

Accounting Issues in Islamic Financial Industry and the Way Out

Shaukat Amer^{1*} Sofri Bin Yahya²

1- COMSATS Institute of Information Technology, Kamra Road, Attock, Pakistan.

2- Dean, Graduate School of Business, Universiti Sains Malaysia, Malaysia

*E-mail of the corresponding author: shaukat_amer@comsats.edu.pk

Abstract

Presently mostly people serving the Islamic financial industry have conventional background in education and training, which is its self a great hazard in operating these organizations. Largely these academicians and professionals are not fit and capable to assume assignments in Islamic financial industry, because of its basic difference in terms of philosophy, approach, expertise and morality with the conventional finance and business theories and practices. The same is the case with the accounting professionals working in the Islamic financial industry. In this background, there is an urgent need to launch a highly profiled accounting and auditing composite Shariah compliant professional qualification imparting education and training in close collaboration with Islamic financial institutions, country regulating bodies, prominent Shariah and International Islamic regulating institutions. This qualification may be called “Certified Shariah Public Accountant” or any other suitable name in lines with the other professional accounting bodies of Muslim world. The task may be entrusted jointly to accounting professional bodies of Muslim countries. Similarly the role of AAOFI may be enhanced to a single accounting setter so that the accounts of Islamic banks and financial institutions must be maintained, finalized and reported as per these standards instead of IFRS, GAAP and national standards.

Keywords: Islamic Financial Industry, Accounting Issues, Accounting & Reporting Standards, New Scheme of Study.

1- Introduction

It is a matter of great satisfaction that the Islamic banking and finance sector is presently growing at a very fast pace in Muslims countries but still there are a lot of challenges ahead to get a fully Shariah compliant Islamic financial industry which can get complete satisfaction of Muslim Ummah as it is a matter of faith. In this respect the most neglected aspect and main hazard in implementing 100 percent fully Shariah complaint Islamic finance is lack of properly trained manpower and professionals who can ensure 100 percent Shariah compliant formulation and implementation of Islamic modes of finance. We need specific education and training in various areas of management for having a fully compliant Islamic financial industry.

“The real problem is the workforce, or the human capital, needed for *Shariah*-compliant management of business and finances of the people. The human resource produced by the conventional academic and capacity-building programs cannot satisfy the demands and challenges of the Islamic financial institutions” (Anis, 2008). Notably highly profiled and qualified academicians and professionals in Islamic finance are required in the following areas:

- i- Shariah
- ii- Finance
- iii- Accounting
- iv- Auditing
- v- Management

- vi- Marketing
- vii- Human Resource Development
- viii- Human Resource Management
- ix- Banking
- x- Governance
- xi- Commercial Laws
- xii- Regulating
- xiii- Master Training
- xiv- Capacity Building
- xv- Institutional Development

Here we are only focusing on the state of affairs in the field of accounting. Presently following a few professional programs of quality is being offered by different institutions:

Name of Institution

Title of Professional Program

International Centre for Education in Islamic Finance Malaysia. (INCEIF)	Chartered Islamic Finance Professional (CIFP)
Accounting and Auditing Organization for Islamic Financial Institutions, Bahrain. (AAOIFI)	Certified Islamic Professional Accountants (CIPA). Certified Shari'a Adviser and Auditor (CSAA)

There is a need to boost and speed up the above efforts. While the efforts of above institution are commendable it is worthwhile to be noted with concern that the accounts of Islamic banks and financial institution are still largely are being maintained , finalized and reported as per IFRS, GAAP and national standards and as regulated by the central bank /corporate law body of the respective country.

