



## **BETWEEN INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRSS) AND FINANCIAL ACCOUNTING STANDARDS (FASS): THE DEBATE CONTINUES**

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### **ABSTRACT**

This article continues the on-going debate on what would be the more relevant accounting standards for Islamic banks. It addresses this important issue by first examining the differences between IFRSs and FASs in light of their objectives, scope, and suitability for adoption by Islamic banks in reporting their *sharī'ah*-compliant transactions. Specifically, the study approaches the issue from the ethics of reporting, that is on the possibility of misreporting leading to *sharī'ah* non-compliance. Most importantly, in reviewing selected standards of IFRSs and FASs, the study finds that the over-emphasis on 'comparability' may potentially lead to misreporting. Thus, it views *sharī'ah* a compliance from a broader perspective instead of only limiting it to the execution of underlying transactions. Finally, it calls for collaboration between the International Accounting Standards Board (IASB) and the Accounting and Auditing Organization of Islamic Financial Institutions (AAOIFI).

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Key words: IFRSs, FASs, *Muḍārabah* investment account, *Ijārah*, Reporting

### **1. INTRODUCTION**

Given the increasing cross border activities in the evolving global economy, it is only logical that there exists a common standard on disclosure practices of companies. Recognizing this, the International Accounting Standards Board (IASB) has developed International

Financial Reporting Standards (IFRSs) to be adopted by companies worldwide. More importantly, these standards are expected to provide for companies to expand and thrive with more cross border business prospects. Of late, the prospect of trade and economic gains, in particular, has led to more countries converging with IFRSs (Ramanna and Sletten 2009). To date, more than 100 countries worldwide have adopted IFRSs (Shafii and Zakaria 2013).

Various reasons account for this. First, the market prefers robust standards that have undergone a strict due process. Second, IFRSs avoid arbitrage. A case in point is accounting for leases. While IFRS117 recognizes an asset on finance lease in the books of the lessee, Financial Accounting Standard (FAS) 8 of the Accounting and Auditing Organizations of Islamic Financial Institutions (AAOIFI) stipulates that the lessee may not recognize the “rights of use” as assets. Thus, companies, if given a choice, will adopt the standard (IFRS117 or FAS8) that would put them in a better light. Thirdly, particularly in Malaysia, given that the Shariah Advisory Council (SAC) of Bank Negara Malaysia (BNM) has stated in no uncertain terms that IFRSs do not contravene *shari’ah* precepts, Islamic banks in Malaysia have no choice on the matter. Accordingly, like all listed companies, Islamic banks in Malaysia follow IFRSs in accordance with MASB’s stand on the matter. MASB believes disclosures and clarification are sufficient to address the inconsistencies of IFRSs (Azmi 2010). Despite the reasons put forth by proponents of IFRSs, one pertinent question is whether such standards are appropriate and relevant for Islamic banks given that these banks have a different set of philosophical underpinnings in their operations.

The debate over which are the more relevant accounting standards for Islamic banks is still continuing. This article is another attempt at further discussion on the same issue. Specifically, we attempt to compare the similarities and differences between FASs and IFRSs on specific Islamic financial transactions. This is important as apart from the *shari’ah* validity of particular transactions in Islamic banks, it is equally important that these transactions are reported in a manner aligned with Islamic principles. Islam abhors misleading acts or misrepresentations which can cause harm to the unsuspecting public. Even from ethical grounds, rightful reporting is a moral obligation. Hence ethics should be cohesively implanted in accounting practices because ethics clearly signal and distinguish right from wrong, good from bad, and justice from injustice (Rahman 2003).

This article addresses this important issue by first examining the differences between IFRSs with FASs in light of their objectivity,

scope, and suitability for adoption by Islamic banks in reporting their *sharī'ah* compliant transactions in the most appropriate manner. Of interest is how reflective and accurate the abovementioned accounting standards are, both in form and substance, in facilitating the reporting needs of Islamic banks. For more focused analysis we have selected two common products offered by Islamic banks (i.e. *muḍārabah* investment account (MIA) and *ijārah*). The rest of this article is structured as follows. Section 2 focuses on the literature review while section 3 analyzes the differences between IFRSs and FASs. This is followed by section 4 which discusses how MIA and *ijārah* should be reported if one were to follow strictly the *sharī'ah* principles on transparent and truthful accounting and reporting practices. More specifically, we examine whether the current practice of recording MIA and *ijārah muntahiah bi al-tamlīk* (IMBT) are reflective of their underlying contracts. Finally, section 5 concludes with suggestions on how to resolve the problem between IFRSs and FASs.

