

AWARENESS OF AAOIFI ACCOUNTING STANDARDS IN THE KINGDOM OF SAUDI ARABIA

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Abstract

The implementation of the accounting standards as a new phenomenon is expected to receive considerable attention from professionals such as academics in the accounting field, external auditors and preparers of financial statements in Islamic banks (e.g. managers and employees). This paper is an empirical study aiming to find the awareness of these three groups regarding AAOIFI accounting standards, and also aims to find the extent by which these groups want AAOIFI standards to be adopted by the Islamic banks in the Kingdom of Saudi Arabia. The study assembled primary data to fulfill its aims through questionnaire. A large number of participants had answered the survey which had been designed to address these issues.

The results of this study indicate that the lack of knowledge and ignorance about AAOIFI standards might be a key factor in delayed application of its standards and regulations. On the other hand, the majority of the participants prefer AAOIFI accounting standards for preparing the financial statements in Islamic banks in Saudi Arabia. In addition, the majority of the participants support the idea of harmonizing accounting standards used for preparing Islamic banks' financial statements, as this step makes Islamic banks' financial statements comparable. Last but not least, participants believes that Islamic windows in the conventional banks in Saudi Arabia are the first step towards Islamisation of all conventional banks especially when they note that most of the customers of conventional banks prefer Islamic products.

Introduction

Islam has given great attention to accounting, and this is reflected in the *Holy Quran* as mentioned in Surah 2: 282, “O you who believe! When you contract a debt for a fixed period, write it down. Let a scribe write it down in justice between you...etc.” from which we understand that *Quran* requires Muslims to record all contracts in writing as well as all their daily business transactions to make the society free of personal problems (Al-Mehmadi 2004). Many Muslim scholars take this verse as the basis for Islamic for Islamic accounting (Omar 1999) . Since then many attempt to define Islamic Accounting such as: “a system of information that communicates the economic position and result of operation of an entity and ensures that information presented is correct, complies with Shari’ah, and is free from any misleading information”(Harahap 2003). Ibrahim (2003) provides further definitin in stating that Islamic accounting is “the accounting process which provides appropriate information ... to stakeholders of an entity which will enable them to ensure that the entity is continuously operating within the bounds of the Islamic Shari’ah and delivering on its socio-economic objectives”(Ibrahim 2003).

From the above definitions we can observe the importance of providing information to the users according to shari’ah. In addition, Islamic banks and financial institutions need to prepare their accounting system with compliance with shar’ah. The need to develop accounting standards that adequately and appropriately reflect the nature of Islamic financial transactions was considered by some experts as an important step to enhance the reliability, consistency, clarity and credibility of financial reporting by Islamic financial institutions which would also enhance investor confidence in Islamic finance. Thus, intensive efforts were made by the Islamic Development Bank (IDB) to establish a formal entity to address Islamic accounting issues. This led to the establishment of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) which was registered on March 27, 1991, in The Kingdom of Bahrain, as a non-profit making independent international organization. The objective of the organization is to prepare and develop accounting, auditing, governance and ethical standards relating to the activities of Islamic financial institutions, taking into consideration international standards and practices and the need to comply with Sharia rules. Some central banks and monetary agencies in some Muslim countries such as the Kingdom of Bahrain, Jordan and Sudan require Islamic banks to comply with AAOIFI accounting standards. On the other hand, AAOIFI regulations are not adopted by any Saudi banks even those banks that claim to be Islamic banks, such as Al-Rajhi Bank, Aljazira Bank and Bank Albilad. However, as Saudi Banks, they have to follow the Saudi Arabian Monetary Agency (SAMA) requirements which do not consider AAOIFI accounting standards as one of the accounting standards that should be adopted in Saudi Arabia.