In addition to other steps, there is a need to launch a highly profiled accounting and auditing composite Shariah compliant professional qualification imparting education and training in close collaboration with Islamic financial institutions, country regulating bodies, prominent Shariah and International Islamic regulating institutions. The objectives of proposed scheme of professional education and training may inter-alia include the following:

- 1- Providing a research and professional base for development of a new set of accounting and auditing standards for commercial and non commercial institutions in lines with Shariah, replacing all type of existing conventional standards. (Present focus would be on Islamic financial industry)
- 2- Development of a complete theoretical and practical accounting and auditing frame work for commercial and non commercial institutions in lines with Shariah, replacing all type of present conventional standards. (Again present focus would be on Islamic financial industry)
- 3- Producing professional and managers in lower, middle and top management level in lines with the above objectives to take positions in commercial and non commercial institutions in the following cadre: (The present focus would be on Islamic financial Industry)
 - I- Finance
 - II- Accounting
 - III- Auditing
 - IV- General Management

- V- Secretarial
- VI- Regulating
- 4- Developing and introducing new institution of firms of accountants and consultants.

2- Literature Review

Established on March 27, 1991, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) is an Islamic international autonomous non-for-profit corporate body that prepares accounting, auditing, governance, ethics and Shari'a standards for Islamic financial institutions and the industry. Professional qualification programs (notably CIPA, the Shari'a Adviser and Auditor "CSAA", and the corporate compliance program) are presented now by AAOIFI in its efforts to enhance the industry's human resources base and governance structures (AAOIFI, 2014).

So far AAOIFI has issued 48 Shari'a, 26 accounting, 5 auditing, 7 governance and 2 ethics standards. (Details at Table 1, 2 & 3). These standards are both in Arabic and English. The organization provides a comprehensive Shariah, accounting, auditing and governance framework for Islamic financial institutions. Ideally the Islamic financial institutions should formulate and adopt the accounting and auditing policies, procedures and practices in lines and compliance with these standards instead of conventional standards. However, the state of affairs in this respect is different.

Kuwait Finance House (KFH) is one of the best examples of Shariah compliant banking. However, they also prepare accounts on the basis of International Financial Reporting Standards (IFRS), as reflects by Table-4. There is no doubt that in every Islamic financial institution a mechanism comprise of a Shariah supervisory board/advisor exist which is supposed to look into the Shariah compliance aspects of banking but they have no direct supervision or control over day to day business transaction. The most important issue here is that the accounts are prepared and reported under IFRS or GAAP or National or a mixed of these standards. This itself negate and in conflict of the philosophy or basis of Shariah and consequently result in a major non-compliance of accounting, auditing and Shariah standards as applicable to Islamic banking and finance.

“Islamic banks operate mainly in developing countries in the Middle East, Africa and South-East Asia and are facing some difficulties adopting unique accounting standards into their practice due to the absence of a legal framework and inconsistency of financial reporting. For instance, financial institutions in some countries, such as Jordan, the UAE and Qatar, are officially required to comply with the International Accounting Standards (IASs). Meanwhile, in countries such as Saudi Arabia, the authorities require compliance with both IAS and local accounting standards. In Malaysia, there are national accounting standards, which are based on IAS (Ahmed, 2002). In Bahrain, the authorities require compliance with both AAOIFI and IFRS as requested by Central Bank of Bahrain (CBB)” (Sarea, 2012).

“It is apparent, therefore, that many aspects of the Islamic economy differ greatly from Western economies. Anglo-American accounting techniques cannot be readily applied in Islamic economies and thus, international accounting standards based on such techniques would create difficulties for Muslims around the world. For this reason, it is important for Muslim accountants to develop accounting standards which are specially adapted to Islamic needs, and for Muslim countries to ensure that these are considered by international accounting standard-setting bodies” (Shadia Rahman, 2007).

