

## The Need of Accounting Standards for Islamic Financial Institutions

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**[Abstract]** The accounting and auditing organization for Islamic financial institutions (AAOIFI) has taken the proper initiative to develop accounting, auditing, governance, ethics, and *Shari'ah* standards for Islamic Financial Institutions (IFIs). The AAOIFI standards serve as a guideline that may reflect the unique characteristics of IFIs and become a useful tool to meet the various needs of IFIs. Currently, one the major challenges facing Islamic Financial Institutions (IFIs) lies in the preparation of financial statements under different accounting standards and which may result to problem of comparability, reliability and compliance level's measurement. This has, however, resulted in a heated debate among scholars that has hitherto translated to the evolving existing literature surrounding the interpretation of the level of compliance with the Islamic accounting standards. This paper, therefore, discusses the Islamic accounting standards through a review of the literature. Overall, the evidence reviewed suggests that the need of the Islamic accounting standards to fill the gap in the Organization of Islamic Conference (OIC) countries. This paper concludes with various recommendations for future research, the most important of which is the need for future studies to be done to implement the Islamic accounting standards, such as the AAOIFI accounting standards. The current paper, therefore, contributes to a better understanding and acceptability of the Islamic accounting standards, such the AAOIFI.

**[Keywords]** Islamic accounting; Islamic financial institutions; AAOIFI; accounting; standards

### Introduction

At present, Islamic banks represent the majority of Islamic Financial Institutions (IFIs), which are spread locally and internationally across both Islamic and non-Islamic countries. The emergence of Islamic banking is due to the increasing demand from Muslims communities worldwide for *shariah's* complied Islamic financial products, services, and the variety of modes of Islamic finance. However, Islamic banking is evolving and growing at a rapid rate with an impressive record of more than 200 Islamic financial institutions (IFIs) operating in 63 Islamic and non-Islamic countries. The past ten years has seen high growth in the number of IFIs around the world, and the industry of Islamic financial institutions has attracted major Western institutions, such as Citibank, HSBC, and Deutsche Bank, which operate Islamic windows within conventional banks (Maali & Napier, 2010). Furthermore, given the rate of growth of the IFIs, the continuous sustainability of the development currently witnessed by Islamic financial institutions in both Islamic and non-Islamic countries needs the Islamic accounting standards, known as AAOIFI accounting standards, due to the unique characteristics coupled with the growing demand of IFIs' products and services so as to facilitate and enhance the credibility and reliability of the financial statements and reports.

Thus, the current standards, which are based on conventional frameworks, seem insufficient to guide the Islamic financial institutions. Currently, the various IFIs institutions apply different accounting standards in their preparation of their accounts due to the absence of Islamic accounting standards (Zaini, 2007). The trend towards the accounting and auditing organization for Islamic financial institutions (AAOIFI) standards has become a pressing issue that has generated heated debate in the Organization for Islamic Conference (OIC) countries.

### Islamic Accounting Standards: Literate review

The needs for accounting and Islamic financial institutions are emphasized in the Quran. It has been clearly stated in the Holy Quran that "...Never get bored with **recording** it, however small or large, up to its maturity date, for this is seen by Allah closer to justice, more supportive to testimony, and more resolving to doubt..." (al-Baqara: 2: 82). In addition, "Those who eat Ribâ (usury) will not stand (on the Day of Resurrection) except like the standing of a person beaten by Shaitân (Satan) leading him to insanity. That is because they say: "Trading is only like Ribâ (usury)," whereas Allâh has permitted trading and forbidden Ribâ (usury). So whosoever receives an admonition from his Lord and stops eating Ribâ (usury) shall not be punished for the past; his case is for Allâh (to judge); but whoever returns [to Ribâ (usury)], such are the dwellers of the Fire -- they will abide therein (2: 275) and "Allâh will destroy Ribâ (usury) and will give increase for Sadaqât (deeds of charity, alms, etc.) And Allâh likes not the disbelievers, sinners. 2: 276).