## 2. LITERATURE REVIEW

The IASB was formed in 2001 to replace the International Accounting Standards Committee (IASC) by the IASC Foundation<sup>1</sup>. As an independent standard-setting body, it has been entrusted with the task of developing standardized and objective standards in the public interest. Its agenda is mainly to promote useful financial reporting among the participating countries. Aimed at having accounting standards that are fundamentally relevant, faithful, clear, consistent and comparable, IFRSs were subsequently issued following an international consultative process. However the involvement of government and political influence in driving the policy decisions of the standard setting bodies remains a challenge that needs to be dealt with by the standard setting bodies (Zeff 2002; Ramanna and Sletten 2009). This makes the standard setting bodies to some extent no longer able to act independently in the best interest of the public alone (Zeff 2002).

Over the years IFRSs have gained acceptance internationally, with more and more countries converging with IFRSs with the latest being the USA and Japan. The initiative to converge the US based Financial Accounting Standards Board (FASB) with IASB is seen as an important milestone in the history of accounting standard setting as it has further strengthened the position of IFRSs and accelerated the pace of convergence with the standards worldwide. Besides that, the promising international trade opportunities via bilateral trade tie-ups

with advanced economies are irresistible to many countries. This has intensified the pressure on countries especially the less powerful to adopt or converge with IFRSs (M.Ibrahim 2007; Ramanna and Sletten 2009). Some countries have adopted IFRSs voluntarily while others were driven by political motives or government policy directives. Many have opted for IFRSs for the apparent economic advantages perceived. As such it is not surprising that even countries like Malaysia, which is one of the pioneers and at the forefront in Islamic finance, had opted for full convergence of its reporting practices with IFRSs in 2012.

Meanwhile, the objectives of accounting, from an Islamic perspective, includes provision of information that enables firms to manifest their accountability to their various stakeholders including the general public (Lewis 2001). Such accountability comprises transparency, consistency, materiality and reliability of the disclosures provided. This is important since Islamic banking is different from conventional banking, not only in structure but also legally (Mohd. Shariff and Abdul Rahman 1997). Accordingly, many believe the Islamic banks require accounting standards consistent with the underlying *shari'ah* principles which are unique (Graiss and Pellegrini 2006; M. Ibrahim 2007; Sarea 2013; Shafii and Zakaria 2013). Thus FASs are seen more suitable for the purpose.

Yet, certain other quarters have different views on the matter. They claim disclosures and notes to accounts are sufficient to resolve the inconsistencies found in IFRSs (Azmi 2010; Mohammed, Fahmi, and Ahmad 2015). Nevertheless, the major problem for Islamic banks that follow IFRSs is that the nature of transactions and their reporting framework do not match. They are challenged between adhering to the distinctive characteristics of their business transactions and business expansion prospects that come with deeper integrity with global financial markets (Shafii and Zakaria 2013). In this regard practitioners too are concerned with the various *shari'ah* issues prevailing when IFRSs are applied in reporting their transactions. Although the IASB framework emphasizes the need to faithfully<sup>2</sup> represent transactions taking place, we see an obvious contradiction between what the Islamic banks are asked to report under IFRSs and what is really being transacted by them.

The need to develop accounting standards that adequately and appropriately reflect the nature of Islamic financial transactions was viewed as an important step in enhancing the reliability, consistency and clarity of financial reporting by Islamic financial institutions. This led to the establishment of AAOIFI in 1991 ("Islamic Capital Market

Fact Finding Report” 2004) by the Islamic Development Bank in its efforts to establish a formal dedicated entity to address Islamic accounting issues. In fact AAOIFI was also entrusted with developing accounting, auditing, governance, ethics and *sharī‘ah* standards for Islamic financial institutions (IFIs). One of its mandates is to prepare, promulgate, interpret and review the accounting and auditing standards for IFIs. This mandate aimed at enhancing user confidence in the financial statements of Islamic banks and thus to encourage customers to deal, transact and invest with them.