“However, it must be noted that the Shariah standards carry a superior imperative authority derived from the established principle for Islamic financial institutions that they must adhere to the Shariah. On the other hand, the accounting standards derive their authority from supervisory agencies adopting and requiring them. This is in addition to the differences between each type in terms of how wide or narrow the need for them may be” (Ghuddah),

“The whole system of conventional accounting theory and practice are deficient (Gambling and Abdel Karim, 1986; Abdulgader, 1994; Ather, 2010; Askary and Jackling, 2004; Baydoun and Wilett, 2000; Mirza and Baydoun, 1999, Amer, 2007; Lewis, 2001; Sulaiman and Wilett, 2001, Abdul-Baki, Zayyad, et al., 2014)

The present accounting profession its self is under heavy criticism. These include both in terms of theory and practice. The present accounting profession lacks the basic Islamic concepts of “*Amanah*” (Amer, 2007), “*Sahadat*” (Amer, 2007), “*Adl*” and “*Ihsan*” (Amer & Sofri, 2014).

Today a basic and big question in front of us is that whether valuation of a business transaction is possible without taking into consideration the accountability aspect of accounting treatment? Through valuation we try to measure and transmit business transaction in monetary terms. Now what are the characteristics of these valuations? In my opinion these are:

- 1- Wide range of discretion to select alternates (accounting policies) to treat transactions which may in return materially affect results which will ultimately effect financial reporting.
- 2- This may lead to incompatible comparison of set of alternates for business decision making.
- 3- Treatment of transaction with the intention to manipulate results.
- 4- Under and overvaluation of accounts to cover misappropriation of funds.
- 5- Although debatable its self, the harmonization of accounting is not achievable.

In above circumstances the present accounting profession is being failed even in its overemphasized role of valuation. Concisely the accounting may not even deliver the correct value of business transactions to the stakeholders. The situation is further grieved in the present global and corporate environment due to governance problems.

There are a number of differences between conventional standards and Islamic teaching. For example the treatment of transaction under going concern would not be valid under a transaction of *mudarabah*. Similarly the valuation of inventory for the purpose of calculation of ‘*Zakat*’ would be different then “lower of market value or cost”. Likewise in practice due to accounts and tax requirements, we use to write back our unclaimed payables after a certain period. However, in the light of following Hadith our treatment to such items would be different.

“Salim b. ‘Abdullah reported on the authority of his father: I heard the Messenger of Allah (Sallallahu Alaihay wa Sallam) saying: “Who ever of you can, should become like the one who had a *faraq* (measure) of rice.” They (people) said: “Who is one who had a *faraq* of rice, Messenger of Allah?” He mentioned the tradition of the people (who were trapped) in the cave by falling of the rock on it. Then they said to another: Recall best of your deeds.” And the third one said: “O Allah! You know I hired a labourer for a measure (*faraq*) of rice, when evening befell I offered him his wages, he refused to accept it and went away. I invested that on his behalf until I gathered on his account a cow and its claves. Subsequently, he met me and said: Give me my wages. I asked him: Go towards that cow and its claves and get that. He went to that (herd) and drove it way.”

(Sunan Abu Dawud)

In order to make the Islamic banking and finance fully Shariah compliant, there is a need that first we go for a new accounting theory based on Islamic principles and develop a new set of accounting standards. In this background the concepts of “*Amanah*” (Custody) (Amer, 2007), “*Shahadat*” (Testimony), (Amer, 2008) “*Shura*” (Counseling) (Amer, 2008), *Al-Adl* and *Al-Ihsan* (Amer & Sofri 2014) and settlement in “*Bay*” (business transaction) (Amer & Suzana, 2014) may be taken into consideration.

There is no doubt that a primary Shariah frame work in the shape of standards and Fatawa of Islamic financial institutions exist but there is a problem with its implementation. In the first instance these standards are not being applied by all the Islamic financial institutions. A few countries like Sudan, Syria and Bahrain have adopted the Shariah Standards issued by the AAOIFI. Mostly the Islamic financial institutions have their own Supervisory Shariah Advisory Boards or Advisors who oversee and responsible for audit and Shariah compliance. In many cases the members of these boards have not the knowledge of both ‘*Shariah*’ and finance. Then such boards are not a part of management of Islamic financial Institutions. Then as a common governance problem, such board may lack independence in their decisions.

