

# SHOULD ISLAMIC ACCOUNTING STANDARD FOLLOW TO INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)? A LESSON FROM MALAYSIA

**Dodik Siswantoro**

Department of Accounting, Universitas Indonesia  
E-mail: dodik.siswantoro@ui.ac.id

**Shahul Hameed Mohamed Ibrahim**

International Centre for Education in Islamic Finance (INCIEF)  
E-mail: mishahul@inceif.org

## *Abstract*

*It has been clearly shown that financing based Islamic teaching has inherent characteristics as well as its accounting. For that reason, it may not be so easy to convert Islamic accounting standard into International Financial Reporting Standard (IFRS) as it may violate some basic principles of Islamic teaching. Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI) still commits to have different accounting standard as it is based on the fiqh (maxims). Furthermore, some countries adopt directly or indirectly the concept in IFRS, for example, in Malaysia. This paper tries to show some evidences on accounting standard which does not have a strong foundation of Islamic teaching would like probably to change by its milieu, especially in the IFRS convergence trend. This is because Islamic accounting standard itself merely based on “the convention” of the so called Islamic scholars.*

**Keywords :** *Islamic Accounting, IFRS, and standard*

## INTRODUCTION

Long before there were IFRS and even the IAS, Islamic financial contracts (Mudaraba, which later became the commenda of the Europeans) and transactions and accounting for them was taking place in Muslim states, Muslim and non-Muslim lands. The success of Prophet Muhammad PBUH in developing Islamic economics even was stated by Adam Smith in his book "the wealth of nation". Unfortunately, due to colonization and the deterioration of the Muslim civilization, this fell into disuse and modern finance and accounting from Europe took over the world. The adoption of interest rate was unavoidable at that time and spread out to entire world. Muslims may force to use the conventional system as there is no other choice. But, after independence and the failure of secular developmental policies, many Muslim countries experimented with Islamization. This can be in the form of Islamic law, bank system and financial system. Afterwards, Islamic accounting is set up to respond that Islamic financial growth.

Many attempts have been done in the setting up of Islamic accounting standards in several Muslim countries. Hence, the development of many Islamic financial institutions in entire world, it is needed for standardization of their accounting in order to be comparable and fulfilling the uniformity criteria. Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) as legal accounting body in this area does not have authority to enforce Muslim and other countries to follow their standards (Ainley, 1997). On the other hand, AAOIFI should learn from (Financial Accounting Standard Board) FASB's experiences in setting up the conceptual framework by evaluating the objectives first and accept responses to reconstruct the framework. However, FASB still has some problems regarding this issue because of the unclear definition of accounting terms (Dopuch & Sunder, 1980; Miller, 1990), incompleteness (Agrawal, 1987) and inconsistencies with some accounting standards (Lane & Terry, 1990). Currently, to solve the divergence of accounting standard, some countries try to adopt one standard, International Financial Reporting Standard (IFRS). The trend of IFRS's convergence has raised a new issue besides some complexity may still exist (Jermakowicz & Gornik-Tomaszewski, 2006).

There has been a crop of research on Islamic accounting since the 1990's as a result of the Islamization trends in many Muslim countries during the 1980's for example, in

Pakistan, Iran, Sudan and Malaysia. These include Gambling and Karim (1993), Karim (1995), Harahap (1997), Adnan & Gaffikin (1999), Shahul (2000), Triyuwono (1999), and Baydoun & Willet (2000). Islamic accounting gained an additional impetus when Islamic banking and finance took off in the early 1990's and became a force in the new millennium.

Speaking of Islam, it is a complete religion that discusses and solves all human being life aspects and problems (including the economics, politics, physical and social science). Whereas, Qur'an is as a guidance for all people in the world, it is stated in (2: 2), "This is the book; in it is guidance, sure, without doubt, to those who fear Allah". Other verses that have similar meaning are in (as guidance): 2: 97, 120, 185, 3: 4, 138, 7: 52, 203, 9: 33, 12: 14, 16: 64, 89, 102, 17: 9, 22: 16, 27: 77, 92, 41: 44, 45: 11, 20. On the other hand, other holy books, for example, the *Torah* was revealed to Prophet Moses (peace be upon him) also for guidance, but it was for a specified group of people at that time (2: 53, 5: 44, 6: 154, 7: 154, 28: 43, 32: 23). It is also for another book, the *Injiil*, that was revealed to Prophet Jesus (peace be upon him) (5: 46).

