The need for Islamic accounting standards: the Malaysian Islamic financial institutions experience

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Abstract

Purpose – The purpose of this paper is to examine views of financial statements preparers with regard to the practices in reporting Islamic Financial Institutions (IFIs), thereby contributing to answer whether there is indeed a need for a separate set of Islamic accounting standards for IFIs.

Design/methodology/approach – Drawing upon seven in-depth semi-structured interviews conducted with IFIs' leading officers who are highly involved in preparing financial statements in Malaysia, the paper offers evidence on the current stance of reporting the operation of IFIs, the influence of AAOIFI accounting standards and the feasible application of IFRSs in reporting IFIs.

Findings – While it is shown that most of the interviewees admit the feasibility of IFRSs in reporting IFIs, many interviewees placed greater emphasis on the spirit of Islam based on Islamic contract. In that case, the findings show that to convince the public that they offer *Shariah* compliance products approved by Shariah Advisory Council, there is a need for specificity guidelines or standards for IFIs within the IFRS framework. The main concern raised in the paper is that separate Islamic accounting standard is not needed, instead the option needs to be within the IFRS framework with the collaboration work of Accounting and Auditing for Islamic Financial Institutions (AAOIFI) and the International Accounting Standard Board (IASB).

Originality/value – With the recent rapid growth of IFIs, this paper contributes regarding the inconclusive stance on the need for specificity accounting standards for IFIs such as the ones issued by AAOIFI. It adds to the current body of knowledge by highlighting the collaboration of the AAOIFI and the IASB for the intended specific guidelines for IFIs to be accepted globally.

Keywords Malaysia, *Shariah*, Accounting and auditing for Islamic financial institutions (AAOIFI), International financial reporting standard (IFRS), Islamic accounting standards, Islamic financial institutions (IFIs)

Paper type Research paper

1. Introduction

Islamic finance has been identified as an important engine to contribute in positioning Malaysia as a hub for foreign direct investment. Accordingly, there has been a remarkable growth of Islamic Financial Institutions (IFIs) in recent years, not only in Malaysia, but also globally, as Western banks have also started to venture into the market. Initially, the establishment of IFIs was an act of response towards the *Shariah*[1] prohibition of paying and

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receiving riba (interest). Therefore, transactions in IFIs are meant to be accountable to God, which turn into an act of worship to seek reward in this world and in the hereafter (Haniffa and Hudaib, 2010). Accordingly, for these IFIs to survive in this dynamic and competitive industry, a high level of public confidence is essential as the stakeholders expect the operation to be *Shariah*-compliant, meaning that the task to report transparently is critical (Archer and Abdel Karim, 2007). Hence, in regulating and supervising IFIs, the decisive issue to search is a standard accounting methodology to regulate various types of pattern or Islamic banking financing schemes that can be accepted internationally. Although there are Accounting and Auditing organization for Islamic Financial Institutions (AAOIFI) accounting standards for IFIs, the current practice in many countries is to apply IFRSs wholeheartedly for IFIs in reporting their practices. Despite the acceptability of such a practice, there are those who believe that the transactions of IFIs ought to be accounted for in a different manner because of the notable differences in objectives and operations (Hanefah and Singh, 2012). Following the debates, the objective of this research is to examine the views of financial statement preparers with regard to the practices in reporting IFIs, thereby contributing to the answer concerning whether there is indeed a need for a separate set of Islamic accounting standards for IFIs.

During the earlier years of IFIs, prior literature suggests the need for a separate set of Islamic accounting standards for IFIs because of the significant differences in the transactions of IFIs from their conventional Western counterparts. Hence, the AAOIFI was established as a body to regulate IFIs, which, to date, has published 27 Financial Accounting Standards (FAST 1–27), as well as standards for Islamic insurance companies, auditing standards, governance standards and codes of ethics for accountants, auditors and employees of IFIs. Despite the full commitment shown by the AAOIFI in the development of accounting standards, these standards will not be enforced without the support from the national regulators.

In Malaysia, although IFIs have existed since the 1970s, there has been an absence of approved Islamic accounting standards. Although there was an attempt from the Malaysian Accounting Standards Board (MASB) to develop special standards for IFIs, it seems that, over the years, the stance on reporting has changed, and reflects that the practices of IFIs very much echo the conventional banking practice. Prior literature has started to discuss how IFIs are moving away from the initial sacred aim in recent years (Kamla, 2009; Haniffa and Hudaib, 2010); however, the issue is beyond the scope of this paper, and, instead, the discussion in this paper focuses on the market needs of reporting the practice of IFIs. The structure of the paper is as follows. Section 2 provides a review of the literature concerning the historical background of the accounting environment of IFIs. This is followed by a discussion about the initiatives taken by MASB and AAOIFI with regard to the issue concerning the reporting of IFIs in Section 3. Section 4 describes the research method adopted for this research, followed by the findings from seven interviews in Section 5. Section 6 provides a discussion and implications of the research to reflect upon the evidence presented, and finally, Section 7 draws conclusions and limitations of the study.

2. Literature review

Islam is a complete way of life that does not separate beliefs and daily activities including any involvement in economic activities. In fact, Islam highly honours trading and Muslims are encouraged to participate in economic activities that do not violate *Shariah*. The independence of many Muslim countries around the world during the period of 1940-1970 contributed to the increasing desire of Muslims to conduct their economic activities in accordance with *Shariah* (El-Ashker, 1987, as cited in Maali and Napier, 2010). This resulted in the emergence of IFIs beginning with the first Islamic bank named the Farmers' Credit Union in Pakistan in the late 1950s, followed in Egypt by Mit Ghamr Savings Bank in 1963, and Nasser Social Bank (Maali and Napier, 2010). While these were social welfare organizations, the oldest commercial Islamic bank, Dubai Islamic Bank in the UAE, was established in 1975 (Saleh, 1986, as cited by Maali and Napier, 2010). Since then, there have been remarkable developments in the IFIs industry, particularly in recent years.

Following a similar trend in resurging to carry out economic activities in accordance with *Shariah*, the Malaysian government established the first Islamic bank in Malaysia, Bank Islam Malaysia Berhad in 1993, which was governed by the Islamic Banking Act 1993. Then, in fulfilling the need of the Malaysian Muslim society, a second Islamic bank, known as Bank Muamalat Berhad, was established in 1999. The years after have seen an expansion in the Malaysian industry where foreign Islamic banks, such as the Kuwait Finance House, Al-Rajhi Banking and Investment Corporation and Qatar Islamic Bank, joined the market, and domestic banks created Islamic subsidiaries, such as RHB Islamic bank and Hong Leong Islamic bank. Nowadays, the IFIs are not only operating in competition with conventional banks in Muslim countries but the industry has expanded to Western countries like the USA, the UK and Australia (Haron and Wan Azmi, 2008).