Unlike IFRSs, FASs give value to the differing nature and legal form of Islamic finance transactions. AAOIFI’s approach in developing accounting standards, as Lewis (2001) explains, is to ensure that objectives based on the spirit of Islam are first established and subsequently to consider these objectives in relation to contemporary accounting thoughts. More importantly, AAOIFI’s standards are complementary to IFRSs. AAOIFI develops its own standards only if there is no IFRS that caters to specific transactions of Islamic banks or when applying an existing standard may lead to *sharī‘ah* non-compliance issues. Further, AAOIFI’s accounting standards are issued as guidance only. Thus, FASs are not binding on Islamic banks, unless mandated by the law of a country as in the case of Bahrain and the United Arab Emirates, for example.

Contradicting the above view is the opinion of the SAC of BNM, a point alluded to elsewhere in the paper. The SAC sees no *sharī‘ah* issue in presenting financial statements in accordance with IFRSs. Specifically, the SAC argues that financial reporting is a recording function that neither sanctifies nor nullifies the *sharī‘ah* validity of a transaction. Accordingly, IFRSs are not in conflict with *sharī‘ah*. This is indeed a significant development in the accounting history of Malaysia which has resulted in Malaysia converging with IASB in January 2012. Nevertheless some countries still have their Islamic banks presenting their financial statements in accordance with AAOIFI standards. A case in point is Bangladesh. According to Ullah (2013), Islamic banks in Bangladesh comply with 44.68 percent of AAOIFI guidelines regarding “General Presentation and Disclosure in the Financial Statements”. More impressive are the findings of Sarea and Hanefah (2013) on the practice of Islamic banks in Bahrain. Their findings indicate that Islamic banks of Bahrain are in full convergence with FASs.

Earlier literature in this regard forward mixed views and recommendations. An ISRA<sup>3</sup> research paper on this sees no contradiction between the IFRSs underlying principles and *sharī‘ah*,

specifically on form over substance, time value of money, fair value measurement and recognition based on probability (Shafii et al. 2013). It recommends that IASB provide guidelines on disclosures. Similarly, Mohammed, Fahmi, and Ahmad (2015) and Shafii and Zakaria (2013) also propose standards on disclosures or technical guidance instead of separate accounting standards. Mohd. Shariff and Abdul Rahman (1997) note that harmonizing accounting practice is difficult without regulatory support. They believe the AAOIFI needs more effort to market the standards it has developed. On the other hand, Sarea (2013) opines that by applying the FASs for reporting transactions, Islamic Banks could enhance comparability and transparency of their reporting.

### 3. IFRSs VERSUS FASs

One may expect many differences between IFRSs and FASs especially due to their different objectives. Firstly, IASB was set up to facilitate accounting needs of all social and economic activities including that of public listed companies, non-listed companies, small and medium enterprises (SMEs) and non-profit organizations. AAOIFI's mandate, on the other hand, is to promulgate standards for IFIs only. Thus, IFRSs are broader in scope and purpose and support different types of organizations and businesses as compared to FASs.

Secondly, IFRSs are principle based and include broad guidelines as well as detailed procedures with more emphasis on the substance or the economic purpose<sup>4</sup> as compared to the form. To IASB the right of ownership is not essential in determining the existence of an asset as it gives little weight to the legal form of the transactions. This, in part, allows it to better manage its broader scope and makes for better acceptance, particularly among its key member countries. Meanwhile AAOIFI adopts a contract-specific approach in presenting its FASs. As the Islamic financial transactions are founded upon specific *sharī'ah* contract(s), its view is that these transactions should be recorded accordingly to adequately reflect the underlying contract(s). Accordingly, this gives due consideration to the rights and liabilities of the reporting entity without any compromises as the end does not justify the means in Islam. In particular, there should not be any attempt at withholding relevant information. AAOIFI ensures both form and substance are equally considered in developing its accounting standards.

Thirdly, IFRSs cover all types of transactions and activities whereas FASs are issued on particular Islamic finance transactions

that are not fully supported by IFRSs. In other words, FASs are complementary to IFRSs. It was never the intention of AAOIFI to replace IFRSs, a point alluded to earlier. For example, the MIA is a common product offered by Islamic banks cross jurisdictions and it is not covered by any of the IFRSs issued by the IASB. Similarly, given that *ijārah* contracts are primarily operating leases, a specific FAS was developed in order to address the peculiar nature of leases in Islamic banks.

