Comparative analysis between the IFRS and the AAOIFI accounting standards

Research · November 2015

DOI: 10.13140/RG.2.1.3966.1525

1 author:

Otmane amrani hannoudi
University of Strasbourg

UNIVERSITÉ DE STRASBOURG

Comparative analysis between the IFRS and the AAOIFI accounting standards

By

Otmane Amrani Hannoudi

A thesis submitted in partial fulfillment of the

Requirements for the degree of

Master in Islamic Finance

Defended in September 2015

Submitted To:

Prof. Laurent WEILL

Acknowledgements

My gratitude for the accomplishment of this thesis goes to Prof. Laurent WEILL for his advice.

Special thanks to my family for its support throughout my studies.

Strasbourg University does not intend to give any approval or disapproval to the views expressed in this thesis. These opinions should be considered as specific to their author.

Table of Contents

General introduction

Accounting is an essential tool for the determination of an entity's result during a period, we can define it in more formal way as a system for recording information about business transactions to provide a summary of the financial position and performance of an entity by the submission of periodic standardized documents that are supposed to represent fairly the financial position (balance sheet, income statement, etc). And therefore the task of making decisions will be facilitated to all users of such information; we can classify into:

-Financial accounting which produce financial statements for external stakeholders (suppliers, customers, banks, potential investors, ect)

-Tax accounting is method of accounting that focuses on providing information needed by a business to comply with all regulators such as tax rules; this includes all activities related to filing tax returns and computing for the tax payables;

-Management accounting is the process of preparing, analyzing, and interpreting reports for the entity's internal audiences such as finance department and the chief executive officer; so that managers may take short-term decisions more easily.

Nowadays, we live in a world characterized by globalization, the ultimate goal of all businesses is to face severe competition and to develop their competitiveness to survive and flourish in such demanding business climate.
Accounting is considered as a language for the business, because information is largely communicated to interested parties, , it constitutes a mirror for potential investors to make a judgment whether the company is a good investment or it does not worth it by reviewing stock price for public companies or other ratios derived from the analysis of the financial statements for private companies, in order to reflect a net picture of real economic situation of the entity for any interested investor worldwide; the language used while the production of the statements needs to be understandable by all.

Accounting regulators mainly in developed countries has been sensible to the issue of having many accounting languages to exhibit the financial positions around the world, and its negative consequences on comparability and understandability several decades ago.

For that reason, in 1973 several countries created a new body-setter IASB at an international level which had responsibility to cover the accounting by the issuance of IASs called IFRS since 2001 after some modifications of the structure. Many countries tried to adapt its accounting rules and laws to respect these standards.

In my thesis, I choose to highlight the aspects of accounting that belongs to one particular field which is Islamic finance through the study of the rules applied to Islamic financial institutions ”IFI” mainly those issued by AAOIFI ”Accounting and Auditing Organization For Islamic Financial Institutions” by reference to IFRS.

The objective of the thesis is to analyze the standards of accounting applied to IFI by focusing on the major contracts used by the IFI in order to respond to the following questions:

- Does IFRS include standards incompatible with the practices in IFI?
- is the gap between IFRS standards and AAOIFI really too big, which make the IFRS unable to involve the IFI?

To provide answers to these questions, I have structured this thesis as follow:

Chapter 1	IFRS and AAOIFI frameworks
Chapter 2	Islamic accounting AAOIFI accounting requirements
Chapter 3	comparison of contracts in IFI and conventional financial institutions

Chapter 1: IFRS and AAOIFI frameworks

Introduction of the chapter 1

In order to be able to analyze similarities and divergences between transactions in conventional financial institutions and IFI, I will focus in my thesis on the accounting aspect of the contracts which does not mean a total ignorance of other important features in particular, a brief introduction to fundamentals of Shariah that regulates the whole contracts and the definition of contracts used in Islamic finance.

In the current chapter, I will present IFRS and AAOIFI frameworks and provide a brief overview of history of the body-setters and their main objectives of creation; then I will introduce their organization chart and detail the functions of their major bodies. After that I will exhibit their mechanisms of issuing standards by detailing the steps of the due process.

The next key point, I considered essential to focus on, is to review the basic accounting assumptions and underlying principles; because there are a stone corner to build any accounting system. That is to say that, the journal entries made in every transaction is nothing more than a consequence and interpretation of the assumptions and principles into a common language of debits and credits generally understood by accounting professionals.

I- IFRS Framework

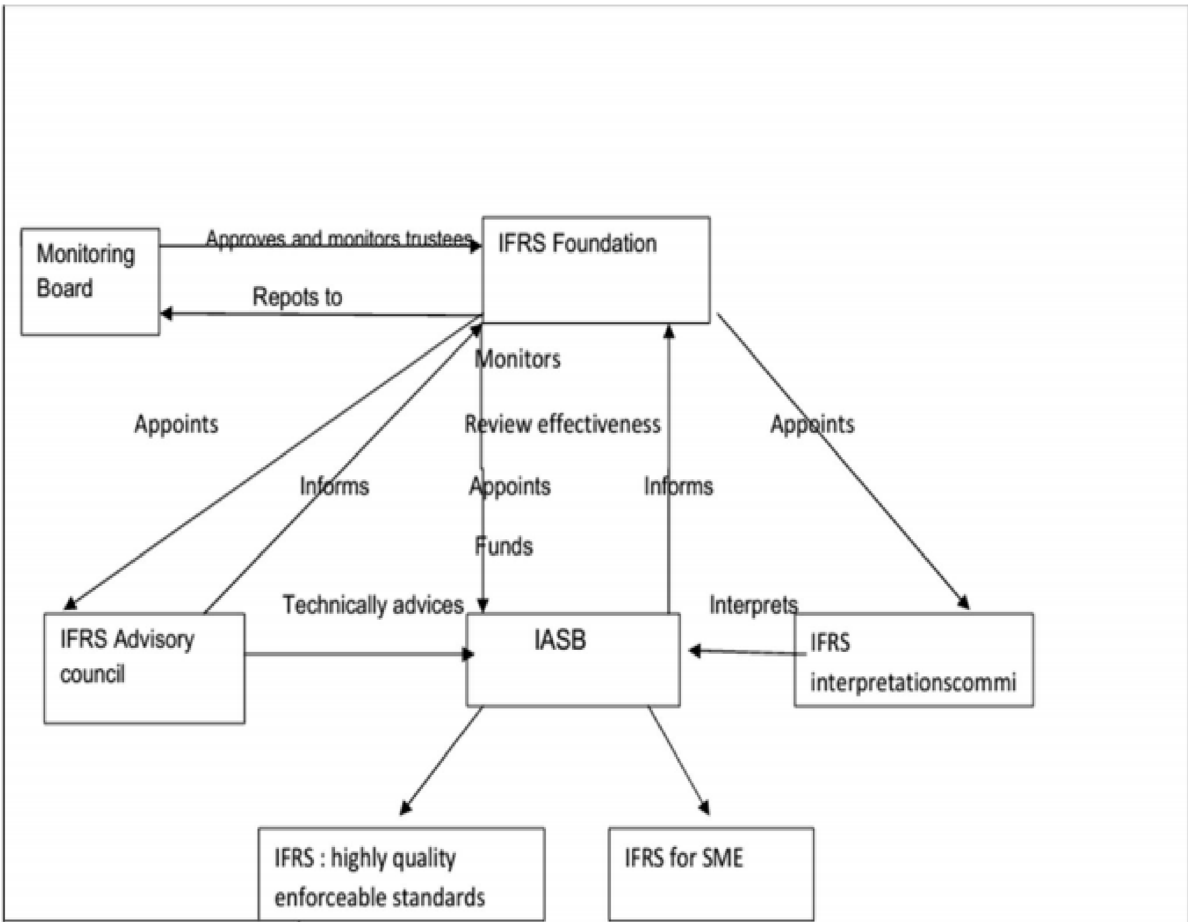
Introduction

International financial reporting standards (IFRS) constitutes a set of guidelines and rules established by the International Accounting Standards (IAS), that are used by companies to prepare their financial statements, these accounting rules are followed by more than 100 countries. All states of the EU require the use of IFRS for listed companies since 2005. International Accounting Standards Committee (IASC) was founded in 1973 by the accounting professional organizations of Australia, Canada, France, Germany, Japan, Mexico, Netherlands, UK, Ireland, USA. IASC has issued several International Accounting Standards (IAS) till 2001, then the IASC has been modified to the International Accounting Standards Board (IASB) and the new standards established since 2001 are called IFRS.

The main objectives of IFRS are to develop a unique framework for accounting reporting, this set of standards must be understandable, transparent, applicable, and wholly accepted; these characteristics will help investors in their decision-making process. The IASB aims also to facilitate IFRS adoption by the convergence with national accountings standards Generally Accepted Accounting Principles (GAAP) of different countries, also by taking into consideration particularities of entities of certain size such as Small and Medium- sized Entities (SME) or those existing in special context as hyperinflationary economies.

1 -The organizational chart of IASB

The IASB is structured as follow:



Source : www.focusifrs.com

This structure is composed of the standardizing body the IASB which involves sixteen members from different geographic region chosen for their experience in accounting standardization. They are nominated for five years renewable only once, the IASB has two main tasks, first, the establishment of IFRS; second, the approbation of interpretations prepared by IFRS Interpretations Committee.

The monitoring body, IFRS Foundation, which has twenty two trustees from different zones appointed for three years. It has many missions such as, the definition of organization of procedures of the IASB, the nomination of the IFRS Interpretations Committee and the IFRS

Advisory Council, the annual evaluation of strategy effectiveness of the IASB, and the approval of IASB budget.

The interpretative Instance, the IFRS Interpretations Committee is composed of 14 voting members, in addition to the Chairman who has no voting rights and two observers the International Organization of Securities Commissions (IOSCO) and the European commission (EC),the voting members are appointed for a period up to 3 years renewable by the trustees of the IFRS Foundation for a fixed term. They are chosen for their awareness of current issues and their technical competence to solve it, they also assist the IASB to get international convergence of accounting standards by working with national standard-setters. These members are professional accountants and users of financial statements, who are distributed between geographic zones.

The advisory body IFRS Advisory Council, composed of twelve members and a non-voting chair for the IASB chairman or vice-chairman. The members are originated from diverse geographical regions, its role is to validate and modernize the contact between the IASB and setting bodies in order to increase the adoption of IFRS and to get feedback on solutions proposed.

2-The due process for IFRS adoption

IASB seeks to develop high quality standards in six steps:

- ### Setting the agenda

The IASB appraises the need for adding a potential item to its agenda, mainly by looking into the needs of investors, modifications in the IASB's Conceptual Framework could create difficulties for entities ,the IASB receives demands from stakeholders to interpret, review or amend existing publications and from these comments , the IFRS Advisory Council and the IFRS Interpretations Committee, and staff research and other recommendations. To help the IASB in considering its future agenda, its staff is asked to identify, review and examine all requests, take into considerations major issues raised by regarding its agenda priorities, for example, the factors related to IFRS convergence initiatives with other accounting standard-setters.

- ### Planning the project

The IASB identifies the nature of the issue and it decides of its degree of influence on the concerned parties, then the IASB may establish a Consultative group at this stage, generally the team of the project is composed by the two most senior members of the technical staff, the director of technical activities and the director of research. .And depending on each item the IASB decides to lead the project alone or scrutiny the item jointly with another body-setter.

- The development and publication of a discussion paper

Whereas a Discussion Paper is not compulsory, generally the IASB produces it on any major new items, these discussion papers comprises an overview of the issue; and provide any possible approaches in addressing the issue; also the IASB solicits opinions and invite constituents to comment.

The IASB publishes the paper based on the basis of analysis of its staff research and their suggestions, as well as recommendations of the IFRS Advisory Council, and presentations from invited parties. All debates of technical issues of the draft paper take place in public sessions.