The Accounting and Auditing Organization for Islamic financial institutions has introduced a complete set of international accounting and auditing standards for Islamic financial Institutions. As a policy these standards should replace National Standards, IFRS and Standards based on GAAP. However, except for a few countries, these have not been adopted.

Presently there is no accounting theory based on Islamic teachings. The present conventional accounting is its self under fire(e.g. GAO, 1996, Largay,2002, Colson, 2004, Kearney, 2005, Waddock, 2005, Hansen,2008, Bratton et al, 2006, McGregor & Street, 2007)which as we have seen, is in conflict with Shariah. Non existence of accounting theory and non adoption of AAOIFI standards plays a big question mark on Shariah compliance by the Islamic financial institutions.

The same is the case with the auditing procedures and auditing standards adopted by the Islamic financial institutions. Most of the financial institutions have not adopted the auditing procedures and standards issued by AAOIFI. Then the non-competence in Shariah and audit of both internal and external auditors carries a big question mark.

There is a lack of confidence and coordination between international and national law makers and regulating authorities. For example it was the duty of central banks to prevail upon the Islamic financial intuitions to adopt all the standards issued by AAOIFI as now State Bank of Pakistan has adopted a policy to impose Shariah Standards on Islamic banking slowly and gradually. For this purpose necessary amendments in relevant laws should had been made. However, it appears that the central banks don’t want to forgo their supremacy. Actually the affairs of Islamic financial institutions should be made 100 percent ‘*Shariah*’ complaint. In Islam there is no concept of less or more “*haram*”(inadmissible). In Shariah a thing is 100 percent “*haram*” or ‘*halal*’ (permissible).

3- Findings

There is a need of a complete conceptual framework of accounting consist of accounting theory and standards specifically developed for Islamic countries. Side by side there is an urgent need to produced “*Shariah Complaint Accountants*”. In this respect the following steps are proposed:

3-1-1 All the accounting professional accounting bodies join hand together to develop conceptual framework as being discussed here.

Module-8	<ol style="list-style-type: none"> 1- Accounting and Accounting Standards based on Islamic Teachings (Present Focus on Islamic Financial Industry)-II 2- Auditing and Auditing Standards based on Islamic Teachings (Present Focus on Islamic Financial Industry)-II. 3- Corporate Laws and Governance
----------	---

3-1-4 Proposed Minimum Eligibility Criteria

B.Com. BBA.BA, BSC and any Bachelor or Equivalent Degree from a recognized educational institutions or “*madaris*”.

3-1-5- Experience Requirements or Certification

3 to 4 years in commercial and non commercial institutions including Islamic financial institutions at the time of applying for the membership.

4-Conclusion

A big questions in front of Muslim ‘*Ummah*’ is that why we don’t take our own start through copying Sahabah (Razi Allahu un-huma) and Caliphs. Our first step in this respect should be to develop a complete accounting and auditing framework for Islamic financial industry completely based on Islamic teachings. The accounting professional bodies of Islamic countries, IFSB and AAOIFI can play a major role in this respect. As a start all the Islamic financial institutions should adopt completely all the standards of IFSB and AAOIFI. AAOIFI should be the only accounting standards body. In this respect necessary legislation may be done by the Muslim countries to make it binding by all the parties. Riba based transactions may completely be banned in the Muslims countries. For international transactions with the non- Muslim countries a workable mechanism can be evolved in the light of Shariah.

Side by side we should produce such professional who may carry out different business assignments as being discussed here. Especially the managers, accountants and auditors should completely be “Shariah Compliant Professionals”.

In this respect the professional accounting bodies of Muslim countries should jointly start a highly profiled accounting composite Shariah compliant professional qualification in close collaboration with Islamic financial institutions, country regulating bodies, prominent Shariah academies and International Islamic regulating institutions. This qualification may be called “Certified Shariah Public Accountant” or any other suitable name as deemed appropriate through a cluster approach as proposed by Amer and Yahiya in case of business education (2014).