Based on that quoted verses of the Holy Quran, Allâh has permitted trading and forbidden Ribâ. Allah sent his prophet Mohammed (SAW) to the Ummah to teach and guide them. Islam has gained tremendous popularity and is currently recognized as the second-largest and fastest-growing religion in the world. Islam does not only entail ritualistic religion confined to individuals; rather, it also involves an integrated way of life that combines politics, economics, culture, religion, and every aspect of human life (Hameed, 2001). Based on the fact that Islam is a belief system that unites about 1.2 billion people around the world, which approximately constitutes one-quarter of the global population (Masood & Tahir, 2008); it is necessary that Muslims develop and embrace a unique economic system to meet their needs. In this regard, the Islamic banking system came to fulfill this need by helping the Muslims community avoid Ribâ (usury) in people's financial engagement and daily transactions.

Islamic bank transactions as reflected in the financial reporting are prepared under many accounting standards, which pose a threat to the accounting system. Thus, the need for Islamic accounting standards possesses the potential to ensure a compatible accounting system. This, therefore, has led to the growing aspiration for a financial statement that has the potential to enhance the credibility of financial statements that are in accordance with the *Shari'ah* ruling and, thus, the need to make the Islamic accounting standards operationalized. Before the implementation of the Islamic accounting standards, such as AAOIFI by Islamic financial institutions, it is necessary to ascertain whether the AAOIFI accounting standards are appropriate and suitable for Islamic banks and whether or not the compliance with the AAOIFI accounting standards may disclose more information to create confidence among investors and the public to invest their money.

Islamic banks operate mainly in developing countries; the Middle East, Africa, and South-East Asia are facing accounting standards problems in their practice due to a number of reasons. For instance, financial institutions in countries, such as Jordan, the UAE and Qatar, are officially required to comply with the International Accounting Standards (IASs). Meanwhile, in countries such as Saudi Arabia, the authorities require compliance with both IAS and local accounting standards. In Malaysia, there are national accounting standards (MASB), which are based on IAS (Ahmed, 2002).

Therefore, researchers in the area of financial reporting for Islamic financial institutions have conducted a considerable number of studies to investigate the Islamic banks' compliance to accounting standards. Until recently, one of the main problems facing Islamic banking includes a lack of standardized accounting and auditing standards (Pomeranz, 1997). However, conventional accounting is inappropriate for Muslim users and Islamic organizations (Hameed, 2001), and it is inappropriate to impose unmodified Western accounting practices on developing countries (Karim, 1987). In addition, International Accounting Standards based on such techniques would create difficulties for Muslims around the world. Therefore, it is imperative for the Muslim accountants to develop accounting standards that are specially adapted to Islamic needs and for Muslim countries (Shadia Rahman, 2007).

Basically, there is lack of evidence regarding the adoption of the Islamic accounting standards and analysis of Islamic banking principles under the national *Shari'ah* advisory council, central bank roles, political systems, and economic structures. Moreover, the major problem is in the basis of accounting standards and disclosure in IFSs that is still based on the conventional accounting philosophy (Harahap,

2003). The adoption of accounting standards by Islamic banks will help enhance their credibility and fuel their growth worldwide (Ariss & Sariheddine, 2008). However, the rapid development of Islamic financial institutions needs standards for disclosing information, satisfying not only the general standards of disclosure but also standards relating to Islamic values (Harahap, 2003).

The real state and the level of implementation of the Islamic Accounting Standards, such as AAOIFI, requirements among Islamic banks is currently unknown and needs to be investigated based on the fact that these requirements are voluntary, and no one has the authority to enforce them. In addition, due to the absence of Islamic accounting standards, Islamic financial institutions currently have applied different accounting standards to their preparation of financial reporting. Thus, diversities exist in terms of their class structure, political systems, legal systems, financial systems, educational systems, and the very nature of conducting business and business ownership (Choi & Meek, 2005). Furthermore, the problem may be due to lack of representation of the diverse environment factors as a result of adopting or complying with different accounting standards by Islamic banking. These differences among countries would dictate different accounting practices, each reflective of the environmental factors of its respective country. A single, harmonized standard of accounting practices would be inappropriate and not representative of all the varied environmental factors exhibited in global markets (Lovett, 2002). However, accounting standards are used to generate comparable and reliable accounting information to help investors, creditors, and other users to make investment decisions. These standards reflect the culture, history, and other characteristics of accounting problems facing that country (Abonewa, 2005).

Due to the current different regulatory requirements and legislation, the relevance and comparability of financial statements are the foundations upon which accounting standards are predicated. Lovett (2002) documented that with financial statements prepared under different accounting standards, a problem may exist in 1) comparability of financial statements prepared globally, and 2) reliability and creditability.