- The development and publication of an exposure draft

The issuance of an exposure draft is obligatory in due process, the IASB introduces the establishment of the exposure draft with a reviewing the staff research suggestions and on particular item, an examination of recommendations formed by the IFRS Advisory Council, consultative groups; then the meetings resolve issues and the IASB orders the staff to formulate the exposure draft. .when finishing the draft, and after the IASB votes it, the IASB publishes it for public consulting.

- The development and publication of an IFRS

The IASB considers if it should publish a second exposure draft, after the emergence of substantial issues that appeared during the comment period, its staff assess if the issues were presented in clear terms for the interested parties. When the IASB is satisfied with the conclusion attained on the issues arising from the Exposure Draft, it commends the draft of the IFRS. Then the draft is submitted to external check by the IFRIC and it is posted on eIFRS (a limited access website), before the IASB votes the standard, after the due process is completed and resolution of different problems, the IASB members vote for the issuance of a new IFRS.

3-Assumptions of the IFRS

- Going concern:

This assumption a is fundamental principle in accounting that assumes an entity will continue to be in operation for the foreseeable future; this principle means that in case a company has the intention to quit the business. then the company is declared liquidated, all debts become immediately in full, tangible assets are worth only what they will be sold for in an auction, and the intangible assets become worthless.

- The accounting entity:

This assumption implies that financial statements reflect the financial activities of a clearly defined economics unit that is accounted for separately from the people who finance it or those who work for it., and in order to insure the accuracy of accounting, the entity should not be flexible or regularly changed.

- The accounting period

The accounting period principle is the concept that a firm should report their financial statements of its activities over a period of time generally a quarter or a year, this period tends to be similar and covers an equal duration of time.

- The stability of purchasing power of the monetary unit

This assumption refers to an accounting convention that financial transactions should be recorded with a unit of measure which is the business's domestic currency, for instance, the Euro for French firm. It also implies that in spite of the purchasing power's change of the unit of measure used by the company due to inflation or deflation; the assets and liabilities are recorded at their historical cost, generally without restatement in values.

4- Conventional accounting principles

- Matching Principle

This principles implies that expenses are incurred by an entity must be accounted into the income statement in the accounting period in which the revenue is earned, this principle is related to the accrual method of accounting which states that under the accrual basis of accounting, expenses are reported on the income statement when they are paid; while the cash basis of accounting, revenues are reported on the income statement when the cash is received.

- Objectivity principle

This principle states that accounting measures and records on the basis of objective evidence and verifiable data and not based on personal opinions or feelings which means that different professionals looking at the evidence will arrive nearly to the same values for the transaction.

- The consistency principle

This principle requires accountants to apply the same methods and procedures from period to period, and when they change a method a full disclosure of the change and an explanation of its effects on the accounts of the financial statements must be provided.

- The uniformity and comparability principle

This principle refers to appliance of similar procedures by different entities in order to achieve comparability; this will lead to a reduction of diverse accounting practices.

- The Materiality principle

The principle of materiality serves as a guidance for the accountant in terms of what is essential be disclosed in the financial reports, an information is considered as material if its omission or misstatement could influence the decision-makers; the materiality takes into consideration also the cost of obtaining financial information which must not exceed the benefits derived from such information, also a balance between timelessness and providing reliable information.

- The cost principle

This principle means that a company is obliged to record its fixed assets at their actual purchase price or production cost. The value recorded in the accounts for an asset is not changed until later if the market value of the asset changes then based on new evidence and by new transaction the accountant changes the original value of the asset.

- The realization principle

This principle recognizes the revenue be taken into the accounts by the time the transaction is completed, such as when products are sold or services are supplied. Sometimes an transaction occurs over many accounting periods, for example, a firm place an order to purchase a computer in January, the machine arrives in February, and the invoice in March; according to the realization principle, the transaction has to be recorded in the accounts at the point when ownership of the asset passes from one party to another and this occurs usually when the goods are received.

- Full disclosure principle

The full disclosure principle requires a company to provide the necessary information that influences the decisions of an informed user of the financial statements; this disclosure must be neutral without manipulations that tend to modify the real picture of accounts, free from bias of both errors and omissions, sufficiently complete to ensure that it represents underlying events. This concept refers also the aspect of substance over form of the transactions, which means that reporting financial information must represent the substance of an economic phenomenon rather its legal form.

II- AAOIFI framework

Introduction

After an introduction of the IFRS framework, through different corners:

- Some information about the creation and the presentation of the role of main bodies
- The due process of issuance of new standard or revising an existing one
- The introduction of both the assumptions and the underlying principles of that framework

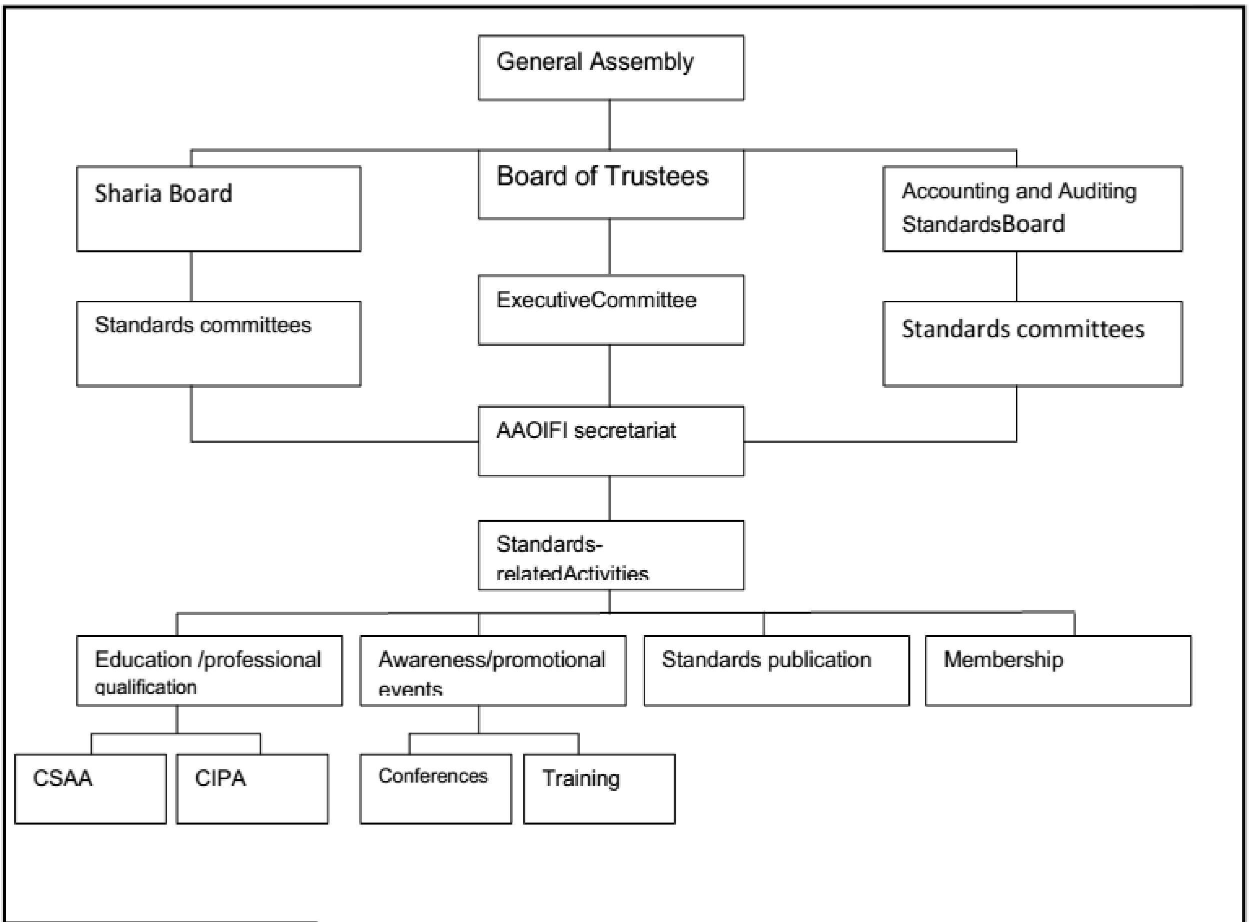
I intend to follow in this section, the same steps, so that; a comparative vision could be achieved for the reader of current chapter.

The AAOIFI was established in accordance with the agreement signed by Islamic financial institutions in 1990 in Algiers and it registered in 1991 in Bahrain. It is an Islamic international autonomous non-for-profit corporate body that prepares accounting, auditing, governance, ethics and shariah standards for Islamic financial institutions. It was supported by central banks, Islamic financial institutions, and other actors of the international Islamic banking and finance industry. Its standards are now adopted by many countries such as the kingdom of Bahrain, Jordan. The AAOIFI is responsible for formulation, issuance of new standards and reviewing existing standards that comply with shariah principles till now 88 standards was issued: 48 standards on Shariah, 26 standards on accounting, 5 standards on auditing standards, 7 standards on governance, and 2 codes of ethics.

The major tasks of AAOIFI are the standardization and harmonization of international Islamic finance practices, the assurance that shariah principles and rules are respected in Islamic financial institutions, the support of the growth of the industry by trainings, seminars, and publication of periodical newsletters.

1-Organizational chart of AAOIFI

The AAOIFI is structured as follows:



Source : www.aaoifi.com

The main bodies of AAOIFI:

The supreme authority the General Assembly composed of all founding, associate, observing members, regulatory and supervisory authorities. The General Assembly must have at least one meeting a year. It has many roles, such as the validation of the amendments of the Statute of AAOIFI, the approval for admission of new members to the General Assembly, the nomination of the members of the Board of trustees, and the validation of financial statements and the audit report.

The Accounting and Auditing Standards Board (AASB) is comprised fifteen part time members, they are appointed by the General Assembly for four years and they must meet twice per year. These members are chosen from regulatory authorities, shariah fiqh scholars from different schools of thought, professional accountants, auditors and users of financial statements of IFI, taking into consideration their distribution over various geographic zones. It has many missions such as, the preparation and interpretation of standards for IFI, the organization and adoption of due process for standards adoption and regulations of the AASB.

The Shariah Board includes less than twenty members appointed by the Board of Trustees for a four-year term from among fiqh scholars who represent Shariah supervisory boards of members of AAOIFI, and Shariah supervisory boards in central banks. Their powers include harmonization in the concepts and application among the Shariah supervisory boards of IFI to avoid contradiction between the Fatwas, the contribution to development of IFI by the creation of shariah compliant instruments, also the examination of any issues addressed to the Shariah Board of IFI, and the revision of standards throughout the stages of the due process.

2-The due process for AAOIFI accounting standards adoption

According to (Archer, Karim2007), the AAOIFI accounting standards are established following the same due process as the IFRS; which includes among other things, the issuance of exposure drafts and holding public hearing.

3-Assumptions of the AAOIFI

While preparing and presenting their financial statements, the AAOIFI has adopted several assumptions: IFI must comply with it, by adopting those assumptions as a body-setting had made choices from different schools of thought in order to provide the industry with assumptions that facilitate the integration of IFI into global financial markets; even though an assumption is denied by most of shariah scholars. These divergences between scholars constitute a hindrance to accounting development in this sector, because it causes issues to harmony in practice.

- Going concern

This assumption accepts the continuance of existence of IFI, the adoption of such position is justified by the opinion of many scholars who consider that unless the mudarabah contract stipules a limited term, the continuity is presumed. Many scholars defend this position by reference to Islamic principle of Istishab “presumption of continuity”.