We should always remember the message of Allah Subhanahu wa Tala that “And strive hard in Allah's Cause as you ought to strive (with sincerity and with all your efforts that His Name should be superior). He has chosen you (to convey His Message of Islamic Monotheism to mankind by inviting them to His religion, Islam), and has not laid upon you in religion any hardship, it is the religion of your father Ibrahim (Abraham) (Islamic Monotheism). It is He (Allah) Who has named you Muslims both before and in this (the *Qur'an*), that the Messenger (Muhammad SAW) may be a witness over you and you be witnesses over mankind! So perform AsSalat (Iqamat-as-Salat), give Zakat and hold fast to Allah [i.e. have confidence in Allah, and

depend upon Him in all your affairs] He is your Maula (Patron, Lord, etc.), what an Excellent Maula (Patron, Lord, etc.) and what an Excellent Helper!"

(Surah Al-Hajj:: Verse 78)

References:

- Abdul-Baki, Z., Uthman, A. B., Olanrewaju, A. A., & Ibrahim, S. A. 2013. Islamic perspective of management accounting decision making techniques. *Journal of Islamic Accounting and Business Research*, 4(2), 203-219.
- Accounting and Auditing Organization for Islamic Financial Institutions, 2014, Standards, retrieved on March 11, 2014, www.aaofii.com.
- Amer, Shaukat & Sofri Yahya, 2014, Development of Islamic Accounting Theory: Principle of *Al-Adl* and *Al-Ihsan*, *Research Journal of Finance and Accounting*, 5,(4),13-20.
- Amer, shaukat & Suzana, Raja, 2013, Exploring "*Bay*" in Search of New Dimensions for Accounting Theory and Standards, *European Journal of Business and Management*, Special Issue on Islamic Management and Business, 5 (11) 83-93.
- Amer, Shaukat, 2007, "Development of Islamic Accounting Theory: Principle of Amanah and Accountant as Ameen", Dacca, Bangladesh, World Business Institute, Australia.
- Amer, Shaukat, 2012, Development of Accounting Theory Based on Islamic Principles and Accounting Standards Setting Mechanism, International Islamic Accounting and Finance Conference 2012, Kuala Lumpur, Malaysia.
- Amer, Shaukat, 2007, "Development of Islamic Accounting Theory: Principle of Shahadat (Testimony) - 2nd Principle", *International Review of Business Research Papers*, 3(3), 56-68.
- Anis, Ahmed, 2008, Human Resource & Capacity Building for Islamic Financial Institutions, retrieved on March 02, 2013 from KANTAKJI, www.kantakji.com/fiqh/Files/Manage/k110.pdf.
- Bukhari, Muslim, Malik, and Dawud Hadith Collection, Imaan Star. Com., www.imaanstar.com/hadith.php.
- General Accounting Office Report, 1996, "The Accounting Profession-Major Issues: Progress and Concerns" Hansen, Bowe, 2008, Lobbying of the International Accounting Standards Board: An empirical investigation", Social Science Research Network, www.ssrn.com.
- Ghuddah, Abdus Sattar Abu, The Mechanism of Shariah Standards and the Necessity of Commitment to Them, retrieved from, International Shari'ah Research Academy for Islamic Finance (ISRA), www.isra.my/articles/islamic-accounting.html
- James A. Largay, 2002, Editorial" Lessons from Enron" , *Accounting Horizons*", American Accounting Association, New York.
- John J. Kearney, 2005, President's commentary, "The Trusted Professional", a Newspapers of NYSSCPA (New York Society of Certified Public Accountants) New York.
- Kuwait Finance House, Shariah Supervisory in Islamic Banks, retrieved on March 11, 2014 from Kuwait Finance House website <http://www.kfh.com/en/about/supervisory-board/index.aspx>.
- McGregor, Warren & Street, Donna L.,2007, IASB and FASB Face Challenges in Pursuit of Joint Conceptual Framework", *Journal of International Financial Management and Accounting*. Noble Quran", Islamasoft Solutions, www.islamasoft.co.uk.
- Robert H. Colson, 2004, editorial message, "Accountancy Comes of Age" "The CPA Journal", The New York State Society of Certified Public Accountants, New York.
- Sarea, Adel Mohammed, 2012, The Level of Compliance with AAOIFI Accounting Standards: Evidence from Bahrain, *International Management Review*, Vol. 8 No. 2.
- Shadia, R., (2007). Islamic accounting standards. Retrieved from <http://islamicfinance.net/islamicaccounting/acctg5.html>. pp. 1-9.