These IFIs were meant to fulfil *Shariah* obligations in serving Muslims who are prohibited from paying and receiving riba (Al-Ajmi *et al.*, 2011). Based on *Shariah*, Islam views riba (usury), i.e. the flat annual interest rates, as evil because it involves accepting fixed gains without sharing the risks entailed in productive enterprise (Shook and Hassan, 1988). Consequently, banking transactions are not supposed to be separate from the Islamic faith but to be accountable to God in seeking reward in this world and the hereafter (Haniffa and Hudaib, 2010). Following *Shariah*, IFIs aim to be different from conventional financial institutions in terms of their objectives, operations, principles and practices (Abdul Rasid *et al.*, 2011). Nevertheless, IFIs operate in a competitive Western-dominated and dynamic industry, thereby requiring regulatory supervision much like Western institutions (Islam, 2003). The different approaches adopted by the supervisory authorities of IFIs may render the financial statements of IFIs non-comparable (Kamla, 2009). Therefore, the IFIs industry calls for a sound accounting and reporting system that, first, meets the requirements of *Shariah*, and, second, relevant to be practiced (Abdul Rahman, 2003). The report by ACCA and KPMG (2010) presents that a problem might exist in the practices and the level of understanding among accountants, and the level of compliance of Islamic banks globally because of the variety of applications of accounting standards, either IFRSs or local accounting standards, in the preparation of financial statements among the Islamic banks worldwide.

This issue of effective supervise on and regulation has become the main challenge for the IFIs that operate in a dynamic and competitive industry (El Qorchi, 2005). Although IFRSs exist as a tool for regulatory supervision, the application of the same accounting standards as conventional banks implies that the products offered by IFIs are exactly the same as those offered by conventional financial institutions. As IFIs were developed with the aim of complying with *Shariah* principles, some prior literature suggests that the development of Islamic accounting standards is required to address the difference in transactions between IFIs and the conventional banks (Vinnicombe, 2010; Kamla, 2009). The recent remarkable growth of IFIs in the market has created interest in Islamic accounting (Maali and Napier, 2010). The interest in Islamic accounting has led to the discussion of a separate set of Islamic accounting standards for IFIs using a stakeholder theory (Sarea and Hanefah, 2013). Prior literature suggests that the development of this special set of Islamic accounting standards can address the problems encountered by IFIs that relate to the lack of conventional accounting standards, such as the International Financial Reporting Standards (IFRSs) or local Generally Accepted Accounting Practice in accounting for IFI transactions (Archer and Abdel Karim, 2007). Furthermore, the development of accounting standards for IFIs will fulfil the desire of Muslims to apply Islamic principles in all aspects of their lives including their banking transactions.

Islamic accounting scholars reveal that the main principle of Islamic accounting is accountability to God (Napier, 2009). To be accountable to God, it is essential for IFIs to gain public trust and confidence by reporting a faithful representation of the economic transactions or events that it purports to represent (Archer and Abdel Karim, 2007). The transactions have to be reported in accordance with the substance as well as form of *Shariah* contracts that govern these transactions or events. Additionally, a special agency problem (in reference to worshipping God) has appeared in IFIs that demands the information disclosed should reflect the Islamic transactions environment (Archer and Abid, 1996). As IFIs play an essential role in promoting economic prosperity as a basis of social stability where people live with good values and religious faith, it is vital for IFIs to deliver high quality financial statements (Vinnicombe, 2010). A high-quality financial statement is an important tool for IFIs to survive in the industry where the public are confident that the products comply with *Shariah* principles (Archer and Abdel Karim, 2007).

The question is how to issue a standard accounting methodology to regulate various types of pattern or Islamic banking financing schemes that can be accepted internationally. AAOIFI has in fact attempted to develop the so-called "Islamic accounting standards" in trying to resolve the differences between the products of IFIs and conventional banking products. Although the standards formulated by AAOIFI (1998) are still based on capitalistic accounting (International Accounting Standards), prior literature suggests that they can be used as a starting point that may help lead to an improved IFIs system of reporting (Harahap, 2003). The establishment of the AAOIFI in Bahrain in 1991 as the institution to formally regulate the Islamic banking sector is one of the important milestones in the development of IFIs. This organization, which has the support from the institutional members from the international Islamic banking and finance industry, worldwide, has so far produced 60 AAOIFI accounting, auditing, governance and *Shariah* standards. However, the AAOIFI standards are not mandatory, Islamic banks, particularly in Islamic countries, such as the Kingdom of Bahrain, Dubai International Financial Centre, Jordan, Lebanon, Qatar, Sudan and Syria, have been following the accounting standards set by the AAOIFI (Maali and Napier, 2010).

Based on the above discussion and the fact that the establishment of the first Islamic bank in Malaysia was more than three decades ago, it is puzzling as to why Malaysia does not adopt the separate Islamic accounting standards, i.e. the AAOIFI accounting standards, in preparing the financial statements for the IFIs. Hence, the objective of this research is to examine the perspective of AAOIFI accounting standards by the IFIs, thereby contributing to answering the issues puzzling many people concerning whether there is a need for a separate set of Islamic accounting standards.

3. Islamic financial institutions and the Malaysian regulatory environment

In examining the perspective of IFIs on AAOIFI accounting standards, it is useful to understand the current practice of financial reporting and how it relates to the IFIs' operation and products. IFIs usually have a Shariah Supervisory Board to regulate their activities to ensure that transactions comply with *Shariah*. Under *Shariah*, any kind of interest is considered usurious and prohibited; hence, IFIs aim to offer riba free transactions. The ethical factors, such as justice ('adl) and cooperation (ta'awun), are the reasons behind the prohibition of riba that aims to address social inequitabilities resulting from the unequal distribution of wealth created by the system (Abdul Rasid *et al.*, 2011). Therefore, IFIs practice ethical choice that embraces a profit-sharing framework (Mudaraba) and other classical transactions, namely, sale by order (Salam and Istisna) and true leasing (ijara) (Abdul Rasid *et al.*, 2011).

As mentioned above, one popular Islamic finance product is Mudaraba. Mudaraba is a type of profit-sharing arrangement where the bank provides funds to an entrepreneur (Mudarib). The profit will then be shared between the two parties with an agreed ratio but the bank will bear all the financial losses while the mudarib receives no reward in case of losses. Another type of profit sharing arrangement is Musharaka where every partner involved in a financial transaction shares the associated risks and profits. The Islamic feature of this transaction is the possibility of losing capital in Mudarabah and Musharakah contracts despite proper monitoring. Another common practice of IFIs is to use mark-up instruments, called Murabaha where the purchaser can decide whether the supplier is making unequitable profit by knowing the original price that the seller paid to the original supplier.

