<u>1,020,519</u>
<b>Accumulated depreciation</b>					
Balance at beginning of the year	123,073	136,930	342,408	602,411	563,620
Charge for the year	4,609	25,480	54,018	84,107	75,544
Disposals	(2,604)	(13)	(41)	(2,658)	(36,753)
Balance at end of the year	<u>125,078</u>	<u>162,397</u>	<u>396,385</u>	<u>683,860</u>	<u>602,411</u>
<b>Net book value</b>					
As at December 31, 2006	<u>302,258</u>	<u>137,356</u>	<u>146,637</u>	<u>586,251</u>	
As at December 31, 2005	<u>230,290</u>	<u>87,987</u>	<u>99,831</u>		<u>418,108</u>

Property and equipment include work in progress as at December 31, 2006 amounting to SAR 208.4 million (2005: SAR 87.7 million)  
Equipment, furniture and vehicles include information technology related assets.

# Arab National Bank – Saudi Joint Stock Company

## NOTES TO THE FINANCIAL STATEMENTS

For the years ended December 31, 2006 and 2005

(Saudi Riyals in Thousands)

### 8. Other assets

	<u>2006</u>	<u>2005</u>
Accrued special commission receivable - banks and other financial institutions	20,369	1,526
- investments	256,239	315,405
- loans and advances	321,355	175,580
- derivatives	125,595	88,880
- other	62	115
Total accrued special commission receivable	<u>723,620</u>	<u>581,506</u>
Positive fair value of derivatives (note 9)	151,776	183,284
Other	530,483	520,249
Total	<u><u>1,405,879</u></u>	<u><u>1,285,039</u></u>

### 9. Derivatives

In the ordinary course of business, the Bank utilizes the following derivative financial instruments for both trading and hedging purposes:

#### a) Swaps

Swaps are commitments to exchange one set of cash flows for another. For commission rate swaps, counterparties generally exchange fixed and floating rate commission payments in a single currency without exchanging principal. For currency swaps, fixed commission payments and principal are exchanged in different currencies. For cross-currency commission rate swaps, principal, fixed and floating commission payments are exchanged in different currencies.

#### b) Forwards and futures

Forwards and futures are contractual agreements to either buy or sell a specified currency, commodity or financial instrument at a specified price and date in the future. Forwards are customized contracts transacted in the over-the-counter market. Foreign currency and commission rate futures are transacted in standardized amounts on regulated exchanges and changes in futures contract values are settled daily.

#### c) Forward rate agreements

Forward rate agreements are individually negotiated commission rate contracts that call for a cash settlement for the difference between a contracted commission rate and the market rate on a specified future date, on a notional principal for an agreed period of time.

#### d) Options

Options are contractual agreements under which the seller (writer) grants the purchaser (holder) the right, but not the obligation, to either buy or sell at fixed future date or at any time during a specified period, a specified amount of a currency, commodity or financial instrument at a pre-determined price.

#### Held for trading purposes

Most of the Bank's derivative trading activities relate to sales, positioning and arbitrage. Sales activities involve offering products to customers and banks in order, inter alia, to enable them to transfer, modify or reduce current and future risks. Positioning involves managing market risk positions with the expectation of profiting from favorable movements in prices, rates or indices. Arbitrage involves identifying, with the expectation of profiting from price differentials between markets or products.

#### Held for hedging purposes

The Bank has adopted a comprehensive system for the measurement and management of risk. Part of the risk management process involves managing the Bank's exposure to fluctuations in foreign exchange and commission rates to reduce its exposure to currency and commission rate risks to acceptable levels as determined by the Board of Directors within the guidelines issued by SAMA.

# Arab National Bank – Saudi Joint Stock Company

## NOTES TO THE FINANCIAL STATEMENTS

For the years ended December 31, 2006 and 2005

(Saudi Riyals in Thousands)

### 9. Derivatives (continued)

The Board of Directors has established levels of currency risk by setting limits on counterparty and currency position exposures. Positions are monitored on a daily basis and hedging strategies are used to ensure positions are maintained within the established limits. The Board of Directors has established the level of commission rate risk by setting limits on commission rate gaps for stipulated periods. Asset and liability commission rate gaps are reviewed on a periodic basis and hedging strategies are used to reduce commission rate gap within the established limits.

As part of its asset and liability management, the Bank uses derivatives for hedging purposes in order to adjust its exposure to currency and commission rate risks. This is generally achieved by hedging specific transactions as well as strategic hedging against overall balance sheet exposures. Strategic hedging, other than portfolio hedges for commission rate risk, do not qualify for special hedge accounting and related derivatives are accounted for as held for trading.

The Bank uses forward foreign exchange contracts and currency swaps to hedge against specifically identified currency risks. In addition, the Bank uses commission rate swaps and commission rate futures to hedge against the commission rate risk arising from specifically identified fixed commission-rate exposures.

The Bank also uses commission rate swaps to hedge against the cash flow risk arising on certain floating rate exposures. In all such cases, the hedging relationship and objective, including details of the hedged items and hedging instrument are formally documented and the transactions are accounted for as fair value or cash flow hedges.

The tables below show the positive and negative fair values of derivative financial instruments, together with the notional amounts, analyzed by the term to maturity and monthly average. The notional amounts, which provide an indication of the volumes of the transactions outstanding at the year-end, do not necessarily reflect the amounts of future cash flows involved. These notional amounts, therefore, are neither indicative of the Bank's exposure to credit risk, which is generally limited to the positive fair value of the derivatives, nor market risk.