This article will examine the perceptions of academics, auditors and professionals regarding their awareness of AAOIFI as well as their preference of applying it in the Islamic banking sector in Saudi Arabia. Harmonizing accounting standards is required in order Islamic financial statements be comparable. Hence, the researcher seeks the view of the participants to know their opinion regarding this issue. A general background will be presented about Islamic accounting, AAOIFI accounting standards and Islamic banks regulations. Followed by the data collections and methodology adopted in this study. Finally, the researcher will present the final thought and recommendations at the end of this article..

The Accounting and Auditing Standards for Islamic Financial Institute (AAOIFI)

The interest in developing financial accounting standards for Islamic banks started in 1987, in this respect, several studies have been prepared (AAOIFI 2002). In 1991, several practicing accountants and central banks helped set up the Financial Accounting Organization for Islamic Banks and Financial Institutions (FAOIBFI) (Karim 1994), and recently known as the accounting and auditing organization for Islamic Financial Institutions (AAOIFI) Islamic international independent non-profit making body in the kingdom of Bahrain which prepares accounting, auditing, governance, ethics and *Shari'ah* standards for Islamic financial institutions.

The objectives of the AAOIFI are:

1. to develop accounting and auditing thought relevant to Islamic financial institutions.
2. to disseminate accounting and auditing thoughts relevant to Islamic financial institutions and its applications through training, seminars, publication of periodical newsletters, carrying out and commissioning of research and other means;
3. to prepare, promulgate and interpret accounting and auditing standards for Islamic financial institutions;
4. to review and amend accounting and auditing standards for Islamic financial institutions.

The organization structure of AAOIFI consists of general assembly of 75 Islamic institutions from 16 countries. The AAOIFI has a board of trustees and a board of accounting and auditing standards, each consisting of 15 members, a *shari'ah* board consisting of no more than 15 part-time members, an executive committee, and a secretary-general who is a full-time executive and hands the general secretariat(Mustafa 2003).

Like the International Accounting Standards Boards IASB, AAOIFI, as a self-regulatory body, has no power to enforce its respective standards. The AAOIFI depends on the quality of its pronouncements to persuade governments, central banks, monetary authorities, and stock exchanges to support the implementation of its accounting standards in some Islamic countries. Mustafa (2003) added that it would not be easy jobs for AAOIFI to have all Islamic countries adhere to its standards because of existing different legislation and regulatory requirements.

Islamic Banking Regulation

(Chapra and Khan 2000) mentioned that most countries have adopted the international standards, including the Basel Committee's Core Principles and minimum risk-weighted capital requirements and the International Accounting Standards Committee's international accounting standards.

- Some countries are implementing crash programmes to adopt the international standards but report difficulties, particularly in the risk weighting of assets created by the Islamic modes of finance. A few countries have not revealed the state of their compliance with international standards.
- Compliance with the standards set by the Accounting & Auditing Organization for Islamic Financial Institutions (AAOIFI) has not yet fully materialised; only two countries (Bahrain and Sudan) have so far explicitly adopted the standards set by it.
- Since most Islamic banks are small, some countries have announced a program of mandatory merger of Islamic banks and strengthening of their capital to make them viable in an international environment which has become characterised by megabanks.
- Three countries, Iran, Pakistan and Sudan, which have initiated the transformation of their entire economies in accordance with Islamic teachings, have announced major restructuring programmes for their banking sectors. All the three countries have active plans for privatisation of banks. Pakistan and Sudan have announced a mandatory programme for strengthening the capital of banks and of mergers to the extent to which this is necessary for the purpose (Chapra and Khan 2000).

The Saudi Arabian Monetary Agency (SAMA) does not have an independent control system for Islamic banks or for the Islamic branches of conventional banks, since the banks control system of SAMA is conventional system applied to the conventional banks recognised by SAMA. The Saudi Arabian Monetary agency dose not recognise the

existence of Islamic banks authorised to work in the Saudi market even if these Islamic banks actually exist under the conventional banks(Al-Sayed 2005).