- The accounting entity

The AAOIFI Statement of Financial Accounting (SFA) n°2 recognizes a separate accounting entity for IFI from its owners, many the scholars who accept it, and they say that during the early centuries of Islam this separation was acknowledged in public sector in both the institution of endowment (waqf), and in the public treasury and by using the principle of Maslaha defined as the act of seeking for a good, and the avoidance of an evil as understood by the Shariah. This Maslaha should converge to aims of shariah (Maqâsid) defined by Imam Alghazali as the promotion of well-being of all mankind by safeguarding their faith (din), their human self (nafs), their intellect (aql),their progeny (nasl) and their wealth (mal) .The scholars have extended this concept to private entities such as corporations.

- The accounting period

The accounting period assumption is derived from the going concern concept, it is importance for allocation of expenditure as expenses over different accounting periods; muslims were interested to this concept in order to respect the religious obligation of paying the Zakat; it is reported that the prophet has said ” No Zakat on wealth until a year passes” ; this was the motivation for Muslims to calculate their wealth in a year.

- The stability of purchasing power of the monetary unit

The SFA n°2 assumes the stability of the monetary unit during the accounting period, this assumption leads to an ignorance of inflation rate, in the Quran: [Give measure and weight with full justice][1].

4- The AAOIFI accounting principles

- Matching Principle

This principle states that expenses should be recognized in the same period as their linked revenues as I said in IFRS principle it is attached to the accrual accounting, it is considered as one of main pillar in Islamic accounting; because it enhances fairness and justice between different stakeholders of IFI such as shareholders , depositors, investment account holders (IAH).

- Objectivity principle

From Islamic point of view, this principle is adopted to increase the usefulness of financial reporting, also for fairness in recording different transactions for example, using historical cost to record the asset at date of acquisition. However, in circumstances where using other method will lead to more relevant information; the entity is allowed to apply a method such as current value.

- The consistency principle

This principle states that similar economic transactions should be accounted in a same manner over many accounting periods, from Islamic accounting perception; this will lead to accurate information that will help the achievement of religious obligations as the determination of the amount of Zakat due in a period.

- The uniformity and comparability principle

[1] Surat Al-‘An’âm, verse 152

This principle encourages the firms to apply similar procedures so that the diversity in accounting practices could be avoided, and comparability of financial statements will be facilitated. Islamic accounting has no objection to this principle as it will enable investors to take the right decisions.

- The Materiality principle

This principle enables to report the right information in the financial statements, which does not contravene any shariah requirements.

- The cost principle

This principle states that a company records its fixed assets at their actual purchase price or production cost, it is related to both objectivity and going concern principles; therefore accepted in Islamic accounting.

- The realisation principle

This principle accepts the record of the revenue into the accounts by the time the transaction is completed by cash receipt or an effective exchange, generally accepted in Islamic accounting, however, some investors in IFI have the right to withdraw their funds whenever they want; and those who do this in mudarabah contract will be deprived from sharing the result profits or losses of project they have contributed in as it is not liquidated yet, and this is considered as not fair.

- Disclosure principle

The disclosure principle states that an entity has to release information that influences the financial statements interpretations ; these disclosure must enable a fair presentation Islamic scholars accept it, nevertheless, a major point that Islamic accounting does not refer to is the aspect of substance over form under which the accounting for transactions is related to their substance and economic reality and not simply their legal form. This concept is one of the key determinants of reliable information in the IFRS framework, whereas; it is not accepted by the AAOIFI.

Conclusion of the chapter 1

To conclude this chapter on the two frameworks IFRS and AAOIFI, I want to mention that the AAOIFI has attempted to duplicate or at least apply a quite analogous system for its internal organization and during the due process as the IFRS framework does. Up to me I consider that the AAOIFI has failed in this particular point, because, having a structure and process near the IFRS framework should not be the aim; if those structures lack in efficiency. In order to illustrate the weakness, I give the website as example; the IFRS website is full with interesting information about the standard in progress, the user can find comments of international entities on a specific standard; while the AAOIFI website is empty of such information.

Concerning the standard issuance ,I can easily notice that the AAOIFI has been inspired by the experience of older accounting body setters mainly the IASB, therefore AAOIFI does not issue standards similar to IFRS that could be applied by IFI as far as they do not contradict with Islamic accounting rules, for instance, for both IAS 10 "events after the reporting period" and IAS 24 "related party disclotures"; the AAOIFI focus on IFRS standards that cannot be adopted in by IFI such as IAS 39 " financial instruments: recognition and measurement"; also the AAOIFI issues standards for transactions specific to IFI such as FAS 2 " murabaha and murabaha to the purchase order" and other features related to IFI such as FAS 9 " Zakat".

Another interesting point is that the AAOIFI as a body-setting by adopting its assumptions and principles had made choices among scholars' opinions in order to provide the industry with a framework that facilitates the integration of IFI into global financial markets; even though, an assumption is denied by most of shariah scholars, for instance, the AAOIFI accepted the going concern, regardless of its refusal by several scholars who provide many arguments to support their position:

- Only God will live continuously
- Islam discourages long term contract
- Based on tandeed[2] concept, liquidation is required for investments financed by mudarabah funds

The AAOIFI has adopted this accounting principle based on Islamic principle of Istishab, which is classified as a secondary source of Islamic law that is based on human interpretation and reasoning.

[2] is the conversion of the Mudarabah assets into money, in actual practice, through sale, or constructively, through accounting methods which rely on the valuation of assets at a certain date and effecting the division (distribution) of profit accordingly

Chapter 2: Islamic accounting and AAOIFI accounting requirements for IFI

Introduction of chapter 2

After the presentation of the IFRS and AAOIFI, in this chapter, I will present some concepts given by accounting experts, that render the Islamic accounting different from conventional accounting, after that, I will outlay the need of reporting for IFI under the AAOIFI standards, first of all I want to mention that IFRS standards do not specify special treatment for the IFI's operations. If we scrutiny the IAS 30 "Disclosures in the Financial Statements of Banks and Similar Financial Institutions" [The objective is to prescribe appropriate presentation and disclosure standards for banks and similar financial institutions (hereafter called 'banks'), which supplement the requirements of other Standards. The intention is to provide users with appropriate information to assist them in evaluating the financial position and performance of banks, and to enable them to obtain a better understanding of the special characteristics of the operations of banks][3]; this standard was is superseded by IFRS 7 "Financial Instruments" that applies to disclosures since 1 January 2007. It is important to notice that this standard does not refer to IFI, however some authors mentioned IAS 30 as possible link between the IFRS with IFI industry perhaps due to the "similar financial institutions" that may comprise the IFI.

I- the Islamic vision of accounting

1-Accounting in the early Islamic state

Historians believe that the ancient Egyptians were first bookkeepers an archaeologist Dr. Gunter Dreyer of the German institute of archaeology discovered 5,300-year-old bones on which recorded the detail of the inventory of goods kept in royal warehouses.

Most of researchers in accounting history consider the appearance of double-entry bookkeeping by Luca Pacioli in his book " Summa de arithmetica" in 1494 in Italy as the most important event in the development of accounting through the ages.

More recent authors have been interested by the accounting the early Islamic state, (Leiber,1968) suggests that Italian traders obtained their knowledge of sophisticated business methods from the muslims merchants, Italians were also the first who translated

[3] http://www.iasplus.com/en/standards/ias/ias30

algebra from Arabic, another evidence of the Muslims' contribution was the use of Arabic numbers by Pacioli in "Summa de arithmetica".

The development of accounting in Muslim society was initiated by the teachings of Islam in the year 610 A.D with the revelation of the Quran to the prophet Mohammed, peace be upon him, the accounting was developed was to meet the religious obligation of the zakat by the introduction books, concepts and procedures during the rule of the second caliph, Omar Ibn Kattab. The terms accounting and accountant were not used in the early state of Islam instead Al amel or Kateb Almal were used for accountant and "Muhasabah" referred to the function of accounting.

Among Muslim scientists that were interested by accounting, Alkhawarizmy in 976 A.D. wrote a book "Mafatieh Al Uloom" (keys of sciences) in which he described the types of records used by the Dewans[4] in chapter dedicated to "secretary-ship"; the accounting reflected the kinds of projects in progress in the Islamic state, the accounting systems include both general procedures for all types of projects, and special requirements for each agricultural, financial, and industrial program. Then the accounting process was detailed in the writing of Al Mazendarany in 1363 A.D "Rissallah Falakiyyah Kitabus Siyakat".

2-Islamic accounting definition

Islamic accounting is influenced by the environment in which it operates that's why the authors used a slightly different definition to refer to as [the process of identifying, measuring and communicating economic and other relevant information, inspired by Islamic worldview and ethics and complied with the "shariah" (Islamic law) - in order to permit informed judgements and decisions by potential and expected users of information- to enhance social welfare and seek mardhatiallah (the blessings of Allah)][5]

From this definition, we can notice two major aspects that differentiate the accounting from Islamic vision:

- Shariah compliance
- Islamic vision of accounting

3- Shariah compliance

In this definition above shariah refers to principles of Islamic commercial law based on two major sources classified depending on its origins:

[4] Is the noun form of Arabic verb " Dawana" (to write), it was used to mean the book of revenues and the office of recording and maintaining accounting books

[5] An introduction to Islamic accounting theory and practice, Abdul Rhim abdul rahman

- Primary sources: the Quran and the sunna[6] , those are based on revelation
- Secondary sources: known as Ijtihad, includes several tools and methodologies that enables law-making.
    - Ijma': it refers to the consensus of Muslim jurists on a particular issue at a particular point of time after the death of the prophet.
    - Qiyas: it is an analogical reasoning that extends the rule of an existing case to a new issue by drawing a parallel.
    - Istihsan: it takes place when a jurist makes a decision in specific case, that is different from the one decided in similar case, due to a stronger and more appealing reason. It enables to remove the rigidity of laws.
    - Maslahah: it looks for public interest, by the search of something useful or removal of something harmful.
    - Istishab: the retaining of any event or verdict experienced in the past, until evidence is found that this event or verdict has changed.

The two major elements to be avoided by the Islamic finance industry are:

- The prohibition of interest (riba)

The distinction in Islam is that money is not considered an object that can be sold or rented, because it has no intrinsic value; it is only a medium of exchange and a store of value; thus, no contract is legitimate if it is based on the creation of money from money without the combination of a capital or labor. Also Islam considers that the time is a creation of God and belongs to him alone, therefore any business transaction based solely on the passage of time is unlawful.

Definition: [Riba refers to the "premium" that must be paid by the borrower to the lender along with the principal amount as a condition for the loan or for an extension in the duration of a loan. At least four characteristics define the prohibited interest rate:(1) it is positive and fixed ex-ante; (2) it is tied to the time period and the amount of the loan; (3) its payment is

[6] The way of life prescribed as normative in Islam, based on the teachings and practices of Muhammad

guaranteed regardless of the outcome or the purposes for which the principal was borrowed, and (4) the state apparatus sanctions and enforces its collection][7]

The prohibition of riba is clear in the Quran:

[Those who consume interest cannot stand [on the Day of Resurrection] except as one stands who is being beaten by Satan into insanity. That is because they say, "Trade is [just] like interest." But Allah has permitted trade and has forbidden interest. So whoever has received an admonition from his Lord and desists may have what is past, and his affair rests with Allah . But whoever returns to [dealing in interest or usury] - those are the companions of the Fire; they will abide eternally therein][8].

- The prohibition of Gharar

Gharar can variously be defined as 'uncertainty' or 'deceptive uncertainty' or "ambiguity" or ignorance of essential components of contacts; some authors include also "risk".