#### Derivative financial instruments

##### Notional amounts by term to maturity

<u>2006</u>	Positive fair value	Negative fair value	Notional amount total	Within 3 months	3-12 months	1-5 years	Over 5 years	Monthly average
<b>Held for trading:</b>								
Commission rate swaps	33,258	28,303	5,746,681	-	100,000	5,260,089	386,592	5,909,571
Commission rate futures and options	-	-	-	-	-	-	-	-
Forward foreign exchange contracts	99,446	59,582	20,823,621	14,501,883	6,290,820	30,918	-	17,684,881
Currency options	8,131	7,826	814,443	730,355	84,088	-	-	872,449
Other	-	-	-	-	-	-	-	-
<b>Held as fair value hedges:</b>								
Commission rate swaps	10,389	41,320	6,625,146	1,660,000	1,528,888	3,233,647	202,611	8,180,524
<b>Held as cash flow hedges:</b>								
Commission rate swaps	552	7,251	2,317,500	200,000	1,812,500	305,000	-	985,625
<b>Total</b>	<b>151,776</b>	<b>144,282</b>	<b>36,327,391</b>	<b>17,092,238</b>	<b>9,816,296</b>	<b>8,829,654</b>	<b>589,203</b>	<b>33,633,050</b>

##### 2005

<b>Held for trading:</b>								
Commission rate swaps	14,091	10,707	5,176,395	-	1,050,000	3,343,200	783,195	3,299,734
Commission rate futures and options	-	-	-	-	-	-	-	67,923
Forward foreign exchange contracts	124,933	65,865	13,944,716	8,257,741	5,326,795	360,180	-	18,402,041
Currency options	25,373	24,811	997,809	594,094	403,715	-	-	2,940,211
Other	1,662	1,662	100,000	-	-	100,000	-	100,000
<b>Held as fair value hedges:</b>								
Commission rate swaps	15,544	35,540	11,367,588	4,405,324	3,012,028	2,044,405	1,905,831	5,846,189
<b>Held as cash flow hedges:</b>								
Commission rate swaps	1,681	9,571	817,500	-	352,500	465,000	-	795,417
<b>Total</b>	<b>183,284</b>	<b>148,156</b>	<b>32,404,008</b>	<b>13,257,159</b>	<b>10,145,038</b>	<b>6,312,785</b>	<b>2,689,026</b>	<b>31,451,515</b>

# Arab National Bank – Saudi Joint Stock Company

## NOTES TO THE FINANCIAL STATEMENTS

For the years ended December 31, 2006 and 2005

(Saudi Riyals in Thousands)

### 9. Derivatives (continued)

The tables below show a summary of hedged items and portfolios, the nature of the risk being hedged, the hedging instrument and its fair value.

Description of hedged items	Fair value	Cost	Risk	Hedging instrument	Positive fair value	Negative fair value
<u>2006</u>						
Fixed commission rate investments	1,697,615	1,681,802	Fair value	Commission rate swap	5,375	7,282
Fixed commission rate loans	3,846,425	3,817,707	Fair value	Commission rate swap	4,970	33,689
Fixed commission rate deposits	1,125,333	1,125,638	Fair value	Commission rate swap	44	349
Floating commission rate investments	2,317,664	2,317,500	Cash flow	Commission rate swap	552	7,251
<u>2005</u>						
Fixed commission rate investments	1,060,939	1,039,218	Fair value	Commission rate swap	2,859	14,707
Fixed commission rate loans	9,241,944	9,237,745	Fair value	Commission rate swap	12,685	16,884
Fixed commission rate deposits	1,086,676	1,090,625	Fair value	Commission rate swap	-	3,949
Floating commission rate investments	817,462	817,500	Cash flow	Commission rate swap	1,681	9,571

Approximately 41% (2005: 35%) of the positive fair value of the Bank's derivatives are entered into with financial institutions and less than 8.8% (2005: 7.2%) of the positive fair value contracts are with any single counter-party at the balance sheet date. Derivative activities are mainly carried out under the Bank's treasury banking segment.

### 10. Due to banks and other financial institutions

	<u>2006</u>	<u>2005</u>
Current accounts	134,334	120,573
Money market deposits	2,964,269	8,256,361
Total	<u>3,098,603</u>	<u>8,376,934</u>

### 11. Customer deposits

	<u>2006</u>	<u>2005</u>
Demand	21,995,560	18,814,567
Saving	84,504	96,120
Time	38,270,875	28,322,891
Other	1,422,555	1,598,886
Total	<u>61,773,494</u>	<u>48,832,464</u>

Time deposits include deposits against sale of securities of SAR 2,861 million (2005: SAR 5,265 million) with agreements to repurchase the same at fixed future dates. Other customer deposits include SAR 923 million (2005: SAR 972 million) of margins held for irrevocable commitments.

The above include foreign currency deposits as follows:

	<u>2006</u>	<u>2005</u>
Demand	1,237,936	683,340
Saving	4,244	4,510
Time	14,181,745	14,809,286
Other	292,700	217,470
Total	<u>15,716,625</u>	<u>15,714,606</u>

# Arab National Bank – Saudi Joint Stock Company

## NOTES TO THE FINANCIAL STATEMENTS

For the years ended December 31, 2006 and 2005

(Saudi Riyals in Thousands)

### 12. Other liabilities

	<u>2006</u>	<u>2005</u>
Accrued special commission payable - banks and other financial institutions	35,539	32,534
- customer deposits	206,791	139,575
- derivatives	273,352	209,473
- term loan	18,641	14,944
- other	20,039	-
<b>Total accrued special commission payable</b>	<b>554,362</b>	<b>396,526</b>
Negative fair value of derivatives (note 9)	144,282	148,156
IPO Subscription	254	658,967
Other	1,296,750	1,429,853
<b>Total</b>	<b>1,995,648</b>	<b>2,633,502</b>

### 13. Term loan and debt securities in issue

During the year ended December 31, 2005, the Bank entered into a three year syndicate term loan facility agreement for an amount of USD 350 million. The Bank, however, has an option to effect an early repayment, subject to the terms and conditions of the related syndicate agreement.

During the year ended December 31, 2006, the Bank has issued USD 500 million 10 year subordinated floating rate notes under its USD 850 million Euro Medium Term Note program. The notes carry a special commission rate of Libor plus 83 bps. The notes are non-convertible, unsecured and listed on the London stock exchange. These notes are callable after 5 years.