In correlation with this paper, as a Muslim we should use Qur'an as guidance in the developing and setting up of the standards, especially the accounting standards. The standards must be derived from Qur'an because this is an obligation to a Muslim and it will give benefits to all human beings. Qur'an can be a yardstick means that if the system has changed to secular and opposed to Islam, it does not mean that we can change the yardstick. The different systems should be adapted and based on Qur'an as a yardstick. In addition, Qur'an itself has given many approaches to different systems and conditions that were suitable and based on the capability of human beings. On the other hand, other sources are *hadits* (the saying of Prophet Muhammad (peace be upon him)), *ijma* (the consensus of ulama (scholar)), *qiyas* (find the similar event from the Islamic perspective) and others are complement sources of Islamic law.

There are two approaches in setting up the accounting standards according to Accounting and Auditing for Islamic Financial Institution. First, the direct approach that means we derive the concepts and fundamentals of accounting standards from the source of Islam. Second is the indirect approach where we adopt the existing concepts and fundamentals of accounting then, test them based on the Islamic teaching. Actually as Muslims, we should adopt the ideal approach, the first approach. Somehow, there are some different perspectives regarding this case. Furthermore, this paper will discuss the conceptual

framework of Islamic accounting standards in Malaysian context, there are some pros and cons arguments regarding which approach that is suitable to Islamic teaching. Then, the development of Islamic accounting standard in Malaysia would be discussed along the first standard issued related to the trend of IFRS's convergence.

### **THE BACKGROUND OF SETTING UP ISLAMIC ACCOUNTING STANDARDS IN MALAYSIA**

The Muslim population in Malaysia is only 53 percent, but they can perform and apply the Islamic teaching well (Encarta Encyclopedia, 2002). This shows that the bigger number of Muslim in one country does not always give a better Islamic teaching implementation. In this case, the government of Malaysia supports the development of Islamic institutions and other similar areas such as education, economics, and other sectors.

The implications of the development of the Islamic banks in Malaysia affect other aspects of life. For example since the existence of Islamic banks, Muslims could deposit their money in these institutions; they have realized to have transactions based on Islamic teaching. This caused shifting or transferring funds to the Islamic banks or economics in stages. On the other hand, the collapse of conventional banks, the fragility of economic fundament that based on a conventional basis support the development of Islamic financial institutions. It will change the cultural tendency of the society to be more Islamic.

There are many Islamic institutions that provide Islamic economics and banking transactions in Malaysia. The other aspect is the accounting, because some scholars argue that conventional accounting cannot accommodate the Islamic principles and are not established on Islamic values (Adnan & Gaffikin, 1997; Archer & Karim, 2001; Triyuwono, 2000). In addition, it is unsuitable for Islamic purpose (Rahman, 1998; Gambling, 1993). Even, the socialist countries like China has their own conceptual framework which mainly focus on meeting the requirements of national macroeconomic control, the needs of all concerned external users and needs of all management (Davidson, *et.al.*, 1996). This means that the different culture may also have different framework (Parera, 1989). Similarly, Peasnell (1982) categorized three different ways in forming the conceptual framework, (a) *laissez faire*, given to the market (b) state control and supervision and (c) delegation of power to the profession. On the other hand, the existing accounting standards for Islamic financial Institutions which were prepared by AAOIFI has some weaknesses in terms of accounting

concepts and practices (Pomeranz, 1997; Ainley, 1997; Akauntan Nasional, 2000). Therefore, hard working in studying the accounting for Islamic business transactions is very much urgent and important.