TABLE 1  
Comparison between IASB and AAOIFI

Aspect	IASB	AAOIFI
Objective	To facilitate accounting needs of all social and economic activities including that of public listed companies, non-listed companies, small and medium enterprises (SMEs) and non-profit organizations	To promulgate standards for IFIs
Approach	Principle based and includes broad guidelines as well as detailed procedures Emphasizes the substance or the economic purpose	Adopts a contract-specific approach Both form and substance are equally considered; gives due consideration to the rights and liabilities arising from the underlying contract(s)
Scope	Covers all types of transactions and activities	Complementary stance; only look at particular Islamic finance transactions that are unique and not fully supported by IFRSs
Basis	Guided by generally accepted accounting practices (GAAP) that focuses on comparability	Guided by the underlying <i>shari'ah</i> contracts and the arising rights and liabilities

Fourthly, IFRSs are conceptually guided by generally accepted accounting practices (GAAP). More specifically, GAAP is a set of rules, procedures and conventions to be followed across all stages of accounting for better consistency and comparability, thus benefitting users especially investors. FASs, on the other hand, ensure

that the reporting of Islamic finance transactions upholds their underlying features and is performed accordingly. Since FASs are reflective of the underlying contracts and the corresponding risks and rewards, as well as the rights and liabilities, users particularly the investors will be assured of the *sharī'ah* compliant status of Islamic banks. Given this, stakeholders will have more confidence in dealing with Islamic banks. A summary of the differences between both standards is given in Table 1. The following section discusses disclosure issues pertaining to MIA and *ijārah* contracts.

#### 4. REPORTING OF *MUDĀRABAH* INVESTMENT ACCOUNT AND *IJĀRAH*

##### 4.1 *MUDĀRABAH* INVESTMENT ACCOUNT

*Mudārabah* is a unique classical contract which has no exact representation in conventional finance. Al-Zuhailī (2001) defines it as a silent partnership. In essence it is a trust based agreement between two parties, the capital provider and the *muḍārib* (entrepreneur) to share in the profits made from a venture. In case of losses, the capital provider will lose his capital whereas the entrepreneur's loss is in terms of the labor expended. Nonetheless, if the losses are due to the negligence of the *muḍārib*, the capital provider has the right of recourse against the *muḍārib*. Given that there is no intervention from the capital provider, in *muḍārabah* contracts, the responsibility for business success is solely on the *muḍārib*. Accordingly, the liability of the capital provider is capped to the capital contributed to the venture.

Islamic banks commonly apply *muḍārabah* contract to structure their investment deposit products as *wadī'ah* and *qarḍ* contracts do not allow depositors right to profits. Islamic banks offer MIA as the alternative to conventional fixed term deposit (FD) to solicit funds from the investment account holders (IAHs). Since the agreed contract is *muḍārabah*, the IAHs have no say on the decisions to be made by the Islamic banks pertaining to the details of how their capital will be managed except on the initially agreed terms (as per the contract). Thus, the IAHs have no channel to express their views or to take care of their interest (Grais and Pellegrini 2006). The only alternative is for them to exit when it is no longer feasible for them to remain as IAHs of a particular Islamic bank. Islamic banks generally categorize MIA as either general investment account (GIA) or special investment account (SIA)<sup>5</sup> when there is no specific investment

restriction imposed. GIA and SIA are also called unrestricted investment accounts (UIAs). When specific restrictions are imposed on the MIA, it is called specific investment account and classified as a restricted investment account (RIA).

According to the *sharī'ah* interpretation, MIA is not a liability for the Islamic banks. Unlike FD, the risk of the capital in MIA rests with the IAHs. However, the IASB has no provision to support MIA or similar products (contracts). This is understandable given that deposits in conventional banking are defined as liabilities<sup>6</sup>. As such, when Islamic banks adopt IFRSs, they have no choice but to report MIA as a liability. However, this is an obvious misrepresentation which may give rise to fiduciary risk. In this regard one may not accept disclosures in the notes as sufficient to clarify the matter. The irony is that, *sharī'ah* views aside, even from pure common sense one could observe some unacceptable deviation by the standard setting bodies when they allow MIA to be classified as a liability in the financial statements of Islamic banks. Even more surprising is the declaration by the SAC that reporting of MIA as a liability on Islamic banks is not in conflict with *sharī'ah*. Although one may acquiesce to their second view, that the reporting of MIA as a liability on the Islamic banks is insignificant in terms of its *sharī'ah* validity, the pertinent question at hand is not on the execution of the transaction but rather on the misreporting and misleading accounting practices imposed on Islamic banks under the ongoing international convergence initiatives. Such practices can be deemed deceitful from the stricter views of Islamic precepts.