### 14. Share capital

The authorized, issued and fully paid share capital of the Bank as at December 31, 2006 consists of 325 million shares of SAR 10 each (2005: 250 million), following a five to one share split on April 8, 2006. The ownership of the Bank's share capital is as follows:

	<u>2006</u>	<u>2005</u>
Saudi shareholders	60%	60%
Arab Bank PLC – Jordan	40%	40%

During the year ended December 31, 2006, 15 million shares of SAR 50 each were issued after approval by the shareholders at their Extraordinary General Assembly meeting held on March 12, 2006 to increase the share capital of the bank from SAR 2,500 million to SAR 3,250 million by transferring SAR 750 million from the general reserve through the issuance of three bonus share for every ten shares held. During the year ended December 31, 2005, ten million shares of SAR 50 each were issued after approval by the shareholders at their Extraordinary General Assembly meeting held on March 13, 2005 through the issuance of one bonus share for every four shares held.

### 15. Statutory and general reserves

In accordance with Saudi Arabian Banking Control Law and the Articles of Association of the Bank, a minimum of 25% of the annual net income is required to be transferred to a statutory reserve until this reserve equals the paid up capital of the Bank. Accordingly, SAR 650 million has been transferred from 2006 net income (2005: SAR 500 million). The statutory reserve is not currently available for distribution.

Further to the bonus share issue (see note 14 above), SAR 750 million has been transferred from general reserve to share capital during 2006 (2005: SAR 500 million).

On December 17, 2006, the Board of Directors has approved a proposed transfer to general reserve amounting to SAR 1,270 million (2005: SAR 730 million) with the intention to increase the Bank's share capital through a two for five bonus share dividend subject to a final approval of the Extraordinary General Assembly.

# Arab National Bank – Saudi Joint Stock Company

## NOTES TO THE FINANCIAL STATEMENTS

For the years ended December 31, 2006 and 2005

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### 16. Commitments and contingencies

#### a) Legal proceedings

As at December 31, 2006 there were legal proceedings of a routine nature outstanding against the Bank. No material provision has been made as related professional legal advice indicates that it is unlikely that any significant loss will event.

#### b) Capital commitments

As at December 31, 2006 the Bank had capital commitments of SAR 265.8 million (2005: SAR 360.2 million) in respect of building and equipment purchases

#### c) Credit related commitments and contingencies

The primary purpose of these instruments is to ensure that funds are available to customers as required.

Guarantee and standby letters of credit, which represent irrevocable assurances that the Bank will make payments in the event that a customer cannot meet its obligations to third parties, carry the same credit risk as loans and advances.

Cash requirements under guarantees and standby letters of credit are considerably less than the amount of the commitment because the Bank does not generally expect the third party to draw funds under the agreement.

Documentary letters of credit, which are written undertakings by the Bank on behalf of a customer authorizing a third party to draw drafts on the Bank up to a stipulated amount under specific terms and conditions, are generally collateralized by the underlying shipments of goods to which they relate, and therefore have significantly less risk.

Acceptances comprise undertakings by the Bank to pay bills of exchange drawn on customers. The Bank expects most acceptances to be presented before being reimbursed by the customers.

Commitments to extend credit represent the unused portion of authorizations to extend credit, principally in the form of loans and advances, guarantees and letters of credit. With respect to credit risk on commitments to extend credit, the Bank is potentially exposed to a loss in an amount equal to the total unused commitments. However, the likely amount of loss, which cannot readily be quantified, is expected to be considerably less than the total unused commitment as most commitments to extend credit are contingent upon customers maintaining specific credit standards. The total outstanding commitments to extend credit do not necessarily represent future cash requirements, as many of these commitments could expire or terminate without being funded.

#### i) The maturity structure of the Bank's commitments and contingencies is as follows:

	<u>2006</u>	Within 3 months	3-12 months	1-5 years	Over 5 years	Total
Letters of credit		2,849,889	2,093,549	144,402	-	5,087,840
Letters of guarantee		2,706,517	2,384,950	3,044,625	40,917	8,177,009
Acceptances		720,740	486,565	100,531	48,743	1,356,579
Irrevocable commitments to extend credit		3,439	874,910	694,067	-	1,572,416
Other		-	-	-	391,567	391,567
<b>Total</b>		<u>6,280,585</u>	<u>5,839,974</u>	<u>3,983,625</u>	<u>481,227</u>	<u>16,585,411</u>
	<u>2005</u>					
Letters of credit		1,416,283	981,923	471,270	-	2,869,476
Letters of guarantee		2,285,306	1,822,523	1,031,486	14,283	5,153,598
Acceptances		576,313	476,286	22,344	-	1,074,943
Irrevocable commitments to extend credit		182,616	539,441	882,011	503,879	2,107,947
Other		-	-	-	439,236	439,236
<b>Total</b>		<u>4,460,518</u>	<u>3,820,173</u>	<u>2,407,111</u>	<u>957,398</u>	<u>11,645,200</u>

The unutilized portion of non-firm commitments as at December 31, 2006, which can be revoked unilaterally at any time by the Bank, amounts to SAR 11,631 million (2005: SAR 8,838 million).

# Arab National Bank – Saudi Joint Stock Company

## NOTES TO THE FINANCIAL STATEMENTS

For the years ended December 31, 2006 and 2005

(Saudi Riyals in Thousands)

### 16. Commitments and contingencies (continued)

ii) The analysis of commitments and contingencies by counter-party is as follows:

	<u>2006</u>	<u>2005</u>
Government and quasi government	1,288,886	159,008
Corporate	11,483,956	8,794,035
Banks and other financial institutions	3,171,758	1,716,957
Other	640,811	975,200
<b>Total</b>	<b><u>16,585,411</u></b>	<b><u>11,645,200</u></b>

### d) Assets pledged

Assets pledged as collateral with other financial institutions for security are as follows:

	<u>2006</u>		<u>2005</u>	
	Assets	Related liabilities	Assets	Related liabilities
Available for sale investments (note 5)	-	-	551,083	550,808
Held to maturity investments (note 5)	4,899,135	2,554,000	437,792	421,352
Other investments Held at amortized cost (note 5)	433,875	307,000	6,026,879	5,908,280
<b>Total</b>	<b><u>5,333,010</u></b>	<b><u>2,861,000</u></b>	<b><u>7,015,754</u></b>	<b><u>6,880,440</u></b>

### e) Operating lease commitments

The future minimum lease payments under non-cancelable operating leases where the Bank is the lessee are follows:

