Exploring Perceptions on Financial Reporting Standards in Islamic Financial Institutions

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Exploring Perceptions on Financial Reporting Standards in Islamic Financial Institutions

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بسم الله الرحمن الرحيم

“O you who have believed, when you contract a debt for a specified term, write it down. And let a scribe write [it] between you in justice. Let no scribe refuse to write as *Allah* has taught him. So let him write and let the one who has the obligation dictate. And let him fear *Allah*, his Lord, and not leave anything out of it. But if the one who has the obligation is of limited understanding or weak or unable to dictate himself, then let his guardian dictate in justice….” (*Surat Al-Baqarah:* 282).

صدق الله العظيم

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ABSTRACT

Islamic finance, emerged in modern times, as a religiously or *Shari'ah* constructed financial method and institution with the objective of providing religio-ethical financial solutions. Due to its different and unique nature, it is considered by that a special accounting system based on *Shari'ah* that fulfils the particular requests of Islamic finance instruments is required. For this purpose, the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) have been issuing and developing Islamic accounting standards. Nevertheless, those standards are not adopted by most of the Islamic financial institutions (IFIs) that are still reporting with International Financial Reporting Standards (IFRS), which are issued for conventional financial institutions. It is, on the other hand, claimed that IFRS may be irrelevant to the needs of other cultures and people of the world especially for institutions emerged from Islamic worldview, such as Islamic banks and financial institutions due to the nature and working mechanism of these institutions. This study, hence, aims at exploring and critically investigating the main environmental factors influencing the adoption of IFRS to IFIs. This study also aims to investigate empirically the need for special accounting treatments for Islamic financial institutions that is reliable worldview, and in consistent with the values and socioeconomic formation of Muslim society by harmonising or merging with AAOIFI and IFRS.

The identified research questions were responded through primary data collected from a survey questionnaire, which, among other things, mainly attempted to explore IFIs in relation to their position as to whether they would prefer to account under IFRS issued by the IASB or under the Financial Accounting Standards or FAS issued by the AAOIFI. This questionnaire, also aimed at exploring the perceptions of the participants regarding accounting practices employed in different Islamic institutions and the issue of considering adopting a particular accounting system that satisfy their needs if it is available. In addition, the questionnaire also aims to investigate the perceptions of the participants on the nature of Islamic finance and whether IFRS is considering its special needs. Furthermore, particular attempt is made to measure the perceptions on rationalising Islamic accounting as a practice and as a paradigm.

The study finds that most of the IFIs participated in this study employed IFRS' as the main accounting system, which resulted in a number of problematic issues in treating Islamic finance transactions and contracts and endogenising other religious elements, such as the prohibition of *riba* and paying *zakat*. The findings also indicate that employing IFRS in the IFIs is not applicable within the normative world and the requirements of Islamic finance as aspired by the foundational axioms developed by Islamic moral economy despite the extensive use of it in current times. Therefore, in order to be authentic IFIs require special accounting standards that are different from the IFRSs, such as AAOIFI accounting standards, which may be considered as rationalising the emergence of Islamic accounting as a practice and field, which was the case in history.

Key words: Accounting Reporting, IFRS, Islamic accounting, AAOIFI, Harmonisation

DECLARATION

No part of this thesis has been submitted elsewhere for any other degree or qualification in this or any other university. It is all my own work unless referenced to the contrary in the text

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In the name of *Allah,* the Entirely Merciful, the Especially Merciful.

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AI-'ihsan; is a significant value of the Muslim society. It is doing what is 'beautiful' and accept with a pleasure a less than what is due receive readily and paying back, a larger share than what is due to give.

Al-'adl; is the justice, fairness and equitableness. It fundamentally encompasses from two features: firstly, a basic of equilibrium have to be sustained between individuals with respect and appreciation to their rights; secondly, every individual should obtain things that are due to him and give things that are due from him.

Al-Shari'ah: Literally means "a way". In Islamic terms, *Shari'ah* means Islamic official law based on the teachings of the Qur'an and the traditions of the Prophet (Hadith and Sunna), prescribing both religious and secular duties and sometimes retributive penalties for lawbreaking.

Al-Sunnah and Al-Hadith; are the clarification of the Qur'an by the Prophet Mohammed's sayings, deeds and the practices. They are the second most important source of Islamic *Shari'ah* and authority for Muslims.

Baitul Mal; refers to (public treasury) who received the money collected by the state from different sources, including *Zakat* and *Waqf*.

***Diwan*;** is the noun derived from the Arabic verb *'Dawwana'* (writing). *Diwan*, is the main administration centre, and also, used to mean the book of revenues and the office of recording and maintaining accounting books.

Falah; is the tangible quality to seek and achieve the pleasure of God.

Fard: Means 'responsibility'. It is an essential matter in Islam's all-encompassing and primary belief system, moral value, social norms and judicial principles.

Ghara; is an Arabic word, which literately means 'reduction'. It is a trade of that which is not known to exist or not, whose measure is not known to be large or small, and that is undeliverable.

***Hayat al-tyyebah*;** is an Arabic concept which mean the high levels of good life

Ijarah wa iqtina* or *ijarah muntahia bittamleek; contract can contain a promise of transfer of ownership from the lessor to the lessee.

Ijarah; is the Arabic word for leasing contract as well as hiring contract.

Istisna'a; is a contract to purchase now, for a definite price, something that may be manufactured or constructed later according to agreed specifications. The object of *istisna'a* is often not available now, but will be made later by the manufacturer or contractor.

***Khilafah*;** indicates an individual's role as God's vicegerent on earth.

Maqasid al-Shari'ah**;** it relates to everything: laws, behaviour, attitudes, products, transactions, activities, and services. The meaning of *'maqasid'* includes the understanding and knowledge behind rulings, the purposes of specific actions. It is considered as the foundation or the directing principle of Islamic economics and Islamic finance.

Maysir; is an Arabic word which means gambling and speculation.

Mudarabah; means a contract of partnership of which the one partner is the owner *(rabb-ul-mal)* is entitled to profit on account of his stock *(ras al-mal)* and the other partner is entitled to a profit on account of his labour. Profits are distributed according to a prearranged ratio.

Muhasabah; it is an Arabic term means accounting.

Muhasib; it is an Arabic term means accountant

Murabahah**;** linguistically means 'profitable action'. It is also, known as 'cost-plus financing' or 'financing resale of goods' which means it is the contract sale between the bank and its costumer of selling goods at cost plus an agreed mark-up.

Musharakah; means an investment-based technique to joint enterprise in which all the partners share the profit or loss of the joint venture.

Riba al-fadhl; it is often translated to mean 'usury of increase'. It is the type of *riba* that is associated with the exchange of an entity for the same kind of entity, for an increase in quantity.

Riba Al-Jahiliya; is practiced in the pre-Islamic Arabia. It also, known as *Riba al-nasia*; or the 'usury of deference'. More precisely, *riba* is a pure return (or rent) on money *per se,* where neither business risk is borne nor other goods or services are provided.

Riba; is often translated as 'interest' or 'usury'. In the Islamic terminology interest implies effort less profit or that profit which comes free from compensation or that extra earning obtained that is free of exchange.

Salam **Financing;** is a contract involving the purchase of a commodity for deferred delivering in exchange for immediate payment according to specified condition.

Tawhid Ar**-Rububiyyah;** in Islamic terminologies means "Unity/Oneness of Lordship". In Islamic finance rububiyyah, is one of the basic philosophies of the Islamic economic system which refers to "divine arrangements that relate to nourishment, sustenance, and power of directing all things towards their perfection.

Tawhid; is an essential belief in Islam that "there is no god but Allah." It is the foundation of the Islamic faith and all other Islamic worldviews are based on *tawhid* which indicates the vertical dimension of the ethical system. *Tawhid* is the unity of God and sovereignty as Islam is a code/system of life given by *Allahs.w.t*.

***Tazkiyah*;** is purification of human being in the sense of purifying his/her "self" from any (physical and non-physical) dirty, purifying the relationship between creatures and creatures, between creatures and universes, and between creatures and God.

The Holy Qur'an; is the Holy Book or the Scriptures of the Muslims that was revealed from to Allah (God) to the Prophet Muhammad and through His angel Gabriel. It lays down the fundamental rules and commandments, including the social and moral behaviour, and consisting a complete religious philosophy.

***Ukhuwwah*;** it is an Arabic term means Islamic brotherhood.

Ummah; It is an Arabic and Islamic terminology which means community of believers.

Zakat; is a religious tax that all adult Muslims have to pay as long as their wealth exceeds a particular amount

The Glossary for this thesis was taken from the following sources;

Siddiqi, (1972), Hamdi, (1986), El-Ashker, (1987), Murata and Chittick, (1994), Al-Dareer, (1997), Zarqa, (1997), AAOIFI, (2003), Khan, (2003) Thani *et al*, (2003), Dusuki and Abdullah, (2007), Asutay, (2007), Zuhayli *et al*., (2007), Abd Al-Rahim, (2010), Ismail, (2012).

ABBREVIATIONS

INTERNATIONAL BODIES AND ABBREVIATIONS USED IN THIS THESIS

AAOIFI: The Accounting and Auditing Organization for Islamic Financial Institutions

FAS: Financial Accounting Standards (issued by AAOIFI)

IFIs: Islamic Financial Institutions

IFB: Islamic Financial Bank

IASB: International Accounting Standards Board

IASC: International Accounting Standards Committee

IAS: International Accounting Standards

IBF: Islamic Banking and Finance

IFRS: International Financial Reporting Standards (issued by IASB)

GAAP: Generally Accepted Accounting Principles

SFA: Statement of Financial Accounting (issued by AAOIFI)

URIA: Unrestricted Investment Account

ABBREVIATIONS OF QUALIFICATIONS UTILISED THROUGHOUT THE THESIS

ACCA: Association of Chartered Certified Accountants

ACPA: American Certified Public Accountant

APFA: The Association of Professional Financial Advisers

BCCA: British Chartered Certified Accountant

CAIIB: Indian Institute of Banking and Finance

CIFP: Chartered Islamic Financial Professional

CIPA: Certified International Professional Accountant

NCPA: National Certified Public Accountant

MBA: Master of Business Administration

CHAPTER 1

INTRODUCTION

1.1 INTRODUCTION

Islamic banking and finance (IBF) has become an alternative and innovative ethical financial method since it was institutionalised in the form of a commercial bank in 1975. Over the years, the industry has shown unprecedented growth with double-digit annual growth rate; as a result, the asset value of the IBF institutions has reached $2 trillion in 2014 (The Banker, 2013). This growth trajectory demonstrates that the industry has become a vital component of the international financial services sector. In oarticular, considering positive resilience from the IBF in the face of the the recent global financial crisis and economic decline, the international attention turned towards IBF has increased. Consequently, IBF is now operating over seventy five countries in various forms regardless of whether they are Muslim country or not (The Banker, 2013).

As part of this globalisation, around 700 IBF institutions (IBFs) are registered as *shari'ah* compliant of which 500 of them are fully *shari'ah* compliant, whereas the other 200 are conventional institutions operating *shari'ah* compliant products (Islamic windows) operating in 75 countries and providing employment for more than 300,000 people. Countries such as Malaysia and the Middle East, including UAE, Saudi Arabia, Kuwait and Iran are still considered as the major players in this niche industry (TheCityUK, 2013, IBFN, 2014). Islamic finance industry in remains Middle East such as Turkey, Egypt, Jordan, Syria and Africa such as Nigeria and Sudan are demonstrating rapid progress. In regard to Asian countries Islamic finance is not just operating in countries where the Muslim are the Majority such as Bangladesh, Pakistan, but rather in places where the Muslim are the minority such as Hong Kong, Singapore, China and India. The Western countries are not exceptional since Islamic finance industry has been developed in some European countries such as UK which has the largest Islamic assets with $19bn in reported assets, France, Germany, Luxembourg, Australia and Switzerland (TheCirtUK, 2013).

IBFs are operating mainly within the dual banking system, where the fully-fledged, conventional and multinational financial institutions provide '*Shari'ah-compliant'* financial products and solution. Despite the mentioned success trajectory of IBFIs, the industry is not without its challenges. One of the reasons as part of the observed challenges is the fact that IBFIs are trying to operate and invest in markets where the regulations and financial reporting frameworks are disparate (ACCA and KPMG, 2010). Hence, as has been observed, in order to meet the regulatory expectations, some IBFIs have a preference for reporting by using the IFRS. However, these types of accounting standards might not meet the requirements of IBFIs, as they necessitate special accounting so that compulsory alms giving such as *zakah* and special Islamic financial instrument such as *murabahah, mudarabah, musharakah, ijarah, istisna etc.* can be accounted for. As a result, the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) was established to meet the demands of these particular organisations, (Amin, 2011; Abdul Rahman, 2010; AAOIFI, 2003).

Nevertheless, the AAOIFI is limited geographically to primarily the GCC countries, with Malaysia being the only country from outside the region that has subscribed to the AAOIFI standards. Moreover, as it is not mandatory in the GCC, the Islamic accounting standards issued by the AAOIFI are therefore, only implemented in two countries, Bahrain, and Qatar, whilst the rest of the GCC countries use IFRS. By the end of 2010 IFRS had become practically the most universal accounting practice recognised across the world (Amin, 2011).

According to the above discussion, it can be argued that it could be inconsequential that the AAOIFI remaining to produce more accounting standards to challenge an organisation such as the International Accounting Standard Board (IASB), which has been issuing accounting standards for decades. This is because those standards will be neglected in most other countries, including most of the Muslim countries that have IBFIs (Amin, 2011).

This research, hence, aims to explore and examine the environmental factors that make the IFRS irrelevant for IFIs transaction through perceptions and opinions of participants.

1.2 BACKGROUND AND RATIONALE FOR THE STUDY

Within the international accounting literature, culture has been identified as an essential factor in the development of accounting systems worldwide. The influence of culture on accounting systems has been explored within the field of international accounting in recent years, which have recognised that the disparate cultural values found worldwide can have an impact upon and can stop united accounting practices. In addition, culture has been noted to have had a profound influence on accounting values across the world (Askary, 2006; Perera and Mathews, 1990; Goodridge, 1991; Fechner and Kilgore, 1994; Gray, 1988; Perera, 1994). Therefore, culture can have a powerful and effective impact upon national accounting systems, which needs to be taken into account by organizations with respect to national accounting practices (Askary *et al.*, 2006).

Hofstede (1984:51) defines national culture as “the collective programming of the mind which distinguishes the members of one human group from another”. Therefore, Askary *et al.*, (2008:67) argue that “the cultural environment is generally acknowledged to be a national (or regional) system comprising language, religion, morals, values, attitudes, law, education, politics, social organisation, technology, and material culture. The interactions of these cultural elements on accounting are expected to be exceedingly complex”.

Culture is an important factor affecting the development of accounting systems and the process of accounting change (Verma and Gary 1997; Deegan, 2000). In exploring the social constructivist nature of accounting, Violet (1983) sates that accounting is a ‘socio-technical activity’ that requires relations between both human and non-human resources and added that it cannot be seen as being culture-free. He (1983: 3) asserted that accounting is closely related to culture, stating that;

> Accounting is a social institution established by most cultures to report and explains certain social phenomena occurring in economic transactions. As a social institution, accounting has integrated certain cultural customs and elements within the constraints of culture postulates. Accounting cannot be isolated and analysed as an independent component of a culture. It is, like mankind and other social institutions, a product of culture and contributes to the evolution of the culture which employs it. Since accounting is culturally determined, other cultural customs, beliefs, and institutions influence it.

It can, therefore, be stated that accounting reflects the economic, social, legal, cultural, religion and political environments of a country if it is to function properly (Briston, 1978). Consequently, different environments can impact upon the harmonisation of IFRS. Generally, the practice selected will depend on culture including religion, as this is seen as being a significant cultural factor that has a strong effect upon most or all social institutions, of which accounting is recognized to be one, (Belkaoui, 1990; Thomas, 1989; Gambling, 1987; Briston and El-Ashker, 1986).

Hofstede (2001) argues the likely effect of religion on the four cultural values he identified and concluded that religion affects such cultural values. Since religion and culture are closely related (Nobes, 1998: 176), and culture affects accounting, then it could, therefore, be argued that religion has an effect on accounting. Other factors within a certain country that might have an influence upon the accounting system and must be considered are taxation, the legal system, business organizations and ownership, as well as the accounting profession (Haidar, 2006). Research indicates that these factors vary between counties to countries including between the countries in the Islamic world, where the accounting system, and the banking and finance industries are established on Islamic beliefs and therefore, is different to those values found within the Western nations such as the UK and US.

The philosophy of *Shari'ah* (Islamic law), which is taken from the *Qur'an* and from other sources depending upon one's sect, holds firmly that social accountability is required within a society. This is in direct contrast to western society, which upholds a belief in principal personal accountability and is established in accounting practices too (Ahmed and Gao, 2004).

The effects of the Islam on the accounting and reporting practices of Islamic business enterprises was discussed by many at a normative level, (*e.g*. Hamid *et al*. 1993; Magid, 1981; Gambling and Karim, 1991; Adnan and Gaffikin, 1997; Suliman, 2000; Alam, 1997; Lewis, 2001; Baydoun and Willett, 2000).

The responsibility of Muslims to give '*zakah'* (an Islamic religious tax) is acknowledged as one of the main issues that would affect accounting and financial reporting. As Islamic principles require the valuation of assets subject to '*zakah'* at current values, many scholars argue about using the current market values as the source for Islamic objects' financial reporting, and furthermore, the asset-liability approach for income measurement purposes, (Karim, 2001).

Moreover, the Islamic principles, or '*Shari'ah Law*' forbids paying interest or charging on the lending out of money itself. Islamic banks instead usually provide profit-sharing investment accounts, in order that investors' returns are reliant on the return on the assets financed by the investors' funds (Karim, 2001). This alternative financial transaction is another factor that can affect accounting and can lead to development of a particular accounting treatment and standards. Hence, the prohibition of interest, whilst acceptable within Islam, it is not suitable for most of the discounting-based accounting processes found in western banking methods. In addition, the alternative transactions that are undertaken by Islamic entities are not covered in the conventional accounting standards, (Hamid *et al*. 1993; Karim, 2001).

In this regard, as Islamic banks undertake many transactions that are at least in theory, different from conventional accounting transactions, and which are subject to Islamic principles, this research aims also to understand how the religious or Islamic principles affect the choice of accounting and reporting polices made by these banks.

It should be noted that there is a growing tendency that one of the most effective accounting practices by which IBFIs can employ to cover its transaction is Islamic accounting, which is a new sub-discipline attracting the attention of organisations and researchers across the world. Thus, the availability of recent literature is rather limited, although some material has been published to the needs of an observed gap.

In general accounting can be defined as "the process of identifying measuring and communicating economic information in order to permit informed judgement by the users of information" (Abdul Rahman, 2010:5). Accounting, hence, is 'the language of businesses' that are required to be understood carefully, in order to manage the financial aspects of business, (Abdul Rahman, 2010). By the same token, Islamic accounting aims to provide information on the business to users. What type of information is identified, how it is documented, calculated, communicated, and furthermore, to whom it is communicated (the users), describes in detail the nature of accounting (Ibrahim, 2007). According to Abdul Rahman (2010: VI), Islamic accounting, hence, is:

> The process of identifying, measuring and communicating economic and other relevant information, inspired by the Islamic worldview and ethics, and complied with *shari'ah* (Islamic law), in order to permit informed judgments and decisions by

> potential and expected users of information to enhance social welfare and seek *mardhatillah* (the blessings of Allah).

From the above definitions, it could be understood that conventional accounting differs from the Islamic accounting. It can be argued that traditional accounting has at its heart permissive rather than moral practices, whilst the latter is established upon moral regulations produced in the *Qur'an*. The *Qur'an* is considered by Muslims to be the word of God revealed to the Prophet Muhammad as a guide in everyday practice of life of fellow Muslims. The second Islamic ontological source is *Sunnah*, which consists of *the* acts and sayings of the Prophet conveyed through traditions known as the *hadith* (Ali and Leaman, 2008: 108). Thus, both of these sources has implications for Islamic accounting in terms of how it should be constructed.

It should also be mentioned that the ontological reference points of both systems are different. In its most theoretical sense of ontological references, conventional accounting has limited disclosure, which means it provides information that is for the public interest and focuses on those who regulate capitals (personal responsibility). In contrast, Islamic accounting has full disclosure with the purpose of satisfying any rational request for information in harmony with *Shari'ah* (Islamic law) and its public accountability focuses on the community who participate in exploiting resources (Baydoun and Willet, 2000).

Moreover, conventional accounting concentrates on identifying economic events and transactions, whilst Islamic accounting must identify socio-economic and religious transactions and events (Ibrahim, 2007).

It should be noted that according to Perera (1989), each and every accounting system is a result of its explicit environment. He continues by stating that diverse patterns of accounting are linked to the different societal values, political systems and religion, and in addition, previous history have participated in shaping the setting in which each accounting system functions (Mueller *et al.*, 1994). Muslim societies are not an exception as Abdul Rahman (2010) claims that accounting can be affected by the commercial and economic system functioning in a society and the philosophy behind its system. As a consequence, it is rational to have various accounting systems according to the modes of production and the cultural environment of each society.

The Islamic society during the time of the second Caliph Umar Ibin Al- Khattab (as it will be discussed in Chapter 4) used an accounting embedded in the cultural environment by establishing a separate accounting department to record the all the money comes to the public treasury and the all money was spent.

However, due to the high growth rate in the society and the high diffusion of the IBF activity in recent years, advanced Islamic accounting is needed to serve the interest, functioning and development of these new alternative financing institutions (Abdul Rahman, 2010). As a result the AAOIFI was established in the 1990s, in order to improve the accounting practices for IBFIs.

The main aims of accounting for IBFIs according to the AAOIFI (AAOIFI, 2003; Abdul Rahman, 2010) are the following;

(i) to increase accounting and auditing ideas related to Islamic financial institutions;

(ii) to prepare, understand and disseminate accounting and auditing standards for Islamic financial institutions;

(iii) to re-evaluate and modify accounting and auditing standards for Islamic financial institutions;

(iv) to spread accounting and auditing ideas relevant to Islamic financial institutions through training, seminars, publication of periodical newsletters and undertaking research.

In spite of the development of AAOIFI standards, the majority of IBFIs are still following IFRS, which are at least theoretically different from the Islamic accounting standards. Therefore this study aims to explore the appropriateness of international standards to serve Islamic institutions in the light of its unique cultural environment (specifically Islamic religion).

1.3 RESEARCH PROBLEM

Even though the AAOIFI has spread a range of accounting standards, most Islamic financial institutions still need to report to the market in order to comply with national accounting standards or IFRS. Furthermore, a range of accounting principles, which are not standardised for Islamic banks and financial institutions; and even accounting items, can be differences from one Islamic bank to another. As a result, this may cause variances between the treatment of Islamic products under national accounting standards such as GAAP or IFRS and their treatment under Islamic principles.

Moreover, due to the specific nature of most of the Islamic products such as *murabahah, mudarabah, musharakah, ijara, istisna etc.* as well as the increasing difficulties in reporting GAAPs and IFRS, financial reporting has become very confusing and complicated for most Islamic financial institutions.

In spite of the importance of having an advanced accounting system in IBFIs to meet the standard for direct, sustained foreign investment with conventional institutions, adopting the IFRS may be required. However, the IFRS are produced with the economic environments of the western nations in mind, while, IBFIs are based upon Islamic philosophy and the principles of *Shari'ah* that claim the unity of God. Therefore, the cultural differences (especially, Islam as one the inputs of culture) will need to be taken into consideration before embarking on any process that would result in the adoption or harmonisation of IFRS. Hence, this study aims to explore such tensions and dynamic areas in relation to the accounting experiences of bankers and financiers in the IBFIs.

1.4 AIMS, OBJECTIVES AND THE RESEARCH QUESTIONS

In recent years, most of the countries in the world have opted for the application of IFRS as part of their accounting system. This has also encouraged the most of IBFIs to be in favour of reporting by using the IFRS resulting into neglecting the Islamic accounting standards established by the AAOIFI and related regulations by Islamic Financial Services Board (IFSB). As a result, most of Islamic finance instruments are being treated and reported by irrelevant accounting standards that issued by IFRS, which results into inconsistency.

This study, therefore, aims to explore and examine the accounting practices, Islamic accounting standards developed by AAOIFI and the potential issues with the suitability of IFRS to IFIs in the light of the unique Islamic environment by referring to the opinions and perceptions of various stakeholders, chiefly the participant of the IBFIs.

In a more comprehensive manner, this study aims to critically analyse and discuss the main factors that influence the adoption of IFRS by Islamic financial institutions. This is due to the fact that there are an increasing number of authors who hold the opinion that the accounting systems developed by the IASB with Western culture in mind, may possibly be irrelevant to the needs of other cultures in different societies, especially Islamic culture, (Baydoun and Willett, 1995; Wallace 1990). Although, the AAOIFI has established Islamic accounting standards, the majority of the Islamic financial institutions do neglect these standards and do still report with the IFRS method, which has mainly been developed for conventional financial institutions. Hence, this study aims also to explore the factors hindering the adoption of AAOIFI standards and also the perceptions of the participants on the concept and possibility of Islamic accounting.

In responding to the aims, this research utilises ontological and historical knowledge, and also benefits from the body of knowledge emerged from historical and contemporary practices. In addition, data were generated through questionnaire survey to better understand the contemporary practices in IFIs.

The following research objectives are also developed in order to respond to the aims of the research

(i) to explore the impact of culture upon accounting harmonisation with particular focus on the relationship between Islamic, political and legal cultures and accounting development and change;

(ii) to develop an advanced understanding of the concept of Islamic accounting;

(iii) to explore and understand treatment of Islamic financial concepts such as *zakah* and *riba* as well as the Islamic finance instruments including *murabahah, musharakah, mudarabah, ijara, salam, istisna' etc.* within the established knowledge and practice in IFIs;

(iv) to explore the reasons behind the adoption of IFRS and the effect they have on accounting and reporting in IFIs;

(v) to explore the perceptions on whether Islamic accounting is seen as a way forward for standardising the accounting practices Islamic financial institutions.

(vi) to explore the reasons as to why AAOIFI standards have not diffused widespread into IBFIs;

(vii) to investigate whether IFIs are required to be accountable under IFRS issued by the IASB or if they should be under the FAS published by the AAOIFI;

(viii) to explore the perceptions of participants on whether harmonising IFRS with AAOIFI is the best solution for the accounting problems in IFIs in the light of the unique Islamic culture;

(ix) to discuss the barriers obstructing the achievement of harmonisation in accounting practices in Islamic financial institutions;

(x) to provide recommendations for accounting systems for IFIs;

(xi) to evaluate the perceptions and opinions the perceptions and opinions of participants from banking and finance sectors on the accounting and Islamic accounting issues in IBFs;

In order to achieve the stated aims and objectives, the researcher addressed the following research questions:

(i) Do the IFIs aim to employ the IFRS type of accounting and harmonise their standards with this practice?;

This question addresses the objective (viii), (vii) and (x).

(ii) Do the IBFIs prefer a specific accounting standard to be developed by focusing on the specific aspects of IBFs?;

This question addresses the objectives (iii) and (vii).

(iii) What are the factors that determine the demand for Islamic accounting? And hence, what are the factors prevent the adoption of Islamic accounting standards in the IBFIs?

This question addresses the objectives (i), (iv), (vi) and (ix).

(iv) What are the main attitudes of the various stakeholders in IFIs towards AAOIFI and IFSB's attempt to develop accounting standards for them?

This question addresses the objectives (ii) and (xi).

(v) What are the opinions of participants developing Islamic accounting as an alternative accounting system?

This question addresses the objectives (ii) and (v).

In order to answer these research questions, appropriate research methods are essential, as briefly explained in the following section.

1.5 RESEARCH METHODOLOGY

In management and business studies, researchers often use a combination of approaches (Collis and Hussey, 2003). Therefore, in considering the nature of this study and the aims and objectives of this research, this study is designed as an exploratory case study, and used quantitative method 'self-administered' questionnaire to collect primary relevant data. In addition, in responding to the ontological and historical knowledge and practices, mainly literature based research was conducted. The primary data collected were analysed by using SPSS software, and since the distribution of the data was found to be considerably deviated from normal distribution, non-parametric tests such as Kruskal-Wallis and Mann–Whitney U tests were used to explore the identified issues. Detailed description of the research methodology process is provided in Chapter 5.

1.6 OVERVIEW OF THE STUDY

This thesis is organised in eight chapters. The first chapter aims at clarifying the background to the study and outlines the main objectives.

Chapter 2 provides a review of the literature with regard to the IASC and IAS'. The first part of this chapter starts with a brief historical perspective on IAS' and their development, and then discusses the regulation of IAS', whilst the second part describes the harmonisation of IFRS. This includes the definition of harmonisation and other relevant concepts, together with arguments for and against harmonisation and its advantages among prepares and users. Besides this the chapter provides a general background about AAOIFI, including a comparison between IAS' and AAOIFI's accounting standards.

A literature review is presented in Chapter 3, which relates to culture and its impact on management and accounting, with special reference to Hofstede and Gary's models. In addition, it examines accounting issues from a cultural perspective and how culture can impact on accounting.

The general background of the Islamic accounting and standards such as AAOIFI accounting standards for IFIs is considered in Chapter 4. In addition, this chapter discussed the Islamic world view and its impact on employing the IFRS in the IFIs as well as the axioms of moral economy and linking them to Islamic accounting by expressing Islamic accounting as part of Islamic moral economy.

Chapter 5 presents and explains in detail the methodology and methods that have been used in this study and the techniques used in collecting and analysing the data.

Chapter 6 is the first empirical chapter for this study, which presented the findings developed from the analysis of the questionnaire data together with an analysis and discussion of the empirical findings by using the statistical SPSS software.

The rest of the empirical findings about exploring perceptions on Islamic accounting standards are presented in Chapter 7.

Chapter 8 presents an interpretative discussion on the findings as well as providing the conclusion of the study, contributions, limitation and recommendation.

CHAPTER 2

THE INTERNATIONAL ACCOUNTING STANDARDS AND HARMONISATION: A LITERATURE REVIEW

2.1 INTRODUCTION

Within the current sphere of accounting, considerable attempts have been made to ensure that accounting standards are coordinated with regards to financial reporting. On the subject of international financial accounting and reporting standards in financial statements, businesses and capital markets worldwide, in reality, must follow and practice these regulations. The purpose of this is to make sure that practices and standards are consistent, in order to allow countries to undertake business freely and explain their trade without having to pay for the expenditure of the conversion of standards (Uddin, 2005).

The European Parliament stated in Regulation No 1606 that “in order to contribute to a better function of the internal market, publicly traded companies must be required to apply a single set of high quality international accounting standards for the preparation of their consolidated financial statements” (Palea, 2013:250). Consequently many countries around the world, for instance, members of the European Union, Canada and the United States have implemented an International Accounting Standards (IAS) in recent years.

Although most of the discussions over the last 15 years have concentrated on the development and implementation of international accounting measures and, furthermore, encouraged the industrialized countries to accept these codes of practice, much less attention has been paid to the ability of developing countries to accept these standards (Zeghal and Mhedhbi, 2006). Quinn (2004) claims that it is still challenging to trust the accounting systems and financial information from developing countries, even though these countries urgently require foreign investment and capital, and in spite of the insistence from different users such as formal investors, banks and international institutions for such standards.

Although a large number of developing countries have already started to adopt IASs partly or completely in their specific frameworks, there is still no particular time limit as to when all these countries will have fulfilled with IAS. This procedure is, however, likely to develop the excellence and reliability of accounting information and increase the flow of capital and investment, which in turn would result in economic growth (Zeghal *et al*., 2006). Following this line of argument, Wolk, *et al*. (1989) explained that it is beneficial for developing countries to make use of international accounting arrangements, as it gives them improved standards, as well as enhancing their values and their accounting structures. Nevertheless, to adopt IASs would not be totally possible in the case of Islamic banks.

The purpose of this chapter, therefore, is to present ‘the International Harmonisation Procedure of Accounting Standards’ in a historical overview with the objective of highlighting the developments in harmonisation of financial reporting practices. The meaning of the phrase harmonisation and bound it from different ways is also discussed. In addition, consideration is given to the reasons that activated the harmonisation procedure as well as the advantages and disadvantages of such process. The most important performers and their affects are also discussed, in order to describe, what the procedure is concerned with. However, considering the development of Islamic banking and finance necessitates a particular method of accounting, it makes it essential to consider the standards and rules that have been developed to endogenise the Islamic way of accounting. For this the Accounting and Auditing Organisation for Islamic Financial Organisations (AAOIFI) is explained. Besides, AAOIFI’s implications for the harmonisation process are touched upon with the intention of making a comparison to identify potential areas of convergences as well as divergences.

2.2 ACCOUNTING HARMONIZATION: CONCEPT AND MEANING

Several authors have defined accounting harmonisation in different ways. Before considering definitions of international accounting harmonisation, it is first essential to define the term harmonisation. Lawrence (1997) states that ‘harmonious’ means ‘fitting together well’ and that ‘to harmonize’ means to ‘make or become harmonious’. In addition, he explained that harmonious can also mean ‘agreeable and compatible (Lawrence, 1997). International accounting harmonisation, however, can be explained as “the process of bringing International Accounting Standards into some sort of agreement so that the financial statements from different countries are prepared according to a common set of principles of measurement and disclosure” (Haskins *et al.*, 1996: 29).

In accounting literature the term harmonisation is explained as the level of bringing together or likeness amongst a variety of combinations of local accounting standards and techniques, and forms of financial information (Meek *et al*., cited in Uddin, 2005). A similar definition is found in Choi and Meek (2005) and Nobes and Parker (2006), who state that, practically, the harmonisation of accounting is likely to be explained as the procedure of increasing the compatibility and the implementation of accounting by setting limits for the level of difference.

Moreover, Deegan, *et al*. (2006), define the harmonising of accounting standards as a practice trying to fit various techniques simultaneously. It is the procedure of combining and blending different practices into a systematic framework that creates an agreeable outcome. In other words, harmonisation cares about minimising the variety that exists between accounting practices with the aim of developing the comparability of financial information provided by organisations from various nations (Murphy, 2002). Therefore, harmonisation is thought essential to defeat the problems that are occurring from variations in the treatment of objects and their procedure of understanding and position in financial statements (Uddin, 2005).

2.3 RATIONALE FOR HARMONISATION

Due to the globalization of industries and financial markets, as well as the services, in addition to an increase in cross-border investments and capital movements, it is argued that monetary information organized in relation to a national accounting system may not satisfy customers who have become more global in terms of their decision making and choices (Zeghal *et al.,* 2006; Gangolly *et al.*, 2002). Walton *et al.* (2003) and Nobes *et al.* (2008) argue that financial statements of overseas businesses should be understandable to shareholders and financial analyst, who might wish to buy shares, because in some cases the variation in accounting practices could potentially be incompetent, causing missed opportunities and be detrimental to the financial performance and capital markets. Investors and financial analysts want to make sure that financial reports from various countries either are consistent and similar, or to be understandable regarding the nature and level of dissimilarity. Besides, they need certainty in the reliability of auditing (Nobes *et al.*, 2008). Hence, better comparison in consequences leading to greater understanding can be possible as well as results in less hazards and more efficient investment choices.

Choi *et al.* (2002:293) argue that "financial statement users have difficulty interpreting information produced under non-domestic accounting systems. They claim that harmonisation will make it more likely that users will interpret the information correctly, and thus make better decisions based on that information". Consequently, the concept of the harmonisation of international accounting has gained widespread popularity, which implies that the differences among national accounting standards should be kept to a minimum (Iqbal, 2002). This explains why large numbers of organisations such as the International Financial Reporting Standards (IFRS) support the need to harmonise international accounting. Furthermore, a similar argument was put forward by Anderson (1993), who argued that an international set of accounting standards would allow a more equal playing field, for the reason that competing businesses would become more reliable in producing their income statements and balance sheet ratios. In support of this, Choi (1998:8) stated that accounting practices in many countries around the world are not similar. For instance, the balance sheet style and analysis, and meaning of assets assessments might differ significantly from country to country. The main argument in favour of harmonisation is efficiency in trans-border transactions and understanding the financial statements of foreign companies. Thus, it is argued that International Accounting Standards, generate a universal language for explaining, translating and publishing of financial statements worldwide (Blanc, 2003).

Following this line of thinking, the business society has acknowledged that accounting is "the language of businesses" (Rajasekaran and Lalitha, 2011:2). As different languages call for translation, it may make sense to have a method, which has a common language or some mechanism of translation, as "Financial information is a form of a language" (Victoria and Nicoleta 2008: 983). Otherwise, the counter parties of other countries (who may be investors, co-ventures, authorities, financial and capital market analysts, *etc.*) might find it difficult to appreciate and analyse the accounts that are prepared literally in a different accounting language, under different assumptions and also audited under a different manner (Belkaoui, 1994, Bloomfield, 2008). Hence, there would be a need for the harmonisation of the accounting standards (IASs), and especially for IFRS, in order to overcome the difficulties in the capital markets and therefore, improve the flow of capital and investment. However, this is not to say that removal of differences is necessarily a good thing, but it should be valued that an attempt is made to amend a language for international business (Walton *et al*, 2003).

Harmonisation of international accounting standards is also seen as more important in reducing the dissimilarities in financial reporting practices of businesses in diverse nations in worldwide. A considerable number of contenders, such as McComb (1979); Choi and Bavishi (1982) and Fitzgerald (1981) studied the variations in accounting practices. They state that the decrease in the variations in practices was measured to be vital to the international accounting harmonisation procedure (Baker and Barbu, 2007). It is not essential here to provide evidence that country-to-country differences in accounting methods continue. However, in an international framework, it is significant to understand as to why differences in inter-country accounting methods exist, and whether they disclose deeper structural dissimilarities due to the lawful and common structure and to the environment of the economy (Nobes and Parker, 1988).

Existence of those differences comprised a difficulty to suitable global communication of financial information (Nair and Frank, 1980: 61, and Bonham, *et al*., 2007). For instance, financial reporting in some states has evolved on the foundation of regarding investors as the main significant party permitted to obtain financial information, while in other countries financial reporting has expanded from the basis that accounts were declared by tax authorities and other government bodies interested in economic planning (Bonham, *et al*., 2007). These diverse opinions on the purpose of financial reporting have negatively influenced the condition and a possible loss of quality of the aggregate description of the whole business (Bonham, *et al*., 2007 and Stolowy *et al*., 2001). Hence, Haskins *et al.* (1996) claim that differences in particular financial reporting practices from around the world are useful to consider. Nevertheless, Nobes *et al.* (2006) argues that increased understanding and knowledge of these variations has led to improved attempts to lessen the influence, specifically by the International Accounting Standards Board (IASB), which issues IFRS.

According to Schieneman (2000), the differences in accounting principles had a vital effect on the financial reporting practices of most of the businesses included in the study. This is true for developing countries like Libya that has widespread, inadequate financial reporting, which it is stated is currently frustrating the countries attempting to encourage investment from overseas. Similarly, according to Quinn (2004) cited in Zeghal and Mhedhbi (2006: 374);

> Accounting and financial information originating from developing countries is still difficult to trust, despite the urgent need for these countries to attract foreign investment and foreign capital, and despite the pressing demands from individual and institutional investors, lending institutions, and multinational agencies.

In considering the difficulties facing worldwide depositors in Africa's stock markets, The Economist (1997: 67) cited in Gangolly *et al.* (2002) "poor company reporting and weak accounting rules make matters difficult [for foreign investors]". Therefore, in the case of under-developed and developing countries, implementing international standards is costing lesser than creating their own accounting system (Gangolly *et al.*, 2002). Nevertheless, there is a large challenge facing the harmonization of IFRS. Following this line of argument, Iqbal (2002) and Kantor *et al*. (1995) state that different accounting principles are not the major problem. The major problem in financial reporting practices is the influence of the operating environments of different businesses in diverse cultures and settings (Iqbal, 2002; Kantor *et al.,* 1995).

Conversely, it should be noted that different environments can raise problems with the adopting of IFRS, in order to follow International Accounting Standards (IAS). Generally, the model selected will rely on the economy, culture, the accounting profession within a nation or a county, business organizations and ownership, taxation, also on political and legal systems (Nobes and Parker, 2006; Iqbal, 2002; Choi and Mueller, 1992). Islamic banking and finance can be considered such a case. Existing literature explains that these factors are articulated differently even between the Middle Eastern and North African (MENA) regions, and the Gulf Cooperation Council (GCC), where most of the financial institutions are located. Although, they are sharing the same religion and have similar culture background, the implementation of *Shari'ah*, for example, which is considered to be one of the most powerful environmental factors, varies between these Muslim countries. This in turn influences the type of business activities and the accounting practices employed in these countries (Iqbal, 2002; Haidar, 2006).

If the IASB aims to combine accounting practices and standards worldwide, it has to understand and be sensitive to the exciting, energetic and developing markets and Islamic finance in other parts of the world, apart from those in Europe and North America**,** which have particular characteristics that require focus and time (Haidar, 2006). Therefore, the setting in which a country functions will have an effect on its accounting practices (Blake and Hossain 1996; Nobes *et al*., 2006; Radebaugh *et al.*, 2006). As Enthoven (1978:20) notes, "since accountancy operates in a socio-economic framework as a 'service' function, the socio-economic activities and policies have a major bearing on accountancy". It is also argued that accounting practices in every country are not the same (Roberts *et al*. 2008). Thus, the way the economic and business environment is shaped and operates determines the nature and framework, as well as the mechanism of accounting.

Having such differences has generated the idea of standardisation, as discussed above. However, in recent years, the emergence of more cultural specific forms of business and finance, such as in the case of Islamic finance has raised the rationale for culture specific accounting methods. Thus, as school of thought two major trends have emerged in recent years as discussed in the following sections.

2.4 HISTORICAL OVERVIEW OF DEVELOPMENTS IN THE HARMONISATION OF FINANCIAL REPORTING PRACTICES

Accounting harmonisation is not a recent phenomenon amongst accounting professionals, such as in Anglo Saxon countries. International accounting harmonisation began in the U.S. in 1904, which alongside other events, has meant that support for the harmonisation of accounting standards has risen over the years, especially more recently (Larson and Kenny, 1999). Indeed, in the last twenty-five years, international accounting has grown rapidly, and this is revealed in the considerable amount of accounting literature that is available on the subject (Stolowy *et al.*, 2001).

In 1973, the International Accounting Standards Committee (IASC) was established as a result of an agreement between a number of accountancy bodies such as the UK, Australia and the US (Nobes and Parker, 2004). Harmonising the accounting standards internationally was one of the major aims of this Committee (IASC, 1995: 29).

The IASC started the process of developing the IASs, once it had been set up. As a result, the first international accounting standard and exposure draft appeared in 1974. Following on from this, the IASC deliberated on the development of international accounting standards. From 1974 to 1979, the Committee had issued 13 International Accounting Standards globally. Nevertheless, the organisation met with minimum success in relation to its objectives of harmonising accounting standards, due to a lack of enforcement with businesses that did not cooperate (Basoglu *et al.*, 2005).

The IASC believe that implementing IASs will improve the quality of financial statements and in turn they will increase the level of financial reports' comparability prepared by businesses from different regions (Murphy, 2002; Choi and Parker 2005). In 1997, the IASC concluded that to continue to perform its role effectively, it would need to encourage national accounting standards and practices, and first-rate global accounting standards to be combined and work together. Therefore, for this to occur, the IASC decided to change the structure of the organisation. In late 1997, a Strategy Working Party was formed to examine the IASC's structure and strategy (Basoglu *et al*, 2005). In March of 2000, a new IASC constitution was agreed and endorsed and the name was changed to be the International Accounting Standards Board (IASB). In April 2000, the new board (IASB) began its work and thus, reports to the IASC Foundation and is presently perceived as being the vanguard in establishing and providing financial accounting standards (Basoglu *et al.*, 2005).

Between 2000 and July 2005, the Board (IASB) changed from an organisation concerned with private interests and dominated by accountants in countries with similar laws, with cooperative links to other professional associations, into a unified, international organisation producing standards permitted by a number of securities regulators at a national, regional and international level (Donnelly, 2007).

According to IFRS Foundation Report (2012), the IASB in 2001 started its operations with the following objectives:

(i) To develop, in the interest of the public, a single set of high quality understandable and enforceable global accounting standards that require transparent and understandable information in financial statements and other financial aspects. This is in order to help the participants in the various capital markets of the world and other users of the information to make economic decisions;

(ii) Promote the use and rigorous application of those standards;

(iii) Work actively with national standards-setters to bring together national accounting standards and IFRS to provide first-rate solutions.

In April 2001, the IASB adopted all IAS and created a set of new standards called IFRS. The IFRS, together with IAS are a set of standards that are 'principle-based' and establish rules that are distinct in nature, rather than just ordering accounting treatments that are explicit (IFRS Foundation, 2002; Bonham *et al.*, 2007). IFRSs are created to be appropriate for the general purpose financial statements and financial reporting of all profit-orientated bodies. This includes companies participating in commercial, financial, industrial and similar activities (IASB, 2006).

It should also be mentioned that International Financial Reporting Interpretations Committee (IFRIC) is a committee in the IASB, which works with and supports the IASB, to set up and enhance IAS' and IFRS', and offers leadership on financial reporting issues, which are not specifically addressed in IAS' and IFRS', in the context of the IASB framework. Furthermore, it performs other assignments at the request of the IASB (Donnelly, 2007).

The IASB has the responsibility of establishing accounting standards and issuing IFRS and detailed explanations of IFRS for accountants and auditors to apply to the extent that national laws and practices make this possible. Over the next few years, a considerable number of companies will begin to utilise IFRS as their principal basis in producing financial reports. Recently, in Europe, the European Commission issued a directive, which apart from a few omissions, requires all publicly listed companies undertaking business within the EU to arrange their consolidated financial statements in line with IFRS from 2005 onward (Deloitte and Touche, 2002 and Bonham, *et al*, 2007).

The IAS is a set of principles that explain how various transactions and other events should be transparently revealed in financial statements. In addition, IAS is a plan to harmonise financial reporting requirements that elucidates resources and other information of interest to those working in the sector such as employees, tax authorities and investors (Deloitte and Touche, 2002).

As regards to the impact of harmonisation issues in IBFIs, Archer and Abdel Karim (2007:302) have questioned whether "IFRS are adequate to cater for the specificities of Islamic financial services which, as claimed by students of Islamic finance, require accounting treatments which are not specifically spelled out in IFRS". In supporting this argument, Karim (1996) argues that Islam does not differentiate between secular and spiritual affairs, and perceives business as a substance of ethics, subject to the main beliefs of *Shari'ah*. He adds that Western accounting rules are observed as unethical rules. Consequently, in relation to those institutions that present IFS, if accounting information is to give a dependable and honest representation of economic transactions or other procedures, it is crucial that they are accounted for and presented in accordance with the matter, as well as in the form of *Shari'ah* contracts such as *murabahah, mudarabah, mosharakah, etc.* that regulate these transactions (This argument is discussed in details in Chapter 4).

It can be argued that these developments occurring in traditional accounting appear to be closer to responsible and social accounting. As a result, it may be that conventional accounting is moving closer towards Islamic accounting practices in an intangible way rather than in a way that is defined by Islam.

2.5 ARGUMENTS FOR AND AGAINST HARMONISATION

According to Zeghal *et al.* (2011), the philosophies by a number of nations that are beyond the implementation of the IASs have frequently been an issue of disagreement in the accounting literature. For this, two main schools of thought exist. One in favour of adopting the international standards founded on the argument that harmonisation could raise the excellence of financial reporting and develop the comparability of accounting reporting worldwide. This comparability could reduce the existing misunderstandings regarding the consistency of overseas financial statements and might eliminate the main significant obstacle to the flow of global investment. It would also ease financial processes on a wide-reaching level, and therefore, contribute to increasing overseas assets as shareholders; financial analysts and overseas creditors would be able to recognize the financial statements of overseas corporations (Piper and Samuels, 1985). Additionally, it also argues that this facilitates a comparison with the investment opportunities and would assist them to make accurate judgments in relation to investments.

It is argued that harmonisation would save time and money that is currently being spent to strengthen different financial information when more than one set of reports is required to act in accordance with national laws or practices that are varied. It will also improve accounting standards across the world to attain higher levels and to be consistent with local economic, legal and social conditions (Choi, *et al*., 1999). It is felt that harmonisation would be advantageous to countries, which do not have sufficient codified standards of accounting and auditing, and to international accountancy firms that have at least one foreign subsidiary (Nobes and Parker, 2006) and reduce complications to some degree. A further advantage for international accounting companies will be the easier movement of staff between different countries and moreover, it will be less expensive to provide staff training.

In exploring this, the following question should be answered: How can harmonisation support financial decision-making to control essential relationships with dealers, clients and others? Multi-national companies are the group that would benefit from harmonising the accounting standards because it would ease the communication of financial information within these groups (Lawrence, 1996). A further advantage that might be gained from harmonisation would be the significant contribution, particularly for those countries that do not have first-class standards, to reinforce amalgamation and rivalry in financial markets (Peavy *et al.*, 1990). Besides, Wolk *et al*. (1989) claims that developing countries will benefit from harmonising international accounting, given that it offers them superior accounting standards, frameworks and principles. Additionally, Zeghal, (2006) states that the study has been done by Chamisa (2000), found the same result, when he used Zimbabwe as a case study to examine the problem with the value of IAS' for developing countries.

In contrast, the second school of thought argues that specific environmental issues in each country's context must be considered when issuing local accounting practices, such as the case for Islamic ontology and cultural norms, and their impact on accounting (Zeghal, 2006). Talaga and Ndubizu (1986) argue that accounting principles in a country or a region have to be modified to its national environmental situations. Indeed, it was established that the accounting information issued with regards to the accounting structure of developed countries is not necessarily relevant to the decision model of developing countries.

For example, different countries have different users of accounting information (Lawrence, 1997). In other words, each group requires varied information, such as shareholders require information, which is related to investment assessment; tax institutions need information formed at the level of tax regulations; workers want information of a public style and administration requires information created with a public uniform arrangement in mind and moreover, to direct and organize businesses (Lawrence, 1997). Bearing in mind all these diverse requirements and users, it is complicated to achieve all these different financial reporting needs within a certain framework with few choices and flexibility in the request of the framework (Chairas and Radianto, 2001).

In considering the case for an Islamic accounting system, the operations of IBFIs has by definition accounting implications which can require a distinct accounting practice due to being based on Islamic principles involving personal and social accountability, as opposed to the principal personal accountability in Western societies and accounting practices. This has implications for harmonisation process. Thus, on the one hand accounting in Islamic financial institutions should ensure that all accounting information is fully transparent and divulged, in order to serve the objective of state (or social) accountability, rather than what is divulged and not divulged being the outcome of a political process (Karim, 1995; Baydoun and Willett, 2000). On the other hand, IBFIs are imposed to work in an environment determined by IAS. This paves the way for the emergence of harmonisation problems.

In Baydoun and Willett's (2000) research from over a decade ago of financial reports between Western accounting and the Islamic system, they commented that the state (or 'the mass' political terminology) is the critical consumer of accounting reports. In addition, they explained that organizations must serve the interest of the socialist state (or the masses). Therefore, the accounting profession has to give priority to and place importance on the execution of the laws, rules and economic policies of the state, when they provide accounting services in their daily operations and prepare annual reports (Baydoun and Willett, 2000).

It should be noted that, in line with such arguments, some researchers did not recommend developing countries to adopt IAS' (Hove, 1989, Perera, 1989b). Kinsey (2006) supports this argument when he insists that there is not one set of accounting systems that can be appropriate for the particularities of developed and developing countries, as the culture and economic environments between the two sets of countries are different. However, several other contenders claim that a single set of accounting principles could be beneficial to both advanced and emerging nations equally, as long as IAS' are flexible enough to allow for dissimilarities in culture and industry practices across countries and regions (Kinsey, 2006).

Although improving and applying IAS' has been a concern in the past few years, the implementation of these principles by emerging nations, including Muslim countries has not received a similar level of consideration (Zeghal, *et al*. 2011). Zeghal *et al* (2011) added that in an investigation of 64 developing countries that included Muslim countries, it was discovered that factors such as levels of education, the existence of an Islamic financial business and cultural association were definitely and considerably correlated with the implementation of IAS'. This is explained by that fact that developing countries including Muslim countries, which have a high level of education, have financial markets and are influenced by Western culture, are more likely to accept IAS (Zeghal, *el at*. 2011).

2.6 TYPES OF ACCOUNTING HARMONISATION

In accounting literature, the terminology of *'harmonisation'* is understood in many different methods. We can define harmonisation in two characteristics: material (or *de facto*) and formal (or *de jure*) harmonisation (Rahman, *el at*. 1996). The former indicates the harmonisation of reporting practices applied by various companies, which is about reliability in genuine requests (Tay and Parker 1990:73). Canibano and Mora (2000:353), however, defined *de facto* harmonisation as the following:

> *"De facto* measurement harmonisation is an increase in the degree of comparability and means that more companies in the same circumstances apply the same method to an event or give additional information in such a way that the financial reports of more companies can be made comparable".

However, '*de jure'* harmonisation is related to the harmonisation of principles and rules (Tay and Parker 1990). Wolk *et al* (2001) point out that this is emphasised from a theoretical standpoint, because this could mean that the similarities and differences between the regulations and rules of different states, groups or clusters be revised, and harmonised.

It is believed that formal harmonisation, namely *'de jure'* may be accompanied by disharmonisation, if the standards permit companies to have more options. Furthermore, it is felt that material *'de facto'* harmonisation may occur simultaneously without being furthered by formal harmonisation. This is referred to as unplanned harmonisation (Canibano and Mora, 2000). They added that *'de jure'* and *'de facto'* harmonisation might be related to the accounting system applied or to the level of disclosure. The formal harmonisation is called 'disclosure harmonisation' and material harmonisation called 'measurement harmonisation' (Canibano and Mora, 2000).

Perramon and Amat (2006) argue that Tay and Parker (1990) examined six separate investigations that focused on the measurement of international harmonisation and commented on the challenges of applying different operational definitions of harmony and study designs. They highlighted that the measurement of *de jure* harmonisation does not appear to be a valuable topic, if the ultimate concern of harmonisation is to increase the comparability of financial reporting. The authors believed that research performed on *de facto* harmony in changing the regulatory environment assists in specifying the close relationship between *de jure* and *de facto* harmonisation. In supporting the debate, Rahman *et al.* (1996) added that existing research on the evaluation of accounting harmonisation have tended to deliberate on material 'de facto' harmonisation or its effects, rather than investigating formal '*de jure*' harmonisation. It should be noted that a considerable number of these pieces of research carrying out assessments on material harmonisation have calculated the effects of formal harmony on banking practices (Rahman *et al*., 1996).

2.7 ALTERNATIVES TO HARMONISATION

For the sake of making financial statements similar, Fritz and Lammle, (2003) stated that there are three aspects that might be considered as an alternative to harmonisation, which are 'mutual recognition', 'reconciliation' and 'standardisation'. Choi and Meek (2005) argued that those approaches have been put forward as possible solutions to problems related to cross-board financial statements filings (Choi and Meek 2005; Fritz *et al*. 2003).

The following sections provide an understanding on these suggested alternative mechanisms to harmonisation.

2.7.1 Mutual Recognition

Choi and Meek (2005) defines mutual recognition as national financial statements that are recognised internationally, even though those statements were structured according to the accounting standards of the respective nation state. While, Achleitner and Behr (2000) argues that mutual recognition is possible as long as there are similarities in the fundamental accounting standards between the countries, such as the US and Canada, and European countries are not exceptional. Nevertheless, this statute is not always automatically applied. For example, accepting financial statements based on the US-GAAP by some European enterprises did not allow them to enter and trade easily in some vital American capital markets, since the SEC deters the recognition of non US-GAAP in the US (Achleitner and Behr 2000).

2.7.2 Reconciliation

Choi and Meek (2005) argues that with reconciliation, foreign firms can report financially, in relation to their national accounting standards. However, they have to make a compromise with the important accounting methods such as stakeholders' equity and net income available locally, and in the country where the financial statements are being filed. He claims that the cost of reconciliation is cheaper than making a complete set of financial statements in regard to various collections of accounting values. Nevertheless, they only present outlines, not the complete image of the company (Choi and Meek, 2005). However, this approach still entails expenses that might not arise if there was a single set of internationally recognised accounting principles (Fritz *et al.*, 2003).

2.7.3 Standardisation

The word standardisation is commonly related with the IASC, whereas the word harmonisation is more likely to be related to the translational legislation originating from the EU (Nobes, and Parker, 2002). While harmonisation is the practice of raising the compatibility of accounting systems by setting bounds to their level of difference, standardisation implies the obligation of additional inflexible and strict regulations (Nobes, and Parker, 2002). It has been argued that standardisation, uniformity and harmonisation are concepts, which are applied in the literature with different meaning. The three terms have no variation in the meaning, except possibly in the level of harmonisation they engage (Uddin, 2005)

Standardisation means creating uniform business processes across various divisions or locations. However, Choi and Meek (2005) claims that standardisation and harmonisation have some variations. While the former is the process whereby all the countries have to accept the system of one country, the latter is identified as the understanding of varied opinions. Additionally, Blake and Hossain (1996) stated that both Samuels and Piper (1985:56) and Nobes (1991:70) distinguish between 'standardisation' and 'harmonisation'. Standardisation gives an indication of inflexibility and uniformity, while harmonisation is the process of stopping short of uniformity by narrowing areas of dissimilarity.

2.8 ACCOUNTING AND AUDITING ORGANIZATION FOR ISLAMIC FINANCIAL INSTITUTIONS ORGANISATION (AAOIFI)

In the recent years, the size and the number of players in the Islamic financial industry have risen all over the world, including in Muslim and non-Muslim countries, as indicated by The Banker (November 2013), the number of Islamic banks and financial institutions have risen over five hundred institutions with over USD 2 trillion asset base. This requires related and appropriate infrastructure to be established including relating to standards and accounting. In other words, since the Islamic instrument differs to a conventional one, a corresponding alternative set of accounting standards needed to serve those principles in compliance with the *Shari'ah* requests.

To meet the needs of the Islamic institutions, an international, independent, not-for-profit commercial Islamic organisation, the AAOIFI was established in 1990 and registered in 1991 in Bahrain with 200 members from 45 countries (Abdel Karim, 1999, AAOIFI, 2015). AAOIFI prepares 'accounting', 'auditing', 'governance', morals and *Shari'ah* principles for Islamic financial institutions (IFIs), which has considerable support from all over the world, including central banks, IFIs, and other members from the international Islamic banking and finance commerce, and yet, unlike the IASB, it does not have influence on the IFIs to enforce them to adopt its standards (AAOIFI, 2007). However, many Islamic banks now apply AAOIFI standards, and therefore Islamic banks in Bahrain, Sudan, Jordan, Syria, Qatar and Qatar Financial Centre and Islamic Development Bank Group have adopted the AAOIFI rules. Furthermore, some countries that already use IFRS such as Malaysia, Singapore, Pakistan, Brunei, South Africa and Indonesia, Kuwait, Lebanon, Saudi Arabia and UAE, Egypt, Dubai International Financial Centre *etc.* started to adopt AAOIFI as guidelines or basis for national standards in authorities, although they have not fully implemented it yet (AAOIFI, 2012). Within the structure of AAOIFI there is a *Shari'ah* board, which is compiled of not more than twenty members, including *fiqh* scholars, who signify *Shari'ah* supervisory boards in the Islamic financial institutions that are members of AAOIFI (AAOIFI, 2007).

Until 2015 AAOIFI had issued a total of 94 standards 26 Accounting Standards, 54 *Shari'ah* Standards, 7 Governance Standards, 5 Auditing Standards and 2 Ethics Standards. Also there are another 4 standards issuances planned to be released during 2015 (AAOIFI, 2015). AAOIFI has been encouraging central banks to adopt those rules by trying to persuade IFIs of their value system in rationalising its standards (Pomeranz, 1997). However, to implement AAOIFI standards fully, Karim (2001) suggests that AAOIFI could be dependent on the relationship of regulators in national banking who would help to convince the government with necessity of adopting AAOIFI standards, because Islamic banks commonly operate in a country where its economy is controlled and directed by the government.

IFRS concentrates on the economic value and substance of a transaction or product, as opposed to the legal form, while AAOIFI established its own objectives in accordance with the principles of Islamic *Shari'ah* that indicates a complete structure for every detail in daily life. Establishing these aims should encourage the growth of accounting standards that are reliable with one another. As a result, users' confidence in the financial reports of Islamic banks should enhance (AAOIFI, 2007:11: para 19).

It is argued that the substantial differences between IFRS and AAOIFI accounting standards arise from the different objectives of accounting for the reason that financial accounting is principally specialised in delivering figures, in order to support operators to make the right decisions. Whilst for others who have a business with Islamic institutions including banks, complying with Islamic requirements in their businesses and other transactions are their priority (AAOIFI, 2007).

The objectives of AAOIFI are as following (AAOIFI, 2007: xiii):
(i) To develop accounting and auditing thoughts relevant to Islamic financial institutions;
(ii) To disseminate accounting and auditing thoughts relevant to Islamic financial institutions and its applications though training, seminars, publication of periodical newsletters, undertaking and commissioning research and other means;
(iii) To prepare, promulgate and interpret accounting and auditing standards for Islamic financial institutions; and
(iv) To review and amend accounting and auditing standards for Islamic financial institutions.

Considering the objectives of AAOIFI, they should be seen as complementary to that of the IASB's objectives that were discussed above for the following reasons (AAOIFI, 2007:12):

(i) Islamic banks must comply with the principles and rules of *Shari'ah* in all their financial dealings;

(ii) The functions of Islamic banks are significantly different from those of traditional banks, which have adopted the Western model of banking;

(iii) The relationship between Islamic banks and the parties that deal with them differs from the relationship of those who deal with traditional banks.

It should be reiterated that Islamic banks are different to conventional banks as they do not use interest (usury) (as discussed in detail Chapter 4) in their investment and financing transactions, whereas conventional banks use interest in their financial transactions. Therefore, it is argued that accounting standards developed for conventional banks may by irrelevant to the needs of Islamic banks (Baydoun *et al*., 1995).

Table 2.1 Comparison on Structural Objectives between AAOIFI and IFRS

Comparison on structural objectives	AAOIFI	IFRS
A. **Differences on coverage of standards**	• Specific to the Islamic finance industry. • Based on requirement of Islamic finance practices	• For entire economic and social activities. • Generic, generally not industry-specific.
B. **Differences on types of standards**	• All-encompassing. • Accounting, • *Shari'ah*, • Auditing, ethics and governance.	• Type-specific. • Accounting.

Sources: AAOIFI (2008:2)[1]

As the comparison between the structural objectives of AAOIFI and IFRS in Table 2.1 depicts, IFRS' are intended to apply to the general purpose financial statements and other financial reporting of all profit-orientated bodies. These bodies include those employed in financial, commercial, industrial and similar activities, whether categorized in corporate bodies or other structures (IASB, 2006). The objectives of IFRS were issued with Western culture in mind, which is different to the Islamic culture (as will be discussed in the next chapters) and therefore, their objectives that were established for conventional banks should be different to those objectives that were created for the Islamic banks (AAOIFI, 2007). However, it does not mean that all the IFRS standards should be rejected as there are several common aims between Muslim and non-Muslim users of accounting information. For example, Muslim and non-Muslim investors may have a strong wish to increase their wealth and to gain acceptable returns on their endeavours, for which IFRS could play a facilitator role in international markets.

2.8.1 Conceptual Frameworks of IASB and AAOIFI

The IASC adopted the financial accounting standard board's (FASB) framework issued in 1989 and in 2000 the name IASC was changed to IASB. In 2001, the IASB adapted the same framework that was originally approved by IASC in 1989. This framework and its objective of determining financial reports and the specific features of valuable data were reviewed in 2010 by the IASB. However, the outstanding files from 1989 are still operational (IFRS, 2010).

[1] available at http://www.kantakji.com/media/2738/aa303.pdf

This conceptual framework identifies the thoughts of preparing and presenting the financial reports for users from outside the organisation. It provides general guidelines for future accounting standards, the specific features of beneficial financial data, the meaning and thoughts of investment and investment conservation, as well as the objectives of financial reporting and measurement, and appreciation of the features from which the financial statements are designed (IFRS, 2010). The purpose is to assist the IASB to develop new international standards and practices that might reduce the diversity that exists in accounting practices, and to help national organizations that develop standards to set international measures which are consistent (IASC, 1989, para.1). However, the IASB' conceptual framework does not address specific issues of concern to IFIs.

AAOIFI established a similar conceptual framework to that of the IASB. It supplies the foundation for the FAS' of AAOIFI, including the primary objects along with the conceptions that underlie financial accounting and reporting by IFIs. The framework covers financial accounting and reporting objectives and the concepts that flow from them, as well as signifying the structure of standards underlying financial reporting.

Before the establishment of the AAOIFI's framework, full consideration was paid to the other methods that are applied by organisations that establish standards that contradict with *Shari'ah*. The approach that AAOIFI (2007:27 para, 7) used to develop the conceptual framework consists of the following;

(i) Acknowledging accounting models which have previously been developed by other standard setting organisations are in line with the Islamic principles of honesty, equality and accuracy;

(ii) Recognizing models, which are used in traditional financial accounting, which are inappropriate for use in Islamic *Shari'ah*. As a result, these ideas were either discarded or sufficiently altered to comply with *Shari'ah* for the purpose of financial reporting by IFIs (Karim, 1995);

(iii) To define those features of financial accounting in Islamic banks, which are unique to the Islamic way of performing business? This includes theories and ideas based on the Islamic laws defining the risks and rewards associated with business transactions, and the incurrence of costs, and profit, which is not actually permitted in Islam (Karim, 1995);

(iv) The identification of the major users of financial reports and the information they need, mainly, individuals that do not the influence or capability to achieve the right to use the data not integrated in financial reports.

According to the prior discussion, it could be argued that establishing the conceptual framework was essential since it would provide a wider recognition of accounting information integrated in common principle financial reports, which in turn, make the users more confident in IFIs. Moreover, it allows financial report users to understand the information included in financial statements prepared traditionally with financial accounting standards. Significantly, the conceptual framework encourages harmonisation by providing a base to select the most appropriate accounting method allowed by the financial accounting standards (AAOIFI, 2007).

2.8.2 Comparison between IAS/IFRS and AAOIFI's Accounting Standards

The above argument illustrates that the objectives of accounting information users are different within the two organisations. Therefore, this guides towards diversity in the types of accounting principles. AAOIFI issued standards for particular IFIs and businesses are not enclosed by IASB/IFRS standards, because IASB/IFRS standards are not for businesses particularly apart from IAS 41 which was issued for agriculture and IAS 30 replaced by IFRS 7 that established to treat 'disclosures in the financial statements of banks and similar financial institutions', thus, it is not possible for IFIs to adopt these standards. Moreover, it is not possible to follow IAS 30 in full, for the reason that *Shari'ah* conformity matters (Rizk, 2013).

Furthermore, IAS 17 cannot be adopted in whole by the IFIs; therefore, AAOIFI issued FAS 8 for particular Islamic finance contracts, such as *ijarah* and *ijarah muntahia bittamleek*. AAOIFI also issued specific standards such as FRS 2 for *murabahah*, FRS 3 for *mudarabah*, FRS 4 for *musharakah*, FRS 7 for *salam*, FRS 9 for *zakah*, and FRS 10 for *istisna* (see the detailed discussion in details in Chapter 4), because the IASB has no IFRS to cover them (AAOIFI, 2007).