By having the above products, IFIs are said to offer riba free products as an alternative to conventional banking products. Despite the initial aim of IFIs to practice ethical transactions, the growth and evolution of modern IFIs are influenced by the dynamics of political and socio-economic circumstances in the Islamic as well as conventional bank industry (Haniffa and Hudaib, 2010). The legal rules seem to dominate Islamic banking, while the Quranic spirit of justice and mutual aid is compromised to shape the products that may look Islamic in form only (Abdul Rasid *et al.*, 2011). Many IFI products, such as credit and hire transactions that replicate the conventional banking model lead to criticism of IFIs. Indeed, over time, the implicit and explicit intentions and goals of IFIs have evolved, thus affecting the nature of IFIs today.

The evolution in the IFI industry has seen a similar trend in the reporting environment. The development in reporting has seen the stance of the regulatory authority in Malaysia, i.e. the MASB, on the need for a set of accounting standards specific to IFIs has also changed over time. In the early 2000s, the MASB was actively engaged in the development of Islamic accounting standards to streamline the reporting of IFIs[2]. According to the MASB, the absence of a proper set of accounting standards for IFIs prevented the comparison of banks' financial performance as well as between periods for individual banks. Consequently, the MASB held the view that the lack of dedicated standards will hamper the development of Islamic investment vehicles as well as a robust Islamic capital market. Hence, the MASB has considered the AAOIFI accounting standards in developing new standards for IFIs, in that they believe that having a separate set for IFIs will enhance transparency and help nurture the development of these institutions.

The early development has seen the issuance of FRSi-1: Presentation of Financial Statements of IFIs (previously known as MASBi-1) as providing a basis for the presentation and disclosure of financial statements representing Islamic banking activities. However, this standard has been withdrawn lately because of redundancy of the IFRS requirements. The standard has now become known as the MASB Exposure Draft ED i-3: Presentation of Financial Statements of IFIs. In later years, the MASB issued a few discussion papers on Islamic financial transactions to create a wider understanding of the issues; DP i-1 Takaful, DP i-2 Sukuk, DP i-3 *Shariah*-compliant profit-sharing contracts. Besides the issuance of discussion papers by MASB, Bank Negara (The Central Bank of Malaysia) issued some guidelines on the reporting of IFIs; Revised Guidelines on Financial Reporting for Licensed Institutions (BNM/GP8); Guidelines on Financial Reporting for Licensed Islamic Banks (BNM/GP8-i); TRi-1: Accounting for Zakat [1] on Business; and Tri-2: Ijarah [2][3].

The stance of agreeing to have a separate set of Islamic accounting standards changed nearly a decade later along with the vast growth of IFIs. The Chairman of the MASB, Mohammad Faiz Azmi, was quoted by the Malaysian Reserve in 2009, as agreeing with there being no necessity for Islamic accounting standards (Singh, 2009). According to him, there is no significant divergence between the Islamic and conventional banking system, and IFRSs can cater to the requirements of IFIs. Currently, the MASB is of the opinion that approved accounting standards adhere to the principles of *Shariah*, and, therefore, they can be used as financial reporting standards[4].

This paper posits that the vast development in IFIs together with Western banks entering the Islamic financial market has influenced financial reporting behaviour in Malaysia, as well as internationally. This approach reveals that many products offered by IFIs echo the products offered by the conventional banking system, implying there are no significant differences between Islamic and Western banking transactions. Despite the approach of the MASB, there is still an ongoing debate that IFIs need a separate set of accounting standards. For example, Sarea and Hanefah (2013) have evidenced the need for Islamic accounting standards to fill the gap in accounting practice among the IFIs, although they have not looked at the practical views of the preparers of the financial statements. Hence, the MASB approach to convergence in every aspect of transaction and the arguments for Islamic accounting standards prompt further research to examine whether IFIs agree with the regulatory approach, their views on AAOIFI accounting standards as a separate set of accounting standards as well as the way forward for accounting regulatory for IFIs. Additionally, according to Altarawneh and Lucas (2012), what is missing in the literature are the possible reasons for Islamic accounting not being adopted by developing Islamic countries, despite the growth and global acceptance of Islamic financial instruments. Consequently, this paper aims to provide insights into the said matter that will add value to the current body of knowledge.

4. Research method

This paper discusses the views of seven interviewees gathered from seven semi-structured interviews conducted during the period of three months from October 2012 to December 2012. The seven interviewees who participated in this research comprised of officers of management team which include vice president, three senior managers, general manager and two managers in finance department of IFIs in Malaysia. All of the above interviewees are actively involved in preparing IFIs financial statements, and therefore they can provide a rich explanation on the reporting practices. In addition, most of them represent the main IFIs in the Malaysian banking industry. All of the interviewees were found to have strong passion towards Islamic banking thereby providing fruitful insights into this current research.

Consequently, the semi-structured questionnaire was envisioned to capture the essential evidence concerning the research objective raised in the first section. Semi-structured interviews were held within a fairly open context; hence, the questions asked were not necessarily prepared in advance. Many of the questions were spontaneously generated during the interview, which gave flexibility to both the interviewer and the participant to explore and discuss further details or to consider other related issues, in contrast to structured interviews, where all questions are organized and compiled ahead of time. Basically, the interviews were in the form of a conversation rather than a question and answer technique. Five interviews were carried out face-to-face, lasting 1-2 h each, while two interviewees answered in writing by email. All of the interviews were conducted in English with a slight mixture of Malay. They were tape-recorded and then transcribed. The Malay conversations were translated from Malay to English where necessary. They were then coded manually by the researchers.

The process started by telephoning the respondents to seek their willingness to participate in this research. If the respondents agreed to participate, appointments were set for those who agreed to meet, while questions were emailed to those who were willing to answer via email. Following the initial contact, a letter of introduction was provided explaining the purpose and objectives of the research study. Generally, the researchers started the interviews by thanking the interviewee for their interest and willingness to contribute in this research. The researchers also requested and received their permission to record the interviews. The researchers also assured the interviewees of complete confidentiality, in which no single identity would be disclosed. The researchers ended the interviews by asking the interviewees if they had any issues to discuss, or if there was any document that would improve the validity and reliability of the data and also the research findings. The process continued with the analysis of the interview transcripts and documentary data using the qualitative analysis method of coding and re-coding manually by the researchers. The interviewees are coded as P1(Vice President), P2(Senior Manager), P3(General Manager), P4(Senior Manager), P5(Manager), P6(Manager) and P7(Senior Manager) to represent the opinion from the interviewees. Parts of the findings are reported in this paper in the following section.