	<u>2006</u>	<u>2005</u>
Less than 1 year	71,556	48,795
1 to 5 years	205,290	131,491
Over 5 years	155,531	89,979
<b>Total</b>	<b><u>432,377</u></b>	<b><u>270,265</u></b>

### 17. Net special commission income

	<u>2006</u>	<u>2005</u>
<b>Special commission income</b>		
Investments:		
Available for sale	172,979	45,900
Held to maturity	54,551	100,138
Other investments held at amortized cost	688,309	759,116
<b>Total</b>	<b><u>915,839</u></b>	<b><u>905,154</u></b>
Due from banks and other financial institutions	174,544	90,120
Loans and advances	3,519,945	2,449,460
Other	48,983	446
<b>Total</b>	<b><u>4,659,311</u></b>	<b><u>3,445,180</u></b>
<b>Special commission expense</b>		
Due to banks and other financial institutions	836,801	486,271
Customer deposits	1,203,471	721,027
Term loan	74,043	48,753
Debt securities in issue	20,039	-
<b>Total</b>	<b><u>2,134,354</u></b>	<b><u>1,256,051</u></b>
<b>Net special commission income</b>	<b><u>2,524,957</u></b>	<b><u>2,189,129</u></b>

# Arab National Bank – Saudi Joint Stock Company

## NOTES TO THE FINANCIAL STATEMENTS

For the years ended December 31, 2006 and 2005

(Saudi Riyals in Thousands)

### 18. Fees from banking services, net

	2006 SAR' 000	2005 SAR' 000
Fee income:		
Share trading and fund management	736,724	560,728
Trade finance	112,138	84,807
Other banking services	468,700	297,896
<b>Total fee income</b>	<b>1,317,562</b>	<b>943,431</b>
Fee expense:		
Credit cards	94,600	48,460
Custody and Brokerage Fees	135,380	109,532
Other banking services	101,081	91,524
<b>Total fee expense</b>	<b>331,061</b>	<b>249,516</b>
<b>Fees from banking services, net</b>	<b>986,501</b>	<b>693,915</b>

### 19. Income from FVIS financial instruments, net

	2006	2005
Fair value change on financial assets and liabilities held as FVIS investments	29,745	259
<b>Total</b>	<b>29,745</b>	<b>259</b>

### 20. Trading income, net

	2006	2005
Derivatives	2,612	3,646
Other	-	13,968
<b>Trading income, net</b>	<b>2,612</b>	<b>17,614</b>

### 21. Dividend income

	2006	2005
Available for sale investments	-	2,396
<b>Total</b>	<b>-</b>	<b>2,396</b>

### 22. Gains on non-trading investments, net

	2006	2005
Available for sale	106,033	90,670
<b>Total</b>	<b>106,033</b>	<b>90,670</b>

### 23. Other operating income

	2006	2005
Gains on disposal of property and equipment	30,459	1,286
Gains on disposal of other real estate	2,598	1,569
Recoveries of loans and advances previously written off	22,632	27,851
Other	14,880	3,047
<b>Total</b>	<b>70,569</b>	<b>33,753</b>



# Arab National Bank – Saudi Joint Stock Company

## NOTES TO THE FINANCIAL STATEMENTS

For the years ended December 31, 2006 and 2005

(Saudi Riyals in Thousands)

### 24. Other operating expenses

	<u>2006</u>	<u>2005</u>
Loss on disposal of property and equipment	14	67
Loss on disposal of other real estate	629	135
<b>Total</b>	<b><u>643</u></b>	<b><u>202</u></b>

### 25. Basic and fully Diluted Earnings per Share

Basic earnings per share is calculated by dividing the net income attributable to equity holders of the Bank by the weighted average number of ordinary shares in issue during the year.

The calculations of earnings per share for 2005 have been adjusted retrospectively to reflect the impact of the bonus shares issued during 2006.

The fully diluted earnings per share is the same as the basic earnings per share figure.

### 26. Gross dividend, Zakat and Income Tax

Gross dividend is comprised of the following :

	<u>2006</u>	<u>2005</u>
Interim dividend paid during the year	358,295	272,941
Zakat for second half 2006	30,375	-
Proposed final dividend	-	274,747
<b>Total</b>	<b><u>388,670</u></b>	<b><u>547,688</u></b>

The Board of Directors recommended no further dividend distribution for 2006.

The dividends are paid to the Saudi and non-Saudi shareholders after deduction of Zakat and income tax respectively as follows:

#### Zakat

Zakat attributable to Saudi Shareholders for the year amounted to approximately SAR 38.2 million (2005: SAR 28.6 million).

#### Income Tax

Income tax payable by the non Saudi Shareholder on the current year's share of income is SAR 203.8 million (2005: SAR 152.6 million).

### 27. Cash and cash equivalents

Cash and cash equivalents included in the statement of cash flows comprise the following:

	<u>2006</u>	<u>2005</u>
Cash and balances with SAMA excluding statutory deposit (note 3)	1,128,106	704,515
Due from banks and other financial institutions maturing within ninety days	4,595,837	3,933,675
<b>Total</b>	<b><u>5,723,943</u></b>	<b><u>4,638,190</u></b>

# Arab National Bank – Saudi Joint Stock Company

## NOTES TO THE FINANCIAL STATEMENTS

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### 28. Business segments

For management purpose the Bank is organized into the following major business segments:

#### Retail banking

Deposit, credit and investment product for individuals.

#### Corporate banking

Loans, deposits and other credit products for corporate and institutional customers, small to medium sized businesses and the London Branch.

#### Treasury banking

Manages the Bank's trading and investment portfolios and the Bank's liquidity, currency and commission rate risk.

Transactions between the business segments are reported as recorded in the Bank's transfer pricing system. Segment assets and liabilities comprise operating assets and liabilities, being the majority of the balance.

The Bank's primary business is conducted in the Kingdom of Saudi Arabia with one international branch. However, the total assets, liabilities, commitments and results of operations of this branch are not material to the Bank's overall financial statements.