To specifically deal with the unique nature of MIAs, AAOIFI has issued a specific standard, FAS 6 on "Equity of Investment Account Holders and their Equivalent", to address the reporting and disclosure needs of MIA. Specifically, FAS 6 requires that UIA be presented in the statement of financial position as a separate class of equity on its own, between liabilities and owners' equity while the RIA is to be treated as an off-balance sheet item as the underlying contract of *muḍārabah* is considered non-participating. This is more acceptable as UIA's inclusion is more from the disclosure perspective due to its participative nature. Additionally, AAOIFI requires a separate statement on RIA showing the movement of funds in the statement of financial position of an Islamic bank. We observe that the same position has been proposed by Malaysia in its recently issued Investment Account policy document<sup>7</sup>. Unlike the repealed Islamic Banking Act 1983, which has classified MIA as a deposit<sup>8</sup>, the newly enacted Islamic Financial Services Act 2013 reinforces the legal rights

and obligations of the counterparties that are aligned with the *sharī'ah* viewpoint. As such it will be interesting for us to wait and see how MASB will handle these transactions in future.

Whatever the outcome, we discuss this issue with focus on recording and reporting of a transaction and not on its execution and validity. While a transaction may have passed the first test of fulfilling the tenets of the underlying contract at the execution stage, the second test is whether the reporting practices are aligned with the principles of accountability and full disclosure. As one may recall, according to the IASB, its objective is to “develop in the public interest, a high quality, understandable, enforceable and globally accepted financial reporting standards<sup>9</sup>. Clearly, the requirement that MIA be recorded as a liability runs contrary to this. Reflecting MIA as a liability misleads and confuses the public. The underlying property of the contract is risk sharing and yet the financial statements do not reflect this aspect of MIA. Accordingly, the IFRs that most Islamic banks have adopted in their reporting practices are neither appropriate nor pertinent in the case of MIA.

#### 4.2 IJĀRAH

*Ijārah* or leasing is one of the contracts explicitly discussed in Islamic law (Al-Zuhailī 2001). *Ijārah*, in its original form, is an operating lease (*tashghīlīyah*) where the *ijārah* assets are under the ownership of the lessor and are leased out to the lessee for a rental payment. In other words, *ijārah* effectively involves the sale of the usufruct of an underlying asset by the lessor to the lessee. In Islamic banking, *ijārah* is often used to finance asset acquisition using IMBT contract. IMBT may take several forms in attempting to transfer the ownership of the leased asset to the lessee at the end of lease period. Leased assets can be transferred in various ways; as a gift at the end of lease period, sale for a specified consideration, sale for a token amount as well as a gradual transfer of title over the lease period. However it is a *sharī'ah* requirement that the eventual transfer of title should not be made a condition of the initial lease (Kamali 2007). Similarly, IAS 17 defines lease as an agreement whereby the lessor conveys to the lessee the right to use an asset for an agreed period, in return for a specific rent. However, IASB further classifies lease as either an operating or a finance lease. If the lease transfers substantially all the risks and rewards incident of ownership to the lessee, it is a finance lease; otherwise it is an operating lease<sup>10</sup>. More importantly, IASB

emphasizes the economic substance of the transaction as opposed to its legal form<sup>11</sup>.

The economic effect of IMBT financing such as *ijārah thumma al-bai'* (AITAB) car financing in Malaysia ends with the lessee owning the leased asset. According to the IASB, two organizations that carry out transactions which have identical economic effects should account for the transaction in the same way. In this regard IASB equates IMBT with conventional lease financing, citing that there should be no difference between Islamic and conventional lease financing for accounting purposes as the end objective is the same. Accordingly, under IFRS 117 (IAS 17), IMBT transactions are regarded as finance leases and are to be accounted as receivables from the lessee. Thus, this is regarded as a debt in the books of the lessor. However, *sharī'ah* views IMBT differently. Firstly, IMBT transactions are two separate contracts namely a lease and a sale and that the latter cannot be made a condition of the former. Thus, *ijārah* necessitates the assumption of ownership by the lessor and thus the risks and liabilities arising therefrom. Secondly, the lessee is simply the benefiter of the usufruct. Therefore the notion of leased assets appearing in the books of the lessee is inconsistent with *sharī'ah* standpoint and thus considered as misreporting and *sharī'ah* non-compliant. Accordingly, AAOIFI does not recognize finance lease and treats all leases as operating leases subject to certain variants. AAOIFI's definition of *ijārah* reflects the same position, that *ijārah* is an ownership of the right to the benefit of using an asset in return for consideration<sup>12</sup> whereby the fulfilment of the benefits should be in accordance with *sharī'ah*<sup>13</sup>. AAOIFI's FAS No. 8 paragraph 2/2(a) reconfirms this view by requiring the leased asset to be held in the lessor's books and depreciated accordingly.