Global accounting standards are perceived by a segment of the financial community as the solution to this problem, while other members of the community adhere to the philosophy of maintaining individual, national accounting standards (Lovett, 2002). In the adoption process of the accounting standards, influences that affect the rate of adoption are identified. These influences cause changes in the attitudes of participants in a social system towards the adoption of accounting standards. The influences and their effect on the rate of adoption are what need to be studied in order to interpret the association of the variables influencing the adoption of accounting standards (Lovett, 2002).

Moreover, diversity in IFIs practices means that there are practices that have not been covered by Islamic accounting standards (AAOIFI) or any accounting standards that are in line with *Shari'ah* principles. Islamic banks worldwide prepare their financial statements using variety of accounting standards, and the problem may exist in the practices and the levels of compliance among accountants and the Islamic banks across the world. Thus, the need for Islamic accounting standards may possibly be the right way to resolve these issues.

There have been arguments in previous studies that because of the unique transactions of Islamic banks, conventional accounting rules, such as International Financial Reporting Standards, are not compatible to Islamic banks (Maali & Napier, 2010). Since the depositors' funds are not guaranteed, customer deposits cannot be reported as liabilities in the balance sheets of Islamic banks. Recently, many Islamic banks have been adopting the accounting standards set by the AAOIFI (Maali & Napier, 2010). Therefore, understanding factors affecting the levels of compliance with the Islamic accounting standards (AAOIFI) needs to be investigated in future studies.

The acceptability and understanding of the role of the Islamic accounting standards (AAOIFI) can be of high significance for policy implications, regulators, and standard setters. Currently, the evolving literature surrounding the interpretation of the levels of compliance with the Islamic accounting standards generated a heated debate among the researchers. Thus, this paper aims to provide answers to the current debate. A clear understanding and acceptability have the potential to lead to more compliance with Islamic accounting standards (AAOIFI).

Regarding the compliance with the AAOIFI accounting standards, determining whether or not the Islamic banks would switch to the AAOIFI standards or adopt a combination of both of the AAOIFI and

local standards or regulations. It is necessary that we ask the following question: Which implementation, voluntary compliance or mandatory compliance, and why?" In reference to the Central Bank of Malaysia (BNM) guideline, it is clearly stated that IFIs should comply with the AAOIFI standards as a guideline. With regard to AAOIFI's set of standards, BNM has no objection to the adoption of the AAOIFI standards (Ismail & Latiff 2001).

### **The Need Of Islamic Accounting Standards**

The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) prepares and issues accounting, auditing, and corporate governance standards, as well as ethics and *Shari'ah* standards, for Islamic financial institutions. Currently, AAOIFI has published 81 standards, 25 accounting standards, 5 auditing standards, 7 governance standards, 2 ethics standards, and 41 *shari'ah* standards (AAOIFI, 2010).

The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), a private standard setting body, was established by the Islamic banks and other interested parties to prepare and promulgate accounting, auditing, and governance standards based on the *Shari'ah* precepts for Islamic financial institutions (Karim, 2001). The AAOIFI organizations has been recognized and mandated to develop accounting, auditing, governance, and ethics standards that are in line with *Shari'ah* standards in order to promote comparable, transportable, and reliable accounting information. The formulation and adoption of AAOIFI standards in any country is intended to increase foreign investment, as well as investor's confidence. These standards are set up to produce financial statements that are transparent in their preparation and easily interpretable by users (Karim, 2001).

AAOIFI had tended to start with objectives established in contemporary accounting thought, testing these objectives against Islamic *shari'ah*, and accepting those that are consistent with *shari'ah* and rejecting those objectives that are not consistent with *shari'ah* (Maurer, 2010). The objectives of the AAOIFI organization is to prepare and develop accounting, auditing, governance and ethical standards relating to the activities of Islamic financial institutions. According to AAOIFI (2008), the objectives of financial accounting for Islamic banks and Islamic financial institutions are as follows:

- (a) To determine the rights and obligations of all interested parties, including those rights and obligations resulting from incomplete transactions and other events in accordance with the principles of Islamic *Shari'ah* and its concepts of fairness, charity, and compliance with Islamic business values.
- (b) To contribute to the safeguarding of the Islamic bank's assets, its rights and the rights of others in an adequate manner.
- (c) To contribute to the enhancement of the managerial and productive capabilities of the Islamic bank and encourage compliance with its established goals and policies and, above all, compliance with Islamic *Shari'ah* in all transactions and events.
- (d) To provide through financial reports useful information to the users of these reports to enable them to make legitimate decisions in their dealings with Islamic banks.