In addition, because of the unique nature of *takaful* compared to conventional insurance, IFRS4 on insurance contracts cannot be followed by Islamic insurance companies (Ibrahim, 2007). Hence, four standards are circulated; FAS 12, FRS 13, FRS15 and FRS 19; while the first standard was issued for general performance and disclosure in the statements of Islamic insurance companies, the second standard was established with regards to declaring bases to regulate and allocate extras or shortages in Islamic insurance companies. The third standard, however, was distributed to supply assets in Islamic insurance companies, with the last standard being for contributions in Islamic insurance companies (AAOIFI, 2007).

Another important difference between the two organisations is the overall disclosure and performance required in the financial statements of conventional institutions and Islamic financial institutions. While the IAS 30 requires particular disclosure of accounting policies; the substance of the financial position statement (balance sheet), the cash flow statement, income statements, variations in owners' equity statement and off balance sheet objects, including eventualities and requirements and any notes on the financial statement, the FAS 1 requires more general disclosures in the financial statements (Rahman, 2010). In addition, three more statements were added to the complete set of conventional financial statements in the FRS 1 that might be useful for users of Islamic banks and financial institutions. These are outlined below as follows (AAOIFI, 2007 para 2:64);

(i) A statement of sources and users of funds in the *Qard* fund;
(ii) A statement of changes in restricted investment;
(iii) A statement of sources and users of funds in *zakah* and charity funds (when the bank assumes the responsibility for the collection and distribution of *zakah*).

In addition, the standard specified that IFIs and Islamic banks, in addition to IAS 30 disclosure, in relation to basic information about the institutions (AAOIFI, 2007 para 2.3: 66):

> they should disclose two more important aspects of their unique functions which are the bank's responsibility towards *zakah* and the role of the *Shari'ah* adviser or the *Shari'ah* board in supervising the bank's activities and the nature of adviser's or board's authority in accordance with the bank's by-law and in actual practice.

Unlike the conventional IAS 30, FRS 1 requires the IFIs and Islamic banks to disclose the amount of earnings and expenditure that are not permitted by *Shari'ah*. The standards also require the Islamic banks to disclose how it intends to dispose of the assets generated by the prohibited earnings or acquired through prohibited expenditure (AAOIFI, 2007 para 3.6:68). Another fundamental point of argument that distinguishes AAOIFI FRS 1 from the IASB IAS 30 is that the former requires disclosure related to unrestricted and restricted investment accounts, such as the equity of unrestricted investment accounts, which requires separation from liabilities and owners' equity, because AAOIFI treat the unrestricted investment accounts as equities not liabilities (Rahman, 2010).

Moreover, the financial statement of IFIs should disclose the distribution of unrestricted investment accounts, by type, in accordance with their respective periods for reaching maturity, from the date of the statement of the financial position (AAOIFI, 2007 para 3.9:68). The maturity period is designed to disclose liquidity requirements during the next period and liquidity requirements during the following periods. This is to ensure transparency on the accounting and management of the unrestricted investment accounts (Rahman, 2010). With regard to interest, due to the unique environment of Islamic banks that prohibits interest, the financial statement items presented in FAS 1 are largely the results of free-interest financial instruments such as *murabahah*, *mudarabah* and *musharakah*, which are not disclosed in the financial statements of conventional banks, whereas financial statement items that are presented in IAS 30 are largely the product of financial instruments that have interest. Table 2.2a and 2.2b illustrate more accounting issues that could occur while employing IFRS in the IFIs.

Table 2.2a: Recognising Possible Accounting Issues when IAS is applied for IFIs

Issues	IAS	Islamic Finance Principles
Deposit contract	• Conventional banks generally rely on a contractual liability plus interest for their deposit contract. Therefore, all deposits are treated as liability under IAS. • Contractual obligations to pay depositors will clearly be liabilities of the institution.	• Islamic banks use *mudaraba* (profit sharing) and *wakala* contracts (agency contract) for structuring their deposits. • FAS-1 (AAOIFI) requires unrestricted investment accounts 'funds (*mudaraba* deposit) to be presented in the right hand side of the Statement of Financial Position in a separate section in between liability and equity
Financial Lease Vs *Ijarah Muntahia Bittamleek*	• The inherent risks and rewards associated with the asset have been transferred to the lessee, who in substance is deemed to be the owner. • Finance lease is reported as receivables/loans on the bank's book and an ownership interest being recorded by the lessee	• Asset should be reported in the lessor's (bank) books. Maintenance costs are borne by the lessor. • The presentation of the lease as a loan/receivable on the bank's book and an ownership interest being recorded by the lessee contradict the principles of *Shari'ah*. *Shari'ah* stresses that asset ownership rests with lessor throughout the lease term.

Source: Hidayat (2010: 9).

Table 2.2a: Recognising Possible Accounting Issues when IAS is applied for IFIs

Isues	IAS	Islamic Finance Principles
Recognizing a sale of good with deferred payment (AOSSG, 2010)	• Reporting all Islamic financial transactions as financing transactions • IAS 18 requires the difference between the fair value and the nominal amount of consideration in a sale of goods is recognized as interest revenue (AOSSG, 2010).	• The staff of Indonesian Accountant institute indicates that: "according to *Shari'ah fatwa* in Indonesia, *murabahah* cannot be accounted for as financing transaction. This kind of transaction should be treated as sales transactions. Treating it as financing will eliminate the essence of *shari'ah* principle. (AOSSG, 2010). • The staff of Institute of Chartered Accountants of Pakistan (ICAP) mentions that: "Deferment of profit is allowed by scholars, but it should be separately recorded as a deferred profit and not as interest. (AOSSG, 2010)
***Takaful* concept**	• The premium received is part of the insurance company's revenues.	• Takaful is not insurance, it is a mutual protection scheme where the underwriting fund does not belong to the takaful company but to the policyholders. Hence we actually have two accounting entities (Siswantoro and Hameed, 2011). • Therefore, the *Takaful* Company must segregate between shareholders' funds and policyholders' funds in its financial report (Hidayat, 2010).
Conceptual Aspects	• Substance over form principle. This principle recommends recording a transaction according to its reality (what is) not to its legal form (what ought to be) (SII, 2006).	• From an Islamic point of view, although reality (what is) should be taken into account in deciding strategies, it cannot be a substitute for what ought to be (Hameed, 2009). • The reality may reflect a deviation from normative precepts of Islam. In fact, Islam has already eternal ethical and behavioural principles and objectives (Hameed, 2009).

Source: Hidayat (2010: 9).

2.9 CONCLUSION

This chapter presents a literature review on the harmonising of accounting standards, the IASB and AAOIFI, as well as comparing the two sets of the standards and highlights the essential differences, which result from the specifics of *Shari'ah* compliant transactions. The adoption of IFRS' is considered advantageous for developing countries because IAS' permit those countries to produce reliable financial reports and accounting information comparatively inexpensively and efficiently, while at the same time encouraging investors. However, IFRS were created with conventional products and services in mind. If and when they are applied to Islamic financial products, understandably they will treat the products, as being equivalent to their usual products and as a result, this would make it non-compliant with *Shari'ah*. This is due to the fact that the nature and activities of banks in Islamic business are considerably unlike conventional banks.

For instance, Islamic financial institutions apply the profit loss sharing contract (PLS); in the case of deposit mobilization, IFIs use *mudarabah*, and in the case of customer financing they use other applications such as *musharakah, ijarah, salam, murabaha* and *istisna'*. These instruments need special accounting standards to treat them, which are not available in the IFRSs standards. Therefore, full adoption of IAS-IFRSs might not be possible, given that it could affect the transparency and accountability of financial reporting for Islamic finance, if they use IFRS' to account for Islamic products and transactions, although they might have the advantage of worldwide acknowledgment and practice. In other words, it would be neither suitable nor practical for Islamic banks to financially report by using IFRSs. In addition, it is interesting to acknowledge that the instruction of Islamic law or *Shari'ah* is one of the main factors that cause variations in accounting practices. For instance, as mentioned above, a gap exists between the two sets in their accounting practices. In line with this argument, Khairul Nizam, the Director of Technical Development at AAOIFI (as cited by Ibrahim, 2007:8) states that:

> It is clear that gaps and differences exist and will continue to exist between the two set of standards. These gaps and differences are a natural result of the differing structural objectives of the IASB and AAOIFI. AAOIFI's mandate is to develop standards where IFRS's do not cater for the specificities of Islamic Banking or leads to *Shari'ah* compliance issues. As long as there are economic, legal and social differences between Islamic and conventional banking and finance practices, there will also be differences in the standards issued.

CHAPTER 3

THE IMPACT OF ENVIRONMENTAL FACTORS ON THE DEVELOPMENT AND PROGRESSION OF ACCOUNTING SYSTEMS

3.1 INTRODUCTION

The inter-and-intra cultural diversity among societies and countries has implications for accounting practices, which is reflected in financial statements. In order to overcome inconsistency, a movement for a uniform method or adopting universal accounting systems in the form of IFRS was established in the 1970s. However, objections have been raised against such a movement recently, on the basis of the significance of culture, which is identified as an imperative factor impacting upon accounting practices and the development of accounting changes.

This chapter explains the impact of environmental factors on the development of accounting systems in the context of international accounting. As a critical survey of the literature, each influential environmental factor is analysed and evaluated. The relationship between the influence of cultural factors as a significant key to international progress and accounting harmonisation has been discussed in reference to Hofstede (1980) and Gray (1988). It should be noted that Hofstede's work on cross-cultural psychology in shaping work and managerial behaviour did not consider accounting *per se*. Conversely, Gray's conceptualisation is a development and a further study of Hofstede's model that attempts to understand some of the instruments related to cultural variables, which may influence the accurate strategy of accounting knowledge (Baydoun and Willett, 1995). These together with other aspects of environmental factors such as deterministic variables are discussed in the following sections, in terms of their impact in shaping the accounting systems.

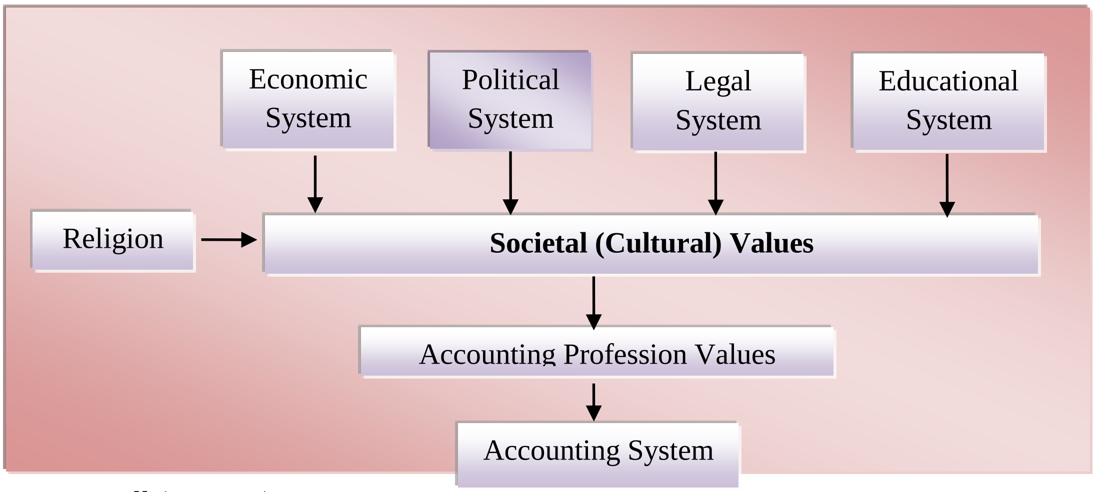
3.2 THE IMPACT OF ENVIRONMENTAL FACTORS ON ACCOUNTING DEVELOPMENT

In the literature, the differences in environmental factors between different national settings are recognised as an influential element in understanding or studying a country's accounting practices. Environmental factors are considered as a significant factor to be taken into account, while attempting to harmonise the accounting system in a country (Nobes and Parker, 2004). In substantiating this Novak (2007a) argues that accounting is mainly an outcome of its environment. In the same line with this argument, several authors (such as Radebaugh and Gary 2006; Belkaoui, 1985; Adhikari and Tondkar, 1992) claim that accounting cannot exist from scratch; however, it reveals the special environment in which it is established and this describes why accounting standards in countries are different. Gray (1988) also argues that national accounting systems are determined by environmental factors, who added that variations in environment created differences in accounting forms as well as obstructing international harmonisation and economic growth (Gray, 1998). Therefore, in international accounting investigation, studying the accounting environment is one of the most important steps, in order to understand accounting models in a particular country.

It is believed that research on environmental influences would help the professions in accounting standards make an accurate judgement when adapting and issuing their accounting standards and when making decisions to harmonise international accounting standards. This can be undertaken by carefully taking into consideration their own environment, including, amongst others, culture and religion, and moreover, in relation to this study, Islamic worldview and life-style. A large list of previous studies argued that the establishment of accounting standards in a country would be affected by a variety of elements, for instance culture, and legal, economic and political systems, and in addition, religion and level of education (among others see: Walton, 1998; Belkaoui, 1985; Harrison and Mckinnon, 1986; Gary, 1988; Radebaugh *et al.*, 1993; Lawrence, 1996; Iqbal, 2002).

Referring to the reasons for accounting differences, Figure 3.1 provides a summary of the factors that might have a direct impact on an accounting system (Gebenedio *et al.*, 1998 and Hill, 2003).

Figure 3.1: Environmental Factors Impacting Accounting Practice



Source: Hill (2003:91)

Thus, based on this introduction, the following sections discuss each of these factors in detail.

3.2.1 Culture as a Deterministic Factor on Accounting Practices

In the relevant literature, culture and its historical roots have been recognized as an important variable in influencing the improvement of accounting systems in different countries. Thus, Arcy (2001) suggested that for an enhanced understanding of any country's differences and its accounting practices, it is essential to be familiar with its culture. It has, therefore, been argued that differences in culture have a significant impact on the development of accounting systems, particularly in how accountants would make their judgments in relation to disclosure and assessment (Schultz and Lopez, 2001).

It should be noted that the impact of cultural environment on accounting practices has become an important factor in accounting literature in recent years. This topic has been significantly explored by a number of international accounting researchers for more than three decades. These researchers, who have recognised that differences in cultural articulations that have been obstructing the unification of accounting systems internationally, as culture is found to impacting accounting standards, both locally and globally (among other see: Perera, 1989, 1994; Gray, 1988; Perera and Mathews, 1990; Goodridge, 1991; Fechner and Kilgore, 1994; Askary, 2006).

Thus, it is argued that a national accounting system could be significantly influenced by the culture of a country (Askary *et al.*, 2008). Besides, Radebaugh and Gary (2002) and Roberts *et al*. (2005) claim that the culture of a country directly influences accounting practices, as it can have a direct influence on the preparers, regulators, auditors and users of accounts. Furthermore, it is argued that due to the variations in culture and traditions, the accounting rule environment, taxation policy *etc.*, there are variances in content and structure between financial reporting standards published by different countries (Stolowy and Lebas , 2002; Roberts *et al*., 2002, 2005).

In the same line with this context, Verma and Gray (1997) and Deegan (2000) state that culture is considered to be an essential element influencing the process of accounting system development and the procedure of accounting modification. Violet (1983), therefore, argues that accounting is a 'socio-technical activity', which involves relations amongst social and non-social resources and consequently, it is not possible to consider accounting as culture-free. Violet, (1983: 3) added that accounting is closely related to culture, by claiming that:

> Accounting is a social institution established by most cultures to report and explains certain social phenomena occurring in economic transactions. As a social institution, accounting has integrated certain cultural customs and elements within the constraints of culture postulates. Accounting cannot be isolated and analysed as an independent component of a culture. It is, like mankind and other social institutions, a product of culture and contributes to the evolution of the culture which employs it. Since accounting is culturally determined, other cultural customs, beliefs, and institutions influence it.

Similarly, according to Harrison and McKinnon (1986: 239), "culture is considered an essential aspect in the framework for understanding how social systems change because culture influences norms and values and group behaviour within and across systems". In addition, Lawrence (1996) stated that the mixture of cultural and economic factors, in addition to the legal and political system does shape the national accounting framework and, therefore, the differences in those elements results in a different environment, which in turn would lead to national financial reporting. Lawrence (1996:5) adds that "culture is the whole set of social norms and responses that condition a population's behaviour" implying that culture is the main factor which makes a difference in social environments. Hence, it can be said that culture is the principal effective element and that others are part of it. Other authors, such as Nobes (1998) are of the view that culture is not mainly the dominant element, since the relationship between cultural factors and accounting development as well as how culture could affect accounting practice is not clear. Moreover, other researchers, such as Jaggi (1975) claimed that managers can be affected by culture in making their decisions, especially with regards to the accuracy of disclosure and the quantity of information they disclose. In his study, he made a comparison between the culture in developing and developed countries and established that cultural differences between two nations could affect the adoption of an accounting system designed for the developed world (Verma, and Gray, 1997).

Belkaoui (1990) also claims that culture has a significant role in the society of daily understanding in accounting, and suggests that the knowledge of accounting is structured in a culturally regulated format that guides people in relation to how to reply to a specific accounting phenomenon. He added that the most significant factors in domestic variances in international accounting are the “cultural, linguistic, political, civil, economic, demographic, and legal and tax relativisms” (Belkaoui, 2002:96). He explained cultural relativism as an important concept used to judge its cultural behaviour, although not from a different cultural perspective. In the context of accounting, this means that accounting values in a country are as important as any other cultural behaviour. Thus, in order to reveal the effect national cultural differences have on the harmonising of international accounting, it is crucial to study the impact of culture on accounting (Belkaoui, 1985).

As discussed above, the cultural norms in each country have evolved over time in shaping its accounting system. Hence, to understand the culture and the central role it plays in society that influences the improvement of the accounting system and the procedure of accounting change, it is important to provide a definition of culture.

3.2.1.1 Definition of culture

Despite being frequently used in everyday language, it is not that easy to define culture. In general, culture is a difficult concept to define and measure, and no single definition of it has reached agreement in the literature. Possibly the most popular explanation is how we act to perform our tasks in society (Lundy and Cowling, 1996). In highlighting this, Hall (1989) claims that culture is not genetic in heritage, although, it cannot exist on its own; but it is constantly a collection of morals shared by members of a society. In other words culture is observed as imparted behaviour that unconsciously prevails throughout society. It influences the whole actions individuals perform in the community, because of their thoughts, attitudes, morals, and normative or predictable prototypes of behaviour. Nevertheless, culture has many complex definitions, developed over centuries. Out of those possible explanations, the following definitions direct this research.

Mulholland (1991) argues that culture is a collection of common and permanent content, sense, morals and principles that describe ethnic, national, or other individuals and guide their behaviour. In addition, Schein (2009:27) states that "Culture is the deeper level of basic assumptions and beliefs that are shared by members of an organization that operate unconsciously and define in a basic 'taken for granted' fashion an organization's view of its self and its environment". Considering influence of culture on international accounting systems, Hill (2003: 89) defines it as "a system of values and norms that are shared among a group of people and that when taken together constitute a design for living". Furthermore, responding to the nature of culture, Hill (2003) states that culture is not static but evolves and is influenced by its determinants, such as religion; language; education; economic and political philosophy prevailing in a society.

In addition to the above explanations, Landis *et al.* (2004:168) state that Kroeber and Kluckhohn (1952) define culture as 'shared values'. According to them,

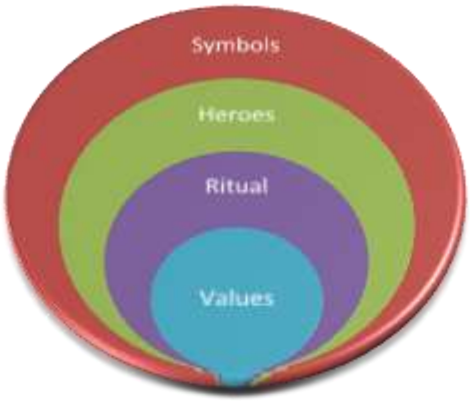
> Culture consists of patterns, explicit and implicit of and for behaviours acquired and transmitted by symbols, constituting the distinctive achievement of human groups, including their embodiment in artefacts; the essential core of culture consists of traditional (*i.e.*, historically derived and selected) ideas and especially their attached values; culture systems may, on the one hand, be considered products of action, on the other conditioning elements of future action.

All things considered, and based on the above definitions of culture it could be said that culture is the behaviour that people learn from others responses to their environment and hence, pass it on to the social environment, which includes economy and finances. Given that a country's culture influences all its systems, the accounting system is not exceptional.

3.2.1.2 Hofstede's model of cultural articulation

Hofstede was one of the first researchers to identify the significance of culture on administration and management. He used a very common set of models to define culture. According to Solas and Ayhan (2007), Hofstede (1980:25) defined culture as "the collective programming of the mind which distinguishes the members of one group from another", that individuals inherited from a previous generation and passed to the next one after they add all the new behaviour they learn. He identified four characteristics, illustrated in Figure 3.2, which are (symbols, heroes, rituals and values) to explain the differences in culture between different groups (Hofstede, 1997; Solas and Ayhan, 2007).

Figure 3.2: Cultural Context



Source: Hofstede (1997: 9)

According to Hofstede, (1997) 'symbols' are the most visible characteristics for individuals from other societies, thus, it can be exchanged between cultures. Examples of symbols are dresses, gestures; status and language (jargon) that only people from the same culture can understand. Heroes chosen by individuals in culture come in the second level of cultural characteristics. Heroes are people who are have achieved great respect in a society and who therefore assist as models of behaviour.

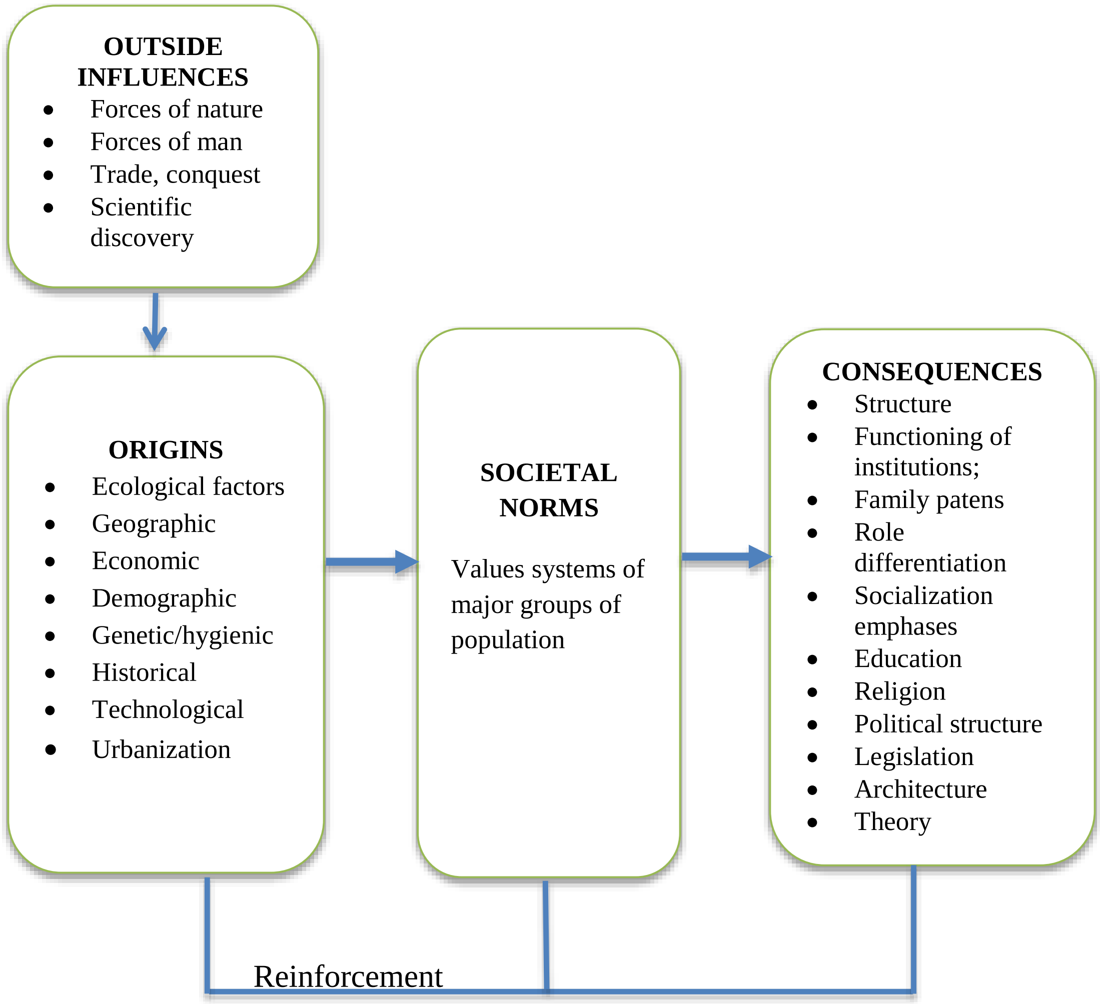
Rituals come in the third level of culture, are considered 'socially essential' and can be achieved and realized by people in that culture. Rituals are shared actions, for instance religious practices and ways of greeting people are all rituals (Hofstede, 1997). Values are the most important and deepest level of culture. These values are the first things that youngsters learn entirely, normally by the age of ten. These are comprehensive teachings with the aim of selecting particular statuses of activities over others, such as the concept of right and good versus wrong and evil. However, these types of values are naturally learnt from living together with people and they cannot be observed by outsiders (Hofstede, 1997). In addition, these cultural values have been considered to be the most influential factors with regards to social systems and organisations in any individual country (Hofstede, 1987 and 1997; Gray, 1988). Similarly according to Baydoun *et al.* (1995), Hofstede claimed that values cannot be easily changed, and he recommended that variances in formal activities could be described by variances in four dimensions of value, which will be discussed shortly. To describe the instruments, origins and outcomes of cultural morals or common norms, Hofstede suggested the model demonstrated in Figure 3.3.

The model in Figure 3.3 illustrates that societies and value systems foremost groups of people have their basis in natural and environmental elements, for example, the economy, the geography and history of society, and consequently develop different social values. Thus, progressive social customs themselves lead to the improvement of organisations inside the society, for example, religion, education, family, patterns and political system. As a result, these influence institutional procedures and the information requests about these procedures. Subsequently, the organisations emphasise the community norms and environmental services that produce them. Change can be positive, such as external changes, which come through forces of environment or forces of men, for instance business, conquest or systematic discovery. This is perceived to be the fundamental debate assisting the argument that every culture has to improve its specific accounting practice to assist its particular different requests (Verma and Gray, 1997; Baydoun and Willett, 1995).

Initial research in the early 1970s by Hofstede attempted to discover the structural factors of culture, especially the factors, which have a strong impact on recognized behaviour in the states of affairs of societies and institutions. Hofstede’s research was possibly one of the greatest widespread cross-cultural studies ever performed, and consisted of a large number of IBM managers in different countries. The study established that cultural variances are linked to four important elements, as the articulation of culture, which are ‘masculinity’, ‘power distance’, ‘uncertainty avoidance’ and ‘individualism’ (Verma, and Gray, 1997).

Assuming that Hofstede has correctly identified those dimensions as important cultural value dimensions, then it can possibly be claimed that there will be a positive relationship between these values and accounting practices, and values which in turn establish the relationship between social values and accounting practices and the impact of culture being measured.

Figure 3.3: Cultural Values and Societal Norms



Source: Verma and Gray (1997:7)

Before taking any steps to classify the important link between accounting values and societal values, it is essential to recognise the significance and meaning of Hofstede and Bond's four value dimensions (1984:10-11).

(i) Individualism versus collectivism: The people of an individualist culture such as the UK, the U.S. and Netherlands express and emphasize themselves as individuals and consider the needs of individuals and their immediate family only. In contrast, people of a collectivist culture, express themselves as members of groups in which people tend to view themselves as members of groups and therefore, the priority is towards groups rather than individuals. In Hofstede's investigation of Arabic countries, including Kuwait, Egypt, Lebanon, Iraq, Saudi Arabia, Libya and the UAE, where Islam is the main religion, 'individualism' is the lowest ranked dimension at 38, compared to a world ranking average of 64.

Hence, most Arabic cultures tend to be collectivist, which has implications for this study.

(ii) *Power distance*: This is related to the concept of leadership and reveals the natural relationship between humans in terms of the special characters that are linked to high and low power distance. With regards to a high power distance, these characters mean that power is a fact of life and every individual has a particular place, and people who hold power should express their position, with full respect and centralised authority. This dimension seems to be high in Arab world in particular, with a rank of 80 and a number of Latin American countries. He argued that these cultures are more likely to follow a standing structure that does not allow its people to be upwardly mobile (Baydoun and Willett, 1995). Hofstede added that these people think and take for granted that leaders will separate themselves from the main group, and this condition is not essentially threatened by the public, but rather recognized by society as their cultural heritage. In contrast, with regards to a low power distance the characters are class constructions, with no set of hierarchies, given that people who are in power minimize position, and respect individualism. This is assumed in Northern Europe and the U.S. In critically reflecting on this dimension, it should be noted that the strong power distance in Muslim countries can be explained by traditional customs rather than Islam, as a religion, as the latter suggests and mandates simplicity and mutuality (Hofstede and Bond, 1984).

(iii) *Masculinity versus femininity:* The former value is related to the level of emphasis on masculine jobs and related aims and confidence, for instance incomes, progression, admiration *etc*. whereas, the latter is related to private aims that are related to individuals, such as friendliness, weather *etc*. These values together with other values explain how individuals are possibly motivated in masculine and feminine cultures. Masculinity is ranked at 52 in the Arab world when Hofstede's dimensions are employed. This includes Libya, where it is slightly more than the average of 50.2. This could indicate that despite the fact that women's rights in Arab countries are limited, it might be as a result of the cultural methods in these societies rather than Islam.

(iv) *Strong versus weak uncertainty avoidance*: Uncertainty avoidance is the term for scaling people's levels of sensing danger in uncertain situations. This could be related to the shortage of formal polices and rules that deal with such circumstances. Societies with weak uncertainty avoidance have more relaxation in which practice counts more than principles and deviance is more easily tolerated. Whereas, societies with strong uncertainty avoidance have less flexible behaviour in which they are intolerant of different ideas.

Accordingly, it could be stated that the basic statement considered by this dimension is the way a nation responds to the reality that life never stops in any situation and the future is unpredictable. For example, power distance uncertainty avoidance influences the systems individuals construct, and their organisations and institutions. Thus, it can be argued that most individuals who live in an environment that has strong uncertainty avoidance would feel anxious in ambiguous and uncertain situations. Individuals, who live in an environment with a low level of uncertainty avoidance, would feel more comfortable in any uncertain situation.

It should be noted that the UK and Hong Kong ranked lower in comparison with Japan in relation to uncertainty; however, the U.S. is ranked lower than the whole study sample. With regards to Arabic countries, Hofstede's analysis discovered that they have a very high uncertainty avoidance ranking of (68), which illustrates a low level of tolerance for uncertainty in these societies. Due to the high level in uncertainty avoidance, these societies are not willing to accept modifications. This means these societies are not ready to accept different accounting systems, such as IFRS that has been established in different culture, especially for those societies that consider their finance to be Islamic finance, which is entirely different to conventional finance.

3.2.1.2.1 Criticisms of Hofstede's model and dimensions

Even though other scholars have a general agreement on the definition of culture and the dimensions Hofstede suggested, several authors have significantly criticised his cultural model and framework over the last few years. The harshest criticism of his study is that the sample in his research was very restricted, as he only obtained his responses from one company, IBM, which was limited to specific departments;

salesmen, managers and office employees. Furthermore, his research treated the whole residents of one nation similarly, ignoring the fact that the majority of countries are groups with different ethnicities (Cray and Mallory 1998).

It should be noted that several authors, for instance Kwek (2003), Cray and Mallory (1998), Holden (2002) and Tayeb (2001) criticised the time when the survey was conducted arguing that it has affected findings. For instance, behaviours such as uncertainty avoidance and masculinity could be different in political situations, especially instability and war. In addition, criticism is directed against the dimensions he suggested claiming that they did not project the correct image regarding cultural differences. According to Kwek (2003:138), this is because Hofstede “fails in his observation to question the ethnocentric origins of his own dimensions or methodology, [or] the implications of such tools for marginalizing other knowledge”. Therefore, Kwek (2003) deliberates that cross-cultural management in the West could be perceived and analysed as a ‘colonial discourse’ (Fougère and Moulettes, 2007).

It should be mentioned that Hofstede has not acknowledged a single important weaknesses or mistakes in his study, although in the last few years a number of significant criticisms have been raised against his model (McSweeney, 2002). However, he replied to the criticisms by defending his model, and the dimensions, methods and results he suggested claiming that all of them are sound and applicable. In addition, in order to satisfy researchers and the users of his model, and evidence that this cultural model remains robust and valid, Hofstede (2002:2) highlighted the following answers to criticisms;

(i) Surveys are not a suitable way of measuring cultural differences (Hofstede answer: They should not be the only way).

(ii) Nations are not the best units for studying cultures (Hofstede’s answer: True, but they are usually the only kind of units available for comparison and better than nothing).

(iii) A study of the subsidiaries of one company cannot provide information about entire national cultures (Hofstede’s answer: What were measured were differences between national cultures. Any set of functionally equivalent samples from national populations can supply information about such differences. The IBM set consisted of unusually well matched samples for an unusually large number of countries. The extensive validation in the following chapters will show that the country scores obtained correlated highly with all kinds of other data, including results obtained from representative samples of entire national populations).

(iv) The IBM data are old and therefore obsolete (Hofstede's answer: The dimensions found are assumed to have centuries-old roots; only data which remained stable across two subsequent surveys were maintained; and they have since been validated against all kinds of external measurements; recent replications show no loss of validity).

(v) Four or five dimensions are not enough (Hofstede's answer: Additional dimensions should be both conceptually and statistically independent from the five dimensions already defined and they should be validated by significant correlations with conceptually related external measures; candidates are welcome to apply).

Based on the above answers, it can be argued that Hofstede considers the possibility that changes might happen to cultural values in the future; hence, additional studies should be carried to evaluate the level and causes of these changes. If social value locations are associated with accounting practices and developments, given that such morals permeate a state's societal structure, as Gray's sub-culture, there should be a relationship between cultural areas and forms of accounting structures globally (Papamarcos and Watson, 2006).

This research also argues that in each society there are different sources of behavioural norms in relation to management. For example, in relation to Muslim societies; the observed reality of distinction between normative Islam and the positive Muslim practice of Islam has rather important implications. As previously mentioned, in terms of power distance, what Hofstede observed are the realities of everyday Muslim societies, rather than what is expected by Islam through its normative worldview and individual behaviour.

3.2.1.3 Culture's effect on accounting: Gray's model

Salter and Nieswander, (1995) stated that Gray (1988) extended the model of culture proposed by Hofstede by conducting accounting morals and practices, and their relationship to the social morals and organizational norms. They also claim that Gray has recognized the method where social values have a close relationship with accounting sub-cultural values, in order to establish the connection between cultures and accounting practices (Gray 1988; Salter and Nieswander, 1995). Following Hofestede, Gray (1988:5) defined culture "as the value system of societal or collectively held values".

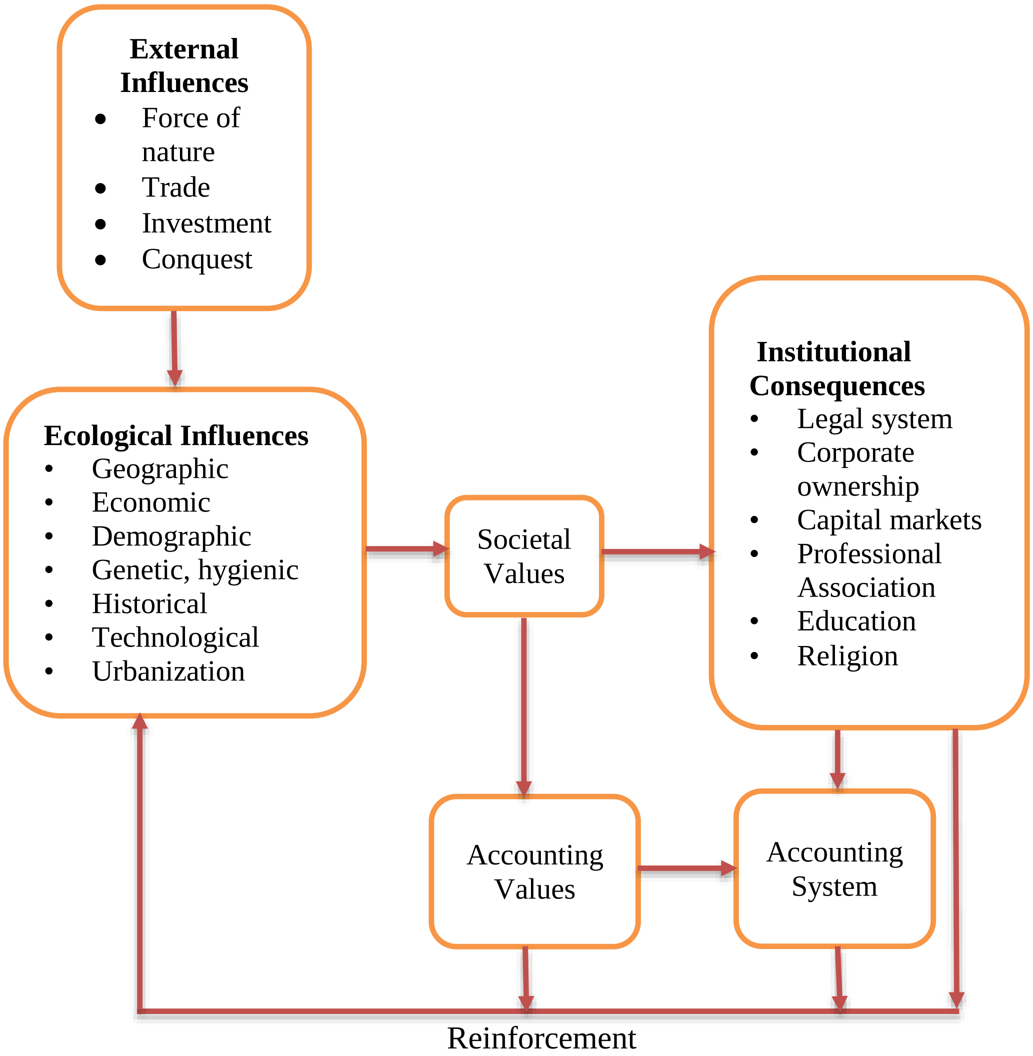
Among others, Verma, (2005), Hooi, (2007) and Solas and Ayhan, (2008) argue that according to Gray (1998), it is possible in theory to measure cultural influence on accounting by linking the cultural and accounting values. Later, Gray used the social values that structured the accounting system to build his model. These values which can be located in elements, which influence the physical and natural environment include historical, economic and geographic factors (Verma and Gray, 1997). This, in turn, led to establishing and improving the professional relations, financial markets and legal institutions of organisations such as the legal system, financial markets and professional relations that support cultural values. As a result, accountants' value systems are achieved from cultural values with a particular way to work-related morals. Hence, it can be claimed that accounting values influence the system of accounting and consequently factors of a culture have a direct impact on the improvement of accounting and financial reporting standards at a national level. Gray's argument with regards to the impact of cultural factors on accounting relied on the framework he suggested, as explained in Figure 3.4 (Verma and Gray, 1997; Doupnik and Tsakumis, 2004).

According to Verma and Gray (1997), Gray's model was the first study to attempt to highlight the cultural effect on accounting by linking cultural and accounting morals and accounting systems. His study also provided a framework that helped to make these links easy to test and analyse. In addition, he suggested four accounting dimensions to be used in defining the accounting sub-culture of a country, specifically; 'professionalism versus 'statutory control'; 'uniformity' versus 'conformity'; 'conservatism' versus 'optimism', and; 'secrecy versus 'transparency' (Ding *et al.*, 2004; Hooi, 2007).

The accounting values suggested by Gray were illustrated as follows (see: Gray, 1988:8; Salter, 1995; Ding *et al*., 2004:10; Solas and Ayhan, 2007: 149; Dahawy and Conover, 2007: 8):

(i) *Professionalism versus statutory control:* Refering to the preference of the individual's use of professional judgment and maintaining professional self-regulation, rather than compliance with legal requirements and prescriptive legal control.

Figure 3.4: Culture, Societal Values and the Accounting Subculture



Source: Gray (1988:7)

(ii) *Uniformity versus flexibility:* Suggesting a preference for implementing one set of accounting systems for all companies, although in contrast, flexibility in harmony with the perceived situations in different companies.

(iii) *Conservatism versus optimism:* Refering to the preference for a careful measurement method, in order to cope with uncertain future events, in contrast, to a more optimistic, non-intervention, risk-based method.

(iv) *Secrecy versus transparency:* Meaning favouring secrecy and limiting disclosure about a business to only those people who are involved closely with the administration and finance, in contrast, to a very transparent, open and widely accountable method.

In identifying these dimensions Gray (1988) describes accounting systems; however, he separates the 'statutory authority' for accounting structures and their implementation from the disclosure and measurement features of accounting structures (Doupink and Riccio, 2006). The first two dimensions are posited to influence the ability and implementation of accounting standards at a nation level, whereas the last two dimensions directly affect the disclosure of accounting information (secrecy) and the measurement of assets and profit (conservatism) at a nation level (Perera and Mathews, 1990; Doupink and Riccio, 2006).

It should be noted that the theoretical framework proposed by Gray claims that one of the consequences of sharing cultural morals within a nation is sharing the same accounting morals that could have an impact on the accounting system environment in a country. He added those morals act together with other cultural consequences on institutions like capital markets to arrive at a single standard accounting practice, which consists of a professional system and financial reporting standards (Sulaiman and Willett, 2003). However, it is possible that the comparative strength of the accounting standards and the institutional consequences would differ from nation to nation in their influence on the ultimate form of accounting practices (Salter and Niswander, 1995).

Additionally, Gray (1988) relates the accounting morals of 'professionalism versus statutory control', 'uniformity versus flexibility', 'conservatism versus optimism' and 'secrecy versus transparency' back to Hofstede's (1980) societal dimensions, primarily 'power distance', 'uncertainty avoidance', 'individualism' and 'masculinity' claiming that moral dimensions of accounting are derived from social morals (Verma and Gray, 1997). Hence, Gray (1988) suggested a connection between the cultural dimensions proposed by Hofstede and the accounting values he identified. Accordingly, Gray's (1988) hypotheses, as cited in Askary and Jackling (2004) and Doupink and Riccio (2006) are as follows;

(i) Countries that have a high rank in individualism and a low rank in power distance and uncertainty avoidance would possibly have a high rank in professionalism;

(ii) Countries with a high rank in terms of power distance and uncertainty and a low rank in terms of individualism would possibly have a high rank in uniformity;

(iii) Countries that rank at a high level in terms of uncertainty avoidance and rank at a lower level in terms of masculinity and individualism would possibly have a high level in conservatism;

(iv) Countries that have a high level in power distance and uncertainty avoidance and a low level in terms of masculinity and individualism would possibly have a high level of secrecy;

The above hypotheses suggested the relationship between cultural values proposed by Hofstede's and accounting values proposed by Gray can be summarised in Table 3.1.

Table 3.1: Gray's Accounting Values

Cultural Values (Hofstede) Secrecy	**Professionalism**	**Uniformity**	**Conservatism**	
Power Distance	-	+	?	+
Uncertainty Avoidance	-	+	+	+
Individualism	+	-	-	-
Masculinity	?	?	-	-

Note: '+' indicates a direct relationship between the relevant variables; '—'indicates an inverse relationship. '?' indicates that the nature of the relationship in indeterminate. *Source*: (Dahawy and Conover, 2007:9).

Before reviewing the theoretical framework and the experimental investigations of the framework, it is essential to know to what extent Gray's accounting values of 'uniformity versus flexibility', 'secrecy versus transparency', 'professionalism versus statutory control' and 'conservatism versus optimism' can be linked to the societal values of 'individualism', 'uncertainty avoidance', 'power distance', 'masculinity, and long-term orientation' identified by Hofstede? Consequently, there have been a number of contributions in the literature attempting to address this question.

For example, a study was undertaken by Salter and Niswander (1995), which used information from 29 different countries. The study established that it is possible to closely link professionalism with individualism and uncertainty-avoidance dimensions. Their position is based on the claim that since the social framework where independence is emphasised with a preference in individuality for decision taking and the effort of the individual is highly respected, then it is possible to find a reliable link to a preference for independent professional judgment. This association is also reliable for low uncertainty avoidance, as they believe that differences in professional judgments would be easy to tolerate in a society where practices are all-significant with as few rules as possible.

In addition, they stated that there is a link, although low level, between power distance and professionalism, which could be accepted in a society where power distance is small and there are worries about equality and rights. This link can also be located in a society where the individuals at different power levels feel secure and trust each other, as well as in a society, which has a belief in the necessity to rationalise the obligation of rules and codes. Moreover, professionalism is assumed to be connected with short-term orientation and masculinity to the level that this suggests an anxiety with different confidence and social positions (Salter and Niswander, 1995).

Salter and Niswander (1995) also determined that there is a possible link between uniformity and the dimensions of individualism and uncertainty-avoidance. They argue that a preference for uniformity is reliable with a preference for a high level of uncertainty avoidance. This in turn leads to thinking about rules and law and inflexible codes of behaviour. It also leads to concern about the necessity of written regulations and rules. Moreover, uniformity value dimension is reliable with a preference for collectivism, which is opposite to individualism, with its powerfully joined societal framework, trust in society and respect for group customs. Furthermore, they established a positive link between uniformity and power distance, clarifying that uniformity is easy to facilitate in a society with high power distance where the obligation of rules, codes and laws supporting uniformity are more likely to be accepted.

In further exploring the connection, Radebaugh and Gray (2002: 47) argue that there would be a possible close connection between conservatism and short-term versus long-term orientations and the dimension of uncertainty-avoidance. In addition, there is a fondness for measuring assets and profits which are more conformist and reliable with a strong uncertainty avoidance, which diverts from the situation of feeling insecure and needs support to adopt the anxiety with safety, over and above a perceived need to adopt a thoughtful theory that assists them to manage uncertain events in the future. They also argued that there is a reliable connection between the preference for a less conservative method of measurement and a short-term orientation where quick results are expected and, therefore, adopting more relative positive theory to conserve assets and investing in long-term results. In addition, there is possibly a weaker relationship between masculinity and high levels of individualism; however, the link between weak uncertainty avoidance and the degree of emphasis on individual achievement could negatively affect conservative measurement methods (Radebaugh and Gray, 2002).

In addition, Radebaugh and Gray (2002: 48) emphasised that a preference for secrecy was suggested as being reliable with strong uncertainty avoidance as the latter is derived from the necessity to restrict the disclosure of information to the public, in order to prevent any possible competition and conflicts, and to reserve security. Moreover, secrecy and power distance have a close relationship to each other, which means societies that have a high power distance are more likely to be categorised by the limitation of information to reserve power variations. Furthermore, secrecy is reliable with a preference for collectivism, as it is the opposite of individualism, in which its concern is for individuals who are interested in the firm rather than external parties.

It should be noted that the fifth cultural dimension of long-term orientation to accounting values has not been addressed by Gray (1988); however, it was proposed that the fifth dimension is a preference for secrecy. This is because the long-term orientation dimension is reliable for the necessity of conserving resources within the firm, in order to guarantee that the funds can be obtained for investment related to the requests of employees and shareholders for higher payments.

3.2.1.3.1 Criticism of Gray's model of accounting values

It should be noted that Gray's framework of accounting values have been accepted widely in international accounting research and accounting education. Therefore, the majority of academics appear to have neglected its main criticisms. However, a number of studies have criticized Gray's framework. For instance, Nobes and Parker (2008) criticized Gray's (1988) accounting level values arguing that they were poor and indirect tests. They also analysed the Gray-Hofstede framework and concluded that culture is not the only factor that has a direct impact on accounting systems, as opposed to other elements such as tax, funding and law (Nobes and Parker, 2008).

In this context, Baydoun and Willett (1995:82) also criticised Gray's framework by arguing that

> It is not entirely clear whether, to the extent that they are meant to be cultural attributes of social groups rather than physical attributes of the technology of accounting, his accounting values serve any useful purpose as intervening explanatory variables between Hofstede's basic cultural dimensions and the characteristics one might expect to find in accounting practice.

Moreover, they also state that "all of Gray's accounting values are defined in terms of preferences for particular courses of action, rather than in terms of apparent attributes of financial statements, such as the qualitative characteristics described in the Financial Accounting Standards Board's (FASB's) conceptual framework project" (Baydoun and Willett, 1995:82).

Additionally, Gray's approach did not clarify the ideal forms of financial statements. For example, under what conditions might a 'Statement of Value Added' be more traditionally applicable than a 'Profit and Loss Account'?, which may have implications for Islamic finance. Thus, "Gray's theory seems, on the one hand, to overlook some important accounting effects of culture, and conversely, to say less than it could about several important aspects of the form and content of financial statements" (Baydoun and Willett, 1995:83). In undertaking their work, Baydoun and Willett (1995) claim that achieving a complete agreement about an approach and full content of corporate reports is assumed to be unlikely.

Subsequent research by Heidhues and Patel (2011) provided major criticism of Gray's framework. They used Germany as a case study to criticize Hofstede-Gray's framework as misleading and failing to improve the understanding of differences in accounting practices. They criticised the prevailing argument that as Gray built his theoretical framework based on probability, which claims that "if Hofstede has correctly identified Individualism, Power Distance, Uncertainty Avoidance, and Masculinity as significant cultural value dimensions then it should be possible to establish their relationship to accounting values" (Gray, 1988:6). Thus, Heidhues and Patel (2011) consider Gray as failing to consider the important criticisms raised against the framework proposed by Hofstede in 1980 that were discussed above, and therefore, this greatly limits the rationality of Gray's framework (Heidhues and Patel, 2011).

In addition, it is argued that the concepts that Gray used to define his four dimensions are open to criticisms. On the one hand, the "terms 'professionalism', 'exercise of professional judgment' and 'maintenance of professional self-regulation' have positive implications"; conversely, the "terms 'statutory control' and 'compliance with prescriptive legal requirements' imply simple book keeping-related tasks and, importantly, imply a lack of professionalism" (Heidhues and Patel, 2011:6). They also go on to state that Gray assumes accountants employing the Anglo-American model are highly educated professionals, whereas accountants from continental European accounting are substandard in concepts of 'professionalism'. Thus, accountants in continental European accounting system claim that the 'professionalism *vs.* statutory control' dimension proposed by Gray strongly establishes preferences against the European countries' accountants and its accounting model. Similarly to the terms that Gray used to define the other three accounting values 'uniformity *vs.* flexibility', 'secrecy *vs.* transparency', and 'conservatism *vs.* optimism' have the same critical preferences. Terms such as 'flexibility', 'transparency', and 'optimism' are employed to reveal positive Anglo-American accounting models, whereas terms such as 'conservatism', 'secrecy', and 'uniformity' are used for continental European accounting models (Heidhues and Patel 2011).

In this respect, it could be said that the four accounting values developed by Gray might reveal his culture and ethnicity (defined as the tendency to believe that one's own cultural tradition is superior to all others) (Heidhues and Patel 2011:6). It should be noted that is not always possible to achieve all the degree of ethnocentricity, however, this does not mean that the cultural studies are limited if it is sufficiently addressed (Heidhues and Patel 2011).

3.2.1.4 Empirical studies on the Hofstede-Gray framework with reference to accounting practices

Gray never tested the hypotheses empirically in detail to prove the validity of his framework; however, this has been performed by other accounting authors, such as Fechner and Kilgore (1994), Doupnik and Salter (1995), Baydoun and Willett (1995), Salter and Niswander (1995), Chanchani and MacGregor (1999), Doupnik and Tsakumis (2004), Doupink and Ritchter (2004) and Doupink and Riccio (2006), who have carried out a number of studies to examine Gray's theoretical framework, while several studies tested various related hypotheses. It should be mentioned that Eddie (1990) was the first empirical research which examined all four hypotheses of Gray's framework.

According to Finch, (2009), Eddie (1990) linked accounting values of thirteen countries located in the Asian-Pacific region to cultural dimensions proposed by Hofstede and verified a connection between the two. However, these results were dismissed, because the construction of accounting values and their measurement method were not precise and had no independent justification. Others, however, tested only one or two of them using archival information at a nation level to test the connection between cultural dimensions proposed by Hofstede and one or more features of national accounting standards examined at a level of individuality only (Doupink and Riccio, 2006). The majority of these studies, such as Wingate (1997), Jaggi and Low (2000), Gray and Vint (1995), Hope (2003) emphasize the secrecy hypothesis suggested by Gray in testing the association between cultural morals and disclosures provided in commercial financial reports.

Gray's hypothesis was also tested by others, who examined the relationship between culture, profits and measurement of assets at a societal level (*e.g.* Sundarwan and Fogarty, 1996; Eddie, 1990). It should be noted that exams aimed at a societal level support the secrecy hypothesis in general, though, exams of the conservatism hypothesis produced mixed results (Doupink and Riccio, 2006). Gray and Vint (1995) applied linear regression methods to a record from approximately 30 different countries to test the hypothesis of the secrecy/transparency dimension identified by Gray. The opinions of national partners at an international accounting firm have been considered to understand secrecy with respect to disclosure practices. They established correlations and proof on the influence of culture on accounting disclosure, which supports Gray's (1988) original hypotheses with respect to secrecy (Finch, 2009).

Zarsekei (1996) used the Gray model to investigate the question of whether culture drives accounting that makes harmonisation totally unachievable and moreover, whether there were any elements, which might cause culture to change. The result of her study demonstrated that culture influences disclosure practices, which support Gray's model. Zarsekei's study (1996) also determined that national culture impacted upon the disclosure practice of national firms. However, in international level firms operating in global markets, there was more disclosure than expected with regards to their national culture, and this might convince international finance of sensible change (Varma and Gray, 1997; Finch, 2009).

Wingate (1997) also attempted to investigate whether culture has influenced the required amount of disclosure, in which she used independent data from 39 different countries and employed Hofstede's index as an independent variable and financial disclosure as the dependent variable. The results indicated that power distance and financial disclosure are not related to each other. This is opposite to the hypothesis proposed by Gray, whereas uncertainty avoidance and individualism are significantly related to the disclosure index (Finch, 2006 and 2009).

Similarly, Jaggi and Low (2000) used the same method as Wingate (1997) used in her study to examine several particular topics related to the environmental factors that influence accounting disclosure. Their samples consisted of three countries using common law and three countries using civil law. Four societal values have a significant relationship to disclosure in civil law countries although only individualism is in the expected direction of Gray's (1988) hypotheses. For common law countries, none of the societal values has a significant influence on disclosure. In conformity to their expectation, cultural values have more influence than market forces on disclosure in civil law countries, while in common law countries market forces dominate culture in influencing disclosure.

Finch (2007) argued that Jaggi and Low (2000) criticise the hypotheses suggested by Gray with regards to the dimension of secrecy versus transparency, as invalid and that the guidelines originally suggested by Hofstede in the 1970's as being out-of-date. In addition, in their findings they recommend that "culture has little or no influence on the disclosure levels once the legal system is considered" (Finch, 2007:27).

Subsequent research by Hope (2003) continued the study conducted by Jaggi and Low (2000) using disclosure indices from the Centre for International Financial Analysis and Research (CIFAR's) for the period 1993 to 1995 as the dependent variable. Using a larger sample from 39 countries, he confirmed a significant connection between societal values individualism and masculinity with disclosure, but that masculinity is opposite to expectation. When he separated his analysis into civil law and common law nations, he obtained mixed results contrary to Jaggi and Low (2000). Nonetheless, he declares that "it is too early to write off culture as an explanatory variable for annual report disclosure levels" (Hope, 2003: 23).

Moving away from testing the links between accounting and culture values suggested by Gray, according to Doupnik and Ricio (2006) there are two studies have been undertaken by Shultz and Lopez (2001) and Doupink and Richter (2004) to examine the impact of culture on accountants' understanding and the application of accounting standards by using Gray's framework as a theoretical foundation. The empirical study performed by Doupnik and Richter (2004) employed verbal possibility terms used in IFRSs as a way to recognise assets and returns as substitutions for accounting practices. From Gray's concept they derived three hypotheses with full consideration given to how the accounting value of conservatism and the framework in which unwritten possibility terms are used to relate to impact upon accountants' interpretations of those terms (Doupnik and Ricio, 2006).

The hypotheses below are as follows:

(i) Accountants in Germany will allocate a *higher* statistical possibility than accountants in U.S. to *positively* framed verbal possibility expressions associated with assets recognition and rises in net income.

(ii) Accountants in Germany will allocate a *lower* statistical possibility than accountants in U.S. to *positively* framed verbal possibility expressions associated with liabilities recognition and declines in net income.

(iii) Accountants in Germany will allocate a *higher* statistical possibility than accountants in U.S. to *negatively* framed verbal possibility expressions associated with assets recognition and rises in net income.

They tested the hypotheses by using a survey of German and US accountants. The findings provide support for the first and second hypotheses; however, not for the third hypothesis. Furthermore, the results were mixed in terms of negatively framed expressions. These outcomes show that the explanation of positively framed verbal possibility expressions was affected by culture. This study provides evidence that through accounting morals of conservatism, culture impacts upon the explanation of possibility expressions in IAS by accountants from Germany and the United States. The outcomes are reliable with conservatism hypothesis proposed by Gray (1988), which posits Germanic (Germany) as conservative countries and Anglo (United States) as optimist countries (Doupnik and Ricio, 2006; Doupnik and Richter, 2004).

Additionally, Doupnik and Ricio (2006:244) examine whether "differences in culture cause accountants in different countries to interpret and apply the same accounting standards differently". Their principal aims of the research are to examine the secrecy hypothesis of Gray with respect to its interpretations of accountants' common-disclosure laws and to extend investigations of conservatism hypothesis to another area of culture that has not yet been tested. To do that, they apply the same theory that was used by Doupnik and Richter (2004).

Doupnik and Ricio (2006) asked a sample of accountants in the US and Brazil, which is categorized as being in a more developed Latin area that scores high on conservatism in Gray's (1988) cultural dimensions to explain verbal possibility terminology employed in IFRS, as thresholds for both disclosure and recognition decisions. Hofstede's Value Survey Module (VSM) was included in the research to confirm that the sample of accountants from Brazil and the U.S. who participated in the study is different in relation to cultural values proposed by Hofstede and in the way they are predicted. They achieved good evidence for the suggestion that culture is impacting upon the interpretation of verbal possibility expressions employed in issuing the threshold for disclosures. Their results also revealed that evidence is in line with the hypothesis that arguing about culture's impact on the accounting moral of conservatism, impacts upon the interpretation of verbal possibility expressions employed in issuing the threshold for identifying factors that enhance income.

It should be noted that the findings mentioned above are consistent with those achieved by Doupnik and Richter (2004) and recommend that Gray's conservatism hypothesis applies when comparison of recognition decisions have been carried out by accountants in developed Latin and Anglo cultural areas (Doupnik and Ricio, 2006).

3.2.2 Religion as a Deterministic Factor with Special Reference to Islam

Religion is considered to be important factor determining individual behavioural norms, but also impacting on organisational and institutional goals and behaviours, which transcends national borders. It is argued that religion, which is defined by a set of beliefs is recognised to be an important factor influencing all social institutions, and influences the way also, for example, business is conducted and recorded. Thus, accounting systems can also be influenced and determined by religion (Belkaoui, 1990; Gambling, 1987; Tomas, 1989; Briston and El-Ashker, 1986).

While some argue that religion is part and parcel of culture, reflecting on Muslim perceptions, others state that religion is the very spirit and core of culture (Faruqi, 1989). In terms of their consequences for culture, there are three different general groups of world religions, with a concept that is related to cross cultures, international faiths, and moreover, local religions which are related to a particular culture or particular national religious groups and new religious activities that are related to recently improved faiths (Graham, 2000).

Numerous definitions have been proposed by theoreticians; however, in general, religion is a difficult term to define (Acquaviva, 1979). This is because the terms of religion and culture can similar in the way they are articulated and embedded in everyday life. They are easy to employ in normal discourse, though, complex to provide an exact definition for (Dow, 2006).

It has been argued that the term ‘religion’ is derived from a similar root as the term ‘ligament’ that links muscles to bones. Thus, the meaning of the root term is ‘to link, to relate to each other, altogether’. As a result, it can be argued that the exact meaning of ‘religion’ is “continuously tying it all together” (Aleyomi: 2012:130). If we use this idea then ‘religion’ can be defined as Gibran (1952) did in his *The Prophet*. In the book, the main character in the form of a sage was asked for his final advice on some issues such as love, marriage, giving, pleasure and sorrow, and some other issues before his departure. Responding to the definition of religion; the sage in the Prophet says, “Have I spoken this day of aught else? Is not religion all deeds and all reflection…? Or to phrase it less poetically, all actions and all thought” (Gibran, 2004:43). This implies an encompassing definition of religion through embeddedness.

Swenson (2009:8) defined religion in concepts of the sacred by arguing that “religion is the individual and social experience of the sacred that is manifested in mythologies, ritual, ethos, and integrated into a collective or organization”. Additionally, in the concept of the spiritual and the scared, another definition of religion is provided by Jaja and Badey (2011:4) arguing that "religion originates in an attempt to represent and order beliefs, feelings, imaginings and actions that arise in response to direct experience of the sacred and the spiritual". Furthermore, Geertz (1973) states that the term religion is occasionally used as an alternative together with 'belief system' or 'faith'; however, religion is unlike faith in that it has a public characteristic. He defines religion as a cultural system by claiming that (Geertz, 1973:90);

> a religion is a system of symbols which acts to establish powerful, pervasive, and long lasting moods and motivations in men by formulating conceptions of a general order of existence and clothing these conceptions with such an aura of factuality that the moods and motivations seem uniquely realistic

It should be noted that since the 1970s, culture and hence religious values have been recognised to have an impact on everyday business and commerce. The emergence of cross-cultural management and later Islamic finance and management, clearly vindicates the role played by religion in finance, business and management alongside culture. Accounting, indeed, could not be kept away from such a transformation in our understanding of religious impact. After years of holding the opinion that culture has a direct impact on accounting environments, in recent years the investigation moved toward understanding the relationship between accounting and religion and the possible impact of the latter on the former (Gambling, 1987; Hamid, *et al.,* 1993; Clarke, *et al.,* 1996; Gambling and Abdel-Karim, 1986; Gambling and Abdel-Karim, 1993). However, Jaggi (1975) was at least one of the first to acknowledge and suggests this relationship by claiming that religion considered as one of the main cultural elements could influence accounting practices and in turn financial disclosure systems (Askary, 2001).

Violet (1983a) also discusses the influence of culture and religion in the process of developing IAS from a different angle. He states that accounting is a product 'of its culture'. He added this idea or statement is true with religion by claiming that "… the religion of a society incorporates the philosophical beliefs and very often the legal statues of the society…" (Violet 1983a: 3). Due to the positive relationship between culture, accounting and religion, Violet (1983a: 9) argues that "since accounting is culturally determined, other cultural customs, beliefs and institution influences it".

Accordingly, religion could be wisely considered as one of the general frameworks of the cultural ethics of a society. According to this statement, it has been argued that using the Hofstede and Gray's model is a significant approach to investigating the relationship between religion and accounting. Following the discussion in the previous section that referred to the models proposed by Hofstede and Gray, religion was seen as one of cultural factors that have a possible influence on accounting practices in societies (Askary, 2001). Therefore, it is not a surprise to argue that Islamic finance which is based on *Shari'ah* influence the implication of IFRS in the IFIs and make it invalid for reporting the transactions of Islamic finance.

Moreover, Hofstede (1980) and Gray (1988) presented religion to be an organisational factor that has equivalent standards with other fundamental general social substructures. They argue that as long as social morals and organisational factors including religion have a direct influence on the management, and legal, political and education systems, *etc*. those social values will in turn impact on the accounting practices and morals driving it.

Gray (1988) has linked his conceptualisation of accounting values to Hofstede's cultural hypothesis by a model that can be seen in diagram 3.4 followed by four hypothesises to explain the link between social and accounting morals, and accounting systems. Subsequently, he splits the authority and implementation of accounting systems from the disclosure and measurement matters of accounting practices (Gray 1988). It is stated by Baydoun and Willett (1995) that Gray associates the two former factors to the accounting's cultural morals of uniformity and professionalism. Accordingly, it could be argued that depending on Hofstede's approach to cultural morals, religion will influence accounting practices through the techniques organisations have designed and the procedures that they apply. For instance, the value of conservatism will affect assets' measurement and profits. In contrast, the nature and extent of disclosure practices would be affected by the value of secrecy (Sulaiman and Willett, 2003).

In the debate related to the impact of religion, Islam is a particular case in point. According to the Islamic perspective, religion is defined as "a system of beliefs and worships which includes a code of ethics and a philosophy of life with the worship of One God as its central theme" (Ahmed, 1995: section 1). Thus, it is simply defined as a way of life (Hamid, 2004). It should be noted that semantically, Islam means 'peace' and 'submission', and as a religion it is a strongly monotheistic religion was founded by the Prophet Muhammad after receiving the initial revelations approximately 1500 years ago (Hamid *et al.*, 1993; Abdul Rahman, 2010). Having implications on every day practices of life, Islam also aims to shape and structure the behavioural and contractual norms between the faithful, and between Muslims and non-Muslims through the principles of *Shari'ah* (Islamic regulation), which originated from the *Qur'an* and from other sources, depending upon one's Muslim sect, and the community and the environment. Karim, (1995) and Baydoun and Willett (2000) argue that in comparison to accounting practices in Western societies, Islam suggests a form of social accountability instead of private accountability.

Al-Buraey (1990) argues that as a religion, Islam is considered to be a comprehensive social code for life emphasising the responsibilities of people in a society but not the rights of the individual. In addition, in Islam, *Shari'ah* law consists of Islam's central expression, whereas, Christianity characterises policy as an important factor of Christian belief (Esposito, 1991). Williams (1994) claims that this is because Christianity is a religion of theory, concerned with the right articles of faith to hold, while Islam is mainly a moral religion, concerned with the right things to do.

Shari'ah is a code of law taken from the *Qur'an*, as well as from the teachings and examples of the Prophet Mohammed (*Hadith* and *Sunnah*). In other words, Islamic ontology and its epistemological expression is based on reveal knowledge and the practice of that knowledge by the Prophet of Islam, which as the normative worldview aims to shape individual, organisational and societal behavioural norms. Alongside the moral dimension of Islam, namely *maqasid al-Shari'ah* or the objectives of *Shari'ah* (which is interpreted as human well-being), *Shari'ah* is a set of divine values, commands, advice and general principles, including the rules of all aspects of a Muslim's life, such as the principle rules and foundations for all Islamic institutions (Sulaiman and Willett, 2003). This differs from Western tradition in which fundamental business ethics flow from codes established and required by specialised governments (Baydoun and Willett, 2000).

Gambling and Karim (1986) explain that beyond the ontological differences, in terms of operational side, three *Shari'ah* instructions set Islamic financial transactions apart from practice in the West. First is prohibiting involvement in any immoral trades leading to sins like drinking alcohol, gambling and eating pork, but also other economic activities, which are considered harmful to humans, as *Shari'ah* is interpreted as 'human well-being'. Second is a strict ban on interest or *riba*, whereas the third is the aim of avoiding *gharar* that fundamentally means extreme risk-taking and uncertainty. In addition, Islamic principles encourage profit-loss-sharing financing over debt-based financing (these are discussed in detail in chapter 4).