Generally scholars distinguish between contracts with minor gharar (yassir) this leads to a valid contract ,for example, uncertainty regarding some elements object or quantity of the unilateral contracts such as gift is allowed, while substantial gharar (fahish) is prohibited for instance, the ignorance of object, quantity, quality in synallagmatic contracts such as a sale contract will conduct to invalid contract. , therefore unlike riba, gharar is a relative concept difficult to detect in contracts

Scholars enumerate many hadiths to prove this prohibition, according to Ibn Majah reported that "the prophet prohibited the pebble sale and the gharar sale", also the prophet banned the sale of "the birds in the sky or the fish in the water"

- The prohibition of Maysir and Qimar

Maysir refers to an easy acquisition of wealth by chance depending on the occurrence of a predetermined uncertain event in the future, whether or not it dispossesses the other's right is involved in contracts, while Qimar is defined as gambling transaction that are considered as completely unfair in Islam such as any games of chance (lotto, casino-type games).

[7] Iqbal Z, and A Mirakhor ; an introduction to islamic fiance theory and practice, wiley finance edition
[8] Surat Al-Baqarah, verse 275

The ban is mentionned in the Quran:[O you who have believed, indeed, intoxicants, gambling, [sacrificing on] stone alters [to other than Allah], and divining arrows are but defilement from the work of Satan, so avoid it that you may be successful][9]

4- Islamic ethic and vision of accounting versus western accounting

Many authors (Baydoun and Willett (2000)) compared between principles of Islamic accounting and Western accounting, according to their study they identified that the application of conventional accounting as a basis in IFI might be harmful to the development of the Islamic accounting due to distinct characteristics summarized in table 2 below.

Table 2: Comparison between Western and Islamic accounting (Baydoun & Willett, 2000).

Characteristics	Western accounting	Islamic accounting
Philosophical viewpoints	Economic rationalism	Unity of God
Principles	Secular Individualistic Profit maximization Survival of fittest Process	Religious Communal Reasonable profit Equity Environment
Criteria	Based upon modern commercial law – permission rather than ethical; Limited disclosure (provision of information subject to public interest); Personal accountability (focus on individuals who control resources)	Based upon ethical law originating in the Quran (Islamic law –As-sunnah); Full disclosure (to satisfy any reasonable demand for information in accordance with the shariah); Public accountability (focus on the community who participate in exploiting resources

9 Surat Al-Mā'idah verse 90

II- Inconsistency in accounting framework for IFI

1-different approach by regulators

Table: approach by country for IFI

	Legal authority	Regulatory, supervisiory and monitoring arrangements	Shariah boards
Bahrain	CBB Law	Dual system of banking with islamic banking law. CBB sole supervisor for banks, mutual funds, investment advisory services	Each islamic bank must have a sharia board
Indonesia	Act No. 10 1998 & Act No.23 1999 and other	BOI – the central bank OKJ—responsible for regulation and supervision of banks, insurance companies and pension funds	Separate shariah board required
Iran	Law for Usury Free banking 1983	BMJII-single banking system based on shariah principles Separate regulator for insurance	No sharia board
Kuwait	Law No.30 of 2003 that amended law No 32 of 1968	CBK monitors islamic banks under dual investment system of banking Separate regulator for insurance	Separate sharia board for each bank
Malaysia	Islamic banking Act 1983	BNM is responsible for islamic banks, leasing companies, investment banks and conventional institutions operating in these areas. The MOF is closely involved in the supervision of islamic banks SEC is responsible for securities markets, investment banks	Separate shariah boards at institutional level and in the BNM and SEC
Pakistan	Banking companies ordinance (BCO) 1962 as amended	SBP for islamic banks SECP for takafuls, securities markets, investment banks, modarabas, leasing companies	At the SBP level At each islamic banking institution
Sudan	Bank of Sudan Act (BSA) 2002	Bank of Sudan – a single banking system based on shariah principles applied in the North of the country, most recently, a system for conventional banks to serve the South of the country	Central bank, has a shariah supervisory board. Separate sharia boards for banks

Source: Islamic banking and finance, what is and what it could be

This table shows many approaches that regulate the IFI through countries, for example, concerning the shariah boards some countries require shariah board for each bank i.e Kuwait , while other countries ,i.e Malaysia, adopt separate shariah boards for each bank with a shariah supervisory board of Central bank that brings stability to the industry as it holds the ultimate decision on the validity of new contract; this also reduces the divergence between fatawas issued by the shariah boards of IFI.

Concerning the shariah board, Iran could be considered as an outlier often overlooked; as it is an illustration of country that does not require shariah board. However, the study of this case could provide us with interesting outcome about the possibility of ruling IFI without this body that affect the competiveness of the whole industry by huge remunerations.

2-Different “Madahib” schools of thought

There are four prominent schools of Islamic law; most Sunni Muslims esteem these four schools as valid interpretations of the religious law of Islam. All madahibs recognize the authority of the Quran and Sunna

Hanafiyya School	Founded by Imam Abu Hanifa (died.767 A.D.). It generally reflects the views of the jurists of Iraq. this school is followed in Turkey, Palestine ,Egypt, etc
Malikiyya School	Founded, by Imam Malik bin Anas (died. 795 A.D.) The next in order of time, it reflects the views and practises associated with Medinah , the adherents of this school are largely in North African countries, for example, Algeria, Libya, Morocco, Tunisia
Shafiyya School	Founded, by Imam al-Shafi (died. 820 A.D.) This school is strong in Malaysia, Indonesia, Egypt, Syria.
Hanbaliyya School	Founded, by Imam Ahmad bin Hanbal (died. 855 A.D.). only Saudi Arabia follows this school.

Most Sunni Muslims consider these four schools as valid interpretations of shariah, The schools agree on essential aspects of the religion, however in certain situations, the four schools diverge with each other. For example, bay’ al-urbun

Table: divergence between various school of thought about bay’ al-urbun

School of thought	Position	arguments
Shafiyya and Malikiyya	Void	-hadith of prophet that prohibit bay’ al-urbun
Hanbaliyya	Defective	-gharar (one does not know whether the sale will be concluded or not -double deferment of countervalues
Hanbaliyya	Permitted	-hadith of prophet that permit the down-payment

3- Several organizations that affect the accounting for IFI

In addition to the AAOIFI that issue specific accounting standards and IASB that influence the IFI’s accounting by international accepted standards; other institutions influence this accounting:

+IFSB” Islamic Financial Services Board”:

An international standard-setting organisation established in 2002 in Kuala Lumpur, Malaysia that promotes and develops the stability of the Islamic financial services industry by issuing global prudential standards and guiding principles for the industry, including banks, capital markets and insurance sectors. It is composed of representatives of the central banks of countries of the Organization of the Islamic Conference and other countries, representatives of international organizations including the International Monetary Fund, the World Bank. The IFSB also organize seminars and conferences for regulators and industry stakeholders on industry related issues.

+ IIFA” International Islamic Fikh Academy”:

An assembly of shariah scholars established in 1981, It is based in Jeddah, Saudi Arabia. It issues fatawas (religious opinions) on various topics, it is considered as a shariah committee that financial institutions can consult via their shariah supervisory board. For example, according to its resolution 179 (19/5) in 2009 related to Tawarruq[10], the classical tawarruq is

[10] Buy spot and sell deferred payment or vice versa to facilitate cash liquidity

permissible ;while organised tawaruq is not permissible, because the transaction is considered as containing the element of riba.

4- Reporting for IFI by countries

Table: Accounting standards applicable to Islamic banks by countries:

Country	Accounting standards
Bahrain	AAOIFI and/ or IFRS
Indonesia	Indonesian GAAP(including specific requirements for IFI)
Kuwait	IFRS or AAOIFI
Malaysia	Malaysian GAAP (including specific requirements for IFI)
Pakistan	IFRS, with some local amendments for all banks
Qatar	AAOIFI
UAE	IFRS (including specific requirements for IFIs)
UK	IFRS or UK GAAP

Source: Harmonising financial reporting of islamic finance, KPMG/ACCA report

The table above show clearly many differences between countries for IFI's accounting, this demonstrate of the failure till now of the AAOIFI in its objective to bring coherence and harmonization to the accounting of IFI.

Important to realize that, Malaysia has recently adopted proactive approach; it has formed an Islamic group in order to communicate with IASB on adequacy of IFRS to IFI within the AOSSG[11] (Asian-Oceanian Standards Setters Group). In 2012 MASB (Malaysian Accounting Standards Board) established the MFRS (Malaysian Financial Reporting Standards) framework comprises conceptual framework based on accounting standards as issued by the IASB. The MASB also aims to facilitate the issuance of a Technical Release (TR) instead of a separate accounting standard for the IFI, for instance, MASB technical release TR i-2 for Ijarah accounting

[11] Comprises national accounting standards-setters of the region, its role is to discuss issue towards IFRS implementation

III- Financial statements of IFI

Financial reporting in IFI industry is different from conventional organization due to the nature of islamic financing operations and the contracts underlying these transactions, also the financial statements of IFI must reflect compliance with shariah requirements. the components of IFI include (balance sheet, income statement ,etc). Generally those statements above are common to conventional and IFI, moreover the IFIs are required to disclose according to AAOIFI standards:

- Statement of changes in restricted investments
- Statement of sources and uses of funds in the Qard/ Hassan and charity fund
- Statement of sources and uses of funds in the zakat fund

1-Balance sheet

It is a financial statement that summarizes a company's assets, liabilities and owners' equity at a specific point in time. These three elements provide investors with an idea about the sources of funds (liabilities+ owners 'equity) and uses of these funds (assets) and what the company owns and owes, as well as the net worth of the business that represent (asset – liabilities). The balance sheet must follow the following formula:

Assets = liabilities + owners' equity

In the of case of IFI, the elements of the balance sheet include in addition to the assets, liabilities and owners' equity another component the unrestricted investment accounts which is considered as additional sources of funds distinct from liabilities and owners' equity, these accounts can neither be assimilated to liabilities because unlike deposits they are not guaranteed nor integrated to owners' equity as the providers of those funds do not have executive board representation like the shareholders. As a result the accounting equation of IFI is presented as:

Assets = liabilities+ unrestricted investment accounts + owners' equity

- Assets

An asset is anything that an entity has acquired and that has money value it can be cash, something physical such as machinery, or an enforceable claim against others such as accounts receivable, or a right, such as copyright .The assets are usually classified on their owner's balance sheet are according to the ease of conversion into cash.

The following characteristics must be shown so that the assets can be reported in the balance sheet of IFI [SFA N°2:

- It must be capable of financial measurement with reasonable certainty
- It should not be associated with a non-measurable obligation or a right to another party
- The Islamic bank must have acquired the right to hold, use or dispose of the asset][12]

The first and second conditions refers to the shariah requirement of excluding the Gharar related to uncertainty in price determination and measurement, these features apply to all entities, while the third characteristic is specific to IFI as it emphases on of the ownership of the property of the asset and the complete right to use and dispose belongs to IFI, otherwise i.e.in an ijarah contract, the IFI has restricted control and usufruct only, thus this item is reported as off-balance sheet element.

- Liabilities

A liability is a claim against the assets such as accounts payable, or legal obligations of an organization e.g. taxes payable, arising out of past or current transactions or actions. Liabilities require mandatory transfer of assets, or provision of services, at specified dates or in determinable future.

The following characteristics must be shown so that the assets can be reported in the balance sheet of both conventional and IFI:

[The outflow of resources embodying economic benefits (such as cash) from the entity is probable.

The cost / value of the obligation can be measured reliably][13]

- Unrestricted investment accounts (URIA)

URIA are funds collected by the IFI based on a mudarabah contract with an agreed on profit sharing ratio between the IFI (Mudarib) and his client (Rab al mal) either individual or institution, the IFI has the right to invest those funds without restrictions and can mix them with other URIA or its owners ‘equity.

[12] Accounting for islamic financial institions, CIMA

[13] http://accounting-simplified.com/liability-recognition.html#sthash.ZjNQH847.dpuf

2-Income statement

Income statement is a financial statement that measures a company's financial performance over a specific accounting period, this performance is assessed by reporting the revenues, gains, expenses, losses, net income, in the case of IFI it has to report also the profit distribution to investment account holder during this accounting period.