Even though Bank Islam Malaysia Berhad was already established in the 1983, not many people in Malaysia become aware of accounting in Islamic perspective. By the time, people become aware of the need for Islamic accounting and this is also supported by the increasing number of Islamic financial institutions and banks. This can be seen as supportive factor for the setting up of Islamic accounting standards. In addition, in the company Act 1965 there is a space for the setting up of specified accounting standards for Islamic financial institutions (Section 167 (1)), “Every company and the directors and managers thereof shall cause to be kept such accounting records as will sufficiently explain the transactions and financial position of the company and enable true and fair”.

In addition, the Islamic Banking Act 1983 regulated the setting up and development of Islamic banks fundamentally strong. This Act amended some other Acts, for example, the definition of Islamic banks in the Banking Act 1973 and the Companies Act 1965, thus any business transactions dealing with Islamic bank refers to the Islamic Banking Act 1983 (Akauntan Nasional, 2000). Likewise, the Islamic Banking Act 1983 authorized Bank Negara Malaysia with powers to supervise and regulate Islamic banks, not exceptionally, the Islamic Accounting Standards.

### **The Development of Islamic Financial Institutions in Malaysia**

The development of Islamic bank in Malaysia may be inspired by the success of the establishment of *Lembaga Tabung Haji* in 1963. Furthermore, there are three types of Islamic bank in Malaysia, e.g. the full-fledged, Islamic windows, and mixed (Islamic windows and full-fledged Islamic banking branches). In addition, three stages of development in the timeline of the Islamic financial landscape may characterize as follows (Hussin, 1999). The first stage, the “monopolistic years”, actually previously there was only one Islamic bank, Bank Islam Malaysia Berhad. This does not mean that the purpose of the Malaysian government to develop only one Islamic bank, it was only a beginning step. The name of “monopolistic” is not appropriate because people can assume an unfavourable image with this name. The second stage was started in 1990, Bank Negara Malaysia proposed alternative or optional system for conventional banks, e.g. the Islamic window, allowing the setting up

of new Islamic banks, or supporting the conventional finance companies to operate under Islamic Scheme (known as Islamic Banking Scheme 1994). The last option gave the most effective ways in the number of services and in shorter period (started on March 1993 from 22 increased to 47 banking institutions e.g. 17 domestic, 4 foreign-owned banks, 14 finance companies, 5 merchant banks and 7 discount houses). Lastly, the take off period, started on January 1994 with the existence of Islamic Money Market and the establishment of National Shari'ah Advisory Council (NSAC) of Bank Negara Malaysia in May 1997 where all Islamic financial institutions must be under NSAC supervision. Furthermore, the second Islamic Banks was formed in 1999, known as Bank Bumi Muamalat Malaysia Berhad (BBMMB) is a merger of Bank Bumiputra Malaysia Berhad (BBMB) and Bank of Commerce (M) Berhad (BOCB) (stated in Bank Negara Malaysia website).

Alternatively, there are non-financial institutions that give a significant contribution to economic development in Malaysia, they are (Hussin, 1999):

1. *Takaful* (insurance)
2. Savings institutions (Lembaga Tabung Haji, Bank Rakyat)
3. The development financial institutions (Industrial Bank of Malaysia, Development and Infrastructure Bank of Malaysia, and Agriculture Bank of Malaysia)
4. Other financial intermediaries which offer Islamic banking services such as Islamic leasing companies and National Mortgage Corporation.

Basically, some these institutions have Islamic windows that have similar principles with Islamic banks (e.g. not used interest rate and avoid gambling "*gharar*"). They also used similar Islamic modes of finance such as *mudharabah* (profit sharing), *musharakah* (partnership), *bay* (selling), and *ijarah* (leasing). Thus, these financial institutions will also use similar accounting treatments but with slight modification at least. Furthermore, it will become other supportive factors in the setting up of accounting for Islamic financial institutions or Islamic accounting standards.

Explicitly, there is no restriction in dealing and setting up Islamic financial institutions (Section 124 (1), Banking and Financial Institutions Act 1989), "... nothing in this Act or the Islamic Banking Act 1983 shall prohibit or restrict any licensed institution from carrying on Islamic banking business or Islamic financial business, ..."