Objectives, Methodology and Data Collection

This article aims to explore the perceptions of the academics and professionals regarding some issues in accounting practice in the Islamic banking in Saudi Arabia, some of the quotations which this study attempt to answer are:

- 1- Are the Islamic windows in the conventional banks in Saudi Arabia considered as the first step towards Islamization of these banks?
- 2- Are academics and professionals in Saudi Arabia aware of AAOIFI accounting standards?
- 3- Do academics and professional in Saudi Arabia prefer AAOIFI accounting standards to be implemented in Islamic banks in Saudi Arabia?
- 4- Do academics and professionals in Saudi Arabia support the idea of harmonizing accounting standards?

In addition, this study will examine the affect of experience of the respondents on their awareness of AAOIFI accounting standards as well as their preference of applying it according to the following hypotheses:

Hypothesis 1:

H0: there is no significant relationship between the experience of the respondents and their awareness of AAOIFI accounting standards.

H1: there is a significant relationship between the experience of the respondents and their awareness of AAOIFI accounting standards.

Hypothesis 2:

H0: there is no significant relationship between the experience of the respondents and their preference of applying AAOIFI accounting standards.

H1: there is a significant relationship between the experience of the respondents and their preference of applying AAOIFI accounting standards.

In order to achieve the objectives of this study, questionnaire methods were used to collect data. The choice of the samples was mainly based on the groups' knowledge of Islamic banking and Accounting environment in Saudi Arabia. The samples chosen in this study are as follows:

- 1- Academics specialized in Accounting & Finance in Saudi Universities,
- 2- External auditors in Saudi Arabia, and
- 3- Employees in Islamic Banking and Islamic windows in Saudi Arabia.

The questionnaires were distributed through mail; personal delivery, and electronic format through the personal website (<http://www.al-abdullatif.net>).

The researcher distributed 135 questionnaires to all academics working in accounting departments in the following universities: Umm Al-Qura University in Makkah; King Abdul Aziz University in Jeddah; King Saud University in Qassem; Al-Immam Muhammed Ibn Saud Islamic University in Riyadh , Qassem and al-ahsaa; King Faisal University in Al-ahsaa; King Fahd University of Petroleum & Minerals in Dhahran. The responses were 58, out of which 53 were useable responses. Further, 200 questionnaires were handed to six leading banks in Saudi Arabia in the field of Islamic banking and Islamic windows as following:

Al-Rajhi Bank, Al-Jazira Bank, Saudi American Bank, Saudi British Bank, Commercial Bank and Riyadh Bank. The responses were 88, out of which 80 were usable responses.

Moreover, 164 questionnaires were distributed to the external auditors listed by the Saudi Organization of Certified Public Accountants (SOCPA) released on 7-4-2003. The responses in total were 55, out of which 51 were useable responses.

Table 1-1: Overall response rates for the three samples

Samples	Total distributed	Total responses	Usable responses	Response rate
Academics	135	58	53	39.25%
External auditors	164	55	51	31%
Employees in Islamic Banks	200	88	80	40%
<u>GRAND TOTAL</u>	<u>499</u>	<u>201</u>	<u>184</u>	<u>36.87%</u>

In order to achieve the study objectives, statistical package for the social science (SPSS) were used. Both, descriptive and inferential analyses were adopted by using frequencies, percentages and graphs to explore the respondents view regarding the questions of this study, whereas, cross-tabulations and chi-square have been used to examine the relations between the experience of the respondents and their answers.

Results and Analysis

In this section, the results of the survey will be presented and discussed. The first result is the view of the respondents whether they believe Islamic windows in Saudi Arabia are the first step towards Islamizing conventional banks or not figure 1-1 below will reveal this result.