5. Findings

This section documents interviewees' views in relation to IFIs reporting. The analysis starts with their views on the concept underlying the Islamic products offered in IFIs as well as the application of IFRS in reporting the products. Then, interviewees' views on the relevance of AAOIFI accounting standards are further analyzed. This section ends with the discussion on the future of AAOIFI accounting standards.

5.1 Products and application of International Financial Reporting Standards in Islamic finance reporting

Prior studies into the practices of Islamic banks conclude that transactions in IFIs are similar to those of conventional banks in substance, albeit the description and legal form of the transactions are distinctive (Napier, 2009). In relation to that, this research contends that the similarities in functioning between IFI products and conventional banking products make it feasible to use IFRSs in reporting IFIs. Most of the interviewees agree that the transactions in IFIs are very similar to the conventional banking transactions. According to most of them, the products in IFIs are developed referring to the conventional banking transactions. The products are then repackaged according to Islamic contract. For example, according to P2:

> IFIs tend to suit the Islamic to conventional banking system but not the other way around. They start with the conventional product first, then change the specifications until that product becomes Shariah-compliant.

Hence, there is a tendency for IFIs in Malaysia to copy many of the conventional banking transactions since they provide the same services for the need of their customers. P7 mentioned that the businesses are still the same; the only difference is the concept and methodology. Furthermore, he emphasized that IFI transactions are different from conventional banks since IFI products are based on a different product concept; for instance, products that involve equity based financing or debt based financing, whereas conventional banking is merely a creation of money or interest.

The views from the accounting practitioners from the IFIs above are consistent with the literature; for example, Khan (2010) described how the growth of Islamic finance has seen many products being offered, which are copied from the conventional banking industry. Furthermore, Haniffa and Hudaib (2010) divided Islamic finance development into three phases: the first phase was the experimental period (1940 to mid-1970s) where the intention was to fulfil the goals of *Shariah*, which were to restrain from dealing with interest-based activities and to achieve socio-economic justice. In this case, the "sacred intentions" and goals were on top of the agenda of the newly independent Islamic states following the struggle against Western colonialism and secularism; the second phase was the amorphous period (mid-1970s to 1990), which was the period that marked the start when sacred intentions became mixed with secular goals facilitated by the alliance with highly respected *Shariah* scholars; and the third phase was the metamorphosis period (1991-present), which has seen a greater alliance between bankers, governments and *Shariah* scholars, which facilitates the innovation of *Shariah*-compliant products as opposed to *Shariah*-based products (i.e. based on the sacred goal of Islamic finance). The growth of IFIs moves along with the increased acceptability of IFRS around the world, contributing to the lower demand for a specific set of accounting standards for IFIs (Napier, 2009).

Consequently, Napier (2009) recommends that the IFIs be regulated in consideration of the actual bank practice. In actual bank practice, many IFI products are similar in function but differ in contract. The difference between IFI products and conventional bank products is because of the fundamental structure of the Islamic products in terms of the breakdown of the transaction(s) involved. One obvious example is hire purchase. Hire purchase is a pure financing for leasing in a conventional bank with Al Ijarah Thumma Al Bai (AITAB) being its equivalent in Islamic financing. The fact that makes the two transactions different is the aqad. According to P2:

> The offer and acceptance change everything, which subsequently renders the transaction halal although it appears to be like a conventional product.

Further P2 explains:

> For Ijarah in IFIs, there are two aqads for each contract in AITAB. The first contract is an Ijarah, which outlines the terms for leasing over a fixed period and the other contract is a *Bai* that triggers a purchase once the term of the Ijarah is complete. These breakdowns and aqad reflect the Islamic way of conducting hire purchase although people may not be able to tell AITAB apart from hire purchase of conventional banking.

Consistent with the above, many of the interviewees agree that *Shariah* is more towards form over substance. One practitioner pointed out that form over substance takes place in Islamic transactions because, according to P4:

> When the aqad exists, everything is rightfully accepted.

Hence, some scholars suggest that to report in accordance with Islamic principles, requiring the one who has possession of an asset is responsible for the asset, which means that the legal form of any contract must be consistent with its substance (Gambling and Karim, 1991; Ismail and Latiff, 2000). Since the assumptions underpinning the contract are different from those behind a Western finance lease, by rights the owner should disclose his assets.

Nevertheless, in actual practice, ijarah is very similar to conventional leases where there is a transfer of ownership at the end of the lease period to the lessee, emphasising the role of the lease as a financing transaction (Napier, 2009). In this case, for this product, P2 remarked that although this should not be an issue from the perspective of Islamic banking, because Islam places emphasis on form (aqad) over substance, the issue is complicated by the principles of substance over form and time value of money in IFRSs, since the substance of AITAB is basically a financing that trades on money. IAS17 deals with ijarah, which requires the lessor to disclose the items leased as receivables rather than as property, plant and equipment even though the lessor still holds the legal title. This is because the conventional accounting standards follow the substance over form principle, where, in this case, the substance of the transaction implies that the lessee is the one who is responsible for and controls the item; therefore, the lessee should disclose it as his asset in the financial statement (Napier, 2009). This is against the Islamic principles, as in the above paragraph. Nonetheless, P2 noted that in the Malaysian context, Bank Negara accepts the substance over form approach because it argues that "it is based and refers back to the intention" of the transaction. The notable question here in this case is that the inner intention differs from what is written in aqad. Consequently, when it comes to reporting, by following IFRS, it will inform the products in a similar way to the practice of conventional banks.

The recent development shows that the International Accounting Standard Board (IASB) is currently re-looking at how leases are accounted for. They are working to replace the current IAS 17 for leases. The upcoming replacement for IAS 17 may require lessees to recognize the "right to use" the asset and lease liability for all but the most insignificant use of a lease asset. To the MASB, this is more conceptually compatible with *Shariah* than the existing IAS 17 (MASB, 2012). This is because according to *Shariah*, ijarah is akin to the bai' (sale) of manfaat (benefit) of an asset to the musta'jir (lessee) while the muajjir (lessor) retains ownership of the (underlying asset). *Shariah* further recognizes that manfaat is mal (an asset) to the lessee. Hence, the IASB's proposal to require lessees to recognize a right-of-use asset and a lease liability ought to be commendable under *Shariah* (MASB, 2012).