Regarding the feasibility of the implementing of Islamic teaching, Islamic bank should be applied in a full and complete system without other interventions in order to obtain optimum results. Unfortunately, in the master plan of Malaysian banking it is stated that (Bank Negara Malaysia), “The long-term objective of BNM is to create an Islamic banking system operating on a parallel basis with the conventional banking system”.

If we look the long-term objective of Bank Negara Malaysia related to Islamic banking system deeply, it seems that they do not want to eliminate the interest rate system (still prevent the conventional system). This, actually, was not conducive for the development of Islamic banking and economics system. This should be in the short-term not in the long term at least. However, it will implicate to other financial instruments for example, the accounting treatments will be so hard that how to treat the prohibited transactions (no clear direction to avoid interest rate). In other word, this is a part of the problem not the ultimate solution. Actually, Malaysian can learn from Indonesia where they could apply the Islamic economic system orderly.

#### **The Need of Accounting for Islamic Financial Institutions**

In general, the need of Islamic Accounting Standards is caused by the establishment of Islamic financial institutions (which have different fundamental concepts and principles from conventional institutions). In addition, this was established in order to accommodate the accounting of Islamic financial transactions and make them comparable. Other countries such as Yemen, Indonesia as well as Malaysia utilized the central bank to set up and organize the Islamic Accounting Standards.

Serious efforts have been done by Malaysian Accounting Standards Board (MASB) jointly with the central bank (Bank Negara Malaysia) and Shari’ah advisors. They studied the Companies Act 1965 and the existing standards in order to harmonize it with Islamic accounting standards. Actually, the main reason why Islamic accounting standards is needed (MASBi-1), “The absence of a proper set of accounting standards for the recognition, measurement, and disclosure of Islamic based transactions complicates or hinders attempt to compare financial performance among banks or between periods for individual banks”.

Furthermore, in the standard is stated that<sup>2</sup>, “The existing accounting standards that based on International Accounting Standards (IASs) cannot address accounting issues

within Islamic banking operations adequately.....useful in providing a structural framework for reporting, but they are inadequate to accommodate Shari'ah precepts, which form the basis of all Islamic transactions”.

A question will arise from the statement above, on what basis that existing standards are not in line with Islamic teaching. Because, on the other hand, the MASBi-1 still refer to the existing standards, such as MASB 1 (presentation of financial statement), MASB 3 (net profit or loss for the period, fundamental errors and changes in accounting policies), MASB 5 (cash flow statements), and MASB 8 (related party disclosure). This can be called as dualism in accounting standards, in other words the spirit of conventional accounting is still the basis of the Malaysian Islamic accounting standards. In addition, Malaysian Islamic accounting standards do not include *zakat* and *qard* statements in the components of financial statements. However, these statements may be able to reflect the transparency of the company which is required by the AAOIFI. In addition, *zakat* is one of five pillars in Islam.

Furthermore, Malaysian Islamic accounting standards do not state explicitly that they still refer to Accounting and Auditing Organization for Islamic financial institutions (AAOIFI). Nevertheless, they actually have adopted from AAOIFI from the starting point by emphasizing on the objectives and their approaches. Furthermore, another question will arise regarding the standards are (a) the “enforceable” issues and (b) avoid hampering the healthy of Islamic economic practice. Because, actually, the Islamic Accounting Standards have already been applied indirectly by Bank Islam Malaysia Berhad itself in the simple form.<sup>3</sup> Therefore, other questions will arise regarding the issues, “Does the statements really in real economic condition or just a decoration for some purposes (to make the standards seems more legitimized)?”

#### **Standardization of Accounting Standards for Islamic Financial Institutions**

Standardization will almost create problems because of inability to capture in one single standard (Sunder, 1988). The purpose of the development of accounting standards is merely decision usefulness. This can be achieved by other supporting principles and concepts in accounting such as comparability and consistency that coherent with the objective of the standard. Unfortunately, what the Malaysian Accounting Standards



Malaysia (MASB) almost did the similar approach with what Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) has done (Business Time, 2000). MASB, actually, should learn from the AAOIFI's experience and Indonesia.<sup>4</sup> Indonesia has a problem in determining the direction of Islamic financial institutions because of lack of Islamic accounting scholars. Finally, they followed the Middle-East concepts in order to make it easier. On the other hand, in the case of Malaysia in the mid of process of Islamic accounting standards establishment process, finally they also referred to the AAOIFI because<sup>5</sup> (Business Times, 2000), "... there is a lack of intellectual resources in the country that possess expertise in both accounting issues and the syariah principles (Zain)".