Waddock, S., 2005. Hollow men and women at the helm...Hollow accounting ethics? , Issues in Accounting Education, American Accounting Association, USA.

Table-1: AAOIFI Accounting Standards

<p>Conceptual Framework FOR Financial Reporting by Islamic Financial Institutions</p> <p>FAS 1- General Presentation and Disclosure in the Financial Statements of Islamic Banks and Financial Institutions</p> <p>FAS 2- Murabaha and Murabaha to the Purchase Orderer</p> <p>FAS 3- Mudaraba Financing</p> <p>FAS 4 - Musharaka Financing</p> <p>FAS 5- Disclosure of Bases For Profit Allocation Between Owners' Equity and Investment Account Holders</p> <p>FAS 6- Equity of Investment Account Holders and their Equivalent</p> <p>FAS 7- Salam and Parallel Salam</p> <p>FAS 8- Ijarah and Ijarah Muntahia Bittamleek</p> <p>FAS 9-Zakah</p> <p>FAS 10-Istisna'a and Parallel Istisna'a</p> <p>FAS 11- Provisions and Reserves</p> <p>FAS 12-General Presentation and Disclosure in the Financial Statements of Islamic Insurance Companies</p> <p>FAS 13- Disclosure of Bases for Determining and Allocating Surplus or Deficit in Islamic Insurance Companies</p> <p>FAS 14- Investment Funds</p> <p>FAS 15- Provisions and Reserves in Islamic Insurance Companies</p> <p>FAS 16- Foreign Currency Transactions and Foreign Operations</p> <p>FAS 17- Investments</p> <p>FAS 18- Islamic Financial Services offered by Conventional Financial Institutions</p> <p>FAS 19- Contributions in Islamic Insurance Companies</p> <p>FAS 20- Deferred Payment Sale</p> <p>FAS 21- Disclosure on Transfer of Assets</p> <p>FAS 22- Segment Reporting</p> <p>FAS 23- Consolidation</p> <p>FAS 24- Investments in Associates</p> <p>FAS 25- Investment in Sukuk, Shares and Similar Instruments</p> <p>FAS 26 - Investments in Real Estate</p>

Source AAOIFI Website (2014)

Table-2 : AAOIFI Auditing, Governance & Ethics Standards

Auditing Standards	Governance Standards
A S 1- Objective and Principles of Auditing	G S 1-Sharia Supervisory Board:
A S 2- The Auditor's Report	Appointment, Composition, Report
A S 3- Terms of Audit Engagement	G S 2- Shari'a Review
A S 4- Testing for Compliance with Shari'a	G S 3- Internal Shari'a Review

<p>Rules and Principles by an External Auditor A S 5- The Auditor's Responsibility to Consider Fraud and Error in an Audit of Financial Statements</p>	<p>G S 4- Audit & Governance Committee for Islamic Financial Institutions G S 5- Independence of Shari'a Supervisory Board G S 6- Statement on Governance Principles and Disclosure for Islamic Financial Institutions G S 7- Corporate Social Responsibility Conduct and Disclosure for Islamic Financial Institutions</p>
<p>Ethics standards:</p> <ol style="list-style-type: none"> 1. Code of Ethics for Accountants of Islamic Financial Institutions 2. Code of Ethics for the Employees of Islamic Financial Institutions 	

Source AAOIFI Website (2014)

