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Islamic accounting standards: historical retrospective, challenges and key players

Abstract. A historical exploration of Islamic Accounting Standards is presented in this paper. The fundamental players' roles in the emergence and expansion of Islamic accounting standards are also identified. To collect data, documents were examined and key players that are involved in the development of Islamic Accounting Standards were interviewed. It has been determined that the Dubai International Finance Centre (DIFC) primarily sets Islamic Accounting Standards in the UAE. Since the reporting standards and backgrounds of accountants may have global effects beyond their jurisdictions, this study suggests accounting standards setters with differences in the ideological and religious backgrounds should communicate with one another in an era of globalization.
Keywords: Islamic Accounting Standards; Dubai International Finance Centre; DIFC; UAE; Islamic Shariah Law; Financial Management; Behavior, Accounting, Globalization; Accounting and Auditing Organization for Islamic Financial Institutions; AAOIFI
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1. Introduction and Theoretical Framework

Let us examine how Islamic accounting standards were developed. As Islamic accounting standards have been used primarily in Islamic banking systems, we need to familiarize ourselves with their history in order to have an insight into this issue. In Islamic banking, all banking activities are compliant with Islamic Shariah law. The financial processes in Islamic countries were governed by Shariah law before Islamic accounting standards were introduced. Islamic teachings are based on Shariah law.

This research presents a development of our previous investigation of the subject (Sharairi & Islam, 2013). Various studies have previously examined International Accounting Standards as well as Islamic Accounting Standards (IAS). It examines two key issues, according to Ashbaugh et al. (2020) - first, whether varying accounting standards across national borders affect analysts' ability to accurately forecast non-US firms' earnings, and second, whether analysts' forecast accuracy changes with the adoption of IASs. As a result of the convergence of accounting policies brought about by adopting IAS, they found that analyst forecast errors decreased following the adoption of IAS. According to Kamla et al. (2006), Islamic principles can be used to account for the environment. As a result, they demonstrated that Islamic principles play an important role in reorienting dominant accounting practices and thinking.

International Accounting Standards Board (IASB) accounting standards and Islamic accounting standards differ in many ways. Leases, restricted contracts, and specialty investment accounting are among the areas where Islamic accounting standards differ from IFRS (Romzie et al., 2016). The Islamic principles remain relevant despite differences between the IASB and the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). As Islamic financial institutions are based on religious beliefs and principles, they must follow an Islamic accounting system and standard in order to perform Shariah-compliant transactions (Romzie et al., 2016).

Voronova & Umarov (2021) presented research on the need for Islamic accounting in modern economy. While explaining the governing system of modern economy and accounting, he presented the goals and concepts of Islamic accounting using the questionnaire tool. By examining the correct and fair view from the Islamic point of view, and using the questionnaire tool, Mahar et al. (2024) introduced the use of the standards of the Islamic Accounting and Auditing Organization as implying the realization of the correct and fair view in Islamic accounting.

Abras & Jayasinghe (2023) investigated the necessity of the theoretical framework of financial reporting with an Islamic approach by using interpretive, critical and Delphi methods. The results of this study show that the academic and professional financial reporting experts agree that the difference between the economic and social principles of Islamic business units compared to the capitalist economy of the western type business units and the inadequacy of meeting the needs of Muslim users and Islamic business units by conventional financial reporting is a necessity. Revision and formulation of the theoretical framework with an Islamic approach as the basic law of Islamic financial reporting is required in order to attract the trust of Muslim investors and the Islamic society.

Using conventional accounting practices according to existing normal accounting standards is not sufficient to resolve Islamic financial institutions' accounting and transactional problems. As part of the AAOIFI conceptual framework, the consumers are identified and specific goals, values, high-level principles and components behind the assessment and identification laws are outlined (Sutton et al., 2015). Shariah principles guide Islamic financial institutions, which depict desired aspects of business transactions. As a result, Islamic banks have introduced their own financial reporting processes that are not regulated.

Islamic accounting standards were assessed in the literature studies. AAOIFI standards have not yet been adopted in the Islamic countries or examined their potential impact on Islamic institutions as a result of their adoption. An analysis of the key players in AAIOFI's Islamic accounting standards is presented in this paper in order to identify the feasibility and benefits of adopting Islamic accounting standards in the United Arab Emirates (Nadzri, 2019; El-Halaby, 2020).

In certain countries, Islamic banks adopt a variety of Shariah principles. A description of the main characteristics of Islamic banks' application of Sharia principles is given in the research by Sarea (2012). For instance, the BIMB bank of Malaysia is the only bank where has been introduced usage of Arabic words for the description of all the *Shariah* principles which are used for the governance of the operations of the BIMB Bank. Whereas, other Islamic banks in other countries have retained Arabic words only for some or few principles only, and these Islamic banks use words in place of other words used in the *Shariah* principles. In Islamic banking, the Shariah principles are divided into four parts: profit and loss sharing, free service, fee-based, and ancillary principles.