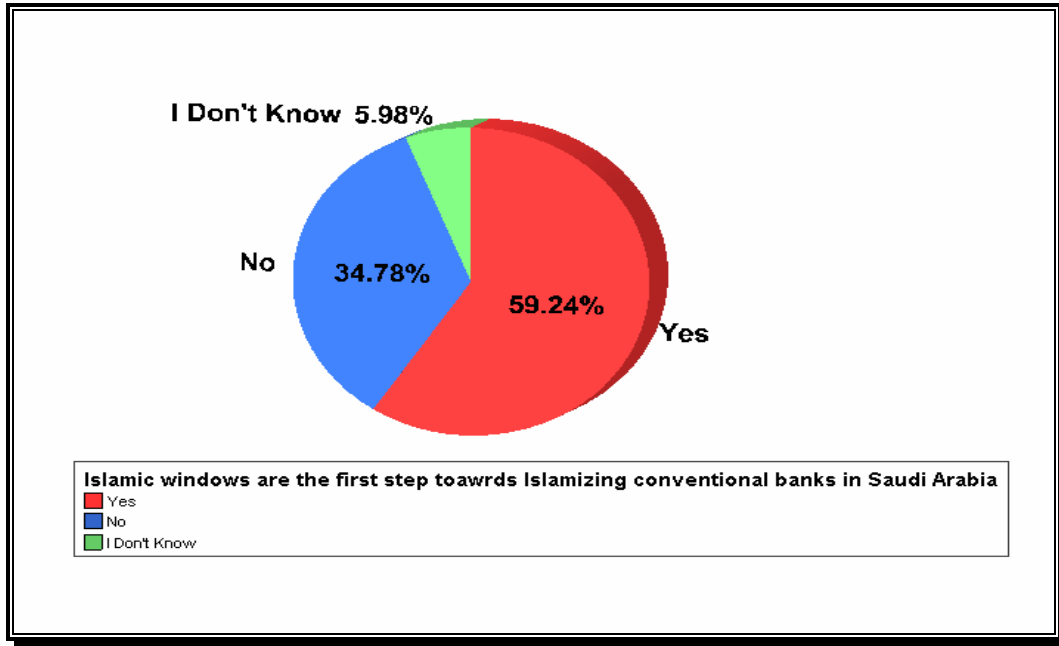


Figure 1-1: respondents' view regarding the Islamization of conventional banks in Saudi Arabia.

As we can see from the above figure 1-1, the majority of respondents 59.24% agreed that Islamic windows in the conventional banks in Saudi Arabia are the first step towards Islamizing it. On the other hand, 34.78% do not believe so. This result is consistent with the general trend towards Islamization of conventional banks as we are witnessing a tremendous shifting in the last recent years in the Kingdom of Saudi Arabia. In addition to Al Rajhi bank, bank Aljazira and bank Albilad who are already known as the only Islamized banks in Saudi Arabia, there are some conventional banks announced that they will Islamize their banks such as the national commercial bank (AlAhli) and SAMBA. Issa Al-Issa the executive chairman of SAMBA, announced that SAMBA has the intention and going ahead with the Islamization of all branches, and this requires time, according to the possibilities available to SAMBA, he added that a lecturer indicated that more than 95% of customers prefer the traditional Islamic product (Al-Hamazani 2006).

On the other hand, the Custodian of the Two Holy Mosques, King Abdullah bin Abdul Aziz announced the intention of establishing a new bank called (Al-Enma) with a capital of 15 billion Saudi riyals. The bank is expected to be Islamic banks which will be considered as the biggest bank in Saudi Arabia which will add more competition in the field of Islamic banking Kingdom.

Next result will reveals the respondents' awareness of AAOIFI accounting standards as shown in figure 1-2 below.