- Revenue

Revenue is an increase in assets or decrease in liabilities caused by the provision of services or products to customers, during the period covered by the income statement, for IFI any revenue must be lawful and legitimate according to shariah principles; the recognition of revenue require an inflow to the entity except from deposits of owners 'equity or IAH, and the amount of revenue should be measured with reliability

- Expense

Expense is a decrease in assets or an increase in liabilities related the period covered by the income statement, it represents the money spent or cost incurred by entity to generate revenue, for IFI an expense must be incurred only in shariah compliant transactions, recognition of expense require an outflow from the entity except from withdrawals of owners 'equity or IAH

- Profit distribution between shareholders, depositors of IFI and URIAH

After the profit realization from operations, the IFI must share it between shareholders, depositors and URIAH, the AAOIFI recommends two methods:

(1)Separate investment account method:

According to this method, the IFI will share the gross profit with URIAH who supports only direct expenses, while the overhead expenses such as administrative expenses are borne by the IFI.

(2)Pooling method :

Based on this method, the URIAH supports not only direct expenses; but also the administrative and other overhead expenses with the IFI.

Table: Profit Allocation Methods

Separate investment account method	$	Pooling method	$
Income from sales investments, and financing	XXX	Income from sales investments, and financing	XXX
Less: Direct expenses	(XXX)	Less: Direct expenses	(XXX)
Gross Margin	XXX	Gross Margin	XXX
Less: Allocating profits to URIAs	(XXX)	Add: Fee-based income	XXX
Add: Fee-based income	XXX	Less: Overhead expenses	(XXX)
Less: Overhead expenses	(XXX)	Less: Allocating profits to URIAS	(XXX)
Net income to the IFI before tax and zakat	XXX	Net income to the IFI before tax and zakat	XXX

3- Specific statement to IFI required by AAOIFI standards

3-1Statement of changes in restricted investments

When providers of funds –restrictive investment accounts holders “RIAH”- choose to select their investments by making restricted investments; these RIAH are considered as an-off balance sheet item and the IFI do not have the right to commingle these funds with other funds provided by URIA, depositors, owners ‘equity; also the IFI must issue a separate statement of changes in restricted investments. So that the investors are assured that their funds are used according to their preferences in terms of portfolio, investment horizon, risk profile. In this case the IFI manage these funds based on either a mudarabah contract or an wakalah contract and earn as an investment agent (mudarib) a profit share or a compensation as an agent (wakil)

3-2 Statement of sources and uses of funds in the Qard/ Hassan and charity fund

Qard /Hassan is free-interest loan that will be repaid at maturity by the borrower to the IFI, generally available in a limited way and for short period, the Qard /Hassan fund is created for social objectives; usually it is used to finance small business without the purpose to share profits and losses, also for assistance in personal difficulties such as a death, illness. The sources of this fund are either external i.e. Depositors who decide to enable the IFI to use certain sum of their accounts and owners ‘equity or internal sources i.e. Prohibited earning if any and the repayment of funds provided to individuals.

3-3 Statement of sources and uses of funds in the zakat fund

The IFI have to establish a zakat fund and act as a collecting and distribution agent, according the AAOIFI FAS N°9, the zakat is religious personal obligation only for Muslims; which implies that the IFI must calculate the zakat base by focusing only on the assets that belong to Muslims shareholders. The IFI may either advise the shareholders on the amount payable or pay it in these three situations:

(a) when the law requires the Islamic bank to satisfy their zakat obligation;

(b)when the Islamic bank is required by its charter or by-laws to satisfy their zakat

obligation,

(c) when the general assembly of shareholders has passed a resolution requiring the Islamic bank to satisfy their zakat

The standard specifies two methods to determine the zakat base:

- Net asset method:

Zakat base = assets [subject to zakat] – (liabilities due in the current period + equity of unrestricted investment account + equity held on behalf of government, endowment, charities and not for profit organisations)

- Net invested fund method:

Zakat base = paid up capital + reserves + provisions not deducted from assets + retained earning + net income + liabilities (non-current) + net fixed assets – investments (not for trading) – accumulated losses

After the determination of the zakat base, this amount is multiplied by the zakat rate 2.5% for lunar period

Conclusion of chapter 2

All in all, I want to mention that some authors, while comparing the Islamic accounting with western accounting are not fair in their presentation of the facts, for example, the description of the former to be communal oriented and aiming to a reasonable profit, and the latter as individualistic and profit maximization; this may be true in books dedicated to islamic economics, Unfortunately the current model of IFI is characterized by the use mostly contracts as murabaha based on margin rather than profit and loss sharing contracts; surprisingly the IFI are more greedy for profits in general IFI's contracts are more expensive than conventional ones.

In addition, the fact of being religious based principle, compared with, secular conventional accounting is challenging for bankers without knowledge of islamic commercial law. Because, they face ambiguous principles such as, the gharar which is difficult to define for scholars, mainly when they relate this concept to risk-taking which cannot be accepted, because all business transactions involve some level of risk. In addition, including shariah aspects the IFI have found themselves obliged in order to gain a legitimacy to deal with a lobby of shariah scholars who set in most shariah boards with consequent compensation without real contribution to the industry.

Besides that, I believe that in order to permit innovation and generation of new shariah compliant contracts suitable to our modern time; secondary sources of Islamic commercial law should be given more importance. Because, based on these sources contracts can be revised and developed; while the primary sources are limited.

Another key point, is that accounting of IFI use different standards for their financial reporting; this inconsistency is the result of diverse causes such as the difference of regulatory framework of IFI, and divergence of the school of thought. Therefore, the question of whether we really need to look for means that enables convergence between the AAOIFI and IFRS; or we should first bring coherence in the accounting practice within the IFI.

Also competition between international Islamic hubs impede the achievement of standards wholly agreed on by regulators of main countries that had allowed the establishment of IFI , that is the case of Bahrain with the AAOIFI and Malaysia with IFSB:

+ The primary role of the AAOIFI was accounting and auditing, but it has issued standards also on governance, and ethics codes

+ The primary function of IFSB was the capital market, it has not only extended to governance standards, but also, it has issued guidance on accounting, for example, "Guidance note on the practice of smoothing the profits pay-out to investment account holders". Therefore is an overlap between the two institutions that may increase with the failure of AAOIFI to bring consistency to IFI's accounting; and the different and interesting approach of IFSB as it collaborates with international institutions. It also publishes the standards and guidance both in English and Arabic.

Chapter 3: comparison of contracts in IFI and conventional financial institutions

Introduction of chapter 3

In the last chapter, I will compare some standards of IFRS and its counterpart used by the AAOIFI; our aim is to look for evidences that either demonstrate that we really need two distinct standards to report for IFI or it is possible with great efforts from body-setters to achieve a convergence between the two frameworks. I choose to select the following contracts:

Interest-based loan Vs Murabaha

Lease VS Ijarah

Construction contracts VS Istisna

The choice of these contracts to compare was not arbitrary. First, I consider that both Murabaha and Ijarah are most used contracts by IFI worldwide; we can easily notice that they represent more than 80 % of contracts in IFI. Also Istisna' at least from accounting facet, I think it is a contract that could be used more by IFI, as it does not contain major difficulties for IFI.

Second, the selection of these contracts enables me to draw a comparison between contracts widely used by conventional financial institutions and contracts applied by IFI.

Third, the accounting standards of the AAOIFI are not easily available for the public, and I was able to get only the standards related to those contracts.

I -Interest-based loan Vs Murabaha

A loan has a different approach , Islam encourages free interest loan , it is included in contracts of donation” tabaruat”; the borrower could give a discretionary gift “hiba” to lender, provided that this could not be stipulated in the loan contract. While a loan with interest is a pillar of the conventional financial system.

1-Interest-based loan

1-1 Historical review and definition

Usury was prohibited in the original teachings of the 3 monotheists religions: Judaism, Christianity, and Islam; the words Ribit in the language of the Old Testament, Riba in the Quran, usury and interest were used to express the same idea “paying a rent for the use of money”, but now usury refers to an excessive interest rate and it is till now forbidden while interest change the meaning into a fee paid for the use of another party's money, to the borrower it is the cost of renting money, to the lender the income from lending it.

1-2 The scope

Under IFRS a loan is regulated by the IAS 23 ”borrowing costs”, these costs are interests costs and other costs directly attributable to the acquisition, construction or production of a 'qualifying asset'; that the entity incurs in connection with the borrowing of funds (IAS 23,5). Borrowing costs may include the following (IAS 23,6):

- Interest expense calculated according to the effective interest method (IFRS 9; IAS 39,9)
- Finance charges relating to finance leases recognized to IAS 17 (IAS 17,25; IAS 17,26)

The items excluded from the scope of IAS 23 :

- ✓ Qualifying assets measured at fair value, such as biological assets accounted for under IAS 41 Agriculture
- ✓ Inventories that are manufactured, or otherwise produced, in large quantities on a repetitive basis and that take a substantial period to get ready for sale (for example, maturing whisky)

1-3 Classification of loan

It seems interesting to me to classify interest into simple interest and compounding interest; IAS 23 has not interested with such basic difference, normally the financial institutions use compounding interest. However in our study and from shariah perspective, this classification could have great impact.

We can define simple interest as an interest earned on original principal only, while compounding to interest earned by an investor on his original investment, plus all interest earned. Because some scholars tried to limit the meaning of usury to compounding interest as indicated in: [O you who have believed, do not consume usury, doubled and multiplied, but fear Allah that you may be successful][14]

The supporters of this idea defend their position with reference to this ayat of Quran, and they had explained it mainly the expression “doubled and multiplied” with interest on interest ; which is the compounding interest for them. This interpretation had been rejected in a resolution of International Islamic Fikh Academy in 1984.

1-4 Accounting consequences

As the legitimacy of interest, is no more discussed as a potential issue in conventional finance, the accounting of the borrowing costs is interested by distinguishing the treatment of interest:

- In case, the borrowing costs are directly attributable to the acquisition, construction or production of qualifying asset; the interest forms part of the cost of the asset and therefore should be capitalized. The standard focuses on more detailed questions such as, what is considered a qualifying asset and how to calculate the portion of interest that has to be capitalized.
- Otherwise, the borrowing costs are recognized as an expense.

2- Murabaha

2-1 historical review and definition

Literally, Murabaha came from the root of word (Ribh) which means increase in capital or profit of trading.

Technically, in the Islamic jurisprudence, the term Murabahah refers to a form of sale in which the seller expressly mentions the cost of the sold commodity he has incurred because it is considered as a contract of trust (Amana), and sells it to another person “the buyer” by adding pre-determined mark-up. The teaching of Islam encourages sale, in our case Murabaha, and reject usury, the difference between the two concepts is very slight; for that reason, many conditions are required in the transaction of Murabaha to be shariah compliant:

---

[14] Surat Al Imran, ayat 130

- The object of contract must exist at the time of conclusion of the contract with disclosure of cost of purchase to the customer
- Transparency in transaction : mark-up, delivery and payment
- The buyer must own the object of contract, as the margin he gains from operation is justified by risk assumed during the duration of possession
- The buyer is allowed to receive a deposit from the customer that shows his commitment known as hamish al-jiddiyyah

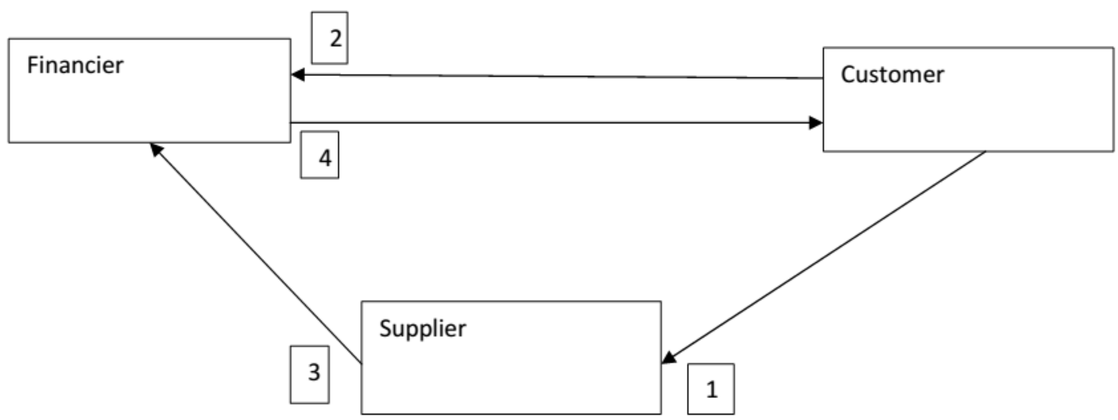
2-2 The scope

Under the AAOIFI, the Murabaha and Murabaha to the purchase order "MPO" is regulated by the Financial Accounting Standard (FAS) N °02, which prescribes the reporting requirements.