Most of the Islamic banks in many countries do not apply all the four of the above *Shariah* principles, and most of the Islamic banks apply only three of them. There are, however, some banks who apply all the four *Shariah* principles, namely: the IBBL bank of Bangladesh, JIB Bank of Jordan, BIMB Bank of Malaysia, and FFI bank of Turkey. Islamic banks apply 14 principles within these four categories in their daily operations. The United Arab Emirates-based DIB bank and Bahrain-based IBB bank have the least number of Shariah principles, required to be applied by all Islamic banks.

2. Research Methods

Data collection was conducted using two methods. Our first step was to interview managers at Al Hilal Islamic Bank, Dubai Islamic Bank, members of Dubai Islamic Bank's Fatwa and Shariah Supervisory Board, members of Abu Dhabi Islamic Bank's Fatwa and Shariah Supervisory Board, as well as members of AAOIFI's board of trustees. Interview questions include the following (Odiabat, 2010):

- What have been the causes of Islamic Accounting Standards introduction in the UAE?
- Where and when have been the initial attempts made toward devising Islamic accounting standards in the UAE?
- Where and when have been the initial attempts made toward coming devising Islamic accounting standards in the UAE?
- How have the issues been resolved?
- Which fundamental parties have been involved in implementing Islamic Accounting Standards in the UAE?

Also, we used documents from relevant organizations and research papers to gather data. As a result of its unique development, we can state that the Islamic accounting standards are connected to the emergence of the Islamic world on both a financial and political level. Middle Eastern countries have become increasingly important from an economic perspective as the Islamic region contributes more than 25% to the world population, and amongst eighteen oil producing countries (Islas-Moreno et al., 2023), 10 Muslim countries supply 40% of the total oil production. Moreover, Islamic countries are increasingly contributing to world trade, which further strengthens their strategic positions. American Finance House, the Islamic Bank of Britain, Amana Mutual Fund Trust, MSI financial services are some of the major financial institutions and banks involved in international activities in the Islamic region. In addition, many of the MEC's members are members of considerable international organizations, such as the WTO, World Bank, and the UN. Middle Eastern countries' increasing involvement in international financial activities has led to their recognition as a factor in the development of international accounting standards.

Additionally, Islamic banks implemented and adopted International Accounting Standards (IAS) during this period. Their specific requirements were not met because they follow international accounting standards. Here are two examples:

1) Fiduciary hazard: under the Mudaraba contract, the mudarib assumes responsibility for the loss;

2) Displaced commercial hazard: When Islamic banks vary the percentage of profit taken as Mudarib share to «smooth» returns on Investment Account Holders.

Main players: Fundamental Parties Involved in preparing Islamic Accounting

We have previously noted that Islamic accounting standards were developed as a result of the collaborative attitude of many parties. Among the fundamental players which are involved in the growth of the Islamic Accounting Standards were Shariah law, Islamic financial institutions, AAOIFI (Accounting and Auditing Organization for Islamic Financial Institutions) and Islamic communities. It cannot be ignored that the IAS, International Financing Reporting Standards (IFRS) and International Accounting Standards Board (IASB), have also made an important contribution to Islamic accounting standards, for without these authorities, there would not have been a foundation for the Islamic accounting standards to be developed (Chua & Taylor, 2008). In order to address the loopholes in existing accounting standards, Islamic accounting standards have been developed according to Islamic Shariah Law.

Islamic banking and accounting have been transformed by AAOIFI, in particular. In addition to devising and setting standards for various Islamic financial institutions, Islamic central banks, and other luminaries from the Islamic Financial Territory, AAOIFI is an international autonomous non-profit Islamic corporate body. Over 200 institutional members from 45 countries provide advice and suggestions to the AAOIFI. Various standards are then issued to ensure that all Islamic Financial Institutions comply with Shariah principles regarding accounting, auditing, and ethics.

3. Results and Discussion

We discuss in this section the results of our qualitative study, which involved unstructured telephone interviews with five of the fundamental players in the UAE's Islamic accounting standards.

As a result of these qualitative findings, the documentary illuminates issues and explores in more depth the issues related to adopting Islamic accounting standards in the UAE, as well as verifying the expected impacts and benefits of such move.

Initially, a question was asked about *the main causes of the introduction of IAS in the UAE*. In the *first interviewee's* opinion, since the UAE was already compliant with IAS and followed IFRS religiously, it did not have any trouble keeping track of all these financial records, but Islamic authorities around the world are gradually adopting the AAOIFI accounting standards. AAOIFI's Islamic accounting standards, which were introduced in 2004 with the introduction of Dubai International Financial Center (DIFC), were approved by UAE as a vital representative of the Islamic world.