It should be noted that considerable attention has been devoted in the *Qur'an* and in the *Hadith* (sayings) and *Sunnah* (actions) of Prophet Mohammed to the prohibition of interest and debt (*riba)*. For example, *Qur'anic* verse (3:130) states that "O you, who have believed, do not consume usury, doubled and multiplied, but fear *Allah* that you may be successful". Furthermore, it was mentioned in another verse "*Allah* has permitted trade and has forbidden interest" (*Qur'an*, 2: 275). In actualising this, the Prophet Muhammad said in his farewell sermon in 10 Dul-hajj, 10 Hijra or 523 AD:

> God has forbidden you to take *riba* therefore all *riba* obligations shall henceforth be waived. Your capital, however, is yours to keep. You will neither inflict nor suffer inequity. God has judged that there shall be no *riba* and that all the *riba* due to 'Abbas ibn 'Abd al Muttalib shall henceforth be waived (Islamica, 2009:2).

Ribawi or interest based transactions is one of the unlawful transactions in Islamic financing law. The literal meaning of *al-riba* is interest and linguistically has the meaning 'to rise', and 'to add-on'. In *Shari'ah*, however, *'riba'* is a concept of a transaction between two parties exchanging the same kind of commodity, and in paying back the creditor receives extra from the debtor of what the former gave without involving any investment risk for the lending party (Razi, 2008). Muslims believe that it is immoral for the creditor to have a fixed and certain return, whilst the creditor experiences unguaranteed and changing returns. In general, Shari'ah prohibits all detrimental or harmful products are prohibited in Islamic law, which means preferred stock is also unlawful (Baydoun and Willett, 2000).

As argued before, the Islamic ethical system does not only aim to regulate every aspect of life but also finance and accounting. To understand and contextualize the Islamic accounting position, Table 3.2 below summarizes some significant variances that exist between financial accounting systems in the West and Islamic systems.

Table 3.2: Key differences between Western Financial Accounting Systems and the Islamic System

Characteristics	Western Financial Accounting System	Islamic Corporate Reports
Philosophical Viewpoint	Economic Rationalism	Unity of God or *tawhid*
Principles	Secular Individualistic Profit Maximization Survival of Fittest Process	Religious Communal Reasonable profit Equity Environment
Criteria	Based upon modern commercial law Limited Disclosure Personal Accountability	Based upon ethical law originating in the Qur'an Full disclosure Public Accountability

Source: Baydoun and Willett (2000:82)

Another aspect of Islamic accounting objectives that needs to be dealt with in the context of its effect on the accounting system is mandatory social responsibility, such as the case with *zakat*. According to Haqiqi and Pomeranz (1987) and Abdul Rahman (2010) z*akat* is the fourth essential pillar of Islam, for those who are obliged to pay *zakat*. In the literal sense *zakat* has the meaning of 'purifying', which means the purification of a Muslim's wealth and soul in the sense of returning the right of the society to society in the form of wealth distribution. "Wealth purification implies the enlistment of assets for the determination of financial growth and justified distribution, whilst purification of the soul means freedom from hatred, jealousy, selfishness, nervousness and greed" (Siddiqi, 1982: 8). Thus, it has more important effects than just paying a tax (Haqiqi and Pomeranz, 1987).

Zakat is a legitimate religious tax that all adult Muslims have to pay as long as their wealth exceeds a particular amount (*nisab*) (El-Ashker, 1987). Clarke *et al*. (1996) argue that in the West tax is considered as an evil, that all people attempt to avoid by asking their accountants to find a way to reduce tax without cheating the system or breaking the law, whereas, paying *zakat* is an act of worshipping *Allah* and an essential religious duty that devout people compete to pay.

It should be noted that *zakat* is paid on gold, silver, livestock, the net balance that is not used for a whole lunar year, business inventories and profits at 2.5 %; although in the case of the agricultural output of staple food crops it is 5% or 10% depending on whether the land is watered naturally or otherwise (Mohamad Ibrahim, 2000). However, it is not always easy to calculate the correct amount of *zakat*, since there are some obligations that have to be considered before paying. For example, *zakat* is only required for those who are of legal age and have the wealth that exceeds the *nisab* for one year or more. The mentioned obligations are characterised into two comprehensive groups: *zakat* performer and *zakat* asset (Gambling and Karim, 1986; Clarke *et al*., 1996).

According to Clarke *et al*. (1996), the majority of the asset information enclosed in a conventional balance sheet does not comply with Islamic law. For example, they use the current market value as an estimate for calculating *zakat*, whereas IFRS value the inventories at the lowest cost or market value, which is normally net achievable value. In practice, this law often has consequences in 'cost' being the valuation of the balance sheet. This cannot be applicable to calculate *zakat* as the evaluation should be the selling price only. Thus, this means the evaluation that IFRS is using does not comply with *Shari'ah*, and therefore, it cannot be followed by devout Muslims.

According to the previous discussion above, it could be argued that Islam's prohibition of interest and its own authentic Islamic financial instruments (as discussed in Chapter 4) and *zakat* might possibly has impact on the system and the structure of accounting in the Islamic world and therefore, obstruct the international harmonisation and the use of the IFRS in the IFIs, because interest calculations are an essential element of the accounting standards in the West (Shaari *et al*., (1993).

3.2.3 Political and Legal Systems

Generally, legal systems connected to political and economic variations produce an enormous variety of accounting practices globally, which makes having one set of international accounting standards challenging (Roberts, *et al*., 2002; Nobes and Parker, 2006). Among others, Ball *et al*. (2000), Leuz *et al*. (2003) and Bushman *et al*. (2006) argue that the national legal system in a country and jurisdictional organisations influence the accounting systems and the principles of the country. While overcoming the difficulties creating such differences is important, Luther (1996), Saudagaran (2001) and Roberts *et al*. (2002) argue that political factors are considered to be a significant obstacle to harmonising accounting standards, since variations in political systems will lead to variations in how the economy is structured and organised. In addition, Radebaugh and Gary (2002) claim that the political system and political philosophies significantly impact upon the accounting system in which the latter will illustrate political objectives, for instance, central planning versus enterprise.

It can, therefore, be argued that freedom in politics in a nation is significant for developing accounting systems, reporting, and in particular disclosure. This is because when individuals have the right to choose members of a government, they would be able to impact on government policies and in turn they are more likely to produce an accounting profession built on the principle of fair and full disclosure (Choi and Muller, 1984). This results in a negative relationship between freedom in reporting or disclosure and politics.

The legal system is considered to be another essential factor in shaping the law and regulations of accounting systems. According to Roperts *et al.* (2002) and Nobes and Parker (2006), liberal-democratic countries used to a legal system which has common law and civil law. While, the former is non-jurisdictive law concerned with specific cases rather than formulating common rules for the future, the latter is a jurisdictive system that authorises commercial codes and issue rules in detail for accounting and financial reporting. These variations in legal systems indicate various accounting standards at an international level, as accounting might be employed to imply some of these laws.

Experimental research has been performed, in order to investigate significant differences in the elements of accounting practices between the two codes countries. The findings of one of these studies suggested that the activities that come from traditional systems based on civil law are relatively different to the conceptual framework that arises from common law (Buchanan, 2003). Governments in countries with civil law generally regulate accounting as a part of their measures to confirm systematic business behaviour. For instance, accounting rules have often been established with the need of creditors and tax authorities, as they are the most important users of financial statements (Roperts *et al*, 2002). Good examples of civil law countries are France, Italy, Germany, Spain, Japan and so on.

In contrast to civil law, common law countries have accounting regulation in order to protect the owners of companies. England is the place where common law was formed, thus, it be similarly formed in other countries impacted by England, such as Ireland, Australia, India, *etc*. Accordingly, it is obvious that the nature of accounting rule in a country is influenced by its common law system, and the accounting rules and practices may be affected more by other issues (Roperts *et al.*, 2002; Nobes and Parker 2006). It has been suggested that common law is more suitable for merging or harmonising the international financial reports into a single system (Buchanan, 2003). Most Arabic societies that are secular Muslim states have other unwritten laws, in addition to their civil law derived from Egyptian models, which in turn are based on a mixture of Turkish, French and other Western legal systems. These unwritten 'social laws' derived from tradition and culture as a historical legacy also has a strong influence on everyday practice in most Arab countries. Moreover, anyone acting contrary to these social laws may face social punishment despite the fact that a formal legal system may not have any consideration for such cases. Such social punishments are considered very severe, as they affect not only the individual person but the entire family. This may not be seen, for example, in Western countries where the only binding force in society is the law, which in most Arabic Islamic states comes secondary to social law. This could have a major influence on the efficiency of legal and regulatory regime on these countries and in turn affects the development of accounting system. As stated by the World Bank (2002), the one of the key to guarantee obedience with the accounting requirements is to implement a strong regulatory regime and effective enforcement mechanisms.

3.2.4 Economic System

The existing body of knowledge provides evidence on the impact of the economic environment on the development of accounting systems and practices within a different context. Arpen and Radebaugh (1985) investigated in considerable detail the way that the environmental characteristics of a country could affect the development of accounting systems, and established that one of the factors that had a significant influence on accounting development were the economic characteristics. They argue that "economic development affects many social-cultural attitudes and brings about changes in legal, political and educational objectives and sophistication, each of which in turn can affect accounting practices" (Arpen and Radebaugh, 1985:23).

It should be noted that there are two aspects of economic environment, namely macro and micro. Several authors, among others, Gray (1988) and Perera (1989b) argue that macro-economic factors such as the type of economic system, level of export, the level and growth rate of income and inflation have also influenced the process of harmonising global accounting practices together with the level of rules within an economy, whereas Chow and Wong-Boren (1987) and Baker and Barbu (2007) dispute that choices in accounting development and the financial reporting practices of countries can be significantly influenced by micro-economic factors, including the complexity and variation in the size of businesses, the sources of funds, *etc*.

In addition to this, the economic ties between countries, and the degree of international activity might also have the potential to influence shaping the development of accounting practices (Saudagaran, 2001). In addition, an unsteady economic structure appears to influence accounting practices by making it very difficult to formulate rationally reliable forecasts. Thus, economic stability is essential for the improvement of a cogent and responsive accounting practice (Frank, 1979; Choi and Mueller, 1978; DaCosta *et al.,* 1978; Iqbal, 2002).

Related to economic factors, Adhikari and Tondkar (1992) claim that the level of economic growth in countries significantly impacts on the process of developing accounting standards. Radebaugh and Gary (2002) state that as many countries moved from an agricultural to a manufacturing economy in the 20th century, new accounting challenges related to the way to recognise intangible assets, including goodwill, human resources and brand names *etc*., became important and, therefore, accounting systems were modified, in order to respond to requirements to the changes in a more active business environment (Radebaugh and Gary, 2002 and Iqbal 2002). Hence, countries with advanced levels of economic growth, and economic and business activities need advanced accounting practices (Zeghal and Mhedhbi, 2006).

It should also be mentioned that new economic sectors and areas have developed beyond manufacturing sector since the early 20th century, which have had a direct impact on accounting practices, as innovation is required in relation to how these new economic and financial practices can be accounted for; such as the important role played by the service sector, as well as the emergence and common use of Islamic financial products. Thus, the impact of the economic environment and level of economic development has had a direct influence on the process of developing the accounting system. For example, the majority of high-quality accounting practices exist in countries where the level of economic growth is high, whereas, in countries where the development of the economy is still at a low level, which is the case in most countries where the IFIs are operating, the accounting system is still basic (Radebaugh *et al.*, 1993; Kantor *et al.*, 1995; Doupnik and Salter, 1995). In line with this argument, Iqbal (2002) claims that accounting systems in countries that have a developed and technologically advanced economy might be unlike the accounting system in a country, which operates mainly an agrarian economy (Adhikari and Tondkar, 1992; Iqbal, 2002).

Furthermore, the export and import levels might also significantly affect the development of accounting system and practices. In the line with this view, Belkaoui (1985:67) claims that

> … the higher the development levels of exports and imports, the higher the need for better reporting and disclosure. Free-trade policies in general and export promotion in particular increase cooperation with other countries, the flows of human and physical capital and the need for comparable reporting and adequate disclosure.

Another issue that needs to be mentioned regarding economic factors is the structure or the nature of capital markets. In the accounting literature, there is a broad argument in relation to the impact of capital markets on the accounting system. Therefore, it has been argued that the nature of accounting standards in any country, particularly developing countries is influenced by the capital markets. This impact principally depends on who the investors or creditors are, individuals, banks, states, and also who is using the information and what kind of information they need (HassabElnaby *et al.*, 2003). HassanElnaby *et al*. (2003) add that a growing number of businesses in the capital market produce demands for accounting and auditing services, as most of the related financial information to encourage private investment or authorise public financing depends on accounting information (HassabElnaby *et al.*, 2003). Therefore, the sizes of the activities in the stock markets call for the importance of improving accounting practices, in order to convince investors from inside and outside the country (Doupnik and Salter, 1995).

However, the need for accounting data in Germany for instance is different to the accounting information required in the US. The main reasons for financial reporting in Germany, where that the majority of the financial capital markets come from creditors, mostly banks, is to protect the creditors and in turn to continue the capital.

However, in the US, protecting investors is the foremost aim of financial reporting, given that the capital market in the US is equity based (Doupnik, 2007; Nobes and Parker, 2008). Therefore, Saudagaran (2004) argues that the type of capital market, including equity-oriented or debt-oriented nature of the financial market, considerably influences the development of accounting systems and financial reporting at both a cosmetic and substantive level (Saudagaran, 2004).

Furthermore, the types of economic systems are an important consideration for the orientation of a country's accounting systems. For example, the accounting system used in Socialist countries is different from the one used in market based economies, as the former use the Material Product System (MPS) rather than the System of National Accounts (SNA) (Kornai, 1992). In capitalism, the main aim of accounting is to determine the profit and to provide sufficient information to different stakeholders from creditors and investors to the capital market, so as to make the right economic decision (Kornai, 1992). However, in socialism, the aim of accounting is to reflect on the activities in the framework of central economic planning, targets and budgets. Thus, an accounting system in Socialism does not provide financial information to different groups, since it does not consist of a database that would be used to make economic decisions. Consequently, the objectives of the accounting system in Socialism is to prepare data that could be used for annual financial statements at a company level, due to the absence of private ownership and collective economy (Kornai, 1992; Blake and Lunt, 2001 and Belkaoui, 2004).

Another aspect of economic factors that need to be dealt with in the context of its effect on accounting systems in a country is 'inflation'. The necessity and the importance of how inflation adjusts financial statements have been investigated by a number of accounting studies. There is a general agreement that the inflation level in a country is one of the environmental factors, which shapes accounting systems and causes accounting diversity (Doupnik and Salter, 1995; Iqbal 2002). This is because it has an effect on the method of asset valuation, which is due to situations of high-inflation having an accounting standard, which complies with inflationary situation, and therefore, is an important matter (Saudagaran, 2004).

During the 1970s many countries were affected by the energy crisis, which caused high levels of inflation, and therefore, to deal with and account for the impact of inflation, the majority of industrial countries started to develop new standards. From there on, the effects of inflation on financial statements began to be recorded (Archambault and Archambault, 1999). Different countries established different methods to measure inflation. For instance, in 1973, the United Kingdom used the Current Purchasing Power Method (CPP), which was replaced in 1976 by Current Cost Accounting (CCA). This standard is used to match current returns with the current cost of the resources that are expended to earn them (Whittington, 1983). The US, however, developed two methods, namely Current Purchasing Power (CPP) and current-cost/constant-dollar-based, which are also known as the General Price Level approach (Hanna, 1988). The CPP standard includes the refurnishing of historical figures at current purchasing power (Gutierrez, 1990). Brazil and Mexico also used this method after it was recommended by the IASC to be used in economies with hyper-inflation and in countries which have not experienced significant inflation (Price Waterhouse, 1996). However, most Latin American countries, which have profound experiences of spiralling inflationary rates, replaced this method with principles that deal with the changing value of the nation’s currency, in order to decrease the influence of inflation on financial reporting and to achieve the appropriate information. Consequently, it could be said that the development of inflation accounting standards in countries where the level of inflation is low are slower compared to countries that have hyperinflation like Argentina and Brazil. Therefore, different levels of inflation led to differences in accounting systems, and thus, inflation affects accounting standards and practices (Whittington, *et al.*, 1997; Archambault and Archambault, 1999).

Business firms of different sizes and complexities also considered the implications of explaining differences in accounting systems. It has been claimed that developed countries with complicated systems of business companies have different accounting systems as compared to the procedures used in developing countries. Indeed large enterprises that have varied production lines and which operate on a significantly extensive basis need different financial reporting and accounting systems from small business manufacturing a single product (Radebaugh and Gray, 1997; Saudagaran, 2004). Similarly, the enterprises that operate internationally require different information to those which operate nationally, which is even different to the information required by small businesses (Choi and Mueller, 1992; Choi and Meek, 2008).

3.2.5 The Accounting Profession: Values and Education

In the literature, accounting practices and financial reporting are also considered to be affected by the status of the accounting professions and their level of education. In countries where the legal systems are derived from code law such as France, Germany and Italy, the accounting profession is less important and the government takes the lead role in regulating the professions. In common law countries such as the US and Canada, the accounting profession is greatly self-regulated and has significant part in shaping accounting and auditing systems, and establishing an educational system to develop and promote the profession itself (Ainsworth, 2001; Saudagaran, 2004). Thus, the quality of financial reporting standards could be significantly influenced by the degree of professional progress in accounting (Archambault and Archambault, 1999).

A number of contenders in the field agree that the size, strength, competence and skills of the accounting profession in a country are likely to be more developed and therefore, audit reports are potentially respected more as being independent and reliable. However, countries with weak accounting professions usually produce financial statements with less duality and thus, there are questions regarding whether auditors have the stature and independence to select the correct accounting system for the companies which they audit (Saudagaran, 2004; Nobes and Parker, 2008).

In addition, the accounting system in a country could also be influenced by the status of the accounting profession, especially in developing countries, where most IFIs are operating, since the level of education is considered to be weak compared to Western countries (Shoenthal, 1989). According to the above argument, it could be stated that the existence of quality accounting education and research in a country significantly influence the improvement of the accounting profession, and in turn the accounting systems. As a result, more widespread and complex accounting systems and reports become possible and accounting problems might be reduced (Iqbal, 2002; Radebaugh and Gray, 2003).

According to Iqbal (2002), the educational system and levels of literacy in a country impact upon the country's accounting system in different ways. For example, when the users of accounting information are highly educated, they can easily understand particular information in balance sheets, or in annual report. Besides, a high level of education would usually produce accountants that have better skills and abilities to correctly complete professional assignments. Iqbal (2002) added that the levels of knowledge of users of accounting information considerably influence the extent of progress and level of complexity in a country's accounting system. This means the standard of accounting is considered to be of low-quality in countries where their level of education in accounting is weak (Iqbal, 2002). Hence, developing accounting education would influence the environment and improvement of accounting systems, and in turn accounting requirements.

A number of studies argued that there is an interaction between the quality of accounting education and the reputation of the accounting profession in a country. A lack of the latter could influence the quality of the education system and as a result, might signify a restrictive element in the development of accounting systems. Probably the foremost noticeable relationship is whether calculations and maths is sufficient to permit the gathering and analysing of statistical data (Enthoven, 1983; Gao, 1995; Saudagaran, 2004). Conversely, Nobes (1998) holds a different opinion by stating that it cannot relate the causes of the differences in accounting systems to the variation in the levels of education and the accounting profession.

According to Gernon *et al.* (1987), the relationship between the level of education and the capability of professional accountants is positive. Hence, it is expected that accounting education in developed countries where accounting professions have significant influence on their accounting education should be the same as the one in developing countries, where the general level of knowledge in their accounting professions is low. Consequently, the impact of the profession on ways to educate accountants is inconsiderable (Wallace, 1990; Melancon, 1998; Gernon *et al.,* 1987; Ainsworth, 2001).

3.2.6 Taxation System

Without doubt, taxation is one of the most powerful factors that impacts considerably on accounting practices in a country, particularly for accounting measurements. Seidler (1981) states that the relationship between taxation and financial reporting in countries varies, and moreover, that the relationship can be clearly seen in the accounting of owner-managed industry, as opposed to international ones. Different national law systems followed to determine taxable profits that describe precisely and regularly the conduct of business and, therefore, accounting practices (Seidler, 1981).

Countries where civil law is exists including Germany, Spain, Italy and France follow the dependence method in defining taxable results. In other words, the returns gathered from profitable accounts are considered to be the main source of tax calculations. All forms related to taxation guidelines and certain financial regulations must be undertaken to calculate taxable incomes (Basu, 1997; Nobes and Parker, 2002; Radebaugh and Gray, 2006).

In contrast, countries where common law is practised including the UK and the US follow the independence method. Under this method, they apply two different sets of rules, where the first is for tax purposes and the second for commercial results (Green, 1995; Basu, 1997; Nobes and Parker, 2002; Radebaugh and Gray, 2006). In common law countries, the connection between taxes and accounting is much weaker compared to civil law countries, as they do not use commercial accounting rules for taxation (Seidler, 1981). However, even though, taxation depends on commercial accounts, some tax modifications cannot be avoided. Accordingly, variations in international taxation rules cause variations in international accounting practices (Nebes, 1998; Nobes and Parker, 2002).

Furthermore, the relationship between taxation and financial reports has been examined between Anglo-Saxon countries and several other European countries. Thus, the UK and the US have been used as examples of the former and France and Germany as examples of the latter (Simon, 2002). Lamb *et al.* (1995) determined that the impact of taxation on accounting can be clearly distinguished between the two groups that have been studied. Moreover, they also ascertained that how the strength of tax impacts on accounting could be different within the same group of countries using the same criteria. For example, it could distinguish Germany from France, and the USA from the UK (Lamb *et al,* 1998; Porcano and Tran, 1998; Simon, 2002). Therefore, the contrast in the two models including the European and Anglo-Saxon procedures simplifies the rigid model investigated between taxation and financial reporting in the participating countries (Porcano and Tran, 1998)

3.3 CONCLUSION

In conclusion, Hofstede's framework demonstrates that aspect of life in each society is influenced by different fundamental, technical and environmental elements, and therefore, develops various social morals. This implies that every culture has established its particular accounting system, in order to serve its particular individual needs. Additionally, Fechner *et al.* (1994) argued that culture influences accounting systems, which in turn obstructs the harmonisation of international accounting standards between countries, given that accounting is not only a technical matter, but also rather cultural. Therefore, it could be said that the culture of a country controls the choice of its accounting techniques and the perception of its different accounting practices and systems (Belkaoui *et al.*, 1991). As argued by this study, either as part of culture or as an independent factor, religion also plays an essential role as to how accounting practice can develop and can be performed. This is particularly the case with Islam, from whose norms and principles Islamic banking and finance develop and is being practised in many parts of the world. Thus, Islam as a religion and the emergence of Islamic financial practices according necessitates to consider a case for Islamic accounting due to ontological reasons but also due to professional practice of 'actually doing accounting' within the normative world of Islam.

CHAPTER 4

THE IMPACT OF ISLAMIC WORLDVIEW ON SHAPING THE ACCOUNTING SYSTEM: AN EXPLORATION FOR ISLAMIC ACCOUNTING

4.1 INTRODUCTION

Islamic religion with its emphasis on non-separation between sacred and secular aspects of life also has implications for accounting practices, which have been substantiated with an initial discussion in Chapter 3 in the form of the effect of religion on accounting practices.

Reflecting on the emergence of accounting issues in IFIs, several scholars of Islamic accounting have suggested that the primary objectives of IFRS no longer satisfy the requirements of IFIs and, therefore, an alternative 'Islamic accounting system' that assists Muslims to evaluate their own accountabilities to God by providing stakeholders with applicable information on an institution, where they would be able to make sure that the institution is constantly operating within the frame of Islamic rules (*Shari'ah*) and moral norms is required. Suchan's argument rationalises the need for specialised and perhaps culturally defined institutions. In the case of IBF, this led to the creation of AAOIFI.

The literature on accounting from an Islamic perspective and accounting in Islamic banks has increased over the last three decades with the development of the IBF industry. However, the aim of constructing an Islamic accounting system by means of the Islamic moral economy by essentialising the axiomatic foundations of Islam is a relatively new approach. Therefore, this chapter attempts to explain the principles of Islamic finance, such as *riba*, profit-loss sharing, risk sharing, asset-based financing, *etc*, as an essential subject of Islamic accounting. Furthermore, it will also present the mechanisms and instruments of Islamic finance such as *mudarabah, musharakah, murabahah*, in addition to *zakat* and *qard-ul-hassan* with the objective of identifying their treatment as an accounting issue.

In addition, this chapter addresses and reviews the literature concerning the religious reasons behind existing Islamic accounting, for instance Islamic moral economy; and therefore, will rationalise the necessity of Islamic accounting through the axiomatic approach by identifying philosophical foundations. This includes axioms, such as *tawhid,* al-*‘adl wa’l-ihsan, ikhtiyar, rububiyah, tazkiyah, khilafah, falah* process, *here-after,* and their objective function being *maqasid-al Shari’ah* or the objective of *Shari’Ah,* which is defined as human well-being. Finally, the objectives and characteristics of Islamic accounting are discussed. The conclusion and the summary are provided in the last section.

4.2 DEFINING ISLAMIC ACCOUNTING

Prior to delving further, it may be necessary to provide a brief definition of ‘Islamic accounting’. The term accounting in Islam has many implications according to the situation it is used in. Arabic dictionaries refer to ‘counting and recording financial actions and transactions’, whilst also referring to the accountability and responsibility of the individual or by others. The term account (*hisab* in Arabic), is used in the *Qur’an* in its general meaning, in relation to somebody’s responsibility to account to *Allah* on all matters relating to human effort (Lewis, 2001). The word ‘*hisab’* is derived from the root *h-s-b*. With regards to this, nine forms occur 109 times in the *Qur’an* (Badawi and Abdelhaleem, 2008) and moreover, the term *‘hisab’* is repeated over eighty times in various verses of the *Qur’an* (Askary and Clarke, 1997). The basic meaning of *‘hisab’* is reckoning, accounting, calculation and judgment, which is clearly indicated in the *Qur’an* (*e.g.* 4:86; 14:41). As can be perceived these are mainly spiritually orientated definitions.

The term *‘hisab’* can also mean reward and retribution, or adjectively according to a number of *Qur’anic* verses (3:27; 78:27 and 78:35), it can also mean sufficient, fitting and occasionally plenty.

Hasib (accountant) is another form derived from the root *h-s-b*, which is mentioned twice in the *Qur’an* (21:47). *Hasib*, basically means “one who reckons” or “one who works out an account” (Badawi and Abdelhaleem, 2008). The *Qur’an* required Muslims to keep records of their debt and to confirm just and fair financial transactions between people (2:282). It should be understood that this specific verse explained the following accountancy terms: “‘debt’, ‘debt quantity’, ‘debt’, ‘debt writer’, ‘fair in writing', 'dictator', 'special cases', 'witnesses', 'writing aim', 'exceptions' and 'neutrality'" (Kantakji, 2003:3). Therefore, it is clearly substantiated that Islam has provided the main principles and guidelines for how people can record and report their transactions (Lewis, 2001). It could, therefore, be argued that the Islamic *shari'ah* was the first to create financial systems not only to record transactions but also made it a religiously prescribed duty similar to *ibadah* or 'worshipping'. Hence, such systems with material and spiritual methods are different to conventional ones (Kantakji, 2003).

According to Napier (2006; 2009), the concept 'Islamic accounting' could have historical and geographical implications. In other words, it may be considered as Islamic accounting due to the fact that a particular accounting system prevails in one particular part of the Muslim world (Napier, 2009). However, beyond such a pragmatists understanding, Islamic accounting "can also be understood in a religious sense and used as a tool, which enables Muslims to evaluate their own accountabilities to God" (Napier, 2009:123). Thus, Islamic accounting in a field of practice and study is related to such a definition, as Islamic principles and moral economy help to socially construct such an accounting system, as in the case of Islamic banking and finance.

In this context, Triyuwono (2004) defines Islamic accounting (*shari'ah* accounting) as science or a process of accounting that functions as a medium for providing information and fulfilling accountability to awaken users' consciousness with regards to God. However, from a financial context, accounting was defined as a practice that provides applicable information to shareholders regarding an institution that would allow them to make sure that the organization always operates in accordance with Islamic *shari'ah* rules (Hameed, 2000). He also defined it as a significant language and to be specific, it is used as a tool by Islamic financial institutions *i.e.* Islamic banks to monitor and achieve their objectives, which are considered to be different to the objectives of conventional entities and will make decisions in a manner consistent with Islamic morals to achieve *maqasid-ul-shariah* or *shariah* compliance (Hameed *et al*., 2004).

4.3 THE RATIONALE FOR ISLAMIC ACCOUNTING

A number of scholars of Islamic accounting have provided arguments regarding the effect of Islamic religion on accounting practices (*e.g.* Hamid *et al*., 1993; Baydoun and Willett, 1997 and 2000; Sulaiman 2000; Lewis, 2001). Such arguments took place in both normative and practical Islamic banking transactions through which they argued for a significant relationship between Islam and accounting. In line with this argument, as mentioned in a previous chapter, Hofstede (1980) also ascertained that religion in Islamic societies considerably affects the way accounting is practised. Therefore, a different set of standards may efficiently serve institutions and organisations, such as Islamic banks.

The purpose of why Islamic accounting practices and values, and conventional ones must be distinguished is why IFIs were established in the first place (Tag El-Din, 2004). Thus, the growing industry in IFIs is considered to be one an important element that necessitates an alternative Islamic accounting system. In other words, due to the special needs of the IFIs, the IFRS do not satisfy these needs in their financial reporting (Tag El-Din, 2004). In line with this argument, Ibrahim (2007:2) claims that “the Islamic financial industry needs a corresponding alternative set of accounting standards which can at best be harmonized, not standardized due to the different nature and activities of the Islamic banks and financial institutions.”

The main issue of his statement is that the Islamic economic system, and the operations and mechanisms of IFIs differ from the mechanisms and the system of capitalism and socialism that underlies current IFRS. In addition to the ontological and ideological difference, the objectives of conventional accounting differ from the objectives of Islamic accounting: while the former is based on a ‘decision usefulness framework’, the latter is based on accountability within a *Shari’ah* compliance framework (Ibrahim, 2007). In other words, Islamic accounting complies with the objectives of financial accounting by providing “useful information to users of these reports”, to “enable them to make ‘legitimate decisions’ in their dealings with Islamic banks, as opposed to buying, selling or holding decisions to increase their wealth” (AAOIFI, SFA 1). In addition, according to Sarea and Hanefah (2013:70) one of the main objectives of financial accounting for IFIs with regards to accountability with the *Shari’ah* compliance framework is to “determine the rights and obligations of all interested parties, including those rights and obligations resulting from incomplete transactions and other events, in accordance with the principles of Islamic *Shari'ah* and its concepts of fairness, charity and compliance with Islamic business values". Ibrahim, (2007) has related the variations in and gaps between the two accounting systems to the difference in nature and structural objectives of the IFIs economic system and the capitalist system (Ibrahim, 2007).

Besides the differences and changes in the business environments, the prohibition of interest in Islam and the use of alternative financial transactions is another factor that has an effect on accounting, as these alternative transactions undertaken by Islamic entities are not covered in conventional accounting standards. Moreover, the functions and contracts applied by IFIs are not the same as the ones applied by ordinary banks that are taking interest on loans. In order to avoid receiving or paying interest, Islamic banks across the world use different contracts, for instance a *mudarabah* contract or an agency contract, which is allowed to earn profit in Islam. In the case of a *mudarabah* contract, the bank would manage the investment of others (as a *mudarib*) and receive a percentage of the returns, as long as there is a profit. Nevertheless, the bank receives no reward for its effort if there is a loss and these losses are allocated by the provider of funds or *rabb-al-mal*. In the case of an agency contract, the bank receives reward in relation to either profit or loss. The reward could be a lump sum or a percentage of the invested amount (Ibrahim, 2007). Such a transactional nature is considered to be best served with a particular accounting system.

According to the above discussion, the prohibition of interest in financial transactions is one of the main reasons that require the establishment of an accounting system, which might serve the Islamic environment in an efficient way. In addition, there are several other factors and exceptional details that rationalise the formation of an Islamic accounting system. However, to develop a particular accounting system which significantly satisfies the particular requirements of the Islamic environment, it is important to understand the Islamic worldview.

Muslims undoubtedly believe that Islam provides a comprehensive way of life that is beyond a belief system. They also believe that the Islamic worldview and its articulations, such as Islamic jurisprudence, is universal for all humankind, perfect and comprehensive for all things and affairs, permanent for all times and indivisible and inseparable, as supported by one Qur'anic verse, which states, "We have neglected nothing in the book" (*The Qur'an*,6:38).

In terms of the ontological position, in addition to defining and shaping humans' relationship with God in a profound manner, Islam regulates economic, social and political affairs in mundane spaces. The *Qur'an* (the holy words of God), and *Hadith* and *Sunnah* (the Prophet Mohammed's sayings and deeds) are the main sources of Islamic *Shari'ah* or the Islamic worldview and its articulations. These two sources are the only ontological and epistemological sources of Islam, which aims to provide meaning to social reality in everyday life, regardless of the profane or mundane. In the hierarchical order of knowledge, these two sources are also supplemented by the *ijma'*, specifically the third source of *Shari'ah* or the consensus of Islamic scholars on issues not discussed explicitly in the *Qur'an* and *Sunnah* (Abdul Rahman, 2010). This characterises the Islamic law of social behaviour that controls all issues concerned with Muslims' lives. Islam as a whole system, and thus, consists of a set of sub-systems, which integrate and act together to achieve the spiritual and secular satisfaction of individuals.

The Islamic economic system is a sub-system of the Islamic order. Islam encourages commerce and trade, but requires that any transaction should be conducted in accordance with *Shari'ah*, or Islamic law, which prohibits - among other things - transactions involving *riba* (interest), unlawful and speculative trade, *gharar* (uncertainty) and *maysir* (gambling) and also requires Muslims to pay *zakat* or give alms. Thus, a number of positive and negative measures relating to the economy are directly mentioned in the *Qur'an*, such as the prohibition of *riba*, "*Allah* has permitted trading and forbidden *riba* (usury)" (*Qur'an,* 2: 275-276).

As compared to individualistic behavioural norms, the Islamic worldview also essentialises social responsibility; as the 'rights of society should be returned to society', as in the case of *zakat* payments from one's own wealth (Asutay, 2007). The Islamic worldview essentialises that everything belongs to *Allah* and that people are trustees and temporary users of what has being given to them, as *amanah* or trust by *Allah* (Abdul Rahman, 2010). If, therefore, business activities are performed with obedience the commands of *Allah* and the Islamic code of behaviour, then these activities can also be considered as a part of *ibadah* (Ahmad, 1988). Therefore, Islamic economics is defined as "the knowledge and application of injunctions and the rules of *Shari'ah* that prevent injustice in the acquisition and disposal of material resources, in order to provide satisfaction to human beings and enable them to perform their obligations to Allah and society" (Hasanuzzaman, 1984:52).

The question of how the Islamic worldview would affect the choice of particular accounting and reporting policies in everyday life is an important one, although the effect of religion has rarely been investigated at an organizational level. The Islamic worldview incorporates both '*al-dunya'* (the worldly aspects) and '*al-akhirah'* (the religious aspects) in which the former aspect has to be connected in a profound and devoted way to the latter aspect, in which the '*al-akhirah'* has the final and ultimate importance (Abdul Rahman, 2010) in terms of human salvation. Specifically, it means that while we are performing our *ibadah* including *muamalat* (transactions) we also must do the best in our work in this world without indicating any intention of ignoring or being forgetful of the *dunya* aspect (Abdul Rahman, 2010). The fourth *khalifah* Ali Ibn Abi Talib (600-661) (the Son-in-law of the Prophet Muhammad *pbuh*) highlights this by stating "Do for this life as if you live forever, do for the afterlife as if you die tomorrow" (Kabbani: 2003: 118). As stated by this quotation as well, Islam does not prohibit human beings from pursuing happiness in this world, but it is not determined on material wealth only or only in connection with happiness in this world. In fact, Islam calls out for balance between life in this world and the hereafter, as *falah* or the welfare concept in Islam (Kuran, 1995). Chapra (1992) argues that economic and indeed accounting practices are considerably affected by the holistic approach to life, which encourage Muslims to have a balance in satisfying both the material and spiritual needs of all human beings, *as falah* is defined as a tangible quality to seek and achieve the pleasure of God (Siddiqi, 1972).

In the Islamic worldview, the objective function of individuals in whatever they are undertaking is expressed as '*falah*', specifically salvation in this world and in the hereafter. Thus, accounting is immediately part and parcel of individual objective function through *falah,* as the consequences of this life are received in the hereafter through an evolutionary process by God. However, individual level '*falah*' or accounting cum salvation is not enough for '*falah*' to be actualized; which has to be substantiated with '*ihsan*' as a social capital; to be precise 'beneficence'. In other words, in order to reach '*falah*' each individual is expected to conduct *'ihsan'* in the sense of contributing to the '*falah*' of the fellow individuals. Thus, '*ihsan*' becomes an important 'constituent' and '*susbtance*' of the *'falah'* process at an individual and social level. The *Qur'an* mentions the term *falah* or its derivatives in forty distinctive places. A perusal of these verses guides us to define the forms of *falah* at different levels, such as the spiritual, cultural, economic and political levels (Khan, 1984).

In the context of the economy, *falah* can be achieved by directing all economic activities, such as trade, business, buying, selling *etc.* in a moral (Abdul Rahman, 2010). It has also been argued that any economic decisions including financial reporting regarding economic activities in any society, especially in Islamic society, then Islam should have a direct influence upon the accounting system (Abdul Rahman, 2010).

It should be noted that having the hereafter as a reality endogenised in Islamic thinking and everyday life has implications for accounting. As explained, this provides spiritual accountability from an individual's sense, in a state of mind to assess their gains and losses not only for this world but also for the hereafter. This defines the foundation of accounting in Islamic tradition, as the famous proverb states: "What have you done for Allah today?" This is a simple definition of personal accounting in everyday life in line with Islamic teaching. However, the heavy emphasis on *haqq* (right) and *adalah* (justice) by definition requires a form of accounting to be implemented so that the *haqq* and *adalah* can be served for all the stakeholders.

The main purpose of accounting is to release the accountability of enterprise, as a result of separation of ownership and management. Stockholders, creditors, possible investors and the community are the main users of accounting information. The term accountability, in Muslim society, holds a profound meaning of vice regency or *khalifah*, implying that individuals are created to represent God on earth (this will be discussed in more detail later in the chapter). Within such responsibility, Islamic teaching perceives that the duty of an individual in this world is to achieve the function of its being in the universe, who was consequently created as trustee and accountable for all his/her personal actions during their lives on the day of resurrection (Napier, 2007), as stated in the *Qur'an* (486) "certainly, *Allah* is ever a careful account taker of all things" (4:86).

It should be noted that the *Qur'an* uses the word *hisab* (account, calculation) and its derivative more than eighty times in different verses (Askary and Clarke, 1997:42 cited in Napier, 2007:4). *Muhasabah* is an Arabic word that means 'accounting', which as a word is derived from the verb *hisab* can also be pronounced as 'reckoning' (Napier, 2007), which as a concept brings about feelings of responsibility toward God, His created beings and the soul which is accountable for adhering to the commands and prohibitions of the *Shari'ah*. By means of *muhasabah*, man comes to understand that he is created with a purpose, and that God gave him responsibility on this earth and that man will be responsible to God for his actions and the trust placed in him, and that he must return to *Allah* (Chaudhry,1999).

In Islam, providing financial information to the public and users is not the only function of accounting, rather that accountants should discharge their accountability by providing information to enable society to follow the commandments of God as prescribed by the concepts of *tawhid*, *adala*, *ihsan*, *rubibiyah* and *tazkiyah* in the process of facilitating *falah* (Abdul Rahman, 2010). Hence, from this perspective, Gambling and Karim (1991) argue that accountants as ethical governors have to ensure the accountability and transparency of the internal procedures of the institution, so that policy and governance issues are discussed and recorded correctly, at the point where ethical difficulties arise in the first place.

It is therefore, the aim of the Islamic economic system, from the point of view of ambition to obtain the economic well-being and improvement of people through the establishment of social justice, equal distribution of material resources, and the provision of human needs, as well as achievements of moral and material development, given that development is defined as 'human centred' and for 'human well-being'.

As the discussion so far indicates, Islam has a different worldview that also impacts upon the social and economic actions of its believers. This in turn affects the accounting system, as accounting is a public action and organisation that has to reflect the values of its society and helps to reach its social and economic objectives (Hameed and Yaya, 2005).

Consequently, Islamic ontology and epistemology are also articulated in nature and the everyday practice of accounting, resulting in 'Islamic accounting'. Hameed (2000) argues that the differences in worldviews and morals lead to differences in economic systems and therefore require different accounting systems that meet their needs. Despite the fact that several religious scholars recognise the worldview of Islam as a monotheistic religion following the five pillars of faith; the axiomatic framework of Islamic moral economy shaping the nature of Islamic accounting is discussed as follows:

Tawhid (the unity of God and sovereignty as Islam is a code/system of life given by *Allah*) is the foundation of the Islamic faith which indicates the vertical dimension of the ethical system (Asutay, 2007). According to Naqvi (1994:26) "*tawhid* particularly denotes the vertical dimension of Islam-linking the imperfect and finite social institutions with a Perfect and Infinite Being". The concept of *tawhid* refers to the unity of God and faith, and that the creation did not come into existence accidently, but was created by God (Maliah, 2005; Abul Hassan, 2005). *Tawhid* as the main pillar of Islam ensures the integrative manner of life indicating through complementarity that methodologically in life everything is integrated and interacted, and therefore any analysis has to consider such integrated understanding and interactiviness. Thus, *tawhid* suggests that every person is considered to be an essential part of the whole (Asutay, 2007; Ather 2009). It should also be added that Islam encompasses both '*Hablum-min'Allah wa Hablum-min'annas*' (the relationship between Man and *Allah* and relationship between Man and Man) (Abdul Rahman, 2010). Hence, in Islam, practical accounting covers social actions in everyday life in terms of a horizontal relationship (with other human beings/*Hablun- mia'annas*) reflecting on the social nature of accounting, although it also relates to a vertical relationship (with *Allah/ Hablun-mia'Allah*) as a path to individual development and accountability (Murtiyani, 2009).

Consequently accountants in Islam should maintain a good and proper relationship with God by satisfying the religious requirements which in turn the human and public relations would be enthused by the significance of honesty, justice, tolerance and respectability *etc.* since the basic principle of the accountants who comply with the worldview of *tawhid* (oneness of God) is to regard life in the hereafter as their important point because it is eternal life (Abdul Rahman, 2010). He added this does not mean that individuals should forget their share and aims of this world, as long as they are within the limits provided by religion (Abdul Rahman, 2010).

It should be observed that in order to increase the level of beauty in life (*hayat al-tayyebah*), both person and group, human beings should also follow the law of equilibrium, specifically *Al-'adl wa Al-'ihsan*or justice and beneficence, the 'horizontal' dimension of Islam which entails promoting social harmony and preserving just balance in the basic construction of society together with unity (*tawhid*) in which individual actions must follow an integrated whole (Naqvi, 1997; Ahmad, 2003). In other words, all mankind are accountable for human and material growth, for their own thoughts and actions, and for their relations with the 'other' and with nature around them (Osman, 1998). Therefore, it could be argued that although this axiom provides freedom in which individuals have to act, they must do so whilst bearing the general well-being of present and future generations (Asutay, 2007).

Al-'adl (justice) is *'Ant:al-thulm',* (oppression and injustice), which as the second essential axiom, means justice, fairness and equitableness, which fundamentally encompasses two features: firstly, the basis of equilibrium has to be sustained between individuals with respect and appreciation to their rights; secondly, every individual should obtain things that are due to him and give things that are due from him (Khan, 2003), as what *Allah* has intended is percentage and balance in the fairness of rights (Khan, 2003; Siddiqi, 2004). For that reason, it could be claimed that *al-'adl* requires that everyone should be provided with all of his/her ethical, social, financial, political, legal and public rights (Khan, 2003).

Al-'adl in Islamic culture is a moral principle. Each person in society should look for justice in all his/her actions and transactions, including accounting. Kamali (2010) states that justice is fundamentally a social concept, because it includes social relations *(muamalat)* based on the concept of *ukhuwwah* (Islamic brotherhood). He added that economic justice is a prerequisite of social justice. Therefore, as a technical term, 'social justice' is often associated with economic justice although it does not equalize it (Kamali, 2010).This can be understood clearly form the statement by Qutb (1953), cited in Gambling and Karim (1991:32), the "Islamic economic system should be viewed from a holistic perspective, which involves an understanding of the concept of

God, the universe, life, and the human being. This holistic approach provides an appreciation of the nature of social justice in Islam".

According to Ahmad (1971), the social and economic morals of Islamic finance include beneficence or *'al-'ihsan'*. *Ihsan* or 'doing what is beautiful' is to accept with pleasure less than what is due to receive readily and pay back, a larger share than what is due (Murata and Chittick, 1994). *AI-'ihsan* is a significant value of Muslim society. It is beyond and greater than the legal fairness of justice *(al-'adl)* and it is practiced voluntarily. Thus, it is argued that *ihsan*, is "a cluster of various values such as *amanah*, (honesty), *ithar* (sacrifice) *ta'awun* (cooperation), *sabr* (patience), *shukr* (thanksgiving) *tawakkul* (trust), *infaq* (spending), and *silatur rahm* (joining of kinship ties), *etc*." (Uddin *et al*., 2013:15).

The importance of *al'adl wa al'ihsan* can be noticed from the number of times it is mentioned in the *Qur'an*. For example, in *Surah Al-Nahil*, the *Qur'an* states that "*Allah* commands *al'adl* (justice) and *al'ihsan* (beneficence)..." (16:90). Justice and kindness is a term which is wide-ranging, and possibly consists of all the qualities of cold philosophy. Conversely, religion invites people to perform good acts, which are exceedingly generous and more human, although they are not necessarily required by justice (Ali, 2003). In other words, it means generosity in giving and taking for people (Najar, 2010). For example, the hadith of the Prophet of Islam states that 'paying the agreed amount of money for someone who works for you before his sweat dries is due to *adl*. However, if this person is paid more money than what is due, then it is out of *ihsan* (Ansari, 2011). The *Qur'an* (*e.g*. 10:26; 55:60) indicates that the reward of the righteous will be far more than in proportion to their merits, in this life and the hereafter (*hayat al-tayyebah*).

The prophet stated that *ihsan* is "to worship God as if you see Him, since if you do not see Him he sees you" (Al-Bukhari: 47). Given that *Allah* knows everything, whether visible or hidden, including most secret thoughts as the *Qur'an* (33:51) has indicated. Thus "*ihsan* demands that people be aware of God's presence and act appropriately, but also demands that they think feel and intend appropriately" (Murata and Chittick, 1994: 278). Therefore, it could be argued that the Prophet's definition of *ihsan* presents us with a profound meaning and perception into the quality's inner dimension, its psychology and it clarifies human attitudes and inspirations that go hand in hand with *ihsan* (Murata and Chittick, 1994).

In Islamic finance, the implementation and encouragement of *ihsan* is significantly required by *shari'ah*, not only to make the economic cycle run smoother, but also as it provides a humanistic dimension by emphasizing the moral aspect of human transactions (Kamali, 2010).

In reflecting upon *ihsan* and its articulation for accounting, accounting standards for IFIs have to be improved reliably by taking the unique objectives of financial accounting for IFBIs into consideration (Tag El-Din, 2004). Consequently, Islamic auditors can arrange their financial reports on an organizational level, which follow these particular concepts and allocate them over and above its main practices (Khan, 1985). Thus, consistent information has to be presented in the correct form and in full disclosure, as it is required according to the concept of social accountability in Islam. Related and truthful disclosure of information is essential in various features of Islamic life (Lewis, 2001). Such as "….be maintainers of justice…" (4:135) is one of the *Qur'anic* references referring to the meaning of 'relevance' and the other one (2:71) "…now you have brought the truth…", therefore, it is argued that financial information is related to an Islamic view, as long as it contains the quality of 'truth-fair' and perfect disclosure of the materials at hand (Lewis, 2001).

Al-adl wa al-ihsan according to Islamic conception is also referred to as the fair and equitable distribution of wealth. In this context, to distribute the recourses of the economy with fairness and justice, the Islamic economic system has implemented a highly structured system of *sadaqat* and *zakat* in addition to other Islamic morals, for example, kindness and sympathy *(ihsan)* which 'encourage people to contribute more than they are ordained and take less than they are authorised', between Muslims in the community, as the *Qur'an* occasionally indicates (*e.g.,* 9:13) (Chaudhry, 2003; Kamla *et al*., 2006; Najar, 2010), such as the case with pious foundations or the *awqaf* system.

In order to protect and sustain the harmony of Islamic society as a unit and ensure the accountability of business and trade, a number of institutions were established during the seventh and eighth centuries, which is the time of the Abbasids State, including the institution of *al-hisba* that regulates the market and protects society from fraud and corruption (Wilson, 1997; Kamla 2009). One of its main objectives was to emphasise the fundamental components of Islam, including the fairness of all Muslims and the prohibiting of unfairness because of race, sexual orientation or class, since *ihsan* is relevant to every aspect of human behaviour. According to Gambling and Karim (1991) and (Kamla, (2009), the *muhasib* (accountant) was selected to certify whether the market place and dealers in the region accorded with the *Shari'ah*, as well as to maintain public values and the health of government capitals and to prevent market controls, such as controlling prices. As a result, the main role of the *muhasib* was to certify fairness *(adl)* and beneficence *(ihsan)* in society, including both religious and material dimensions (Murtuza, 2000).

Formally, the Islamic economic system is presented as an optimum system, as it revises the discipline of economy, in order to suit the needs of changing times. To achieve this, freedom has turned out to be the '*sine qua non'* of serving as a guide for additional legislation or rule-making by Muslims. Therefore, freedom is considered as one of the objectives of *shari'ah* (Ibn Al-Khujah, 2004). Siddiqi (2010) argues that the laws of Islam *(Shari'ah)* identified as blessed and representing the *Qur'an* and Prophet Muhammad's *Sunnah* (way of his life and action), and found in the *Hadith* and *sirah* are above man. However, their understanding, interpretation and implementation are entrusted to the community of believers of the former by Islamic jurists, which is specifically Islamic jurisprudence *(fiqh)*. This in itself requires freedom of thought and expression, the right to assemble, to converse and to take part in dialogue, because Muslims as mentioned in the *Qur'an* have been directed "to conduct their affairs by mutual consultation among themselves" (42:38). Sen (2000:53) claims that "enhancement of human freedom in both is the main objective and the primary means of development".

Freedom should provide and ensure both aspects, the procedure of free decision-making and real opportunity of choice, because there will be no meaning of freedom if there is no real opportunity to make a choice and vice versa; the choice being undertaken by someone else (Sen, 2003; Siddiqi, 2010). Nevertheless, the concept of freedom in Islam has a different meaning to the ordinary concept of the absolute autonomy of individual, which is not secured in the Islamic attitude that relates freedom to the *Allah's* will (Naqvi, 1997).

Freedom in Islam is linked to accountability; as humans are given free-will *(irada-i juzziya)* to determine their own destiny, they are accountable for every decision or choice they are taking. It is a known fact that without free will, accountability cannot be established, and justice or *adalah* cannot be determined. Therefore, the Islamic moral economy considers freedom as an essential axiom in constructing the Islamic accounting system. In other words, Islamic accounting is also the consequence of freedom that individuals are given by God. Hence, this axiom, also rationalizes Islamic accounting as a social construct through revealed knowledge and its implications to humans (Asutay, 2007).

Similar to all rights, the right to freedom is accompanied by responsibilities (Siddiqi, 2010). Responsibility *(fard)* is an essential matter in Islam's all-encompassing and primary belief system, moral value, social norms and judicial principles (Abd Al-Rahim, 2010). Hence, Islam requires every individual to consider full responsibility for society as a whole. For example, Islam emphasises the social responsibilities of paying *zakat* and the individual cannot enjoy life or earn profit unfairly, while others cannot (Sirageldin, 2000; Lewis, 2001). This is obvious in the *Qur'an* (9:71) "the believers, men and women are *Auliya'* supporters and protectors of one another; they enjoin Islamic monotheism and all that Islam orders Muslims to do, and forbids all that Islam has forbidden; they perform prayers and offer obligatory charity *(zakat)* and obey *Allah* and His Messenger".

Muslims have no doubt that *Allah* gave man responsibility in this life and he will be accountable to Him for his actions and the trust placed in him. Responsibility *(fard)* in Islam does not honour, but commissions *(taklef)*, which means Muslims are responsible for their actions or inaction in this life and the hereafter. Each person has a book kept about them, which confirms all his/her small and great actions (deeds) that they will be responsible and accountable for on the Day of Resurrection (Al Safi, 1992), which once again relates to accounting.

Both the *Qur'an* and *Hadith* emphasise the accountability and responsibility of man toward the rest of creation. The *Qur'an* (18:49) states, therefore, that"…therein they will say, 'ah woe to us! What sort of book is this, it leaves neither a small thing nor a big thing, but has recorded it with numbers, and they will find all that they did place before them: And your Lord treats one with injustice". This has also been emphasised by numerous other verses in the *Qur'an* (99:7-8). Therefore, accountability in Islam entails everyone in society to ensure that their actions and conduct in this life are performed according to Islamic regulations (Afifuddin and Siti-Nabiha, 2010).

Furthermore, Prophet Muhammad also explained individual and collective responsibility. He said, "Surely every one of you is a guardian and is responsible for his charges: The Imam (ruler) of the people is a guardian and is responsible for his subjects; a man is the guardian of his family (household) and is responsible for his subjects; a woman is the guardian of her husband's home and of his children and is responsible for them" (Sahih Bukhari 3.46.730).

In general, the discussion above demonstrates a strong relationship similar to a hand and a tight fitting glove between responsibility and accountability. Afifuddin and Siti-Nabiha (2010) argue that accountability used to explain the responsibility of those who direct or manage the resources of others. Similarly, Kearns (1994:186) states that "accountability is holding individuals and organizations responsible for performance measured, as objectively as possible". Consequently, in this context accountability signifies accountability to society *(ummah)* or the community as a whole (Lewis, 2001). Lewis (2001) also argues that there is a fundamental similarity and relationship between accounting and *hesab* in Islam in the way that everyone in Islamic society is responsible for performing duties as explained in the *Qur'an.*

Providing the correct information to the *ummah* is the most significant aim of Islamic accounting, seeing as this information will assist users to understand the results and the transactions of an institution on its interests, and to be guided with the requests of *Shari'ah* as to how this has been achieved. In the context of calculating *zakat,* as one of the responsibilities *(fard),* which entails disclosure of the value of resources, it identifies the capability of a Muslim to do so. Reporting with full disclosure is essential in relation to expecting the requirements in the future and evaluating investment risk in Islamic corporations (Lewis, 2001). Substantial suspicion has to be raised whether reporting with IFRS with regards to asset assessment and the measurement of income would comply with *Shari'ah* (Lewis, 2001). Those requirements are not available in the IFRS which are more appropriate to the model of private accountability. As a result, "an accounting system based on the accountability (rather than decision-usefulness) framework, which stresses the responsibility of the accountee to God and community in addition to investors, may be more suitable for Muslim users" (Hameed, 2000:15).

Khilafah "indicates an individual's role as God's vicegerent on earth" (Asutay, 2007:170). The conceptions of *khalifa* (vicegerent), and *amanah* (trust), develop from the principle of *tawhid*. According to the *Qur'an* mankind is chosen as a *khalifa* (vicegerent) and each individual is given this duty and honour in the form of God's trust (Abul Hassan, 2005). *Qur'anic* verse (2:30) states "Behold, thy Lord said to the angels: 'I will create a vicegerent on earth'. They said: "Will you place therein those who will make mischief therein and shed blood? While we glorify You with praises and thanks and sanctify You". He said: "I know that which you do not know".

The concept of *khilafah* has been defined by several authors. For example, Sulaiman (2003:152) defines it as "a person's status and role, specifying the individual's responsibilities to himself and his responsibility to the *ummah* (community of believers)". The duty of man as God's *khalifah*" is to fulfil God's will on earth, promoting what is good, forbidding what is wrong, establishing justice *('adl)* and promoting beneficence *(ihsan)*, resulting in attaining high levels of a good life *(hayat al-tyyebah)*, both individually and collectively" (Ahmad, 2003: 193 cited in Asutay, 2007:8). For this, man is given freedom, that is, freedom of choice and action 'also within limits' (Kamla *et al.*, 2006). Many verses in the Holy *Qur'an* (such as 45:15) strongly emphasize this concept.

The concept of *khilafah*, the right of the vicegerent of man on the earth is closely linked with justice in the *Qur'an* and they both partake in *amanah* (Sulaiman, 2003; Kamali, 2010). With regards to the *Qur'an* utterances can be noted pointing to vicegerent (*khilafah)* and justice *('adalah).* For example, the famous verse with this meaning when the prophet David is summoned to judge with truth *(haqq)* among his subjects because he is the vicegerent of God *(khalifa)* (38:26). From this verse, it can be argued that there is accountability whenever it locates a link between one axiom and another. It also emphasises human accountability before God as it reminds the vicegerent not to forget the Day of Judgment as "man is accountable to God and his success in the hereafter depends on his performance in this life on earth, as he is only a trustee of God"(Afifuddin and Siti-Nabiha 2010:1136).

Individuals as trustees of *Allah's* resources are not only accountable for spiritual aspects, but also for social, business and contractual dealings (Ibrahim and Yaya, 2005). The *Qur'an* states that God commands you to return trusts *(amanah)* to their owners (4:58). Therefore, an accountant in Islam as a trustee of God and holder of *amanah* on earth is encouraged to provide work and excellent service to the *ummah* with *Shari'ah* compliance (whom they are due). It has been suggested that it is possible to use this kind of accountability as the most important aim of Islamic accounting, thus, it is subsequently called Islamic accountability (Hameed, 2000). Khir (1992) supported this idea by stating that this thought is strongly believed in Islamic society, which in turn would provide the ultimate enthusiasm for improving Islamic accounting practices.

Adnan (1996) referring to Arif (1989) that *'rububiyyah'* is one of the basic philosophies of the Islamic economic system which refers to "divine arrangements that relate to nourishment, sustenance, and the power of directing all things towards their perfection" (Ahmed, 1979:12 cited in Asutay, 2007:8). Asutay (2011) argues that it is the basic law of the universe which focuses on the divine form of the development of useful resources and to contribute in support and sharing. In other words, as an axiom, it suggests that everything has been created with a developmental path (*fitrah*). Accordingly, characterized by the development process in accordance with this approach, sustainability is derived from the continuity of rights in the worship of God.

As another axiom, *tazkiyah* or purification (purification and development) was the task of all the messengers of God in all human relationships, God, man, the natural environment, society and state (Asutay, 2011). The Islamic concept of development has to be derived from the concept of Islam in the testimonial, because it is directed at the problem of human growth in all its dimensions, and as it is interested in developmental, expansion in the direction of perfection, through the purification of attitudes and relationships, the consequence of testimonial is *falah*, in this world and in the next (Asutay, 2007).

Tazkiyah is the purification of a human being in the sense of purifying his/her 'self' from anything (physical and non-physical) that is not required, purifying the relationship between creature and creature, between creature and the universe, and between the creature and God (Mulawarman and Triyuwono, 2006). Thus, the aim of

Islam is to purify all actions of individuals whether they are visible or invisible, including souls, whilst Islamic law emphasizes purification' and 'sanctifying' which are mentioned in the *Qur'an* (9:103) "Take, [O, Muhammad] alms from their wealth in order to purify them and sanctify them with it. And invoke *Allah* for them. Verily, your invocations are a source of security for them; and *Allah* is the All-Hearing, All-Knower".

One of the aspects of self-testimonial is to keep away from the repudiating of passion and selfishness, in addition to purifying the human self *(nafs)* from all evil, vices and acts, and to cope with desires and evil inclinations. To achieve this there are several factors, for instance self-accountability and sincerity whose principle aim is to worship *Allah* alone, which is the condition of the acceptance of good deeds. The *Qur'an* (98:5) states that "And they recommended not but that they should worship *Allah*, [being] sincere to Him in religion, inclining to truth, and perform prayers and to give *zakat*, and that it is the right religion".

An accountant in Islam is expected to have a high level of moral standards, which have been discussed above, because accounting practices could be considered as a part of *ibadah* to *Allah* (worshiping) as long as these practices are implemented to comply with the guidelines of *Allah* conducted in accordance with *Shari'ah* (Ahmad, 1988; Ibrahim and Yaya, 2005). In line with this argument, Sulaiman (2003) states that the key concept of accounting is based on the honesty and personal accountability of the accountant. It has also been claimed that the direction and rules of the accounting should be taken from its values instead of its concepts. In other words, accounting should attend to the behaviour of accountants rather than the book of accounting. With regards to the devout accountant, since the Islamic code of conduct has particular personal accountabilities and duties to society, the accountant with testimonial soul*(nafs)* cannot simply cheat or deceive others, and moreover, he cannot betray and he should command good and forbid what is evil (Gerboth,1987). Suliaman (2003) implies that the devout accountant in a perfect Muslim community will be directed by the following verse in the *Qur'an* (8; 27) in purifying his accountability. "O you, who believe Betray not *Allah* and His Messenger, nor betray knowingly your things entrusted to you and all the duties which *Allah* has ordained for you".

This axiomatic foundation is completed with a methodology that is *maqasid al-Shari'ah,* which is believed to be the foundation or the directing principle of Islamic economics and Islamic finance. It relates to everything: laws, behaviour, attitudes, products, transactions, activities, and services. The meaning of *'maqasid'* includes the understanding and knowledge behind rulings, the purposes of specific actions, while, the meaning of the term *'Shari'ah'* is to follow strictly the commands of *Allah* or the way of Islam *(din)* (Dusuki and Abdullah, 2007). Therefore, *maqasid al-Shari'ah* signifies the purposes and the justification of the *Shariah* (Dusuki and Bouheraoua, 2011). Furthermore, it reflects the holistic view of Islam, since Islam is an absolute and combined pattern of life and its objective includes the personal and the public as a whole; in this life and on the Day of Judgment (Kamali, 1998; Ibn-Ashur, 2006; Asutay, 2007; Dusuki, 2009a).

Muslims believe that main objective of *shari'ah* decisions are to protect and conserve the community's benefits *(maslahah)* in all aspects of life, including the Islamic economy, Islamic finance and in turn Islamic accounting, especially as it permits more flexibility, vitality and originality in social strategy (Mumisa, 2002; Hallaq, 2004). According to Imam Al-Ghazāli (d.1111) cited in Dusuki (2009a:4) and Asutay (2007:9) "The objective of the *shari'ah* is to promote the well-being of all mankind, which lies in safeguarding their faith (*din*), their human self *(nafs),* their intellect *('aql*), their posterity *(nasl)* and their wealth *(mal).* Whatever ensures the safeguard of these five serves the public interest and is desirable."

Accordingly, it could be argued that each decision in *shari'ah* (*maqasid al- Shari'ah)* is ruled with a specific aim, which benefit the individual and society at large, and its regulations are designed to protect a human's benefits, and to develop perfection and the conditions of human lives in this life if this perfection relates to the purpose of the hereafter (Dusuki, 2009a). According to Abdul Rahman (2010), the primary objectives of *shari'ah* (*maqasid al- Shari'ah)* are established upon three areas, which are to 'educate individuals', to 'constitute justice' and 'realize benefit' *(maslahah)* to the public. There is a general agreement from the Islamic jurist that all laws in *Shari'ah* seek to secure *maslahah*. Furthermore, the protection of interest is another aspect in the meaning of *maslahah,* which can be classified under three types; the necessities *(darurriyat),* the supplements *(mokamelat)* and the ameliorations *(tahsiniyat)* (Abdul

Rahman, 2010). The theory of *maslahah* can contribute to the development of guidelines for ethical judgement in order to achieve public interest and resolve any conflict. Abdul Rahman (2003; 2010) argues that according to the principles of *maslahah,* there are three levels that accountants can use as guidelines when they determine moral conflicts, which are as follows;

Firstly, no matter what the decisions are in financial and accounting disclosures of business actions and transactions, protecting the subsistence of human life, property and intellect is a priority. Any business activities, which have an effect on these fundamental elements, have to be revealed and discussed in relation to their financial effects as well as in relationship to their vital social effects. This includes all business activities that could destroy in addition to endanger people's lives, the environment and natural surroundings, such as air and water pollution; also activities that might destroy nature, property and lives because of environmental degradation; and damage an individual's brain because of the production and trading of unlawful drugs for public consumption (Abdul Rahman, 2003; 2010).

Secondly, accountants must account and protect all complementary public interests, even though any negligence or action would not lead to difficulties or full disruption to the public. Involvement in trading with the manufacture of or selling tobacco, drugs and alcohol that will affect the public's health is one of the examples that might fall under this type of protection. Moreover, participating in fur trading, animal abuse and animal research that destroys animals' lives; and selling or issuing and publishing magazines and producing videos that inspire bad moral behaviour in society are other examples of the activities which the public must be protected from. Consequently, accountants have to reveal the consequences of such business activities not only with regards to their financial effects but also in relation to the social effects. Therefore, rather than being attached to the process, consequentialism is essential in considering the nature of an action, including accounting practice (Abdul Rahman, 2003; 2010).

Thirdly, the accountants' reports have to reflect achievements and all the necessary actions that have been taken to improve things which are necessary to the public. Hence, those reports have to reflect all the relevant information and attributes such as**,** reliability, inclusiveness, objectivity, suitability and comparability. Accountants are normally aware of such attributes although sometimes they have been a foregone conclusion. The major criticism of accountants' reports is that they use difficult technical terms and jargon, which are not appropriate for the general public to understand. Thus, reports must be simple so that the public can understand them (Beattie and Jones, 1992). In addition, over-portraying to the client on the status of the financial reporting might reflect the bias of accountants, which raises questions concerning the independence of accountants, and therefore means that confidence is lost in financial reporting (Moizer, 1985).

According to the above discussion, Islamic accounting is the outcome of Islamic ontology and epistemology as articulated in the axiomatic approach, each of which rationalises Islamic accounting. While the historical rationale and legitimacy is presented in the following section, the ontological position should motivate individuals to construct Islamic accounting, while taking full account of the working mechanism of IFIs. Therefore, it is better for Muslims to use an accounting system that is based on an accountability framework, which emphasizes the accountability of the accountee to *Allah* and the public. Hence, applying the conventional accounting system in an organization operating under the Islamic worldview might cause incompatibility between the aims of the organizations and the standards they use to report their activities and performance (Hameed, 2000).

4.4 HISTORY OF ISLAMIC ACCOUNTING

After presenting the onolotigical and epistemological rationale for Islamic accounting, it should be noted that history has evidenced Islamic accounting practices in various forms and institutions.

Historically speaking, Islamic accounting emerged from the Islamic ontology and socio-economic development, and economic and financial developments around trade during the various stages of the Muslim Empires of the past. Ibn Khaldun's *Al-Muqaddimah*, which was written in 1337, archives an early view of general history, including the history of Islamic accounting. He discusses how the *diwan* was established during the time of the second Caliph Umar ben Al-Khatab (Napier, 2009). The *diwan*, being the main administrative centre, was a system used to record all the transactions of the state, including, *zakat*, *sadaqah*, and of people's annual salaries paid from the public treasury. Ibn-Khaldun (2005:199, cited in Napier, 2009:131) states that:

> [The *diwan*] constitutes a large part of royal authority. In fact, it is the third of its basic pillars. Royal authority requires soldiers, money, and the means to communicate with those who are absent. The ruler, therefore, needs persons to help him in the matters concerned with 'the sword', 'the pen', and finances. Thus, the person who holds the office (of tax collections) has (a good) part of the royal authority for himself.