1-3 Classification of Mubaraha

Murabaha can be classified as Murabaha credit sale which include two parties, seller and buyer, or Murabaha MPO a three –party transaction the largerly trade contract used by IFI.

Figure: Murabaha MPO



1-Customer identifies supplier and promises to buy the goods from IFI, this promise could be binding or not depending on the agreement between the two parties. In practice, the promise is considered to be binding by AAOIFI to protect the IFI

2-IFI orders the goods

3-IFI purchases at cash price, generally stands the customer as agent to receive the goods

4-IFI sells at mark-up credit price

1-4 Accounting consequences

According to FAS n°2 the asset has to be measured and recorded at historical cost, AAOIFI requires the IFI, if the customer has not fulfilled his promise to purchase the asset the IFI applies the lower between historical value and net realizable value . Otherwise, in spite of decline of the asset value; since the IFI is certain to sell the inventory at Murabaha price no change of value is required. The IFI also reports a provision for doubtful debt is provided of financing amount net of deferred profit.

The standard considers any profit resulting from additional charges due to a delay in payment as interest on outstanding receivales, which is not allowed; nevertheless, in practice, Murabaha contracts most of the time includes a penalty for delay payment; that will be given to a charity foundation.

Illustration:

Bank ABC entered into Murabaha MPO contract with customer A to buy a car for at $25,000 for three-month contract. Bank ABC purchased the car from a car dealership on 1st of January 2010.

Bank asked for hamish al-jiddiyyah as commitment to buy $5,000

Customer A promised to donate 1% of the installment in the month, he does not pay the instatement to charity

<u>In the Bank ABC's book:</u>

January/ Year 2010

Dr. Cash account 5,000

Cr. hamish al-jiddiyyah 5,000

(collection of hamish al-jiddiyyah)

Dr. Murabaha inventory 25,000

Cr. cash account 25,000

(Purchase of car by bank)

Dr. Murabaha receivables 25,000

Dr. Deferred profit 8,000

Cr.Murabaha sales 32,000

(Murabaha sales by bank)

Dr. Cash account 11,000

Cr. Murabaha receivables 8,333 (25000/3)

Cr. Deferred profit 2,667 (8000/3)

(Settlement of murabaha receivables)

Dr. Profit and Loss account 1,250 (25000*5%)

Cr. Provision for doubtful debt 1,250

(Provision for doubtful debt)

February/ Year 2010

Dr. Cash account 11,000

Cr. Murabaha receivables 8,333

Cr. Deferred profit 2,667

(Settlement of murabaha receivables)

During March the customer A does not murabaha receivables of the month

Dr. Unearned murabaha income 2,667

Cr. Deferred murabaha income 2,667

Dr. Cash account 110 (11000*10%)

Cr. Charity account payable 110

April/ Year 2010

Dr. Cash account 6,000

Cr. Murabaha receivables 3,333

Cr. Deferred profit 2,667

(Settlement is only 6,000 we take in account the amount of 5,000 already paid as hamish al-jiddiyyah)

1-5 Disparity between IAS 23 and FAS n°2

The divergence between the two standards is a thorny issue, for accounting professionals who want to realize a convergence between IFRS and AAOIFI, because, both IAS 23 and FAS n°2 have primordial role; the former for conventional financial institutions and the latter in IFI.

In conventional banking system, the relationship between the bank and the client is mostly a lender-borrower relationship; in which the conventional bank aggregates funds from lenders its depositors at a deposit interest rate lower than the lending interest rate under which loans are provided to borrowers the bank's customers. Therefore the gain for the bank called "interest rate spread" earned after deducting interest expense paid to the depositors from interest income earned from the customers.

On the other hand, Islamic banks in order to avoid interest-based contracts; they have to use other support for its contracts to be shariah complaint such as a Musharaka contract, an Ijarah contract, and the most used Murabaha contract. Consequently the gain for an Islamic bank is called "profit rate spread" earned after deducting a profit sharing ratio , and discretionary gift from income earned from the customers.

II- Lease VS Ijarah

1-Lease

1-1 historical review and definition

Leasing as an economic activity was first used by the Sumerians since 2010 BC, archeologists discovered tablets in the ancient city of Ur which prove that they applied a form of lease for agricultural equipment; after that, Hammurabi the Babylonia's king was the first who enacted leasing laws in his famous code. In more recent period, The Ottoman code "Majallat al-al-Ahkaamadliya" the oldest code in the modern Muslim world the sections from 404-496 refers to hire; but of rental only applied to buildings used for residential, agricultural, and hire of animals and the hire for service .leasing appeared first in the united states in the 1700's to finance the use of horse drawn vehicles. Nowadays, the acquisition of expensive assets is still a major hindrance for business development, so rather than paying the whole price of the asset by cash, many entities choose to spread the cost of the purchase of the assets through a period of time to match with revenues generated by the business .And using a contract of lease between a lessor and lessee that allows the lessee rights to the use of a property owned or managed by the lessor for a period of time in consideration of a return of rent .The agreement does not provide ownership rights to the lessee; however, the lessor may allow certain modifications so that the property will suit the needs of the lessee. During the lease period, the lessee is responsible for the condition of the property.

1-2 The scope

Under IFRS the lease is regulated by the IAS 17,(IAS 17.2) applies to all leases other than lease agreements for minerals, oil, natural gas, and similar regenerative resources and licensing agreements for films, videos, plays, manuscripts, patents, copyrights, and similar items.

Also, IAS 17 does not apply as the basis of measurement for the following leased assets: Property held by a lessee that is accounted for as investment property for which the lessee uses the fair value model, and investment property provided by lessors under operating leases both set out in IAS 40. Also the biological assets held by lessees under finance leases and biological assets provided by lessors under operating leases both exposed in IAS 41.

1-3 Classification of lease

A lease is classified as a finance lease if it transfers substantially all the risks and rewards linked to the asset to the lessee but not the ownership which differentiates it from a sale. All other leases are classified as operating leases. Classification is made at the inception of the lease. (IAS 17.4)

Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form. Situations that would normally lead to a lease to be classified as a finance lease according to (IAS 17 on leases) include the following:

- the lease transfers substantially all the risks and rewards incident to ownership of the asset from the lessor to the lessee.

-favorable purchase option: the lessee has the option to buy the asset at a price which is expected to be sufficiently lower than fair value at the date the option becomes exercisable that, at the inception of the lease, it is reasonably certain that the option will be exercised;

-the lease term test: the lease term is for the major part of the economic life of the asset, even if title is not transferred; “major part” is interpreted under IFRS as “75% or more”.

1-4 Accounting consequences

According to IAS 17, a finance lease is recorded upon the criteria of the “substance over form rule”; this implies that the legal form represented by the ownership of the asset by the lessor falls behind the economic considerations that relate benefits of the asset to the lessee .As a consequence, the lessor will report the amount of rent received as receivables in the assets side of the balance sheet, and the lessee will account for the as leasing an asset, at the same time, he reports a liability in term of depreciation.

2-Ijarah

2-1 Definition

Literally, Ijarah came from the root of word “ujr” which means compensation, it also refers to the sale of usufruct.

Technically, in the Islamic jurisprudence, the term 'Ijarah' is used for two different situations. In the first place, it means to employ the services of a person on wages given to him as a consideration for his hired services .The employer is called 'Mustajir' while the employee is called 'Ajir', while the wages paid to the Ajir are called their 'Ujrah'.

the second type of Ijarah as the ownership of the right to the benefit of using an asset called “Ma’jur” in return for consideration for a defined period, in this case, the lessor is called 'Muajir', the lessee is called 'Mustajir' and the rent payable to the lessor is called 'ujrah'.The rules of Ijarah are very much analogous to the rules of sale, because the sale contract is most detailed in Islamic jurisprudence, in both cases something is transferred to another person for a valuable consideration. But the subject of ijarah includes the rent and not a price as in a sale contract, also the benefit in Ijarah is the usufruct called “Manfa’ah” only, the corpus of the property remains in the ownership of the lessor, while in a sale the corpus of the property is transferred to the purchaser. The Ijarah contract is based on the Quran, Sunna and Ijma’.

Figure:pillars of ijarah

Muajir	A person who give something for hire :lessor
Mustajir	A person who takes something on hire: lessee
Ma'jur	A thing given for rent
Manfa'ah	The benefit from the thing: usufruct
Ujrah	Fee given for the payment of lease
Sighah	Offer "Ijab" and Acceptance "Qabul"

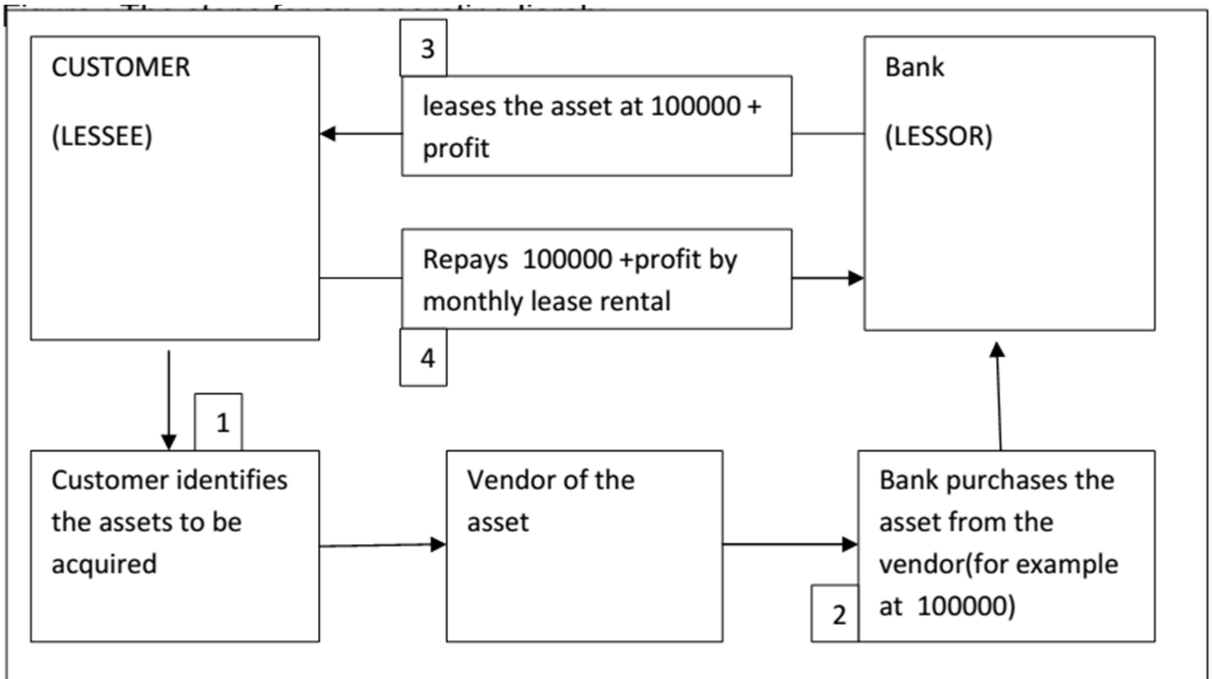
2-2 The scope

Under the AAOIFI the Ijarah financing is regulated by the Financial Accounting Standard (FAS) N °08 issued in June 1997 ,which applies to financial reporting of Ijarah and Ijarah mintahia bi tamleek (IMB); it excludes Ijarah for exploration or use of natural resources, licensing agreements, labour contract and the rent of professional services.