In reference to the objectives, this research has made an attempt to contribute to the current framework and serve as a guide for Islamic financial institutions regarding interest-free transactions through determining the levels of compliance with the AAOIFI accounting standards by Islamic banks.

### **AAOIFI Structure**

AAOIFI structure consists of a General Assembly, a Board of Trustees, an Accounting and Auditing Standards Board, a Secretariat General, and a *Shari'ah* Board. However, AAOIFI develops alternative Islamic standards when 1) the equivalent IFRS cannot be adopted in whole by the Islamic Financial Institutions (IFIs), e.g. Ijarah standard vs IAS 17; 2) the IASB has no IFRS elements that cover the specific Islamic banking and finance practices, e.g. Mudarabah, Musharaka, Salam, and Istisna (Hameed, 2009).

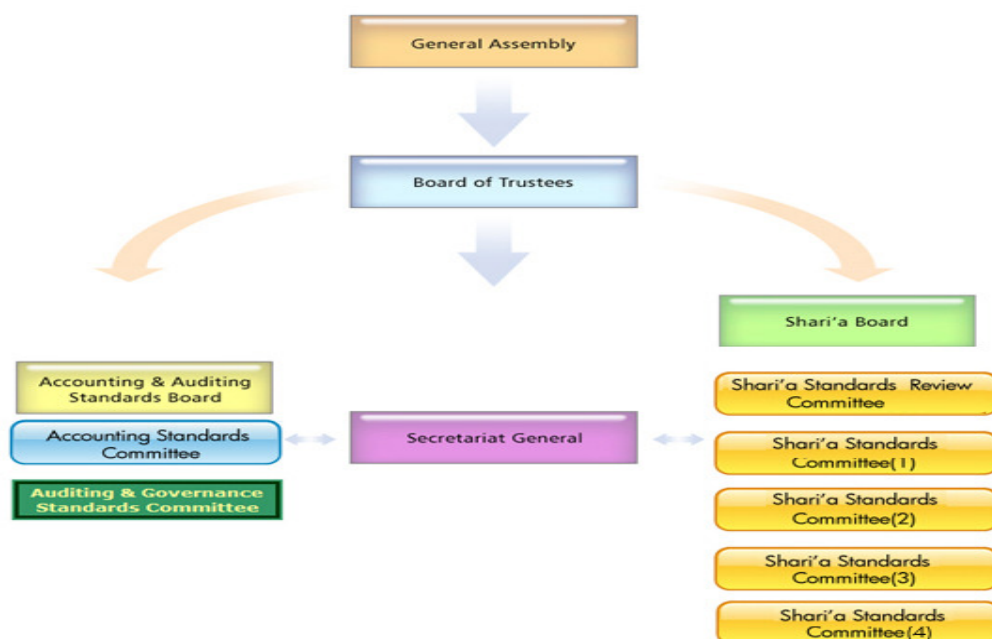


Figure 1. AAOIFI structure

**AAOIFI Financial Accounting Standards (FAS)**

**Table 1.** AAOIFI Financial Accounting Standards Consist of 25 Standards As Following (AAOIFI, 2010)

|  |  |
|--|--|
| FAS 1 Presentation and disclosure  | FAS 2, 3 and 4 Modes of financing (Murabahah , Mudaraba and Musharaka)           |
| FAS 5 Disclosures of bases for profit allocation between owners' equity and investment account holders | FAS 6 Cover equity of investment account holders and their equivalent            |
| FAS 7 and 8 are about Salam and Parallel Salam Ijarah and Ijarah transactions                          | FAS 9 Zakah  |
| FAS 10 relates to Istisna'a  | FAS 11 Covers provisions and reserves  |
| FAS 12 and 13 and 15 and 19 Relates to insurance companies   | FAS 14 and 17 Covers investment funds and investments                            |
| FAS 16 relates to foreign currency transactions  | FAS 18 Islamic Financial Services Offered by Conventional Financial Institutions |
| FAS 20 about deferred payment sale   | FAS 21 relates to transfer of assets   |
| FAS 22 relates to segment reporting  | FAS 23 relates to consolidated financial statements                              |
| FAS 24 Contributions in Islamic Insurance Companies  | FAS 25 Investments in Associates.  |