- a) The Bank's total assets and liabilities as at December 31, 2006 and 2005, its total operating income, expenses and net income for the year then ended, by business segments, are as follows:

	Retail banking	Corporate banking	Treasury banking	Total
<u>2006</u>				
Total assets	24,898,180	28,105,206	25,031,997	78,035,383
Total liabilities	28,693,040	34,926,086	6,436,119	70,055,245
Total operating income	2,653,123	693,286	508,963	3,855,372
Total operating expenses	1,071,517	224,164	54,966	1,350,647
Net income	1,581,606	469,122	453,997	2,504,725
<u>2005</u>				
Total assets	20,514,936	21,200,820	25,776,323	67,492,079
Total liabilities	22,024,343	29,359,435	9,771,622	61,155,400
Total operating income	2,281,752	494,310	365,630	3,141,692
Total operating expenses	866,231	372,836	74,993	1,314,060
Net income	1,415,521	121,474	290,637	1,827,632

- b) The Bank's credit exposure by business segments is as follows:

	Retail banking	Corporate banking	Treasury banking	Total
<u>2006</u>				
Balance sheet assets	22,920,593	27,434,413	24,417,976	74,772,982
Commitment and contingencies	1,749,141	5,695,502	-	7,444,643
Derivatives	-	6,028	410,804	416,832
<u>2005</u>				
Balance sheet assets	19,204,341	20,732,423	25,012,932	64,949,696
Commitment and contingencies	1,171,453	4,327,776	-	5,499,229
Derivatives	-	35,694	507,633	543,327

Credit exposure comprises the carrying value of balance sheet assets, excluding cash, property and equipment, other real estate, and other assets. The credit equivalent value of commitments, contingencies and derivatives are included in credit exposure.

## Arab National Bank – Saudi Joint Stock Company

### NOTES TO THE FINANCIAL STATEMENTS

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#### 29. Credit risk

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and will cause the other party to incur a financial loss. The Bank attempts to control credit risk by monitoring credit exposures, limiting transactions with specific counterparties, and continually assessing the creditworthiness of counterparties.

In addition to monitoring credit limits, the Bank manages the credit exposure relating to its trading activities by entering into master netting agreements and collateral arrangements with counterparties in appropriate circumstances, and by limiting the duration of exposure. In certain cases the Bank may also close out transactions or assign them to other counterparties to mitigate credit risk.

Concentrations of credit risk arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions.

Concentrations of credit risk indicate the relative sensitivity of the bank's performance to developments affecting a particular industry or geographical location.

The Bank seeks to manage its credit risk exposure through the diversification of lending activities to ensure that there is no undue concentration of risks with individuals or groups of customers in specific locations or business. It also takes security when appropriate.

The debt securities included in investment portfolio are mainly sovereign risk. Analysis of investments by counterparty is provided in note 5. For details of the composition of the loans and advances refer to note 6. Information on credit risk relating to derivative instruments is provided in note 9, and for commitments and contingencies in note 15.

The bank classifies its exposure into ten risk categories. Of these, seven categories are for performing and three for non performing. Each borrower is rated on an internally developed objective risk rating model that evaluates risk based on financial as well as qualitative factors such as management strength, industry characteristics, account conduct and company type. An independent credit review unit reviews the assigned ratings periodically. Exposure falling below a certain classification threshold are considered to be impaired, and appropriate specific provisions are made against them by comparing the present value of expected future cash flows for each such exposure with its carrying amount based on the criteria prescribed by IAS 39. Collective impairment is also measured and recognized on a portfolio basis for group of similar credits that are not individually identified as impaired.

# Arab National Bank – Saudi Joint Stock Company

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### 30. Geographical concentration

- a) The distribution by geographical region for major categories of assets, liabilities, commitments and contingencies and credit exposure are as follows:

	2006	Saudi Arabia	Other GCC & Middle East	Europe	North America	Latin America	South East Asia	Other Countries	Total
<b>Assets</b>									
Cash and balances with SAMA		3,214,901	-	1,106	-	-	-	-	3,216,007
Due from banks and other financial institutions		618,750	1,041,360	2,238,916	670,472	-	61,040	2,799	4,633,337
Investments, net		9,888,447	344,562	4,825,408	3,233,141	-	-	-	18,291,558
Loans and advances, net		48,254,785	852,798	567,722	-	-	-	71,919	49,747,224
<b>Total</b>		<b>61,976,883</b>	<b>2,238,720</b>	<b>7,633,152</b>	<b>3,903,613</b>	<b>-</b>	<b>61,040</b>	<b>74,718</b>	<b>75,888,126</b>
<b>Liabilities</b>									
Due to banks and other financial institutions		1,794,349	900,332	72,623	15,164	-	203,635	112,500	3,098,603
Customer deposits		61,491,129	48,845	181,099	323	-	212	51,886	61,773,494
Term loan		296,250	461,250	543,750	11,250	-	-	-	1,312,500
Debt securities issued		-	840,000	810,750	-	-	224,250	-	1,875,000
<b>Total</b>		<b>63,581,728</b>	<b>2,250,427</b>	<b>1,608,222</b>	<b>26,737</b>	<b>-</b>	<b>428,097</b>	<b>164,386</b>	<b>68,059,597</b>
<b>Commitments and contingencies</b>		<b>7,199,342</b>	<b>2,235,738</b>	<b>1,997,451</b>	<b>1,642,795</b>	<b>33,242</b>	<b>3,126,259</b>	<b>350,584</b>	<b>16,585,411</b>
<b>Credit exposure (stated at credit equivalent amounts)</b>									
Commitments and contingencies		3,594,665	1,151,769	889,073	730,358	7,859	964,721	106,198	7,444,643
Derivatives		243,353	2,736	161,852	8,891	-	-	-	416,832
<b>2005</b>									
<b>Assets</b>									
Cash and balances with SAMA		2,493,456	-	1,730	-	-	-	-	2,495,186
Due from banks and other financial institutions		637,500	439,661	2,624,143	152,290	-	78,872	1,209	3,933,675
Investments, net		12,629,584	351,389	3,753,828	3,600,186	-	-	87,663	20,422,650
Loans and advances, net		37,508,070	1,106,038	117,009	-	-	-	47,439	38,778,556
<b>Total</b>		<b>53,268,610</b>	<b>1,897,088</b>	<b>6,496,710</b>	<b>3,752,476</b>	<b>-</b>	<b>78,872</b>	<b>136,311</b>	<b>65,630,067</b>
<b>Liabilities</b>									
Due to banks and other financial institutions		1,717,000	4,293,952	1,283,117	1,059,698	-	20,579	2,588	8,376,934
Customer deposits		48,443,376	186,120	200,429	352	-	-	2,187	48,832,464
Term loan		296,250	461,250	543,750	11,250	-	-	-	1,312,500
<b>Total</b>		<b>50,456,626</b>	<b>4,941,322</b>	<b>2,027,296</b>	<b>1,071,300</b>	<b>-</b>	<b>20,579</b>	<b>4,775</b>	<b>58,521,898</b>
<b>Commitments and contingencies</b>		<b>6,452,123</b>	<b>862,415</b>	<b>2,192,244</b>	<b>514,422</b>	<b>28,942</b>	<b>1,502,039</b>	<b>93,015</b>	<b>11,645,200</b>
<b>Credit exposure (stated at credit equivalent amounts)</b>									
Commitments and contingencies		3,163,568	434,038	981,239	226,206	8,315	661,320	24,543	5,499,229
Derivatives		393,927	5,497	127,577	15,948	-	378	-	543,327