In the *second interviewee's* opinion, Islamic accounting is based on religious beliefs more than on accounting technicalities; every Muslim seeks to transact in accordance with Shariah. As a result, AAOIFI was created with Shariah-compliant laws that are well-suited to the nature of financial transactions in the UAE. In domestic and international transactions, UAE's numerous Islamic banks and other prominent financial institutions will start applying Shariah law-based accounting principles.

There is no need for Islamic Accounting Standards in the UAE, according to the *third interviewee*. The native firms of the country also wanted to take the opportunity and began to plan out schemes with their oil and gas money to expand their business empires in other parts of the world. In this way, a flood of financial transactions started occurring in the UAE.

A second question was asked about *where and when Islamic accounting standards were first developed in the UAE*. According to all the interviewees, Dubai International Finance Centre (DIFC) played a major role in implementing IAS in the UAE. In order to comply with the accounting principles, set by AAOIFI, DIFC has adopted accounting principles. In DIFC, all laws and courts are governed by the Law, and it functions as a jurisdiction that is independent. Businessmen in DIFC are provided with the chance to boost their businesses into and out of emerging markets in the region (DIFC, 2013). Coincidently, the company's starting operations coincided with the launch of the IAS in the UAE. One had to say that it was quite a late arrival of something so significant but they also have to acknowledge the fact that AAOIFI too came into existence. DIFC got its head-start in the year 2004 and AAOIFI started its operation in 1993, only recently, major Islamic institutions all over the world started embracing the accounting principles dictated by Shariah law. Thus, DIFC became the first organization in the UAE to use Islamic accounting standards.

A third question was asked *about the specific issues in the current standards (IASB) that need to be addressed in the Islamic accounting standards, as well as about the efforts that are being made to create Islamic accounting standards*. IASB and IFRS principles are being applied in Islamic countries, according to the *first interviewee*. Monetary experts for this section of the world had to devise a system of unified accounting standards for the entire Islamic world as it came into prominence with phenomenal economic growth. The AAOIFI is the entity responsible for enforcing Islamic accounting standards. According to the *second interviewee*, IFRS compliance was always a problem.

The fourth question was asked on *how the issues had been resolved*. The *first interviewee* explained that AAOIFI addresses most problems of Islamic nations concerning IFRS principles, such as UAE; by establishing a policy framework that tries to include all solutions to these problems in its core. Several Islamic banks and other financial institutions in the UAE reported that the accounting standards and principles established by AAOIFI resolved most of their issues. As a result of AAOIFI's transparency and simplicity in its accounting principles, they were easy to understand and to follow. As a result, investors and UAE citizens trust and believe in these accounting principles, which are also according to the holy teachings of the Quran. In the *third interview*, a financial expert said the country's financial experts were divided over whether to stick to IASB standards (as they had been doing for quite some time) or to devise its own accounting standards. In many Middle Eastern countries, Islamic accounting standards had already been adopted, and this new system was gradually gaining acceptance around the world, including in Western countries. The problem will not be solved by AAOIFI, according to *another interviewee*. Adapt some of the IASs to satisfy Shariah and continue to adopt them.

In the fifth question we asked *who was involved in implementing the Islamic Accounting Standards in the UAE.* AAOIFI accounting standards were embraced by the DIFC earliest of all, and the DIFC played an important role in setting UAE's connection with AAOIFI's norms. As a financial institution, DIFC connects the eastern and western parts of the UAE and is one of the key drivers of the region's economic development. As one of the world's most business-friendly destinations, the DIFC has played a significant role in the UAE's success. In addition to adhering to the most stringent and transparent accounting principles, Dubai Financial Services Authority (DFSA) also adheres to Islamic and International Accounting Standards Board (IASB). Its own financial risk regulator is a major reason for the DIFC's tremendous success as an independent corporate entity. More commonly known as the DFSA, this regulator is responsible for regulating the financial sector in Dubai.

The Proposed Solutions of the Problems

Basically, Islamic finance can be categorized into four issues. The following are some of them:

a) There should be no condemnation of Islamic principles and compatibility with the religious laws is a must;
b) the use of risk & profit sharing strategies;
c) adopting real economic transactions and asset backed transactions;
d) the use of social justice and ethical values.

According to Islamic law, unethical practices and prohibited financial instruments are prohibited. The Islamic finance model is best defined as follows in Figure 1.

As a result of the model, the four main Islamic accounting issues are: liability vs. equity; interest vs. dividend; substance vs. form; ownership in sukuk vs. default.