Source: (AAOIFI, 2010)

**AAOIFI Auditing standards**

1. Objectives and principles of auditing
2. The Auditor's Report
3. Terms of Audit Engagement
4. Testing for Compliance with *Shari'ah* Rules and Principles by an External Auditor
5. The Auditor's Responsibility to Consider Fraud and Error in an Audit of Financial Statements

**AAOIFI Governance standards**

1. *Shari'ah* Supervisory Board: Appointment, Composition, and Report.
2. *Shari'ah* Review.
3. Internal *Shari'ah* Review.
4. Audit and Governance Committee for IFIs.
5. Independence of *Shari'ah* Supervisory Board.
6. Statement on Governance Principles for IFIs.
7. Corporate Social Responsibility.

**AAOIFI Ethics standards**

1. Code of ethics for accountants and auditors of IFIs.
2. Code of ethics for employees of IFIs.

**AAOIFI Shari'ah Standards****Table 2.** *The 41 AAOIFI Shari'ah Standards Are as Follows (AAOIFI, 2010)*

|   |  |
|---|--|
| 1. Trading in currencies                                | 22. Concession Contracts   |
| 2. Debit Card, Charge Card and Credit Card              | 23. Agency   |
| 3. Default in Payment by a Debtor                       | 24. Syndicated Financing   |
| 4. Settlement of Debt by Set-Off                        | 25. Combination of Contracts                                       |
| 5. Guarantees   | 26. Islamic Insurance  |
| 6. Conversion of a Conventional Bank to an Islamic Bank | 27. Indices  |
| 7. Hawala   | 28. Banking Services   |
| 8. Murabaha to the Purchase Orderer                     | 29. Ethics and stipulations for Fatwa                              |
| 9. Ijarah and Ijarah Muntahia Bittamleek                | 30. Monetization (Tawarruq)  |
| 10. Salam and Parallel Salam                            | 31. Gharar Stipulations in Financial Transactions                  |
| 11. Istisna'a and Parallel Istisna'a                    | 32. Arbitration  |
| 12. Sharika (Musharaka) and Modern Corporations         | 33. Waqf   |
| 13. Mudaraba  | 34. Ijarah on Labour (Individuals)                                 |
| 14. Documentary Credit                                  | 35. Zakah  |
| 15. Jua'la  | 36. Impact of Contingent Incidents on Commitments                  |
| 16. Commercial Papers                                   | 37. Credit Agreement   |
| 17. Investment Sukuk                                    | 38. Online Financial Dealings                                      |
| 18. Possession (Qabd)                                   | 39. Mortgage and its Contemporary Applications                     |
| 19. Loan (Qard)   | 40. Distribution of Profit in Mudarabah-based Investments Accounts |
| 20. Commodities in Organised Markets                    | 41. Islamic Reinsurance  |
| 21. Financial Papers (Shares and Bonds)                 |  |

Source: (AAOIFI, 2010)

The AAOIFI financial accounting standards consist of 25 standards (AAOIFI, 2010); these standards are expected to be applied by Islamic Financial Institutions (IFIs). The first eight standards deal with disclosure requirements, and the rest deal with recognition, measurements, and disclosure issues.

### Implementation of the Islamic Accounting Standards

According to Mirza and Baydoun (1999), there is a need for developing a set of standards for Islamic accounting and reporting:

*“The need for accounting standards is not very different from the need for any other kind of standards, whether it is standards for weights and measures, or standards for clothing sizes, grades of beef, or baseball statistics. The goal or objective is to facilitate comparisons and thereby minimize the social and economic costs of assessing the alternatives with which one is faced in making rational decisions. In financial accounting sometimes we tend to think only in terms of investment decisions, but those are not the only decisions for which financial information may be useful, if not critical” (p. 83).*

Shadia Rahman (2007) argues that the adoption of the Anglo-American accounting techniques can cause problems. For instance, Anglo-American accounting is based on the principle that assumes that business has an indefinite life. Meanwhile, this is not appropriate for contracts, such as *mudarabah* (which makes the entrepreneur and the bank partners) banking situation, whereby the contract may be rescinded at any time. This, therefore, makes the Anglo-American accounting techniques unsuitable for Muslims to adopt in their reporting system.