Credit equivalent amounts reflect the amounts that result from translating the Bank's off-balance sheet liabilities into the risk equivalent of loans using credit conversion factors prescribed by SAMA. Credit conversion factor is meant to capture the potential credit risk related to the exercise of the commitment.

- b) The distributions by geographical concentration of non-performing loans and advances and provision for credit losses are as follows:

	Non-performing loans, net		Provision for credit losses	
	2006	2005	2006	2005
Saudi Arabia	369,724	846,626	1,152,357	1,667,983
Europe	-	-	32,714	30,666
<b>Total</b>	<b>369,724</b>	<b>846,626</b>	<b>1,185,071</b>	<b>1,698,649</b>

# Arab National Bank – Saudi Joint Stock Company

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### 31. Currency risk

The Bank manages exposure to the effects of fluctuations in prevailing foreign currency exchange rates on its financial position and cash flows. The Board of Directors sets limits on the level of exposure by currency and in total for both overnight and intra-day positions, which are monitored daily. At the end of the year, the Bank had the following significant net exposures denominated in foreign currencies:

	<u>Long (short)</u>	<u>Long</u>
	<u>2006</u>	<u>2005</u>
US Dollar	308,814	96,140
Euro	20,072	14
Pound Sterling	(19,763)	17
Other	19,403	27,750

### 32. Commission rate risk

#### Commission sensitivity of assets, liabilities and off balance sheet items

The Bank manages exposure to the effects of various risks associated with fluctuations in the prevailing levels of market commission rates on its financial position and cash flows.

The table below summarizes the Bank's exposure to commission rate risks. Included in the table are the Bank's assets and liabilities at carrying amounts, categorized by the earlier of contractual re-pricing or maturity dates. The Bank is exposed to commission rate risk as a result of mismatches or gaps in the amounts of assets and liabilities and off balance sheet instruments that mature or re-price in a given period. The Bank manages this risk by matching the re-pricing of assets and liabilities through risk management strategies.

<u>2006</u>	<u>Within 3</u>	<u>3-12</u>	<u>1-5</u>	<u>Over 5</u>	<u>Non-</u>	<u>Total</u>	<u>Effective</u>
	<u>months</u>	<u>months</u>	<u>years</u>	<u>years</u>	<u>commission</u>		<u>commission</u>
					<u>bearing</u>		<u>rate (%)</u>
<b>Assets</b>							
Cash and balances with SAMA	999	-	-	-	3,215,008	3,216,007	
Due from banks and other financial institutions	4,158,892	37,500	-	-	436,945	4,633,337	4.73
Investments, net	3,176,057	2,198,620	9,671,973	1,365,700	1,879,208	18,291,558	4.76
Loans and advances, net	22,376,744	11,086,930	12,079,777	4,203,773	-	49,747,224	8.10
Other real estate	-	-	-	-	155,127	155,127	
Property and equipment, net	-	-	-	-	586,251	586,251	
Other assets	-	-	-	-	1,405,879	1,405,879	
<b>Total assets</b>	<u>29,712,692</u>	<u>13,323,050</u>	<u>21,751,750</u>	<u>5,569,473</u>	<u>7,678,418</u>	<u>78,035,383</u>	
<b>Liabilities and shareholders' equity</b>							
Due to banks and other financial institutions	2,358,594	605,675	-	-	134,334	3,098,603	4.82
Customer deposits	34,723,070	5,860,955	495,114	-	20,694,355	61,773,494	3.25
Other liabilities	-	-	-	-	1,995,648	1,995,648	
Term Loan	1,312,500	-	-	-	-	1,312,500	5.37
Debt securities in issue	1,875,000	-	-	-	-	1,875,000	5.38
Shareholders' equity	-	-	-	-	7,980,138	7,980,138	
<b>Total Liabilities and shareholders' equity</b>	<u>40,269,164</u>	<u>6,466,630</u>	<u>495,114</u>	<u>-</u>	<u>30,804,475</u>	<u>78,035,383</u>	
<b>On balance sheet gap</b>	<u>(9,558,775)</u>	<u>6,856,420</u>	<u>21,256,636</u>	<u>5,569,473</u>	<u>(24,123,754)</u>		
<b>Off balance sheet gap</b>	<u>1,535,193</u>	<u>1,327,316</u>	<u>(2,659,898)</u>	<u>(202,611)</u>	<u>-</u>		
<b>Total commission rate sensitivity gap</b>	<u>(8,023,582)</u>	<u>8,183,736</u>	<u>18,596,738</u>	<u>5,366,862</u>	<u>(24,123,754)</u>		
<b>Cumulative commission rate sensitivity gap</b>	<u>(8,023,582)</u>	<u>160,154</u>	<u>18,756,892</u>	<u>24,123,754</u>	<u>-</u>		

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## NOTES TO THE FINANCIAL STATEMENTS

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### 32. Commission rate risk (continued)