On the other hand, IASB seems to be over-emphasizing the economic purpose and ignoring the context of *faithful reporting*. This impedes the very objective of instituting Islamic finance as a separate dimension of doing finance. It also points to IASB's inconsistency in accommodating the differing needs of particular economic activities. On the one hand we take note that IASB has issued a separate set of standards for SMEs but when it comes to the unique transactions of Islamic finance institutions we have yet to see any concrete move by the IASB to come up with standards more reflective of their unique contracts. Thus, the misclassification of Islamic financial transactions such as reporting of *ijārah* assets as a debt instead of equity must be given due attention by all concerned parties.

## 5. CONCLUSION

In this article, we have analyzed the different views of the IASB and AAOIFI with regard to accounting for financial transactions undertaken by Islamic banks by taking two sample products (contracts). Despite the differences, none can dispute that the very object behind standardization of accounting practices is to *uphold the objective of faithful reporting* of financial transactions and economic activities of an organization in order to enable users to make more informed decisions. Given that Islamic banking is regarded as ethical banking, misreporting Islamic financial transactions would not align with such a spirit. Most importantly, accounting practices should not mislead into equating Islamic financial transactions with the conventional ones.

We beg to differ with the IASB's contention on relying on the economic substance<sup>14</sup> of the transaction to differentiate finance lease from operating lease. In our view, *the different passage taken by Islamic finance* to accord with the *maqāsid sharī'ah* (objectives of *sharī'ah*) is *the substance* and this is the righteous path in achieving *falah* (success in the hereafter). In fact to achieve *falāh*, in any economic decisions, including financial reporting, the ethical values should act as the norm (Rahman 2003). Given that owning assets is the ultimate objective of businesses organizations and that is precisely what financial institutions try to fulfil, regardless of Islamic or conventional, we should not find fault in this objective. Instead we should applaud the noble intention of Islamic banks which, despite the challenges, are still insisting on rightful recording of their financial transactions.

In our view, financial statements are equally relevant for the purpose of educating people on Islamic finance. Understandably only the transacting parties could verify the details of execution of Islamic financial transactions. Often it is unclear to transacting parties how these transactions were executed because of several factors. First is the fact that these parties are unfamiliar with Islamic based contracts. Second is the speed at which these transactions are executed and finally, the variations in practice by different Islamic banks. Thus, it is the financial reporting that can provide a platform for sharing the details of these transactions with stakeholders in a more consistent and transparent way. To achieve this, Islamic banks must follow a set of common standards that allow for proper recording of Islamic financial contracts as alluded to in the preceding discussion. This will create better understanding of the financial position of Islamic banks and

enable a more objective comparison of Islamic bank performance. More importantly, *sharī'ah* aligned financial reporting will give stakeholders increased confidence. This point is pertinent as the public is now sceptical of whether there is a real difference between Islamic and conventional banking practices. Vicary<sup>15</sup> says greater efforts are needed to dispel this negative perception (Steffensen 2013). These perceptions are primarily due to ignorance and misconception. Education can help to counter both. For this, the prevailing reporting practices of Islamic banks would not help; there is no room for misreporting.

However, this does not mean that we are against standardization. We believe any standardization should be undertaken with care and it should not compromise the core values that differentiate Islamic finance from conventional finance. We take cognisance that the IASB has already considered a separate set of standards for SMEs. This clearly indicates that “one shoe fits all” is not the policy of IASB. A positive move is for the IASB to collaborate with AAOIFI to address accounting and financial issues of contracts peculiar to Islamic finance. Additionally, countries that promote Islamic finance should join forces and form a common interest group to look into the possibility of convergence/harmonization of accounting practices of Islamic banks. The task may not be difficult as AAOIFI has already done the ground work by issuing many standards that address the gaps between IFRSs and the *sharī'ah* position of the transactions. We strongly believe there is no need for two separate standard setters for Islamic and conventional FIs. AAOIFI can still be relevant by becoming the research organization for this purpose and can work independently and continuously in the best interest of Islamic banks and as a service provider to IASB.