Lasheen, (1973) argues that the word '*diwan*' is originally a Persian phrase used by Arabic people; whereas Al-Qalqashandy (1913) claims that it is an Arabic term. He argues that the word *'diwan',* is a noun derived from the Arabic verb *'Dawwana'* or 'writing down'. This view is supported by several Muslim scholars, such as Sybaw'weh (the Arabic grammarian), An-Nahhas, and Ibn Abbas. Initially, the term *'diwan'* was used as a name for a book that records all the incomes and outcomes, and was a place where they record and maintain accounting books. After that, it was only used to mean an office.

Napier (2009) argues that Islamic accounting history recently developed in the shadow of western accounting history. Therefore, authors of accounting history do not have that much to say about accounting in Islam. He states that historically there has been a lack of publications in other languages other than Turkish. An important reason for the limited material on Islamic accounting history and data on accounting issues in the Muslim world is due to the destruction of archives in the national library in Baghdad by Mongol invaders in 1258.

In recent years, the history of Islamic accounting has received great attention and numerous researchers, many originating from Muslim countries have attempted to review the field. According to Napier (2009), several Turkish scholars, such as Yayla (2007a), Orbay (2005), Cizakca (1995) and Toraman *et al*., (2007) were able to study the record of *waqfs* (pious foundations) that managed to survive given that these articles were established with continuous donations, which then were available in different countries that were under the control of the Ottoman Empire. Moreover, using the Ottoman archives Toraman *et al*., (2006a) were able to consider the financial records of the Eregli Coal Enterprise, which in 1840s was considered to be one of the largest Ottoman businesses. Its accounting system was relatively different to the modern accounting system employed in the West with regards to single-entry and double-entry systems. Furthermore, Scorgie (1994b) discovered accounting systems from various ventures in Cairo from the 11th and 12th centuries, especially after relevant material was discovered in the store room *'geniza'* of a synagogue, which had survived because of a dislike of destroying any material which had writing that included the name of God (Napier 2009: 129).

4.4.1 The Development of Accounting Systems in the Early Islamic State

Teachings of Islam had a direct impact on the development of sciences in Muslim societies, including the development of accounting. For example, establishing the organisation of *zakat* in the year 2 H (624 A.D.) was one of the Islamic teachings that led to the need for accounting to calculate and pay *zakat*, as a result of conducting business and making profit (Zaid, 2004). However, there was no real formulation for this in the form of accounting book systems, models and recording processes until the period of the Second Caliph, Umar bin Al-Khattab, who governed the Islamic State between 13 and 23 *Hijri* (634-644 A.D.). However, during his reign, the *diwans* (accountants' council) were established to record the incomes and costs of *Baitul Mal* (public treasury) and as a result Islamic accounting emerged as a distinct way of accounting (Zaid, 2000a). During that time "the terms of accounting and accountant were not used", although the people in charge of accounting matters, specifically the *kateb al-mal* (accountant or bookkeeper), which became the dominant title in different regions of the Islamic State (Zaid, 2000b: 330). The first time the words '*muhasabah'*and '*muhaseb'* were used was by Al-Khwarizmi in his book *'Mafatieh Al-Uloom'* (*Keys of Sciences*) in 365 H (976 A.D.). He used the former term for the function of (accounting) and the latter for the person responsible for this function (accountant).

In his book, Al-Khwarizmi described the types of records kept by *diwans* and that the books were used to record accounts (Zaid, 2004). Since recording and documenting accounting systems has become important in Muslim society; therefore many Muslim scholars, such as Al-Qalqashandi, Al-Nowayri, Al-Mazenderany, Al-Gazali, Qudamahibn Ja'afar Demashki, and Al-Marodi, engaged in formulating the theoretical and practical base of accountancy (Kantakji, 2004).

Al-Nowayri 733 H (1355 A.D) cited the first professional accountancy, when he wrote the very first essential accounting reference in human history. He explained the reason for having the accountants’ council *(diwan)* and descried the things that accountants might need in relation to accountancy and its belongings. In addition, he discussed what accountants should record and report with regards to one’s income and the tax to pay, and moreover, the method the accountant should employ for calculating together with the difficulties that may arise (Kantakji,2004 cited in Djeffal, 2014).

As an important contributor, Al-Qalqashandi (1356-1418) was a medieval Egyptian author and mathematician during the Mamluk rulers, who was the author of *Subh al-a ‘sha fi sina’at al-insha* (*Blind’s Morning in Making Compositions*), a fourteen volume encyclopaedia in Arabic. This vast book included a section discussing requests for the person of the book *(al-katib)* who “would be technically experienced, well-versed in Islamic *shari’ah* law (particularly the law of commercial transactions – *fiqh mu’amalat*)” (Napier, 2009:132)

Qudamah ibn Ja’far (A.D. 337/948), from the‘Abbasid state’, was the author of *Kitab al-Kharaj wa Sina’at al-Kitabah* (T*he Book of the Land-Tax and the Methods of Recordkeeping*), a work on Islamic administration composed in Baghdad in the early fourteenth century, which contained eight chapters; however, only chapters 5-8 have survived (Heck, 2002). Out of eight chapters only chapter seven deals with taxation, while the others deal with administration, geography and history (Ben Shemesh *et al.*, 1958). Heck (2002) examined Qudamah’s book and argues that section ‘vii’ is devoted to the laws of taxation or more accurately the jurisprudence of revenue *(wujah al-amwal)*. Heck (2002), therefore, concluded that Qudamah’s book provides not only an explanation and examination of a fourth century administrative manual, but also is a significant contribution to our understanding of, and approach to, the history of knowledge in Islamic civilization.

Al-Mazenderany was also among Muslim scholars, who contributed to the Islamic accounting field by authoring his book *Risalah Falakiyyah Kitabus Siyakat* (*The Message Astronomical Book Contexts*) in 765 H (1363 A.D.). In the fourteenth century, his study was extensively used in the Middle East by a number of historians in the political and economic sectors, as a foundation of data on government, tax, prices and other aspects (Napier, 2009). Using *Mafatieh Al-Uloom’s* book (*Key of Knowledge*) as a reference, he explained the accounting system used in the Islamic State in more detail than Al-Khwarizmi (Zaid, 2004). According to Zaid (2004), both books documented seven particular accounting practices established and used in the Islamic State, as follows:

4.4.1.1 Accounting for livestock:

It was considered as stable accounting supervised by stable management. This type of system required all related transactions and procedures to be documented as they occurred. The system reported the transactions for all types of animals used as transport for commercial, military and civil purposes, animal food, in addition to purchasing animals, selling, donated, slaughtered or dead, in addition to wages of the people who took care of the animals. This system was also used by the private sector to record their transactions and measure annual profit, and moreover, for the aim of calculating payment of *zakat*, for the reason that the public were involved in livestock as well. Macve (1994) argues that this system is similar to today's practices that account for the overall 'profit' or 'loss', local income, and loaning bankers of a modern society.

4.4.1.2 Construction accounting

It was a procedure of project accounting applied to construct projects undertaken by the government. This system uses many terms not used in other methods of accounting, such as progress project; therefore, it requires all the related dealings, activities and transactions to be recorded in a separate journal for each construction site, whilst the person responsible for the project supervised all the records from the beginning of the project to its completion. Construction costs recorded in the *jaridah* (journals) including materials received and wages paid to different construction workers. In addition, it required accounting for and disclosing the extras or shortages when the project was completed, and that any discrepancies should be explained. Similarly, the current-day practices of construction accounting systems involve the charging construction costs to the applicable contract. This is obvious from the IAS 11, which states "contract costs included costs related directly to the specific contract, plus costs that are attributable to the contractor's general contracting activity to the extent that they can be reasonably allocated to the contract, plus such other costs that can be specifically charged to the customer under the terms of the contract" (Deloitte, 2011:8).

4.4.1.3 Agricultural accounting (rice farm accounting)

It was a system which specialised in recording the quantities of rice received and distributed. It should be noted that this model was structured for financial reporting rather than for regions that had rice farms, so as to record the harvest of rice, as well as for accounting the quantities received and distributed for the purpose of *zakat*. This system described by Al-Mazendarany and Al-Khwarizmi did not specify a separation of responsibilities between recordings and managing the account, which meant the bookkeeper, was the only one who had the duty of recording and keeping all the records at the same time. This accounting system differs to others that combine exact internal and general, or overall control processes. Therefore, Macve (1994: 59) states that "the rice farm accounting system was alike to the grain accounts of Zenon's or Appianus Egyptian estates, which also required the recording of receipts and issues of grain in physical terms and without reference to the measurement of money".

4.4.1.4 Warehouse accounting system

This system appears to have been established and structured to account for the state's procurements of materials. The types of goods received were recorded in detail into specified books immediately. However, the system did not specify whether these records were in financial terms only, or in both financial and physical terms, which seems most likely in practice. At the end of the financial period, the stock count and stocks recorded in the books were compared. If there were any differences the store man was questioned about them because he was the only person accountable for any shortage between the records in the book and the tangible records. This means that a system of internal control existed, since the bookkeeper and the store-man are not the same person. Macve (1996:6) claims that "the warehouse accounting system differed from that of the ancient world, where the inventories of items were maintained solely in quantitative, physical terms".

4.4.1.5 (Mint accounting (currency accounting)

It is believed that this accounting system was established and practiced in the Islamic State in late 13th century A. D. Accordingly to prevent the theft of the bullion and coins, it was required to convert the gold and silver immediately after they were received by the mint authority and delivered back to the person in charge. Thus, each modern public treasury received an equal amount of bullion and coins. Three specific journals *(jaridah)* were required to be used by the mint accounting system: one for recording inventory, one for income records, and another one for expenses. It was also obligatory to record the purchases and salaries, on top of the costs of the services provided by the mint authority in the expenses journal. The mint authority's income was paid either in accordance to a fixed amount or in accordance to the method of paying 5% of the cost of gold or silver.

4.4.1.6 Sheep grazing accounting

This method was one of the most important accounting systems during the Islamic era. It was also known as farm accounting, which was used by the special department in the government and private business to measure 'profit' or 'losses', which was helpful in calculating the amount of *zakat* that was to be paid at the end of the year. Macve (1994:78) argues that this system was different to the farm accounting system applied in Roman and Greek states "where the accounts did not purport to show any more than movements of cash and kind, any dependence or fixation on the accounting figures in forming ideas about profitability seems much less likely". However, this system used a very special book which was designed to record all essential transactions, for instance the animals provided to a shepherd, incomes received, either in kind or in cash, and all losses, including those due to natural disasters. The book used to record the expenses was different from the one used to record assets and the animals provided. This meant that more than one book was required for recording and documenting the accounting processes. However, it did not demonstrate if the received animals were treated as profits or whether they were added to the capital and recorded in the book of assets. Similar to any type of accounting there were disclosures pertaining to the farm accounting. Thus, it was required to have a separate document to classify each type of animal, whether it was male or female, sheep or goats and their offspring *etc*., as well as to classify and record of sheep slaughtered and meat products distributed.

4.4.1.7 Treasury accounting

This type of accounting system concentrates on transactions involving the inflow and outflow of cash. It is usually used in the public sector at all levels, from small to national branches. This system was used in the Islamic State long time ago. The government of the Islamic State required a daily record of all cash flow activities, for instance treasury revenues and expenses, whether they were financial or non-financial, cash or kind, including inventory required by the government, for example, silver, gold, *etc*. Under this system cash transactions were recorded on a separate column from the non-cash transaction, which were categorized with regards to their nature, colour and other conditions, and subsequently recorded in detail.

Unlike other accounting systems, the treasury accounting system comprised two methods of recording. The method used by Arabs to record the cash and goods inflows on the right and outflows on the left side of the journal, whereas, the method used by Persians, which used two separate books to record the inflows and outflows of cash and goods. In the former method the journal *(jaridah)* was formed to work as a journal and a book; thus, there was no need to have a separate book, as in the case of the latter. Analysing the inflow and outflow activities was required in the Arabian methods, whereas it was not required under the Persian process; thus, the Arabian method was considered to be a superior system.

4.4.2 Accounting Recording in the Early Islamic State

The general meaning of accounting in Islam refers to the operations of recording, which are clearly explained in the *Qur'an* (2:282). This verse has provided the main guidelines and the principle of accounting such as the importance of achieving rights and obligation (Napier, 2009; Afifuddin and Siti-Nabiha, 2010). However, the development of business and *zakat* accountability in the Islamic State created the importance of having accounting records and the measurement of business results. Hence, the accountability of accountants expanded further than just recording transactions for disclosing monthly (*al-khitmah*) and annual reports (*al-khitmah al-jame'ah*) in order to release the religious financial accountability of paying *zakat* as requested by *Shari'ah* (Islamic Law) (Zaid, 2000). As *zakat* should be paid on wealth, which has been kept for at least a year, it is difficult to calculate the completion of one year (*Al-Haol*, or 12 calendar months) on each item of wealth, because purchase dates may vary. To overcome this difficulty, accounting records and reports could assist either the government as well as people to take the correct decision while they calculate *zakat* (Zaid, 2000). Imam Ash-Shafi'ie stated that "… who learnt accounting will make an appropriate decision . . . This means that the trader or any other person cannot express an appropriate opinion or make the right decision without the assistance of the information recorded in the books" (Shahata, 1993:45).

When the *diwan* was established in the period of Caliph Umar ben Al-Kattab, accounting records were in the Roman, Persian, Coptic and Arabic languages. However, the Caliph of Umayyad State Abdul-Malek who ruled between 73 and 86 H (693-705 CE) mandated his assistant *Surjoor* and Saleh bin Abdur-Rahman the assistant of Al-Hajjaj to change the *diwan* of Al-sham, Iraq and Egypt into Arabic (Zaid, 2000). Whereas, his son Al-Waleed who ruled between 86 and 96 H (750-847 CE) was the first person to introduce bound records and registers (Lasheen, 1973).

The awareness of the importance of having records with a high classification and suitable reports had a direct impact on the development and improvement of accounting practices in the Islamic State. The establishment of the accounting books achieved its greatest level of growth between 132-232 H (750-715 CE) during the *Addawlah Al-Abbasiyah* (the third of the Islamic caliphates), which also improved *diwan al-Jund* (Department of Army Personnel) and *diwan al-Kharaj* (Department of Land *Zakat*) under the supervision of Kahlid Ibn Barmak (Zaid, 2000).

During that time, auditing or the 'review of books' played a significant role in the Islamic State. The reviewer's main function was to "check what was written in the books" (Al-Qalqashandy, 1913:130). Al-Gazaly (1980) states that self-control is the vital principle of the religion and *Shari'ah Islami'ah*, which is influenced by the belief of Muslims that *Allah is well* acquainted with all mankind's thoughts and actions. As a result, Muslims should watch their actions and judge themselves in this life before *Allah* judges them in the hereafter, which, as a normative principle, provides the grounds for the notion of 'accounting' in a spiritual sense with implications for this world. It could be argued, as previously mentioned that accountability and having the hereafter as a reality endogenised in Islamic thinking and everyday life has profound implications for accounting.

4.4.2.1 Types of accounting records

While accounting as a philosophy and normative understanding is well established in Islamic teaching, the practice of accounting as an articulation of such an understanding had also been developed historically. During the early periods of Muslim history, loose-leaves were used for accounting records. Later, other books were used for recording, primarily *jaridah* (Bin Jafar, 1981:23), which was an individual journal and one of accounting books that was established and implemented in the Islamic State

(Murtiyani, 2009). Al-Mazendarany 767 H (1363) mentioned the term *jaridah* in his book and observed that the special bookkeeping in the form of *'jaridah'* started with the expression *'Basmallah'* (in the name of Allah) and that it had be registered before it could be used. Registration occurred by numbering all the pages and stamping the *jaridah* with the sultan's seal before it was used (Ziad, 2000; Murtiyani, 2009).

Accounting books and *jaridah* were established and improved during *Ad Dawlah Al Adawiyah* (Umayyad Caliphate). For example, Ibn Saad (1957) states that Umar bin Abd-Alaziz who ruled from 99 to 101 H (717-720 CE) was the first person who established an independent department for each category of income. However, early Islamic history only referred to books established during *Ad Dawlah Al Abbasiyah,* who ruled between 132-232 H (749-846 CE), because they had developed the accounting system and accounting books (Murtiyani, 2009). Accounting *jaridah* commonly used during that time are described as follows:

4.4.2.1.1 Jaridah Al-Kharaj

It was used to record the *zakat* imposed on earnings from agricultural products, livestock and debt repayments, whose design was similar to the modern subsidiary ledger and based on the alphabet, in order to simplify referencing the book, which contained a significant number of pages and accounts. Each page included two columns in the form of debit and credit, where the debit was in the form of accountability and credit as the payment (Lasheen, 1973). This book recorded all the harvests of land crops and animals due for *zakat* (*Kanoon al-Kharaj*), which was also demonstrated as *al-Kharaj* obligations that people had to pay, in addition to instalments paid until the whole obligation was completed (al-Khawarizimi, 1984). The index of *Jaridah al-Kharaj* was quoted geographically, in order to show that the classification of total tax had been collected and to recognize the outstanding regional amounts of *zakat al-Kharaj* easier (Zaid, 2000).

4.4.2.1.2 Jaridah Annafakat (expenditures journal)

It was used to record all the State's expenditures including the expenses of the Caliph. Similar to *jaridah al-Kharaj*, the indexing of this *jaridah* was quoted in alphabetical order according to the type of expenditures that the *diwan* had incurred (Zaid, 2009).

4.4.2.1.3 Jaridah Al-Mal (funds journal

Diwan Al-Mal or the Department of Treasury was using this *Jaridah* to record all types of *zakat*, the receiving of it and its payment, as required in the *Qur'an* (Zaid, 2009).

4.4.2.1.4 Jaridah Al-Musadareen (confiscated funds journal)

The name of this *jaridah* was derived from the *Diwan Al-Musadareen,* which had used it to record funds impounded from people acting against the requirements of *shari'ah,* including officials working for the government who abused the system (Zaid, 2009).

In addition to these journals or *jaridah*, there are other more books or *dafter* (in Arabic) used for accounting records. Several of these books are discussed by Al-Khwarizmi and Ibn Khaldoon and are described as follows;

4.4.2.1.5 Dafter Al-Yawmi'iah (Daily Book)

It was defined by Al-Khwarizmi (1984:81) as "the daily book used to record expenses and other financial transactions associated with *zakat Al-Kharaj*". According to this definition, it could be argued that the specialisation of books was essential; *Jaridah al-Kharaj* used for recording *al-Kharaj* revenues, whereas *Dafter Al-Yawmi'iah* was employed for recording Al-*Kharaj* expenses.

This type of book and all associated documents were expected to be kept and indexed in a straightforward manner, which would allow them to be located whenever they were required, once the recording and filing was completed (Zaid, 2009). Therefore, the Sultan's stamp was used as a copy that would be kept as proof of recording in the central records. This recording illustrates the significance of *Dafter Al-Yawmi'iah* as the foremost reference and the source for posting subordinate books (Lasheen, 1973).

4.4.2.1.6 Dafter Attawjihat (book of directions)

This was one of the most significant books used by the Islamic State, which has a similarity in nature to the current general book. This book was used for the purpose of recording budget expenditures classified in relation to the kind of action and budget classification to dominate regional expenditures and to guarantee sultanate/provincial fulfilment with budget distributions and conditions. Historically, the Muslim empires used two types of budgets, specifically *itlakiyyah* (discretionary budget) and *mukarrariyah* (operational/recurrent budget). While the former budget was flexible which meant that it could be changed and modified by either the sultan or any authorised administrators, the latter budget was to be strictly adhered to (Zaid, 2000; Zaid, 2009).

4.4.2.1.7 Daftar Attahwilat (book of transfers)

Historically, each *Wilayah* (State) within the Islamic State maintained this type of book, in order to record the funds transferred from a *Wilayah* to the main government. According to the system developed, the budget of each *Wilayah* had to be approved by the federal government. It should be noted that various elements were taken into account when ratifying the budget, such as the *Wilayah zakat* collections, payments, population, geographical size, *etc.*, (Zaid, 2000; Zaid, 2009).

This type of book contained information on all incomes collected by the *Wilayah* and transfers from and to the *Wilayah*. Hence, to control the budgetary process, two books were kept: *daftar Attawjihat* and *daftar Attahwilat*. While the former was designed to control the expenditure, the latter was designed to control incomes and modifications for shortages or excesses. At the end of the financial year, they extracted the difference between the two books, specifically the incomes and expenditures books. Subsequently, any surplus or deficits were transferred from or to the federal government and recorded in the *daftar Attahwilat* (Zaid, 2000; Zaid, 2009).

4.4.3 The Contribution of Islamic Accounting to the Development of the Modern Accounting

As the preceding sections indicate, Muslim history evidences the contribution made in developing the principles of accounting and also of accounting practice. There is a growing argument nowadays that accounting used during the Muslim empires of the past might have a positive impact on the modern-day-accounting system. Have (1976:11) claims that "the Italians borrowed the concept of double entry from the Arabs". In relation to this argument Zaid (2000) states that there is historical confirmation maintained in Turkey and Egypt which signifies that accounting records and statements created in the early Muslim empires were equivalent to those used in the Italian Republics outlined by Pacioli in 1494. Furthermore, a number of the records and reports used in at various times in the old Muslim empires are very similar to modern books and reports. Furthermore, Zaid (2000) relates the influence of accounting records in the Italian Republics and the commercial link between Muslim and Italian traders. The main point with respect to this association is that the Italian primary book *'Zournal'* is the exact translation of the Arabic word *'Jaridah'* (Zaid, 2000:89). In addition, Zaid (2000) claims that the design of a number of books, chiefly the accounts receivable subsidiary ledger and the classification of debts into three core groups as collectable, doubtful, and uncollectible could be seen as an indication of the influence.

Nobes (2001: 207) argues that "there are clear influences from the Muslim world on some antecedents to Western accounting developments and on some features of pre-double-entry accounting in the West". However, no verification is provided in that literature or by Zaid (2000) to argue in relation to the double-entry method originating in Italy. The main point of this rebuttal is that no evidence can sustain Zaid's argument that records concerned with double entry and reports were used in the Islamic State, influenced the model used in the Italian Republics. Conversely, Kam (1990) believed that historically, double-entry bookkeeping was used in Italy in approximately the thirteenth century. In support of the Islamic influence, Shehata (1998) added that the term accounting was formerly mentioned in Muslim documents, which occurred before the double-entry method was established by Pacioli in Italy in 1494.

In addition, Nobes (2001) claims that Zaid (2000:81) suggested that the word *'journal'* or *'zornal'* used in the Italian Republics' accounting system "may be based on the translation of the Arabic word Jaridah". Nevertheless, the word *'journal'* has the same meaning as the English word *'diurnal'*; obtained from the French *'journal'* and related to the Italian *'giornale',* which was taken from (like the English word 'diurnal') the Latin adjective *'diurnalis'* and the ancient Latin adjective *'diurnus'* (both meaning diurnal or daily). It should be noted that this is visible in modern English dictionaries (*e.g*. OED, 1970: 1069) (Nobes, 2001).

Have (1976:130), in contrast, argues that "the adoption of the expression 'journal' and possibly the phrase 'in the name of God' could be a suggestion that the Italians adopted knowledge from other cultures". Thus, it seems that Pacioli had translated what existed in other cultures (possibly Islamic culture, as they used the phrase 'in the name of God' *'Basmallah'* in the beginning of their writing) (Chatfield, 1968:45).

It might be true that there is no strong evidence demonstrating that the double-entry process used in Italy was directly influenced by the Islamic double-entry system. However, whether or not there is enough evidence, it is clear that numerous elements of pre-double-entry accounting were applied in the Islamic world prior to being applied in the West (Nobes, 2001). Considering that there have always been trade relations between both shores of the Mediterranean, it is inevitable that there should be some exchanges of practices related to accounting. In particular, considering that it was the knowledge created by Muslim scholars in the medieval period which contributed to the development of the Reformation period in Europe, it is inevitable that accounting related knowledge would have been exchanged.

4.5 ISLAMIC FINANCE: PRINCIPLES

The discussion so far has focused on rationalising Islamic accounting through ontology, epistemology and historical practice. An important aspect of this rationalisation relates to the contemporary needs and practices, which, therefore, brings us to Islamic finance. This is due to the rise and expansion of Islamic finance, the debate as to whether there should be Islamic accounting to correspond to the needs of Islamic finance has risen. Therefore, this section focuses on Islamic finance to particularly emphasize Islamic accounting related implications.

As the discussion so far indicates, Islamic accounting is based on a particular ontological world view, which, historically, was also shaped by the anthropological realities of Muslim life and the way Muslims articulated Islamic principles in their everyday life, for instance accounting practices. Significantly as well, given that Islamic accounting is a tool to register transactions, there must also be a ‘subject’ to which Islamic accounting principles should be applied. This brings us to the *Shari’ah* compliant economy and financial practices shaped by Islamic principles. In other words, existing Islamic accounting practices also have peculiar Islamic financing methods being different to conventional practice, financial modes and instruments.

While Islamic finance came to prominence in the late 20th century, the *Qur’an* directly relates to certain principles related to economics and financing, and therefore, because of the original Muslim societies in Makkah and Madinah, various financial instruments, institutions and financial practices developed through the norms, principles and values of Islam.

Thus, in order to provide further rationale for Islamic accounting, this section presents the distinguishing principles of Islamic finance, which by definition requires a different accounting treatment to justify why Islamic accounting is a necessity beyond ontological reasoning, as debated above. Therefore, the following section discusses the salient features of Islamic finance, which have implications for accounting.

4.5.1 *Riba* (interest, usury)

Riba is the most eminent feature in Islamic economics and finance, which the *Qur'an,* and *Sunnah* have clearly prohibited, and, thus, by Islamic law. Hence, the presence of *riba* in financial transactions is contrary to many commercial practices in modern economics. For example, the conventional banking system is systematized on the basis of a fixed payment named interest, which in turn makes the activities and performance of the conventional banking system are against the philosophies of Islam that rigorously forbid *riba* (Asutay, 2010). Literally speaking, there are too many detailed interpretations of *riba*. The following sections aim to provide a conceptual understanding of the term *riba* and its implications for accounting.

4.5.1.1 Definition of *riba*

Riba is derived from the Arabic word root *r-b-a'*, which is the past-tense of the word *riba,* meaning to increase (El-Gamal, 2006). In the economic context, however, the word *'riba'* is often translated as 'interest'. The concept of interest in Islam implies profit without effort such as profit obtained free from indemnification, *etc.* More precisely, *riba* is a pure return (or rent) on money *per se*, where neither business risk is borne, nor other goods or services provided (Hamdi, 1986). In this respect, the majority of modern *fugaha* (Islamic scholars) interpret *riba* as being equivalent to 'interest' (Karim, 1999: 34). Chapra (1992) also argues that all Muslim scholars agree that interest is synonymous with *riba*.

Nevertheless, in a wider context, *Shari'ah* has suggested a precise meaning for *riba,* including 'increase', 'addition', 'expansion', 'gain' or 'growth' (Sulaiman, 2003). Moreover, in the context of *Shari'ah,* Saleh (1992:16) defines *riba,* "as generally agreed, as an unlawful gain derived from the quantitative inequality of the counter-values in any transaction purporting to effect the exchange of two or more species *(anwa', singular naw')*, which belong to the same genus *(jins)* and are governed by the same efficient cause *('illa, pl. 'illa)*".

Furthermore, Saleh (1992:16) argues that "deferred completion of the exchange of such species, or even of species that belong to different genera but are governed by the same *'illa'* is also *riba*, whether or not the deferment is accompanied by an increase in any one of the exchanged counter-values". In short, *riba* contains any unjust or excessive business activities (Gambling and Karim, 1991).

4.5.1.2 The prohibition of *riba* in Islam

Islam prohibits *riba* as evidently revealed in the *Qur'an* and the *Sunnah*. Similarly, all practices that use prediction of the future are also forbidden. According to *Shari'ah*, *riba* is strictly forbidden, since it leads to unearned income and wealth; as Islam considers financial activity as an embedded economy implying that the finance is directly connected to productive economic activity (Asutay, 2010). Since 'interest' does not provide return to capital owner due to his or her direct participation in the economic activity, as a partner, interest is considered to be 'unlawful' in terms of bringing a fixed return. Therefore, the prohibition of *riba* has been completely agreed upon by all Islamic schools of thought. For the reason that Muslims take all their guidance from sources that they do not doubt, the *Qur'an* and the *Sunnah*, there is a general unanimity among all Muslims on the fact that the practice of *riba* is prohibited in Islam (Ariff and Iqbal, 2011).

The word *riba* and its prohibition are mentioned in numerous verses of the *Qur'an*, the basic source of Islamic ideology. The *Qur'anic* verses that instruct the prohibition of usury are clear and reflect the severity of the admonition administered on those who do not abide by it. The verses that strongly condemn *riba* are those in *surat Al-Baqarah* verses 275, 276, 278 and 279 and verse 130 in *surat 'Ali Imran*.

All Muslims have a full and comprehensive understanding that *riba* is one of the major sins in Islam which clearly explains what it means to eliminate the practice *of riba* from society. Thus, Muslims are asked, when dealing in financial transactions involving further obligation (debt), to write down faithfully and precisely this obligation (*Qur'an*, 2:282), because as Muslims, we have to consider avoiding any forms of *riba* whenever we undertake any financial transactions. Therefore, the requirement of accounting practice in Islam helps to prevent *riba* by recording the rights and dues of all parties' (Ahmed, 1994).

Prohibition of *'riba'* is not limited in the *Qur'an* only, but in the *Sunnah* as well. There are a number of famous *ahadith* of the Prophet Muhammed *(pbuh),* which illustrate that he has clearly convicted *'riba'* in money and commodity transactions. For example, in the saying "[avoid the seven great destructive sins]. The people inquired, O Allah's Messenger! What are they? He said, to associate others in worship along with Allah…, to eat up *Riba* (usury)…." (Sahih al-Bukhari: 840; Sahih Muslim: 161). The Prophet equates the person who earns *riba* to the one who believes in partnership with God which is the biggest sin in Islam.

For example, in the saying 'avoid the seven great destructive sins'. The Prophet equates the person who earns *riba* to the one who believes in partnership with God which is the biggest sin in Islam. He said, "To associate others in worship along with Allah…, to eat up *Riba* (usury)…." (Sahih al-Bukhari: 840; Sahih Muslim: 161)

The Prophet Muhammad not only placed his wrath (cursed) on the earner of *riba* and its payer, but also on the writer and the two witnesses. Jabir said that "the Prophet Muhammad cursed the receiver of usury and its payer, and one who records it, and the two witnesses, and he said: They are all equal" (Sahih Muslim: 3881).

Due to the importance of *riba*, the Prophet Muhammad did not forget among other things to enforce the prohibition of *riba* in the farewell Pilgrimage given on the 9th of *Dul-hijjah,* 10 *Hijri*. He said "God has forbidden you to take *riba*; therefore, all *riba* obligations shall henceforth be waived. Your capital, however, is yours to keep. You will neither inflict nor suffer inequity. God has judged that there shall be no *riba* and that all the *riba* due to Abbas ibn Abd al Muttalib shall henceforth be waived" (Sahih Muslim: 2083).

4.5.1.3 Types of *riba* (usury) in Islamic law

From the above discussion it is apparent that the *Qur'an* did not identify any specific type of *riba,* although the word *al-riba* in the *Qur'an* generally explains the type of dealing that people used to practice before Islam *(riba al-jahiliya)* (Ahmed, 1992).

However, according to *ahadith* when Islam first emerged the Prophet Muhammad defined two types of *'riba'* namely: *riba-al-fadl* and *riba-an-nasia* (Chaudhry, 1999).

Riba al-nasia or the 'usury of deference' is the worst form of *riba*, which is also known as *riba al-jahiliya* that was practiced in pre-Islamic Arabia (El-Ashker, 1987; El-Gamal, 2006). The term *nasia* means to postpone or to wait. In other words, it means extending the period of a loan by charging more than the main value. Therefore, it refers to the time permitted for the debtor to pay back the loan in profit with the accumulation of the premium. Consequently, it denotes the interest on loans (Chapra, 1984; El-Ashker, 1987). The prevention of *riba al nasi'ah* signifies that the agreement in advance of a positive return on a loan as a reward for waiting is not permitted in Islam (Chapra, 2006).

Riba al-fadhl or 'usury of increase' is the type of *riba* that is associated with the exchange of an entity for the same kind of entity, for an increase in quantity (El-Ashker, 1987). *Riba al-fadl* is defined as "an unlawful excess in the exchange of two counter-values, where the excess is measurable through weight or measure" (Usmani, 2002:253). Therefore, it forbids the exchange of commodities that have similar categories and types with different quantities (El-Gamal, 2006). The following tradition *(hadith)* of the Prophet Muhammad is an authority on the prohibition of *riba al-fadl*. The Prophet Muhammad said that "Gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates, and salt for salt - like for like, equal for equal, and hand-to-hand; if the commodities differ, then you may sell as you wish, provided that the exchange is hand-to-hand" (Sahih Muslim: 3853, 3854; Sahih Al-Bukhari:382).

4.5.1.4 The impact of *riba* on accounting and reporting policies

For the reason that accounting is a part of an environment that reflects the business practices of society, the prohibition of *riba* does have a direct influence on accounting practices that comply with the requirements of Islamic *shari'ah*. According to Sulaiman (2003), at first, it will affect the capital structure of a business, which in turn will impact on the disclosure practices of financial reporting. This is because the balance sheet of an Islamic firm is likely to exclude loans with interest, as well as debentures and all practices use prediction of future, because the future is in the hands of *Allah*. Thus, the following section discusses the potential impact of Islamic financial principles on accounting principles.

4.5.1.4.1 *Capital structure*

The capital structure of Islamic companies is not the same capital structure as conventional companies because Islamic enterprises are not permitted to include any type of *riba* in their operations and transactions. Islamic finance, in its aspirational sense does not encourage debt transactions, although interest-free debts are not prohibited in Islam (*Qur'an*, 2:282). Thus, it could be argued that Islam does not permit debentures, because those debentures have a fixed ratio of interest (Sulaiman, 2003). Furthermore, preference shares are not an exception, since they have fixed dividends, which are prohibited in Islam (Hamid *et al.*, 1993). However, if the fixed dividend rate attached to preference shares is to be eliminated, as a form of capital these preference shares would not disturb any precepts of the *Shari'ah*. In effect, it would be comparable to the role played by a partner in a *musharakah*or a *mudarabah* (El-Ashker, 1987; Mohsin, 1992).

In addition, the structure of long term loans that usually comes with a period of more than 10 years, such as infrastructure financing, which are also reported as non-current liabilities, can take the form of a *mudarabah* partnership in IBF's framework. In this form, the bank and the company are sharing the profit and the loss made. In the case of making a profit, the bank and the company divide the profit in accordance with a prearranged ratio. However, if there was a loss, then the bank loses the capital and the company loses the provision of labour (Sulaiman, 2003). This would encourage banks to make additional effort by working more carefully with enterprises to make sure that their assets were managed efficiently. This means, Islamic banks will interfere in any work and decisions made by their clients, which in not always the case in conventional banks (Sulaiman, 1997).

Consequently, from the above discussion, it could be argued that the capital structure of *shari'ah* compliant business will contain any preference shares with a fixed rate of dividend or debentures that have a fixed rate of interest, which is different from the one employed in the West. This implies that different accounting practices are essential to endogenise their practices based on Islamic principles.

4.5.1.4.2 *Disclosure*

Financial reporting in an Islamic society shaped by an Islamic moral economy should be more detailed than the one which exists in western societies. More relevantly, perhaps, there would be more emphasis on transparency and disclosure. This would include disclosure of transactions that are particularly prohibited in the Islamic code, such as *riba* (interest), although IFIs should not participate in any businesses relating to interest, even at the lower levels of direct measurement (Sulaiman, 2003). According to the Islamic system, firms are not just required to illustrate the amount of interest paid, but additionally, a detailed account is likely to be provided to explain the reasons of how this interest occurred and the steps which they have taken to avoid the payment of interest, (such as taking a loan from Islamic banks) (Sulaiman, 2003). Hence, different accounting principles are essential to respond to such distinguishable business practice, specifically the necessity of Islamic accounting.

4.5.2 Gharar and Maysir

Gharar is an Arabic word, which literally means 'deception' (Cornell, 2007:211). In *fiqh*, it is defined as ambiguity that carries the risk of reduction, uncertainty, and hazard in any commercial trade, or fraud, deceit or excessive benefit (Al-Dareer, 1997; Obaidullah, 2005). Moreover, scholars have defined the concept of *gharar* as "a trade which is known not to exist or not, whose measure is not known to be large or small, and that is undeliverable" (Al-Dareer, 1997:10; Zuhayli *et al*., 2007: 84). Gambling is an example, of which the result is hidden. Such a transaction is highly risky and may lead to undesirable consequences and enmity; besides obtaining something for less or nothing is a type of injustice (Al-Suwailem, 2000: 65).

The *Qur'an* and the *Sunnah* have evidently prohibited all transactions that lead to unfairness in any form, to any parties. Unlike *riba*, *gharar* is not strictly prohibited in the *Qur'an* and moreover, there is no such explicit prohibition of *gharar*. However, many verses in the *Qur'an* warn believers to be aware of the ambiguous character of worldly pleasures and not to be deceived by such temptations (*e.g*. *Qur'an*, 4: 29) (Obaidullah, 2005). The *Sunnah* uses the word more obviously than the *Qur'an* and there are several *hadiths* of the Prophet prohibiting commercial transactions involving *gharar* (uncertainly), including any type of transaction which is not known to occur, *e.g*. 'birds in the sky' and 'fish in the water' or 'the catch of the diver', as well as any object that may not yet exist, such as purchasing an 'unborn calf in its mother's womb'. The rationale for prohibiting such transactions comes from the fact that the buyer does not know what he or she is paying for (Al-Qarafi cited in El-Gamal, 2001:26; Obaidullah, 2005; El-Gamal: 2007).

Al-Dareer (1997:10) argues that *gharar* could occur in essence or in the terms of a contract, which includes;

> 'two sales in one', 'down-payment *('arboon)* sale', 'the pebble', 'touch', and 'toss' sales, 'suspended *(mu'allaq)* sale', 'future *(mudhaf)* sale', or it could arise *gharar* in the object of contract which also includes; 'ignorance of the genus', 'ignorance of the species', 'ignorance of the attributes', 'ignorance of the quantity of the object', 'ignorance of the specific identity of the object', 'ignorance of the time of payment in deferred sales', 'inability to deliver the object', 'contracting on a non-existent object', 'not seeing the object'.

Apart from the above discussion, contracts involving a risk factor are not always void from an Islamic point of view. For example, profit and loss modes of finance, such as *mudarabah* (discussed in the next section), in which one party provides funds, and the other invests these funds, including a risk factor are acceptable and indeed preferable in the Islamic framework. However, it is forbidden to accept unnecessary risk on unpredictable results. Moreover, financial transactions such as options and forward sales are not permitted (except for *salam* sales, discussed later in this chapter). The reason for a ban is due to *gharar* resulting from the harm of the transaction. For example, forward contracts such as currency forward contracts: if the agreed price upon currency rises to the extent that it exceeds the exercise price, the seller will lose, and vice versa, which includes trading of risks and harm.Thus, *gharar* has been also linked to the possible occurrence of asymmetric information between the seller and the buyer, which makes the implications of trade unclear to the country party (Ali, 2015).

In addition to the ban on (excessive) *gharar*, commercial activities and financial transactions are also subject to additional restraint: the prohibition on *maysir*. *Maysir* is an Arabic word, which means gambling and speculation. Islam does not accept any agreement where financial achievement arises from speculation or chance (Visser, 2009). Gambling is seen by Muslim scholars as a zero-sum game. If one party gains, it does so at the expense of the other party and thus, it does not contribute to a rise in overall welfare (Tag El-Din *et al.*, 2007). Islamic jurists claim that gambling (*maysir*) and uncertainty (*gharar*) are related to each other: as where ever features of *gharar* are presented, the elements of *maysir* are commonly found (IIBI, 2009b). Similarly, with regards to *riba* and *gharar*, the *Qur'an* clearly bans *maysir*, in several verses (2:219, 5:90, 91).

Shari'ah scholars argued that the contracts of conventional insurance are fundamentally gambling contracts. For instance, when the policy holder aims and hopes to gain more than the amount of premium s/he pays if the incident that has been insured against does not occur, s/he will lose the amount of money paid for the premium. In contrast, if the incident occurs in an earlier stage of the premium and the claim was far higher than the amount paid by the policy holders, the company will be in deficit (IIBI, 1999). The objection is not against the concept of insurance but due to involvement of *riba* (usury), *maysir* (gambling) and *gharar* (uncertainty). The same applies to financial markets where there are numerous contracts that do not specify the exact nature, date or value of what is received in exchange (Visser, 2009).

Therefore, it could be argued that in contrast to conventional law, Islamic law prohibits selling commodities that a person does not own at the time of contract, but also these sales are not valid under *Shari'ah* even if the seller actually has the product in ownership and delivers it to the buyer. Given that most of the sales end on liquidating the transaction by payment of the price differential (Al-Dareer, 1997). It is also worth mentioning that contrary to *mudarabah* and *murabahah*, contracts involving a risk factor, for instance insurance are avoidable from the Islamic point of view.

4.6 PROFIT-LOSS SHARING AND RISK SHARING (PLS) AND DEBT BASED ISLAMIC FINANCE INSTRUMENTS AND THEIR ACCOUNTING

As previously discussed above, receiving a fixed rate or floating payment in addition to accepting specific interest or fees *'riba'* for loans of money is prohibited by *Shari'ah*. Thus, taking part in risky economic activity and sharing of profit and loss between stakeholders is the fundamental technique to avoid such prohibitions (Hasan, 1985). In other words, profit and loss sharing (PLS) was considered as the Islamic solution and reaction to principal interest-based banking, so as to comply with the prohibition of interest (Tahir, 2007).

In this context, Ayub (2007) argues that in order to avoid interest, IFIs have to use one of the key instruments as the basis of their intermediary activities. Sharing profit or loss rising on investments, earning a return on their trading and leasing activities is the important axis around which economic and business activities take place (Asutay, 2010). The Islamic solution of profit and loss sharing (PLS), suggests the sharing of risks and loss/profits equally between the parties participating in a financial transaction. Furthermore, Siddiqui (1987) argues that the profit and gains on a transaction will be characterized as *riba* (interest), unless there was a risk involved while the transactions were made. Therefore, bankers and investors have to make sure that the profits and returns on the original amount are directly associated with the risk undertaken on the investment.

The majority of Islamic economists state that PLS relies on two major forms of financing, known as commends *(mudarabah)* when only one partner – the bank – provides the capital and partnerships (*musharakah)* and when both partners contribute the capital (Udovitch, 1970). These were the original equity-based instruments suggested in Islamic economics literature, in order to avoid lending on interest (Chapra, 1992). Ibrahim (2000) also states that *murabahah* (or cost plus pricing technique) financing is extensively used in the Muslim world, including Islamic banks. Although it is a debt based instrument, *murabahah* has been widely used by Islamic banks, while the use of *mudarabah* and *musharakah* is limited.

The following sections aim to briefly discuss financial instruments.

4.6.1 Mudarabah

The concept of *mudarabah* has been used broadly as one of the operating principles in Islamic finance for joint business ventures. It is an Arabic term derived from the root verb *'darb'* that means to 'walk or travel in the land', in the language of Iraq, as in the medieval period the *'darib'* had to travel to land far from his home to undertake risky trading to make profits (Chaudhry, 1999). The word *'darb'* is used for the same meaning in verses of the *Qur'an*, for instance (4:101). In addition, the word *almudarabah* (in the language of Iraq) is synonymous with other Arabic terms, which is used to designate this contract: *almuqaradah* derived from the root verb '*qirad'* (in the language of Hijaz), which means a loan that indicates the surrender of rights over capital by the owner to the user (Abu Saud, 1976). Al-Zuhaily, (2007) claims that while the first name emphasizes that both the capital owner (*rabb ul mal*) and the entrepreneur share in profits, the second name highlights the fact that the capitalist provides part of his capital and part of his profit to the entrepreneur. Moreover, the word *mudarabah* has been translated in different ways by various scholars, who have defined it as 'trust financing', while, others have defined it as "'trustee profit sharing', 'equity sharing', a 'sleeping partnership' and 'profit sharing'"(Ahmed, 2010:115).

In the language of law and from business organisation, *mudarabah* means a partnership contract, where one partner is the owner *(rabb-ul-mal)* and is eligible to profit on account of his stock *(ras al-mal)*, whereas the other partner is eligible to a profit on account of his labour, because he is giving to manage the property *(mudarib)* (Hamid *et al.*, 1993: Doi, 1997: Kamal, 2009: Abdul Rahman, 2010). In other words, it is "cooperation between an investor who gives funds or capital to a party who will manage the fund or capital for trading" (Arshad and Ismail, 2011:157).

The practice of *mudarabah* is not a new phenomenon; the Prophet Muhammad worked as a *darib* for Khadijah before the message (Chaudhury, 1999). Nevertheless, this type of practice is not mentioned in any verse of the *Qur'an* or in the tradition of the Prophet (Chaudhury, 1999). Therefore, it is assumed and more likely that the rules and regulations of this practice were established and developed by his companies and Muslims, in addition to the duties and rights of the *darib* and the *mudarib*, duration of the contract, *etc*. Several jurists call *mudarabah* a partnership contract, as both the *mudarib* and *darib* divide the profits, nevertheless, some others, call it an agency contract between the principal *mudarib* and the agent *darib* because the entire loss is borne by the principal (Chaudhury, 1999).

A *mudarabah* contract can be conducted between the Islamic banks as a *mudarib* and investment account holders as providers of funds, and the Islamic banks. It could also "be determined between the Islamic bank as a provider of funds, on behalf of itself or on behalf of investment account holders, and business owners and other craftsmen, including farmers, traders, *etc*." (AAOIFI, 2003:87). There are two types of *mudarabah* contracts, namely, restricted *mudarabah (mudarabah muqayyadah,)* and unrestricted *mudarabah (mudarabah mutlaqah)* (Hamid *et al.*, 1993: Abdul Rahman, 2010). In the restricted contract, the investor specifies a particular business for the manager, who may then invest in that particular business only. Restricted *mudarabah* financing could be used for financing a particular project given to the client. In the unrestricted contract, however, the investor allows the manager to invest in any type of business. For instance, a *mudarabah* contract, could be used towards financing client's working capital requests (Abdul Rahman, 2010: Arshad and Ismail, 2011). "Based on these two types of *mudarabah* contracts, Islamic banks have two types of investment accounts, unrestricted and restricted investment accounts" (AAOIFI, 2003, Para 11: 27).

In *mudarabah* financing, the bank cannot request a guarantee from the *mudarib* for the repayment of capital, because the bank accepts the financial risks. However, some Islamic scholars permit banks to ask for guarantees against the *mudarib's* omission (AAOIFI, 1999: 173). Hence, the provider of capital *(rabb-ul-mal)* shares the risks and the profits with the worker *(mudarib)*. Profits are shared by the two parties at any agreed ratio. In the *mudarabah* contract, the *mudarib* cannot ask for any monthly salary or payment for the work he has undertaken. In case of loss, *rabb-ul-mal* will be borne and pay all the losses, and the *mudarib* obtains no profit on his/her work. This means the liability of the *mudarib* is limited to his effort, unless because of misbehaviour or carelessness in relation to the terms and conditions agreed upon by the Islamic bank. In those cases, *mudarib* will be borne and pay the loss (Karim, 1995; AAOIFI, 2003, Para 9a: 27; Abdul Rahman, 2010).

4.6.1.1 Accounting treatment of *mudarabah* investment account

Financial Accounting Standard No.6 (FAS 6) published by the AAOIFI states that "equity of unrestricted investment account holders shall be presented as an independent category in the statement of financial position of the Islamic bank between liabilities and owners' equity" (AAOIFI, 2003:206: Para16).

In line with the above standard, Ibrahim (2007) states that unrestricted investment accounts (URIA) in the form of *mudarabah* should not be determined to be liabilities, but a special class of equity in the form of quasi-capital. Whereas, restricted investment accounts are not the assets or liabilities of the bank although they should be reported off the balance sheet in the fundus are collected under *wakala* or restricted *mudarabah*. Karim (2001) defends this by claiming that, investment accounts are not a liability of the bank which is different to debt instruments, since they earn their returns by sharing the profits produced from their funds and also tolerate their share when they experience any losses.

Furthermore, Islamic banks do not guarantee the value of these investment accounts. The fact that the *mudarabah* contract is neither a debt nor an equity instrument means that it is not an amalgam instrument consisting of debt and equity (Karim, 2001). It has been added that investment account holders should not be observed as a liability, as by the nature of the *mudarabah* contract they stand to bear all losses, nor are they shareholders, because they stand to bear all losses, nor are they shareholders, because they would contribute in the profit sharing of their investment before dividend distributions and are not able to vote. Leaving out these customers' exposure or reporting them as liabilities would acutely misrepresent the status of these account holders (Sultan, 2006).

4.6.2 *Murabahah* (Set profit sale)

Murabahah is a type of sale that is considered lawful or *shari'ah* compliant from the Islamic point of view for the benefit of contractors and the community at large (Thani *et al.*, 2003). This type of financing is extensively used for house and motor vehicle financing by Islamic banks (Abdul Rahman, 2010).

Linguistically, '*murabahah*' means 'profitable action', in which the Arabic root *r.b.h* is the source of the term *'ribah'* which has the literal meaning of profit (Thomas *et al*., 2005). It is known as 'cost-plus financing' or 'financing resale of goods', which means it is the sale of goods at cost, plus an agreed mark-up (Haniffa and Hudaib, 2002; Dar and Presely, 2000). In the form of *murabahah*, the buyer agrees with the seller on a commodity whose price includes a stated profit known to both seller and purchaser (Thani *et al.*, 2003; Chong and Liu, 2009; Abdul Rahman, 2010).

Murabahah financing is not deliberated either as interest *'riba'* nor a conventional loan. In a *murabahah* transaction, the intermediary purchases the commodity and sells them to the customer in instalments at a mark-up. This means profit is made on the exchange of money for goods and not money for money (Thani *et al.*, 2003). To be *Shari'ah* compliant, the entity of the sale must exist at the time of the sale and the buyer should know the cost (which also includes any other costs incurred by the seller). In addition, the seller should already possess the goods or purchase them (Abdul

Rahman, 2010). Furthermore, one of the conditions for the legitimacy of the contract is that it should not include any kind of *riba* (Hassanien, 1996: 20).

Murabahah financing has other forms, specifically *bai'muajjal* (credit sale) and *bai' bithaman Ajil* (deferred payment sale) (Abdul Rahman, 2010). *Bai' muajjal* is a shortened form of *bai' bithaman ajil* (Obaidullah, 2005: 68; Visser, 2009:57). The term is a composite of two words *'bai'* and *'muajjal'* which are derived from the Arabic words *'bai'* (purchase and sale) and *'ajal'* (fixed time or fixed period)(Khan and Bhatti, 2008). *Bai-muajjal* can be defined as a financing method used by Islamic banks, which takes the mode of *murabahah muajjal*. Additionally, it is a term that refers to the sale of commodities requested by the client on a postponed payment basis at a price, which includes the bank's mark-up (profit) agreed by both parties in a lump sum or in fixed instalments. However, the price cannot be increased in case of default (Sarker, 1995; Ibrahim, 1997; Abdul Rahman, 2010).

The permissibility and legitimacy of a deferred payment financing sale is mentioned in the *Qur'an* (2: 275) "but *Allah* has permitted trade and has forbidden interest". This verse is understood as the price increase in the deferred payment sale is lawful, given that the rise in deferred sale is part of the price of the product can be esteemed at any price. The increase in loan, however, is prohibited, because money can only be evaluated by similarity (Abdul Rahman, 2010). Many Islamic scholars (Mulhem, 1989; Hassanien, 1996) agree with this point of view, arguing that mark-up charged over the original cost is not interest. In contrast, some Islamic scholars (such as Al-Abadi, 1988; Abdullah, 1996; Ahmed and Dzuljastri, 2005) claim that profit degree which is calculated by Islamic banking have some elements of *riba* and *gharar* similar to that being practiced in conventional banks; therefore, *murabahah* is *non-Sharia* compliant (Pisol *et al.*, 2012).

This raises a persuasive argument that if this financing as practiced by Islamic banks is similar in some aspect to a loan provided by a conventional bank, the conventional accounting standards, such as IAS18/IFRS15 and IAS39/IFRS9, which require that the financing charges separated from the profit margin are suitable to account for *murabahah* transactions. However, mark-up charged over the actual cost is not dividable into transaction profits and separate charges from recognition, because this could be to treat the recognition capability as a loan and part of the mark-up as interest on this loan. Therefore, IFRS accounting standards require the identification of profit margins and moreover, that the interest charges are not appropriate from the Islamic point of view (Archer and Karim, 2001).

As a result, the AAOIFI provides FAS 2 for the treatment of *murabahah* and *murabahah* to the purchase orders. To be *Shari'ah* compliant the AAOIFI adopted the method and recognized the profits at the time of contracting if the sale is cash or on credit not exceeding the current financial period (AAOIFI, 2003: 122, FAS 2, Para 8). However, profits of credit sale whose payment is due after the current financial period, shall be recognized using one of the following methods:

(i) Proportionate allocation of profits, whether or not cash is received. The AAOIFI preferred and adopted this method for the profits over the period of the credit as the basic treatment (AAOIFI, 2003: 122).
(ii) The cash basis when the instalments are received is allowed as an alternative to recognized profit. Accrued amount of profit which is not yet received is disclosed. The costs of goods sold shall be recognized at the time of concluding the contract (AAOIFI, 2003: 122).

Furthermore, the AAOIFI prefers to value assets available for deferred payment sale at the end of the financial period, at their fair value, because these assets are treated as an investment rather than fixed assets. This would assist the institution to recognize and measure any unrealised gains and losses arising from the investment (Abdul Rahman, 2010). On the contrary, conventional accounting (IFRS) generally employs historic cost (or lower) to calculate and value assets and liabilities. While the idea of presenting fair value measurements is evident and real, its working is relatively complicated due to its difficulty and as it is hard to verify (Hameed, 2009).

From the above discussion, it could be argued that deferment of profit is permissible as long as it is recorded separately as a deferred profit and not as interest. Moreover, IAS18/IFRS15 issued by IFRS is not an appropriate standard to treat this type of financing, given that it recognizes the difference between fair value and the nominal amount of consideration in a sale of goods, as interest revenue.

4.6.3 *Musharakah* (Partnership)

Literally, the term *musharakah* means sharing. In the context of *Shari'ah* compliant financing Usmani, (2002: 1) defines it "as an investment-based technique to joint enterprise in which all the partners share the profit or loss of the joint venture". As in *musharakah*, the company and the client contribute to the capital of the business in variable amounts and agree to share the net profit in proportion to the amounts invested by each (Thani *et al.*, 2003). In Islamic jurisprudence, the term *'shirkah'* is more common than *musharakah*. *Shirkah* (partnership) can be translated to mean the "participation of two or more persons in a certain business for sharing profit and loss in a specified proportion" (Siddiqi, 1985: 15).

According to the *Shari'ah, musharakah* is divided into two broad types; *shirkat al mulk* (property partnership) which is the combined possession by two or more people of a particular asset or assets without its joint mistreatment. For instance, the joint ownership of a house left, to the inheritors of a dead person. *Shirkat al aqd* (contractual partnership) is a partnership where the partners share the profit or loss that is an outcome of their endeavour (Usmani, 2002; Thani *et al.*, 2003). *Shrikah al aqd* has three different categories; *shirkat al mal* (finance partnership), where money is the foremost principle of the creation of the partnership. In the context of Islamic banks this type of *musharakah* is the obvious method of partnership (Thani *et al.*, 2003). The other two categories are *shirkat al a'mal* and *shirkat al wujooh* (credit partnership), while the partnership in the former is based on the experience or skills of a partner, whilst the latter uses credit alone for the partnership investment (Usmani, 2002; Thani *et al.*, 2003).

The contract of *musharakah* can be discontinued at any time, provided that the partner gives his associate notice to this effect. In relation to this, if the assets of the *musharakah* are in cash, this has to be allocated *pro rata* between all the partners. Otherwise, the partners may find another solution, such as liquidating the assets, or allocating them between the partners (Usmani, 2002). The *musharakah* contract can also be terminated in this case if one of the partners dies, becomes insane or otherwise becomes unable to perform commercial transactions (Usmani, 2002; Abdul Rahman, 2010). According to this discussion, it could be argued that there are at least two types of *musharakah* financing: constant *musharakah* and diminishing *musharakah (musharakah mutanaqisah)*. The partner's share in the first type remains throughout its period, whereas in the second type one party has the right to buy a part of the other party's share, which decreases until one becomes the only owner of all the capital (Abdul Rahman, 2010).

Similar to *mudarabah* and *murabahah* financing, *musharakah* is a replacement for interest-based financing with extensive effects on both production and distribution. In *musharakah,* the financier will face losses if the joint venture fails to make a profit, whereas the interest-based loan cannot suffer losses, whether or not they make a profit. The amount of profit to be distributed between the partners has to be arranged at the time of affecting the contract. Otherwise the contract is not valid from a *Shari'ah* point of view (Usmani, 2002).

Consequently, the accounting treatments for *musharakah* financing in connection with the measurement of capital in kind and profit recognition is very similar to *mudarabah* financing. According to the AAOIFI FAS 4;

> The Islamic bank's share in *musharakah* capital (cash or kind) shall be recognized when it is paid to the partner or made available to him on account of *musharakah*. This share shall be presented in the Islamic bank's books under a *musharakah* financing account with (name of client) and it shall be included in the financing statements under the heading '*musharakah* financing' (AAOIFI, 2003:168 para3).

The share of the Islamic bank in *musharakah* capital is measured at the end of the financial period at a historical cost (the amount which was paid or at which the asset was valued at the time of contracting) (Abdul Rahman, 2010). In the case of diminishing *musharakah* financing, however, the Islamic bank's share at the end of a financial period is determined at historical cost less the portion transferred to the partner at fair value. The variation is recognized as profit (loss) in the income statement (Abdel Karim, 1996). Moreover, if the diminishing *musharakah* financing is settled before the bank's share is reassigned to the partner, the recovered amount (by liquidation) from the Islamic bank's share must subsequently be credited to the Islamic bank's *musharakah* financing account. Hence, the profit (loss) from the difference between the book value and the recovered amount must be identified in the Islamic bank's income statement (Abdul Rahman, 2010).

Consequently, it has been argued that FAS 4 (the form of equity or profit and loss financial instrument) is comparable to IAS 31 (IFRS11). IAS 31 does not allow the cost method in such cases; however, it allows the equity method. Furthermore, to be *Shari'ah* compliant FAS 4 requires that the Islamic bank's share is recognised as receivable, due from the partner and not presented in the partner's capital in the *musharakah* in the case of liquidation or settlement of account the Islamic banks due share of profit remains unpaid (AAOIFI, 2003:170 para14 and 16).

The equity method requires the share of undistributed profits to be integrated in the carrying amount of the investment, which can be split into two components on the balance sheet; the cost element (partner's capital for FAS 4 requirements) and the share of undistributed profits (a *musharakah* account receivable for FAS 4 requirements), thus, FAS 4 is compatible with IAS31 (Mustafa, 2003: 23). This means harmonising the IFRS and AAOIFI might be able to be employed in Islamic institutions.

4.6.4 *Ijarah and Ijarah wa Iqtinah* (Leasing)

Ijarah is the Arabic word for leasing contract as well as hiring contract. It is the terminology which denotes the sale or agreement of *manfaah* (usufruct), whereby the lessor (owner) leases out an asset or object to its customer (not the ownership of the equipment itself, that have to remain with the lessor) at an agreed rental fee and pre-determined lease period upon the *aqad* (contract) (Thani *et al*, 2003; Tag El-Din and Abdullah, 2007). Abdul Rahman (2010:139), has defined *ijarah* "as a process by which the usufruct of a particular property is transferred to another person in exchange for rent claimed from him/her".

Leasing might take the form of an operating lease, where the bank usually owns the asset for renting purposes, and the client asks the bank to rent the asset for a specific period. It may also take the form of a capital lease, which is referred to as *ijarah wa iqtina* or *ijarah muntahia bittamleek*. Under the *Shari'ah* concept of *ijarah wa iqtina*, the client might ask the bank to purchase a fixed asset, for example, a machine or building and then lease the asset for long-term contract, or the contract can contain a promise of transfer of ownership from the lessor to the lessee (Thani *et al.*, 2003).

Ijarah wa iqtina (ijarah muntahia bittamleek) in an Islamic context is different to the leasing concept in conventional finance. The main difference between the two versions is that under *Shari'ah* compliance the lessor *(mu'ajir)* undertakes full ownership risks and the maintenance of the corpus of the leased asset unless the damage is caused by the carelessness or the misbehaviour of the lessee *(musta'jir),* whereas in a conventional lease these costs are passed on to the lessee (Kettell, 2011). Furthermore, IAS 17 classifies lease "as finance lease if it transfers substantially all the risks and rewards incident to ownership of the asset, otherwise it would be classified as an operating lease" (Abdul Rahman, 2010: 140; Kettell, 2011: 79). In contrast, the AFS 8 classifies the lease as operating *ijarah,* if there was no promise it confirms a legal title will pass to the lessee. If there is a promise, however, it is *ijarah muntahia bittamleek*, which is still not the same as the element over form regulation as in the IAS17 (Abdul Rahman, 2010). FRS 8 also states that the benefits have to be *Shari'ah* compliant, since *Shariah* does not authorise *ijarah* to be used in an asset, where the interest *(riba)* is involved (Abdul Rahman, 2010; Kettell, 2011).

Accordingly, the financial accounting standard (AFS 8) issued by the AAOIFI to treat *ijarah* (leasing) differs to the international accounting standard (IAS17) issued by the IFRS. For example, due to differences in the substance of the contracts between conventional lease and *ijarah*, the returns recognition and the influence of remaining value are different. The IAS17 is a reminder to the lessor to record the uncertainty over the collectability of lease charges income and the future level of interest rates. However, the FRS8 for *ijarah* does not mention the provision of doubtful debt or requiring any records on interest rate uncertainty, since in *Shari'ah* law the rental fee is fixed thought-out the *ijarah* contract and the lessor cannot increase the rent individually (Abdul Rahman, 2010).

From the above discussion, it can be understood that leases with *Shari'ah* compliance operate leases. This is different than the finance lease found in conventional finance; therefore, these differences, affect accounting treatments. In the case of *ijarah,* leased assets are presented in the lessor's statement of financial position under investments in *ijarah* assets (AAOIFI, FRS8, para 8:244). In the case of a finance lease, however, the lessee treats the leased asset as its own property (fixed assets) and recognises the equivalent liability for lease payment, whereas the lessor recognises an account receivable for the lease payments. Thus, according to this criterion, there is no harmonious existence between IAS 17 and FAS 8. This means all the Islamic institutions applying the IFRS system to treat Islamic financial products may not be *Shari'ah* compliant.

4.6.5 *Salam Financing* (Advance purchase)

A *Salam* contract is an alternative method of debt used by Islamic businesses. It is also, known as *bai' salaf* or borrowing (Thani *et al.*, 2003). It has been defined as "a contract involving the purchase of a commodity for deferred delivering in exchange for immediate payment according to specified condition"(AAOIFI, 2003: 229; Khaldi and Hamdouni, 2011:153). The contract in overall terms permits an early payment (the price) for the sale of a defined product (the sale object) to be delivered later at a specified time (Al Zaabi, 2010). In Arabic, the term *al-musallim* alludes to the owner of capital or the buyer, the seller or the party who takes on the obligation to deliver the object or goods at a future date called *al-musallam ilayhi*. The term *ras ul mal* refers to the price paid in advance, while the term *musllam fihi* alludes to the purchased commodity or the sale object (Al Zaabi, 2010).

Similarly to many other methods of sales, *salam* sale is permitted by the Prophet Muhammed for poor farmers who required money to procure seeds and feed their family until the time of the next harvest by sell their agriculture commodities in advance, since Islam has prohibited *riba* (usury) that could occur due to the loans on products or assets which have not yet been produced or manufactured. This type of sale is also permitted for small entrepreneurs (Taqi Usmani, 2009, cited in Karim 2010). However, the permission was subjected to some strict conditions. For example the buyer have to pay the full price to the seller at the time of completing the contract. In addition, the *salam* sale can be only applied to Goods which can exactly specify their quantity and quality. This type of sale also, cannot be particularized to a specific product or on a specific product in the farm. Besides, the buyer and the seller have to clearly agree about the amount of the product as well as the exact place and date of delivery (Taqi Usmani, 2009).

The Islamic bank can use *parallel salam* that permits the bank to purchase a product through a *salam* contract with one client for deferred delivery on one side and as a seller on another side, by selling the same product for future delivery on another contract to another customer. This is allowed as long as the two contracts are not legally related or binding; hence, mutual exclusivity is essential. Furthermore, the seller in the first contract cannot be made buyer in the parallel *salam* contract, for the reason that it will be a buy-back contract, and therefore, not acceptable in the *Shari'ah*

(Kettell, 2011). This discussion came at the same time as a *fatwa* issued by the *Shari'ah* supervisory board of the *Rajhi* Bank, which permits *parallel salam*, as long the two contracts are not made dependent on each other (AAOIFI, 2003). In contrast, several modern *fuqaha* or scholars have forbidden this type of finance, especially if such business becomes regular for the purpose of trading, which might involve *riba* (AAOIFI, 2003).

As the relationship between depositors and borrowers in conventional finance (interest-based) is different to *salam* finance offered by Islamic banks, the accounting treatment in return is different. Therefore, the AAOIFI issued the FRS7 standard which addresses accounting rules relating to *salam* financing and parallel *salam*. FRS7 requires Islamic banks to recognise *salam* financing when the capital (cash, kind or benefit) is paid or when it is made ready to the client *(al-musallam ilayhi)* at the time of contracting the capital measured by the amount paid if it was cash. Otherwise, it will be measured at the fair value agreed between the parties. In the case of receiving a different quality of commodity or with different market value, the differences shall be recognised as profit or loss. However, if the *salam* contract is partly or completely cancelled and the client could not repay the capital of *salam*, the amount is recognised as a receivable due from the client. All these transactions must be recorded in the financial statement under the heading of *salam* financing (AAOIFI, 2003:223:224).

In the case of parallel *salam*, the Islamic back recognises the transactions after they receive the capital of *salam* (in cash, kind or benefit). These transactions must appear in the Islamic bank's statement as a liability under the heading parallel *salam* (AAOIFI, 2003:223).

As discussed above, *bai' salam* is an alternative technique to loan with interest or borrowing in conventional finance. The IASB has issued IAS 23 for borrowing costs, such as interest on short and long term borrowings and other costs sustained for the borrowing of funds. Borrowing costs shall be identified as an expense in the period in which they are sustained, whilst in relation to the benchmark treatment, borrowing costs are recognized as an expense in the period in which they are acquired, irrespective of how the borrowings are utilised (Mirza and Holt, 2011). In the case of FRS 7 issued by the AAOIFI (2003) when the client fails to deliver the products on time and the delivery date is extended, the book value of *al-musalam fihi* shall remain as it is. However, in the case of borrowing costs there will be increase in the interest. For the reason that this standard treats borrowing costs with interest, it is not appropriate for treating *salam* financing, which means that the AAOIFI standards are required in Islamic institutions to treat such business.