**Figure 2.** Developing accounting standards for an Islamic society (Mirza & Baydoun, 1999)

To date, a few studies have been conducted in this area. For instance, Ismail and Latiff (2001), Harahap (2003), Abdul Rahim (2003), Hameed, et al (2006), Che Pa (2006), Zaini (2007) Nadzri (2009), and Vinnicombe (2010) were found to have examined the understanding, the acceptability, and the levels of compliance with accounting for Islamic financial institutions. The first study in this area was conducted by Ismail and Latiff (2001), who theoretically examined the extent to which Islamic financial institutions adhere to the AAOIFI standards and IAS standards. Based on the fact that AAOIFI has no authority to impose its standards and compliance on the financial institutions, its standards, therefore, remain voluntary in countries such as Malaysia. In Malaysia, the Central Bank of Malaysia (BNM) has no objection to the adoption of the AAOIFI standards--but not in contradiction to the national requirements. Basically, there are no specific requirements for the statements to show movement in Zakah, charity, and Qard as required by the AAOIFI standards. Some requirements regarding some modes of finance (FAS 2 Murabahah, FAS 3 Mudaraba, and FAS 4 Musharaka) based on the AAOIFI standards are not relevant to the practice of BIMB. On the other hand, the AAOIFI FAS 1 general presentation and disclosure requires a cash flow statement to be prepared as is the case in IAS 7 requirements.

Nadzri (2009) concluded that the extent of disclosure by the IFIs is much lower than the AAOIFI requirements. The test performed also revealed that those who adopt AAOIFI provide more disclosure when compared to the non-adopters. However, the mean result is relatively low to suggest full compliance with the AAOIFI. The 25 IFIs are examined from 12 different countries, and it is indicated that 10 out of the 25 IFIs explicitly stated in the financial reports adopted the AAOIFI. These IFIs are from Bahrain, Sudan, Palestine, Bangladesh, and Qatar. Based on the test conducted in 2006, only 5 out of 25 samples managed to disclose at least half (50%) of the *zakah* disclosure requirements. These IFIs are Bahrain Islamic Bank, Gulf Finance House, Abu Dhabi Islamic Bank, Sharjah Islamic Bank, and European Islamic Investment Bank. Out of these 5 banks, 2 claimed that the AAOIFI standards were fully adopted, while the European Islamic Investment Bank indicated the use of AAOIFI FAS 9 in the preparation of the financial reports. Other IFIs failed to disclose at a minimum requirement rate of 50% and 8 IFIs scored a 0% disclosure of *zakah*. Among these 8 IFIs, 4 (or 50%) did not communicate anything about *zakah* in their annual reports. These are AlBaraka Bank Limited, Qatar Islamic Bank, Mashreq Bank, and Islamic International Arab Bank. Another 2 banks, Al Salam Bank and AlBaraka Banking Group, only provided statements in the SSB report that the banks are not responsible for paying *zakah*. Meanwhile, Faisal Islamic Bank and Syarikat Takaful Malaysia recorded the amount of *zakah* payment for the financial period in the income statement, and no further information was provided in the notes of the financial statements.

Vinnicombe (2010) argued the extent to which Islamic financial institutions comply with the accounting and governance standards issued by the AAOIFI in their financial reporting. Because Islamic banks operate under vastly different regulatory regimes and political and economic conditions across the globe, the sampled banks were selected from the kingdom of Bahrain. The compliance for the purpose of this study can be defined as the degree to which Islamic financial institutions comply with the multitude of issues in the financial accounting standards (FASs) issued by the AAOIFI. However, the findings of the study indicate high level of compliance with respect to the governance standards relating to the in-house supervisory boards of Islamic banks and reporting the Islamic Murabahah contract. In contrast, compliance with the AAOIFI's requirements regarding the *zakah*, otherwise called the religious tax, and the Mudarabah contract is relatively low. In addition, a higher number of compliance items are associated with retail as opposed to wholesale banks. However, it should be noted that the samples of the retail bank are more homogeneous and consistent over time compared to those of the wholesale banks.