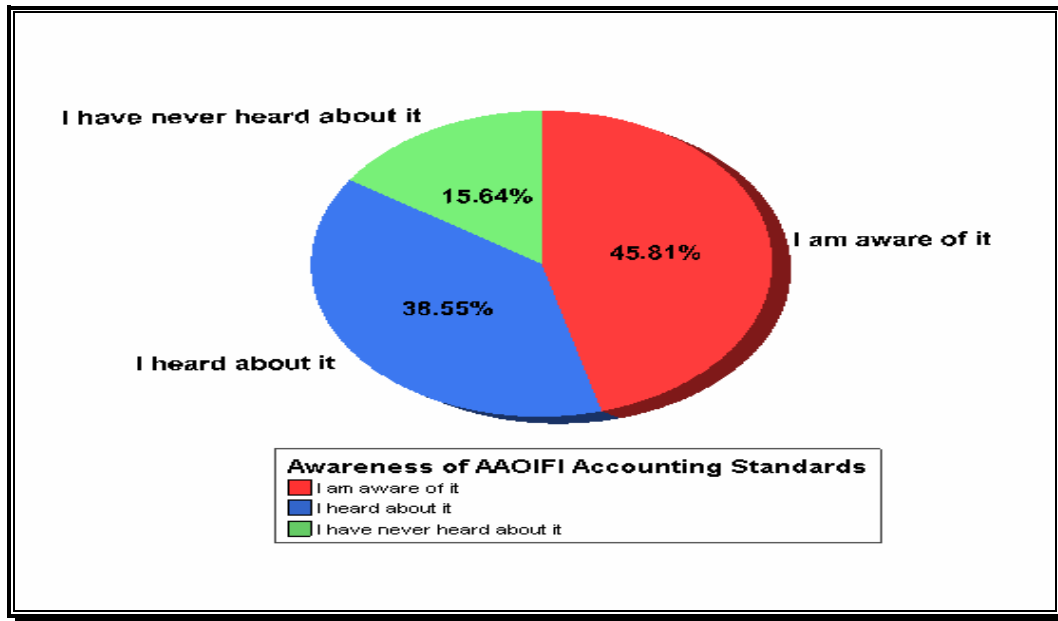


Figure 1-2: respondents' awareness of AAOIFI accounting standards.

As we can see from figure 1-2 above that only 45.81% of the respondents were aware of the AAOIFI accounting standards. Although, this percentage looks quite high, however, this result is rather disappointed if we know that the respondents were believed to be the most knowledgeable groups who supposed to know every thing in this felid. The researcher was expected a higher percentage, however this result gives an indications that 15.46% are completely ignorance of the existing of AAOIFI accounting standards, whereas 38.55% only heard about it. the researcher believes that this result because AAOIFI accounting standards are not adopted by SAMA, in addition, there are neglect of presenting AAOIFI to accountant students at Saudi Universities.

The following result will decided to what extent that respondents prefer AAOIFI accounting standards to be adopted in Islamic banking sector in Saudi Arabia, table 1-2 below will reveal the result.

Table 1-2: Preference of AAOIFI Accounting Standards

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Dislike	3	1.6	1.6	1.6
	Dislike	4	2.2	2.2	3.8
	Neutral	19	10.3	10.4	14.3
	Prefer	39	21.2	21.4	35.7
	Strongly Prefer	117	63.6	64.3	100.0
	Total	182	98.9	100.0	
Missing	System	2	1.1		
Total		184	100.0		

From the table 1-2 above it is very obvious and clear that the majority of respondents prefer AAOIFI accounting standards to be implemented in Islamic banks in Saudi Arabia with 85.7% .This high percentage can be divided into two subdivision which are 64.3% of them strongly prefer and 21.4% who said they prefer to apply it. On the other hand, only 1.6% strongly dislikes AAOIFI accounting standards to be adopted in Saudi Arabia. This result gives a clear indication that the majority of academics and professionals in Saudi Arabia follow the trend of the Islamization banking sector in Saudi Arabia and want the Islamic banks' financial statements to be prepared according to AAOIFI accounting standards.

Next result which listed in table 1-3 below will reveals whether respondents support the idea of harmonizing accounting standards used for Islamic bank's financial statements or not.