This reason is quite weak because many Muslim scholars have tried to develop and derive from Islamic teaching (Zaid & Tibbits, 1997), not taking the conventional concepts and test with Islamic teaching (second approach of AAOIFI), especially at International Islamic University of Malaysia. Other example is the paper that is written by Nabil Baydoun and Roger Willett (Islamic Corporate Report) which can be as reference for fundamental concepts. Furthermore, regarding the approaches and Islamic teaching implementation, Dr. Nordin Mohd Zain, the executive of director MASB argued that (Business Times, 2000), "... one of the ways MASB is overcoming the setback in manpower is to collaborate with the shari'ah advisory council from Bank Negara Malaysia".

The Shari'ah Advisory Council only knew in the appearance of accounting principles and concepts. They mainly did not focus on the accounting theory and concepts deeply (usually there is a gap between shari'ah scholar and practitioners), because each accounting concepts mainly are influenced by the big 5. The big 5 are clearly reflecting the capitalists that control the accounting policy. The spirit of the capitalists in the accounting concepts will not be seen if we just observed from the appearance or in the existing conventional accounting standards (it needs a deep accounting courses to comprehend all accounting theory and system).

The standards, however, still give some biased application because it still refers to the existing conventional accounting standards. All of them are inspired by the International Accounting Standards Committee (IASC) and Financial Accounting Standard Board (FASB). The dominant accounting body in the setting up of accounting standards always bound the local accounting standards.

### **The genuineness of Malaysian Accounting Standards Board (MASB)**

The Malaysian Accounting Standards Board claimed the Islamic Accounting Standards were created originally from the Malaysian experience ([www.islamiq.com](http://www.islamiq.com)), “MASB concluded that there was a need for the creation of Malaysia’s own genre of standards that would cater to the specific needs of IFIs in the country (Raja Datuk Arshad Uda, the chairman of MASB).<sup>6</sup>

However, it seems to contradict with the reality that the standards itself refer to AAOIFI indirectly. Raja Datuk Arshad Uda said that AAOIFI does not address these issues (Islamic banking regulatory framework, a dual banking system and different Shari’ah interpretations of Islamic banking practices). What AAOIFI has done is preparing the standards in general terms. This means that each country or institutions that want to adopt can make a modification that appropriate to their accounting system. In addition, MASB separate the task for each standard (Ijarah, Mudarabah and Murabahah), this will take much time and ineffective. Naturally, the Islamic modes of finance should inherently reflected in the conceptual framework (presentation of financial statements of Islamic financial institutions).

In analyzing the accounting standards, some academics usually will observe from the conceptual framework. The conceptual framework, at least, will describe the qualifications of accounting in general term. Most of accounting standards will have similar conceptual framework that depend on their directions (e.g. IAS, FASB, etc).

Many scholars argue that conceptual framework is as the spirit of accounting. Conceptual framework is not defined clearly by some scholars, only explain in the form of elements (objectives, qualitative characteristics and the fundamental concepts) (Hendriksen & Van Breda, 1992).

The major feature of the framework consists of 3 parts, they are (Hendriksen & Van Breda, 1992): the objective of accounting and the qualitative of characteristics of useful accounting information. In other word, the conceptual framework is only the framework of conceptual accounting in order to be based on some principles (Brownlee, *et.al*, 2001). At the first time, the conceptual framework was defined as (Paton & Littleton, 1940),

Subsequently, this definition was eliminated because it seemed to refer to one an accounting constitution. This is not the intention on the conceptual framework of accounting. Then, it is urged that the conceptual framework should be able to guide standards setters and preparers in understanding the strengths and limitations of financial reporting process (Brownlee, *et.al*, 2001). Some qualitative characteristics differences between Financial Accounting Standards Board (FASB) and MASB-*i* 1 are merely caused by the direction of accounting standards. MASBi-1 is more likely close to International accounting standards which do not emphasize these qualitative characteristics. Ideally, to set clearly the conceptual framework of Malaysian Islamic Accounting Standards should have such a hierarchy of the qualitative of the conceptual framework.