4.6.6 *Istisna'a* (Contract of Manufacture)

Istisna'a means sale on order, which is a type of *bai muajjal* used for financing work-in-progress inventories in manufacturing or construction. It is defined as "a contract to purchase now, for a definite price, something that may be manufactured or constructed later according to agreed specifications. The object of *istisna'a* is not often available nowadays, although it will be made later by the manufacturer or contractor" (Zarqa, 1997:68). In other words, the purchaser asks the seller to supply a specific product for an agreed price and method of payment. The conditions of validity for the *istisna'a* is that the price and future delivery date are fixed with the consent of the parties and that the necessary specification of type, quality and quantity of the commodity (intended to be manufactured) is fully settled between them (Usmani, 2002).

Istisna'a or commissioned manufacturing is quite similar to *salam* (discussed above) in the method of selling something, which is not owned or under the control of the seller at the time of the sale and thus, make it a lawful sale according to *Shari'ah* compliance. Moreover, both *istisna'a* and *salam* can be used in a parallel method. This means the bank (financier) might involve a forward contract, for instance selling the goods to a third party on the spot payment, in order to avoid the risk emerging from the price of the goods. Similar to *salam*, the contract must be legally independent of the original contract (AAOIFI, 2003).

Conversely, there are several differences between them. While *istisna'a* is a contract of sale of a commodity, which always needs manufacturing, *salam* is the deferred sale of goods that do not involve manufacturing. In the case of *salam*, the contract cannot be cancelled individually, whereas in *istisna'a*, the contract can be cancelled, as long as the manufacturer has not started the work. Furthermore, in the case of *salam*, the contract has more restrictions on the payment, which must be paid in full and the time of delivery has to be identified at the time of the contract. However, in the case of *istisna'a,* the payment and the time of delivery can be delayed as it is not necessary for it to be fixed (Usmani, 2002; Thani *et al*, 2003).

It is believed that *istisna'a* used by Islamic banks is different to the investment finance form, which is used in conventional institutions; thus the AAOIFI issued FAS 10 to address the accounting rules of *istisna'a* and parallel *istisna'a*. Islamic banks as sellers would measure and recognize the costs revenues from *istisna'a* and parallel *istisna'a*. Costs experienced during a financial period and the pre-contract costs in an *istisna'a* working-in-progress account or *istisna'a* cost account in the case of parallel *istisna'a* and reported under assets in the statement of financial position of Islamic banks (AAOIFI, 2003). Under the IAS 39, assets categorised as loans or receivables are determined at their remunerated costs using an efficient interest rate, with the aim of considering the time value of the money. On the contrary, an *istisna'a* finance receivable would be valued at historical cost under FAS 10 of the AAOIFI (Tayyebi and Hijazi, 2010).

4.6.7 *Zakat*

The fundamental principles of *zakat* and how it can affect the structure and mechanisms of accounting in the Islamic world were discussed in the previous chapter. This section, however, focuses on the significant differences between *zakat* and conventional taxation, and their accounting treatment.

Zakat is financial worship and is one of the pillars of Islam; hence, payment of *zakat* is indispensable in fulfilling this obligation. It is considered to be a significant solution to the social and economic problems in the world, primarily poverty, as the social aim of *zakat* is to act as a mechanism for the distribution of wealth among the poor or to be spent by the state for the welfare of the needy and helpless, in order to reduce the economic gap between the poor and the rich (Yusoff, 2006; Adnan and Abu Bakar, 2009; Abdul Rahman, 2010). This philosophy is different to the conventional taxation system, which is forced by the government according to the tax law that might be subjected to modifications due to changes in government or the economic climate.

Furthermore, conventional taxation is based on economic factors and ignores religious and ethical values, such as the submission to God, seeking the pleasure of God and accountability to Him, and moreover, believing in the hereafter (Abdul Rahman, 2010).

As a result, Muslims would be more unlikely to cheat on *zakat*, seeing as it is a spiritual duty for which he/she has to account for in the hereafter, although a Muslim might still cheat on tax (Adnan and Gaffikin, 1997). Tax and *zakat* are different in their rules and in the causes for which they are spent. Thus, payment of tax does not rule out the obligation of *zakat*, while tax is not deducted from the amount of *zakat* due, whereas if tax is due before the time of determining *zakat* it is deducted prior to arriving at the *zakat* base, as it represents a liability (account payable) (AAOIFI, 2003:288).

The importance of *zakat* in Islam could be judged from the fact that it is considered as an essential part of financial responsibility and an instrument of fiscal policy for an Islamic state. This gives *zakat* an essential role in the Islamic macro-economic system if there is a strong foundation system for collecting *zakat* (Chaudhry, 1999; Quraishi, 1999). In this context Tahir (1989) studies the relationship between *zakat* in an Islamic macroeconomic model by concentrating on the determination of aggregate output and the degree of variations in an Islamic economy. He concludes that the aggregate output be influenced by autonomous expenditures, income distribution and *zakat* flows (Yusoff, 2006).

Zakat payment can be individual, which means the owners who are accountable for defining the amount that has to be paid out as *zakat* or in relation to a business is judged to be a separate legal entity, it would be required to gratify the obligation to pay *zakat* itself, either as an entity or on behalf of its owners (Sulaiman, 2003). Hence, it has been claimed that one of the main aims of accounting in an Islamic society is to provide information to enable individuals and legal companies to determine their *zakat* liability, in order to achieve socio-economic justice. This information will also allow customers to guarantee that their Islamic organisations are operating within Islamic restrictions (Gambling and Karim, 1991). For example, FAS 9.3 requires the Islamic bank disclosing all the information related to the *zakat*, as a holding company pays its *zakat* from its subsidiaries, and whether or not it accumulates and pays zakat on behalf of holders of investment accounts and other accounts (AAOIFI, 2007, FAS9; para. 13;18). The standard also requires the Islamic bank to treat *zakat* that collected from deposits and investments accounts in the financial statement as a non-operating expense and be included as a deduction from net income. In the case of unpaid *zakat*; it should be treated as a liability of the Islamic bank and presented in the liabilities section (AAOIFI, 2007, FAS9; para. 9). Moreover, (FAS9; para 15 and para 18) required the banks to state in their financial statement to have full disclosure in the following cases;

(i) "Whether or not the Islamic bank as a holding company pays its share of *zakat* obligations in its subsidiaries" (paragraph 15).

(ii) "Whether or not the Islamic bank collects and pays *zakat* on behalf of holders of investment accounts and other accounts" (paragraph 18).

According to the above discussion, it could be argued that Islamic accounting is required to report or disclose any activities of *zakat* collection and distribution, as well as *zakat* calculation and measurement. Fairness of values is required in Islamic accounting to ensure that no group is disadvantaged of its rightful share of wealth. Thus, the valuation of *zakat* needs to be based on current market value, although Adnan and Gaffikin (1997) state that historical cost and periodicity concepts are likely to be used for calculating zakat. Their justification for this was that Islamic accounting might have a strong realisation principle with assets being carried at historical cost until used or sold (Napier and Haniffa, 2011). However, the valuation of stocks at the lower end of cost (IAS 2) and net achievable value is definitely not acceptable from an Islamic point of view, given that it leads to lower profits (in times of rising prices) and therefore, *zakat* being undervalued. This leads to a reduction of the rights of *zaka*t beneficiaries. Furthermore, in some cases current valuations of items, such as goodwill and brands are not predictable, which may in turn lead to over-valuation of shares in the past and end up defrauding outsiders. Hence, the continued use of a historic cost model may result in negative wealth transfer effects (Hameed, 2000).

The FAS 9 on the valuation of trading assets makes it clear that "trading assets should be valued for *zakat* purposes at their market selling price (cash equivalent value), and not at a historical cost. This is in order for the *zakat* base to include the historical cost and any holding gains (losses)" (AAOIFI, 2003:289). This rule is irrelevant to the IFRS rules and practices. Consequently, most of the asset information contained in traditional Western balance sheets valued at the lower cost is inconsistent with Islamic law (Abdul Rahman, 2010). In addition, Islamic analysis emphasizes productive assets, while the traditional Western balance sheet incorporates provisions for deferred tax assets, capitalized expenses, goodwill on consolidation, *etc*. The compulsory information for appropriate determination of the amount of *zakat* places exceptional demands on accounting information systems, demands that cannot be ascertained in Western accounting reporting standards (IFRS) (Gambling and Karim, 1986).

According to the above discussion, it can be concluded that the continued use of IFRS alone in the Islamic institution may result in negative impact on Islamic compliance, because it seems very likely indeed that IFRS may fail to cover all the accounting needs for Islamic banks, such as *zakat* determination and calculation. Thus, due to *Shari'ah* compliance issues, IFRS cannot be followed in full. This means a capable accounting system appropriately for calculating and disclosing the amount of *zakat* payable is imperative (Hameed, 2000; Taheri, 2000).

4.7 PRACTICE OF ISLAMIC ACCOUNTING AND ACCOUNTING STANDARDS

Despite discussion on the rationale of Islamic accounting through Islamic ontology and historical knowledge and practice, nowadays, the majority of countries in the world, including Muslim countries where most IFIs operate are increasingly moving towards adoption of or convergence with IFRS developed by the IASB with Western culture in mind, so as to report on financial performance and position by both public and private companies. For the reason that IFRS remain the only globally recognised set of financial reporting standards and is the responsibility of all publicly listed companies in Europe, the approval of Islamic accounting standards by IFIs may affect their ability to register in major capital markets, such as in the European Union, in addition to being queried by investors if financial statements are arranged using accounting standards other than IFRS. Thus, in order to remain as part of the global financial system and be competitive, they feel that they are obliged by definition to follow IFRS.

Consequently, most of the IFIs demonstrate their financial statements by employing a framework and certain globally acceptable standards, which are trustworthy; which therefore means that the performance of entities can be more easily compared. However, as previously discussed in this chapter several of the Islamic financial instruments and religio-financial instruments, such as *zakat, murabahah, mudarabah, musharakah etc.*, need special treatments that are not adequately covered by IFRS. Thus, it is necessary that they account and present their financial statements in accordance with the form of *Shari'ah* rules by adopting the AAOIFI standards. This section, presents some examples on the subject of accounting practices in different Islamic banks, operating in different countries.

Numerous studies have compared the differences between the practice of Islamic banks in some Islamic countries and the standards recommended by the AAOIFI in accounting treatment for Islamic instruments. For example, Karim (2001) and Sarea (2012) argue that the following banks: Jordan Islamic Bank, Qatar Islamic Bank, Bahrain Islamic Bank, Turkish Evkaf Finance House-Turkey, Kuwait Bank Islam Berhad Malaysia, Faisal Islamic Bank-Sudan, Dubai Islamic Bank and Tadamon Islamic Bank-Yemen treat investment accounts that are based on the *mudarabah* contract as liabilities and report them on balance sheets. Abdul Karim (2001) states that the justification for Islamic banks to treat investment accounts as a liability item is that investment accounts are similar to deposits in a commercial bank. However, "such a justification is not entirely unfounded" (Abdul Karim: 2001:184).

Other banks, such as the Arab Banking Corporation's Islamic Window in Bahrain, have treated investment accounts on the balance sheet, as they reported them as part of equity and classified these accounts as participating shares, or what is known as class 'B' shares. (Abdul Karim: 2001). He added that this treatment is similar to deposits in commercial banks, as the laws that govern some of these banks were adopted from commercial banking perspectives that operate in these countries (Abdul Karim, 2001).

Conversely, banks such as the Al Rajhi Bank, the Shamil Bank of Bahrain, the Faysal Islamic Bank of Bahrain and the Arab Islamic Bank-Bahrain have treated investment accounts as 'fiduciary' investments and, accordingly they report them as off-balance sheet items. The reason behind treating investment accounts as an off-balance sheet item is due to the fact that the nature of these accounts is similar to funds under management (Abdul Karim: 2001; Sarea: 2012). This accounting treatment is in line with IAS 30, which argues that banks perform as trustees and in other fiduciary capacities which result in the holding or placing of assets on behalf of individuals, trusts, retirement benefit plans and other institutions, subsequently, these assets are not the assets of the bank and, therefore, are not included in its balance sheets (IAS 30, para 55).

Abdul Karim (2001) provides an example from the Faysal Islamic Bank of Bahrain (FIBB). He argues that during 1995, 1996 and 1997, Price Waterhouse auditing agency used IAS' to issue financial statements for FIBB and they treated unrestricted investment accounts to the off-balance sheet. However, this was rejected by the Capital Intelligence rating agency that rates and ranking a number of Islamic banks around the world when it was rating and qualifing the FIBB in Decmber 1996. The agent required the FIBB to transfer unrestricted investment accounts that treated off-balance sheet to the balance sheet. This is in line with the recommendation of AAOIFI's Islamic Financial Accounting Standard (IFAS) No 1 that treats unrestricted investment accounts on the balance sheet) on the bank's liquidity and capital adequacy ratios (Abdul Karim, 2001).

Capital Intelligence (1998 cited in Abdul Karim, 2001: 178) argues that using the AAOIFI standards by FIBB to present the supplementary information, allows a client to produce a more accurate picture of the financial health of FIBB. For example,

> … under the new accounting treatment (including unrestricted investment accounts on balance sheet); profitability ratios such as return on average assets become more meaningful (2.06% as opposed to 6.4% using IAS). Thus in analysing the composition of FIBB's asset structure, we have assumed unrestricted investments to be part of the Bank's balance sheet, since they have a direct effect on the Bank's liquidity and profitability and give a more accurate reflection of the magnitude of business operations (Capital Intelligence, 1998; cited in Abdul Karim, 2001: 178).

Moreover, the current accounting treatment of *ijarah wa iqtina* or *ijarah muntahia bittamleek* (Islamic hire purchase) in Malaysia is based on IAS hire-purchase standards. Nevertheless, it is different from the hire purchase method employed by conventional financial institutions (Rules, 2000). This is because there is no *Shari'ah* law evident that regulates the process of Islamic hire purchase exactly; therefore, in Malaysia any institution offering this facility tends to impose its own rules based on the *Shari'ah* principle and in the spirit of the Hire Purchase Act 1967 and Contract Act 1950 (Tag El-Din and Abdullah, 2007). Conversely, in a double banking system, it is evident that Islamic hire-purchase is confronted by similar challenges in adjusting to the conventional system which has been in place for a lengthy period of time, as several conventional practices are in conflict with the principles *of Shari'ah*, which means that these aspects are unacceptable. As a result, promoting harmonisation between conventional and Islamic regulations might be the most appropriate solution to avoid redundancy of laws in the Islamic banking system.

4.8 CONCLUSION

This chapter has sought to raise a number of important issues that surround the impact of the Islamic worldview on shaping the accounting system. It began by discussing the rationale for Islamic accounting and explaining the reason for the need to develop a specific accounting model that may serve Islamic societies better. It also attempted to answer the question of how the Islamic worldview would affect the choice of particular accounting and reporting policies in everyday life by including a literature review of writing on Islamic axioms, such as *falah*, *tawhid*, *al-'adl wa al-'ihsan, khilafah, tazkiyah*, and *maqasid al-Shari'ah*, although the effect of religion has rarely been investigated at the organizational level. This chapter further discussed the history of Islamic accounting defining the term Islamic accounting and explaining the development of the accounting system in the early Islamic State and how it has contributed to development of the modern accounting system.

Furthermore, this chapter has explored the Islamic financial principles and how these principles are different to conventional practices and financial modes and instruments affecting the existence of Islamic accounting practices. For example, it is argued that PLS type instruments, namely *mudarabah and musharakah*, as well as debt based products, such as *murabahah* would affect accounting practice in Islamic banks as they need special treatment to be *Shari'ah* compliant, otherwise, it is sensible to assume the adoption of IAS. Nevertheless, as discussed in this chapter, Islamic principles influence the view of transactions in Islamic banks, which in turn can reflect on the form of accounting practice and regulation. This can be seen clearly from the comparison between the AAOIFI's accounting standards to treat Islamic financial instruments and IAS that some Islamic banks are applying to treat those instruments.

It is interesting to note that there has been disagreement between Islamic banks on whether to treat investment accounts on the balance sheet and report them as part of equity (according to IFS 1) or to treat investment accounts as 'fiduciary' investments and report them as off-balance sheet items (according to IAS 30). In the example of the FIBB bank changing the accounting treatment from IAS' to the AAOIFI' standards made profitability ratios, for instance the return on average assets more meaningful. In addition, treating unrestricted investment accounts on balance sheets would provide a more precise image of the degree of business operations.

CHAPTER 5

RESEARCH METHODOLOGY

5.1 INTRODUCTION

In the previous chapters, existing literature on Islamic accounting and harmonisation of international accounting financial reports, as well as the impact of environmental factors on accounting development is reviewed. This chapter provides an explanation of business and accounting research methodology that is adopted in this study, and starts by defining the term ‘research’ and subsequently, examines the methodology of research. This chapter also presents the data collection method used (secondary and primary data) indicating their types, sources and advantages for data gathering. Moreover, the details of the researcher’s justification of why a qualitative methodology using a questionnaire was selected as primary data collection for this study are discussed. To determine the most suitable way to analyse data, this chapter discusses how the research data will be analysed statistically. This is followed by discussion of the limitations and challenges of the research methodologies.

5.2 DEFINING RESEARCH

Fundamentally, research is an action which every one of us participates in, in order to study and discover more in relation to the environment and the influence we have upon it. Research is a common word that involves any type of investigation, such as ‘academic’, ‘scientific’, ‘fundamental’, and ‘applied’ with the aim of discovering answers to valuable questions by means of a methodical and technical method (Saunders, *et al.*, 2007). The term ‘research’ contains two syllables, *re* and *search.* The meaning of the first syllable is to do it all over again, whereas the second syllable is to investigate methodically, or to examine. Both syllables are derived from ‘form’ a noun “describing a careful, systematic, patient study and investigation in some field of knowledge, undertaken to establish facts or principles” (Kumar, 2011:7).

Furthermore, research is a procedure of gathering, analysing and interpreting data to find answers to the research questions. Nevertheless, there are some steps that should be considered during the process, for instance controlling the research as far as possible; moreover, it should be legal and confirmable, rigorous, methodical, experimental and critical (Welman *et al.*, 2005; Kumar, 2011). Saunders, *et al.*, (2007) also argue that research has a number of characteristics that involve 'systematic data', 'systematically interpreted data' and 'clear purpose to find things'.

Based upon this brief discussion above, it could be argued that the determination of research is to uncover solutions to problems that have not been discovered by using technical processes mentioned earlier. Thus, it is only through research that we can make progress and new contributions to existing knowledge in a subject. Saunders *et al*., (2003), state that research needs to be planned carefully to ensure that relevant and up-to-date literature is located. This will establish what research has already been performed and previously published in the particular area of research under study.

Based on such qualifications, Redman and Mory (1923:10) define research as "a systematized effort to gain new knowledge". It is also defined as "the process of finding solutions to a problem after a thorough study and analysis of the situational factors" (Sekaran, 2003: 3). In addition, Smith and Brown (1995:68-69), and Riley (2000:7) referred to research as an investigation to study what leads to the discovery of facts or expands knowledge in specific areas. Furthermore, in a comprehensive manner, Saunders *et al.*, (2003, 2007) define it as the methodical examination of a topic which is aiming to discover new information including interpretation of any relationships between the topics' constructs (hypothesising). Overall, although there are many definitions of research, they are generally considered as rational and methodical exploration for new knowledge and valuable data on a specific subject. Consequently, the study undertaken in this thesis should be considered as research, as it aims to uncover certain unknowns (participants' understanding of the accounting issues in Islamic banks and financial institutions) in a particular area (accounting issues in Islamic banks and financial institutions).

5.3 RESEARCH METHODOLOGY

The term methodology refers to the general method of the investigation procedure, from the hypothesis construct to gathering and analysing the data.

It should be noted that since "like theories, methodologies cannot be true or false, only more or less useful" (Ragsdell *et al.*, 2002:140), methodology is the process of selection of a specific system of methods followed by a particular discipline (Hussey and Hussey, 1997). Thus, research methodology is how we conduct our research (Saunders *et al.*, 2007). Methodology is more complex than method; therefore the researcher should determine factors, such as the research question and level of evidence, prior to making a decision regarding the result (Saunders *et al.*, 2003; Crotty, 1998). Welman *et al.*, (2005), claim that research methodology reflects and explains the reason for research approaches and methods. They added that the scope of research methods is narrower than the scope of research methodology, for example views and surveys, which makes research methodology have more scope than research techniques (Welman *et al.*, 2005).

It has been argued that social research can be characterised into two main approaches, namely 'qualitative' and 'quantitative'. Both terms have a wide range of use in management and business studies to distinguish each of the data collection methods and analysis processes (Saunders *et al*., 2007).

Quantitative research is used widely in social sciences, such as economics, as well as finance and accounting. It is "a planned technique for merging particular experimental observations with the deductive logic of the individual with the purpose of determining and confirming a combination of probable casual rules that could be utilized to predict overall designs of social activity" (Neuman 1997:63 cited in Cavana *et al*., 2001). Additionally, Creswell, (1994) defined quantitative research as a form of investigation, which could be used to describe a situation by gathering numeral information which are examined by using statistical systems. Furthermore, according to Cohen *et al.*, (2011), quantitative research is defined as a public investigation, which uses experimental approaches and experiential reports based on the real world by discarding the situation, as it is rather than what the situation must be.

In contrast, qualitative research is interested in a qualitative situation, such as a situation related to kind or quality. Furthermore, this type of research is an area of investigation in its own right that mostly emphasises arguments and words, and aims to acquire the richness and difficulty of social knowledge and experience (Mason, 2002; Neuman, 2006), as it relates to behaviours, opinions and perceptions, which are socially constructed. Denzin and Lincoln (2008: 3) provide comprehensive definitions describing what qualitative research is about and define it as (Denzin and Lincoln, 2008: 3);

> A situated activity that locates the observer in the world, it consists of a set of interpretive, material practices that make the world visible. These practices transform the world. They turn the world into a series of representations, including field notes, interviews, conversations, photographs, recordings and memos to the self. At this level, qualitative research involves an interpretive, naturalistic approach to the world. This means that qualitative research study things in their natural settings, attempting to make sense of, or interpret, and phenomena in terms of the meaning people bring to them.

Creswell (2009) and Zikmund and Babin (2010) argue that in most cases qualitative research is used in experimental projects to discover and measure the meaning of individuals and groups or human difficulties. Usually, exploratory design might be required to progress the thoughts that lead to the hypotheses of the research.

It can, therefore, be argued that, there are genuine differences in principles that separate quantitative and qualitative research, although they complement each other. Table 5.1 summarizes the main differences between the two approaches.

Table 5.1 Differences between quantitative and qualitative research

Quantitative Research	Qualitative Research
Reality is objectives and singular, and apart from the researcher	Reality is a subjective and multiple, as seen by participants in as study
Researcher is independent of that being researched	Researcher interacts with that being researched
Researcher is assumed to be value-free and unbiased	Researcher is value-laden and biased with values generally made explicit
Theory is largely causal and deductive	Theory is can be causal or non-causal, and is often inductive
Hypotheses that researcher begins with are tested	Meaning is captured and discovered once the researcher becomes immersed in the data
Concepts are in the form of distinct variables	Concepts are in the form of themes, motifs, generalisations, taxonomies
Measures are systematically created before data collection and are standardised	Measures are created in an ad hoc manner and are often specific to the individual setting or researcher
Data are generally many cases or subjects	Data are in the form of words from documents, observations and transcripts
There are generally many cases or subjects	There are generally few cases or subjects
Procedures are standards, and replication is assumed	Research procedures are particular and replication is rare
Analysis proceeds by using statistics. Tables or charts, and discussing how what they show relates to hypotheses	Analysis proceeds by extracting themes or generalisation from evidence and organising data to present a coherent, consistent picture.

Sources; Neuman (1997: 14); Cavana *et al*, (2001: 35); Cresswell (1994: 5)

As for the reasons for using qualitative research, Kane and O'Reilly-De Brun (2001) state that it can be used for several reasons, for instance understanding the meaning of material which has been gathered via quantitative techniques, demonstrating and fleshing out results from quantitative research, obtaining an initial image so that the researcher has sufficient information to improve his or her plans and, finally, questions, and ruling out hypotheses.

With regards to this study, given that research methodology refers to the overall philosophical frame within which the research is located, this research is framed as ‘qualitative research’, as it aims to explore the perceptions, opinions, and behaviours of the participants in a particular area. Therefore, the research questions established by the study are important, and also practically the advantages of such a methodological frame listed by Saunders *et al.*, (2009) are also considered:

(i) Assists understanding of how and why;

(ii) Allows researchers to study changes which occur during the research process;

(iii) High quality of understanding social processes.

Thus, to recap, this research applies a qualitative research frame to explore how and why Islamic institutions are still using IFRS, although they have Islamic accounting standards, specifically AAOIFI and IFSB. This is undertaken through the perceptions and opinions of the participants sampled from the Islamic banking and finance sector including accountants through a questionnaire survey, and hence, this study is identified as qualitative research. Having the motivation for the study as ‘exploration’ also enables this study to be framed within a qualitative research methodology.

It has been argued that a qualitative approach and case studies offers an influential method for exploration in business and management topics, in addition to accounting (Flick, 2007). Therefore, this methodology is expected to facilitate the achievement of a high quality understanding of the accounting practices implemented and of the related issues in those institutions.

5.4 RESEARCH DESIGN

Research design could be considered as the strategy, the plan of study that is used to answer the research objectives along with the procedure of collecting and analysing the data (Gray, 2009); to be precise, it is the structure of conducting a research project. Moreover, it gives direction and systematizes the research, whilst answering the questions: How can the answers to the research question be obtained and hypotheses tested? (Kerlinger, 1973; Allison *et al.,* 2000:4; Bryman, 2008). According to Yin, (1989: 29) research design "deals with a logical problem and not a logistical problem", adding that design is a rational duty taken to confirm that the evidence gathered allows us to find a solution to questions, or to examine philosophies, as correctly as possible (Yin, 1989).

There are different types of designs, which are used in any research. Some of the most commonly used designs are case study design, comparative design and survey design (Welman *et al.*, 2005; Bryman and Bell 2011). Before discussing the types of research designs, it is essential to learn and understand the role and the reasons for research design; in addition, it is important to understand what research design is.

The term research design has been defined in numerous ways by several authors; however, none of the definitions provide the complete features. For instance, Luck and Rubin (1987), state that research design is the purpose and declaration of the overall research method, the approach applied/or the specific plan. In addition, research design is an effective structure of the research, which specifies what data should be gathered and analysed, from what type of source and by which process. It is the requirement of approaches and processes to obtain the information required and it constitutes the design for gathering, measuring, and analysing the data (Cooper and Schindler, 2003; Green and Tull, 1988; Bryman and Bell, 2007; Bryman, 2011).

In a functional manner, Christensen *et al.*, (2011) defines research design as the process of planning, designing and strategy, which apply in searching for answers to the research questions. In other words, it a special design that indicates how to gather data and analyse it. Design is a strategy for choosing the sources, it is a structure for identifying the relationship between the research variables, and it is a plan which summarises each process from the hypotheses of the data analysis. If the researcher has created a 'good' research design, then more valid conclusions and inferences may be drawn from the work (Cooper and Schindler, 2003). Therefore, choosing the research design has to be consistent with the nature, aims and the method of the study.

As listed below, there are different research designs that can be used in research, as each design has advantages and disadvantages. They are as follows:

5.4.1 Case and Field Research Design

Case study designs are defined in various ways and there is no standard definition. However, perhaps the most common definition is established by Scapens, (1990), Robson (2002) and Yin (2009) who claim that a case study is one of the approaches that can be used in research, which includes an experimental analysis that explores modern phenomenon within its actual life context, while the borders between context and phenomenon are not fairly obvious, and in which various sources of data are employed.

Ryan *et al*., (2002) state that this type of approach has become popular and an applicable research process in accounting research, since it offers investigators the chance to consider the nature of accounting in practice, with regards to how it is used, especially when little is known about a phenomenon. Moreover, Maanen (2000), and Remenyi *et al*. (2005), remark that researchers could use the case study to create reliable and effective evidence, as well as using it as a method to establish a narrative explanation of the situation being researched.

Furthermore, researchers in accounting can use the case study in order to describe the determinants of existing accounting practice and to discover the application of new processes (Smith, 2011). This study also describes the accounting system and practices in Islamic banking and finance institutions, and whether they use Islamic Accounting standards (AAOIFI and IFSB) or use International Financial Standards Reports (IFRS).

Saunders, *et al*., (2007: 139), Benbasat *et al*., (1990: 370) note that there are three reasons for the case study to be feasible:

1. It is essential to explore the phenomenon in its ordinary location;
2. It has significant skill to create solutions to ‘why’ and ‘how’ enquiries, in order to comprehend the difficulty and the nature of the procedures taking place;
3. The case study can be used in a study piloted in a place where limited, if any, prior research has been conducted.

Ryan *et al*., (2002) distinguish five different types of accounting case study. However, the choice of a proper design for the research depends mainly on the nature of the aim and objectives, in addition to the research questions that the study seeks to answer (Hakim, 1987; De Vaus, 2001). The following are some of the different types;

5.4.1.1 Exploratory case studies:

As one of the research strategies, exploration is heavily used or heavily related to qualitative techniques rather than quantitative, which is the nature of this study (Cooper and Schindler, 2003). Exploratory case studies are mostly primary data based studies, planned to produce concepts and hypotheses for difficult experimental analysis at an advanced stage. The exploratory case study is a first step in subsequent research that in this case, aims to produce generalisations concerning Islamic accounting practices (Ryan *et al.*, 2002; Smith, 2011). Hence, it should be noted that this study is an exploratory case study observing the type of accounting standard employed in the selected IFIs and whether IFRS is consistent with Islamic financial instruments, such as *murabahah*, *mudarabah*, *musharakah*, takaful, *ijara*, *etc*.

5.4.2 Descriptive or Survey Research Design

The purpose of this design is to clarify and describe present situations by applying several topics and questionnaires to explain the phenomenon in full. Its purpose is to collect primary information using different methods, for instance telephone, face-to-face, online or email. Therefore, a survey can be defined as a technique that utilises communication in gathering primary data with a typical sample of individuals (Zikmund and Babin, 2010). Survey research design is usually associated with a deductive approach and quantitative findings, given that most surveys are descriptive research (Saunders *et al*, 2007).

5.4.3 Exploratory Research Design

The purpose of exploration design is mostly to discover something new in any topic, in any field, and most of the time attempts to highlight any unidentified areas of knowledge (Cooper and Schindler, 1998). This type of design is mainly beneficial when investigators are aware of the challenges they can face throughout the research, or when they do not have enough information on how similar difficulties or study subjects have been previously solved (Cavana *et al.*, 2001). In addition, it can help researchers to create new areas in sciences and help them to recognise the difficulties of those specific research disciplines. Moreover, it can be used to investigate how and why particular accounting practices are adopted (Smith, 2011).

These idea settings one of the important purposes why an exploratory study is suitable for the research designs of this PhD thesis. The aim of this research is to explore the accounting problems that exist in the IFIs due to the various accounting practices that based on IFRSs or local GAAP which were issued for conventional institutions. Furthermore, exploratory research is beneficial as theory as a background to the subject has not been developed yet (Collis and Hussey, 2003). In other words, the academic background for this study based on Islamic accounting, as a sound academic foundation for the employment of AAOIFI and IFSB have not yet developed globally. In addition, and importantly, since this study examines the subject matter through the perceptions and opinions of the participants; by definition, hence, it is an exploratory case study based on cross-sectional questionnaire-survey research.

5.5 RESEARCH STRATEGY

'Research strategy' is described as how a researcher aims to adopt or to implement to be able to finish research (Biggam, 2008) in terms of establishing a connection between theory and data. In a functional manner, the term of research strategy has been defined as the process of gathering philosophical and theoretical knowledge which might impact on judgments taken regarding the design for research, and the selection of particular approaches to gather and analyse data (Gravetter and Forzano, 2003).

Selecting the relevant research strategy is often determined by the type of research questions the study is aimed at and the sort of results, which research aims to generate (Gravetter and Forzano, 2003). Therefore, choosing the correct research strategy for any study or project is of great importance. As Fitzpatrick (1998) suggested, this should result from a careful examination of the most meaningful and useful methods for the desired outcome of the research. Normally, two types of research methods are addressed, specifically deductive and inductive (Fitzpatrick, 1998).

While the deductive approach starts with progress of philosophy, hypothesis, observation over information and data, and confirmation, the inductive approach starts from the last stage of the deductive approach and subsequently, moves back to the first stage as follows; observation, design, hypothesis and finally, the philosophy (Saunders *et al*. 2009).

According to Crowther and Lancaster (2009), inductive strategy is the method used to work through a particular suggestion, in order to generalise the phenomenon, as per the study subject that is related to the phenomenologist model. As there is no responsibility for a pre-defined philosophy to collect information and data, it tends to let the data lead to the emergence of concepts**.** Therefore, it is claimed that inductive research is a flexible approach (Collis and Hussey, 2003; Yin, 2011).

Since this research is an exploratory research in nature, as it aims to investigate what specific perceptions (feelings and thoughts) are established through the accounting practices in Islamic financial institutions, it is constructed within inductive research strategy rather than theory examining, since this owes more to a phenomenologist position that allows the reality of research from feeling, intention and action, and places emphasis on the excellence and depth of data (Arbnor, 1997). In other words, perceptions and opinions of the participants collected through the research field will be the starting point which helps to generalise the observed matters; and hence this study follows the indicative strategy.

5.6 RESEARCH METHOD

Research method means the process that determines which data and information data can be gathered and analysed. Thus, it can be defined as actions and instruments used in choosing and constructing a technique to gather data, such as observations, questionnaires, interviews, analysis of records, *etc.* (Kothari, 2008).

According to Collis and Hussey (2003), if the researcher is aiming to study phenomena, the researcher would use different research methods in the form of qualitative and quantitative method or a mixture. Cavana, *et al.*, (2001) argue that under a phenomenological pattern, researchers use the research methods which are linked with the moulds and the approaches of the paradigm which permeate the full research design. Regardless of which philosophy the researcher follows, most of the time there would be a mixture of qualitative and quantitative contributions in the researcher's data creating actions, as qualitative and quantitative methods for data collection have a combination of advantages and disadvantages (Collis and Hussey, 2003).

It should be noted that this study mainly benefits from the quantitative method of data collection and analysis; as questionnaires will be used to collect primary data. However, the research process is detailed as follows:

5.6.1 Research Method: Data Collection

"Data collection is not just a process of collection; it is also a process of creation - of using information in unique ways related to the purpose of the study" (Birley and Moreland, 1998; 40). Accordingly, before delving into further issues regarding the research process, it is important to know what data are. According to Yin (2011) the term 'data' can be referred to as the gathering of structured information, containing words, statistics, images or figures, mainly as measurements or examination of a group of variables. In relation to this, data collection is a terminology applied to define a procedure of arranging and gathering information. Simply it is how information is gathered (Collis and Hussey, 2003). It should be noted that collecting data is a vital feature of any kind of exploration study, as incorrect data collection could influence research findings and eventually lead to inaccurate results.

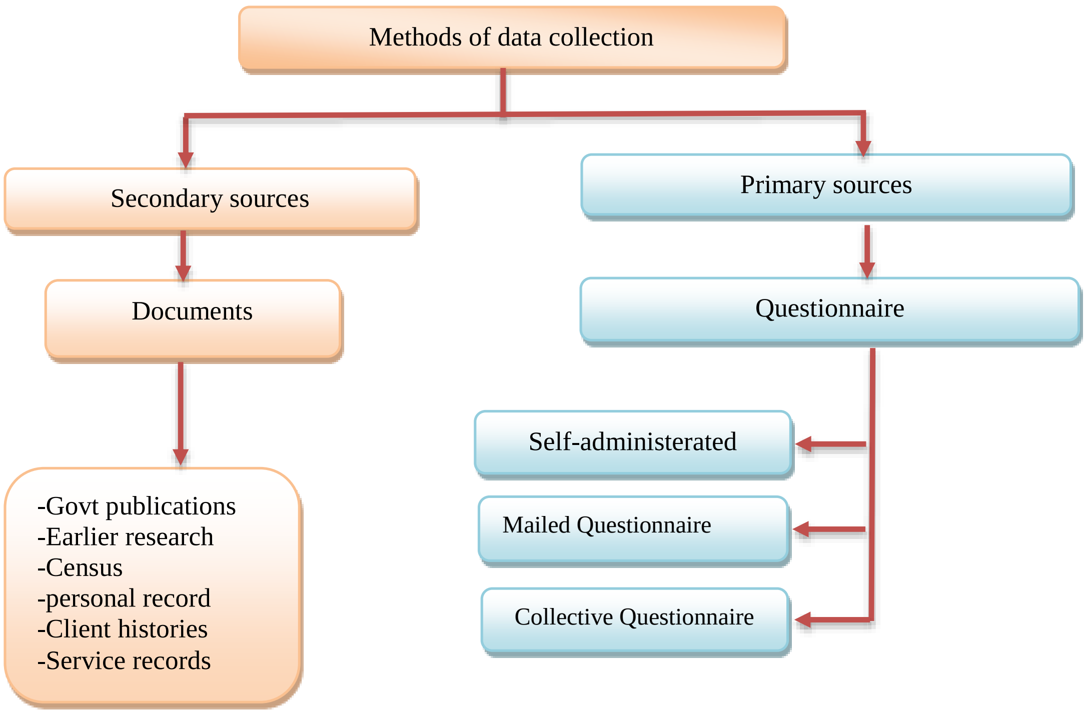
Kumar (2011), states that we can use both quantitative and qualitative data collection and analysis methods. However, "the choice of data collection techniques is to a large extent shaped by the nature of the research questions and all these techniques can yield enormous amounts of evidence" (Ragin, 1994: 26). There are two types of data described as qualitative data concerned with qualities and non-numerical characteristics and quantitative data which can be categorised as separate data or continued data (Collis and Hussey, 2003).

5.6.1.1 Methods of data collection

Data can be collected from various resources, including people as primary and documents as secondary data (Blaikie, 2000; Sekaran, 2003). Figure 5.1 identifies the data types and their sources.

As noted by Eriksson and Wiedersheim (1999) secondary data, contains materials, figures, information and statistics that was previously available, such as the information gathered or created by others, and possibly for a different aim. Secondary data also involves a review of the literature. Cottrell and McKenzie (2011), state that the literature review is essential to identifying the study's problem, which could be answered by data collection. They added that the literature review would enable the researcher avoid the repetition of any research and avoid the mistakes that have been made previously. Therefore, the researcher could develop the instrumentation and the design for their research that was not successful before.

Figure 5.1 Methods of Data Collection



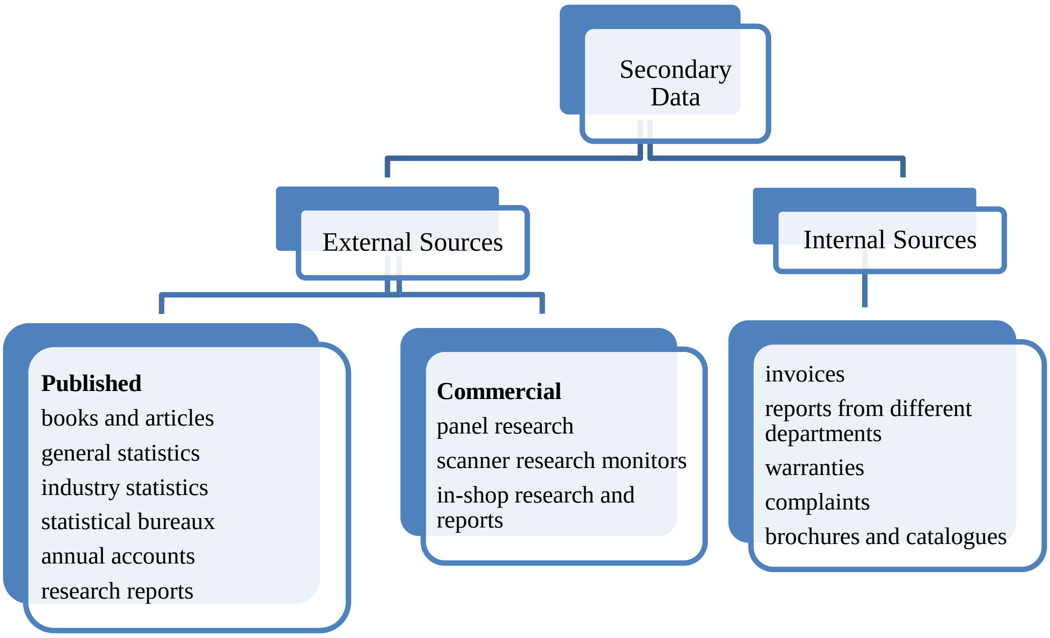
Source: Kumar (2011:139) (Modified Version).

According to Lekvall and Wahlbin (1993), there are two main sub groups of secondary data; specifically internal and external. While the former are data that is accessible inside the organisation, the latter are data supplied by sources outside the organisation.

As for the sources of secondary data, in practice, collecting secondary data usually means 'library' or 'desk' research. The researcher can obtain the data from external sources or from the material which is regularly gathered by the planning organisation. There are different sources for secondary data, for example books, journals and other materials in libraries, the internet, newspapers, reports from organisations or companies, museums, *etc*.

As can be noted in Figure 5.2, the sources of secondary data collection fall into two main categories;

Figure: 5.2. Secondary Data Sources



Source: Ghauri and Gronhaug (2010: 97)

As for this research, the researcher used the library at Durham University as well as the library's on-line system to access electronic journals and articles related to the research problem. In addition, the researcher used several regional libraries, including the libraries of Newcastle and Northumbria universities, in order to search for publications regarding the harmonisation of International Financial Reporting Standards (IFRS) and Islamic Accounting.

Accordingly, it became apparent that there had been considerable research conducted into this topic in relation to conventional finance and accounting; therefore, there were a large number of textbooks, journals and articles covering the area of research which had to be reviewed. However, in relation to Islamic finance and accounting a limited number of materials were available. Furthermore, as the study examined Islamic accounting and accounting standards developed by AAOIFI and IFSB and the potential issues with regards to international harmonisation, it was necessary to review several issues relating to this topic, such as regulations and standards that were issued by accounting and auditing organisations for Islamic finance institutions, as well as the regulations issued by International Financial Report Standards.

As for primary data, according to Ghauri and Gronhaug (2010) the researcher has to collect the data which is related to the study when the secondary data are not available or cannot answer the research questions. Therefore, primary data can be defined as data gathered and used for the first time, and normally collected by direct investigation (Eriksson and Wiedersheim, 1999). Moreover, Sekaran and Bougie (2009) remark that primary data can be defined as first-hand information that is acquired by the investigator on the interested variables, for the particular aim of the research. Furthermore, Blaikie (2000:184) states that:

> "Primary data can come from many sources, they are characterized by the fact that they result from direct contact between the researcher and the source, and that they have been generated by the application of particular methods by the researcher. The researcher, therefore, has control of the production and analysis, and is in a position to judge their quality".

Primary data has many advantages with the main one being that this type of data is gathered for the specific study at hand. This makes primary data more reliable, in relation to the research questions of the study and its objectives. However, primary data also have some disadvantages with the main one being the long time that the primary data might take to be collected, in addition to being very expensive to gather (Ghauri and Gronhaug, 2010). This study also gathered primary data through the use of a questionnaire survey, as detailed below.

Saunders *et al.,* (2009) claim that in most cases the researcher uses a mixture of primary and secondary data to answer the research questions. They added that the researcher has to rely mainly on data s/he gathers whenever the secondary data available are limited.

In business and accounting research, most investigators have to gather some primary data in order to find solutions to the research questions. After the investigator has chosen to gather data using primary methods, they have to choose the data collection methods that should be used (Ghauri and Gronhaug, 2010). Primary data can be gathered through several methods. The researcher should choose the method depending on the reason for the study, the resources at hand, and the abilities and skills of the researcher (Kumar, 2011). Table 5.2 below demonstrates the differences between secondary and primary data.

Table 5.2: The Differences between Primary and Secondary Data

	Primary	Secondary
Definition	This research is data that you collect.	This research is data that someone else has collected
Sources	A primary source is an original document containing first and information about a topic	A secondary source interprets and analyses primary sources. Secondary sources are one step removed from the event. The most important feature of secondary sources is that they offer an interpretation of information gathered from primary sources.
Source Examples	• Diaries • Interviews • Letters • Original works of art • Photographs • Works of literature	• Biographies • Dissertations • Indexes, Abstracts, Bibliographies • Journal Articles • Newspapers

Sources: Ghauri and Gronhaug (2010:110)

The main method of primary data collection for this research is the questionnaire, which was utilized in this study, and is explored and described as a research process in the following sections.

5.6.1.2 Data collection method: questionnaire

Sharp and Howard (1996) and Sekaran and Bougie (2009) state that over the past century, questionnaires have become a popular method of collecting data, given that they are an effective method for gathering data, if the investigator knows exactly what type of information is required and how to determine the variables of interest.

The questionnaire as a research method is defined by several authors: Among others, Sekaran and Bougie (2009: 197) define the questionnaire as “a pre-formulated written set of questions to which participants record their answers, usually within largely closely defined alternatives”. In addition, Collis and Hussey (2003: 173) provide a more general definition: “a list of carefully structured questions, chosen after considerable testing, with a view to eliciting reliable responses from a chosen sample. The aim is to find out what a selected group of participants do, think or feel”.

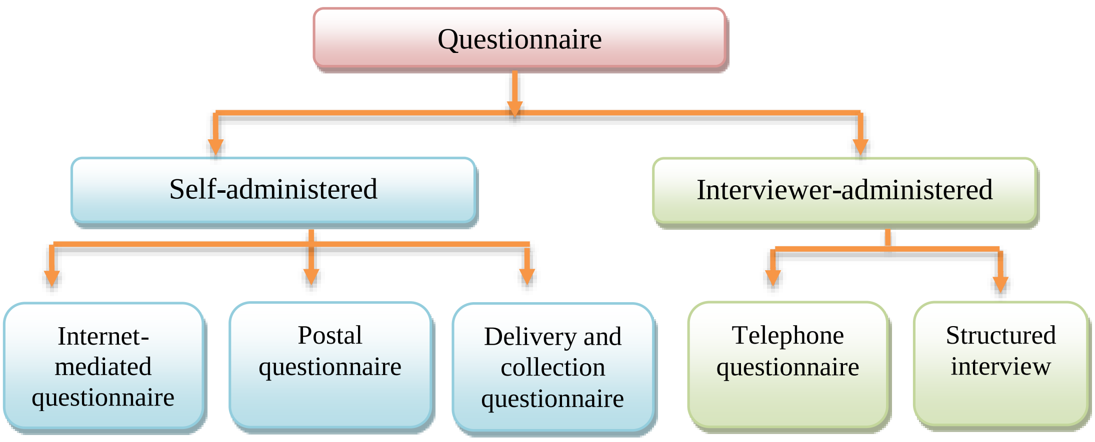
Since this study aims to explore perceptions, opinions and attitudes from samples from various parts of the world, the questionnaire is considered to be an efficient method of data collection. Having exploration as the motivation, by definition requires using the questionnaire as a method.

5.6.1.3 Types of questionnaire

Questionnaires can be categorized according to the way they are administered, and by the method of delivery or the quantity of contact the researcher has with the respondents. Figure 5.3 details types of questionnaires. As can be seen, in general there are two main types of questionnaires; each is designed to discover a variety of features or extract different responses. Some of the more popular include: the personally completed questionnaire or the 'self-administered' questionnaire completed by the respondents *i.e.* the postal or mail questionnaire, that it is sent and returned via post/email after completion by the respondents. Moreover, the self-administered questionnaire can be sent online using the internet or email (Bryman and Bell, 2011; Saunders, 2009).

There are various methods by which questionnaires can be administered; one that can be mentioned is hand to hand delivery to each respondent and subsequently, collecting the questionnaire later on. Questionnaires can also be administered by contacting the respondents by telephone. Moreover, the structured interview is used where the interviewer meets respondents face to face (Saunders *et al*., 2009).

Figure 5.3. Questionnaire Types



Source: Saunders *et al*, (2009: 363).

As for this research, online questionnaires via email were employed, as the researcher believes that the main advantages of this method is that it is very easy to manage and less costly than postal surveys, and moreover, people are more likely to complete an email questionnaire as opposed to a postal questionnaire. In addition, this study had samples from across the world, which implies that it was not possible to contact all the sampled Islamic banks through personally administered questionnaires. Bryman and Bell (2011) support this particular method and thus, remark that the postal or emailed questionnaire with a sample which has a geographical spread is the most efficient self-administered questionnaire.

5.6.1.4 Questionnaire design

It has been argued that in order to overcome the difficulties of weak response rates, in relation to questionnaires sent by email, it is essential to make the design of the questionnaire appear clear and as short as possible by making the space and margins between questions reasonable. In other words, it is very important to make sure that the questionnaire has a design that is easy to read and relevant to the participants. This could be reached by choosing the right fonts, italics, bold and capitals where ever applicable. This means that it is essential to use one style for general instructions. For example, one for questions, one for headings and one could be for close-ended answers (Bryman and Bell, 2011).

Moreover, Thomas (2004) argues that in order to avoid problems in obtaining appropriate and significant answers to survey questions, it is essential to use very clear language and phrasing, since unclear terms can be vague, ambiguous or inexplicable to respondents. By following the advice, this research made sure that the questionnaire was efficiently designed to help the respondent to explore its construct, which can be seen from the sample questionnaire schedule provided in the appendix section.

Another important point, which should be taken into consideration in designing the questionnaire, is how to arrange the fixed answers; horizontally or vertically? This is especially important in the ranking questions, where the vertical format is preferred, since employing this design as a horizontal format could confuse the respondents. Nevertheless, the horizontal design is more likely to be preferred in a Likert scale format, as the vertical format can take too much space, which makes the questionnaire appear too lengthy (Saunders *et al*. 2009; Bryman and Bell, 2011). This again was taken as advice when designing the questionnaire in this study, with the aim of increasing efficiency in terms of completion.

Another design issue is in relation to the response designs; it is expected that the researcher has to be clear about the way he/she wants participants to reply in the case of closed answer questions. It is important to clarify whether they are supposed to place a circle or a tick for the appropriate answer. Moreover, the design of the questionnaire should always be obvious about which questions require one answer and which ones need more than one answer (Bryman and Bell, 2011). As the questionnaire in this study was administered online, by definition the respondents use the ticking option, which is an efficient way of organizing the administration of the questionnaire.

In conclusion, in this study the researcher considered the recommendations mentioned above while designing the questionnaire. The questionnaire in this study clearly arranged the closed questions vertically, as well as indicating wherever, which questions have one and multiple answers. Importantly, the Likert scale format was arranged horizontally to appeal to the respondents, as it is recommended that this can help to save some space, and in turn the questionnaire will appear shorter.

5.6.1.5 Questionnaire structure

It is important to consider that we can increase the number of respondents by constructing a high-quality questionnaire. In order to make the survey flow smoothly it might be a good idea to include filter questions. One way of doing this is to design the questionnaire, with the choice of skipping the questions that are not applicable to respondents (Saunders *et al*. 2009). According to Bryman and Bell (2011:238) "far more important than making the questionnaire appear shorter than is the case, is to make sure that it has a layout that is easy on the eye". The questionnaire should attract the participants, and should encourage them to complete and return it. This point can be obtained by using analysis software, such as 'Sphinx Development' 'Snap' and 'Survey Monkey' which have a sequence of style patterns for typefaces, page layout and colours that might be more helpful in constructing professionally-looking questionnaires (Saunders *et al*., 2009).

In this study, 'Survey Monkey' software was used to construct and design the questionnaire. The questionnaire was designed to ask about four different areas; therefore, it was divided into four main sections (see appendix). Alreck and Settle (1995:153) claim that "the most effective questionnaire is the one in which has its items grouped into sections". Hence, the four sections in the questionnaire for this study were grouped into related information. The first section asked participants about general background information and contained nine main questions, for instance age, gender, position, professional qualifications, academic qualifications, experience, location of where their IFI is operating, and the nature of their institution.

Section two focused on specific information, in relation to participants and was divided into two parts. 'Part A' attempted to collect data about financial reporting standards in the institutions the respondents worked for, while 'Part B' asked participants about Islamic accounting standards in terms of awareness, knowledge and practice. 'Part A' also contained seven questions seeking to gather information with regards to respondents knowledge of IASB and its main objectives, and moreover, whether these objectives take the special needs of IFIs into account or not. 'Part B', however, contains thirteen questions, with each question aimed at seeking different information related to Islamic accounting standards, which are employed in their institutions and how these standards treat Islamic financial instruments such as *ijara, murabahah, musharakah, etc*. Section two of 'Part B' also aims to investigate the respondents' perceptions regarding factors that might distinguish Islamic accounting from conventional accounting by using the Likert scale format.

Section three was designed to obtain information about the importance and the role of AAOIFI accounting standards, and consisted of twelve statements carefully designed to ask participants' opinions about making these standards mandatory for IFIs, as they will increase the accuracy and the comparability of the financial information of IFIs. It was also designed to examine perceptions about the idea of harmonising the AAOIFI accounting standards with IFRS' to work together for the IFIs, as IFRSs did not satisfy the needs of the IFIs. The fourth and final section was designed or constructed to determine the opinion of the respondents in relation to the factors that presented as barriers to employing IFRSs in the IFIs. It should be noted that eight statements were enclosed in this section, which aimed to explore the reasons for the differences between Islamic culture and other cultures of Islamic finance.

5.6.1.5.1 The order of questions on the questionnaire

The order of the questions on the questionnaire is one of the most important steps to consider in designing and structuring the questionnaire. Thomas (2004) claims that question order is one of the important elements in securing appropriate and essential answers to survey questions. Therefore, Saunders *et al*., (2009) argue that it is essential to start the questionnaire with straightforward questions that might make the respondents enjoy answering them. Meanwhile, these questions must be relevant to the stated aim of the questionnaire, since it is not fair to waste the participants' time responding to questions which have less value to the research (Bryman and Bell, 2011).

Before sending the questionnaire, it is important to enclose it with a covering letter that clarifies the reason for the survey, as this is the first page that would be read by most of the respondents before they decide whether to participate in the survey (Saunders *et al*, 2009).

As far as the questionnaire schedule used in this study is concerned, it started with general questions to assemble background information about the participants. The second part asked more technical questions relating to another issue (IASB) in part 2A, followed by questions relating to (IASs) in part 2B. Questions in each section were clustered into an understandable order that would make sense to the participants, as in each section questions moved from general to specific and easy to difficult. Saunders *et al*., (2009) stated that it is important to place the questions that are more complex in the middle of the questionnaire, given that at this point the participants should be nearly completing the survey confidently, and be neither bored nor tired.

Moreover, the Likert scale format questions that ask about the opinion of the participants were placed at the end of the questionnaire in part 3 and part 4. The researcher believes that the order in the survey questionnaire followed the required specifications, in order to avoid any confusion among participants and help individual participants to feel comfortable, and in turn he/she can give sensible and clear answers and opinions.

Furthermore, a cover letter as a section in 'survey monkey' provided the context for the questionnaire for the respondents to understand the aims and objectives of this study, so that data could be efficiently gathered.

5.6.1.5.2 Type of questions

Researchers are frequently concerned about which one of those two particular formats they should ask. In general, there are two types of questionnaire questions, closed-ended and open-ended questions: ‘closed-ended questions’ and ‘open-ended questions’.

Closed-ended questions ask participants to respond with either ‘yes’ or ‘no’ answers, although these questions limit the answers, therefore, participants can choose from a list of pre-arranged answers provided in the questionnaire (Collis and Hussey, 2003; Hussey and Hussey, 2003). Using these types of questions makes it easier for the researcher to compare similar responses, in addition, it is easy to code and statistically analyse the data (O'Leary, 2004; Bryman and Bell, 2011).

All the questions in the questionnaire were designed as closed-ended format. This allowed the researcher to ask the participants to make a choice amongst a list of options, such as answering ‘yes’ or ‘no’, or tick the right answer as appropriate. These types of questions make the answers easy to process, since the relevant code could be almost automatically developed from the selected answers. The research also used the Likert scale to test the respondents’ perceptions about several statements and the degree of agreement using the scale from ‘strongly agree’ to ‘strongly disagree’. Such a design explained the meaning of the questions to the participants and improved the comparability of the answers, which means it easily reveals the relationship between variables and in return makes a comparison between respondents (Bryman and Bell, 2011).

When answering complex issues, ‘open-ended questions’ give participants permission to express their personal experience about these sorts of questions. However, the space should be limited, otherwise the answers become off-putting. Open-ended questions can be used in exploratory research, while the researcher is looking for detailed answers to become foremost in the participants’ minds (Cavana *et al*., 2001; Hussey and Hussey, 2003; Saunders *et al.*, 2009). It has been argued that the open-ended format is more beneficial for interview rather than the self-completion questionnaire.

‘Open-ended questions’ ask respondents to answer by using their own expressions. Respondents can put forward any information and any view they desire, even though the size of gap provided for an answer will usually limit the answer. Such questions also permit respondents to answer in any way they prefer (Oppenheim, 1992; Hussey and Hussey, 1997; Cavana *et al*., 2001; O’Leary, 2004). Open-ended questions also give respondents greater freedom to answer the question because they answer in a manner that suits their understanding (Denscombe, 1998; Kelley, 1999; May, 2001; Miller and Brewer, 2003).

Conversely, the open-ended format is not always beneficial. Such questions may be of limited value to the researcher for certain reasons, such as, lack of responses, owing to unclear questions or lack of a prompt; certain respondents being more eloquent than others; responses being hard to quantify, several respondents perhaps needing to give more than one response; and it not being easy to obtain a wide range of views. It should be noted that open-ended questions require more effort on the part of the respondents; thus, although they can produce rich and open data, it may be data that is difficult to code and analyse (Black, 1999; Denscombe, 1998; Collis and Hussey, 2003; O'Leary, 2004).

In this study, only one open-ended question was used, thus, the last question in the questionnaire was left in open-ended form, in order to allow the respondent to comment and to add anything on the topic that might not have been covered or might have been inadequately recorded in the questionnaire.

5.6.1.6 Translation of the Questionnaire

Since the sample for this survey targeted all the IFIs including those ones operating in some locations, such as Libya where the English language is not the official language, it was essential to translate the questionnaire before distributing it in such locations. However, the main form of the questionnaire was prepared in English and distributed using survey-monkey.

The researcher attempted to translate the questionnaire in the most accurate way, by taking the exact meaning of individual words and grammar into consideration, which meant that it could be easily understood by the respondents. In order to achieve the highest level of efficiency, it was necessary to have it checked by a specialist in translation. Therefore, this translation was revised by a PhD student in English language translocation to ensure that all the vocabulary, terms and terminology were understandable and in the correct form.

5.6.1.7 The Sample and the Administration of the Questionnaire

It should be noted that this survey was designed to examine the perception of the IFIs about the AAOIFI accounting standards; therefore, the sample for this study was targeting all the IFIs, such as Islamic banks, Islamic finance institutions, Islamic window as part of a conventional bank, Islamic window as part of a conventional financial institution and *takaful* companies operating around the world. These institutions were selected in view of the fact that they are specialised and have extensive experience in Islamic finance. The survey targeted different levels, for instance Heads of Departments, Financial Managers, Auditor Managers, Senior Accountants, Senior Auditors, Accounting Specialists, Relationship Managers, and *Shariah* Advisory.

Although, the questionnaire was distributed by survey monkey, a number of them were distributed and collected with assistance from some friends who work in Libyan banks that have Islamic windows, while a number of questionnaires were delivered to Egypt, where friends distributed and collected the questionnaires. This process lasted by over nine months running from September 2012 to June 2013.

It should be noted that each institution was required to respond to one questionnaire, since this survey was investigating the accounting system employed in these institutions.

Since emails for the 'internet based questionnaire' (survey monkey) were used in this study, in the first circulation of the questionnaire, 25 respondents replied to the emails, while in the second circulation another 17 institutions answered the questionnaire. In relation to the questionnaires that were distributed hand to hand, 12 respondents replied; 4 of them from Libya and 8 from Egypt. In total, 54 Islamic financial institutions from 18 countries around the world responded. It should be noted that 51% of the sample were Islamic banks; 29% were Islamic financial institutions, whereas the rest of the participants were Islamic windows as part of conventional banks and Islamic windows as part of conventional financial institutions with a total of 20%.

As for pilot study, due to the difficulties in collecting data through questionnaire it was not possible to undertake initial process of piloting. However, the questionnaire structure, contents, questions and language was several times edited and overviewed by a number of colleaugues and friends to overcome any inconsistencies.

It should be noted that the data collection process was rather difficult. It was difficult to reach the number of responses that the researcher hoped to achieve in order to give better understanding of the participant's perceptions, although, 'survey monkey' was used to distribute the questionnaire , as well as personal emails being sent to encourage individuals to participate.

5.6.2 Research Method: Data Analysis

It should be noted as was mentioned earlier in this chapter; this study is restricted within the qualitative research methodology philosophical frame and quantitative research method as an operational frame. In order to develop these data and use it as information, the quantitative analysis technique is required to explore, examine and interpret the data (Saunders *et al*., 2012).

Robson (2011:414) defines quantitative data analysis as "a field where it is not at all difficult to carry out analysis which is simply wrong or inappropriate for your data or purposes. In addition, the negative side of readily available specialise statistical software is that it becomes that much easier to generate elegantly presented rubbish".

Accordingly, to manage and process the data in an efficient and advanced way, SPSS software was utilised. Analysing the data using the SPSS software provides an array of methods that offer incredible assistance in producing the results and interpreting the research findings (Kinnear and Gray, 2009).

Usually, as recommended by Saunders *et al*., (2012), after collecting the completed questionnaire the researcher starts to prepare to input the data into the computer and verify it. First of all, the researcher starts to examine the type of data and whether it is categorical or numerical, followed by which required coding, such as coding categorical and missing data. The next stage is to enter data into the computer correctly by attaching the individual labels to each variable and by associating the codes with each of them, whilst the well-known 'maxim 'rubbish in' and rubbish out' applies. Finally, the data is tested carefully by looking for illegitimate codes, checking irrational relationships, and checking if the rules in the filter questions are followed (Saunders *et al*., 2012).

In analysing the data, initially descriptive statistics are used including frequency, percentage distribution and standard deviation. In addition, in order to give meaning to the descriptive results, the results were ranked according to their mean values in the form of mean ranking. This helps to identify the level of importance given by the participants to each of the statements or issues listed.

Furthermore, the quantitative variables were tested for normality using the Kolmogorov-Smirnov and Shapiro-Wilk test with the objective of determining the nature of statistical instruments to be used, in terms of parametric or non-parametric tests. Table 5.3 provides the results, which indicates the output from the SPSS statistics.

The null hypothesis for this test of normality is that the data are normally distributed.

H0 is rejected if the significance is below 0.05: H0< 0.05 is rejected or assume it is not normality.

H0 is accepted if the significance is greater than 0.05. H0> 0.05 is accepted or assume normality.

As it can be clearly seen from Table 5.3, the significance is achieved, as the normality test is produced 0.000. This means the following: H_0< 0.05 which means H_0 is rejected, as the test of normality is significant at 0.000. As a result, the data significantly deviates from a normal distribution.

Achieving such a result indicates that in terms of the data analysis method, parametric methods will not be used and instead non-parametric tests are utilised. For example this study used the Mann-Whitney test to compare or find the relationship between two groups or variables, whereas, the Kruskal–Wallis test was used for the data that have a nominal and ranked variable to determine if there are statistically significant variations between two or more groups of an independent variable. Moreover, factor analysis was used to examine further perception of the factors that might affect the implementation of IFRS in the IFIs.

Table 5.3: Test of Normality

	Kolmogorov-Smirnov			Shapiro-Wilk		
	statistic	df	Sig	statistic	df	Sig
There is a need for AAOIFI accounting standards due to the particularities of Islamic Finance.	.384	38	.000	.688	38	.000
IFIs should account under the Financial Accounting Standards issued by AAOIFI	.353	38	.000	.742	38	.000
AAOIFI standards must be made mandatory for Islamic finance.	.261	38	.000	.858	38	.000
AAOIFI should protect the Islamic financial institutions from the effect of IFRS	.339	38	.000	.786	38	.000
AAOIFI will increase the accuracy and the comparability the financial information of IFIs	.249	38	.000	.825	38	.000
AAOIFI must globalise its own accounting standards otherwise IFIs should report with IFRS even though it is not suitable for the Islamic environment.	.278	38	.000	.866	38	.000
Harmonising or integrating IFRSs with AAOIFI standards is the best solution for accounting problems.	.376	38	.000	.719	38	.000
AAOIFI should not continue to issue accounting standards if those standards are going to be neglected by the IFIs	.217	38	.000	.888	38	.001
IFRS are applied internationally because the IASB is a neutral body	.298	38	.000	.850	38	.000
IFRS satisfy the needs of conventional institutions and the needs of Islamic Institutions.	.255	38	.000	.885	38	.001
The applications of all IFRS in Islamic financial institutions are suitable for the Islamic environment.	.227	38	.000	.882	38	.001
Reporting with IFRS will cancel the need for AAOIFI accounting standards.	.204	38	.000	.908	38	.004
The cultural environment e.g. religion and morals greatly influence the use of IFRS.	.240	38	.000	.853	38	.000
The nature of Islamic Finance and Islamic Economic system may necessitate of not using IFRS.	.319	38	.000	.845	38	.000
The prohibition of *riba* (interest) has significant implications for using the IFRS.	.247	38	.000	.831	38	.000
The importance of paying *zakat* has significant implications for using the IFRS.	.192	38	.001	.840	38	.000
The IFRS is not consistent with Islamic financial instruments such as *mudaraba, musharaka, ijara, istisna, etc*	.299	38	.000	.841	38	.000
The necessity of reporting with Islamic principles will influence the use of IFRS	.318	38	.000	.825	38	.000
The differences of the Islamic world view calls for a morally embedded accounting system	.355	38	.000	.762	38	.000
IFRS does not consider Islamic business rules, thus IFRS is not relevant to devout Muslim users.	.307	38	.000	.830	38	.000

5.7 LIMITATIONS AND DIFFICULTIES

It should be noted that the researcher faced some difficulties in distributing the questionnaire, which in turn limited the respondents' rate. As was stated earlier, the sample in this study is from all the IFIs operating in all over the world, hence, it was difficult to distribute and collect the questionnaire in person at all the locations. Consequently, the researcher relied on post and emailed a large number of the questionnaires, which affected the number of respondents. Another factor that limited the distribution of the questionnaire was that it was difficult to obtain access to the contacts at all the IFIs, which consequently limited the number of the sample in the first place. Moreover, to be more efficient and professional, Survey-Monkey software was used to distribute the questionnaire via a link when the participant clicks on a given page and when s/he clicks ‘done’ it is returned to the sender. However, this could be a limitation since participants might experience technical problems in opening the link. Overall, the lack of volunteering for academic research from employees of Islamic banks and financial institutions is an issue that has been registered by many as a problem.

CHAPTER 6

EXPLORING PERCEPTIONS ON FINANCIAL REPORTING STANDARDS AND THE BARRIERS FACED IN ISLAMIC FINANCIAL INSTITUTIONS IN EMPLOYING THESE STANDARDS

6.1 INTRODUCTION

The aim of this chapter is to present detailed empirical findings regarding the International Accounting Standard Board (IASB) that issues International Financial Reporting Standards (IFRS) based on the data collected from sampled Islamic banks and financial institutions. This chapter also explores and discusses the factors as the potential obstacles for employing these standards in any Islamic financial institutions (IFIs). As this research investigates the type of accounting system that is applied in the IFIs and the accounting cultural environment that might affect the choice of accounting system, a questionnaire survey, as discussed in Chapter 5, was formulated to develop an improved understanding of the issues regarding the topic.

