The Potential Adoption of Islamic Accounting Standards Developed by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) by Islamic Banks in the United Arab Emirates

Mohammad Haroun Sharairi

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Abstract

This study investigated the potential impact of applying the accounting standards of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) in Islamic banks in the United Arab Emirates (UAE). This study aimed to examine the International Financial Reporting Standards (IFRS) currently in use by Islamic banks in the UAE, as compared to the AAOIFI accounting standards, in order to identify the differences and determine which system may better satisfy user needs in the UAE, as judged from the perspective of respondents to a research survey. This study also provided an understanding of the roles of key personnel in developing the AAOIFI’s standards in the UAE and the factors leading to the development of these standards were explored.

Data was collected for this purpose through examination of documents, conducting a questionnaire survey with professionals and managers of Islamic banks in the UAE and conducting interviews with key personnel involved in the development of the Islamic Accounting Standards. It was found that the main participant in developing the Islamic Accounting Standards in the UAE is the Dubai International Finance Centre (DIFC).

This study found that there is a serious concern, particularly in the Islamic countries, with regard to the IFRS dealing with transactions involving interest (Ribā). One implication of this study was that in the era of globalization, accounting standard setters who came from different ideological and religious backgrounds should communicate with each other because their reporting standards and their different backgrounds can have global implications beyond their jurisdictions. The study also revealed that factors such as religion, culture and local investors, may have limited influence on the current adoption of accounting standards in the Islamic banks. This contrasts with economic and political factors such as domestic regulators, foreign investment, and global financial institutions which are major influences on the Islamic banks with regard to the adoption of IFRS.

Furthermore, the study uncovered a concern among respondents of issues that may develop when Islamic banks commence the transition to AAOIFI standards. These issues include the prevention of attracting foreign direct investments, affecting the relationship with the big four accounting firms, giving rise to certain costs of time and sources and limiting the comparability with financial statements of other financial institutions. The study also indicated that there was a high level of support (61.5%) amongst respondents for the adoption of IFRS; however, the respondents’ opinion does not also reflect a perception that all IFRS
are suitable for application of *Shariah* transactions. Therefore, the findings suggest support for not replacing IFRS, but to find a way to comply with AAOIFI standards as well as to continue using IFRS by Islamic banks in the UAE.
Acknowledgments

In the name of GOD, the merciful, the beneficent

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Finally, I am deeply grateful to my Mum & Dad, who are an example of the great parents of this life, for their support and encouragement. My warm love and thanks go to my wonderful wife Rasha for her support, encouragement and sacrifice while I completed my DBA.
## Abbreviations

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<th>Description</th>
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<tr>
<td>AAIOFI</td>
<td>Accounting and Auditing Organization for Islamic Financial Institutions</td>
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<tr>
<td>AICPA</td>
<td>Institute of Certified Public Accountants</td>
</tr>
<tr>
<td>CFA</td>
<td>Confirmatory Factor Analysis</td>
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<tr>
<td>CIPA</td>
<td>Certified Islamic Professional Accountants</td>
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<tr>
<td>CSAA</td>
<td>Certified <em>Shariah</em> Advisors and Auditors</td>
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<tr>
<td>DFSA</td>
<td>Dubai Financial Service Authority</td>
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<tr>
<td>DIFC</td>
<td>Dubai International Financial Centre</td>
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<tr>
<td>EFA</td>
<td>Exploratory Factor Analysis</td>
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<tr>
<td>ERM</td>
<td>Enterprise Risk Management</td>
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<tr>
<td>FASB</td>
<td>Financial Accounting Standards Board</td>
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<td>FDI</td>
<td>Foreign Direct Investment</td>
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<tr>
<td>GAAP</td>
<td>Generally Accepted Accounting Principles</td>
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<tr>
<td>GCC</td>
<td>Gulf Cooperation Council</td>
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<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
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<tr>
<td>IAH</td>
<td>Investment Account Holders</td>
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<td>IAS</td>
<td>International Accounting Standards</td>
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<tr>
<td>IASB</td>
<td>International Accounting Standards Board</td>
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<tr>
<td>IASC</td>
<td>International Accounting Standards Committee</td>
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<tr>
<td>IFIs</td>
<td>Islamic financial institutions</td>
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<td>IFRS</td>
<td>International Financial Reporting Standards</td>
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<td>IFSB</td>
<td>Islamic Financial Services Board</td>
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<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
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<tr>
<td>MEC</td>
<td>Middle Eastern Countries</td>
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<td>MENA</td>
<td>Middle East North Africa</td>
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<tr>
<td>MoU</td>
<td>Memorandum of Understanding</td>
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<tr>
<td>PLS</td>
<td>Profit &amp; Loss Sharing</td>
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<tr>
<td>SAC</td>
<td>Standard Advisory Council</td>
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<tr>
<td>SCF</td>
<td><em>Shariah</em> Compliant Financing</td>
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<tr>
<td>SEC</td>
<td>Securities and Exchange Commission</td>
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<td>UAE</td>
<td>United Arab Emirates</td>
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Glossary