2-3 Classification of Ijarah

According to FASN°8, the Ijarah contract is considered as operating Ijarah in if the IFI (Muajir) acquires the assets, then rents it to the lessee (Mustajir) without any intention to transfer the asset (Ma'jur) at the end of the Ijarah period

Figure : The steps for an operating Ijarah:



Source : http://www.tonysurridge.co.uk/ACCA-Tips/financial-management/islamic-finance

While the contract is assumed to be an IMB, if at the time of conclusion of the contract; the intention was that the lessee will benefit from a lease in the first stage, and a transfer of ownership will occur during or at the end of the lease period according one of the following methods:

Gift at the end of the period	The title of ownership of the asset is transferred according to a prior binding promise to the lessee by a gift contract, after the last lease rental payment.
Sale for a token consideration at the end of the Ijarah contract	The ijarah contract and with a binding promise to sell to the lessee if he wishes at a token consideration. The consideration can be any amount agreed on between the two contractors
Sale at the end of the lease for an amount specified in the lease	The Ijarah contract is accompanied with a promise to sell the asset, the amount to be paid after the termination of the Ijarah contract must be a pre-determined price
Sale during the lease period for the remaining instalments	The ijarah contract includes a promise to sell the asset to the lessee, whenever he wants to buy the asset during the period of the lease at a price equal to the remaining installments
Sale through gradual transfer of title	Gradual transfer the title of the asset to the lessee until the asset is fully transferred. And each transfer must be reflected by a reduction in lease rental as the ownership of the bank declines

IMB distinguishes between two contracts with a clear separation of contractual rights and obligations during the lease and transfer of title, in contrast, a conventional finance lease combines the hire and purchase contracts in form of disguised loan that generates interest from outstanding capital payments

2-4 Accounting consequences

According to FAS 8, the reporting of IMB includes two stages:

- First stage: the leased asset remains in the lessor's book; who supports also maintenance and insurance costs ; in exchange of ijarah revenues.

- Second stage: the title of ownership is transferred from the lessor to the lessee through one of methods cited before, each one of them has accounting repercussions, for example, if the assets are transferred through a sale during the lease period; the IMB are sold at a price equivalent to remaining Ijarah installments, and the lessor will recognize any gain or loss from the difference between the selling price and the book value

Illustration:

Bank X entered into an IMB contract with customer Y to lease equipment for a period of 4 years. Bank X purchased equipment from a trader on 1st of January 2010 for $ 80,000. The customer decides to buy the assets at the end of 3rd year

Rentals at the end of each quarter 6,000

Estimated useful life 4 years

<u>In the lessor's book: Bank X</u>

Year 2010

Dr. Fixed Asset account 80,000

Cr. Cash account 80,000

(Purchase of equipment)

Dr. IMB asset account 80,000

Cr. Fixed assets accounts 80,000

(Recognition of ijarah assets)

On the receipt of rent 1st quarter

Dr. Ijarah Receivable 6,000

Cr. Ijarah Revenue 6,000

(Receipt of rental income on each quarter)

In December 2010

Dr. Profit and Loss account 20,000

Cr. Provision for depreciation IMB account 20,000

(Recognition of depreciation per year)

In December 2012

Dr. Profit and Loss account 20,000

Cr. Provision for Depreciation IMB asset account 20,000

(Recognition of depreciation per year)

Dr. Cash account 40,000

Cr. Ijarah Muntahia Bitamleek Asset account 40,000

(Transfer of ownership based on equivalent remaining installments)

<u>In the lesse's book: Customer Y</u>

Year 2010

On the payment of rent in 1st quarter

Dr. Ijarah expense 6,000

Cr. Ijarah payable 6,000

(payment of rental expense on each quarter)

In December 2012

Dr. IMB Asset account 40,000

Cr. Cash account 40,000

(Transfer of ownership based on equivalent remaining installments)

2-5 disparity between IAS 17 and FAS n°8

IAS 17 deals mainly with the finance lease, under AAOIFI standards the contract whereby one can take ownership of leased asset is the IMB; the major difference between IAS 17 and FAS n° 8 is" the substance over form" rule; this implies that the leased asset has to be reported in the lessee's balance sheet as the economic benefits accrue to lessee in spite of the fact that the asset belongs to lessor. The AAOIFI scholars adopt the opposite rule" form over substance" in the accounting treatment of IMB.

III- Construction contracts VS Istisna

1-Construction contracts

1-1 Definition

IAS 11 defines construction contract as a contract specifically negotiated for the construction of an asset or a combination of assets , such as the construction of highways, buildings.

1-2 Scope

The standard IAS 11 deals with accounting of construction contracts from the perspective of the contractors who enter into construction projects in the interest of their clients. The standard excludes self- constructed assets which are reported in accordance with IAS 16.

1-3 Classification

Under IAS 11accounting treatment for construction contracts depends on expected outcome, thus we distinguish two cases:

- The outcome of a contract can be reliably measured.
- The outcome of contract cannot be measured reliably

1-4 Accounting consequences

Based on the reliability of estimated costs of the construction contract, the reporting differs:

If the outcome of a construction contract can be estimated reliably, revenue and costs should be recognized in proportion to the stage of completion of contract activity. This is known as the percentage of completion method of accounting. [IAS 11.23-24]

If the outcome cannot be estimated reliably, no profit should be recognised. Instead, contract revenue should be recognised only to the extent that contract costs incurred are expected to be recoverable and contract costs should be expensed as incurred. [IAS 11.32]

2- Istisna

2-1 Definition

Literally, the word Istisna' derived from the arabic verb "Istisna" which is mean to request someone to manufacture an asset.

Technically, in the Islamic jurisprudence, the term Istisna is employed to refer to sale contract whereby the producer (al-sani') manufactures or acquires a manufactured product (al-masnoo') according to specifications of the buyer (al-mustasni') at an agreed price which can be paid in advance, by instatments or deferred to a specified future time.

2-2 Scope

Under the AAOIFI standards, the FAS n° 10 regulates the accounting reporting of istisna' and parallel istisna'.

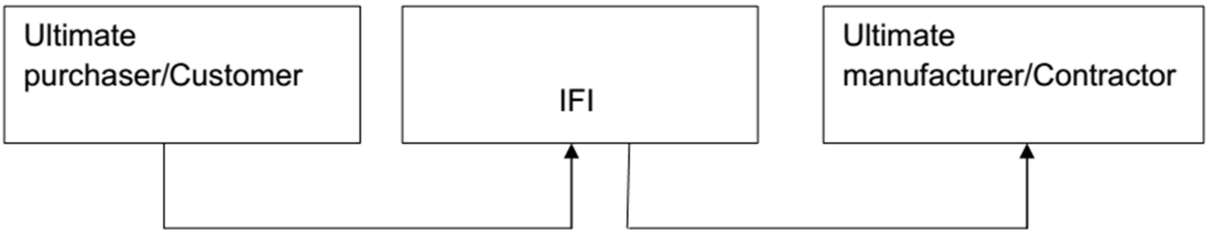
2-3 Classification

Istisna can be classified into:

- istisna’ financing : a two-party contract, that involves the producer and buyer

- Parallel istisna’ financing contract: refers to contractual agreement that comprises two independent istisna’ contracts

Figure: parallel istisna’ financing



-1st istisna’ contract

-Purchase price is $120,000

-Delivery date 1 May

-2nd istisna’ contract

-Purchase price is $100,000

-Delivery date 30 April

2-4 Accounting consequences

According to FAS n°10 the istisna’ costs include both direct cost and indirect costs excluding general and administrative, selling and research and development expenses.

The Istisna revenue refers to total price agreed between the customer and the producer is measured according to:

- Completed contract method: this method is used when both the percentage of completion and the expected cost of the contract cannot be reasonably estimated, in this case, no revenue could be recognized until the contract is fully completed, and contract costs are transferred in istisna’ work in progress account.

- Percentage completion method: it is considered as the preferred method of profit recognition, istisna’ profit for a year is calculated as follow:

(Contract price - Total estimated costs)* percentage of completion.

The customer has the right to insert a penalty clause in the contract against non-delivery on time of the manufactured product

Illustration:

XYZ Bank concluded an Ististina' contract , with the entity A to build a warehouse.

Contract price: $ 1,000,000 expected profit: $ 200,000

Total estimated costs: $ 800,000

Duration of the contract: 3 years

Costs incurred year 1: 200,000

Year 2: 400,000

Year 3: 200,000

Using the percentage completion method

Beginning year 1

Dr. Istisna' costs 200,000

Cr. Cash account 200,000

Dr. Istisna' work-in progress 200,000

Cr. Istisna' accounts payable 200,000

(costs incurred year 1)

End year 1

-percentage of completion year 1: 200,000/800,000= 0.25

- Istisna' revenue year 1: 0.25*1,000,000= 250,000

- profit on Istisna' contract: (1,000,000 – 800,000)*0.25= 50,000

Dr. Istisna' work –in progress 50,000

Dr. Istisna' costs 200,000

Cr. Istisna' revenue 250,000

(recognition of revenue year 1)

Beginning year 2

Dr. Istisna' costs 400,000

Cr. Cash account 400,000

Dr. Istisna' work-in progress 400,000

Cr. Istisna' accounts payable 400,000

(costs incurred year 2)

End year 2

-percentage of completion year 2: 400,000/800,000= 0.5

- Istisna' revenue year 2: 0.5*1,000,000= 500,000

- profit on Istisna' contract: (1,000,000 – 800,000)*0.5= 100,000

Dr. Istisna' work –in progress 100,000

Dr. Istisna' costs 400,000

Cr. Istisna' revenue 500,000

(recognition of revenue year 2)

Beginning year 3

Dr. Istisna' costs 200,000

Cr. Cash account 200,000

Dr. Istisna' work-in progress 200,000

Cr. Istisna' accounts payable 200,000

(costs incurred year 3)

End year 3

Dr. Istisna' work –in progress 50,000

Dr. Istisna' costs 200,000

Cr. Istisna' revenue 250,000

(Recognition of revenue year 3)

2-5 disparity between IAS 11 and FAS n°10

The two standards are in accordance with each other on main pillars of accounting for the transaction; also, The customer has the right to insert a penalty clause in the contract against non-delivery on time of the manufactured product. which could considered a development in the accounting for Islamic contracts, this point is essential and may give more importance the use of Istisnaa contract by IFI.

Conclusion of chapter 3

To sum up, by the study of the two contracts interest-based loan and Murabaha:, I have identidied two channels of thought adopted by experts towards the gap between interest-based loan and murabaha:

The first approach considers the difference to be normal as the underlying concepts of conventional and Islamic banking system differs, thus there is no need to enforce a convergence among two different contracts in nature.

The second approach, a minority, attempts to convince the Islamic finance community, that with the development of trade. Money has become a commodity among others, therefore, the concept of riba should be restricted to very little cases such as Riba Al-Jahiliyyah which is related to the increase in loans when rescheduling a previous debt, it was common among the Arab people of Jahiliyyah.[15]

Up to me, I acknowledge that the difference between Riba and trade is slight, but it was also confusing for the Arabs at the time of the prophet; and when they had said to him that trade is similar to Riba. The response comes clear in the Quran: [That is because they say, "Trade is [just] like interest." But Allah has permitted trade and has forbidden interest][16] .Thus, the second approach has a little chance to gain recognition among scholars.