This chapter examines and presents the findings developed from the analysis of the questionnaire data together with an analysis and discussion of the empirical findings by using the statistical SPSS software. Firstly, it presents the demographic section, which describes the primary overview of the results by looking at frequencies and estimating mean values before moving to inferential statistical analysis which aims to explore the significance of mean differences through non-parametric tests. These include the Independent Samples Kruskal-Wallis Test (KW Test) and the Mann-Whitney U Test (MWU Test). The results and the outcomes of these tests are based on a demographic section that contains independent variables such as ‘age’, ‘gender’, ‘academic qualifications’, ‘professional qualifications’, ‘current position’, ‘working experience’, ‘location’, ‘nature of the institution’ and the variable relating to financial reporting standards which is raised in section two A. In developing the inferential statistical analysis, the numerical significance of control variables in the responses provided by respondents is organised in tables. Each table reveals inferential statistics results in relation to the significance of control variables on the statements relative to the categories in the demographic section.

It should be noted that in order to increase the available results for this chapter, the confidence level in inferential statistical analysis reduced to 90% implying that event the results that are significant at 10% significance level are accepted. In other words, the significant variable should be at .05 (5%) or less, however, in this study the statistical significance level is extended to 0.10 (10%). These specific findings are recognised with the symbols (*) and (**) for statistical significance at a 5% level and for statistical significance at 10% level, respectively.

Finally, this chapter also presents the findings from a factor analysis test, which was applied for question 33 in the questionnaire which includes a number of statements related to the factors that signify the obstacles reported under the IFRS in the IFIs. The aim of this test is usually to reduce the amount of variables used to clarify a relationship or to determine which variables more effectively define a relationship.

6.2 EXPLORING THE DEMOGRAPHIC NATURE OF THE PARTICIPANTS

As mentioned above, the first part of the questionnaire included questions related to the general background information about the participants such as their age group, gender, academic qualifications, professional qualifications and their position in the institution. The table 6.1a reveals the findings from the demographic profile. As the results indicate, the respondents who completed this survey were aged from 25 to over 60 years of age. It should be noted that the largest group of participants were from 25 to 35 years old with a percentage of 42.3%. In addition, the table shows that the group which were defined as 35-45 age groups was involved with more than the group aged from 45-55 age group with a percentage of 34.6% and17.3%, respectively, whereas only 5.8% of the respondents were from the group aged 55 year old and over. In general, it could be argued that the largest age group of the respondents involved in this survey ranged from 25 to 45 years of age.

Furthermore, with regards to the sex of the respondents, as depicted in table 6.1a, 88.5% of the participants involved in the survey were male, whereas only 11.5% of females completed the questionnaire. Therefore, these statistics might be used as a reflection of the presence of more males working in these particular institutions, as Muslim societies are generally viewed as being patriarchal societies.

Table 6.1a: Demographic Profiles

Variable Group	Frequency (Valid)	% (Valid)
Age group:		
25-35	22	42.3
35-45	18	34.6
45-55	9	17.3
55- 65+	3	5.8
Gender:		
Male	46	88.5
Female	6	11.5
Academic qualifications:		
BSc in Accounting, Economic and Finance	18	34.6
MSc in Accounting, Economics and Finance	17	32.7
PhD in Accounting, Economics and Finance	6	11.5
MBA	9	17.3
ACCA	2	3.8
Professional Qualifications:		
National Certified Public Accountant.	24	51.1
American Certified Public Accountant	1	2.1
British Chartered Certified Accountant	3	6.4
CIFP, CIPA, APFA and CAIIB.	12	25.5
ACCA.	1	2.1
MBA.	2	4.3
NO Professional qualification.	4	8.5
Current Position:		
Head of Department	13	25.5
Financial Manager	11	21.6
Auditor Manager	3	5.9
Senior Accountant	5	9.8
Senior Auditor	6	11.8
Accounting Specialist	2	3.9
Relationship Manager	6	11.8
Academic Professional	4	7.8
Shari'ah Advisory	1	2.0
Working period:		
Less than one year	6	12.0
From one to 5 years	12	24.0
From 5 to10 years	17	34.0
From 10 to 15 years	8	16.0
More than 15 years	7	14.0

Regarding academic qualifications, as the results in table 6.1a show, in general there was a very high proportion of participants who were well educated and qualified: 61.5% of those who responded had postgraduate qualifications ranging from the equivalence of an MSc in accounting and finance to a PhD in accounting and finance. 38.4 % of the respondents held an academic qualification lower than that, either a BSc in accounting and finance at 34.6 % or the Association of Chartered Certified Accountants (ACCA) with 3.8 %. As can be seen, individually, master's degree holders came first in the postgraduate qualifications, at 32.7 %, followed by those with a business administration management (MBA) degree at 17.3 %. In addition, only 11.5% of the participants who contributed to the survey held a PhD degree.

Table 6.1b:Demographic Profiles (cont.)

Variable Group	Frequency (Valid)	% (Valid)
Location of the company:		
Bahrain	2	3.7
Malaysia	4	7.4
Pakistan	4	7.4
Qatar	3	5.6
Saudi Arabia	2	3.7
Turkey	4	7.4
Turkey- Iraq	1	1.9
UAE	2	3.7
UK	1	1.9
USA	1	1.9
Egypt	8	14.8
Global	1	1.9
Indonesia	2	3.7
Jordan	5	9.3
Kenya	1	1.9
Kuwait	1	1.9
Libya	4	7.4
Luxembourg	1	1.9
Undeclared	7	13
The nature of institutions:		
Islamic bank	23	51.1
Islamic finance institution.	13	28.9
Islamic window as part of conventional bank	3	6.7
Islamic window as part of conventional financial institution	6	13.3

It should be noted from the findings that the vast majority of participants who completed this survey held various professional qualifications. National Certified Public Accountants came first with represented by 51.1% out of the total sample, followed by those who held CIFP, CIPA, APFA and CAIIB at 25.5%. This was followed by British Chartered Certified Accountants, American Certified Public Accountants and ACCA at 6.3%, 2.1% and 2.1% of the total sample respectively. Table 6.1a clearly illustrates that only 8.5% of the sample did not hold any professional qualifications.

'Current position of the respondents in their bank' was one of the important questions used to acquire background information concerning the participants. Although the majority of the institutions which responded to this survey were Islamic banks and Islamic financial institutions, only 2% of the respondents were *Shari'ah* advisory. This could be related to the minority of real Islamic finance practices in those institutions or to the lack of knowledge regarding the role of *Shari'ah* advisory in an Islamic financial institution.

Table 6.1a reveals that the highest percentage of respondents was Head of Department group at 25.5%, followed by Financial Managers with a percentage of 21.6%. While the Senior Auditors and Relationship Managers were the same at 11.8%. The remainder of respondents held various positions at 5.9% for Auditor Managers, 9.8% for Senior Accountants, 3.9% for Accounting Specialists and 7.8% for Academic Professionals.

The questionnaires were also targeted at the diversity of work experience, with this variation being from less than one year to more than 15 years. The vast majority of the participants have been working for their institutions from 5 to 10 years with 34% out of the total sample, whereas 24% of them had worked for their organizations from 1 to 5 years. The number of respondents who worked for their institutions from 10 to 15 years and more is exactly the same number as those who had worked from one to five years with 24% out of the sampled respondents. Lastly, those who worked for less than one found to be 12% of the sample.

Based on the classification of respondents in terms of geographical location, as can be seen from table 6.1b, approximately 15% of the respondents were from Egypt, followed by Jordan at nearly 10%, then Qatar which came third with around 6%. The percentage of respondents from Malaysia, Pakistan, Turkey and Libya was the same at 7.4%, whereas Bahrain, Saudi Arabia, UAE and Indonesia shared the same percentage at 3.7%. The rest of the respondents came from other locations such as Turkey-Iraq (subsidiary of a Turkish Islamic bank in Iraq), the UK, USA, Kenya, Kuwait and Luxembourg at 1.9%, at a rate of one response from each country.

After presenting the initial demographic nature of the participants, this section examines the nature of institutions the participants came from. As can be seen in table 6.1b, unsurprisingly, most of the respondents were from Islamic banks; at roughly 51.1%, followed by Islamic finance institutions, which also have quite high percentage at almost 29%. Islamic windows as part of conventional financial institutions and

Islamic windows as part of a conventional banks came after at 13.3% and 6.7% respectively.

There are many different Islamic financial institutions practicing Islamic finance. Several of them are completely Islamic and others are windows, such as entities offering or issuing Islamic finance products and services along their conventional financial offerings called *'Islamic windows'*. Therefore, it was essential to ask participants what type of entities should apply Islamic Accounting Standards. The respondents were asked to tick more than one choice if applicable. Thus, the number of replies in question 9 is 10 answers are more than the responses. This can be seen clearly in table 6.1c where the frequency was 64 responses.

Table 6.1c: The Institutions Required Using Islamic Accounting Standards

Variable Group	Frequency (Valid)	% (Valid)
Islamic Financial Institutions whose business are entirely Islamic	32	50
Other entities offering/issuing Islamic finance products or services 'Islamic windows'	15	23.44
Counterparties to entities offering /issuing Islamic finance products or services, e.g. a customer of an IFIs, holder of *Sukuk* certificates,	7	10.94
Others, No Requirements	10	15.62

It can be observed from the findings in table 6.1c that 50% of the participants indicated that their institutions are required to apply Islamic accounting standards are the financial institutions whose business is entirely Islamic. Whereas, approximately 24% of the respondents identified their institutions that are offering or issuing Islamic finance products or services namely 'Islamic windows'. Furthermore, about 11% of the respondents indicated that Islamic Accounting Standards should be required in counterparty to entities providing or issuing Islamic finance products or services, *e.g.* a customer of a IFIs and holder of *sukuk* certificates. The result in table 6.1c also shows that approximately 16% of the respondents revealed that no institutions are required to employ Islamic Accounting Standards.

6.3 EXPLORING PERCEPTIONS ON FINANCIAL REPORTING STANDARDS: DESCRIPTIVE STATISTICAL ANALYSIS

It should be noted that this section illustrated the descriptive analysis results from the survey related to the perceptions of the participants on issues such as financial reporting standards issued by the IASB and its main objectives, and whether the IFRS is the main accounting reporting standard applied in the institutions where the participants come from.

Table 6.2: Awareness on International Accounting Standard Board (IASB)

Variable Group		Frequency (Valid)	% (Valid)
Hearing about IASB:	Yes	41	93.2
	No	3	6.8

This survey asked respondents if they have any knowledge concerning the International Accounting Standard Board (IASB). The results in table 6.2 indicate that the majority of the participants surveyed heard of the IASB, at around 93%. This is due to the nature of the IASB, which has come to be globally known and accepted by most of the companies around the world. As can be seen, only 6.8% of the respondents answered ‘no’ and indicated that they had not heard of the IASB.

Table 6.3: Perceptions on the Objectives of IASB

Variable Group	Frequency (Valid)	% (Valid)
To develop a single set of high quality, effective and practical global accounting standards	14	29.80
To take account of, as appropriate, the special needs of small and medium-sized entities and emerging economies	1	2.12
To work generally for the improvement and harmonisation of regulations, of national accounting standards and IAS to provide high quality solutions	9	19.15
All of the above	23	48.93

Table 6.3 depicts the results in relation to perceptions on the objectives of the IASB, which shows that approximately, 30% of the respondents indicated that the main aim of the IASB is to develop a single set of high quality, effective and practical global accounting standards. Whereas, only 2% of the participants surveyed thought that the

best described objectives of the IASB is to take into account the particular requirements of small and medium-sized institutions and emerging economies. Furthermore, about 19% of the respondents stated that the most important objective of the IASB is to improve and harmonise the national accounting standards and international accounting to provide high quality solutions. In addition, around 49% of the respondents believed that the objectives of the IASB are all the points mentioned above.

Table 6.4: Objectives of IASB do not consider the Special Treatment Expected Of the IFIs

Variable Group	Frequency (Valid)	% (Valid)	Mean	Mean Ranking	Standard Deviation
Strongly	2	4.8	3.6667	4	1.22308
Disagree	8	19.0			
Neutral	4	9.5			
Agree	16	38.1			
Strongly Agree	12	28.6			

In this survey, the respondents were asked to state their opinion about whether the objectives of the IASB consider the special needs and the required special treatments of the IFIs into account or not. They were given the 5-point Likert scale from 'strongly disagree' to 'strongly agree'. As can be seen clearly from table 6.4, 38% of the participants surveyed agreed that the IASB does not consider the special needs of the IFIs, whereas, around 29% strongly agreed, which amounts to a total of 66.7%. In contrast, some of the respondents believed that the IABS do take the special needs of IFIs into account by expressing their opinions on the statement. Of the contributors, 19% disagreed and around 5% strongly disagreed, while the rest, 9.5% were neutral. The mean value here is 3.6667, thus, it can be concluded that there was an inclination towards a position of agreement concerning this statement.

Table 6.5: The Financial Reporting Standards Employed in the Respective Institution

Variable Group	Frequency (Valid)	% (Valid)
International Financial Reporting Standards (IFRS)	17	39.5
National standards based on IFRS	13	30.2
National standards not necessarily based on IFRS	7	16.3
AAOIFI	3	7.0
AAOIFI&IFRS	3	7.0

In the next question in the survey, the respondents were asked to indicate as to what types of financial reporting standards are employed in their respective institution. The results in table 6.5 demonstrate that a large number of the respondents (69.7%) indicated that the financial reporting standards implemented in their institution were either IFRS or national standards based on the IFRS.

As the results show, merely 7% of the respondents use AAOIFI standards, although their business is Islamic finance. The same percentage (7%) was the answer of the respondents who indicated that the financial reporting standards employed in their institution are national standards which are not necessarily based on IFRS. Only 7% of the respondents replied that their institutions are merging both the IFRS and AAOIFI systems. This could be an efficient solution for Islamic institutions to use a set of high quality IFRS that are internationally accepted to deal with conventional products and moreover, to use AAOIFI standards to treat the Islamic finance products that are not considered by the IFRS.

Table 6.6: Policy of convergence with or adopting IFRS

Variable Group	Frequency (Valid)	% (Valid)
No, we do not have plans for convergence / adoption at this time	8	22.9
Yes, we have already converged with / adopted IFRS	27	77.1

When the respondents were asked whether they have a policy to converge with, or adopt, IFRS if IFRS are not employed in their institution. As the results in table 6.6 shows, consequently, the largest number of respondents indicated that they have a plan or they have already converged with/adopted IFRS at 77.1%.

Table 6.7: Consideration of Applying a Different Financial Reporting Standard

Variable Group	Frequency (Valid)	% (Valid)
Yes;	16	41.0
No,	23	59.0

The findings in table 6.7 showed that 41% of respondents answered ‘yes’ when asked about whether their respective institution considered applying different financial reporting standards if IFRS are not employed, while 59% responded ‘no’ and thus, moved to question 17 in the following table.

Table 6.8: The Name of the Reporting Standards Respective Institution Is Aiming to Migrate

Variable Group	Frequency (Valid)	% (Valid)
AAOIFI	9	16.7
IFRS	2	3.7
FAS	3	5.6
Do not know	40	74.1

As can be seen from table 6.8, 16.7% of the respondents who answered yes in table 6.7 indicated that they would apply AAOIFI, whereas, 5.6% of the respondents assumed that their institution would apply FAS based on AAOIFI. By contrast, only 3.7% of the surveyed participants believed that they would move to IFRS.

6.4 PERCEPTIONS ON THE BARRIERS EMPLOYING IFRS IN THE IFIS AND FURTURE REFLECTIONS

Part four of the questionnaire asked the respondents to express their views on the factors that might represent barriers to employing IFRS in the IFIs. This section also includes questions in relation to the refelctions of the participants on the future of accounting issues in IFIs, such as the case for Islamic accounting. The questions in this section are based on a 5 points Likert scale, 1 stands for 'strongly disagree' and 5 'strongly agree'.

Table 6.9a demonstrate that the perceptions of the respondents on different statements, which shows that 34.2% of the participants strongly agreed and 34.2% of them agreed that the cultural environment, for instance, language, religion, morals, values, education, politics, *etc.* greatly influenced the use of IFRS, thereby totalling approximately 68.5% of the participants. This is further supported by the mean value of 3.8421. In contrast, only 2.6% and 13.2 of participants strongly disagreed and disagreed with this statement respectively, while 15.8% of participants remained neutral.

As can be seen from table 6.9a, on the assertion that 'the nature of Islamic finance and the Islamic economic system may necessitate not using IFRS', only 2.6% of the respondents strongly disagreed, whereas 13.2% disagreed with this statement. As can be seen, 52.6% of the participants agreed and 15.8% strongly agreed with this statement. Therefore, a total of 68.4% of the respondents believe that the nature of the Islamic economy and Islamic finance influence the use of IFRS in Islamic institutions, with the mean value of 3.6579 providing verification to support this assumption. Moreover, 15.8% of the surveyed participants were neutral.

Table 6.9a: Perceptions on the factors representing the barriers to employing IFRS in IFIs

Variable Group	Frequency (Valid)	% (Valid	Mean	Mean Ranking	Standard Deviation
The cultural environment greatly influences the use of IFRS:					
Strongly disagree	1	2.6			
Disagree	5	13.2	3.8421	4	1.12769
Neutral	6	15.8			
Agree	13	34.2			
Strongly Agree	13	34.2			
The nature of Islamic Finance system may necessitate of not using IFRS					
Strongly disagree	1	2.6			
Disagree	5	13.2	3.6579	4	0.99394
Neutral	6	15.8			
Agree	20	52.6			
Strongly Agree	6	15.8			
The prohibition of *riba* has significant implications for using IFRS					
Strongly disagree	3	7.9			
Disagree	1	2.6	3.8158	4	1.15911
Neutral	8	21.1			
Agree	14	36.8			
Strongly Agree	12	31.6			
The importance of paying *Zakat* has significant implications for using IFRS:					
Strongly disagree	0	0.0			
Disagree	11	28.9	3.4211	3	1.7707
Neutral	10	26.3			
Agree	7	18.5			
Strongly Agree	10	26.3			

It should be noted from the findings that 36.8% of the participants agreed that the prohibition of *riba* is one of the factors that signify obstacles to employing IFRS in the IFIs, while 31.6% strongly agreed with this statement. Thus, it can be argued that the majority of the respondents gave serious consideration to the prohibition of *riba* in regard to ineffectiveness of using the IFRS in IFIs at a total of 68.4%. This can be clearly seen from the mean value of 3.8158 which reveals general support for this statement. On the contrary, the findings from table 6.9a show that only 7.9% and 2.6%

strongly disagreed and disagreed respectively. The rest of respondents chose to be neutral to this statement at 21.1%.

In addition, the respondents were asked to express their opinion regarding the statement that ‘the importance of paying *zakat* has significant implications for using the IFRS’. The findings in table 6.9a illustrated that 28.9% of the respondents disagreed, while 26.3 remained neutral. The results also showed that the rest of the participants either agreed at 18.5% or strongly agreed at 26.3% on this issue. The mean was 3.4211, which gives an indication that there is a position of agreement in relation to this particular statement indicating that *zakah* treatment would have implications for using IFRS.

It should be mentioned that the respondents were also asked to indicate to what extent they agreed or disagreed with the statement that ‘the IFRS is not reliable together with Islamic financial instruments such as, *ijara, mudarabah, musharakah, istisna etc’*. From table 6.9b, it can be clearly seen that the vast majority of the respondents either agreed at 52.6% or strongly agreed at 21.6%, meaning that a total of 74.2% of the participants agreed with this statement. This is evident by the mean value 3.8684. In addition, as the findings in table 6.9b verify, 15.8% of the participants did suggest agreement with this statement, whereas 13.2% of the surveyed participants remained neutral.

With regard to the statement that ‘financial reporting in IFIs must be compatible with Islamic principles, as this will influence the use of IFRS’, table 6.9b revealed that only 5.3% of the respondents were in disagreement with this assertion, while 18.4% of them were in a neutral position. Furthermore, the results in table 6.9b show that 57.9% of the participants agreed and that 18.4% strongly agreed with this suggestion. This means that the vast majority of the respondents believe that Islamic principles are one of the factors which signify barriers to employing IFRS in IFIs and thus, reaching a total of 76.3%. The mean value for this statement is 3.8947, which indicates that there was an inclination towards a position of agreement.

Table 6.9b also demonstrated the views of respondents on whether they agree or disagree with the statement that ‘the Islamic worldview is different and therefore will call for a morally embedded accounting system’. The findings disclosed that 63.2% of the respondents agreed and 21.1% disagreed. However, the percentage of participants who disagreed and neutral are the same at 7.9%. Since the percentage for those who agreed and strongly agreed was high at 84.3%, it provides evidence that they were in favour of this statement with a mean value of 3.9737; and hence, it seems that there is an aspirational expectation perhaps to develop Islamic moral embedded accounting method or system.

Table 6.9b: Perceptions on the Factors Representing Barriers to Employing IFRS in IFIs (cont)

Variable Group	Frequency (Valid)	% (Valid)	Mean	Mean Ranking	Standard Deviation
IFRS are not consistent with Islamic financial instrument such as, *ijara, mudarabah, musharaka, istisna etc*.					
Strongly disagree	0	0.0			
Disagree	3	7.9	3.8684	3	0.84377
Neutral	7	18.4			
Agree	20	52.6			
Strongly Agree	8	21.6			
Reporting with Islamic principles will influence the use of IFRS:					
Strongly disagree	0	0.0			
Disagree	2	5.3	3.8947	3	0.76369
Neutral	7	18.4			
Agree	22	57.9			
Strongly Agree	7	18.4			
The Islamic worldview is different and therefore will call for a morally embedded accounting system:					
Strongly disagree	0	0.0			
Disagree	3	7.9	3.9737	3	0.78798
Neutral	3	7.9			
Agree	24	63.2			
Strongly Agree	8	21.1			
IFRS are not relevant to devout Muslim users:					
Strongly disagree	0	0.0			
Disagree	6	15.8			
Neutral	5	13.2	3.7632	3	0.97077
Agree	19	50			
Strongly Agree	8	21.1			

In the last statement in part four, respondents were asked to indicate their opinion as to whether they agree or disagree with the argument, which claims that 'IFRS do not consider Islam's own cohesive rules and therefore, IFRS are not relevant to devout Muslim users'. The results showed that 50% of the respondents agreed and 21.1% strongly agreed with this issue, coming to a total of 71.1%, while, 15.8% of the respondents disagreed with the above statement and 13.2% gave neutral as their opinion. The mean value here is 3.7632. As can be see, this result also indicates the aspirational expectations of authenticating Islamic accounting.

6.5 EXPLORING DETERMINING VARIABLES OF EXPRESSED PERCEPTIONS: MEASURING MEAN DIFFERENCES THROUGH INFERENTIAL STATISTICS

The analysis based in this section is based on the examination and analysis of the various answers given by respondents to each statement of Part two A and Part Four of the questionnaire by using non-parametric tests, including the Independent Samples Kruskal-Wallis Test (KW Test) and the Mann- Whitney U Test (MWU Test). The objective is to locate the statistically significant independent variables in determining the nature of the answers given. For this, as mentioned in the Research Methodology chapter mainly the demographic variables were selected as the independent variables. Hence, the analysis focuses on their impact of the independent variables on the given answers.

Table 6.10 presents the results of testing the opinions and knowledge of the contributors with regards to the statements asking them about the International Accounting Standards Board.

The analysis in table 6.10 clearly showed that a professional qualification as a control variable is significant at a 5% significance value, as its estimated p-value is 0.024. This indicated that there are statistically significant variances in the perceptions of the participants holding different professional qualifications regarding the statement on the awareness of the IASB.

This significance of the independent variable for this statement is comparatively evidenced by the high mean rank of some of the group categories in the professional qualifications independent variable. Respondents who hold a Master in Business Administration (MBA) scored the highest mean rank at 29.00 followed by those who are a Chartered Islamic Finance Professional (CIFP), a Certified Islamic Professional Accountant (CIPA), the Association of Professional Financial Advisers (APFA) and a Certified Associate of the Indian Institute of Bankers (CAIIB) at 21.22. The lowest mean rank was tagged by respondents who hold a qualification from the Association of Chartered Certified Accountants (ACCA), are a National Certified Public Accountant (NCPA) and a British Chartered Certified Accountant (BCCA) at 19.00. This low figure could be due to the low level of education that has not covered the related methods of the IASB

Table 6.10: Significance of Control Variables on the Statement: *'Are you aware of the International Accounting Standards Board'*

Statement	Group (Control Variables)	Group Categories	Mean Rank	Test	Asymp. Sig. (p)
Knowledge about the International Accounting Standard Board (IASB)	Professional qualifications	National Certified Public Accountant	19.00	KW Test	0.024*
		British Chartered Certified Accountant	19.00		
		CIFP, CIPA, APFA and CAIIB	21.22		
		ACCA	19.00		
		MBA	29.00		
		No Professional qualification	29.00		
	Location	Bahrain	32.00	KW Test	0.069**
		Egypt	21.00		
		Global	21.00		
		Indonesia	21.00		
		Jordan	21.00		
		Kenya	43.00		
		Libya	21.00		
		Luxembourg	21.00		
		Malaysia	21.00		
		Pakistan	21.00		
		Qatar	21.00		
		Saudi Arabia	21.00		
		Turkey	26.50		
		Turkeom Iraq	21.00		
		UAE	21.00		
		Unknown	21.00		

Note: (*) Statistically significant at a 5% level; (**) statistically significant at 10%.

As depicted in table 6.10, the independent variable for location is statistically significant at a 10% significance level. This denotes that there is a statistically significant difference between the participants from different countries in the awareness of the IASB with an estimated *p*-value of 0.069, with various mean rankings, which gives a weight to Kenya that held the highest mean rank with 43.00. This figure was followed by Bahrain at 32.00 and Turkey at 26.50, whereas the rest of the countries remained at a mean ranking of 21.00.

Table 6.11 represents the findings on the independent variables that are statistically significant in relation to the statement that the objectives of IASB do not have a provision for the special needs of IFIs. As can be seen, only location control variable is significant at 10% with an estimated *p*-value of 0.056.

Table 6.11: Significance of Control Variables on the Statement: '*The objectives of IASB did not consider the special need of the IFIs'*

Statement	Group (Control Variables)	Group Categories	Mean Rank	Test	Asymp. Sig. (p)
The objectives of the IASB did not consider the special need of the IFIs	Location	Bahrain	12.50	KW Test	0.056**
		Egypt	23.00		
		Global	36.50		
		Indonesia	29.50		
		Jordan	27.70		
		Kenya	1.50		
		Libya	22.00		
		Luxembourg	36.50		
		Malaysia	22.50		
		Pakistan	17.17		
		Qatar	21.83		
		Saudi Arabia	6.50		
		Turkey	8.25		
		Turkoman Iraq	6.50		
		UAE	36.50		
		Unknown	36.50		

Note: (*) Statistically significant at a 5% level; (**) statistically significant at 10%

The mean rank in table 6.11 highlighted the various knowledge bases available to the various countries, with those from developing and developed countries. The mean rank clearly shows that the respondents from the developed countries, such as Luxembourg and countries which have a direct economic relationship with the developed world, for instance, the UAE have more information and knowledge about the IASB and its objectives with a mean ranking of 36.50. This could be due to the IASB rules, which made reporting with regards to IFRS mandatory for all listed companies in Europe.

Indonesia came in second place with a mean ranking of 29.50. This again might be due to greater access to relevant information and a higher involvement of their economy with the developed countries that report with IFRS, which in turn made many less developed countries adopt the IFRS. It should be noted that the lowest figure relating to mean rank value as demonstrated in table 6.11 is for Kenya at 1.50, although Kenya secured the highest mean rank value in the statement, which asked the respondents if they had heard about the IASB. The mean rank for the remaining countries varies from 22.00 for Libya to 6.50 for Saudi Arabia and Turkoman Iraq.

Table 6.12: Significance of Control Variables on the Statement: '*The name of the financial reporting standards employed in your institution'*

Statement	Group (Control Variables)	Group Categories	Mean Rank	Test	AsymSig (p)
The name of the financial reporting standards employed in your institution	The name of the accounting system	AAOIFI Financial Accounting Standards (AAOIFI FAS)	18.91	KW Test	0.100**
		National Islamic standards adapted from AAOIFI FAS	33.75		
		National Islamic standards not based on AAOIFI FAS	21.17		
		National Standards based on IFRSs	17.50		
		National Standards not based on IFRSs	27.67		
		IFRSs	11.20		

Note: (*) Statistically significant at a 5% level; (**) statistically significant at 10%

Table 6.12 depicts the significance of the particular control variables on the question of the name of the financial reporting standards employed in their institutions. The independent variable that was found to be significant for this statement is the name of the accounting system, which is statistically significant at a level of 10% with *p*-value of 0.100.

According to the results revealed in Table 6.12, most of the participating institutions use national Islamic standards adapted from the AAOIFI as an accounting system with a highest mean rank value of 33.75; national Standards not based on IFRSs followed this ranking with a value of 27.67, while national Islamic standards not based on AAOIFI achieved a mean ranking of 21.17. The AAOIFI standards and National Standards based on IFRSs reached a mean rank value of 18.91 and 17.50 respectively. The lowest mean rank recorded in this statement was held by the institutions employing IFRS' as an accounting system, with a value of 11.20.

Table 6.13 displays the significant independent variable, namely 'the name of the accounting system' in relation to the statement about 'the consideration of applying a different financial reporting standards', which is statistically significant at a 5% value with an estimated *p*-value of 0.022. The results of the analysis on the statement in table 6.13 noticeably indicate that institutions which employ an accounting system that is not related to Islamic finance, such as National Islamic standards not based on AAOIFI and national standards not based on IFRSs achieved the highest mean rank when considering applying a different accounting system to the one they are using now, with a ranked value of 26.00. Subsequently, this was followed by participants employing national standards based on IFRSs with a mean rank of 22.50. The lowest mean rank values in relation to this independent variable were scored by the respondents coming from the institutions with AAOIFI and national Islamic standards adapted from AAOIFI FAS with a mean rank of 14.33 and 8.50, respectively. This means that institutions already employing an accounting system related to Islamic finance have to consider paying less attention to changing their accounting system, and *vice versa*.

Table 6.13: Significance of Control Variables on the Statement: '*Consideration of applying different financial reporting standards'*

Statement	Group (Control Variables)	Group Categories	Mean Rank	Test	Asymp. Sig. (p)
Consideration of applying different financial reporting standards	The name of the accounting system	AAOIFI Financial Accounting Standards (AAOIFI FAS)	14.33	KW Test	0.022*
		National Islamic standards adapted from AAOIFI FAS	8.50		
		National Islamic standards not based on AAOIFI FAS	26.00		
		National Standards based on IFRSs	22.50		
		National Standards not based on IFRSs	26.00		
		IFRSs	15.50		

Note: (*) Statistically significant at a 5% level; (**) statistically significant at 10%

Table 6.14 presents the findings related to the significance of independent variables on the question about 'the reporting standards your institution is aiming to move to'. As can be seen, the nature of the institutions independent variables is significant at 5%

level of significance with a *p*-value of 0.035. As can be seen in table 6.14, the highest mean rank is scored by Islamic window category as part of a conventional bank with a mean rank value of 27.50. This high score could be related to the reason that those types of institutions employ IFRS as the main accounting system and they do not have the intention of moving to another accounting system that could be unusable for them, as most of their transactions are not Islamic finance.

As the results depicted in Table 6.14 shows the Islamic finance institution recorded the second highest mean rank with a value of 23.38, followed by the Islamic banks with a mean rank value of 21.64. However, the Islamic window as part of a conventional financial institution achieved the lowest mean rank with a value of 9.50.

Table 6.14: Significance of Control Variables on the Statement: '*The name of the reporting standards your institution is aiming to move to'*

Statement	Group (Control Variables)	Group Categories	Mean Rank	Test	Asymp. Sig. (p)
Which reporting standards your institution aims to move to	The nature of your institution	Islamic bank	21.64	KW Test	0.035*
		Islamic finance institution	23.38		
		Islamic window as part of a conventional bank	27.50		
		Islamic window as part of a conventional financial institution	9.50		
	The name of the accounting system	AAOIFI Financial Accounting Standards (AAOIFI FAS)	12.73	KW Test	0.018*
		National Islamic standards adapted from AAOIFI FAS	19.00		
		National Islamic standards not based on AAOIFI FAS	25.00		
		National Standards based on IFRSs	25.00		
		National Standards not based on IFRSs	25.00		
		IFRSs	15.20		

Note: (*) Statistically significant at a 5% level; (**) statistically significant at 10%

The table 6.14 depicts also the significant independent variable, the name of the accounting system, in relation to the statement asking the respondents about 'the name of the reporting standards your institution is aiming to move to', which is statistically significant at 5% with an estimated *p*-value of 0.018. As can be seen, national Islamic standards not based on AAOIFI FAS, national standards based on IFRSs and national standards not based on IFRSs scored the highest mean rank with a value of 25. This ranking is followed by national Islamic standards adapted from AAOIFI FAS with a value of 19.00. The IFRS scored a lower mean rank value with regards to this statement with a value of 15.20, while the lowest mean rank value was attained by AAOIFI FAS at 12.73.

In exploring the responses provided for the statement that 'the cultural environment *e.g.* religion and morals greatly influence the use of IFRS', table 6.15 depicts the results in relation to independent variables such as age, period of working, nature and location of institutions.. As the results show, the age group independent variable is significant at 10% with a *p*- value of 0.091, which implies that in the context of this particular statement the group aged between 55-65+ reached the highest mean rank value with a value of 25.25, while the age group 35-45 came second with a mean rank of 23.19, followed by the age group 45-55 at 20.67. The lowest age group in these control variables is the group aged 25-35, with a mean ranking of 14.19.

The period of working independent variable is also found to be statistically significant at 10% with an estimated *p*-value of 0.100. As the results in Table 6.15 depicts, people who worked more than 15 years for the participating institutions achieved the highest mean rank value with a value of 24.50. People who worked for less than one year and from 5-10 years followed this ranking with a value of 21.50. Employees who worked from one to 5 years secured the lowest mean rank at 11.89. Therefore, the findings classify a clear variance between the answers of the respondents in relation to the statement, arguing that the cultural environment *e.g.* religion and morals greatly influence the use of IFRS.

Table 6.15 also displays the institutional nature control variable, which, as can be seen, is significant at 5% level with an estimated *p*-value of 0.042. As can be seen, the highest mean rank value was scored by the group category of Islamic window as part of a conventional financial institution at 24.17. The second group category regarding the nature of the institution is the Islamic window, as part of a conventional bank, which managed to score mean rank value of 22.25; followed by the Islamic finance institution with a mean rank value of 19.19. Furthermore, Islamic banks secured the lowest mean rank value with a value of 12.82.

As can be seen in table 6.15, location as an independent variable is statistically significant at 10% with an estimated *p*-value of 0.68, which shows that Indonesia scored the highest mean rank value at 32.00, followed by Libya and unnamed countries at 28.75 and 27.67 respectively.

Table 6.15: Significance of Control Variables on the Statement: '*The cultural environment e.g. religion and morals greatly influence the use of IFRS*'

Statement	Group (Control Variables)	Group Categories	Mean Rank	Test	Asymp. Sig. (p)
The cultural environment *e.g.* religion and morals greatly influence the use of IFRS	Age Group	25-35 35-45 45-55 55- 65+	14.19 23.19 20.67 25.25	KW Test	0.091**
	Period of working	Less than one year From one to 5 years From 5 to 10 years From 10 to 15 years More than 15 years	21.50 11.89 21.05 16.50 24.50	KW Test	0.100**
	The nature of your institution	Islamic bank	12.82	KW Test	0.042*
		Islamic finance institution	19.19		
		Islamic window as part of a conventional bank	22.25		
		Islamic window as part of a conventional financial institution	24.17		
	Location	Egypt	25.25	KW Test	0.068**
		Global	19.00		
		Indonesia	32.00		
		Jordan	21.60		
		Libya	28.75		
		Luxembourg	4.00		
		Malaysia	17.00		
		Pakistan	12.67		
		Qatar	12.67		
		Saudi Arabia	4.00		
		Turkey	8.00		
		Turkoman Iraq	4.00		
		UAE	19.00		
		Unknown	27.67		

Note: (*) Statistically significant at a 5% level; (**) statistically significant at 10%

Furthermore, Egypt secured the forth highest mean rank value with 25.25, which is followed by Pakistan and Qatar with a mean rank value of 12.67. Institutions operating in different countries named Global and UAE achieved the same mean rank with 19.00. As can be seen, the lowest mean rank is recorded by Luxembourg, Saudi Arabia, and Turkoman/Iraq with a value of 4.00, while Turkey obtained a mean rank value of 8.00. Hence, the results classify an obvious dispersion between the opinions of the participants from different countries.

Table 6.16 Significance of Control Variables on the Statement: '*The importance of paying Zakat has significant implications for using the IFRS'*

Statement	Group (Control Variables)	Group Categories	Mean Rank	Test	Asymp. Sig. (p)
The importance of paying *zakat* has significant implications for using the IFRS	Age Group	25-35 35-45 45-55 55- 65+	14.41 23.35 19.92 24.75	KW Test	.098**

Note: (*) Statistically significant at a 5% level; (**) statistically significant at 10%

In examining the responses provided for the control variable on the statement that 'the importance of paying *zakat* has significant implications for using the IFRS', the results in table 6.16 shows that the age control variable is statistically significant with an estimated *p*-value of 0.098. As the results show 55-65+ age group scored the highest mean rank with a value of 24.75, while the 35-45 and 45-55 age groups scored mean rank value of 23.35 and 19.92 respectively. The lowest mean rank noted here held by the 25-35 year old group with a value of 14.41.

Table 6.17 presents the significant control variables in the context of the statement that 'the obligation to report with Islamic principles will influence the use of IFRS'. The independent variable of professional qualifications is found to be significant at 10% level of significance with an estimated *p*-value of 0.086. As can be seen in table 6.17, different professional qualifications have a different perception to the statement in question. Accordingly, the highest mean rank is achieved by the National Certified Public Accountant group category at 20.05, whereas the British Chartered Certified Accountant and No Professional qualifications scored the same mean rank at 17.50. Additionally, CIFP, CIPA, APFA and CAIIB group category secured a somewhat lesser value of 13.50. There were two group categories that attained the lowest point for the mean ranking specifically, ACCA and MBA which obtained the same ranking value of 1.50.

In analysing the impact of control variables on 'the differences in the Islamic world view are calling for a moral embedded accounting system', table 6.18 shows that two control variables, namely the professional qualifications and the name of the accounting system, are statistically significant at 10% level of significance with an estimated *p*-value at 0.096, and 0.073 respectively. With reference to the professional qualification control variable, the highest mean rank is secured by the British Chartered Certified Accountant and the CIFP, CIPA, APFA and CAIIB with the same ranking value of 22.17, which is followed by no professional qualifications at group category at 17.50 and the national certified public accountant group category at 16.86, whereas the lowest mean rank was recorded by the MBA group category with a rank value of 2.00.

Table 6.17: Significance of Control Variables on the Statement: '*The obligation to report with Islamic principles will influence the use of IFRS'*

Statement	Group (Control Variables)	Group Categories	Mean Rank	Test	Asymp. Sig. (p)
The obligation to report with Islamic principles will influence the use of IFRS	Professional qualifications	National Certified Public Accountant	20.05	KW Test	0.086**
		British Chartered Certified Accountant	17.50		
		CIFP, CIPA, APFA and CAIIB	13.50		
		ACCA	1.50		
		MBA	1.50		
		No professional qualifications	17.50		

Note: (*) Statistically significant at a 5% level; (**) statistically significant at 10%

As the findings in table 6.18 shows, in the accounting system group category, the national Islamic standards adapted from the AAOIFI FAS group category scored the highest mean rank value at 34.50, whereas National Islamic standards not based on AAOIFI FAS obtained a mean rank of 21.17. This is followed by AAOIFI Financial Accounting Standards (AAOIFI FAS) with a mean rank of 20.63. The mean ranking of the IFRS group category scored a mean rank value of 18.40, followed by National

Standards based on IFRSs with a mean rank value of 16.25. National Standards not based on IFRSs recorded the lowest mean rank with a value of 8.50.

Table 6.18: Significance of Control Variables on the Statement: *'The differences in the Islamic world view are calling for a moral embedded accounting system'*

Statement	Group (Control Variables)	Group Categories	Mean Rank	Test	Asymp. Sig. (p)
The differences in the Islamic world view is calling for a moral embedded accounting system	Professional qualifications	National Certified Public Accountant	16.86	KW Test	0.096**
		British Chartered Certified Accountant	22.17		
		CIFP, CIPA, APFA and CAIIB	22.17		
		ACCA	5.00		
		MBA	2.00		
		No Professional qualifications	17.50		
	The name of the accounting system	AAOIFI Financial Accounting Standards (AAOIFI FAS)	20.63	KW Test	0.073**
		National Islamic standards adapted from AAOIFI FAS	34.50		
		National Islamic standards not based on AAOIFI FAS	21.17		
		National Standards based on IFRSs	16.25		
		National Standards not based on IFRSs	8.50		
		IFRSs	18.40		

Note: (*) Statistically significant at a 5% level; (**) statistically significant at 10%

Table 6.19 reports the results of the analysis of the significance of control variables in relation to the statement that 'IFRS do not consider Islamic business rules; thus, IFRS are not relevant to devout Muslim users'. A number of control variables are found to be significant: age, academic and professional qualifications.

As can be seen in the results depicted in table 6.19, the age control variable is statistically significant at 5% level with a *p*-value of 0.012. Accordingly, the 55-65+ age group achieved the highest mean rank at 34.00, whereas the 35-45 year old age group achieved a score of 22.65. This rank was followed by the 45-55 year old age group with a mean rank of 20.25. The group aged from 25-35 years-old obtained the lowest mean rank at 13.69.

Table 6.19: Significance of Control Variables on the Statement: '*IFRS do not consider Islamic business rules; Thus, IFRS are not relevant to devout Muslim users'*

Statement	Group (Control Variables)	Group Categories	Mean Rank	Test	Asymp. Sig. (p)
IFRS do not consider Islamic business rules; Thus, IFRS are not relevant to devout Muslim users	Age Group	25-35 35-45 45-55 55- 65+	13.69 22.65 20.25 34.00	KW Test	0.012*
	Academic qualifications	BSc in Accounting, Economics and Finance	22.13	KW Test	0.093**
		MSc in Accounting, Economics and Finance	20.33		
		PhD in Accounting, Economics and Finance	21.00		
		MBA	10.08		
		ACCA	12.25		
	Professional qualifications	National Certified Public Accountant	19.45	KW Test	0.098**
		British Chartered Certified Accountant	23.33		
		CIFP, CIPA, APFA and CAIIB	13.50		
		ACCA	3.50		
		MBA	3.50		
		No professional qualifications	9.00		

Note: (*) Statistically significant at a 5% level; (**) statistically significant at 10%

With regards to the academic qualifications control variable, it is significant at 10%, with a *p*-value of 0.093. Table 6.19 reveals that participants holding an academic qualification in a BSc in Accounting, Economic and Finance scored the highest mean rank with a value of 22.13. The PhD in Accounting, Economics and Finance category came in the second place with a mean rank value of 21.00, whereas those holding an MSc in Accounting, Economics and Finance recorded a lower mean rank at 20.33. As can be observed, the mean rank of the above mentioned categories are close to each other, which means their opinion is similar with regards to this statement. In contrast, there were differences in opinion between participants holding an MBA, ACCA and the three group categories mentioned above, since the MBA and ACCA recorded the lowest mean rank with a value of 10.08 and 12.25, respectively.

Table 6.19 also depicts that professional qualification control variables are statistically significant with regards to the statement that ‘IFRS do not consider Islamic business rules; thus, IFRS are not relevant to devout Muslim users’ with an estimated *p*-value of 0.098, which points to differences in opinions the respondents recorded for this particular proposition. The highest mean rank is achieved by the British Chartered Certified Accountant, with a value of 23.33, and it is followed by the National Certified Public Accountant with a value of 19.45. The lowest mean ranks were recorded by ACCA and MBA with the same ranking of 3.50. The CIFP, CIPA, APFA and CAIIB group categories remained in the middle with a mean ranking value of 13.50.

Table 6.20 depicts the findings related to the statement, which states that ‘IFRS do not consider Islamic business rules; thus, IFRS are not relevant to devout Muslim users’. It should be noted that the current position, the period of working, location and the nature of the institution are found to be significant in the case of the answers given in response to the statement above.

As can be perceived from table 6.20, the current position as a control variable is significant at 5% significance level with an estimated *p*-value of 0.028. This indicates that there were variances in the perceptions directed at this statement by respondents holding different positions, which is obvious from the comparatively high mean rank for most of the group categories in the current position control variable.

Table 6.20 clearly demonstrate that participants holding an accounting specialist position and the senior accountant group categories scored the highest mean ranking at 34.00 and 26.20 respectively, followed by respondents who hold the position of financial manager with a mean rank of 22.44, while the head of department as a group category scored mean rank value of 20.20. The lowest mean rank is scored by those whose current position is relationship manager with a value of 12.25 and *shari’ah* advisory with a mean rank value of 6.80. Such a low mean rank in this group suggests that the number of *shari’ah* advisory holding positions in the Islamic institutions surveyed is lower than the other specialties in the group categories and might also have no impact on decision-making.

Table 6.20: Significance of Control Variables on the Statement: ‘*IFRS do not consider Islamic business rules; Thus, IFRS are not relevant to devout Muslim users*’

Statement	Group (Control Variables)	Group Categories	Mean Rank	Test	Asymp. Sig. (p)
IFRS do not consider Islamic business rules; Thus, IFRS are not relevant to devout Muslim users	Current Position	Head of Department	20.20	KW Test	.028*
		Financial Manager	22.44		
		Auditor Manager	12.25		
		Senior Accountant	26.20		
		Senior Auditor	16.63		
		Accounting Specialist	34.00		
		Relationship Manager	6.80		
		Shari'ah Advisory	9.00		
	Period of working	Less than one year	18.13	KW Test	.094**
		From one to 5 years	13.11		
		From 5 to10 years	17.00		
		From 10 to 15 years	22.07		
		More than 15 years	25.17		
	Location	Egypt	22.69	KW Test	0.041*
		Global	21.00		
		Indonesia	34.50		
		Jordan	26.40		
		Libya	27.75		
		Luxembourg	3.50		
		Malaysia	7.17		
		Pakistan	15.17		
		Qatar	13.00		
		Saudi Arabia	3.50		
		Turkey	19.67		
		Turkoman Iraq	3.50		
		UAE	9.00		
		Unknown	25.50		
	The nature of your institution	Islamic bank	13.32	KW Test	0.093**
		Islamic finance institution	19.94		
		Islamic window as part of a conventional bank	19.00		
		Islamic window as part of a conventional financial institution	22.83		

Note: (*) Statistically significant at a 5% level; (**) statistically significant at 10%

It should be noted that the period of working as an independent variable is also found to be significant in the context of ‘IFRS do not consider Islamic business rules; thus, IFRS are not relevant to devout Muslim users' at 10% level of significance, with an estimated *p*-value of 0.094. As can be seen, the highest mean rank is achieved by those participants who worked for their institutions for more than 15 years with a value of 25.17. This ranking is followed by the subgroup, who worked from 10 to 15 years, with a mean rank at 22.07. The lowest mean rank is scored by the subgroup who worked from one to 5 years with a ranking of 13.11.

As can be seen in table 6.20, in relation to the independent variable location, a wide range of opinions were expressed by the participants in different countries in relation to the mentioned statement, which is statistically significant with *p*-value of is 0.041 at 5% level of statistical significance. The highest mean ranking is scored by Indonesia at a level of 34.50, which is followed by Libya and Jordan with a mean rank of 27.75, 26.40 and 25.50 respectively. As can be seen, the lowest mean ranks are recorded by Luxembourg, Saudi Arabia and Turkoman Iraq with the same mean rank value of 3.50.

The nature of institution as an independent variable is found to be significant at 10%, level of significance with a *p*-value of 0.093. The highest mean rank is scored by Islamic window as part of a conventional financial institution category with a value of 22.83, followed by the Islamic finance institution and Islamic window, as part of conventional bank categories with a value of 19.94 and 19.00 respectively. The lowest mean rank is scored by the Islamic bank category with a value of 13.32.

6.6 BARRIERS IN EMPLOYING IFRS IN ISLAMIC FINANCIAL INSTITUTIONS: FACTOR ANALYSIS

In achieving the best model of variables, further examination of the perceptions on the factors that represent the barriers to employing IFRS in Islamic financial institutions in relation to the statements listed in Q33 were examined further. As the statements in Q33 were expected to be grouped together, exploratory factor analysis was applied to bring inter-correlated variables together to create further meaning.

Table 6.21: KMO and Bartlett's Test Results for the Significance of Cultural Environment Obstruct reporting with IFRS in the IFIs

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		.762
Bartlett's Test of Sphericity	Approx. Chi Square	104.236
	Df	28
	Sig.	.000

Firstly, the factorability of the 8 statements related to cultural environment were examined. As can be noted in Table 6.21, the results of the Kaiser-Meyer-Olkin (KMO) measure of sampling adequacy is .762, which is above the commonly recommended value of .6. This is considered as a high partial correlation and an acceptable KMO value implying that factor analysis will be appropriate for these particular questions and its statements. Table 6.21 also shows that a sufficient correlation exists among the variables, since Bartlett's test of sphericity is statistically found to be significant at 0.000 which is >.05. This again indicates that factor analysis is applicable to the data.

Table 6.22: Total Variance Explained for Factors of Cultural Environments Obstruct reporting with IFRS in the IFIs

Component	Initial Eigenvalues			Extraction Sums of Squared Loadings			Rotation Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	3.624	45.295	45.295	3.624	45.295	45.295	2.675	33.435	33.435
2	1.336	16.704	62.000	1.336	16.704	62.000	2.285	28.564	62.000
3	.891	11.133	73.133						
4	.663	8.289	81.422						
5	.511	6.392	87.814						
6	.416	5.206	93.020						
7	.349	4.360	97.380						
8	.210	2.620	100.000						

Extraction Method: Principal Component Analysis

Since the aim is to recognise the linear grouping of variables that account for the highest quantity of shared variance, the principal component analysis related to the eight variables were conducted and the results are reported in table 6.22. Each subsequent factor attaining an Eigenvalue above 1 was selected as they contributed to the model. As can be seen from the results, only two components have Eigenvalue higher than 1, namely 3.624 and 1.336 respectively. As for the variance explained by these two components, 45.295% of the variance is explained by the first component and 16.704% by second component; both explain about 62% of total variations between themselves.

In the next stage, the analysis continues with the rotated component matrix with the objective of locating the allocation of the factors under two of the established components, the results of which displayed in table 6.23.

Table 6.23: Rotated Component Matrix for the Environmental Factors affecting the employment of IFRS in the IFIs

Statements/ Variables	Component 1: The cultural environment	Component 2: The nature of Islamic Finance
1. The cultural environment *e.g.* religion and morals greatly influence the use of IFRS.	.752	.338
2. The nature of Islamic Finance and the Islamic Economic system may necessitate not using IFRS	.145	.553
3. The prohibition of *riba* (interest) has significant implications for using IFRS.	.315	.675
4. The importance of paying *zakat* has significant implications for using IFRS.	.244	.769
5. The IFRS is not consistent with Islamic financial instruments, such as *mudaharabah, musharakah, ijara, istisna etc*.	-.010	.804
6. The obligation to report Islamic principles will influence the use of IFRS	.831	.016
7. The differences in the Islamic world view are calling for a moral embedded accounting system	.667	.390
8. IFRS do not consider Islamic business rules, thus, IFRS are not relevant to devout Muslim users.	.891	.143

Extraction Methods: Principal Component Analysis.
Rotation Method: Varimax with Kaiser Normalisation. Rotation converged in 3 iterations.

Principal Component Analysis (PCA) was used to group the variables into recognised components as identified in table 6.23; the Rotated Component Matrix in Table 6.23 shows the factor loadings for each of the established components (two components) and. As the results show 8 factors are distributed into 2 components with loading values of 0.5 or above. With PCA, in each row, the values of each factor loaded to 0.5 and above are highlighted in table 6.23

As table 6.23 show, the first, sixth, seventh and eighth variables should be reported as cultural environment factors, which the participants considered as obstructing the use of IFRS in the IFIs. Thus, component 1 was named as the 'cultural environment factor'. As the results demonstrated, the second, third, fourth and the fifth variables, are related to the nature of Islamic finance as a barrier to reporting with IFRS. Thus, as re-grouped components, these were composed of the following;

Component 1: Cultural Environment Factors:

(i) 'the cultural environment *e.g.* religion and morals greatly influence the use of IFRS';

(ii) 'the obligation to report Islamic principles will influence the use of IFRS';

(iii) 'the differences in the Islamic world view are calling for a moral embedded accounting system';

(iv) 'IFRS do not consider Islamic business rules, thus, IFRS are not relevant to devout Muslim users'.

Component 2: The Nature of Islamic Finance:

(i) 'the nature of Islamic Finance and the Islamic Economic system may require not using IFRS';

(ii) 'the prohibition of *riba* (interest) has significant implications for using IFRS';

(iii) 'the importance of paying *zakat* has significant implications for using IFRS';

(iv) 'IFRS are not consistent with Islamic financial instruments such as *mudarabah, musharakah, ijara, istisna* etc*'*

As can be seen, the re-grouped factors are meaningful and consistent in explaining the barriers for the use of IFRS in Islamic financial institutions. Thus, two main independent variable as composite variables are constructed in the factor analysis, each of which consists of four factors.

In sum, it should be noted that the results of the factor analysis in this section were evident, as the factors related to the cultural environment came under one component and the factors regarding to the nature of Islamic finance were listed under another component. These factors suggested that the way in which people responded to the factors represent the barriers to employing IFRS in the IFIs in the form of cultural environments and the nature of Islamic finance. The way they value their preference of cultural environment tended to be very similar to the way they responded to the nature of Islamic finance factors. For example, if a participant's attitude towards the cultural environment, such as religion and morals greatly influence the use of IFRS, perhaps that participant also had the same opinion that the nature of Islamic finance and Islamic economic systems may require IFRS not being used. How they expressed their opinion to the factors mentioned tended to be very similar to how they responded to the remaining factors mentioned in components one and two. Therefore, the results indicated that cultural factors remain as significant as religious factors in constructing the employment of IFRS in the IFIs, as revealed in table 6.23.

6.7 CONCLUSION

This chapter has examined and discussed the data collected with regards to the international financial reporting standards and the factors that prevent the IFRS from being used in the IFIs.

As the results in this chapter indicate, the vast majority of participants were male aged 25-35, holding an academic qualification of either a BSc in accounting, economics or finance supported by work experience of 5-10 years. Most of the respondents came from Islamic banks operating in 18 different countries, which claim that the objectives of IASB did not consider the special needs of the IFIs, nevertheless, 40% of the participants' IFIs were reporting with IFRS. These institutions have the intention to apply another accounting system to deal with the Islamic products, such as AAOIFI accounting standards, as they believe that the Islamic cultural environment, for instance, prohibition of *riba* and paying *zakah* greatly influences the use of IFRS.

Factor analysis was also utilised in this chapter for statements listed in Q33 in order to investigate whether some variables of interest have a sufficient relationship. As a result, two components emerged as composite variables, which are named as Cultural Environment Factors and the Nature of Islamic Finance.

CHAPTER 7

EXPLORING PERCEPTIONS ON ISLAMIC ACCOUNTING STANDARDS

7.1 INTRODUCTION

This chapter aims to present the findings and materials collected in relation to the AAOIFI accounting standards, as well as the type of Islamic accounting standards that are applied in the surveyed institutions, in addition to the treatment and the recognition of some Islamic finance products. Thus, the analysis presented in this chapter relates to part two or B and part three or C of the questionnaire.

It should be noted that the statistical SPSS software was employed in order to examine and assess the data collected by the questionnaire. The first section of this chapter presents the descriptive statistics created by the SPSS software after it was organised into tables. The second section, however, reveals the inferential empirical results from the questionnaire after it is subjected to Non-Parametric Tests and Inferential Statistics test using SPSS software.

Continuing the same analysis that was used in Chapter 6, as part of non-parametric data, the Independent Samples Kruskal-Wallis Test (KW Test) and the Mann-Whitney U Test (MWU Test) are also used in this chapter. Again the results and the outcomes of these tests are based on independent variable developed from the demographic section of the questionnaire that contains variables such as ‘age’, ‘gender’, ‘academic qualifications’, ‘professional qualifications’, ‘current position’, ‘working experience’, ‘location’, ‘nature of the institution’ and ‘the type of Islamic accounting standards applied in the institutions’. The analysis is conducted in order to develop an understanding based on the respondents’ view as to whether Islamic reporting standards should be applied in the IFIs and to examine the perceptions of the participants with regards to the AAOIFI accounting standards whether to be mandatory in those institutions.

The statistical analysis results related to the inferential statistics are reported at 5% and 10% significance level. As was discussed in Chapter 6, normally, the significance level should be kept at 0.05 (5%) or less. However, in this research, the statistical significance level is extended to 0.10 (10%). These specific findings are recognised with symbols (*) and (**) for statistical significance at a 5% and 10% level, respectively. Moreover, in order to examine the relationship between the complex variables that have similar patterns of responses in Q30 and Q32, a factor analysis test is applied.

7.2 DESCRIPTIVE STATISTICS

The initial analysis in this section relates to the question asked respondents as to whether which accounting standards applied in their institution. As the results in table 7.1 shows, 43.6% of the respondents who participated in this survey indicated that the accounting system they apply in their institution is AAOIFI FAS. Table 7.1 also indicated that 5.1% of respondents who completed this survey applied national Islamic standards adapted from AAOIFI FAS.

Furthermore, the percentage of respondents who applied national Islamic standards not based on AAOIFI FAS and national standards based on IFRSs in their institutions were the same at 15.4%. It can be observed from the findings in table 7.1 that 7.7% of the participants indicated that their organisation apply national standards not based on IFRS', whereas, approximately 12.8% of the respondents identified that the accounting standard applied in their institution was the IFRS.

Table 7.1: The Accounting Standards Applied in your Institution

Variable Group	Frequency (Valid)	% (Valid)
AAOIFI Financial Accounting Standards (AAOIFI FAS)	17	43.6
National Islamic standards adapted from AAOIFI FAS	2	5.1
National Islamic standards not based on AAOIFI FAS	6	15.4
National Standards based on IFRSs	6	15.4
National Standards not based on IFRSs	3	7.7
IFRSs	5	12.8

Question 18 in part two or B of this investigation asked respondents about the possibility of adopting special FRS deals with Islamic finance, if they do not have any. Respondents had to answer with either Yes or No in this question. As can be seen from table 7.2 the majority of participants surveyed answered yes at 71.4%, whereas 28.6 indicated that they have not considered adopting accounting standard deals with IFIs.

Table 7.2: Consideration of Adopting Accounting Standards Dealing with IFIs

Variable Group	Frequency (Valid)	% (Valid)
Adopting special FRS to deal with IFIs:		
Yes	25	71.4
No	10	28.6

Table 7.3 demonstrate the results of the responses regarding the transactions and reports addressed by the respondents' by the respective Islamic accounting standards used by participants' organisations. It can be seen in table 7.3 that 18.6% of the respondents presented their financial statements under Islamic accounting standards, while more than 20% of the participants use the Islamic standards to address their sales-based contracts such as *murabahah* and *salam*, whereas approximately 14% of them used partnership-based contracts *e.g. musharakah, mudarabah*.

Table 7.3: Transactions and Reports Addressed by the Respective Islamic Accounting Standards

Variable Group	Frequency (Valid)	% (Valid)
Presentation of financial statements	16	18.60
Sales-based contracts (*e.g. murabahah, salam*)	18	20.93
Partnership-based contracts (*e.g. musharakah, mudarabah*)	12	13.95
Takaful	15	17.44
Ijara	11	12.79
Sukuk	11	12.79
None	3	3.50

The findings in table 7.3 also illustrated that 17.44% of the respondents addressed the *takaful* by means of Islamic accounting standards. It should be noted that the percentage of respondents who have used Islamic accounting standards to address *ijarah* and *sukuk* is the same at 12.79%. Only 3.5% of the participants do not use Islamic accounting standards to report or address the stated transactions.

Table 7.4 show the findings of the general principle that give the best description for recognising an element of the financial statement under Islamic accounting standards.

Table 7.4: The Best Description for the General Criteria for Recognising an Element of the Financial Statement under Islamic Accounting Standards.

Variable Group	Frequency (Valid)	% (Valid)
When it is probable that an economic benefit will flow to or from an entity	6	17.6
When the transaction or event becomes contractual	13	38.2
When cash is paid or received	13	38.2
As per Central Bank	1	1.9
None	1	1.9

As can be clearly observed the percentage of participants who chose 'when the transaction or event becomes contractual' and those who chose 'when cash is paid or received' are the same at 38.2%, followed by the percentage of respondents who indicated that the best description of the general criteria for recognising elements of the financial statement under Islamic accounting standards is when it is probable that an economic benefit will flow to or from an entity at 17.6%. However, a minority of the respondents chose as per central bank or none at 1.9%.

Table 7.5: The Recognition of Sale-based Transaction (*e.g. a Murabahah sale*) when the Repayment Period exceeds one Annual Period

Variable Group	Frequency (Valid)	% (Valid)
Income is recognised upfront upon execution of the contract.	2	5.7
Income is allocated equally over the number of months/years of the repayment period	10	28.6
Income is allocated over the relevant period using a rate that exactly discounts estimated future chat payments or receipts through the expected repayment period or when appropriate, a shorter period to the net carrying amount of the amount receivable (*i.e.* similar to the effective interest rate method under IFRS	9	25.7
Income is recognised when cash is received.	14	40

For a better understanding on the subject of accounting practices employed in IFIs, the participants were asked to identify how income on a sale-based transaction such as *murabahah* sale would most likely be recognised, when the repayment period exceeds one annual period. Table 7.5 reveals the outcome of the analysis related to this question, where 40% of the respondents indicated that the income on those types of transactions is recognised when the cash is received. Whereas, 28.6% of participants who completed this survey recognised the income by allocating it equally over the number of months/years of the repayment period, followed by 25.7% of them who treated and recognised similarly the effective interest rate method under IFRS. The percentage of the respondents who recognised an income on a sales-based transaction, for instance *murabahah* as upfront upon execution of the contract was the lowest at 5.7%.

Table 7.6: Recognition of the Sixth Element for items with Characteristics of both Liability and Equity

Variable Group	Frequency (Valid)	% (Valid)
Recognition of the Sixth Element:		
Yes	9	25.7
No	26	74.3

In order to find out whether the IFIs that participated in this survey allow recognition of the 'sixth element' of the financial statements for items with characteristics of both liability and equity, *e.g.* some *murabahah* items, it was essential to ask them this question. Respondents were given Yes and No choices to answer it. The results in table 7.6 depict that 25.7% of the respondents opted for 'yes' and 74.3% stated 'no' that they do not recognise the sixth element for objects with features of both liability and equity.

Table 7.7: Treatment of *Ijara* under IFRS if it meets the Criteria for Finance Lease

Variable Group	Frequency (Valid)	% (Valid)
Allowing *Ijara* to be treated as finance lease:		
Yes	20	60.6
No	13	39.4

The respondents who completed this survey were also asked if their Islamic accounting standards allow *ijara* to be treated as a finance lease, as long as it meets the criteria for finance leasing under IFRS. The findings in table 7.7 showed that more than 60% of the respondents answered 'yes' to this question, whereas approximately 40% of the respondents opted for 'no'.

Table 7.8 reveal the findings related to respondents' position in relation to the treatment of *sukuk* held for trading under Islamic accounting standards, which shows that 53.6% of the respondents measure the *sukuk* at a price that would be received to sell the *sukuk* in a transaction with a buyer in the market.

Table 7.8: Measurement of *Sukuk* held for Trading under the Respective Islamic Accounting Standards

Variable Group	Frequency (Valid)	% (Valid)
As a corresponding proportion of the value of the underlying	5	17.9
At cost, with amortisation of premium or accretion of discount	5	17.9
At a price that would be received to sell the *sukuk* in an order transaction with a buyer in the market.	15	53.6
Market to Market	1	3.6
Not Applicable	2	7.1

However, the percentage of respondents' who measure *sukuk* as a corresponding proportion of the value of the underlying and at cost, with amortisation of premium or accretion of discount is the same at 17.9%. Table 7.8 also shows that only 3.6% of the surveyed participants measure the *sukuk* differently from market to market, and just over 7% of the respondents indicated that *sukuk* is not applicable in their institutions.

Table 7.9: The Presence of Financial Statements for a *Takaful* Operator under the Respective Islamic Accounting Standards

Variable Group	Frequency (Valid)	% (Valid)
As a single set of consolidated financial statements	6	20
As an aggregate of the Takaful operator and participants' funds, without elimination of the transaction and balances between them.	9	30
As separate financial statements	9	30
Not Applicable	4	13.3
Under IFRS	1	3.3
Separated for Income Statement	1	3.3

The respondents were also asked to indicate how a *takaful* operator would most likely submit its financial statements, and those of the participants' funds it manages. Table 7.9 demonstrate that the percentage of respondents who present it as an aggregate of the *takaful* operator and participants' funds, without the elimination of transaction and balances between them and as separate financial statements is exactly the same at 30%.

While, 20% of the respondents who present financial statements for a *takaful* operator under their respective Islamic accounting standards as a single set of consolidated financial statements, only 13.3% of the surveyed participants were not applicable to this question. Moreover, more than 3% of the participants put forward their statements under IFRS. This is exactly the same percentage as respondents who present their statement separately from the income statement as established above.

Table: 7.10: The *Takaful* Operators' Recognition of *Qard* Extended to Participants' Funds under Respective Islamic Accounting Standards

Variable Group	Frequency (Valid)	% (Valid)
As an expense	2	6.3
As a liability, measured at cost	14	43.8
As a liability, measured at fair value	4	12.5
As equity or an equity-like item	3	9.4
As a liability, measured at amortised cost	2	6.3
As an Asset	2	6.3
Not Applicable	5	15.6

Question 26 in this survey attempted to examine how *takaful* operators recognise *qard* extended to participants' funds under Islamic accounting standards. Table 7.10 illustrate the overall findings of the respondents. As a general observation, the majority of the respondents, namely 43.8%, recognised that *qard* provided by *takaful* operators as a liability, was measured at cost. The percentages of IFIs that participated in this survey recognised *qard* as an expense, as a liability, measured at an amortised cost and as an asset are the same at 6.3%. Around 12.5% of the respondents considered *qard* extended to a participants' fund as a liability, measured at a fair value. A minority of respondents, 9.4%, measured *qard* as equity or an equity-like item, whereas the rest of the respondents, namely 15.6%, indicated that their IFIs are not applicable to this inquiry.

Different IFIs adopt various accounting practices, including IFRS. The survey attempted to observe the effect of adopting IFRS on IFIs policies to employ Islamic accounting standards. As the results in 7.11 show the majority of the IFIs will retain the Islamic accounting standards as their main accounting practice.

Table 7.11: How Adopting IFRS Affect IFIs Policy on Islamic Accounting Standards

Variable Group	Frequency (Valid)	% (Valid Responses)
We will retain our Islamic accounting standards	17	51.5
We may need to review some of the requirements of the Islamic accounting standards	9	27.3
We will withdraw our Islamic accounting standards	1	3
No change considered yet	6	18.2
Missing Value	21	

Individually, it can be clearly observed in table 7.11, more than 50% of the IFIs indicated that they would keep their Islamic accounting standards, followed by about 27% of the IFIs which might need to re-evaluate some of the requirements of the Islamic accounting standards. In addition, more than 18% of the IFIs signified that no changes were being considered yet. Only 3% of the respondents indicated that they would replace the IFRS with the Islamic accounting standards.