Table 1-3: Supporting the idea of harmonizing accounting standards used for Islamic bank's financial statements

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Yes	171	92.9	95.5	95.5
	No	5	2.7	2.8	98.3
	I Don't Know	3	1.6	1.7	100.0
	Total	179	97.3	100.0	
Missing	System	5	2.7		
Total		184	100.0		

From table 1-3 above it is very clear that the vast majority of 95.5% respondents support harmonizing accounting standards used for Islamic bank's financial statements. Although, the expectance of AAOIFI in the kingdom of Bahrain and its effort to establish accounting and auditing standards for Islamic institutions in order to harmonize accounting standards used to prepare the Islamic bank's financial statements , there are a delay in harmonizing

accounting standards for Islamic banks(Al-Martan 2005). This is exactly the situation in Saudi Arabia as SAMA require the banks to follow the international accounting standards for preparing the financial statements without distinguish between Islamic or conventional banks.

Tables 1-4 and 1-5 below will present the result of the respondents view regarding the role of SAMA in implementing AAOIFI accounting standards in Saudi Arabia.

Table 1-4: respondents' view regarding the role of SAMA in applying AAOIFI accounting standards

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Not Important	9	4.9	4.9	4.9
	Neutral	6	3.3	3.3	8.2
	Important	31	16.8	16.9	25.1
	Very Important	137	74.5	74.9	100.0
	Total	183	99.5	100.0	
Missing	System	1	.5		
Total		184	100.0		

From table 1-4 above, we can see that the majority of respondents 74.9% believe that the role of SAMA is very important in applying AAOIFI accounting standards in Saudi Arabia. This result is expected as SAMA considered as the central bank and regulates the banking system in Saudi Arabia. However, the respondents been asked to determined the importance of the role of each of the following groups in table 1-5 in applying AAOIFI accounting standards.

Table 1-5: classifying the groups regarding the respondents' view of the role of each group in applying AAOIFI accounting standards

	N	Mean
SAMA	183	4.62
Islamic Bank's Management	183	4.58
SOCPA	181	4.55
Audit firms	183	4.41
Ministry of Commerce	182	4.22
Academics in the accounting field	181	4.10
Valid N (listwise)	180	

It can be seen from table 1-5 that respondents had chosen SAMA is the most important body in applying AAOIFI accounting standards in Saudi Arabia with highest mean (4.62). On the second rank, respondents had chosen “Islamic bank’s management” with mean (4.58), followed by Saudi Organization of Certified Public Accounting (SOCPA) with mean (4.55). Audit firms role in applying AAOIFI accounting standards became fourth in the ranks with mean (4.41), and then the ministry of commerce with means (4.22). The last group which respondents believe that their role is in the bottom of the ranks is the academics in the accounting field with mean (4.10).

This result shows that SAMA is the most important organization in which AAOIFI accounting standards could be implemented in Islamic banks sector in Saudi Arabia.

In the next table 1-6 below will examine the following hypothesis:

H0: there is no significant relationship between the experience of the respondents and their awareness of AAOIFI accounting standards.

H1: there is a significant relationship between the experience of the respondents and their awareness of AAOIFI accounting standards.

Table 1-6: Experience * Awareness of AAOIFI Accounting Standards Cross-tabulation

		Awareness of AAOIFI Accounting Standards			<u>Total</u>
		I am aware of it	I heard about it	I have never heard about it	
Experience	Less than 5 years	1	11	6	<u>18</u>
	5- 10 years	13	9	8	<u>30</u>
	10- 15 years	19	13	6	<u>38</u>
	15- 20 years	18	7	4	<u>29</u>
	More than 20 years	31	29	4	<u>64</u>
<u>Total</u>		<u>82</u>	<u>69</u>	<u>28</u>	<u>179</u>

Chi-Square Tests

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	23.382(a)	8	.003

The chi-Square test shown in Table 1-5 confirms a statistically significant relationship between the experience of the respondents' variable and the awareness of AAOIFI standards variable. The level of observed significance (p value) was .003. Hence, the null hypothesis can be rejected. The table shows that 31 respondents who had experience for more than 20 years were aware of AAOIFI accounting standards, compared to only one respondent who had less than 5 years experience was aware of it. This result shows that the more experience respondents had the more they are aware of AAOIFI accounting standards and vice versa.