The Quran emphasizes the need to record debts:

[. . .] Never get bored with recording it, however small or large, up to its maturity date, for this is seen by Allah closer to justice, more supportive to testimony, and more resolving to doubt [. . .] (al-Baqara: 282) (Tag El-Din, 2004).

Nevertheless, the proposals could be the death knell for operating lease accounting, which is in stark contrast to AAOIFI Financial Accounting Standard (FAS) No. 8, Ijarah and Ijarah Muntahia Bittamleek, requiring all ijarah to be treated as operating leases.

Additional to the AITAB issue above is a product called Mudarabah. People might see it as a debtor-creditor relationship although in Islamic contract it exhibits the capital provider-investor relationship, as approved by the Shariah Advisory Council (SAC). The SAC approves the Mudarabah transaction in contrast to the debtor-creditor relationship. Mudarabah involves the rabb-ul-mal (IFI) giving capital to the mudarib (customer) who uses his specialist knowledge to invest the capital. Profit or loss from the investment will be distributed proportionately between the IFI and customer. The actual way of conducting Mudarabah according to Islam is that the depositor deposits his money into a bank account of the IFIs to invest and willingly accept the risk of losing a portion or the whole deposit in the worse scenario. Following this concept, there is no guarantee that the deposits will be repaid or that they will generate any returns (except in the case of misconduct on the part of the bank's management, when depositors are entitled to be compensated for losses) (Maali and Napier, 2007). Although the concept seems to be *Shariah*-compliant, many of the depositors currently do not fully embrace this Islamic concept by expecting their deposits to be guaranteed by the IFIs as done by the conventional banks practices. According to the CEO of CIMB Islamic, in the AAIFC 2012, in practice, in the loss case scenario, the bank will top up using the banks money to guarantee the depositors' money and the SAC approves that practice based on the maqasid al-*Shariah* concept, where the first aim is to provide services to Muslim customers and the second aim is that the service should not harm the people.

From this, it can be seen that although the underlying contract differs, practically, the products turn out to be the same in terms of functioning, which makes reporting using IFRSs feasible. For example, P1 indicated that:

> Accounting treatment, overall, if you were to translate from Islamic to conventional, it has to match what the IFRS dictates. That is why I say IFRS facilitates both the Islamic and conventional, as long as you can spell out the equivalent of the conventional way of accounting treatment for the Islamic accounting needs.

Since the SAC in Malaysia is open to following four mazhabs, as mentioned in the previous section above, many of the interviewees agreed that the IFI products in Malaysia are so innovative and that the SACs in Malaysia are very liberal to allow many conventional products to be copied. Accordingly*, it* is feasible to apply IFRSs in reporting IFIs products because of the equivalent products between IFIs and the conventional banking system. The IFIs translate their products to conventional bank products and then reporting in a similar way.

5.2 Accounting and auditing organisation organization for Islamic financial institutions accounting standards

The objective of the establishment of AAOIFI is to develop accounting and auditing thoughts relevant to Islamic institutions, prepare, promulgate, interpret, review and amend accounting and auditing standards for IFIs and to carry out commissioning of research in the area of Islamic accounting and auditing (AAOIFI, 2007). Prior literature reveals that Islamic banks offer a range of products, which, in complying with Islamic law, often differ from traditional Western financial products (Vinnicombe, 2010). Despite the organization claims that these objectives are carried out in accordance with the precepts of Islamic *Shariah* (Kamla, 2009), it is puzzling to some academics as to why the accounting regulators in Malaysia refuse to implement the use of the AAOIFI accounting standards, which can be considered to be Islamic accounting standards in preparing financial statements. This is particularly so in that the AAOIFI has published a substantial body of accounting and governance standards to guide Islamic financial reporting empirical research that has found various levels of compliance in different areas.

Under this theme, the interviewees were asked about the role of the AAOIFI accounting standards and whether they agreed with the current approach of using IFRSs instead of applying AAOIFI accounting standards wholeheartedly. Most of the interviewees agreed that the AAOIFI accounting standards are meant to complement and not compete with the IFRSs. They are not meant to be a separate set of accounting standards. The complementary task of AAOIFI accounting standards is agreed by P1, who mentioned:

> Dr Mohammad Nedal Alchaar, the Secretary-General of AAOIFI always said that the AAOIFI standard was never meant to compete with IFRS. It is to complement IFRS.

The view is in line with the approach of AAOIFI in developing accounting standards for Islamic entities by adapting from the conventional Western standards (Lewis, 2001). The AAOIFI chose this approach believing that the efficiencies gained from the previous work will facilitate a timely implementation of their standards without compromising *Shariah* law (Vinnicombe, 2010). Because of the AAOIFI accounting standards being based on the standards issued by the West, the international accounting bodies, especially the IASB (International Accounting Standards Board), IFRSs take precedence in reporting IFI products and they refer to the AAOIFI accounting standards just for reference in preparing the financial statements in Malaysia; as remarked by P6. The difference between the

AAOIFI accounting standards and IFRS s is not apparent. The financial accounting standards issued by AAOIFI are basically compatible with the IFRS except in only one or two cases (Archer and Abdel Karim, 2007).

When the AAOIFI accounting standards were developed, the intention was to increase market confidence in the activities of Islamic banks, render them comparable, and facilitate the transfer of Islamic banking and finance practices across national and regulatory contexts (Maurer, 2002; AAOIFI, 2007). The AAOIFI accounting standards were set up to enhance transparency in the preparation of financial statements, and, thereby, easily interpretable by users (Abdel Karim, 2001). However, most of the interviewees saw the comparison issue as one of the factors inhibiting the adoption of AAOIFI in Malaysia. According to most of them, the comparability of financial statements will be affected if we were to have two sets of accounting standards. The current situation shows that IFIs' financial statements are prepared in accordance with the IFRSs. With the whole world moving towards a single set of accounting standards, i.e. IFRSs, many regulators are reluctant to have a separate set of accounting standards. The importance of convergence of accounting standards is undeniable as it is to enhance the comparability of different entities' financial statements.

The two sets of accounting standards produce difficulties in consolidating the financial statements of IFIs with existing branches all over the world, according to P1. Further, P1 notes that in order for IFIs to expand and grow, they are unable to use AAOIFI accounting standards resulting in the incomparability of the financial statements and qualification issue. This is supported by P2 who states:

> Unless everyone agrees to adopt the AAOIFI accounting standards worldwide, the IFIs can never adopt AAOIFI. The IFIs will be in the position where they cannot compare themselves with their counterparts in the conventional banking system because of the totally different standard and basis.