<u>2005</u>	<u>Within 3 months</u>	<u>3-12 months</u>	<u>1-5 years</u>	<u>Over 5 years</u>	<u>Non commission bearing</u>	<u>Total</u>	<u>Effective commission rate (%)</u>
<b>Assets</b>							
Cash and balances with SAMA	-	-	-	-	2,495,186	2,495,186	
Due from banks and other financial institutions	3,457,177	-	-	-	476,498	3,933,675	3.79
Investments, net	4,868,402	1,958,114	10,131,824	2,120,625	1,343,685	20,422,650	4.81
Loans and advances, net	16,157,432	8,790,459	8,537,489	5,293,176	-	38,778,556	8.05
Other real estate	-	-	-	-	158,865	158,865	
Property and equipment, net	-	-	-	-	418,108	418,108	
Other assets	-	-	-	-	1,285,039	1,285,039	
<b>Total assets</b>	<u>24,483,011</u>	<u>10,748,573</u>	<u>18,669,313</u>	<u>7,413,801</u>	<u>6,177,381</u>	<u>67,492,079</u>	
<b>Liabilities and shareholders' equity</b>							
Due to banks and other financial institutions	7,067,612	1,188,750	-	-	120,572	8,376,934	4.40
Customer deposits	23,451,548	5,287,484	583,183	-	19,510,249	48,832,464	3.13
Other liabilities	-	-	-	-	2,633,502	2,633,502	
Term Loan	-	1,312,500	-	-	-	1,312,500	4.23
Shareholders' equity	-	-	-	-	6,336,679	6,336,679	
<b>Total Liabilities and shareholders' equity</b>	<u>30,519,160</u>	<u>7,788,734</u>	<u>583,183</u>	<u>-</u>	<u>28,601,002</u>	<u>67,492,079</u>	
On balance sheet gap	(6,036,149)	2,959,839	18,086,130	7,413,801	(22,423,621)		
Off balance sheet gap	4,581,475	(1,230,755)	(1,444,889)	(1,905,831)	-		
<b>Total commission rate sensitivity gap</b>	<u>(1,454,674)</u>	<u>1,729,084</u>	<u>16,641,241</u>	<u>5,507,970</u>	<u>(22,423,621)</u>		
<b>Cumulative commission rate sensitivity gap</b>	<u>(1,454,674)</u>	<u>274,410</u>	<u>16,915,651</u>	<u>22,423,621</u>	<u>-</u>		

The off-balance sheet gap represents the net notional amounts of derivative financial instruments, which are used to manage the commission rate risk.

The effective commission rate (effective yield) of a monetary financial instrument is the rate that, when used in a present value calculation, results in the carrying amount of the instrument. The rate is a historical rate for a fixed rate instrument carried at amortized cost and a current market rate for a floating rate instrument or an instrument carried at fair value.

### 33. Liquidity risk

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

The table below summarizes the maturity profile of the Bank's assets and liabilities. The contractual maturities of assets and liabilities have been determined on the basis of the remaining period at the balance sheet date to the contractual maturity date and do not take account of the effective maturities as indicated by the Bank's deposit retention history. Management monitors the maturity profile to ensure that adequate liquidity is maintained.

In accordance with Banking Control Law and the regulations issued by SAMA, the Bank maintains a statutory deposit with SAMA equal to 7% of total demand deposits and 2% of saving and time deposits. In addition to the statutory deposit, the Bank also maintains liquid reserves of no less than 20% of its deposit liabilities, in the form of cash, gold, Saudi Government Development Bonds or assets, which can be converted into cash within a period not exceeding 30 days.

The Bank has the ability to raise additional funds through repo facilities with SAMA against Saudi Government Development Bonds up to 75% of the nominal value of bonds held.

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### 33. Liquidity risk (continued)

The maturity profile of the assets and liabilities is as follows:

<u>2006</u>	Within 3 months	3-12 months	1-5 years	Over 5 years	No fixed maturity	Total
<b>Assets</b>						
Cash and balances with SAMA	999	-	-	-	3,215,008	3,216,007
Due from banks and other financial institutions	4,158,892	37,500	-	-	436,945	4,633,337
Investments, net	950,000	736,186	11,006,865	3,719,299	1,879,208	18,291,558
Loans and advances, net	11,566,972	9,328,223	15,414,782	7,013,030	6,424,217	49,747,224
Other real estate	-	-	-	-	155,127	155,127
Property and equipment, net	-	-	-	-	586,251	586,251
Other assets	-	-	-	-	1,405,879	1,405,879
<b>Total assets</b>	<b><u>16,676,863</u></b>	<b><u>10,101,909</u></b>	<b><u>26,421,647</u></b>	<b><u>10,732,329</u></b>	<b><u>14,102,635</u></b>	<b><u>78,035,383</u></b>
<b>Liabilities and shareholders' equity</b>						
Due to banks and other financial institutions	2,358,594	605,675	-	-	134,334	3,098,603
Customer deposits	32,318,653	5,859,868	495,114	-	23,099,859	61,773,494
Other liabilities	-	-	-	-	1,995,648	1,995,648
Term Loan	-	-	1,312,500	-	-	1,312,500
Debt securities in issue	-	-	-	1,875,000	-	1,875,000
Shareholders' equity	-	-	-	-	7,980,138	7,980,138
<b>Total liabilities and shareholders' equity</b>	<b><u>34,677,247</u></b>	<b><u>6,465,543</u></b>	<b><u>1,807,614</u></b>	<b><u>1,875,000</u></b>	<b><u>33,209,979</u></b>	<b><u>78,035,383</u></b>
<u>2005</u>						
<b>Assets</b>						
Cash and balances with SAMA	-	-	-	-	2,495,186	2,495,186
Due from banks and other financial institutions	3,457,177	-	-	-	476,498	3,933,675
Investments, net	312,406	3,697,489	12,182,414	2,886,656	1,343,685	20,422,650
Loans and advances, net	8,462,061	7,021,559	11,808,090	6,857,384	4,629,462	38,778,556
Other real estate	-	-	-	-	158,865	158,865
Property and equipment, net	-	-	-	-	418,108	418,108
Other assets	-	-	-	-	1,285,039	1,285,039
<b>Total assets</b>	<b><u>12,231,644</u></b>	<b><u>10,719,048</u></b>	<b><u>23,990,504</u></b>	<b><u>9,744,040</u></b>	<b><u>10,806,843</u></b>	<b><u>67,492,079</u></b>
<b>Liabilities and shareholders' equity</b>						
Due to banks and other financial institutions	7,067,611	1,188,750	-	-	120,573	8,376,934
Customer deposits	22,986,493	5,286,513	583,183	-	19,976,275	48,832,464
Other liabilities	-	-	-	-	2,633,502	2,633,502
Term Loan	-	-	1,312,500	-	-	1,312,500
Shareholders' equity	-	-	-	-	6,336,679	6,336,679
<b>Total liabilities and shareholders' equity</b>	<b><u>30,054,104</u></b>	<b><u>6,475,263</u></b>	<b><u>1,895,683</u></b>	<b><u>-</u></b>	<b><u>29,067,029</u></b>	<b><u>67,492,079</u></b>