Concerning the second contracts the lease and Ijarah, from my point of view, we do not need to waste time looking for something that has already been done by other people, indeed, Malaysia an international Islamic finance hub uses Al-IjarahThumma Al-Bai' contract as an Islamic alternative to conventional hire purchase. It is a leasing ending with sale and consists of two different contracts a lease and a sale concluded at the same time.

In Malaysia accounting is based on IFRS and has no objection to the "substance over the form" rule ,their argument is the following , since in Al-IjarahThumma Al-Bai' contract the

[15] the Pre-Islamic period

[16] Surat Al-Baqarah, verse 275

assets are used and benefited to the lessee, so substance in this case is " the usufruct" is accruing to the lessee; therefore the assets have to be reported in lessee's book. And they consider that from shariah perspective the reporting ought to reflect the truth about the transaction the substance is preceded to the form.

The last pair of contracts, construction contracts and Istisna can cited as good example of convergence between the IFRS and AAOIFI framework, because it shows that the AAOIFI has inspired many aspects from the IAS 11 construction contracts, as a result, the FAS n°10 on Istisna does not include major differences, compared with IAS 11.

General Conclusion

Through different stages in my thesis, I have tried to study various aspects of accounting of IFI, the choice of comparison with the IFRS framework enabled me to have reference of a body-setter of accounting standards that is globally known for its participative approach for standards issuance and high-quality of standards. This does not mean that IFRS standards are taking for granted all over the world, but at least its organization system is approved for its efficiency to deal with other accounting body such as the FASB (Financial Accounting Standards Broard) of USA to converge both IFRS and US GAAPs.

By studying the organization chart and due process of the AAOIFI, I have noticed an effort to copy many aspects of the organization and the standard issuance process, which could be good point. If the AAOIFI has succeeded to duplicate not only the chart of the organization and the process of issuance but the most important aspect the AAOIFI has failed to achieve is efficiency in standards issuance which include the promotion for the standards for example, during the OIC (Organization of Islamic Cooperation) conference within Muslim countries and asks a member such as Turkey or Saudi Arabia of the G 20 summit to present AAOIFI standards to the world.

Because, I think a point often overlooked by Islamic finance specialists is that the whole industry of Islamic products does not exceed 2% of conventional finance; generally we found in reports about Islamic finance some numbers in billions of dollars. For that reason, I think that the AAOIFI which represent the smaller part of the financial market; it has to move towards the body-setters that issue more representative part such as IFRS or US GAAP. For me it does not matter, if the result of discussion concludes that, for instance, for some features of Islamic finance, it will not be possible to attain a full convergence.

As has been noted in chapter 2, I have noticed that some authors attribute several goods points Islamic accounting such as being ethical; in the other hand, they give a dark picture about conventional accounting system. This attitude cannot help to create to favorable environment for dialogue between the body-setters.

It is important to realize, that accounting of IFI, for example, the AAOIFI standards could bring attention to this small piece of the market.

Supposed that, the discussion between the two-body-setters will attain a satisfying level, for example, concerning the accounting of the lease and Ijarah. Therefore a revised version of IAS 17 will include a paragraph about the accounting for Ijarah and this will be itself a great gain to Islamic finance industry.

In addition, by the acheivement of accounting standards for IFI widely accepted, this will bring stability to Islamic finance as industry; because its development will no more subject to political influence of a party in the Muslim world. If the party governing a country has Islamic reference it will help the industry otherwise, it will neglect the sector.

Through my researches, I consider that there is possible convergence, and by comparing the accounting aspects of Islamic contracts with its equivalents used by conventional financial institutions.

Concerning the three contracts: Murabaraha, Ijarah and Istisna that I focused on, I believe that with an effort from the AAOIFI and the IFRS body-setters ; mainly accounting for Istisna and at lower level for Ijarah could converge with conventional accounting for construction contracts and lease.

I acknowledge that the process of convergence is easier said than done, but we should be convinced that; it is better to be late to begin than never does it. Because things are moving quickly and the faster a step towards other body-setters of (IFRS and US GAAP) the better it would be. Because those body-setters work continuously together, for example, a new standard "IFRS 15 Revenue from Contracts with Customers" has been issued in May 2014; this standard will replace " IAS 11 Construction contracts" and "IAS 18 Revenue"[17] by IASB and at the same time; the FASB will issue a similar standard. This agreement has taken over 10 years of discussion, which shows that each area of the world has its own specific accounting aspects. Regardless of the results of the discussion, I wonder why the AAOIFI as representative of accounting in IFI is not involved in these projects.

By the end of the thesis, I conclude that there are many issues for accounting treatment in IFI that should be solved such as the acceptance of accounting standards by the Islamic finance worldwide; before looking for harmonization with other standards.

Also, it will be interesting to highlight the successful experience of a country in the Far East "Malaysia" which has been able to combine ethical aspects of Islamic finance and the rational western methods to provide competitive Islamic products. With innovative approach for the accounting as it has issued many standards for Islamic products based on IFRS standards.

Once, the accountant finishes his difficult task to prepare the financial statements of IFI, I wonder how can an external professional "an auditor" examine these statements?. Does the auditor need to adopt a different approach that takes into consideration the nature of IFI?

Is the auditor obliged to have knowledge of shariah?

[17] Effective for an entity's first annual IFRS financial statements for periods beginning on or after 1 January 2017

Bibliography

AAOIFI accounting standards, FAS n °2, FAS n°8, FAS n° 10

Abdul rahim Abdul rahman, an IntroductIon to Islamic accounting theory and practice

Accounting systems and recording procedures in the early Islamic state, omar Abdullah zaid, accounting historians journal VOL 31 , N°2, 2004

Riahi-Belkaoui A; the Cultural Shaping of Accounting, library of congress cataloging-in publication data; 1995

Amged Abd El Razik, chanlenges of international financial reporting standards (IFRS) in the Islamic accounting world, case of middle eastern, scientific bulletin, economics sciences Vol (14)

Bennani S, Elhamma A ; La comptabilié en Finance Islamique selon les normes AAOIFI ; Editions Universitaires Européennes 2015

Chartered Institute of Management Accountants (CIMA) UK, Accounting for Islamic Financial Institutions, second edition

Chartered Institute of Management Accountants (CIMA) UK, Islamic Banking and Takaful-Products and Services, second edition

Chartered Institute of Management Accountants (CIMA) UK, Islamic Commercial Law, second edition

Elhamma, A 2015 La comptabilité des produits financiers islamiques: norms AAOIFI Vs IFRS , Revue de management et de stratégie, (1;2), PP 10-22, www.revue-rms.fr, VA press

Elisabeth Jackson-moore, the international handbook of islamic banking and finance ,2009, global professional publishing

Farah Aida Ahmad Nadzri, Roles and Impacts of Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) in Dealing with the Accounting and Disclosure of Zakah and Interest (Riba)Master of Business(2009) Auckland University of Technology

Islamic banking and finance , what is and what it could be, taris a and Eldiwany t, editor tarik diwny

G Cause-Broquet,La finance islamique,2eme edition; RB edition

Karim and Simon ,handbook of Islamic banking, 2007,

Muhammad Akhyar Adnan, Accounting Treatment for Corporate Zakat A Critical Review International Islamic University Malaysia

Muhammad Nozarul Alim; M.Si, AK, European scientific journal June 2014, university of trunojoyo

Nazim Uddin ;Comparative Analysis of Reporting Practices of Islamic Financial Institutions (IFIs)

Rifaat Ahmed Abdel Karim; International accounting harmonization, banking regulation,and Islamic banks; The International Journal of Accounting (2001)

S, Bennani Adaptation du plan comptable des établissements de crédit et application des normes IFRS aux particularités de la finance islamique,mémoire d'expetise comptable ; maroc

Separate legal entity under Shariah law and its application on Islamic banking in Malaysia: A note, university Utara Malaysia, International Journal of banking and finace vol 6, issue 2

Yahiaabdul-rahman, the art of Islamic banking and finance, wiley finance edition 2010

Webography

http://lexicon.ft.com/Term?term=International-Financial-Reporting-Standards--IFRS

http://www.businessdictionary.com/definition/International-Financial-Reporting-Standards-IFRS.html#ixzz3RQkj10X3

http://www.ifrs.org/About-us/IFRS-Foundation/Pages/Home.aspx

http://www.ifrsbox.com/

www.boundless.com/accounting/textbooks/boundless-accounting-textbook/introduction-to-accounting-1/conventions-and-standards-21/full-disclosure-principle-132-3763/

http://free-islamic-course.org/stageone/stageone-module-4/four-schools-law-islam.html

http://www.meezanbank.com/kc_ijarah.aspx

http://www.focusifrs.com/menu_gauche/iasb/structure_de_l_iasb

http://www.businessdictionary.com/definition/going-concern-principle.html#ixzz3TxYRTxiX

http://www.businessdictionary.com/definition/accounting-period.html#ixzz3TxqRXyfn
accounting-simplified.com/financial/concept

http://accounting-simplified.com/liability-recognition.html#sthash.ZjNQH847.dpuf

http://fr.slideshare.net/socca/ias-17-3010983?related=5

http://fr.slideshare.net/pk18july/the-history-of-leasing

http://www.businessdictionary.com/definition/lease-agreement.html#ixzz3VO78KojI

http://www.tonysurridge.co.uk/ACCA-Tips/financial-management/islamic-finance

http://www.investopedia.com/terms/b/balancesheet.asp#ixzz3XAEgAPeS

http://www.masb.org.my/index.php?option=com_content&view=article&id=1377&Itemid=64

Abstract:

In a global context characterized by severe competition, companies are forced to employ great efforts to attain a great performance at all levels: management control, information system, human resources; and at their accounting system.

IFRS comprise a set of financial reporting standards, transparent and comparable, understandable and widely accepted to help investors in decision-making.

For his part AAOIFI has developed specific standards for the accounting in Islamic financial institutions (IFI).

Hence, there is a need to focus on the possibility of harmonization between these two frameworks, especially when we notice that other similar processes were initiated, for example, convergence between IFRS and US GAAP.

the aim of my thesis is to present the two frameworks, also to introduce to some particularities of Islamic accounting, and finally to compare AAOIFI accounting standards with the IFRS through a comparison between :

Interest-based loan Vs Murabaha

Lease VS Ijarah

Construction contracts VS Istisna

Key words: IFRS, AAOIFI, Accounting, Islamic financial institutions (IFI)

Résumé :

Dans un contexte mondial caractérisé par une forte concurrence, les entreprises sont obligées d'employer de grands efforts pour atteindre une grande performance à tous les niveaux: le contrôle de gestion, le système d'information, les ressources humaines; et ainsi que leur comptabilité.

Les IFRS regroupent un ensemble de normes d'information financière, transparentes et comparables, compréhensibles et largement acceptées pour aider les investisseurs dans la prise de décision.

Pour sa part AAOIFI a développé des normes spécifiques pour la comptabilisation dans les institutions financières islamiques (IFI).

Par conséquent, il est nécessaire de se concentrer sur la possibilité d'une harmonisation entre ces deux cadres, surtout quand on constate que d'autres processus similaires ont été lancés, par exemple, la convergence entre les IFRS et les normes comptables américaines (US GAAP).

Le but de mon mémoire est de présenter les deux cadres, aussi d'introduire certaines particularités de la comptabilité islamique, et enfin de comparer les normes comptables AAOIFI avec les IFRS à travers une comparaison entre:

Le Prêt fondé sur les intérêts Vs Murabaha

Le contrat de location VS Ijara

Le contrat de construction VS Istisna

Mots clés: IFRS, AAOIFI, comptabilité, les institutions financières islamiques (IFI)