P3 added that:

> Embracing AAOIFI for IFIs, which do not compete internationally, seems logical since if global acceptance is not so important, there is no need to comply with international standards

As the IFRS are becoming the *lingua franca* of financial reporting, it is difficult for a country like Malaysia that has a Western heritage to adopt AAOIFI accounting standards despite the resurgent need of Muslims in Malaysia. As indicated by Altarawneh and Lucas (2012), their findings show that the most significant factor influencing accounting regulators in their mandating of IFRS was economic dependency on the West. IFIs are therefore operating in an industry that is dominated by Western, comparability, which is another issue prohibiting IFIs from adopting AAOIFI accounting standards in preparing financial statements as the industry is so economically dependent on the West.

The objective of AAOIFI is to establish contemporary accounting thought that tests these objectives against Islamic *Shariah*, thereby embracing those that are consistent with *Shariah* and prohibiting those objectives that are against *Shariah* (Maurer, 2010). However, there are a few Islamic schools of thought that contribute to the differences in the theoretical concept underlying its development. This is another reason why AAOIFI is not adopted in Malaysia. Differences in the mazhab or Islamic school of thought have been applied in the Malaysian Islamic banking environment. Hence, in Malaysia, usage of the AAOIFI accounting standards is restricted to guidelines and a complementary role. It was emphasized by many of the interviewees (P1, P2 and P3) that AAOIFI accounting standards are Bahrain based while in Malaysia each bank has its own *Shariah* advisory council (SAC) as well as in Bank Negara. Most of the interviewees also mentioned that in the Middle

Eastern countries *Shariah* differs from that in Malaysia. It was further noted by the interviewees, that unlike in Middle Eastern countries, the *Shariah* Advisory Councils in Malaysia are very liberal under the principle of *maqassid al*-Shariah, thereby allowing many conventional bank products to be offered by IFIs. The interviewees also reported that there are many differences between the *Shariah* in Bahrain and Malaysia, because of the different mazhabs observed by the countries. The SAC in Malaysia looks at all four of the well-known mazhabs and not only at the Shafi'i Mazhab, which is practised in Malaysia. This is because the AAOIFI accounting standards are promulgated in Bahrain, which practises Maliki Mazhab, and as many products in Malaysia are not within the discussion of AAOIFI it means the IFIs have to refer to the IFRS; as noted by P3.

The interviewees' views above are consistent with Haniffa and Hudaib (2010) who claimed that there *is* a divergence in the interpretations of *Shariah*, which results in the so-called Arab and Malaysian models. Additionally, Malaysia has been accused of being too liberal in its interpretation of Islamic *Shariah* principles regarding banking and financial affairs resulting in the offer of many products that echo conventional banking products (Khan and Bhatti, 2008). According to Haniffa and Hudaib (2010), the approaches used in Malaysia in offering Islamic finance products are:

> Ijtihad (juridico-ethical reasoning and argumentation) for legitimating the innovation of financial products was made based on the unduly application of maqasid al-Shariah (purposes of the law), which takes into account the degree of benefit for human interest (maslahah) as opposed to harm (mafsadah). Other adaptive mechanisms in legitimising the modernization of Islamic finance and financial institutions include urf (local custom) and darura (necessity). Besides deregulation of the financial sector resulting from the policies of the new world-order, greater alliance between bankers, governments and Shariah scholars facilitate the innovation of Shariah-compliant products as opposed to Shariah-based products (i.e. based on the sacred goal of Islamic finance). (Haniffa and Hudaib, 2010, p. 89).

The above approach results in the significant growth of Islamic finance that offers many IFI products that are copied from the conventional banking industry (Khan, 2010). It is argued that rather than fulfilling religious duties, the real aim of IFI has been seen by some as creating secular goals similar to the capitalist approach, and not religious ones, and thereby moving away from the initial sacred aim (Haniffa and Hudaib, 2010). This has led the national regulators including the Malaysian Accounting Standards Board (MASB) to have the view that IFRS adheres to the principle of *Shariah* and is applicable to IFIs. Currently, the MASB is of the view that there is no necessity to have separate Islamic accounting standards, as there is no significant difference in functioning between the IFI products and the conventional banking products.

Although the mandating accounting standards for IFIs is IFRSs, a few interviewees stated that the AAOIFI accounting standard was well received and being referred to by the practitioners because of the Islamic spirit for the transactions. However, the amount of additional disclosure is something that the IFIs are concerned about. Some banks are willing to consider the AAOIFI accounting standards as mentioned by P2:

> Many things need to be in place, especially in terms of the system, infrastructure and education before the AAOIFI accounting standards can be implemented, so that will take some time and resources.

In terms of the latest development, P2 stated that some IFIs were determined to embrace the AAOIFI accounting standards starting from 2014 "where elements of AAOIFI will be incorporated in terms of accounting policy for mudarabah, ijarah and murabahah. There will be additional disclosures as far as AAOIFI is concerned".

The amount of disclosure required by AAOIFI on top of the existing IFRS in Malaysia is perhaps the factor inhibiting the adoption of the AAOIFI accounting standards, as remarked by P3. The reason is that there is a requirement for too much disclosure for the preparers to produce including the write-back of provision against the mudarabah funds being managed, which will consume a lot of time, effort and other resources of the IFIs making the implementation of AAOIFI in Malaysia questionable. The findings are consistent with Nadzri (2009) who revealed that the extent of the disclosure by the IFIs is much lower than the AAOIFI requirements, explaining the unwillingness of IFIs to disclose as much as the requirements of AAOIFI.

5.3 Future of accounting and auditing organisation organization for Islamic financial institutions accounting standards

The regulatory environment of IFIs is not expanding at the same pace as the rapid growth of IFIs, where the growth emphasizes more on financial institutions and financial products (Vinnicombe, 2010). Furthermore, the rapid development of IFIs globally, is among the external factors that halt the opportunity for developing countries to develop or improve their own accounting approach, resulting in the dominance of Anglo-American accounting worldwide (Altarawneh and Lucas, 2012). Consequently, most of the regulators including the MASB in Malaysia are of the opinion that IFRSs adhere to the principles of *Shariah*, and, therefore, they can be used in reporting the financial statements of IFIs[5]. Most of the interviewees agree that IFRSs are able to cater to the reporting of IFIs because they are required by the regulators to use IFRSs for reporting IFI products. Although all the transactions are covered by IFRS because of the equalization of IFI products with conventional bank products, some interviewees question whether it reports the way the product is intended to reflect the Islamisation of IFI products; for example, P2 questioned:

> Everything is covered under the IFRS standard. It is just that whether the accounting treatment is according to Shariah principles or not.

Hence, the sufficiency of IFRSs in reporting IFIs is still questioned, leading to the discussion of any role that AAOIFI can play in improving the financial reporting environment of IFIs.