Table 7.12: Potential Problems Faced by an Institution in Using IFRS for Islamic Finance Instruments

Variable Group	Frequency (Valid)	% (Valid)	Rank of the Importance Attached
Measurement of financial values	12	22.64	1
Some financial transactions	11	20.75	2
Murabahah & *Murabahah* treatment	8	15.10	4
Salam& Parallel *Salam* treatment	5	9.45	5
Takaful Treatment	9	16.98	3
The valuation basis to be used for *Zakat* calculation	2	3.77	7
Ijara	2	3.77	7
All Islamic Products	4	7.54	6

It should be noted that IFRS is the financial reporting which has been issued within Western culture in mind. As discussed in chapters 2 and 3, they are completely different to Islamic culture that is based on the *Qur'an* and *hadith*. Hence, it was necessary to ask the participants about the challenges their institutions faced in applying IFRS to Islamic finance instruments. Table 7.12 depicts the findings of respondents who participated in this survey.

The overall findings in table 7.12 show that there are various problems in using IFRS to treat Islamic finance products. Approximately 23% of the IFIs that participated in this observation indicated that a potential problem is the measurement of financial values, and roughly 22% of them have a problem with some financial transactions. The percentages of respondents who have problems with treating *murabahah*, *murabahah* and *takaful* were very close to each other, at around 16% to 17% respectively. Besides, the percentages of those that have problems in using IFRS to treat *ijara* and the valuation basis to be used for the calculation of *zakat* were exactly the same at 3.77%. Others, approximately 10% indicated that they have problems with using IFRS when they applied it to *salam* and parallel *salam* treatments. The rest of the IFIs, which responded to this survey, specified that using IFRS for Islamic finance affects all Islamic finance products, at approximately 8%.

Table 7.13: Islamic Finance being Religiously Determined Financing Method Requires a Specialised Islamic Accounting System

Variable Group	Frequency (Valid)	% (Valid)	Mean	Standard Deviation
Strongly Disagree	0	0.0		
Disagree	5	13.5		
Neutral	4	10.8	3.9459	0.99850
Agree	16	43.2		
Strongly Agree	12	32.4		

The results depicted in table 7.13 relates to the respondents' opinions on the statement, which argued that 'since Islamic finance is a much specialised and religiously determined financing method, an Islamic accounting system has to be developed'. The findings show that the majority of IFIs that responded to this survey agreed with this statement at around 44% and more than 32% strongly agreed. This indicated that there is a tendency towards a position of agreement. Such a suggestion is reaffirmed by the mean value of 3.9459. In contrast, only a total of 13.5% of the respondents disagreed and strongly disagreed with this statement. In addition, a minority of respondents were neutral to this statement, at approximately 10.8%.

Since the IFRS and Islamic accounting standards are different, it was essential to examine the factors that might distinguish the two practices. The respondents were asked to state their opinion on several statements related to the issue. In each statement they were given a scale from 1 'strongly disagree' to 5 'strongly agree'. The results are reported in table 7.14a and 7.14b.

Table 7.14a: Distinguishing Islamic Accounting from Conventional Accounting Practices

Variable Group	Frequency (Valid)	% (Valid)	Mean	Mean Ranking	Standard Deviation
Islamic accounting principles based on *Qur'an* and *Hadith*					
Strongly disagree	1	2.7			
Disagree	3	8.1	4.0541	4	0.99850
Neutral	2	5.4			
Agree	18	48.6			
Strongly Agree	13	35.1			
The aim and articulation of accountability in both systems are different					
Strongly disagree	0	0.0			
Disagree	7	18.9			
Neutral	2	5.4	3.8649	3	1.05836
Agree	17	45.9			
Strongly Agree	11	29.7			
They are based on different laws					
Strongly disagree	0	0.0			
Disagree	4	10.8	4.0000	3	0.97183
Neutral	5	13.5			
Agree	15	40.5			
Strongly Agree	13	35.1			
Both are products of different forms of cultures					
Strongly disagree	0	0.0			
Disagree	4	10.8	3.9189	3	0.95389
Neutral	6	16.2			
Agree	16	43.2			
Strongly Agree	11	29.7			

In tables 7.14a and 7.14b, there are significant differences in opinion amongst IFIs that responded to this survey. With regards to ontological differences, unsurprisingly it can be clearly noted in table 7.14a that the vast majority of respondents agreed that both systems are based on different principles, at 83.7%. This large percentage is also supported by the mean value of 4.0541. A number of them viewed that the variation in principles does not cause the difference between the two accounting practices with an overall disagreement of around 11%, whilst some of the respondents felt otherwise and remained neutral at about 5.5%.

Table 7.14a also confirmed that 76% of IFI representative which responded to this survey generally agreed (at a mean value of 3.8649) with the statement which argues that ‘the aim and articulation of accountability in both systems are different’, with 45.9% agreeing and 29.7% strongly agreeing. Furthermore, about 19% of the respondents disagreed, while approximately 5.5% remained neutral. The overall findings also showed that 40.5% of the IFIs that responded to the study agreed and more than 35% strongly agreed on the claims of the statement that the IFRS and Islamic accounting systems are based on different laws, whereas around 11% of the respondents disagreed and 13.5% were neutral. The mean value of 4.0000 revealed general support for this statement.

The final statement in table 7.14a specifically asked the respondents about their perceptions of the beliefs and attitudes regarding whether different forms of culture would produce different accounting systems or not. In general, there was an overall agreement that culture is one of the main factors that causes the variances between the accounting practices, at approximately 73%. Thus, an indication of this support can be seen through the mean value of 3.9189 and the level of disagreement is not more than about 11%, while the rest of the respondents were neutral at just above 16%.

It should be noted that table 7.14b summarised the rest of the findings from the question that asked the respondents about the factors that might distinguish Islamic accounting and conventional accounting systems. Respondents were asked for their opinions about whether the differences in the conception of time result in different accounting practices, as the concept and treatment of time and the way it is understood has particular accounting implications. While this was empirically questioned and responded in this section, due to the limited length of this study, the concept of time in Islam and other traditions could not be explored in detail. Their responses were very similar to other statements, with a very high percentage that agreed and strongly agreed, resulting in a total of nearly 60% with a comparatively high mean value of 3.7027, although, roughly 32.5 % of the participants remained neutral. While, just above 8% of the IFIs participants disagreed and 0% strongly disagreed.

Table 7.14b further demonstrate different perceptions of IFIs which participated in this survey about whether or not the different treatments for the concept of value would distinguish Islamic accounting from the conventional one. On the whole, the overall participants who agreed with this statement are more than 70%. The mean value of

3.7838 indicates overall support for this statement. Conversely, only 13.5% disagreed and just over 16% were neutral.

Table 7.14b: Distinguishing Islamic Accounting from Conventional Accounting Practices (Cont)

Variable Group	Frequency (Valid)	% (Valid)	Mean	Mean Ranking	Standard Deviation
The conception of time is different					
Strongly disagree	0	0.0			
Disagree	3	8.1	3.7027	3	0.87765
Neutral	12	32.4			
Agree	15	40.5			
Strongly Agree	7	18.9			
The concept of value is treated differently					
Strongly disagree	0	0.0			
Disagree	5	13.5	3.7838	3	0.94678
Neutral	6	16.2			
Agree	18	48.6			
Strongly Agree	8	21.6			
Islamic and conventional finance require different accounting treatments					
Strongly disagree	0	0.0			
Disagree	3	8.1	4.2703	3	0.90212
Neutral	2	5.4			
Agree	14	37.8			
Strongly Agree	18	48.6			
The need to demonstrate compliance with *Shari'ah* in all activities distinguishes Islamic accounting					
Strongly disagree	0	0.0	4.4474	3	0.68566
Disagree	1	2.6			
Neutral	1	2.6			
Agree	16	42.1			
Strongly Agree	20	52.6			

In addition, there are indications in table 7.14b that the participants believed that one of the most important factors that distinguishes between the two accounting practices is that the Islamic and conventional finance require different accounting treatments. The findings showed that there was unanimous agreement with this argument at around 86.5%, whilst 48.6% of them strongly agreed and 37.8% agreed. The mean value of 4.2703 additionally indicates confident support amongst the participants. However, as can be seen, just over 8% of the participants disagreed and 0% strongly disagreed, while approximately 5.5% of those questioned remained neutral.

Furthermore, the results illustrated that 52.6% of the participants strongly agreed and 42.1% agreed with the suggestion that compliance with *Shari'ah* in all activities distinguishes Islamic accounting from the conventional one, achieving a total of 94.7%. The mean value of 4.4474 emphasised the strong support given to this statement. Unsurprisingly; only 2.6% of the respondents disagreed with this suggestion and 2.6% of those surveyed stayed neutral.

Table 7.15: Considering the Possibility of Adopting the Islamic Accounting System

Variable Group	**Frequency (Valid)**	**% (Valid)**
Adopting Islamic Accounting System if it was available:		
Yes	33	89.2
No	4	10.8

This survey asked the representatives of IFIs that participated in this study to state if there was any consideration to the possibility of adopting the Islamic accounting system issued by AAOIFI. It can be clearly viewed from table 7.15 that the vast majority of the respondents answered 'yes' to this question, at approximately 90%, while the rest of the respondents answered no at just over 10%.

Part three of this survey asked respondents about their perceptions of the beliefs and attitudes with regards to the importance of AAOIFI accounting standards. Using the 5-point Likert scale 'strongly disagree' to 'strongly agree' participants were asked to specify their level of agreement with twelve different sequences of statements. In each case, they were asked to think about whether the AAOIFI or the IFRS standards are the best way for an IFI to report under.

Table 7.16a demonstrate that the vast majority of the respondents either agreed or strongly agreed with the statement which argues that 'the particularities of Islamic finance need AAOIFI accounting standards' at 63.2% and 34.2% respectively, while only 2.6% remained neutral. In contrast, none of the respondents disagreed or strongly disagreed with the statement and remained at 0% for both scales. This opinion is strongly supported by the mean value at 4.3158.

In addition, table 7.16a revealed that none of the respondents neither strongly disagreed, nor disagreed at 0% with the statement which claims that 'Islamic financial institutions should account under the Financial Accounting Standards', whereas, 63.2%

of the respondents agreed and 28.9% strongly agreed. This is obvious from the mean value of 4.2105. The rest of the participants remained neutral at 7.9%.

Table 7.16a: Perceptions on AAOIFI Accounting Standards

Variable Group	Frequency (Valid)	% (Valid)	Mean	Mean Ranking	Standard Deviation
The particularities of Islamic Finance need AAOIFI accounting standards					
Strongly disagree	0	0.0			
Disagree	0	0.0	4.3158	2	0.52532
Neutral	1	2.6			
Agree	24	63.2			
Strongly Agree	13	34.2			
Islamic financial institutions should account under the Financial Accounting Standards.					
Strongly disagree	0	0.0	4.2105	2	0.57694
Disagree	0	0.0			
Neutral	3	7.9			
Agree	24	63.2			
Strongly Agree	11	28.9			
AAOIFI standards must be made mandatory for Islamic finance					
Strongly disagree	0	0.0			
Disagree	2	5.3			
Neutral	9	23.7	3.8947	3	0.83146
Agree	18	47.4			
Strongly Agree	9	23.7			
AAOIFI should protect Islamic financial institutions from the effect of IFRS					
Strongly disagree	1	2.6			
Disagree	2	5.3	3.9474	4	0.89887
Neutral	4	10.3			
Agree	22	57.9			
Strongly Agree	9	23.7			

As can be seen in Table 7.16a, most of the representatives of IFIs participated in this survey, about 71%, agreed to consider making AAOIFI standards mandatory for Islamic finance. This over all agreement is also demonstrated by the mean value of 3.8947. The findings in table 7.16a also confirm that the percentage of respondents who disagreed was very low at 5.3%, while around 24% of the IFIs that participated in this survey chose to be neutral. Furthermore, most of the participants also required that the AAOIFI protects the IFIs from the effects of IFRS. This can be clearly observed in table 7.16a, where overall 81.6% of them agreed and strongly agreed, while only 7.9% of the participants disagreed and strongly disagreed. This is understandable from the mean value of 3.9474. The rest of the participants remained neutral at 10.3%.

Table 7.16b reveal further results in relation to the respondents' opinion and preferences concerning the AAOIFI standards. In general, the majority of the respondents of the IFIs, who participated in the survey for this study, believed that AAOIFI standards will increase the accuracy and the comparability of the financial information of IFI. Thus, 47.4% agreed and 34.2% strongly agreed with this statement and an additional indication was provided by the mean value of 4.1316. Conversely, a minority of respondents disagreed at 2.6% and none of them strongly disagreed. Furthermore, around 16% of the respondents were neutral in relation to this argument.

As the results in table 7.16b show on the statement that 'AAOIFI must globalise its own accounting standards, otherwise IFIs should report with IFRS even though it is not suitable for the Islamic environment', more than 42% of the respondents agreed that AAOIFI standards must be globalised or IFIs have to employ IFRS, and just over 10% strongly agreed. The mean value of 3.1316 signifies a slight tendency towards a position of agreement. Nevertheless, approximately 37% of the respondents believe that IFIs should not report with a statement that is not suitable for the Islamic environment, with 23.7% disagreeing and 13.2% strongly disagreeing. Only 10.5% of the respondents stayed neutral to the above argument.

Respondents were also asked to express their perception about whether harmonising or integrating IFRSs with AAOIFI standards is the best solution for the accounting problems or not. As can be seen in Table 7.16b, majority of the respondents at roughly 85% overall support the idea of harmonising or integrating the two standards. Support for this statement can be evidenced by the comparatively high mean value of 3.9211. On the contrary, few respondents neither disagreed nor strongly disagreed at 2.6% and 5.3% respectively. The rest of the respondents were neutral to the above statement.

The respondents who completed this survey were also requested to indicate their opinion about the statement which claims that 'AAOIFI should not continue to issue accounting standards if those standards are going to be neglected by the Islamic institutions'.

Table 7.16b: Perceptions on AAOIFI Accounting Standards (cont.)

Variable Group	Frequency (Valid)	% (Valid)	Mean	Mean Ranking	Standard Deviation
AAOIFI will increase the accuracy and the comparability of the financial information of Islamic financial institutions.					
Strongly disagree	0	0.0	4.1316	3	0.77707
Disagree	1	2.6			
Neutral	6	15.8			
Agree	18	47.4			
Strongly Agree	13	34.2			
AAOIFI must globalise its own accounting standards otherwise IFIs should report with IFRS even though it is not suitable for the Islamic environment					
Strongly disagree	5	13.2	3.1316	4	1.27705
Disagree	9	23.7			
Neutral	4	10.5			
Agree	16	42.1			
Strongly Agree	4	10.5			
Harmonising or integrating IFRSs with AAOIFI standards is the best solution for accounting problems.					
Strongly disagree	2	5.3	3.9211	4	0.94101
Disagree	1	2.6			
Neutral	3	7.9			
Agree	24	63.2			
Strongly Agree	8	21.1			
AAOIFI should not continue to issue accounting standards if those standards are going to be neglected by the Islamic institutions.			2.9474	4	1.27231
Strongly disagree	7	18.4			
Disagree	7	18.4			
Neutral	8	21.1			
Agree	13	34.2			
Strongly Agree	3	7.9			

Regarding the results depicted in table 7.16b, it is obvious that the opinion about this statement was controversial, given that the results were close to each other. The overall percentage of the respondents who agreed and strongly agreed was just over 42%. This was close to the percentage of the respondents who disagreed and strongly disagreed at 18.4% each and attained a total of 36.8%. In addition, about 21% of the participants were neutral. These results emphasised a variety of opinions regarding this statement at a mean value of 2.9474.

Table 7.16c: Perceptions on AAOIFI Accounting Standards (cont.)

Variable Group	Frequency (Valid)	% (Valid)	Mean	Mean Ranking	Standard Deviation
IFRS are applied internationally because the IASB is a neutral body					
Strongly disagree	1	2.6			
Disagree	6	15.8	3.3947	4	0.91650
Neutral	10	26.3			
Agree	19	50.0			
Strongly Agree	2	5.3			
IFRS satisfy the needs of conventional and Islamic Institutions.					
Strongly disagree	3	7.9			
Disagree	10	26.3			
Neutral	6	15.8	3.1842	4	1.18219
Agree	15	39.5			
Strongly Agree	4	10.5			
The applications of all IFRS in Islamic financial institutions are suitable for the Islamic environment.					
Strongly disagree	3	7.9			
Disagree	10	26.3	3.0000	4	1.03975
Neutral	10	26.3			
Agree	14	36.8			
Strongly Agree	1	2.6			
Reporting with IFRS will cancel the need for AAOIFI accounting standards.					
Strongly disagree	6	15.8			
Disagree	10	26.3	2.6579	4	1.07241
Neutral	15	39.5			
Agree	5	13.2			
Strongly Agree	2	5.3			

Table 7.16c illustrates the findings of the IFIs that participated in this survey. Variations were established across the participants of the representatives of the IFIs, participated in this study on their opinion as to whether 'IFRS are applied internationally because the IASB is a neutral body'. As can be seen, more than 55% of respondents agreed with the assertion, whereas, less than one third (26.2%) of the respondents remained neutral. The findings in table 7.16c showed that 15.8% disagreed and 2.6% strongly disagreed with this suggestion. The moderately high mean value of 3.3947 signified support for this statement.

Table 7.16c also indicate that more than one third (34.2%) of the respondents disagreed with the statement that IFRS satisfy the needs of both conventional and Islamic institutions: 7.9% strongly disagreed and 26.3% disagreed. In total, 50% of the sample agreed with this assertion, while 15.8% of the respondents who completed this survey stayed neutral. The variety of opinions showed that there was no complete agreement at a mean value of 3.1842.

In terms of the suitability of the IFRS applications for the Islamic environment, table 7.16c reveals that more than one third (34.2%) of the respondents did not support this statement with 26.3% disagreeing and around 8% strongly disagreeing. A small percentage of the respondents at 2.6% strongly agreed and around 37% agreed that the applications of all IFRS in IFIs are suitable for the Islamic environment. From another point of view, 26.3% of the participants stayed neutral. This overall difference of opinion was established by the mean value of 3.0.

In furthering the analysis, Table 7.16c also depicts the results related to the assertion that 'reporting with IFRS will cancel the need for AAOIFI accounting standards'. As can be seen from the results, in overall, a high percentage of the respondents disagreed with the statement, with around 16% strongly disagreeing and about 27% disagreeing. In contrast, a small percentage of 18.5% agreed. The rest of the participants remained neutral at approximately 40%. The overall disagreement with this statement was also confirmed by the mean value of 2.6579.

7.3 INFERENTIAL STATISTICS

The descriptive statistical analysis in the previous section provide a base to develop certain understanding in relation to the perception of the participants for accounting related issues for IFIs. This section takes the analysis further in examining the determining factors of the expressed opinions and perceptions by using non-parametric tests in the form of KW and MUW test to identify whether there is any difference in the expressed opinion in relation to the identified independent variables.

Table 7.17 depicts the significant independent variables on the question that asks the participants to what extent their institutions are considering adopting an accounting standard that deals with IFIs. The location control variable is statistically significant at a level of 10%, with an estimated *p*-value of 0.091. IFIs which operate globally, in Luxembourg, Turkey, Turkeym Iraq, and the UAE scored the highest mean rank at a value of 30.50 for all the named countries, while Qatar came second with a mean rank of 21.75. This mean ranking was followed by Pakistan, Jordan and Egypt with a mean rank value of 18.83, 17.38 and 15.19, respectively. The lowest mean rank was 13.00, recorded by Libya, Bahrain, Indonesia, Saudi Arabia and some unnamed countries that participated in this survey.

Table 7.17: Significance of Independent Variables on the Statement: '*The consideration of adopting accounting standards that deals with IFIs'*

Statement	Group (Control Variables)	Group Categories	Mean Rank	Test	Asymp. Sig. (p)
The consideration of adopting accounting standards that deals with IFIs	Location	Bahrain	13.00	KW Test	.091**
		Egypt	15.19		
		Global	30.50		
		Indonesia	13.00		
		Jordan	17.38		
		Libya	13.00		
		Luxembourg	30.50		
		Malaysia	13.00		
		Pakistan	18.83		
		Qatar	21.75		
		Saudi Arabia	13.00		
		Turkey	30.50		
		Turkeym Iraq	30.50		
		UAE	30.50		
		Unknown	13.00		

Note: (*) Statistically significant at a 5% level; (**) statistically significant at 10%

Table 7.18 resports the results of the analysis for the significance of control variables on the statement relating to the best description for the general criteria in recognising an element of the financial statement. The age group control variable is found to be significant at 5% with an estimated *p*-value of 0.034. The subgroup aged 55-65+

scored the highest mean rank value of 25.00; followed by participants aged 35-45 with a mean ranking of 20.67. The subgroup aged 45-55 years old came third with a mean rank value of 19.80. The lowest mean rank was attained by the age subgroup 25-35 at a level of 11.71.

Table 7.18: Significance of Independent Variables on the Statement: '*The best description for the general criteria in recognising an element of the financial statement'*

Statement	Group (Control Variables)	Group Categories	Mean Rank	Test	Asymp. Sig. (p)
The best description for the general criteria in recognising an element of the financial statement	Age Group	25-35 35-45 45-55 55- 65+	11.71 20.67 19.80 25.00	KW Test	.034*

Note: (*) Statistically significant at a 5% level; (**) statistically significant at 10%

The participants were asked as to how their institutions recognise a sale-based transaction such as a *murabahah* sale when the repayment period exceeds one annual period, for which Table 7.19 present the findings. The location and the name of the accounting standards applied in the institution are statistically significant at 10% with an estimated *p*-value of 0.058 and 0.052 respectively.

With respect to the location, table 7.19 illustrate that the highest mean rank was recorded by Egypt with a level of 25.63, followed by Jordan with a mean rank of 24.30. Malaysia came in third position with a mean rank value of 22.75. Unnamed countries that participated in this survey scored a mean ranking at value of 20.83 and were in fourth place. Countries such as Pakistan and Qatar scored a lower mean ranking at 17.67; followed by Indonesia and Turkey with a mean rank of 17.00. Whereas, countries such as Libya, Luxembourg, Turkey, Iraq and institutions operating globally recorded a similar mean ranking with a value of 7.50. The UAE, however, scored the lowest mean rank with a value of 1.50.

It should be noted that in regard to the name of Islamic accounting standards applied in the participated institutions, table 7.19 show that IFIs applied national standards based on IFRSs attained the highest mean rank with a value of 25.63. This ranking was followed by national Islamic standards not based on AAOIFI FAS with a mean rank of 24.67. AAOIFI Financial Accounting Standards (AAOIFI FAS) and national

Islamic standards adapted from AAOIFI FAS scored a similar mean rank of 17.50 and 17.00, respectively. IFRS' and national standards not based on IFRSs scored the lowest mean rank with value of 9.88 and 8.67 respectively.

Table 7.19: Significance of Control Variables on the Statement: '*The recognition of a sale-based transaction (e.g. a murabahah sale) when the repayment period exceeds one annual period'*

Statement	Group (Control Variables)	Group Categories	Mean Rank	Test	Asymp. Sig. (p)
The recognition of a sale-based transaction (*e.g.* a *Murabahah* sale) when the repayment period exceeds one annual period	Location	Egypt	25.63	KW Test	.058**
		Global	7.50		
		Indonesia	17.00		
		Jordan	24.30		
		Libya	7.50		
		Luxembourg	7.50		
		Malaysia	22.75		
		Pakistan	17.67		
		Qatar	17.67		
		Saudi Arabia	1.50		
		Turkey	17.00		
		Turkeym Iraq	7.50		
		UAE	1.50		
		Unknown	20.83		
	The name of Islamic accounting standards applied in your institution	AAOIFI Financial Accounting Standards (AAOIFI FAS)	17.50	KW Test	.052**
		National Islamic standards adapted from AAOIFI FAS	17.00		
		National Islamic standards not based on AAOIFI FAS	24.67		
		National Standards based on IFRSs	25.63		
		National Standards not based on IFRSs	8.67		
		IFRSs	9.88		

Note: (*) Statistically significant at a 5% level; (**) statistically significant at 10%

Table 7.20 illustrate the significance of control variables on the statement asking about the treatment of *ijara* under Islamic accounting standards and whether it meets the criteria for finance lease. As can be seen, gender group was found to be significant at 5% level of significance with an estimated *p*-value of .030. As can be evidently seen from the table 7.20, females reached the highest mean rank at 26.00 followed by males with a mean rank of 15.52.

Table 7.20: Significance of Control Variables on the Statement: '*The treatment of Ijara under Islamic accounting standards and whether it meets the criteria for finance lease'*

Statement	Group (Control Variables)	Group Categories	Mean Rank	Test	Asymp. Sig. (p)
The treatment of *Ijara* under Islamic accounting standards if it meets the criteria for finance lease	Gender	Male	15.52	MWU	.030**
		Female	26.00		
	Location	Egypt	10.50	KW Test	.066**
		Global	27.00		
		Indonesia	27.00		
		Jordan	20.40		
		Libya	22.88		
		Luxembourg	10.50		
		Malaysia	10.50		
		Pakistan	27.00		
		Qatar	16.00		
		Saudi Arabia	10.50		
		Turkey	10.50		
		Turkeym Iraq	27.00		
		UAE	10.50		
		Unknown	10.50		
	The nature of your institutions	Islamic bank	17.00	KW Test	.048*
		Islamic finance institution	10.00		
		Islamic window as part of a conventional bank	10.00		
		Islamic window as part of a conventional financial institution	20.00		
	The name of Islamic accounting standards applied in your institution	AAOIFI Financial Accounting Standards (AAOIFI FAS)	19.30	KW Test	.017*
		National Islamic standards adapted from AAOIFI FAS	27.00		
		National Islamic standards not based on AAOIFI FAS	10.50		
		National Standards based on IFRSs	10.50		
		National Standards not based on IFRSs	10.50		
		IFRS	22.88		

Note: (*) Statistically significant at a 5% level; (**) statistically significant at 10%

Location is another control variable that was found to be statistically significant with this statement. As can be seen in Table 7.20, location is significant at 10% level. Indonesia, Pakistan, Turkeym Iraq and Global scored the highest mean rank at 27.00. In addition, Libya came second with a mean rank of 22.88, followed by Jordan with a mean rank of 20.40, while Qatar achieved a much lower rank compared to Jordan with a mean rank of 16.00. The lowest figure was reached by Egypt, Luxembourg, Malaysia, Saudi Arabia, Turkey, UAE and Unknown with a mean rank 10.50.

In addition, table 7.20 depicts that the control variable of the nature of the institution is also statistically significant at a 5% significance level, which means that there was a statistically significant difference between the participants from different IFIs in the treatment of *ijara* under Islamic accounting standards and whether it meets the criteria for finance lease, with an estimated *p*-value of 0.048, with various mean rankings which gives weight to Islamic window as part of a conventional financial institution that held the highest mean rank with 20.00. This figure was followed by Islamic banks at 17.00, whereas the rest of the IFIs remained at a mean ranking of 10.00.

Furthermore, table 7.20 shows that the name of Islamic accounting standards applied in the participating institutions, which is significant at a level 5% with an estimated *p*-value of 0.017. Thus, the institutions employing national Islamic standards adapted from AAOIFI FAS scored the highest mean ranking at a value of 27.00. This mean rank was followed by the IFIs, which uses IFRSs at a value of 22.88. The institutions that applied AAOIFI Financial Accounting Standards (AAOIFI FAS) came third with a mean rank of 19.30. As the results show, the lowest mean ranking was scored by IFIs which are implementing national Islamic standards not based on AAOIFI FAS, national Standards based on IFRSs and national standards not based on IFRSs with a mean rank of 10.50.

Table 7.21 display the significance of the control variable on the statement that asks the participants about ‘the presence of financial statements of a *takaful* operator under your Islamic accounting standards’. As depicted by the results, the nature of the institutions control variable is statistically significant at a level of 10% with an estimated *p*-value of 0.059. The IFIs group category achieved the highest mean rank with a value of 19.57; this is followed by Islamic banks with a mean rank value of 12.17. The lowest mean rank noted here is held by an Islamic window as part of a conventional bank and Islamic window as part of a conventional financial institution with a mean rank value of 7.00 and 10.80 respectively.

Table 7.21: Significance of Control Variables on the Statement: '*The presence of financial statements of a Takaful operator under your Islamic accounting standards'*

Statement	Group (Control Variables)	Group Categories	Mean Rank	Test	Asymp. Sig. (p)
The presence of financial statements of a Takaful operator under your Islamic accounting standards	The nature of your institutions	Islamic bank	12.17	KW Test	.059**
		Islamic finance institution	19.57		
		Islamic window as part of a conventional bank	7.00		
		Islamic window as part of a conventional financial institution	10.80		

Note: (*) Statistically significant at a 5% level; (**) statistically significant at 10%

Table 7.22 depicts the independent variables that are statistically significant in the statement that asks the perception of the *takaful* operators' recognition for *qard* extended to a participants fund under your Islamic accounting standards. The results show that only the current position and the name of the Islamic accounting standards applied in the participating institutions were significant at 10% with an estimated *p*-value of 0.078 and 0.066 respectively. The mean rank in table 7.22 highlights the various opinions concerning the statement with those who hold different positions and the accounting standards are applied in the participating IFIs.

With respect to the current position, the mean rank clearly signified that the senior auditor, who might have more experience, achieved the highest mean rank at a level of 26.83. This situation was accurate for head of department and financial manager positions, which scored 18.63 and 17.33 respectively. It should be noted that the lowest figure with regards to the mean rank value of control variables shown in table 7.22 is auditor manager at 1.75. The mean rank value for the remaining positions fluctuated from 15.30 for senior accounting to 10.50 for accounting specialist and *Shari'ah* advisory.

Table 7.22: Significance of Control Variables on the Statement: '*The Takaful operators' recognition for Qard extended to a participants fund under your Islamic accounting standards'*

Statement	Group (Control Variables)	Group Categories	Mean Rank	Test	Asymp. Sig. (p)
The *Takaful* operators' recognition for *Qard* extended to a participants fund under your Islamic accounting standards	The current position	Head of Department	18.63	KW Test	.078**
		Financial Manager	17.33		
		Auditor Manager	1.75		
		Senior Accounting	15.30		
		Senior Auditor	26.83		
		Accounting Specialist	10.50		
		Relationship Manager	12.30		
		Shariah Advisory	10.50		
	The name of Islamic accounting standards applied in your institution	AAOIFI Financial Accounting Standards (AAOIFI FAS)	15.04	KW Test	.066**
		National Islamic standards adapted from AAOIFI FAS	20.50		
		National Islamic standards not based on AAOIFI FAS	16.58		
		National Standards based on IFRSs	14.67		
		National Standards not based on IFRSs	7.33		
		IFRSs	27.75		

Note: (*) Statistically significant at a 5% level; (**) statistically significant at 10%

Table 7.22 also demonstrates the various perceptions between the IFIs that applied different accounting standards. The IFIs that implement IFRS' have the highest mean rank value at 27.75; which is then followed by participants who are using national Islamic standards adapted from AAOIFI FAS with a mean rank value of 20.50. The IFIs which participated in this survey using national Islamic standards not based on AAOIFI FAS, AAOIFI Financial Accounting Standards (AAOIFI FAS) and national standards based on IFRS scored less than this mean rank value with 16.58, 15.04 and 14.67 respectively. The lowest mean rank from this control variable was for national standards not based on IFRSs with a mean rank of 7.33.

Table 7.23 presents the findings related to the opinions of the participants on adopting IFRS on the policy on Islamic accounting standards, which shows that location was the only control variable being significant at a 10% significance value, as its estimated *p*-value is 0.080. This shows that there are statistically significant variances in the perceptions of the participants operating in different countries with regards to the statement mentioned above.

Table 7.23: Significance of Control Variables on the Statement: '*More and more countries are converging with or adopting IFRS. How does this affect your policy on Islamic accounting standards?'*

Statement	Group (Control Variables)	Group Categories	Mean Rank	Test	Asymp. Sig. (p)
More and more countries are converging with or adopting IFRS. How does this affect your policy on Islamic accounting standards?	Location	Egypt	17.14	KW Test	.080**
		Global	30.50		
		Indonesia	9.00		
		Jordan	9.00		
		Libya	12.25		
		Luxembourg	22.00		
		Malaysia	30.50		
		Pakistan	13.33		
		Qatar	24.83		
		Saudi Arabia	9.00		
		Turkey	30.50		
		Turkeym Iraq	9.00		
		UAE	9.00		
		Unknown	20.50		

Note: (*) Statistically significant at a 5% level; (**) statistically significant at 10%

This situation is comparatively evidenced by the high mean rank of some of the group categories in the location control variable. The respondents from Malaysia, Turkey, and IFIs operating in different countries (Global) reached the highest mean rank at 30.50; followed by Qatar, Luxembourg and unknown at 24.83, 22.00 and 20.50 respectively. Egypt, Pakistan and Libya achieved less than those figures with a mean rank value of 17.14, 13.33 and 12.25 respectively. The lowest mean rank was scored by respondents from UAE, Turkeym Iraq, Saudi Arabia, Jordan and Indonesia with a value of 9.00.

Table 7.24 presents the impact of independent variables on the statement that 'Islamic accounting principles are based on the *Qur'an* and *Hadith*, whereas the conventional are not', for which four independent variables were found to be significant: academic qualifications, professional qualifications, and the period of working and the nature of the institution. While the first three control variables are significant at a level of 10%, the last control variable is significant at 5%.

Academic qualifications, as an independent variable are significant at a 10% significance value, as the estimated *p*-value is 0.069, which indicated that there are variances in the perceptions directed at this statement by respondents holding different academic backgrounds. This argument is further supported by a relatively high mean rank for the majority of the group categories in the academic qualification control variable. The highest mean rank value was scored by the group with qualifications such as a PhD in accounting, economics and finance at a level with a value of 23.00, followed by a BSc in accounting, economic and finance with a value of 22.11. An MBA qualification and MSc in accounting, economics and finance scored relatively close to one other at 17.58 and 16.75 respectively. The lowest score is for those pursuing a qualification with the Association of Chartered Certified Accountants (ACCA) with a value of 2.00.

The professional qualifications control variable, with an estimated *p*-value of 0.100, points to similarities in the answers recorded by the questionnaire survey for this specific proposition. Table 7.24 shows that the highest mean rank value was scored by the MBA, with a value of 27.50. This mean rank was followed by the national certified public accountant and CIFP, CIPA, APFA and CAIIB with a value of 18.75 and 17.00 respectively. The professionals who are British Chartered Certified Accountants achieved a lower mean rank value than those with professional qualifications with a value of 10.00, which were double the participants who have no professional qualifications, who scored a mean rank of 5.00. The lowest mean rank value was scored by ACCA with a value of 1.00.

The independent variable, the period of working control variable, with a statistically significant *p*-value of .081, resulted in the group who worked for less than one year achieving the highest mean rank with a value of 25.88. This ranking was followed by participants who have been working for more than 15 years and who worked between 5 to 10 years with scores of 19.83 and 19.60 respectively. While the participants who worked from 10 to 15 years scored a mean rank of 18.14, participants who worked from 1 to 5 years scored the lowest mean rank with a value of 10.56.

Table 7.24: Significance of Control Variables on the Statement: '*Islamic accounting principles are based on the Qur'an and Hadith, whereas the conventional are not'*

Statement	Group (Control Variables)	Group Categories	Mean Rank	Test	Asymp. Sig. (p)
Islamic accounting principles are based on the Qur'an and Hadith, whereas the conventional are not	Academic qualifications	BSc in Accounting, Economic and finance	22.11	KW Test	.069**
		MSc in Accounting, Economics and Finance	16.75		
		PhD in Accounting, Economics and Finance	23.00		
		MBA	17.58		
		ACCA	2.00		
	Professional qualifications	National Certified Public Accountant	18.75	KW Test	.100**
		British Chartered Certified Accountant	10.00		
		CIFP, CIPA, APFA and CAIIB	17.00		
		ACCA	1.00		
		MBA	27.50		
		No professional qualifications	5.00		
	The period of working	Less than one year	25.88	KW Test	.081**
		From one to 5 years	10.56		
		From 5 to 10 years	19.60		
		From 10 to 15 years	18.14		
		More than 15 years	19.83		
	The nature of your institutions	Islamic bank	13.24	KW Test	.046*
		Islamic finance institution	22.75		
		Islamic window as part of a conventional bank	14.00		
		Islamic window as part of a conventional financial institution	21.00		

Note: (*) Statistically significant at a 5% level; (**) statistically significant at 10%

With regards to the independent variable of the nature of the institution, a wide range of opinions were expressed for the statement from table 7.24 by different institutions that have different business activities. This is explained by the estimated *p*-value, which is 0.046. Furthermore, the mean ranking supports this suggestion. The Islamic finance institutions achieved the highest mean rank values, with values of 22.75, while participants from Islamic window as part of a conventional financial institution achieved a lower mean rank of 21.00; followed by participants from Islamic window as part of a conventional bank and Islamic banks with a mean rank value of 14.00 and 13.24 respectively.

Table 7.25 depicts the findings by evaluating the impact of control variables on the statement emphasising that 'the Islamic and conventional systems are based on different laws'. The independent variable found to be significant for this statement was academic qualification. This control variable with a *p*-value of 0.059 and statistically significant at a significance level of 10%, resulted in the highest mean rank value being obtained by the group which holds BSc in accounting, economics and finance with a value of 22.00; the subgroup representing MSc in accounting, economics and finance scored the somewhat lesser value of 20.58, followed by the MBA with a mean rank value of 13.67. The lowest mean rank was achieved by PhD in accounting, economics and finance group, and ACCA with values of 4.75 and 9.75 respectively.

Table 7.25: Significance of Control Variables on the Statement: '*The Islamic and conventional systems are based on different laws'*

Statement	Group (Control Variables)	Group Categories	Mean Rank	Test	Asymp. Sig. (p)
The Islamic and conventional systems are based on different laws	Academic qualifications	BSc in Accounting, Economic and finance	22.00	KW Test	.059**
		MSc in Accounting, Economics and Finance	20.58		
		PhD in Accounting, Economics and finance	4.75		
		MBA	13.67		
		ACCA	9.75		

Note: (*) Statistically significant at a 5% level; (**) statistically significant at 10%

Table 7.26 analysed the significance of independent variables on the statement that 'the Islamic and conventional systems are products of different forms of culture'. The only independent variable, which had a statistical significance at 5%, with an estimated *p*-value 0.005 was academic qualification indicating the existence of strong differences among the participants in relation to this statement, which can be attributable to a number of factors, such as a lack of understanding about how culture effects choosing the accounting standards in a country. This independent variable is divided into five subgroups that included a range of different academic qualifications. Among the variables, the BSc in accounting, economics and finance achieved the highest mean rank value at 25.93, followed by the MSc in accounting, economics and finance with a mean rank of 15.25. The MBA and ACCA achieved a lower mean rank value of 14.83 and 10.50 respectively. The lowest mean rank value was awarded to a PhD in accounting, economics and finance with a mean rank value of 5.00.

Table 7.26: Significance of Control Variables on the Statement: '*The Islamic and conventional systems are products of different forms of cultures'*

Statement	Group (Control Variables)	Group Categories	Mean Rank	Test	Asymp. Sig. (p)
The Islamic and conventional systems are products of different forms of cultures	Academic qualifications	BSc in Accounting, Economic and finance	25.93	KW Test	.005*
		MSc in Accounting, Economics and Finance	15.25		
		PhD in Accounting, Economics and finance	5.00		
		MBA	14.83		
		ACCA	10.50		

Note: (*) Statistically significant at a 5% level; (**) statistically significant at 10%

Table 7.27 examined the impact of independent variables on the statement that 'the concept of value is treated differently'. In this table, one control variable was selected and subsequently divided into various subgroups. The academic qualifications variable was statistically significant *p*-value at 0.058, which indicates key differences between the participants directed at this independent variable.

Table 7. 27: Significance of Control Variables on the Statement: '*The concept of value is treated differently'*

Statement	Group (Control Variables)	Group Categories	Mean Rank	Test	Asymp. Sig. (p)
The concept of value is treated differently	Academic qualifications	BSc in Accounting, Economic and finance	23.21	KW Test	.058**
		MSc in Accounting, Economics and Finance	18.71		
		PhD in Accounting, Economics and finance	5.75		
		MBA	13.58		
		ACCA	11.75		

Note: (*) Statistically significant at a 5% level; (**) statistically significant at 10%

The academic qualifications control variable is expressed by various subgroups: The BSc in accounting, economics and finance subgroup achieved the highest mean rank value with the figure of 23.21; followed by the MSc in accounting, economics and finance with a mean rank value of 18.71. In comparison, the MBA and ACCA scored less with a mean rank value of 13.58 and 11.75 respectively. The PhD in accounting, economics and finance secured the lowest mean rank with a value of 5.75.

Table 7.28: Significance of Control Variables on the Statement: '*The Islamic finance and conventional require different accounting treatment'*

Statement	Group (Control Variables)	Group Categories	Mean Rank	Test	Asymp. Sig. (p)
The Islamic finance and conventional require different accounting treatment	The current position	Head of Department	14.50	KW Test	.021*
		Financial Manager	24.56		
		Auditor Manager	12.50		
		Senior Accountant	28.00		
		Senior Auditor	9.00		
		Accounting Specialist	28.00		
		Relationship Manager	13.50		
		Shariah Advisory	12.50		
	Location	Egypt	26.50	KW Test	.059**
		Global	2.00		
		Indonesia	12.50		
		Jordan	17.30		
		Libya	28.50		
		Luxembourg	12.50		
		Malaysia	20.50		
		Pakistan	23.17		
		Qatar	6.33		
		Saudi Arabia	12.50		
		Turkey	17.83		
		Turkeym Iraq	2.00		
		UAE	12.50		
		Unknown	17.83		

Note: (*) Statistically significant at a 5% level; (**) statistically significant at 10%

The analysis of the opinions of the participants in relation to 'the Islamic finance and conventional require different accounting treatments' is presented in Table 7.28. There were two independent variables with sub-categories that were found to be significant. The 'current position' was significant at 5% with a *p*-value of 0.021, which reflects the wide variety of attitudes centred on this variable. Unsurprisingly, in this independent variable, 'senior accountant' and 'accounting specialist' secured the highest mean rank with a value of 28.00, which is followed by 'financial manger' with a value of 24.56. Head of Department achieved a mean rank value at 14.50, and this is slightly higher than what relationship manager, auditor manger, and *shari'ah* advisory who achieved a mean rank value of 13.50, 12.50, and 12.50 respectively. The lowest mean rank in this control variable was achieved by the 'senior auditor' with a mean rank value of 9.00.

It should be noted that location as an independent variable was also found significant at 10%, with an estimated *p*-value of 0.059. This clearly points to the differences in the responses recorded by the questionnaire survey for this particular question. As can be seen from table 7.28, the respondents from Libya scored the highest mean rank value with 28.50, whereas Egypt scored slightly less with a mean rank value of 26.50. This mean rank was followed by Pakistan with a value of 23.17 and Malaysia with a mean rank value of 20.50. In addition, some countries scored the same mean rank. For example, Turkey and unknown countries scored the same mean rank with a value of 17.83, with Jordan attaining slightly less with a mean rank of 17.30. Another example of countries that achieved the same mean rank value is Indonesia, Luxembourg, Saudi Arabia and UAE with a value of 12.50. The lowest mean ranks were scored by Turkeym Iraq and Global with a value of 2.00.

Table 7.29: Significance of Control Variables on the Statement: '*The need to demonstrate compliance with Shari'ah in all activities distinguishes Islamic Accounting'*

Statement	Group (Control Variables)	Group Categories	Mean Rank	Test	Asymp. Sig. (p)
The need to demonstrate compliance with *Shari'ah* in all activities distinguishes Islamic Accounting	The nature of your institutions	Islamic bank	14.94	KW Test	.052**
		Islamic finance institution	17.25		
		Islamic window as part of a conventional bank	9.50		
		Islamic window as part of a conventional financial institution	25.00		

Note: (*) Statistically significant at a 5% level; (**) statistically significant at 10%

The table 7.29 displays the results of the participants on the statement that "the need to demonstrate compliance with *shari'ah* in all activities distinguishes Islamic accounting". The nature of the institutions control variable with an estimated *p*-value of 0.052, points to variances in the responses recorded by the questionnaire for this specific argument. As can be seen from the table 7.29, the highest mean rank value was recorded by Islamic windows with a value of 25.00. This mean rank was followed by the Islamic financial institution with a mean rank value of 17.25, while, the Islamic bank scored mean rank at value of 14.94, Islamic window achieved the lowest mean rank with a mean rank value of 9.50.

Table 7.30: Significance of Control Variables on the Statement: '*consideration and the possibility of adopting the Islamic accounting system'*

Statement	Group (Control Variables)	Group Categories	Mean Rank	Test	Asymp. Sig. (p)
Consideration and the possibility of adopting the Islamic accounting system	The nature of your institutions	Islamic bank	16.44	KW Test	.001*
		Islamic finance institution	15.50		
		Islamic window as part of a conventional bank	31.50		
		Islamic window as part of a conventional financial institution	15.50		
	The name of the Islamic accounting standards applied in your institution	AAOIFI Financial Accounting Standards (AAOIFI FAS)	17.00	KW Test	.025*
		National Islamic standards adapted from AAOIFI FAS	17.00		
		National Islamic standards not based on AAOIFI FAS	17.00		
		National Standards based on IFRSs	26.25		
		National Standards not based on IFRSs	17.00		
		IFRSs	20.70		

Note: (*) Statistically significant at a 5% level; (**) statistically significant at 10%

In furthering the analysis, the respondents were asked about their perceptions in relation to applying or adopting an Islamic accounting system that meets their needs in treating Islamic financial instruments. As the findings in Table 7.30 depicts, the nature of the institutions and the name of the Islamic accounting standards applied in those institutions established a significant level of 5% with an estimated *p*-value of 0.001 and 0.025 respectively, which indicates the variation in the answers recorded by the questionnaire for this statement. Islamic window achieved the highest mean rank value at 31.50; the Islamic banks, however, scored 16.44 followed by Islamic window and Islamic finance institution with a value of 15.50. With respect to the name of the accounting system, institutions who applied national standards based on IFRS scored the highest mean rank value at 26.25, which is followed by one of those institutions using IFRSs as the main accounting system with a score of 20.70. The IFIs applying AAOIFI Financial Accounting Standards (AAOIFI FAS), national Islamic standards adapted from AAOIFI FAS, national Islamic standards not based on AAOIFI FAS and national standards not based on IFRSs scored the lowest and the same mean rank value at 17.00.

Table 7.31: Significance of Control Variables on the Statement: '*IFIs should account under the Financial Accounting Standards issued by AAOIFI*'

Statement	Group (Control Variables)	Group Categories	Mean Rank	Test	Asymp. Sig. (p)
IFIs should account under the Financial Accounting Standards issued by AAOIFI	Age Group	25-35	16.16	KW Test	.097**
		35-45	19.42		
		45-55	26.83		
		55-65+	15.50		

Note: (*) Statistically significant at a 5% level; (**) statistically significant at 10%

Table 7.31 displays the significance of control variables in relation to the statement that 'IFIs should account under the financial accounting standards issued by AAOIFI'. As the results show, the independent variable 'aga' was statistically significant with an estimated *p*-value of 0.097. This control variable was subsequently divided into four subgroup categories: the 44-55 years old group demonstrated the highest mean rank value with a value of 26.83. This ranking was followed by the mean rank value of 19.42 for the group category 35-45 years old, while the subgroup 25-35 years old scored a mean rank of 16.16. Finally, the lowest mean rank value was achieved by the subgroup aged 55-65+ with value of 15.50.

Table 7.32 present the results of the analysis of the impact of the control variables on the statement that 'AAOIFI standards must be made mandatory for Islamic finance'. As can be seen, two independent variables are found to be significant: academic qualifications and the Islamic accounting standards applied in the participating institutions. Each control variable is consequently divided into appropriate subgroup categories, which take into consideration the most significant determining elements in each control variable.

Table 7.32: Significance of Control Variables on the Statement: '*AAOIFI standards must be made mandatory for Islamic finance'*

Statement	Group (Control Variables)	Group Categories	Mean Rank	Test	Asymp. Sig. (p)
AAOIFI standards must be made mandatory for Islamic finance	Academic qualifications	BSc in Accounting, Economic and finance	16.47	KW Test	.052**
		MSc in Accounting, Economics and Finance	21.50		
		PhD in Accounting, Economics and finance	33.50		
		MBA	12.83		
		ACCA	27.00		
	The Islamic accounting standards applied in your institution	AAOIFI Financial Accounting Standards (AAOIFI FAS)	23.88	KW Test	.098**
		National Islamic standards adapted from AAOIFI FAS	13.75		
		National Islamic standards not based on AAOIFI FAS	16.00		
		National Standards based on IFRSs	16.00		
		National Standards not based on IFRSs	7.83		
		IFRSs	23.20		

Note: (*) Statistically significant at a 5% level; (**) statistically significant at 10%

The academic qualifications control variable is significant at 10% to be statistically significant. The subgroup for those who hold the ACCA qualification scored the highest mean rank value of 27.00, whereas, the participants who hold a PhD in accounting, economics and finance scored a mean rank value of 33.50 followed by the subgroup qualified with the MSc in accounting, economics and finance and the subgroup with the BSc in accounting, economics and finance with mean rank value of 21.50 and 16.47 respectively. The participants who hold the MBA degree achieved the lowest mean rank with a value of 12.83.

Moreover, the Islamic accounting system standards applied in the contributing institutions as an independent variable is significant at 10%. As Table 7.32 illustrates, IFIs that use AAOIFI Financial Accounting Standards (AAOIFI FAS) as an accounting treatment reached the highest mean rank at 23.88. However, IFRS' scored slightly less than this mean rank with a value of 23.20. The IFIs applying national Islamic standards not based on AAOIFI FAS and national standards based on IFRSs achieved the same mean rank value at 16.00, which is followed by those IFIs which use the national Islamic standards adapted from AAOIFI FAS with a score of 13.75. The lowest mean rank was achieved by the institutions that apply national standards not based on IFRSs with value of 7.83.

Table 7.33 explored the impact of independent variables for the statement which emphasised the statement that 'AAOIFI will increase the accuracy and the comparability of the financial information for IFIs', for which two control variables were established to be significant: gender and current position. Indeed, the gender control variable is significant at level of 10%, and further, it is the male subgroup that reached the highest mean rank at 20.03, whereas, the equivalent subgroup for females scored 10.50.

Table 7.33: Significance of Control Variables on the Statement: '*AAOIFI will increase the accuracy and the comparability of the financial information for IFIs'*

Statement	Group (Control Variables)	Group Categories	Mean Rank	Test	Asymp. Sig. (p)
AAOIFI will increase the accuracy and the comparability of the financial information for IFIs	Gender	Male	20.03	Mann-Whitney U	.071**
		Female	10.50		
	Current position	Head of Department	14.35	KW Test	.019*
		Financial Manager	23.17		
		Auditor Manager	24.00		
		Senior Accountant	31.50		
		Senior Auditor	13.50		
		Accounting Specialist	16.50		
		Relationship Manager	14.10		
		Shari'ah Advisory	4.50		

Note: (*) Statistically significant at 5% level; (**) statistically significant at 10%

It should be noted that table 7.33 showed that the current position independent variable is significant at 5% significance level with an estimated *p*-value of .019. As can be seen from the table, senior accounting group scored the highest mean rank at 31.50; followed by auditor manager with a mean rank value of 24.00. The financial manager scored slightly less compared to the auditor manager with a mean value of 23.17. However, the mean rank then fluctuated from 16.50 for participants who had a specialist accounting position to 13.50 for senior auditor. The lowest mean rank, however, was scored by the position of *Shari'ah* advisory with a value of 4.50.

7.4 FACTOR ANALYSIS

After presenting the mean difference analysis in exploring the determinants of the differences in the opinions of the participants, this section focuses on factor analysis, Thus, in this section, factor analysis is used to explore the responses focusing on the statements which explored what distinguishes Islamic accounting from conventional accounting practices as explored through a list of variables in question 30 of the questionnaire, as well as the statements which argue the necessity of using AAOIFI accounting standards in IFIs listed in question 32.

As part of the initial process, in relation to those statements, the factorability test is conducted through Kaiser-Meyer-Olkin (KMO) and Bartlett's test for the statements in question 30 and the results are displayed in table 7.34.

Table 7.34: KMO and Bartlett's Test Results for the significance of the fundamental difference between Islamic accounting and conventional accounting (Question 30 statements)

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		.687
Bartlett's Test of Sphericity	Approx. Chi Square	119.794
	df	28
	Sig.	.000

From table 7.34, it is obvious that the outcome of the KMO measure for all 8 statements grouped together relating to the principles of Islamic accounting reveals a value of 0.687. This is an acceptable KMO value indicating the suitability of the data for structure detection. In other words, given that the KMO value is higher than 0.6, it implies that this test would be useful in specifying the amount of variance in the variables that may be caused by underlying factors. This is emphasised by Bartlett's test of sphericity that is statistically significant at 5% level of statistical significance with an estimated *p*-value at 0.00 as was illustrated in table 7.34. Therefore, factor analysis is considered appropriate to the data, the outcomes of which are depicted in table 7.35 below.

Table 7.35: Total Variance Explained for the Fundamental Difference between Islamic Accounting and Conventional Accounting

Component	Initial Eigenvalues			Extraction Sums of Squared Loadings			Rotation Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	3.859	48.236	48.236	3.859	48.236	48.236	2.720	33.999	33.999
2	1.379	17.236	65.473	1.379	17.236	65.473	2.518	31.474	65.473
3	.847	10.236	76.055						
4	.523	6.540	82.595						
5	.483	6.035	88.630						
6	.411	5.132	93.762						
7	.342	4.277	98.040						
8	.157	1.960	100.000						

Note: Extraction Method: Principal Component Analysis

The principal component analysis was applied to extract the factors from the variable data by reducing variables into fewer factors with the objective of determining the most effective factors that can explain the total variation as compared to other variables having an Eigen value of less than 1. The results depicted in table 7.35 showed that two factors were extracted that had eigenvalues greater than 1, in which the first factor accounts for 48.2% of the total variation, and the second factor accounts for 17.2 of the total variation. Hence, together they are capable of explaining roughly 65.4% of the total variation.

In looking for distribution of loaded components, Rotated Component Matrix within factor analysis was conducted, as depicted in table 7.36, which distributed the statements or factors two components as being the composite explanatory variable.

Table 7.36 display the outcomes of the Varimax technique used to rotate the two components extracted as initially indicated by table 7.35. As can be seen in table 7.36 the 8 statements are loaded or distributed into 2 new independent variable or conponents with loading values of 0.5 or higher using Principal Component Analysis (PCA) to group the variables into recognised components.

Table 7.36: Rotated Component Matrix for the Fundamental Difference between Islamic Accounting and Conventional Accounting

Statements/ variables	Component	
	1	2
	Environmental differences	Ontological differences
(1) Islamic accounting principles based on the *Qur'an* and Hadith, whereas the conventional is not.	.425	.534
(2) The aim and articulation of accountability in the Islamic and conventional systems are different	.290	.787
(3) The Islamic and conventional systems are based on different laws	.787	.193
(4) The Islamic and conventional systems are products of different forms of cultures	.757	.0294
(5) The conception of time is different between the Islamic and conventional systems	.809	-.024
(6) The concept of value is differently treated	.764	.341
(7) The Islamic finance and conventional require different accounting treatments	.046	.839
(8) The need to demonstrate compliance with *Shari'ah* in all activities distinguishes Islamic Accounting	.155	.818

Notes: Extraction Method: Principal Component Analysis; Rotation Method: Varimax with Kaiser Normalization.[a]

a. Rotation converged in 3 iterations.

It should be observed that both factors are largely affected by the rotation. After the allocation is finished, each factor is distributed to one of the components which are named with regards to the common pattern. The first component named environmental differences' showed that relevant factors were allocated under this component. The second component 'ontological differences' contains all the factors related to the Islamic aspects such as the *Qur'an, Hadith*, and *Shari'ah*. They are as follows;

Independent Variable 1: Environmental Differences

The first rotated component is highly correlated with the following:

(i) 'Islamic and conventional systems are based on different laws';

(ii) 'The Islamic and conventional systems are products of different forms of cultures';

(iii) 'The conception of time is different between the Islamic and conventional systems';

(iv) 'The concept of value is treated differently'.

Independent Variable 2: Ontological differences

The second rotated component is greatly correlated with the following factors:

(i) 'Islamic accounting principles are based on the *Qur'an* and *Hadith*, whereas the conventional is not';

(ii) 'The aims and articulation of accountability in the Islamic and conventional systems are different';

(iii) 'The Islamic finance and conventional require different accounting treatments';

(iv) 'The need to demonstrate compliance with *Shari'ah* in all activities distinguishes Islamic accounting'.

Accordingly, it can be argued that the factor analysis in this section classifies the essential Islamic factor that constitutes the unique differences, which distinguish Islamic accounting from conventional accounting by allocating them under composite new independent variable. In other words, the goal of this section is to categorise the factors that affect the respondents' perceptions about the main features that distinguish Islamic accounting from conventional accounting practices. Those factors are listed in Q30.

As mentioned statements relating to the necessity of using AAOIFI accounting standards in IFIs listed in question 32 were subjected to factor analysis as follows:

Table 7.37 KMO and Bartlett's Test Results for the Significance of the necessity of using AAOIFI Accounting Standards in IFIs (Question 32)

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		.621
Bartlett's Test of Sphericity	Approx. Chi Square	173.775
	df	66
	Sig.	.000

Kaiser-Meyer-Olkin Measure of Sampling Adequacy is applied to recognize any variation in the variables that could be caused by the factors listed in Q32. As can be seen from table 7.37, the value of KMO is close to 1.0 and above 0.6 with a value of .0621. This means factor analysis should be useful with these particular data sets or factor in relation to the necessity of using AAOIFI accounting standards in IFIs. Besides, Bartlett's test of sphericity with the significance level of 0.000 indicates that the variables are related and suitable for structure recognition and therefore, factor analysis is valuable for the data.

Table 7.38: Total Variance Explained for Factors of the necessity of using AAOIFI Accounting Standards in IFIs

Component	Initial Eigenvalues			Extraction Sums of Squared Loadings			Rotation Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	3.750	31.252	31.252	3.750	31.252	31.252	3.096	25.803	25.803
2	2.342	19.515	50.767	2.342	19.515	50.767	2.325	19.374	45.177
3	1.399	11.659	62.426	1.399	11.659	62.426	2.070	17.249	62.426
4	.953	7.941	70.367						
5	.885	7.379	77.746						
6	.704	5.864	83.610						
7	.563	4.689	88.299						
8	.441	3.672	91.972						
9	.382	3.184	95.155						
10	.256	2.129	97.285						
11	.195	1.625	98.909						
12	.131	1.091	100.000						

Note: Extraction Method: Principal Component Analysis.

Table 7.38 displays the variance explained by the initial solution, the variance explained by the extracted factors before rotation and the variance explained by the extracted factors after rotation. As it can be seen, three composites independent variable have eigenvalues higher than 1 with a total account of 62.4% of the variability in the original variables. The cumulative variability explained by these new independent variables in the extraction loading remained the same at 62.4%, which means that the factor analysis explains 62.4% of the total variation. However, by looking at rotation squared loadings, it is obvious that the model makes slight changes to composite independent variable 1 from 31.252% to 25.803% and composite independent variable 2 from 50.767% to 45.177%, whereas composite independent variable remained the same at 62.426%.

Table 7.39 demonstrats the outcome of the Varimax technique used to rotate the three composite independent variable extracts. As can be seen, the three components or composite independent variables are largely affected by the rotation; and all the 12 factors were distributed into 3 components with loading values of 0.5 or above for each factor.

Table 7.39: Rotated Component Matrix for the Necessity of Using AAOIFI Accounting Standards in IFIs

Statements/ Variables	Component		
	1	2	3
(1) There is a need for AAOIFI accounting standards due to the particularities of Islamic Finance.	-.082	.649	-.111
(2) IFIs should account under the Financial Accounting Standards issued by AAOIFI	.041	.743	.036
(3) AAOIFI standards must be made mandatory for Islamic finance.	-.096	.817	.240
(4) AAOIFI should protect Islamic financial institutions from the effect of IFRS	.259	.215	.508
(5) AAOIFI will increase the accuracy and the comparability the financial information of IFIs	.132	.741	.049
(6) AAOIFI must globalize its own accounting standards otherwise IFIs should report with IFRS even though they are not suitable for the Islamic environment.	.703	.093	.307
(7) Harmonising or integrating IFRSs with AAOIFI standards is the best solution for the accounting problems.	-.110	-.107	.913
(8) AAOIFI should not continue to issue accounting standards if those standards are going to be neglected by the IFIs	.491	.212	.561
(9) IFRS are applied internationally because the IASB is a neutral body	.544	-.054	.583
(10) IFRS satisfy the needs of conventional and Islamic Institutions.	.879	-.138	-.140
(11) The applications of all IFRS in Islamic financial institutions are suitable for the Islamic environment.	.654	.043	.366
(12) Reporting with IFRS will cancel the need for AAOIFI accounting standards.	.866	-.011	.048

Notes: Extraction Method: Principal Component Analysis; Rotation Method: Varimax with Kaiser Normalization; aa. Rotation converged in 6 iterations.

The new components were assigned new titles according to the factors allocated under each of the components through the Eigen value selection process by the Varimax technique. The re-grouped factors are listed under the new titles as follows:

Independent Variable 1: Reporting with IFRS in IFIs

Due to such appropriate factors being distributed under this component the first rotated factor is highly correlated with;

(i) 'AAOIFI must globalize its own accounting standards otherwise IFIs should report with IFRS even though they are not suitable for the Islamic environment';

(ii) 'IFRS satisfy the needs of conventional and Islamic Institutions';

(iii) 'The applications of all IFRS in Islamic financial institutions are suitable for the Islamic environment';

(iv) 'Reporting with IFRS will cancel the need for AAOIFI accounting standards'.

These factors indicate IFRSs are enough for IFIs, thus they can report with them.

Independent Variable 2: Importance and Role of AAOIFI

This component referred to all factors that are related to the role of AAOIFI such as mandating AAOIFI accounting standards to be employed in the IFIs. The second component highly correlated with the following factors;

(i) 'There is a need for AAOIFI accounting standards due to the particularities of Islamic finance';

(ii) 'IFIs should account under the Financial Accounting Standards issued by AAOIFI';

(iii) 'AAOIFI standards must be made mandatory for Islamic finance';

(iv) 'AAOIFI will increase the accuracy and the comparability of financial information for IFIs'.

Independent Variable 3: Dominance and the Role of IFRSs

In this component, the factor analysis distributed all the factors related to the power of the IASB over all the financial institutions around the world to force them to report under the IFRSs as one cluster. This component is highly correlated with the following factors;

(i) 'AAOIFI should protect Islamic financial institutions from the effect of IFRS';

(ii) 'Harmonising or integrating IFRSs with AAOIFI standards is the best solution for accounting problems';

(iii) 'AAOIFI should not continue to issue accounting standards if those standards are going to be neglected by the IFIs';

(iv) 'IFRS are applied internationally because the IASB is a neutral body'.

The factor analysis in this section identified 'Reporting with IFRS in IFIs', 'Importance and the Role of AAOIFI' and 'Dominance and the Role of IFRSs' factors by distributing each related factor under one cluster. Table 7.39 clearly shows that the perceptions of the participants have a particular rationale. For example, in component 1, participants who believe that IFRS' satisfied the needs of IFIs, also believed reporting with IFRS will cancel the need for AAOIFI accounting standards unless the AAOIFI globalize its own accounting standards. This also applied to component 2, where we find the group of participants who thought that Islamic finance required special treatment, they also believe IFIs should account under the financial accounting standards issued by AAOIF, given that these standards will increase the accuracy and the comparability of the financial information for IFIs. This consistency in the answers is also obvious in component 3, where factor analysis summarized the information into a set of meaningful factors. For example, those who believe that AAOIFI standards are by the IFIs, because AAOIFI does not have the control that IASB have. Therefore, to serve the interests of the IFIs harmonising or integrating IFRS' with AAOIFI standards could be the best solution for the accounting problems in the IFIs.

7.5 CONCLUSION

This chapter discussed and interpreted the findings from the Kruskal-Wallis (KW) and the Mann-Whitney U (MWU) tests for the data related to part two B that asked the participants their perceptions of Islamic accounting standards, and part three of the questionnaire, which inquired the perceptions of the respondents concerning AAOIFI accounting standards and its role in increasing the accuracy and comparability of the IFIs. Thus, a number of independent variables were found to be significant in explaining the differences of opinions, which provides a detailed understanding of the positions taken by the participants.

The findings in this chapter show that most IFIs do not appear in favour of using AAOIF accounting standards at present. However, the majority of them are willing to adopt accounting standards which deal with the IFIs transactions, as they believe that IFRS' and AAOIFI accounting standards are products of different forms of cultures. This was clearly signified by the significance at 10% level with the estimated *p*-value 0.091 indicating the similarity of responses from participants from different countries.

As a follow-up of the data analysis, the factor analysis test applied to Q30 and Q32 in order to reduce the amount of variable used to clarify any relationship identified and grouped them together. While the factor analysis in the case of former statements produced 2 components or composite independent variables that have Eigenvalues greater than 1, and then produced 3 component solutions. These were the two components in Q30 named 'ecological differences', and 'ontological differences'. Each component contained the relevant factors that have a relationship with each other. The new composite independent variables related to Q32 were named with regards to the relevant factors that have a relationship. They are, 'reporting with IFRS in IFIs', 'importance and the role of AAOIFI', 'dominance and the role of IFRSs' respectively.

The findings produced by this chapter as well as the earlier empirical chapter are subjected to further analysis in the interpretative discussion in the next chapter.

CHAPTER 8

DISCUSSION AND CONCLUSION

8.1 INTRODUCTION

This study aimed to investigate the accounting practices employed in IFIs and whether various international standards, such as IFRS are applicable for the accounting treatment of practices of Islamic instruments such as *murabahah, musharkah, mudarabah*, treatment of *ijara, takaful etc*. This research has also sought to explore the perception of respondents regarding cultural environmental factors that could be presented as the barriers to reporting IFRS' in IFIs. Thus, this research utilises a cultural environment context as a frame by referring to Hofstede's cultural dimensions to focus on religion (Islam) as an output of culture; and aims to explore and examine prevailing accounting practices in Islamic banking in multi-country cases within such a context. Consequently, the study wanted to answer five individual questions; (i) Do IBFIs aim to employ the IFRS type of accounting and harmonise their standards with this practice?; (ii) Do IBFIs prefer a specific accounting standard to be developed by focusing on the specific aspects of IBFs?; (iii) What is the principle attitude of the various stakeholders in IBFIs towards AAOIFI and IFSB's attempt to develop accounting standards for them?; (iv) What are the factors that determine the demand for Islamic accounting? And hence, what are the factors that prevent the adoption of Islamic accounting standards in the IBFIs? (v) What are the opinions of participants developing Islamic accounting as an alternative accounting system?.

8.2 SUMMARISING THE FINDINGS

In responding to the aims and objectives set out in Chapter 1, a questionnaire survey was developed to measure the perception of the IFIs in relation to the most appropriate accounting system that satisfied their needs in terms of treating and reporting Islamic financial instruments in an efficient and effective manner. As discussed in the research methodology chapter, 54 Islamic financial institutions from 18 countries across the world responded to this survey: 51% of the sample were Islamic banks, 29% were Islamic financial institutions, whereas the remainder of the participants were from

Islamic windows as part of conventional banks and Islamic windows as part of conventional financial institutions with a total of 20%.