Table-3 : AAOIFI Shariah Standards

<ol style="list-style-type: none"> 1. Trading in Currencies 2. Debit Card, Charge Card and Credit Card 3. Default in Payment by a Debtor 4. Settlement of Debt by Set-off 5. Guarantees 6. Conversion of a Conventional Bank to an Islamic Bank 7. Hawala 8. Murabaha to the Purchase Orderer 9. Ijarah and Ijarah Muntahia Bittamleek 10. Salam and Parallel Salam 11. Istisna'a and Parallel Istisna'a 12. Sharika (Musharaka) and Modern Corporations 13. Mudaraba 14. Documentary Credit 15. Jua'la 16. Commercial Papers 17. Investment Sukuk 	<ol style="list-style-type: none"> 25. Combination of Contracts 26. Islamic Insurance 27. Indices 28. Banking Services 29. Stipulations and Ethics of Fatwa in the Institutional Framework 30. Monetization (Tawarruq) 31. Controls of Gharar in Financial Transactions 32. Arbitration 33. Waqf 34. Hiring of Persons 35. Zakah 36. Impact of Contingent Incidents on Commitments 37. Credit Agreement 38. Online Financial Dealings 39. Mortgage and its Contemporary Applications 40. Distribution of Profit in Mudaraba-based Investments Accounts 41. Islamic Reinsurance
---	---

<p>18.Possession (Qabd) 19.Loan (Qard) 20.Commodities in Organized Markets 21.Financial Papers (Shares and Bonds) 22.Concession Contracts 23.Agency 24.Syndicated Financing</p>	<p>42.Financial Rights and Methods of Disposal Thereof 43.Bankruptcy 44.Liquidity Management 45.Protection of Capital and Investments 46.Investment Agency 47.Stipulations of Transaction Profit Calculations. 48.Options of Amanah (Trust)</p>
---	---

Source AAOIFI Website (2014)

Table-9: Independent Auditors' Report To The Shareholders Of Kuwait Finance House K.S.C

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Kuwait Finance House K.S.C. ("the Bank") and its subsidiaries (collectively "the Group"), which comprise the consolidated statement of financial position as at 31 December 2011 and the consolidated statement of income, consolidated statements of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the consolidated Financial Statements

The management of the Bank is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards adopted for use by the State of Kuwait, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgement, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Group's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the

effectiveness of the Group's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Group's management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2011, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted for use by the State of Kuwait.

Report on Other Legal and Regulatory Requirements

Furthermore, in our opinion proper books of account have been kept by the Bank and the consolidated financial statements, together with the contents of the report of the Bank's Board of Directors relating to these consolidated financial statements, are in accordance therewith. We further report that we obtained all the information and explanations that we required for the purpose of our audit and that

the consolidated financial statements incorporate all information that is required by the Capital Adequacy Regulations issued by the Central Bank of Kuwait as stipulated in CBK Circular number 2/RBA/44/2009 dated 15 June 2009, Commercial Companies Law of 1960, as amended, and by the Bank's articles of association, that an inventory was duly carried out and that, to the best of our knowledge and belief, no violations of Capital Adequacy Regulations issued by the Central Bank of Kuwait as stipulated in CBK Circular number 2/RBA/44/2009 dated 15 June 2009, Commercial Companies Law of 1960, as amended, or of the articles of association have occurred during the year ended 31 December 2011 that might have had a material effect on the business of the Bank or on its financial position.

We further report that, during the course of our audit, we have not become aware of any material violations of the provisions of Law No. 32 of 1968, as amended, concerning currency, the Central Bank of Kuwait and the organisation of banking business, and its related regulations during the year ended 31 December 2011.

WALEED A. AL OSAIMI
License NO. 68 A
OF ERNST & YOUNG
AL AIBAN, AL OSAIMI & PARTNERS

JASSIM AHMAD AL-FAHAD
Licence NO. 53 A
DELOITTE & TOUCHE
AL-FAHAD, AL WAZZAN & CO

15 February 2012
Kuwait

Source Kuwait Finance House Website (2013)