The harmonization work of the IASB has gained steady support from many countries around the world. Malaysia is no exception in this case, in that the then Malaysian Accounting Standard Board's (MASB) chairman, Dato' Zainal Abidin Putih announced in 2008 that Malaysia will be converging with the IASB's IFRS. Therefore, although there exists the so-called "Islamic accounting standards", IFIs do not have the liberty to adopt AAOIFI accounting standards owing to the fact that the IASB is a more dominant body, which dictates the global accounting standard. P2 mentioned that the Islamic finance market share is very small, less than 10 per cent compared to the rest. Consequently, the IFIs have no say as a minority to implement the regulatory standards for it. Furthermore, the effort to implement the specialized accounting treatment in Malaysia is limited, because, according to P1:

> The role of the MASB actually is to just take the international standard and implement it. They no longer fulfil the role of creating accounting standards any more.

With the convergence to IFRSs, MASB as the regulator in Malaysia plays the role as the mediator to see through changes to the International Standards that will cater to accommodate Islamic finance (Hanefah and Singh, 2012). Particularly, the MASB concerns about the AAOIFI accounting standards are that they are being designed for specific uses of limited types of contract and that having separate Islamic accounting standards could create undesirable opportunities for arbitrage and abuse, leading the MASB to provide no exemption for IFIs under MFRS, which is equivalent to IFRS (MASB, 2012). In fact, because of its power, the debate on the convergence of accounting standards has changed from harmonization to a unilateral standardization. This is evidenced by the preface to IFRS, which states that financial statements cannot proclaim they comply with IFRS unless they fully comply with all the applicable standards and not just some of them. IFRS does not permit exceptions.

Accordingly, the AOSSG (2010) advocates that standard-setters may need to consider balancing the views of their *Shariah* advisors with their plans for convergence, as differences in opinion concerning how to account for Islamic financial transactions have led to divergent treatments of various transactions in various jurisdictions and might still be evident in the future. From the interviews, to reduce variations in the reporting of IFIs, most of the respondents suggest having guidelines or options for IFIs within IFRSs for specific accounting treatments for IFIs to be implemented globally. According to P3, although IFRSs can cater for IFI transactions within Islamic contracts, they do not necessarily correctly address IFI transactions. In fact, the AAOIFI accounting standards were developed and established for this reason. Although there are economic similarities with transactions already addressed by IFRS, there are those who believe that Islamic financial transactions ought to be accounted for in a different manner (Hanefah and Singh, 2012). Most of the interviewees stressed that there is still room for specific guidelines in reporting IFIs. P5 agreed that the different requirements of IFIs could not be completely addressed by IFRSs. Furthermore, P5 noted that the inconsistencies in the accounting treatment of IFI transactions may affect the confidence of the market and the globalization issues. P5 also suggested that the IASB shows some flexibility in seeking consultation to developing the accounting treatment for IFI transactions.

In addition, P7 added to the argument by stating:

> Even though the existing standards are sufficient to cover the Islamic transactions, personally, I am of the view that IFIs should have their own standards where the name, term and concepts used in the standards reflect the Islamic terminology. In fact, the standards should be based on Islamic principles. Also, the standards should emphasize the Islamic concepts and principles with Shariah principles as the guidance.

Furthermore, in order for IFIs to gain public trust and confidence that they offer *Shariah*-compliant products, the prominent area of difference that needs guidelines for IFIs is additional disclosure. Many interviewees agreed on the importance of additional disclosure for IFIs products. P1 noted that:

> Actually the reporting will be slightly different from the conventional bank to some extent. You may have additional disclosures to compare to conventional banking system.

Moreover, P4 added that disclosure is needed to show that the income is halal since the SAC is more concerned about the perfection of the agreement, in revealing that IFIs offer *Shariah*-compliant products.

Hence, although IFRSs are applicable to IFIs, from the above finding, there is still scope for the "Islamic accounting standards" to assure and convince stakeholders, particularly Muslim clients, that their products are indeed *Shariah*-compliant and approved by the SAC. In fact, the standards should be imposed within IFRSs to be effectively implemented internationally as suggested by many interviewees. This is the challenge to the standard-setters and stakeholders to enhance the cross-border comparability of Islamic financial transactions, while considering religious sensitivities (AOSSG, 2010). It is very important to encourage a common understanding between IFRS and IFI since there is still resistance by those who believe that some IFRS principles are irreconcilable with their interpretation of *Shariah* despite internationally acceptable IFRSs (Hanefah and Singh, 2012).

In realizing that IFIs are a potential growth area for enhancing Malaysia's position as a popular foreign direct investment destination, Bank Negara Malaysia (BNM) has made some effort in reconciling the AAOIFI and IFRS. Indeed, P2 agreed that in Malaysia, Bank Negara plays an important role in creating guidelines in reporting IFIs, even though this is not imposed internationally. Bank Negara has taken significant action to support the Malaysian government initiative in positioning Malaysia as Asia's Islamic finance hub.

P4 mentioned that:

> If the IASB does not have the standard, Bank Negara will come up with a guideline. So the gap is being filled by the guidelines of Bank Negara.

Basically, in Malaysia, the guidelines for reporting IFIs have been prepared by Bank Negara, even though this is not happening internationally. Most of the interviewees agreed that, in order for accounting standards for IFIs to be effectively implemented, the AAOIFI and IASB have to work together. In addition, some interviewees would like to see harmonization between the IFRS and AAOIFI accounting standards in areas of inconsistency.

Because of the influence of IASB as a global accounting standard organization and the move towards convergence, a way forward would be to see the option of accounting treatment for Islamic finance products being incorporated into the IFRSs. This was agreed by P1, in that, according to him, the reconciliation between the IFRS and AAOIFI standards is encouraged, as there are various conflicts. P1 added further by saying that the steps are necessary because of the status of the IFRS standards being the global standard. Related to this issue, P1 mentioned that this reconciliation is necessary to avoid problems with the local stock exchange, as if the accounting standards are not under IFRSs, the financial statement of IFIs may become qualified. P1 remarked that because AAOIFI realized that it could not survive on its own, they have offered to work with IASB. However, although the IASB mentioned that they have established a committee to look into the matter, they have never been serious about it according to P1.