It is the AAOIFI, local Shariah boards, and local regulatory bodies that work to solve these problems. The AAOIFI, in particular, has received plenty of support in recent years from countries and institutions such as Jordan, Qatar, Dubai International Finance Centre, Lebanon, Syria, Pakistan, Sudan. AAOIFI's standards and pronouncements have also been acknowledged by Saudi Arabia, South Africa, Australia, Malaysia and Indonesia, among others. As a result, there has been a tremendous amount of pressure on the Islamic world to adhere to the standards norms set by IFRS. Further pressuring the Islamic community to conform to the International Accounting Standards (IAS) has been caused by the increased pace of globalization.

Regarding the challenge of Islamic accounting goals, jurisprudential studies indicate the need to consider justice, human rights, development and prosperity of the country, and accountability as the goals of Islamic accounting. Accounting experts consider these goals suitable for Islamic accounting, but they either disagree or do not have a consensus regarding the inclusion of these goals in international financial reporting standards (Abras & Jayasinghe, 2023). Also, accounting experts consider the appropriate approach of developing Islamic accounting goals according to what has been done in the jurisprudential sector that is, developing Islamic accounting goals by considering the goals of international financial reporting standards and financial accounting standards.

Regarding the primacy of content over the form and time value of money, jurisprudential studies show the legality of using these concepts in Islamic accounting. In this field, accounting experts are in line with the results of the jurisprudence department. Regarding measurement in Islamic accounting, accounting experts, like the results of the jurisprudence department, consider conventional value measurement appropriate and mandatory for Islamic accounting and specifically partnership contracts, but they do not agree on the use of historical cost in this field (Voronova & Umarov, 2021). Regarding the need to present a statement of sources and expenses

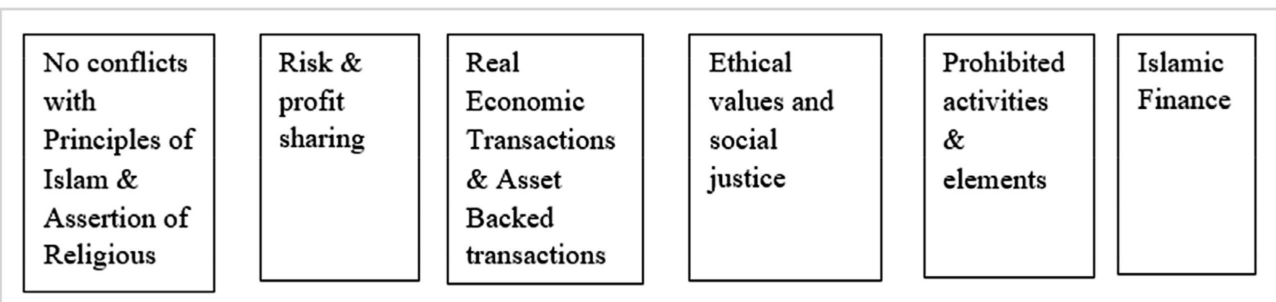

Figure 1:
Islamic finance model
Source: Compiled by the authors

of charity and zakat funds, accounting experts and jurisprudential results are in agreement. However, accounting experts, contrary to the results of the jurisprudence department, consider it desirable to present a statement of sources and expenses of charity and zakat funds.

It was announced on September 30, 2012 (Islamicbanker, 2011) that AAOIFI had introduced its own accounting standards. As a response to issues, concerns, and problems posed by the IASB, the AAOIFI has brought about its initial Financial Accounting Standard No. 1 (FAS1) and a Statement of Financial Accounting (SFA2).

In developing accounting principles for Islamic world countries, AAOIFI closely followed Shariah principles. As outlined by Abdullah (2010), AAOIFI has addressed four issues:

a) a lack of understanding of the in-depth finance opportunities;
b) misperception and unanimity about Shariah law;
c) an inadequate numbers of Islamic financial experts over interested candidates and accounting subjects;
d) a lack of literature and research on Islamic banking and accounting.

As well as identifying these troublesome issues, AAOIFI also suggested solutions for them (Business & Tenders, 2013).

4. Conclusion

Islamic accounting means the process of identifying, measuring and reporting the legitimacy of financial activities, which is useful for decision-making, calculating zakat and calculating the real profit of Islamic investment operations based on the orders of Islam. This research is based on a library method and first introduces the history and literature of Islamic accounting, the goals of Islamic accounting as well as the characteristics of Islamic accounting and then its difference with conventional (western) accounting, the principles of Islamic accounting and finally the criticisms and challenges Islamic accounting pays. By providing a deeper understanding of Islamic accounting standards, this paper will contribute to the existing knowledge and practices of both Islamic and Western countries.

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