Hameed et al. (2006) argued that the *Shari'ah* Supervisory Board (SSB) plays a very important role in ensuring the *Shari'ah* compliance by the Islamic banks. SSB in Islamic banks must be disclosed as part of some requirements. The authors agreed to choose two banks, the Bank Islam Malaysia Berhad (BIMB) and the Bahrain Islamic Bank (BIB). The selections of these two banks were basically based on the argument that they were established in two different countries where the Islamic banking and finance has been immensely developed. This study is to measure the extent to which the Islamic financial institutions complied with the principles laid down in the AAOIFI standards. The calculation is based on the number of the principles that followed the AAOIFI standards relative to the total accounting principles applied. In this regard, (BIMB) complied with only 15 percent, while BIB complied with 61 percent. Thus, the Islamic banks of Bahrain comply more with the AAOIFI accounting standards compared to the Islamic banks of Malaysia.

Abdul Rahim (2003) investigated the classification, recognition, measurement, presentation, and disclosure of Sukuk (Islamic bonds) based on the standards required by the AAOIFI. Considering the function of the accounting system to provide the information, the introduction of AAOIFI standards aims to enhance the transparency and comparability of the Islamic banks' financial statements and provides a descriptive analysis as stipulated in the AAOIFI FAS 17 regarding investment. The conclusion of the study is that, Islamic financial institutions differ from its conventional institutions counterpart, and, therefore, needs an accounting standard that reflects its operation.

Che Pa (2006) examined the levels of understanding of the Sukuk (Islamic bonds) and the acceptability of the AAOIFI FAS 17 investment in Sukuk products among bank managers in Malaysia. The results of the study indicated that Malaysian bank managers who are involved directly in the



investment in Islamic bonds have relatively moderate levels of understanding of the AAOIFI FAS 17. It was also found that those who have acquired significant knowledge in Islamic banking and finance have a better understanding of Islamic bonds. On the other hand, the AAOIFI FAS 17 is well accepted by the Malaysians bank managers and may be considered applicable in Malaysia even though they have not referred to the AAOIFI standards. In line with that, the study by Zaini (2007) also examined the levels of understanding and acceptability of AAOIFI FAS 17 investment in Islamic bonds and the relationship between the understandings of Islamic bonds and the acceptability of the AAOIFI FAS 17. The results indicated that the accounting academics in Malaysia have moderate levels of understanding about Islamic bonds. The AAOIFI FAS 17 is highly acceptable by the respondents, despite the fact that the implementation of the AAOIFI standards, as well as the AAOIFI FAS 17, is not mandatory in Malaysia. Rather, it is accepted as a guideline that may reflect the unique characteristics of Islamic financial instruments.

In a related study, according to Karim (2001), Islamic financial institutions are required to comply with the AAOIFI's standards in Sudan and Bahrain. Efforts are currently underway to mandate it in other countries like Malaysia and Qatar. Some Islamic banks, such as the Bank Islam Berhad Malaysia, and the Islamic Development Bank, have also started to voluntarily use the AAOIFI accounting standards in the preparation of their financial statements. The implementation of the AAOIFI standards in other countries would require exerting more efforts by the central banks and governments where Islamic banks operate.

Based on a study by Harahap (2003), it was found that the Bank Muamalat Indonesia (BMI) is relatively more compliant with the AAOIFI and can be used as a benchmark for Islamic financial institutions when preparing their annual reports. The reason is that BMI's annual report places more emphasis on local regulations and, in particular, those decreed by Indonesia's central bank. In this regard, the AAOIFI does not have the power to enforce its standards on Islamic financial institutions. As a result, the AAOIFI tries to work towards persuading regulatory authorities to adopt its standards globally.

### Conclusion

The Adopting or complying with Islamic accounting standards has increasingly become the focus of among Islamic financial institutions. This paper has discussed previous studies about the adoption of accounting standards in developed and developing countries, as well as prior studies on adoption the Islamic accounting, auditing, governance, and *Shari'ah* standards by Islamic financial institutions and determinants of the extent of levels of compliance with the Islamic accounting standards by Islamic banks. The Islamic accounting standards for Islamic Financial Institutions in accordance with the *Shari'ah* requirements and the AAOIFI accounting standards may be the best choice for reducing costs and increasing foreign investments and investor's confidence. The objectives of the AAOIFI accounting standards are to prepare and develop accounting, auditing, governance, ethical, and *Shari'ah* standards relating to the activities of Islamic financial institutions.

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