As mentioned above, the obvious gap between the AAOIFI accounting standards and IFRSs is with regard to Ijarah. Recently, IFRS 16 Leases was issued by the IASB on 13 January 2016 and is effective for period beginning on or after 1 January 2019[6]. The method in IFRS 16 will widen the gap further between the IFRS and AAOIFI standards. IFRS 16 accounts most leases as a finance lease, which is in contrast to the AAOIFI Financial Accounting Standard (FAS) No. 8, Ijarah and Ijarah Muntahia Bittamleek, requiring all ijarah to be treated as operating leases. Although, the concept of "a right to use" is consistent with *Shariah* commandments, according to MASB's opinion, it remains a Malaysian interpretation. The MASB has also called for the involvement of IASB in the Islamic finance agenda, as it is a US$1tn global industry and has been mushrooming remarkably.

The effort to include accounting standards for IFIs will ensure that convergence incorporates Islamic finance agenda, supporting the effort to promote the values and principles promoted by Islamic finance into the mainstream accounting standard. The proposed harmonization between IFRS and AAOIFI will yield great benefit globally as the comparability of financial statements will be upgraded as well as reporting, as stated in the Islamic contracts. These options ensure a uniform application across the whole industry while blending with the IASB's standards for conventional accounting. It has been reported by Reuters in the year 2012 that the Asian-Oceanian Standard Setters Group (AOSSG), a regional organization that creates accounting guidelines, is suggesting that the IASB should draft the guidelines for Islamic finance standards[7]. Based on their survey, more than three quarters of the 24 financial standards-setting bodies agreed to not have separate Islamic accounting standards outside the IFRS framework because they were inconsistent with the global trend of converging with IFRS.

6. Discussion and implication

The paper has considered the development of IFIs over the years and found that the stance on reporting has also evolved consistently with the growth of IFIs around the world. Interestingly, the evidence indicates that the interviewees placed greater importance on the practicality of reporting in this competitive industry while balancing the need to serve the Muslim society. The findings reveal that the IFIs are aware of the existing AAOIFI accounting standards, where the standards are being used as a reference in preparing financial statements. The prominent reason of concern that prohibits the use of AAOIFI accounting standards in reporting IFIs is the issue of comparability. As many countries around the world have accepted IFRSs globally, it is difficult for AAOIFI accounting standards to penetrate into the IFI market, in that the industry is dominated by the Western industry.

In addition, it was found that another challenging factor in applying the AAOIFI accounting standards is the different Islamic schools of thought in understanding the Islamic principles. Accordingly, the IFI products vary among the Muslim countries depending on the approval of the SAC in that particular country. However, Malaysia has been said to be very liberal since all four mazhabs are referred to in formulating the IFI products, which has resulted in the launching of many IFI products in Malaysia. The application of IFRSs in reporting is well supported by many interviewees, i.e. the practitioners of IFIs, although a few interviewees agreed that the application does not reflect the Islamic part of the products. It was noted that many interviewees simultaneously agreed that their products mostly replicate the mainstream banking products. Most of them remarked that the practice in reporting is to translate IFI products in the way of conventional banking, then treat them according to IFRSs in a similar way to the reporting of conventional products.

The practical implications of our study are two-fold. First, the evidence from the interviews clearly implies how the evolvement in IFIs reporting reflects the practice of IFIs, which reveal how the initial sacred aims of IFIs evolve similarly into the capitalist practice of conventional banking system. As the IFI products are similar in function to the conventional banking products and the only difference lies in the terms of contract, the IFRSs are therefore able to report the IFI products in a similar way to conventional banking products. This paper provides more evidence to suggest that IFIs emphasize the technical instrument of products meaning that the initial aim of IFIs is far reaching. However, the discussion on how can IFIs achieve the true aims of Islamic teaching through their service is beyond the scope of this paper. Further research on how to offer *Shariah*-compliant products aiming to achieve the sacred objective and the respective accounting treatment to follow is worth exploring.

Second, the evidence suggests that separate Islamic accounting standards are not crucial to regulate the IFIs environment; instead, they urgently need standards on disclosure to explain the Islamic contracts and to convince the Muslim society that they are actually offering *Shariah*-compliant products that are approved by the SAC. However, there are respondents who prefer the accounting treatment by AAOIFI to reflect the product contracts according to Islamic principles. Nevertheless, the guidelines for IFIs will not be applied globally if they are separate accounting standards. The resulting extensive with the issue of harmonization and convergence with IFRSs is that most of the interviewees would like to see the accounting treatment or disclosure for IFIs to be placed under the IFRS framework in order for the standards to be successfully applied globally. Including options or guidelines for IFIs under the IFRS framework would be a great advance in Islamic reporting development. Similar approach of the IASB in such development of IFRS for SMEs, a self-contained Standard is worth to be explored. Although some will argue that this effort would still be based on the capitalist nature and help to legitimise the IFI products, it would be a good development in reporting the IFI products. In that case, one future area of research that is critical to Islamic accounting is the need for an Islamic accounting conceptual framework so that standards for IFIs can be developed and implemented based on a coherent basis. It will then be encouraged to be acceptable in within the IFRS framework.

7. Conclusion

More than three decades after the establishment of first Islamic bank in Malaysia, there is still an inconclusive stance regarding the need for specific accounting standards for IFIs, such as the ones issued by the Accounting and Auditing for Islamic Financial Institutions (AAOIFI). Although, the findings reveal the feasibility of IFRSs in reporting IFIs, many interviewees placed greater emphasis on the spirit of Islam based on Islamic contracts. Therefore, the likely option to resolve this dilemma is to have guidelines or options for IFIs within the framework of IFRSs. If these guidelines are to be enforced globally, one possible option is for Islamic organization such as the AAOIFI, to work closely with the International Accounting Standards Board (IASB). One limitation of this study is, this research is observed from the evidence in the Malaysian market. Future research can be conducted to obtain views from other countries. In addition, this study examines the reporting issue of IFIs without further investigating on how Islamic are the products of IFIs. Qualitative research is worth exploring with regard to this issue. Further study on the issue of substance over form in reporting IFIs is also valuable. Despite the limitations, indeed, this study adds to current body of knowledge by contributing in answering the dilemma of the need of separate Islamic accounting standards. In future, it is hoped that IFIs will offer *Shariah*-compliant products in substance and form and for the reporting to be based on the Islamic reporting conceptual framework. This development will help to fulfil the desire of Muslims to apply Islamic principles in all aspects of their lives.

Notes

1. *Shariah*, which literally means "the way to the source of life", is used as a legal system originating from the code of behavior specified by the Holy Qur'an and the Hadith (the authentic tradition) (Lewis, 2001).
2. Accessed on 15/6/2012, http://masb.org.my/index.php?option=com_content&view=article&catid=44:press-release-2000&id=
3. Accessed on 12/6/2012, www.bnm.gov.my/guidelines/01_banking/02_financial_reporting/01_gp8_i.pdf
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