As it can be seen from Table 6.1a, the majority of the respondents (77%), who completed this survey, ranged from 25 to 45 years of age, whereas the respondents aged from 45 to 65 and over were approximately 23%. In addition, 88% of the respondents who participated in this survey were male, with approximately 67% of the them having acquired either a BSc in accounting, economics or finance, or a MSc in accounting, economics or finance, whilst the remainder have gained PhDs in accounting, economics or finance, MBA and ACCA with a total percentage of 33%. The demographic profile of the data analysis demonstrates that more than half of the participants hold a NCPA professional qualification, whereas the rest have various other professional qualifications, such as ACPA, BCCA, CIFP, CIPA, APFA,CAIIB, ACCA and MBA.

Respondents who participated in this survey were from different positions in their banks and financial institutions, for instance heads of departments, financial managers, senior auditors, relationship managers, auditor managers, senior accountants, accounting specialists, academic professionals and *Shari'ah* advisory. However, it is clearly indicated in Table 6.1a that the highest response was from the heads of departments and financial managers with a total of 47%. The majority of the participants, virtually 64%, have been working for their institutions from '5 to more than 15 years', whereas 36% of them have work experience of less than '1 to 5 years'. With regards to their work experience point of view, 85% of the participants (see Table 6.1c) have the opinion that financial institutions, whose business is wholly Islamic, as well as entities offering or issuing Islamic finance products and services *e.g.* a customer of an IFI, holder of *sukuk* certificates called 'Islamic windows' should report with relative Islamic accounting standards.

As the findings in Table 6.2 depict, this survey ascertained that 93% of respondents have knowledge of IASB and understand that its main objective is to develop a single set of high quality effective and practical global accounting standards for all types of conventional businesses, including emerging economies where Islamic finance is operating, with the possibility of global businesses harmonising and adopting those standards. However, Table 6.4 demonstrated that approximately 67% of the respondents generally agree that the IASB did not consider the special needs of the IFIs, which have a different cultural environment. As was revealed in Table 6.11, this level of agreement was clearly supported by the significance level of 10%, which means there was a similarity in the answers to this variable.

Unexpectedly, as it can be seen in Table 6.5 that approximately 70% of respondents indicate that the financial reporting standards implemented in their entity were either IFRS issued by the IASB or national standards based on IFRS, while only 7% of the institutions which participated employ AAOIFI accounting standards that consider the needs of IFIs, whereas a further 7% apply both standards AAOIFI and IFRS simultaneously. Therefore, Table 6.7 illustrated that 41% of those institutions have the objective of adopting another accounting system that might satisfy the needs of IFIs. In addition, roughly 17% of them have expressed their intention to employ AAOIFI accounting standards. However, others have different options concerning which accounting system they would apply. In addition, the findings confirm that the vast majority of participants will retain their Islamic accounting standards if they adopt the IFRS and vice versa (see Table 6.8).

From the findings observed in Tables 6.9a and 6.9b, it can be argued that most of the respondents related the obstruction of employing IFRS in IFIs on the influence of the cultural environment, such as language, religion, moral values, education and politics, *etc*. Moreover, 68.4% of the participants also agreed that the treatment of the prohibition of *riba* and the importance of paying *zakat* are obstructing the use of IFRS in IFIs. Consequently, they believe that the IFRS is not efficient for IFIs, given that the IFRS is not consistent with the accounting and reporting treatment of Islamic financial instruments, for example *ijarah*, *mudarabah, musharakah, istisna etc*. It should be noted that most of the variables were significant at a 10% level of significance, which indicates the similarity in responding to this argument. This can be clearly seen in Tables 6.15 and 6.16.

The results in Table 7.3 also demonstrate that more than 65% of respondents have been using Islamic accounting standards to address their sales-based contracts, for instance *murabahah* and *salam*, and partnership-based contracts, such as *musharakah, mudarabah*, *takaful*, *sukuk,* although they employ IFRS as the main accounting standards.

In addition, Table 7.8 indicated that more than 53% of the respondents measure *sukuk* that is held for trading under Islamic accounting standards, at a price that would be received to sell the *sukuk,* in a transaction with a buyer in the market. In relation to *ijara,* as revealed in Table 7.7, more than 60% of the respondents treat *ijara* as a conventional finance lease under IFRS rather than according to Islamic standards, whereas 40% of them do not. The results presented in Table 7.20 explain that the variation in opinion concerned with the way to treat *ijara* is affected by the nature of the institution, and that the name of the Islamic accounting standards applied in their institutions control variables was significant at 5%. Furthermore, the location where these institutions are operating was established to be significant at 10%, indicating that geographical differences, in the sense of the participants' locations do have implications, as several IFIs operate in locations that are heavily affected by the IFRS.

In addition, respondents also agree in relation to the statement claiming that Islamic finance is a religiously determined financing method; thus, it requires a specialised Islamic accounting system. This is the same reason that distinguishes Islamic accounting from conventional accounting, seeing as the high percentage of respondents agree that Islamic accounting principles are ontologically based on the *Qur'an* and *Hadith,* whereas the conventional is not. Furthermore, the need to demonstrate compliance with *Shari'ah* in all activities distinguishes Islamic accounting according to participants. This made participants agree that both systems are products of different forms of cultural constructs.

Accordingly, the research explains that the vast majority of participants agreed that the particularities of Islamic finance necessitates that AAOIFI accounting standards are made mandatory for IFIs to protect them from the effect of IFRS and in turn increase the accuracy and comparability of the financial information for IFIs. This result is supported by the level of significance with most of the group variables at 10%. However, there is a disagreement between academic qualification group variables in the argument which stated that Islamic and conventional systems are products of different forms of cultures, which is statistically significant at 5%. These results are revealed in Tables 7.32 and 7.26 respectively.

In order to obtain this, the survey reveals that most respondents agreed to the statement that the AAOIFI must globalise its own accounting standards', otherwise harmonising or integrating IFRS with AAOIFI standards is the most appropriate solution for the accounting problems being encountered by IFIs. Given that participants disagreed that the applications of all IFRS in IFIs are suitable for ensuring the Islamicity; hence, they, disagree that reporting with IFRS will eliminate the need for AAOIFI accounting standards.

In providing further evidence, factor analysis is applied. It has been determined that environmental and 'ontological differences' distinguish Islamic accounting from conventional accounting. The findings also established that participants who believe that IFRSs satisfied the needs of IFIs, also believed reporting with IFRS will exclude the need for AAOIFI accounting standards unless the AAOIFI globalizes its own accounting standards. In addition, factor analysis suggested that the way in which people responded to the factors signifies the barriers to employing IFRS in IFIs, in the form of cultural environments and the nature of Islamic finance.

8.3 REFLECTIONS ON THE FINDINGS: MEANING MAKING

This section discusses the particular findings in the empirical chapters and relates these results to the foundation chapters, in particular in relation to Islamic accounting practice, with the objective of providing discursive interpretation by meaning making. In doing so, the findings are also located with the larger body of knowledge in the sense of relating them to the available empirical studies.

8.3.1 Interpretative Discussion on the Findings Relating to Financial Reporting Standards and Barriers Faced in IFIs

This study aimed to explore the main factors obstructing the adoption of IFRS by the IFIs, in order to increase the ability to obtain new knowledge that might help to overcome those barriers and establish a way for the IFIs to adopt the correct accounting standards that meet the requirement of Islamic finance.

In Chapters 3 and 4, several studies, such as Muller (1967), Nobes (1981), Arpen and Radebaugh (1981), Belkaoui (1985), Harrison and Mckinnon (1986), Gary (1988), Radebaugh and Gary (1993), Lawrence (1996), Walton (1998), Iqbal (2002), Hofstede, (1997), Verma *et al.*, (1997) and Deegan (2000) concluded that accounting standards could be affected by different cultural factors including politics, economics, culture, the legal system and regulatory regime, level of education, in addition to religion.

Accordingly the results of this study as shown in Chapter 6 provide similar evidence, which indicates that cultural patterns are considered to be one of the main barriers to employing IFRS independently in IFIs.

Recalling the findings shown in Table 6.9a, approximately 68.5% of the respondents agreed and strongly agreed that differences in the cultural environment including, religion greatly influence the use of IFRS in the IFIs. This is further evidenced by the mean value of 4. This finding is further supported by the argument made by several authors (*e.g*. Belkaoui, 1990; Gambling, 1987; Tomas, 1989; Briston and El-Ashker, 1986) who claimed that the cultural environment in general and religion in particular, as part and parcel of culture, affects the adoption of IFRS by another culture. This pronouncement also goes together with the argument from a previous study, specifically 'a case for MENA representation on the IASB' which highlights the various adoption complications faced by emerging economies and developing countries, such as the Middle East and North African (MENA) region and the Gulf Cooperation Council (GCC), where most financial institutions are located and other global regions, particularly on the matter of religion, which is considered to be the most powerful environmental influence in some Muslim countries (Haidar, 2006). This finding could provide a reasonable answer to the research question, what are the factors that determine the demand for Islamic accounting? Hence, what are the factors preventing the adoption of IFRS in the IBFIs?

With reference to the importance of the geographical dimension, it should be noted that Table 6.15 illustrates that 'location' is an independent variable determined to be statistically significant at a 10% level of significance with an estimated *p*-value of 0.68 in relation to the statement suggesting that cultural environment *e.g*. religion and morals greatly influence the use of IFRS in the IFIs. This result clearly indicates the difference in opinions between respondents coming from different regions or locations. The tendency might have been raised due to the cultural diversity between participants, the geographical locations they reside in and the nature of the financial market in that particular jurisdiction, although some of the locations share the same religion. For example, jurisdictions such as Libya, where Islamic finance has not been fully adopted yet, established no problem in using the conventional accounting system based on

IFRS, given that all the banks in Libya have been conventional banks, until recently (Faye *et al*., 2013).

Besides, the majority of these countries where the participants come from, have already adopted IFRS as the main accounting practice, such as European countries, Luxembourg and Turkey, where the IFRS via the IASB are mandatory as well the the developing countirs like Egypt, where the regulator is the body who decides which accounting practice Islamic institutions should employ.

In the case of the developing countries, the lack of an efficient and fair legal and regulatory regime influences the development of new accounting system. Thus, they adopted a ready high quality accounting standards such as IFRS and force their institutions to report with such standards. For example, regulators in Egypt force the IFIs to employ the IFRS as regulatory regime does not have the efficiency to apply new accounting system such as AAOIFI which is still new comparing to the former (Dahawy *et al*., 2011). This could be true for most of the Arab and third world countries that have a similar culture and political and legal regulatory environment. Since, as it has been established by this study, the legal system in the sampled countries is a combination of traditional laws and customs mainly based on colonial or other western models. Therefore, it is essential that an appropriate and efficient regulatory framework should be developed aiming at removing the barriers of adopting an appropriate accounting system that meets the needs of the Islamic financial institutions.

It is also believed that Malaysia, Indonesia, Pakistan and Saudi Arabia base their accounting standards on AAOIFI's standards, which are issued for the International Islamic Financial Market (IIFM), established in 2001. However, countries, such as Qatar, Jordan and UAE employ AAOIFI accounting standards in conjunction with IFRS. The institutions in these countries may consider AAOIFI accounting standards, because they are official members of the AAOIFI board and they would support the organisation to broaden their standards.

Table 6.15 also demonstrates that the 'nature of the institution' was significant at a 5% level of significance; in relation to the statement that cultural environment greatly influences the use of IFRS in the IFIs with an estimated p-value of 0.042. The result reflects the diversity in the answers provided by the participants who are employed by these institutions. This argument may have been raised by conventional financial institutions and conventional banks that have Islamic windows, which may not be interested in changing their current accounting practices (IFRS) or national accounting systems based on IFRS to any other Islamic accounting standards, given that their business is not entirely Islamic. However, this could make IFRS satisfactory for these institutions. Such a position can clearly been seen from the findings in Table 6.14, which demonstrate that the nature of the institution, as an independent variable is significant at a 5% level of significance with an estimated *p*-value of 0.035 in relation to the statement that asked participants about the name of the reporting standards their institution is aiming to move to. This was obvious by the highest score for the mean rank value of the Islamic windows with a value of 27.50, which emphasises that such institutions do not have the intention to move to another accounting system that could be impracticable for them, in view of the fact that most of their transactions are not Islamic finance.

Moreover, the AAOIFI accounting standards are not globally recognised; hence, reporting with such an accounting system would not be understandable, especially for institutions that operate globally. This could provide an answer to the research question regarding what the main attitudes of the various stakeholders are in IBFIs towards AAOIFI and IFSB's attempt to develop accounting standards.

This study, also examined the influence of the nature of Islamic finance and the Islamic economic system on using IFRS in the IFIs. The findings in Table 6.9a illustrated that approximately 68.5% of the participants with a mean value of 3.6579 agreed that the 'nature of Islamic finance' necessitates reporting with accounting standards that are appropriate for these principles. In relation to this finding, Zeghal and Mhedhbi (2006) ascertained a similar result in their study that examined 64 developing countries, including Muslim countries by analysing the factors affecting the adoption of IAS/IFRS. The study concluded that two of the main factors obstructing the adoption of IFRS were the existence of an Islamic financial market, and cultural membership. Their results also support the findings of this study showed in Table 6.9b, which state that more than 74% of the participants believe that IFRS are not consistent with Islamic financial instrument, such as, *ijara, mudarabah, musharakah, istisn, etc*, and which reflect the nature of Islamic finance.

It is also important to note that the findings indicate that religion decreases the possibility of the use of IFRS practices in the IFIs. As Islam is an ontological source the cultural environment shapes Islamic finance and accounting practice in accordance with the principles of *Shari'ah*; thus, the relationship between religion and accounting is considered to be positive, which, as explained in an earlier chapter, implies that accounting in Islam should be based upon moral law originating in the *Qur'an* and *Shari'ah*. Therefore, full disclosure and accountability to the public is rationalized through ontological sources of Islam which distinguishes Islamic accounting from conventional accounting, in the sense that accounting requirements are non-voluntary in nature when one subscribes to the tenets of Islam. In reflection, the findings in Table 6.9b of this study provide evidence for this position; as more than 86% of the participants either agree or strongly agree with the argument that claims 'reporting with Islamic principles will influence the use of IFRS'. As revealed in Table 6.17, this statement had a significant level at 10% with estimated *p*-value of 0.086, which clearly reflects the firm agreement between the respondents in relation to the above statement. These results have supported previous literature (Hamid *et al*. 1993; Baydoun and Willett, 2000; and Sulaiman, 2000) suggesting that there should be a significant relationship between Islam as a religion and accounting. This also answers the research question regarding what the factors are that determine demand for Islamic accounting? And hence, what factors prevent the adoption of IFRS in the IBFIs?

Therefore, it can be argued that accounting and financial reporting in an Islamic society is expected to be formed by an Islamic moral economy. Consequently, this implies that all transactions should be disclosed, specifically the ones that are forbidden in Islamic code, such as *riba* (interest) and paying *zakah* (alms), indicating that disclosure on fundamental issues is not voluntary and not even formal, although it is linked to the requirements of an Islamic moral economy to achieve 'good deeds' in one's life in an attempt to reach the individual objective of *falah* by performing *ihsan* or beneficence.

Accordingly, this study has examined the suggestion that the importance of paying *zakah* has significant implications for reporting with IFRS in the IFIs. It was revealed in this study that paying *zakah*, which is different from conventional taxation, is a comprehensive reason for the inefficiency of IFRS and in obstructing its use. As revealed in Table 6.9a, this was the opinion of approximately 45% of the participants, whereas only 28% of the participants disagreed. Further evidence is demonstrated in Table 6.16 by the significance of the age group control variable (at a 10% level) with an estimated *p*-value of 0.98. This result clearly indicates that there was an agreement between the different age groups concerning the importance of paying *zakat*, the method of calculation and its disclosure in financial statements, as this disclosure allows clients to make sure that their Islamic institutions are complying with *Shari'ah*.

Zakat, as mandatory alms giving is a spiritual purification which is different to governmental tax; therefore, it has a different evaluation and calculation, in addition to different treatment in the financial statement. The results reflect the opinions of the participants with regards to the nature of *zakat* and its importance in IFIs, which needs an appropriate accounting system that can deal with its treatment. These results and opinions are supported by the requirements of AAOIFI, FRS9 para. 13, which stipulates that the IFIs disclose all the information that demonstrates whether the Islamic institution has collected and paid *zakat* on behalf of holders of investment accounts and other accounts, and moreover, treated unpaid *zakat* as a liability of the Islamic bank, and is presented in the liabilities section. Besides, it requires the IFIs to evaluate the assets at the market selling price and not as ISA 2. Such particular findings in the study are supported by a number of earlier studies, such as Hameed (2000), AAOIFI (2003, 2007) and Abdul Rahman (2010).

As a result, based on the presented findings, it can be argued that the practices of the IFRS are inappropriate for the IFIs, and this in turn necessitates having Islamic accounting to report disclosure of any activities in relation to the collection, calculation and measurement, as well as the distribution of *zakat*.

Another essential issue is the treatment of *riba* or interest, as Islamic finance and banking aims to develop and work within the prohibition of *riba*. Hence, the basic tenets of Islam in relation to Islamic banking and finance have a direct influence on accounting practices. The results in this study presented in Table 6.9a established that more than 68% of respondents agreed that the prohibition of *riba* is one of the factors that affect the disclosure and the capital structure of Islamic banks. These findings were supported by Sulaiman (2003) who studied 'the influence of *riba* and *zakat* on Islamic accounting'. He claimed that *riba* affects the capital structure of the business and the disclosure, since the balance sheet of an Islamic firm is expected to reject loans with interest. Therefore, in the case of Islamic banking, various finance forms of Islamic financial instruments were developed, such as a *mudarabah* partnership, as part of PLS between the bank and the client according to the agreed ratio, which makes the capital structure of IFIs different from the financial aspects of conventional businesses.

Furthermore, this study confirmed that the different worldviews have a direct and positive effect on employing IFRS in the IFIs. As evidenced by this study in Table 6.9b which demonstrated that more than 84% of participants generally agreed that Islamic principles from an Islamic worldview are different to conventional ones; therefore, Islamic teaching will call for a morally embedded accounting system. This pronouncement has similar implications to those raised by Abdul Rahman (2010), who claimed that the Islamic worldview combines both the worldly aspects '*Al-dunya'* where we are undertaking our *ibadah,* including *muamalat* (transactions) and the religious aspects '*Al-akhirah'*, which has the final and ultimate importance. Hence, the distinction of Islamic accounting through Islamic ontology is further substantiated by this study as well. In supporting this among the independent variables, in Chapter 6, Table 6.17 specified that professional qualifications were established at a significant level of 10%, which means that the majority of respondents agreed on the significance of reporting accounting issues according to Islamic principles and an Islamic worldview, which, by definition determines the use of IFRS.

Further evidence on this issue was revealed in Table 6.18 when the name of the accounting system applied in their institutions was found significant at 10% with an estimated *p*-value of 0.073. The highest mean ranking was for institutions that apply national Islamic standards based on AAOIFI FAS and AAOIFI FAS with a value of 34, and approximately 21 respectively. The high mean rank indicates that the level of agreement with the statement arguing that Islamic principles and Islamic worldview call for a special accounting system came from institutions which are already employing Islamic accounting systems, whereas the level of agreement was quite low and varied between the institutions which use national Islamic standards not based on AAOIFI FAS and national standards based on IFRSs.

Given that the findings considered the worldview as important in shaping the accounting system and the accountants' performance, the foundational axioms developed by the Islamic moral economy should be considered as being particularly important. As a result, it may be necessary to develop a systematic Islamic accounting system and approach within the frame of the Islamic moral economy. Thus, this implies a systemic and embedded Islamic accounting understanding based on a '*tawhidi'* worldview with an endogenised spiritual accountability in attempting to perform '*adalah'* by implementing '*ihsan'* since s/he is the *khalifa* of *Allah* on the earth with an individual objective function of achieving *falah* or salvation. This is supported by previous literature from Abdul Rahman (2010), who argued that accountants in Islam should provide financial information, whilst more importantly they should discharge their accountability by providing information to enable society to follow God's commandments as prescribed by *tawhid*, *adalah*, *ihsan*, *rubibiyah* and *tazkiyah*as values and processes in facilitating *falah*.

With regards to this, Table 6.9b demonstrated that this study ascertained that 71% of the participants agreed that IFRS does not consider Islamic business rules, hence IFRS' do not appeal to those participants who favour embedding Islamic values in accounting standards. There was strong support among the participants for this position. For example, as revealed in Table 6.19a, the age group control variable was established to be significant at a level of 5% with an estimated *p*-value of 0.012. The disagreement between the different age groups could be related to experience and seniority in this sector, as well as background and where they come from.

In view of the fact that this survey was answered by a number of IFIs that operate in non-Muslim countries, different cultures might have impacted upon their answers to the survey. The current position, as a variable, is also determined to be significant at a 5% level for this position, which clearly depicts a growing tendency between the different positions in the participating institutions. This could be due to some positions not being specialists in accounting standards (such as heads of department, relationship management and *Shari'ah* advisory) and therefore may not acknowledge the authenticated need for specialised Islamic accounting needs, as aimed for by several others. Other positions such as senior accounting, accounting specialists and financial managers might be in favour of supporting the use of specialist accounting standards that can serve the IFIs in an authentic manner in their attempt to achieve *falah* in this world (*dunya*) and in the hereafter (*al-akhirah*). Thus, the particular work position of participants with the attached specialisation appears to have a deterministic impact on the answer they provide; and hence, they provide opinion from their professional position rather than in compliance with the legal requirements and statutory controls. This result is similar to one of Gray's accounting values, specifically 'professionalism versus statutory control' (Gray, 1988).

Moreover, as the findings in Table 6.19b suggest, location was found to be significant at a 5% level of significance with an estimated *p*-value of 0.041 with regards to the statement which argues that IFRS do not consider Islamic business rules; thus, IFRS are not relevant to devout Muslim users'. These differences are obvious in the opinions of participants coming from IFIs between Muslim and non-Muslim countries. However, it is not logical to have such differences between Muslim countries where religion plays an essential part in their daily life and actions. Nevertheless, this disagreement could be related to the nature of the businesses in these countries. In a location such as Libya, where complete Islamic finance does not yet exist, accountants are not aware of the accounting needs in IFIs. However, in countries such as Turkey and Luxembourg, being part of the EU, they were obligated to follow the EU rules, and hence IFRS.

As this study has argued, the main principles and characteristics of Islamic finance and Islamic accounting are not considered and embedded by the objectives of IASB. This argument as illustrated in Table 6.4 was supported by the findings in this study, which, for example, established that approximately 67% of the participants indicated that the IASB did not consider the special needs of the IFIs, such as alternative transactions for *riba,* including *murabahah, musharakah* and *mudarabah.* The results supported by earlier literature by Hamid *et al*., (1993) and Karim (2001) who found that alternative transactions undertaken by IFIs are not covered in IFRS. This in turn makes IFRS irrelevant for the Islamic environment. These results are in line with the argument raised by Wallace (1990a) and Baydoun *et al.*, (1995), who claim that IFRS were developed by IASB with Western culture in mind, and therefore may be irrelevant to the needs of other cultures, especially Islamic culture. This could answer the second research question, which asks why the IFIs would prefer a specific accounting standard to be developed for their islamically authenticated needs by focusing on the specific aspects of IFIs.

As explained, in Table 6.5, this study determined that 69.7% of the respondents indicated that the IFRS or national accounting practice based on IFRS are the main financial reporting standard implemented in their organisations. This finding is not surprising since these institutions seek to operate, invest and access funding globally, where the AAOIFI accounting standards are not fully recognised. This result was in agreement with the argument stated by Amin (2011) that AAOIFI is limited to Bahrain, Qatar and Malaysia, while the rest of the GCC countries follow IFRS, in view of the fact that IFRS have become almost universally accepted.

Accordingly, location or geographical jurisdiction is established to be a very important control variable that has significant influence on respondents. Hence, it is not a surprise to discover that the location control variable is significant with the statement arguing that 'the IASB did not consider the special needs of the IFIs', which as Table 6.11 demonstrated was significant at a 10% level with an estimated *p*-value of 0.056. Being significant, the result indicates the diversity in opinion between the participants. This result showed that a number of locations are in favour employing IFRS, although they are operating the Islamic financial system and do not want to move to another new accounting system that might be hazardous (uniformity versus flexibility). Besides, the regulators in some countries, especially in the Arab world have the power to force these institutions to follow a particular accounting system, which in turn affects the freedom of these institutions.

These findings are supported by Hofstede (1970s) who studied 38 countries, including Arab countries and determined that the Arabic counties had power distance which makes societies more likely to follow a standing system that does not permit considerable upward mobility of its citizens, and therefore, includes the accounting system. Further empirical support was established by Gray (1988) when he linked Hofstede's value dimensions with his accounting values. He concluded that countries that rank highly in terms of power distance and rank lower in terms of individualism, for instance Arabic countries, are more likely to rank highly in terms of uniformity.

This can be further evidenced by the high mean ranking presented in Table 6.11, which depicts 36 for the UAE, 27 for Jordan, 23 for Egypt, 22 for Libya and 21.83 for Qatar, although they are Muslim countries where Islam should influence everyday life, including financial transactions, specifically '*muamalat'* including business. This result was supported by Hofstede (1970s) who established from his study that Islam is the official state religion in those particular countries, and yet banking and finance are conventional. The highest mean rank at 36 shows that disagreement came from non-Muslim countries, such as Luxembourg, and IFIs operating globally, where they have to apply IFRS as the IASB is mandatory in that region, in countries such as Turkey. The UAE scored the same mean rank, although it is a Muslim country, where most of its institutions are Islamic. However, this high mean rank was due to Dubai's position as an international market and being in partnership with some western enterprises where IFRS is obligatory. These finding are substantiated by Cristea *et al.,* (2010) who determined that the Central Bank of the UAE required all banks and listed companies to publish IFRS financial statements, which is similar to findings in the case of Jordan.

With regards to Libya, the lack of knowledge concerning Islamic finance and Islamic accounting might have affected the opinion of participants, although Islamic windows have recently started to operate in some banks in Libya. The lack of awareness could be related to the educational system in Libya where there are no Islamic finance courses in the country to educate its people about the nature of Islamic finance and its needs. As argued by Shoenthal (1989), level of education affects the status of the accounting profession, which in turn has an influence on the country's accounting system.

The political system in Libya had opted for socialist theory as the main economic process, which, until the revolution, affected development and economic growth in Libya, especially in the Islamic finance sector. This meant that the awareness of accountants was very low level with regards to special accounting needs in IFIs. This finding is in line with the argument raised by several authors, who dispute that very little economic activity would make the accounting system extremely underdeveloped (Radebaugh *et al*, 1993; Doupnik and Salter, 1995), which has been the key in Libya.

Agreement with the statement argued that the IABS did not consider the special needs that could also come from countries for instance Saudi Arabia and Pakistan, where *Shari'ah* law is applied, hence, they do not permit all companies and banks to follow IFRS, due to the fact that in Saudi Arabia and Pakistan *Shari'ah* law inferred from *Quran* is used as legislation. Further support for this finding was provided by Cristea *et al.,* (2010) who argued that Saudi Arabia does not authorise the use of IFRS by all companies and banks, except insurance companies listed on the Saudi Stock Exchange. Moreover, agreement could be raised by locations for instance Malaysia and Indonesia, where they have established their own standards on the basis of IFRS. This result was also established by Cristea *et al.,* (2010) who indicated that Malaysia and Indonesia have announced a strategy to completely converge their GAAP with IFRS.

It should be noted that this study ascertained that the relationship between the factors presented as the main barriers to employing IFRS in the IFIs are relatively positive. The outcomes from factor analysis demonstrated the relationship between all the factors that are related to cultural environment, such as religion, Islamic principles and Islamic world view have the same impact on choosing the type of accounting standards in a country and, therefore, are listed under the same group. These factors are presented in Chapter 6, as follows;

(v) the cultural environment *e.g.* religion and morals greatly influence the use of IFRS';

(vi) 'the necessity of reporting with Islamic principles will influence the use of IFRS';

(vii) 'the differences in the Islamic world view is calling for moral embedded accounting system';

(viii) 'IFRS does not consider Islamic business rules, thus IFRS is not relevant to devout Muslim users'.

The findings in relation to this particular aspect are in line with the results established by a number of other studies, such as Hofstede (1980), Baydoun and Willett (1997), Sulaiman (1998 and 2000), Hamid *et al*., (1993), Alam (1997), Lewis (2001) and Ibrahim and Yaya (2004), who ascertained that the relationship between Islam and accounting could be a significant one.

In addition, this study claims that the nature of Islamic finance would call for different accounting systems that specifically serve the needs of Islamic business. The results of the factor analysis in Chapter 6 provided the factors that relate to the nature of Islamic finance, which have a direct impact in employing IFRS in the IFIs in one group, as follows;

(v) 'the nature of Islamic Finance and the Islamic economic system may necessitate not using IFRS';

(vi) 'the prohibition of *riba* (interest) has significant implications for using IFRS';

(vii) 'the importance of paying *zakat* has significant implications for using IFRS';

(viii) 'IFRS is not consistent with Islamic financial instrument, such as *mudarabah, musharakah, ijara, istisna, etc.'*

As it can be seen from the findings in Table 6.9a the prohibition of *riba* and paying *zakat* has a significant impact on choosing to use IFRS in IFIs. This finding was supported in an earlier study by Sulaiman (2003), who argued that the prohibition of *riba* affects the capital structure of an IFI and disclosure practices in financial reporting. Moreover, the literature by Napier and Haniffa (2011), Taheri (2000) and Hameed (2000) stated that when paying *zakat*, its calculation needs a special accounting treatment that is not available in IFRS.

As can be clearly seen in Table 6.22, factor analysis also grouped Islamic financial instruments in one component with the nature of Islamic finance, as the main factors that obstruct the use of IFRS in the IFIs. These results are supported by several authors, such as Tayyebi and Hijazi (2010), Abdul Rahman (2010), Archer and Karim, (2001) and Sultan (2006) who argued that IFRS accounting standards which necessitate the identification of profit margin and interest charges, and treat investment account holders as a liability are not appropriate from an Islamic point of view (Archer and Karim, 2001). This is discussed in detail in the next section.

8.3.2 Discursive Discussion on the Findings Relating to Islamic Accounting and Islamic Accounting Standards

The previous section reflected on the findings related to reporting standards and the barriers faced in IFIs. It should be noted that the obstacles related to cultural environment were recognised via this survey as a source of further interruption to the adoption of IFRS in Islamic finance. Such cultural environment issues for IFIs also relates how to treat Islamic financial contracts in the accounting system; for example, sales-based contracts such as *murabahah* and *salam*, partnership-based contracts *e.g. musharakah, mudarabah, takaful, sukuk,* as well as the treatment of *ijara,* are all expected to have a particular accounting process. In other words, these Islamic financial instruments need to employ technical practices to deal with and report effectively with these instruments.

According to the results of this study in Table 7.14a, approximately 86.5% of participants agreed and strongly agreed that Islamic finance and conventional finance require different accounting methods. Table 7.13 also demonstrated that this study discovered that more than 75% of the participants agreed that IFRS are not consistent with Islamic financial instruments mentioned above, which means that IFRS' are not appropriate from an Islamic point of view. Furthermore, Islamic accounting literature supports this finding. For example, *murabahah* should be treated similar to the FRS2 requirement as sales transactions and not what IFRS require as a financing transaction (Hmoud, 1988; Hassanien, 1996; Mulhem, 2002).

The findings in Tables 7.3 and 7.5 respectively, showed that roughly 21% of the participants used alternative Islamic accounting standards to recognise sales-based contracts transactions, such as *murabahah* and *salam*, and that 40% of them recognise these types of transactions when the cash is received. This is similar to the second method of FRS2 that AAOIFI recommended using in such transactions. Furthermore, 28.6% of participants who completed this survey recognised income by allocating it equally over the number of months/years of the repayment period, which is comparable to the first method of FRS2, whilst only 5.7% treated such transactions as upfront upon execution. This study also established that 25.7% of participants treated and recognised sales-based transactions as being similar to the effective interest rate method under IFRS.

As revealed in Table 7.19, the recognition of sales-based transactions, for example *murabahah*, when the repayment period exceeds one annual period was determined to be significant in respect of geographical location and the name of Islamic accounting standards applied in IFI control variables at a level of 10% with an estimated *p*-value of 0.058 and 0.052 respectively. These findings reflect the disagreement between IFIs that operate in different parts of the world. As can be seen, location was established to be an important control variable influencing the opinions of the participants. The results identify distinctions between countries such as those which do not have full Islamic finance practices, such as Libya, and those countries where IFRS is obligatory, such as Luxembourg, Turkey and moreover, IFIs operating globally. As a result, it can be claimed that disagreements voiced from locations that report with IFRS, national accounting standards based on IFRS or national accounting standards are not based on IFRS.

Moreover, the significance differences can also relate to the realities of some of the geographical locations, for instance Indonesia which has its own accounting standards issued by DSAK-IAI. In countries, such as Malaysia, Pakistan and Saudi Arabia, the relevant authorities have issued guidelines that are based on AAOIFI's standards. Such a finding can make these locations disagree with other locations that employ IFRSs and that use different methods in treating and recognising sales-based transactions.

As previously discussed, among Islamic finance instruments, *ijarah* is another Islamic financial instrument that needs special accounting standard which differs from IFRS. However, as can be noted in Table 7.7, this study found that more than 60% of the participants allow *ijarah* to be treated under IFRS (IAS17), as a finance lease. This explains the findings in Table 7.12, which explained that only 3.77% of the participants face potential problems in using IFRS for *ijarah*. This finding is not related to *Shari'ah* rules, especially in the case of promising to pass to the lessee (*ijarah muntahia bittamleek*). Moreover, this is also supported by Rules (2000), Abdul Rahman (2010) and Kettell (2011). Table 7.7 shows that this study also discovered that nearly 40% of the participants treated *ijarah* differently under other accounting standards, such as operating lease. In addition, as demonstrated in Table 7.3 approximately 13% of them used alternative Islamic accounting standards to recognise and treat *ijarah*.

As can be seen in Table 7.20, the treatment of *ijarah* was determined to be significant with regards to geographical location at a 10% level of significance. Furthermore, the reason for ijarah being significant in relation to geographical location is most likely for the same reasons that have been discussed earlier. Aspects such as ‘gender’, ‘the nature of the institution’ and ‘the name of the accounting system’ applied by the institutions were also determined to be significant at a level of 5%. Moreover, in the findings, location, the nature of the institution and the type of accounting system affecting each other are obvious, as they are all linked to one another as the control variable. For instance, the nature of the institution will be affected by the location where it is operating, which in turn will affect the type of accounting system employed under the regulations, the regulators in that location and the relationship, and vice versa.

With regards to another matter, it should be mentioned that the findings in Table 7.20 with respect to Islamic accounting standards applied in the institution was the most significant control variable with an estimated *p*-value of 0.017. This confirms the diversity in opinion between the institutions in relation to the treatment of *ijarah*. The disagreement could be due to the fact that these institutions use national Islamic standards adapted from AAOIFI FAS, as they scored the highest mean ranking value at 27.00 and have fully fledged Islamic practices. This is the case in jurisdictions such as Saudi Arabia, Pakistan, Indonesia and Malaysia that merge their national accounting standards with IFRSs as stated by Rules (2000), Cristea *et al.,* (2010). Moreover, the IFIs which have Islamic windows as part of a conventional financial institution that employs IFRS’ also demonstrated a high level of disagreement, as they scored the second highest mean ranking value of 22.88,. Such cases are from countries such as Libya, where complete Islamic business does not yet exist, or from countries, such as Jordan and UAE that have full Islamic practices. However, their regulators force them to employ IFRSs.

Furthermore, according to the findings illustrated in Table 7.9, 30% of participants present their financial statement of *takaful* operator as a separate financial statement. This finding indicates the requirement of the AAOIFI (Hidayat, 2010; Hameed, 2011). In addition, 3.3% of the participating IFIs in this study stated that they report their *takaful* operations under IFRS, whilst another 30% of respondents present their financial statement of *takaful,* as an aggregate of the *takaful* operator and participants’ funds, without the elimination of the transaction and balances between them. This method is similar to the IFRS4 that has been advised to be unhelpful with regards to *takaful*, since it treats the premium received as a part of the insurance company's revenues (Ibrahim, 2009). The high percentage of IFIs reported under or similar to IFRS is further evidenced by the result that depicts that only 17.44% of the participants used alternative Islamic accounting standards to treat *takaful*.

As illustrated in Table 7.21, the financial statements of *takaful* operators under the Islamic accounting standards were established to be significant at a 10% with the nature of the institutions. This control variable is important since it expresses the different opinions in the group categories. It is more likely that the tendency grew in institutions that employed Islamic accounting standards to present the financial statement of *takaful*, such as Islamic banks and Islamic financial institutions. This argument is substantiated by the high mean ranking value of these institutions with 12.17 and 19.57 respectively. The debate has emerged from institutions which are partly Islamic that mostly operate in countries where IFRS is mandatory. Therefore, they present the financial statement of *takaful* under IFRS.

It should be noted that this study is concerned with the increased number of the countries that adopted IFRS to be the main accounting system for their business including the countries where the Islamic finance has becoming essential. However, as it can be seen in table 7.11, this study found that the majority of the participants (51%) will keep their Islamic accounting standards and about 27% of them consider merging their Islamic accounting standards with the IFRS. This could answer the first research question, do the IBFIs aim to employ the IFRS type of accounting and harmonise their standards with this practice? This finding is further supported by the significance level at 10% with an estimated *p*-value of 0.080 for the location control variable revealed in Table 7.23, indicating that geographic influence is an important determining variable.

As can be seen for most of the questions in this survey, location was found to be significant in relation to the optional question on accounting standards. The debate came from different countries, since each country has its own regulations set by the regulators with regards to the needs of its particular market. As explained earlier in some jurisdictions the regulator has to follow the requirements of the IASB, as they are operating in regions where the IFRS' are mandatory, such as Luxembourg and Turkey, and in companies operating globally, and furthermore, in other jurisdictions, such as Malaysia and Indonesia that merge their GAAP accounting standards with IFRS'. Moreover, some countries, for instance Saudi Arabia, do not allow IFRS' in every company, which means other accounting standards, such as Islamic accounting standards are employed in those countries. These results are supported by the accounting literature (Zain, 2009; Cristea *et al.,* 2010).

Furthermore, this study tested the elements that might distinguish Islamic accounting standards and conventional accounting. Thus, as can be seen in Table 7.14a it established that more than 83% of the participants agreed and strongly agreed that one of the elements that differentiate the two systems is that Islamic accounting principles are based on *Qur'an* and *Hadith*, while the conventional is not. This outcome is similar to earlier literature by Karim (1995), Napier (2009) and Triyuwono (2004). As can be seen in Table 7.24, this element was found to be important for academic qualifications, professional qualifications and the period of working control variables at a 10% level of significance, which reflects agreement in the answers to this concept. The nature of the institutions, however, was established to be significant at a 5% level of statistical significance, which means that there are variations in the answers given by the different institutions according to their type of business. For example, the agreement could come from institutions, such as Islamic banks and Islamic financial institutions, since their businesses are expected to be entirely Islamic and they are aware of the differences between the two systems. In contrast, the disagreement could be due to the fact that institutions such as Islamic windows, as part of a conventional bank and Islamic windows as part of a conventional finance institution, where the businesses are predominantly conventional.

It should be noted that the findings of this empirical study demonstrated in Table 7.14a ascertained that approximately 74% of the IFIs participating in this survey agreed and strongly agreed that Islamic and conventional systems are products of different forms of cultures, which in turn distinguish Islamic accounting from the conventional. This result is similar to previous findings in the accounting literature that have been discussed by several authors, such as (Gambling and Abdel-Karim, 1986; Gambling, 1987; Gambling and Abdel-Karim, 1993; Hamid, *et al,* 1993; Clarke, *et al,* 1996) who studied the influence of religion on accounting and (Violet, 1983a; Hofstede, 1980;

Gray, 1988), who studied the impact of culture in choosing the accounting systems in a country.

However, in relation to this particular issue, Table 7.26 shows that academic qualifications, as an independent variable is noted to be significant at a level of 5% with an estimated *p*-value of 0.005. This strong argument could be raised again from participants that hold their academic qualifications from locations where the level of education is relatively low, which might directly influence the knowledge of participants' academic development. This result is supported by numerous literatures that have discussed the effect of cultural environment on the development of the accounting system. Such arguments have been debated by (Archambault and Archambault, 1999; Iqbal, 2002; Saudagaran, 2004; Nobes and Parker, 2008).

Importantly, as can be seen in Table 7.13, this research verified that more than 75% of the participants believe that Islamic finance is a religiously determined financing method; hence, it needs a specialised Islamic accounting system. This result is further supported by another finding in this study outlined in Table 7.14b, which showed that around 95% of the participants agreed and strongly agreed that the need to demonstrate compliance with *Shari'ah* in all activities distinguishes Islamic accounting. This finding is in line with the literature, which argues that what distinguishes Islamic accounting is the same reason why Islamic banking is different to conventional banking (Tag El-Din, 2004).

However, as explained in Table 7.29, the nature of the Islamic institution control variable was found to be significant at a 10% level of significance, in relation to the above statement. In addition, with regards to their nature of business, such disagreement from the participating institutions is clearly apparent. For example, Islamic windows as part of a conventional financial institution and Islamic windows as part of a conventional bank will not agree that they require a special Islamic accounting system, given that most of their activities are conventional; thus, IFRS would be enough for them. In contrast, Islamic banks and Islamic financial institutions would be more interested in applying an accounting system that is compliant with *Shari'ah*.

It should be noted that due to the above findings and factors, the participants' attitude to adopting an Islamic accounting system that satisfied their needs was investigated in this study. As can be clearly seen in Tables 7.15 and 7.16a this study demonstrated that more than 89% of the participants considered applying an Islamic accounting system that can meet their special needs, as 92% agreed that IFIs should be accountable under the AAOIFI accounting standards. This result was ascertained to be significant with the nature of the institutions and the type of accounting systems employed in the control variables of these institutions at a 5% level. It is obvious that such disagreement arises from the institutions whose activities were not totally Islamic, for example Islamic windows as part of a conventional bank and finance institutions that employ IFRS or a national accounting based system on IFRS, as the main accounting system in their institutions. Hence, they are not interested in adopting another accounting system.

Furthermore, according to the findings in Tables 7.16a and 7.16b 70% of the participants agreed and strongly agreed to make AAOIFI accounting standards mandatory for Islamic finance, given that approximately 82% of them believe that AAOIFI will increase the accuracy and comparability of the financial information gathered from Islamic financial institutions. Table 7.32 confirms that the academic qualifications and Islamic accounting standards applied in the participating institutions control variables were found to be significant at a 10% level. This result showed that there is a lack of agreement between the groups. The academic qualification control variable is very important, since it reflects the opinion of the people most related to accounting decisions, such as ACCA, or accountants holding a BSc, MSc and PhD in accounting and finance. However, not all of them came from the same location and background of education and experience in Islamic finance, which can therefore, affect their opinions. Thus, variety occurred in the opinions.

The findings also showed that the argument raised by the institutions depends on the accounting system they employ. The diversity in the answers came from participating institutions that use IFRS and the national accounting system that passed on IFRSs as the main accounting system. They showed no interest in moving to another accounting standard, such as AAOIFI, which is not globally recognised, although it would be suitable for Islamic financial instruments. Hence, they do not agree with making

AAOIFI accounting standards mandatory in Islamic institutions. In addition, the current position and gender group control variables doubt that adopting AAOIFI accounting standards would increase the accuracy and the comparability in relation to the financial information of IFIs. The current position is a crucial control variable, seeing as their opinion will impact on the decision of the institutions about adopting a new accounting system that might consider the special needs IFIs. In this case, merging or harmonising the two accounting standards could be the most appropriate solution for the companies that operate globally, and for those where IFRS are mandatory in their region.

Furthermore, the result in Table 7.36 confirmed that the factor analysis test determined the most effective factors that distinguish Islamic accounting from conventional, and grouped together every component that has a relationship. They are specifically ecological and ontological differences. This finding is supported by a previous argument by Hameed (2000) who argued that the ontological differences and worldviews lead to different economic systems that require special accounting systems, in order to be reliable.

Finally, the outcome of the factor analysis indicated that the IFIs should report with IFRS, which are globally recognized, unless the AAOIFI globalises its own accounting standards. Moreover, due to the particularities of Islamic finance, AAOIFI must also make its standards compulsory for IFIs, which in turn will increase the accuracy and comparability of the financial information of IFIs. Furthermore, the findings in Table 7.39 combine elements that showed the dominance and role of IFRS in one component, which suggested IFRS adopted internationally, since the IASB is an independent standard-setting body. Thus, there is no need for AAOIFI to continue to issue accounting standards. However, the AAOIFI can protect IFIs from the effect of IFRS by harmonising or integrating IFRS with AAOIFI standards. This suggestion could answer research question number one that asks; ‘do the IBFIs aim to employ the IFRS type of accounting and harmonise their standards with this practice?

8.4 IMPLICATIONS OF THE FINDINGS ON PRACTICE

This research was designed to contribute to the current literature in Islamic accounting by providing empirical evidence to substantiate several of the discourses and debates, as this is a new area mainly merged with the growing nature of the Islamic finance industry.

The empirical analyses conducted in this study verified that the most of the IFIs do use IFRS' as the main accounting practice, which, in reality, is not consistent with Islamic financial instruments, such as, *murabahah, mudarabah, musharaka, ijarah, istisna* etc. In another words, the need to demonstrate compliance with *Shari'ah* in all business activities distinguishes Islamic accounting. Hence, Muslim accountants views of Islamic finance and Islamic accounting practice is that they mostly consider IFRS not to be relevant to devout Muslim users due to their expectation that the ontological nature of Islam calls for an authentic treatment of accounting issues within the Islamic norms.

These finding should have positive implications for managers in IFIs, decision makers and in turn on the regulators in a country. It is very important for managers in IFIs to act more efficiently to improve the understanding of the importance of reporting with Islamic accounting, especially for stakeholders and the community as a whole. In another words, if the IFIs are aiming to report with Islamic principles that reflect their business activities, it is important for decision makers in IFIs and the regulators to adopt different accounting treatment, for example AAOIFI accounting standards which were issued to serve the IFIs, in order to increase the accuracy and the comparability of the financial information of Islamic financial institutions.

As AAOIFI accounting standards are not globally recognised, harmonising or integrating IFRSs with AAOIFI standards could be the most appropriate solution for accounting problems. Meanwhile, the AAOIFI must globalise its own accounting standards and continue to issue accounting standards to protect IFIs from the effect of IFRS, and to be recognised as an effective, efficient, and most importantly, an authentic accounting standard for the industry at large.

8.5 REFLECTIONS ON THE POSSIBILITY OF AN ISLAMIC ACCOUNTING

In reflecting on the ontology of Islam with its normative assumptions and historical practice in the Muslim world, as well as current practice in relation to the emergence of Islamic finance, this study assumed at the beginning that 'there is a particular concept and mechanism that we can term as Islamic accounting as a theory and practice'. In reflecting on this assumption it can be argued, with the substantial evidence produced in this study that Islamic accounting could be seen as a different alternative accounting system to IFRS'. Although, this study indicated that the majority of IFIs are reporting with IFRS or national accounting standards based on the IFRS, the study also established that these institutions have considered adopting an accounting system that deals with Islamic financial instruments, such as AAOIFI accounting standards. As has been discussed above, this can be achieved as long as the AAOIFI continued to issue accounting standards that satisfied the requirements of the IFIs, as well as adopt a proactive attitude in expanding the standards in relation to the developing Islamic finance industry. Furthermore, the Islamic accounting would has a future if the AAOIFI could become an internally recognised body and stake holder similar to the IASB and have the power to make its accounting standards mandatory for Islamic finance.

It should be noted that when the IASB started to issue the IAS in 1973, only a few countries around the world adopted those standards; especially developing countries which did not have available, high quality accounting standards, while the countries with a strong economy and high quality accounting system, such as the UK and USA used their own GAAP. Regulators in these countries argued that there is no need to adopt IAS', since who wants to treat with these countries had to use their own national accounting standards. Yet, the IASB continued to establish its accounting standards and harmonise accounting practices, whilst forcing all European countries to report with IFRS by 2005. As we acknowledge, IFRS are adopted by a large number of countries, not just in Europe but also from other places, including Muslim countries where Islamic finance plays a significant role. The implications for Islamic accounting standards is that despite the low interest even from Muslim countries and IFIs, the AAOIFI should continue to proactively develop the necessary accounting standards for IFIs; as the analogy suggests, AAOIFI standards could one day become an essential source of legitimacy for accounting practice in the Muslim world, or for global IFIs.

It should be noted that research in Islamic accounting as a sub-discipline is still at an emerging stage and is increasing steadily. However, by increasing awareness in relation to the significant role that Islamic accounting could play in developing Islamic finance, this area could expand further and in turn regulators in any country would divert their focus entirely on understanding Islamic accounting. In short, there appears to be some light at the end of the tunnel, if research in Islamic accounting develops frequently and the AAOIFI continues to issue guidelines and standards to help researchers and regulators become more involved in Islamic accounting.

8.6 CONTRIBUTION OF THE RESEARCH

This study has provided several contributions to the existing literature on Islamic accounting. In general, this research is a comprehensive study with reference to the implementation of IFRS' and AAOIFI accounting standards in IFIs by providing empirical evidence on IFIs from 18 different countries around the world. In addition, this study has provided empirical evidence that some of the sampled IFIs are at an early level of the implementation of AAOIFI accounting standards, whereas the majority is implementing IFRS practices.

As it was discussed in the foundation chapters that many cultural environmental differences exist, this therefore has implications for the differences in accounting practices implemented in different countries. Hence, this study, attempted to contribute to the existing literature by highlighting these differences in the context of Islamic finance and bridge the gaps between conventional and Islamic accounting standards. In this context, this research provides evidence to substantiate the argument that the IFIs, which implement IFRS, face problems in treating Islamic finance transactions and contracts; therefore, they require special accounting standards that are different from the IFRSs, such as AAOIFI accounting standards.

This research has also contributed empirically to Islamic accounting literature by providing evidence indicating that implementing IFRS in the IFIs is not appropriate within the normative world and the requirements of Islamic finance as aspired to by the foundational axioms developed by Islamic moral economy such as *tawhid*, *adalah*, *ihsan*, *rububiyah* and *tazkiyah.*

8.7 LIMITATIONS OF THE STUDY AND FUTURE RESEARCH

It should be noted that there were several limitations whilst conducting this study, which have to be taken into consideration when interpreting the findings. These limitations are as follows;

Given that this study addressed IFIs across the world; the email was the only way to distribute the questionnaire. As a result, the respondents were lower than expected with only 54 IFIs responding to the survey. Thus, the findings are limited to the IFIs which participated. For future research, samples could be selected from one region as a case study, which would give the research the opportunity to have a higher response rate.

In addition, some questions in the questionnaire could be considered to be confidential, as by answering these questions it could decide whether the IFI is fully *shari'ah* compliant or not, which limited the level of respondents. Besides, some of respondents found several of the questions in the questionnaire challenging to answer; thus, some of the technical questions were not completed. Another limitation with regards to the research method was the difficulties in conducting the interviews due to the geographical area. Hence, future research should be based on a comprehensive examination using document review, interviews and other qualitative methods with the objective of providing further meaning to the analysis and findings.

Furthermore, this study is limited to the perceptions of the IFIs, and the opinion of the IASB and AAOIFI could not be taken regarding the need for Islamic accounting at this stage. Therefore, future studies should involve both organisations by exploring their positions in relation to the future of Islamic accounting.

The findings of this study are limited to the perceptions about environmental factors and Islamic worldviews which have affected the adoption of IFRSs by the IFIs, and do not consider the financial statement, in order to observe how they treat Islamic finance instruments. However, there was some scope for covering some information in the questionnaire regarding how they treat these instruments. Thus, future studies should use secondary data from financial statements and other sources that could give a broader picture concerning the accounting practices employed by the IFIs.

Another important issue which this study was unable to address directly, is examining the impact of the regulators on implementing different accounting system. Exploring the opinions of the regulators could give a better understanding of the problems are facing the IFIs to employ the AAOIFI as the main accounting practice.

8.8 EPILOGUE

In the last thirty years, the Islamic financial industry has grown rapidly, and as a result some circles and individuals have argued for a unique accounting system that meets the requirements of this new industry, especially after IFRS established with western culture in mind is considered to be inappropriate for IFIs. Hence, this study aimed to examine the influence of cultural environments, including religion in general and Islam in particular, as an output for culture as well as the instruments of Islamic finance in using IFRS in IFIS. In order to achieve the aim, as presented in this thesis, an empirical study was carried out to investigate to what extent IFRS are appropriate for the IFIs and whether IFIs should report under IFRS, report under AAOIFI accounting standards or should harmonise both standards to work for IFIs.

The primary study is based on the existing literature related to the factors that might affect choosing the accounting system in a country or region. This study also reflected on the literature that addresses the main differences between the IFRSs and AAOIFI accounting standards. In addition, this study addressed and reviewed the literature in rationalising the necessity of an Islamic accounting structure, or a system through the normative principles of Islamic moral economy, as articulated through an axiomatic approach by identifying the philosophical foundations. Given that implementing appropriate accounting practices for IFIs is considered to be one religious services such as *ibadah-muamalah* that could assist individuals to achieve *falah*, large numbers of participants believe that the current practice which is away from Islamic accounting is not applicable for devout accountants.

The empirical results of this research provide evidence that most of the IFIs that participated employed IFRS’ as the main accounting system. However, this status will no longer exist in the future, if the AAOIFI could globalise its accounting standards, and could convince regulators to adopt Islamic accounting standards, as this study provides evidence that there are some problematic issues associated with the implementation of IFRS, especially with the religious elements, such as the prohibition of *riba* and paying *zakat*, as well as the instruments of Islamic finance. This can have a negative effect on the efficiency of the Islamic finance industry and affect its business performance. Further empirical evidence from this study argues that the majority of participants agreed and strongly agreed that Islamic finance is a religiously determined financing method; thus, it needs a specialised Islamic accounting system. Overall, the findings have extended our knowledge and understanding that the need to determine compliance with *Shari'ah* in banking and financial transactions needs AAOIFI accounting standards. Nevertheless, the lack of a fully functioning Islamic economy has resulted in the impracticality of employing full Islamic accounting standards at this stage.

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APPENDIX

DCIEF
Durham Centre for Islamic Economics and Finance
School of Government and International Affairs
Durham University, UK

Dear Sir/Madam

I am a Ph.D. researcher at the School of Government and International Affairs, Durham University- UK specialising on the aspects of Islamic Accounting for my PhD research on the topic of 'IFRS and AAOIFI Harmonisation or Convergence: The Study of Islamic Financial Institutions' under supervision of Dr Mehmet Asutay (Director of the Durham Centre for Islamic Economics and Finance). Therefore, I am appealing for your assistance, as a selected respondent, in providing data or information on accounting practices in your institution as requested in the questionnaire.

The main aim of this questionnaire is to measure opinion and perception of the participants regarding accounting practice in your institution and the issue of harmonisation as a result of the application of IFRS in the Islamic Financial Institutions. The questionnaire also aims to investigate the perceptions of the participants on the nature of Islamic Accounting in general. Due to your background, experience, and training, your perceptions will be of particular value. Your response to the questions, hence, contained in the associated survey instrument will contribute to possible improvement in the accounting practices in the Islamic Financial Institutions.

All data and information you provide will be analysed for academic purposes and treated as highly confidential. Therefore, it is highly appreciated if you could spend a few minutes of your valuable time to respond to this questionnaire as soon as possible, which is essential for the successful completion of the research. Finally, a summary of my research results will be made available upon request.

Thank you very much in advance for your co-operation

Yours sincerely,

Mahmoud Aleraig

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Durham Centre for Islamic Economics and Finance

School of Government and International Affairs

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THE QUESTIONNAIRE

Part One

General Information

Q1: Please indicate your age?

☐ 25-35 ☐ 35-45 ☐ 45-55 ☐ 55- 65+

Q2: Please indicate your gender?

☐ Male ☐ Female

Q3: What type of academic qualification do you hold? (Please tick appropriate box).

☐ Bachelor Degree in Accounting
☐ Master's Degree in Accounting
☐ PhD in Accounting
☐ Others, Please specify ……………………..

Q4: What type of professional qualification do you hold? (Please tick appropriate box).

☐ National Certified Public Accountant
☐ American Certified Public Accountant (ACPA)
☐ British Chartered Certified Accountant (BCCA)
☐ Others, Please specify ……………………..

Q5: Please select the category that best describes your current position

☐ Head of Dept
☐ Financial Manager
☐ Auditor Manager
☐ Senior Accountant
☐ Senior Auditor
☐Others, Please specify ……………

Q6: How long have you been working for this company? (Please tick appropriate box).

☐ Less than one year
☐ From one to 5 years
☐ From 5- 10 years
☐ From 10 to 15years
☐ More than 15 years

Q7: Please state the country in which your company in operating: ………………………..

Q8: Please state the nature of your institutions:

☐ Islamic bank
☐ Islamic finance institution
☐ Islamic window as a part of a conventional bank
☐ Islamic window as a part of a conventional financial institution

Q9: Which of the following entities are required to apply Islamic accounting standards in your country? (Please tick as appropriate.)

☐ Islamic financial institutions (IFIs), *i.e.* financial institutions whose business is wholly Islamic
☐ Other entities offering/issuing Islamic finance products or services, e.g. a conventional bank offering 'Islamic windows', an entity issuing sukuk.
☐ Counterparties to entities offering/issuing Islamic finance products or services, e.g. a customer of an IFI, a holder of sukuk certificates
☐ Other (please explain) ……………………………………………………

Part Two

A: about Financial Reporting Standards

Q10: Have you heard of the International Accounting Standard Board (IASB)?

☐ Yes ☐ No

Q11. Which of the following in your opinion best describes the objectives of IASB?

☐ to develop a single set of high quality, understandable global accounting standards.
☐ to promote the use of those standards.
☐ to take account of, as appropriate, the special needs of small and medium-sized entities and emerging economies.
☐ to work generally for the improvement and harmonisation of regulations, of national accounting standards and International Accounting to high quality solutions.
☐ all of the above

Q12. Please express your opinion on the following statement.

"The objectives of IASB did not take the special need of the Islamic Financial Institution in account" (please state your opinion on a scale from 'strongly disagree' to 'strongly agree')

Strongly disagree	Disagree	Neutral	Agree	Strongly agree
SD	**D**	**N**	**A**	**SA**

Q13: What financial reporting standards are employed in your institution?

 International Financial Reporting Standards (IFRS)
 National standards based on IFRS
 National standards not necessarily based on IFRS

 It depends on the type of entity (please explain) ………………………

Q14. If IFRS is not employed at all, does your institution have a policy of convergence with, or adopting, IFRS?

 No, we do not have plans for convergence / adoption at this time.
 Yes, we have already converged with / adopted IFRS.
 Yes, we will be converging with / adopting IFRS by
(Please indicate target date for convergence / adoption.) ………………………

Q15. If IFRS is employed do you consider applying different financial reporting standards?

 Yes No (go to question 16)

Q16. If yes to Q14, please state which reporting standards your institution is aiming to move:

Please indicate ……………………………………………………………………………….

B: about Islamic Accounting Standards

Q17. Which of the following Islamic accounting standards apply in your institution?

 AAOIFI Financial Accounting Standards (AAOIFI FAS)
 National Islamic standards adapted from AAOIFI FAS
 National Islamic standards not based on AAOIFI FAS
 Other (please explain)……………………………

Q18. **If you do not currently have special financial reporting standards to deal with Islamic finance do you consider adopting one?**

 Yes No

Q19. Which of the following transactions or reporting are addressed by your Islamic accounting standards? (Please tick as appropriate)

 Presentation of financial statements
 Sales-based contracts (e.g. Murabahah, Salam)
 Partnership-based contracts (e.g. Musharakah, Mudarabah)
 Takaful
 Ijarah
 Sukuk
 Other (please explain) ………………………...

Q20. Under your Islamic accounting standards, which of the following best describes the general criterion for recognising an element of the financial statement?

- When it is probable that an economic benefit will flow to or from an entity
- When the transaction or event becomes contractual
- When cash is paid or received
- Other (please explain)……………………………

Q21. Under your Islamic accounting standards, how would income on a sale-based transaction (e.g. a Murabahah sale) most likely be recognised, where the repayment period exceeds one annual period?

- Income is recognised upfront upon execution of the contract.
- Income is allocated equally over the number of months/years of the repayment period.
- Income is allocated over the relevant period using a rate that exactly discounts estimated future cash payments or receipts through the expected repayment period or, when appropriate, a shorter period to the net carrying amount of the amount receivable (i.e. similar to the effective interest rate method under IFRS).
- Income is recognised when cash is received.
- Other (please explain) …………………………………

Q22. In addition to the usual five elements of the financial statement (i.e. income, expense, asset, liability and equity) some Islamic accounting standards recognise a sixth element which is said to be the appropriate classification for items that bear characteristics of both liability and equity.

Do your Islamic accounting standards allow the recognition of a sixth element of the financial statement for items with characteristics of both liability and equity (e.g. some Mudarabah items)?

- Yes
- No

Q23. **Do your Islamic accounting standards allow for Ijarah to be treated as a finance lease, if the Ijarah otherwise meets the criteria for finance lease under IFRS?**

- Yes
- No

Q24. **Under your Islamic accounting standards, how would a sukuk held for trading most likely is measured?**

- As a corresponding proportion of the value of the underlying asset
- At cost, with amortisation of premium or accretion of discount
- At a price that would be received to sell the sukuk in an orderly transaction with a buyer in the market.
- Other (please explain) ………………………

Q25. **Under your Islamic accounting standards, how would a Takaful operator most likely present its financial statements, and those of the participants' funds it manages?**

☐ As a single set of consolidated financial statements
☐ As an aggregate of the Takaful operator and participants' funds, without elimination of transactions and balances between them
☐ As separate financial statements
☐ Other (please explain) ………………………

Q26. **Some Takaful operators may provide an interest-free loan, Qard, to a participants' fund that is in deficit. Qard is usually repaid when the participants' fund has a sufficient surplus. Under your Islamic accounting standards, how would a Takaful operator most likely recognise Qard extended to a participants' fund?**

☐ As an expense
☐ As a liability, measured at cost
☐ As a liability, measured at fair value
☐ As equity or an equity-like item
☐ As a liability, measured at amortised cost
☐ Other (please explain)…………………………………

Q27. **More and more countries are converging with or adopting IFRS. How does this affect your policy on Islamic accounting standards?**

☐ We will retain our Islamic accounting standards.
☐ We may need to review some of the requirements of the Islamic accounting standards
☐ We will withdraw our Islamic accounting standards
☐ No change is considered yet

Q28. Which of the potential problems faced by your institution in using IFRS for Islamic finance? (you may choose more than on option).

☐ Measurement of financial values
☐ Some financial transactions
☐ Murabaha & Murabaha treatment
☐ Salam & Parallel Salam treatment
☐ Takaful treatment
☐ The valuation basis to be used for Zakat calculation
☐ Others (please explain)…………………………

Q29. Please indicate your opinion on the following statement.

"Since Islamic finance is very specialised and religiously determined financing method, an Islamic accounting system has to be developed" (please state your opinion on a scale from 'strongly disagree' to 'strongly agree')

Strongly disagree	Disagree	Neutral	Agree	Strongly agree
SD	**D**	**N**	**A**	**SA**

Q30. What can distinguish Islamic accounting from conventional accounting practices?

(Please state your opinion on a scale from 'strongly disagree' to 'strongly agree')

Strongly disagree	Disagree	Neutral	Agree	Strongly agree
SD	D	N	A	SA

Statements	SD	D	N	A	SA
There is an ontological difference; *i.e.* Islamic accounting principles based on Qur'an and Hadith					
There is a differences in the aim and articulation of accountability in both system					
They are based on different laws					
Both are product of different forms of cultures					
The conception of time is different					
The concept of value is differently treated					
The Islamic finance elements differ to conventional elements and therefore requires different accounting treatment					
The need to demonstrate compliance with *Shariah* in all activities distinguishes Islamic Accounting					

Q31. If Islamic accounting system was available, would you consider adopting it?

☐ Yes ☐ No

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Part Three:

About AAOIFI accounting standards

Q32: Please indicate the extent to which you agree or disagree with each of the following statements using the scale below: (please state your opinion on a scale from 'strongly disagree' to 'strongly agree')

Strongly disagree	Disagree	Neutral	Agree	Strongly agree
SD	**D**	**N**	**A**	**SA**

No	Questions	SD	D	N	A	SA
*	There is a need for AAOIFI accounting standards due to the particularities of Islamic Finance.					
*	Islamic financial institutions should account under the Financial Accounting Standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI).					
*	AAOIFI standards must be made mandatory for Islamic finance related institutions					
*	Even though reporting with *sharia'h* compliancy is not required, regional accounting standards produced by a regional body such as AAOIFI are necessary to protect the Islamic financial institutions from the effect of IFRS which are produced to satisfy the needs of conventional institutions					
*	The application of AAOIFI will increase the accuracy and the comparability the financial information of Islamic financial institutions					
*	If AAOIFI is not capable of globalising its own accounting standards; Islamic institution should report with IFRS without any discussion of their suitability for the Islamic environment.					
*	Harmonising or integrating IFRSs with AAOIFI standards is the best solution for the accounting problems faced in the accounting practices in Islamic financial institutions in the light of the Islamic unique culture					
*	It is worthless for AAOIFI continuing to issue accounting standards in competition with the IASB, if those standards are going to be neglected by the Islamic institutions.					
*	The IASB is a neutral body and therefore, is capable of producing IFRS to be applied internationally					
*	IFRS which were established to satisfy the needs of conventional institutions are also capable of satisfying the needs of Islamic Institutions					
*	The applications of all IFRS in Islamic financial institutions are suitable for the Islamic environment.					
*	Reporting with IFRS will cancel the need for AAOIFI accounting standards					

Part Four:

About the factors represent the barriers to employ IFRS in the Islamic Financial institution

Q33: In the table below, please, indicate the extent to which you agree or disagree with each statement about the factors represent the barriers to employ IFRS in the Islamic Financial institutions.

(Please state your opinion on a scale from 'strongly disagree' to 'strongly agree')

Strongly disagree	Disagree	Neutral	Agree	Strongly agree
SD	D	N	A	SA

No	Questions	SD	D	N	A	SA
*	The cultural environment such as language, religion, morals, values, attitudes, law, education, politics, social organisation, technology, and material culture, greatly influenced the use of IFRS.					
*	The nature and operation of Islamic Economic System and Islamic Finance may necessitate of not using IFRS.					
*	Islam's prohibition of *riba* (interest) has significant implications for using the IFRS					
*	The importance of paying *Zakat* has significant implications for using the IFRS					
*	The IFRS is not consistent with Islamic financial instrument such as *mudharaba, musharaka, ijara, istisna etc*					
*	Since financial reporting in Islamic financial institutions must be compatible with Islamic principles, this will influence the use of IFRS.					
*	IFRS does not consider Islam's own cohesive rules that dictate how a business should be conducted, for accounting theory and practices to be relevant to devout Muslim users					

Notice:

If you would like to receive a summary of the survey results, please provide the following information:

a) Your name..
b) Your position…………………………………………….
c) Your Institution's name……………………………….

E-mail address.............................