In the next table 1-7 below will examine the following hypothesis:

H0: there is no significant relationship between the experience of the respondents and their preference of applying AAOIFI accounting standards.

H1: there is a significant relationship between the experience of the respondents and their preference of applying AAOIFI accounting standards.

**Table 1-7: Experience * Preference of AAOIFI Accounting Standards
Cross-tabulation**

		Preference of AAOIFI Accounting Standards					<u>Total</u>
		Strongly Dislike	Dislike	Neutral	Prefer	Strongly Prefer	
Experience	Less than 5 years	0	0	2	8	8	<u>18</u>
	5- 10 years	0	4	5	4	16	<u>29</u>
	10- 15 years	0	0	6	15	19	<u>40</u>
	15- 20 years	1	0	3	3	22	<u>29</u>
	More than 20 years	2	0	3	9	52	<u>66</u>
<u>Total</u>		<u>3</u>	<u>4</u>	<u>19</u>	<u>39</u>	<u>117</u>	<u>182</u>

Chi-Square Tests

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	47.745(a)	16	.000

The chi-Square test shown in Table 1-6 confirms a statistically significant relationship between the experience of the respondents' variable and the preference of AAOIFI

standards variable. The level of observed significance (p value) was .003. Hence, the null hypothesis can be rejected. The table shows that a largest number of 52 respondents who had experience for more than 20 years were strongly prefer AAOIFI accounting standards, whereas only two respondents strongly dislike it. On the other hand, whenever respondents experience decreases as those who had experience between 5-10 years, the gap between preference and non-preference of AAOIFI accounting standards became less. This result shows that the more experience respondents had the more they prefer AAOIFI accounting standards to be implemented in Islamic banks in Saudi Arabia.

Conclusion and Recommendations

In summary, this paper examines the awareness of academics and professionals in Saudi Arabia regarding AAOIFI accounting standards. In addition, their preference of which accounting standards they want Islamic banking sector in Saudi Arabia to follow.

In order to reach a conclusion and conclusion for this study, questionnaire have been used to collect data from 184 respondents contents of academics, external auditors and employees in Islamic banks and Islamic windows in conventional banks in Saudi Arabia.

The analysis of the survey reveals that Islamic banks is widely spread in Saudi Arabia and participants believe that conventional banks in Saudi Arabia will be Islamized sooner or later as the general trends and the markets demands want it. Consequently, thinking about regulating Islamic banking and which accounting standards should Islamic banks in Saudi Arabia became a serious issue.

In Saudi Arabia SAMA require all banks to prepare their accounting standards in accordance with the International Accounting Standards (IAS). Therefore, this research explores the perceptions of the participants regarding the need for adopting AAOIFI accounting standards in the Islamic banking sector in Saudi Arabia. The analysis reveals that the majority prefer AAOIFI to be implemented, although the awareness of AAOIFI among the respondents was not up to expected level considering participants as most knowledgeable people in this field.

The participants believe that SAMA is responsible and has the power to apply AAOIFI standards.

The researcher believes that SAMA should try to work very hard in order to solve any obstacles which might prevents SAMA from applying AAOIFI standards. Also, SAMA should accelerate the establishment of Islamic bank's regulations. As the result of this survey reveals that the experience of the respondents show significant relations with their answers, the researcher recommends SAMA to take the view of the experts in this field and open a discussion regarding the advantage and disadvantage of applying AAOIFI accounting standards.

The researcher urges SAMA to learn from the experience of countries which have applied Islamic accounting standards and have special laws and regulations for Islamic banks such as Bahrain, Sudan, Iran and Malaysia. Finally, SAMA should work beside AAOIFI and help them to enhance their accounting standards to reach the level which SAMA required.

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