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### 34. Fair values of financial assets and liabilities

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

The fair values of on-balance sheet financial instruments, except for other investments held at amortized cost, held-to-maturity investments, loans and advances and customer deposits which are carried at amortized cost, are not significantly different from the carrying values included in the financial statements. The estimated fair values of held-to-maturity investments and other investments held at amortized cost are based on quoted market prices when available or pricing models in the case of certain fixed rate bonds. The fair values of these investments are disclosed in note 5. Loans and advances are stated at cost, adjusted for effective hedge, and stated net of interest suspended, provision for impairment and any amounts written off.

The fair values of derivatives and other off-balance sheet financial instruments are based on the quoted market prices when available or by using the appropriate valuation models. The total amount of the changes in fair value recognized in the statement of income, which was estimated using valuation models, is SAR 7.5 millions (2005: SAR 35.1 millions).

### 35. Related party transactions

In the ordinary course of its activities, the Bank transacts business with related parties. In the opinion of the management and the board, the related party transactions are performed on an arm's length basis. The related party transactions are governed by limits set by the Banking Control Law and regulations issued by SAMA.

a) The balances as at December 31 resulting from such transactions included in the financial statements are as follows:

	<u>2006</u>	<u>2005</u>
<b>Arab Bank PLC</b>		
Due from banks and other financial institutions	1,128,524	376,335
Due to banks and other financial institutions	539,435	896,813
Commitments and contingencies	1,978,565	1,259,605
<b>Directors, key management personnel, other major shareholders and their affiliates:</b>		
Loans and advances	1,503,440	987,976
Customer deposits	4,177,872	3,613,009
Derivatives (at fair value)	8,072	8,079
Commitments and contingencies	328,718	377,891
<b>Bank's mutual funds</b>		
Investments	293,645	98,776
Loans and advances	46,112	106,840
Customer deposits	1,455,182	1,366,443

Other major shareholders represent shareholdings (excluding the non-Saudi shareholder) of more than 5% of the Bank's issued share capital

b) Income and expenses pertaining to transactions with related parties included in the financial statements are as follows:

	<u>2006</u>	<u>2005</u>
Special commission income	116,872	37,757
Special commission expense	220,637	149,777
Fees from banking services	47,965	31,848
Directors' remuneration	2,179	1,940

c) The total amount of compensation paid to key management personnel during the year is as follows:

	<u>2006</u>	<u>2005</u>
Short-term employee benefits (Salaries and allowances)	40,649	23,558
Post-employment benefits (End of service indemnity and social security)	3,346	1,633

Key management personnel are those persons, including an executive director, having authority and responsibility for planning, directing and controlling the activities of the Bank, directly or indirectly.



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### 36. Capital Adequacy

The Bank monitors the adequacy of its capital using ratios established by SAMA. These ratios measure capital adequacy by comparing the Bank's eligible capital with its balance sheet assets, commitments and contingencies and notional amount of derivatives at a weighted amount to reflect their relative risk.

	2006			2005		
	Capital	Ratio %		Capital	Ratio %	
Tier 1	7,980,138	13.1		6,336,679	14.0	
Tier 1 + Tier 2	10,470,909	17.1		7,133,330	15.8	
<b>Risk weighted assets</b>	<b>2006</b>			<b>2005</b>		
	Carrying value / notional	Credit equivalent	Risk weighted assets	Carrying value / notional	Credit equivalent	Risk weighted assets
<b>Balance sheets assets</b>						
0 %	15,643,670	-	-	20,077,637	-	-
20 %	8,632,318	-	1,726,463	7,888,915	-	1,577,783
100 %	53,759,395	-	53,759,395	39,525,527	-	39,525,527
<b>Total</b>	<b>78,035,383</b>	<b>-</b>	<b>55,485,858</b>	<b>67,492,079</b>	<b>-</b>	<b>41,103,310</b>
<b>Commitments and contingencies</b>						
0 %	418,719	170,562	-	328,169	147,112	-
20 %	4,655,251	2,225,644	445,129	3,732,789	1,770,987	354,197
100 %	11,511,441	5,048,437	5,048,437	7,584,242	3,581,130	3,581,130
<b>Total</b>	<b>16,585,411</b>	<b>7,444,643</b>	<b>5,493,566</b>	<b>11,645,200</b>	<b>5,499,229</b>	<b>3,935,327</b>
<b>Derivatives</b>						
20 %	27,280,981	259,144	51,829	29,118,779	242,839	48,568
50 %	9,046,410	157,688	78,844	3,285,229	300,488	150,245
<b>Total</b>	<b>36,327,391</b>	<b>416,832</b>	<b>130,673</b>	<b>32,404,008</b>	<b>543,327</b>	<b>198,813</b>
<b>Grand total</b>			<b>61,110,097</b>			<b>45,237,450</b>

### 37. Investment management services

The Bank offers investment services to its customers, which include management of investment funds with assets totaling SAR 2,972 million (2005: SAR 4,086 million).

The financial statements of these funds are not consolidated with these financial statements. However, the Bank's share of these funds is included in available-for-sale investments and fees earned are disclosed under related party transactions.

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

### 38. Comparative figures

Certain prior year figures have been reclassified to conform with current year presentation.

### 39. Board of directors' approval

The financial statements were approved by the Board of Directors on January 15, 2007 ( Dhul-Hijjah 25, 1427)