Fatwa: Islamic religious rules. Religious decree or a legal ruling made according to Shari'ah.

Fiqh: Islamic jurisprudence. The science of the Shari'ah. An important source of Islamic economics.

Gharar: Speculation. An exchange transaction in which one or both parties remain ignorant of an essential element of the transaction.

Haram: An act or product which is unlawful or prohibited in Islam.

Ijara: Lease financing or Islamic mortgage. The purchase of the leased asset at the end of the rental period is optional.

Istisnah: Advance purchase of goods or buildings. Contract of sale of goods to be manufactured or constructed in a fixed time for an agreed price.

Mudharaba: Profit sharing. An investment on your behalf by a more skilled person. It takes the form of a contract between two parties – one who provides the funds and the other who provides the expertise. The division of any profit is agreed in advance.

Mudarib: Entrepreneur in a Mudharaba contract. The entrepreneur or investment manager in a Mudharaba who puts the investor’s funds in a project or portfolio in exchange for a share of the profits.

Murabaha: Cost-plus financing. A contract for purchase and re-sale for cost plus profit, which allows the customer to make purchases without having to take out a loan and pay interest.

Musharaka: Partnership. A contract involves a person placing their capital with another person's capital and them both sharing the risk and reward.

Qard Hasan: Benevolent loan. Non-interest bearing loan or benevolent loan which refers to a loan given by a person (lender) to the borrower without any expectation of extra returns.

Riba: Interest or usury. An increase, addition, unjust return, or advantage obtained by the lender as a condition of a loan. Prohibited in Islamic law.

Shari'ah: Islamic law. Islamic law derived from three sources: the Quran, the Hadith and the Sunnah.

Sukuk: Islamic bond. Shari'ah-compliant financial certificates similar to bonds.

Sunnah: Practice and traditions of the Prophet Muhammad (peace be upon him).
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<td>Takaful</td>
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<td>assistance. Known as ‘Islamic insurance’.</td>
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<td>Zakat</td>
<td>A religious levy as a fundamental duty. An obligatory contribution where</td>
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<td>every wealthy Muslim is required to pay a proportion of his/her wealth</td>
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<td></td>
<td>every year.</td>
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<td>Hawala</td>
<td>Remittance or bill of exchange. A contract which allows a debtor to</td>
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<td></td>
<td>transfer his debt obligation to a third party who owes the former a debt.</td>
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<tr>
<td></td>
<td>The mechanism of <em>Hawala</em> is used for settling international accounts by</td>
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<td>book transfers, thus obviating the need for a physical transfer of cash.</td>
</tr>
<tr>
<td>Kafalah</td>
<td>Guarantee. <em>Shariah</em> principle governing guarantees. It applies to a debt</td>
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<tr>
<td></td>
<td>transaction in the event of a debtor failing to pay.</td>
</tr>
<tr>
<td>Hesab</td>
<td>Account.</td>
</tr>
<tr>
<td>Shirkah</td>
<td>Partnership. A contract between two or more persons who launch a business</td>
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<tr>
<td></td>
<td>or financial enterprise to make a profit.</td>
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