Islamic finance should not be narrowly interpreted as the compliance of products and services to the *sharī'ah* only. Islamic finance has to be seen in the overall context, and in a more holistic manner as an end to end objectivity. From our viewpoint, this is what is normally seen as the major ground for dispute even among the promoters of Islamic finance on what should prevail between *sharī'ah* compliance in form and *sharī'ah*-compliance in form and substance. Thus far Islamic financial activities seem to emphasize more on the compliance in form instead of substance. For example, what is perceived important is the execution of the transactions, while reporting of the transactions pales in comparison. This is probably the very reason reporting of Islamic financial transactions appears not to be as significant as the underlying transactions.

One must bear in mind that financial statements are relevant for a multitude of purposes and their users are much broader than just shareholders and investors alone. The society at large affects and is affected by the commercial and financial activities happening not only within the community but also in other parts of world, thanks to the ongoing market liberalization and globalization. Even the governments and recipients of *zakāh* for example have an interest in the financial performance of business entities including Islamic banks. As such serving a narrow perspective of reporting and relying on the economic substance of a transaction may serve to satisfy the needs of the entity but may not satisfy the needs of other stakeholders. Thus, ignoring the other salient attributes of the transactions including how and what exactly were undertaken by Islamic banks and the consequences of their actions for other stakeholders should never be ignored. Otherwise, the establishment of Islamic banks may not serve to achieve the *maqāsid shari'ah*.

Accounting standards are not a choice for Islamic banks to pick and choose freely, but rather they are bound to follow the standards mandated by law and regulations. For example in Malaysia, the applicable accounting standard is MFRS which had converged with IFRSs in 2012. Accordingly, Malaysian Islamic banks need to apply MFRS in reporting their transactions. Bahrain, on the other hand, has opted to follow AAOIFI's accounting standards to report their financial transactions. In the absence of any harmonization or convergence initiatives between the accounting standards of the IASB and AAOIFI and non-action from IASB to attend to the specificities of Islamic financial transactions, the issue will remain unresolved. Joint effort between the IASB and AAOIFI is needed to resolve this issue. The time to act is now.

#### END NOTES

1. IASC Foundation later became the IFRS Foundation.
2. IASB Framework, paragraph 33 and 34 state that, "to be reliable, information must represent faithfully the transactions," and "... a balance sheet should represent faithfully the transactions and other events that result in assets, liabilities and equity of the entity ...".
3. The International Shari'ah Research Academy for Islamic Finance, Malaysia.
4. Paragraph 35 of IASB Framework emphasizes the importance of substance over form; it reads as "If information is to represent faithfully the transactions and other events that it purports to represent, it is necessary that they are accounted for and presented in accordance with

- their substance and economic reality and not merely their legal form. ...”.
5. Offered to special target groups such like the high net worth and corporate entities.
  6. Investopedia defines bank deposits as, “Money placed into a banking institution for safekeeping. ...”. The “deposit” itself is a liability owed by the bank to the depositor (the person or entity that made the deposit), and refers to this liability rather than to the actual funds deposited.
  7. Issued on 14<sup>th</sup> March 2014 by BNM.
  8. IBA, 1983, Section 2 Interpretation: “Islamic deposit” means a sum of money or monies worth received by or paid to any person, under which the receipt and repayment shall be in accordance with the terms of an agreement made under any Syariah principle on any basis including custody or profit sharing;”.
  9. The objectives of the IASB under the IFRS Foundation Constitution.
  10. IAS 17.4.
  11. IAS 17.10 & IAS 17.11.
  12. Appendix (B) Juristic Rules, FAS 8, Paragraph 1/1.
  13. FAS 8 Juristic Rule 1/3/3/2.
  14. Paragraph 35 emphasizes the importance of substance over form, “If information is to represent faithfully the transactions and other events that it purports to represent, it is necessary that they are accounted for and presented in accordance with their substance and economic reality and not merely their legal form. ...”.
  15. Daud Vicary Abdullah is the President and CEO of Malaysia’s International Centre for Education in Islamic Finance (INCEIF), the Global University of Islamic Finance.

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