## **THE FUNDAMENTAL CONCEPTS IN ACCOUNTING**

Nowadays, there are two additional elements of conceptual framework (Foster & Johnson, 2001), they are (a) criteria for recognizing and measuring those elements and (b) use of cash flow and present value information in accounting measurements. These, however, will broad scope of the conceptual framework of financial statements.

Regarding, the approach of the conceptual framework of Islamic accounting standards, there are two approaches in setting up the accounting standards for Islamic financial institutions. Here as follows (AAOIFI, 1998):

- a. Establish objectives based on the principles of Islam and its teachings and then consider these established objectives in relation to contemporary accounting thought.
- b. Start with the objectives established in contemporary accounting thought, test them against Islamic Shari'a, accept those that consistent with Shari'a and reject those that are not.

After serious discussion and preparing and discussing a paper for each approach, AAOIFI decided to choose the second approach. In the case of Malaysia, Assoc. Prof Dr Syed Musa said that Malaysian Islamic Accounting Standards referred to the AAOIFI what have done. In the case of Indonesia, they did not explicitly state that they follow the approach of AAOIFI, but they were supervised by the AAOIFI (Siswantoro, 2001).

### **Related Acts and Materials That Support and Influence The Malaysian Islamic Accounting Standards**

The Islamic country that already has comprehensive Islamic banking system is Iran. They succeeded in eliminating the role of interest rate in economic development in 1983. The nationalization of Islamic banking in each sector including the central bank and monetary agency was done in a short period, however, one of the strong reasons is due to the intention of the government itself (www.islamicq.com, 2000).

In the setting up the Islamic Accounting Standards, Malaysian Accounting Standards Board (MASB) also refers to other materials and accounting institutions. Here are the following:

a. International Accounting Standards

The Malaysian Islamic Accounting Standards cannot avoid from the influence of International Accounting Standards (IASs). This is for the reason for harmonization accounting standards and recognizable in an international forum; however, this is only a type of force of one authority which should be able to reduce by creating its own standards that are suitable to their own environment.

b. The Companies Act 1965

All companies in Malaysia are based on the Companies Act 1965 as fundamental law. On the other hand, the generalization for fundamental law is used for standardization of accounting standards. It is to avoid misunderstanding or ensure companies to give true and fair view financial statements (section 167 (1), Companies Act 1965). Actually, there is a space in this Act to set up the Islamic Accounting Standards (Akauntan Nasional, December 2000).

c. The Basle requirements

Islamic banks have different characteristics compared to conventional banks in terms of structure of the financial statements. It can be said that the Islamic banks support to use the partnership contract than liability modes. In relation to Capital Adequacy Ratio (CAR) as one of the qualifications for measuring the healthy of the banks, Islamic

banks should have a different method in calculating the CAR. It is caused by the shareholders of Islamic banks can add capital without increasing their equity capital or incurring some risks (Karim, 1996). Furthermore, it is contrary to the Basle objectives that only focus to the equity capital, without considering additional capital that does not include in the equity capital (because it will also have different risks). Karim (1996) suggested applying the first and second methods that are congruence with the Islamic bank treatments (from 4 methods that are available in Basle requirements). Actually, the adoption of Basle requirements should be modified with the nature of Islamic banks.

d. GP8 Guidelines, by Bank Negara Malaysia (BNM)

GP8 can be defined as general provision No.8 which is a BNM guideline on the presentation format and disclosure requirements of Financial Statements of Banking Institutions in Malaysia (Syed Musa, 2002). This relates to the disclosure of balance sheet and profit and loss sharing (Hussin, 1999). For example, in identifying between excluding and including contra, (table1)

**Table 1**  
**The part of balance sheet of Commerce Asset-Holding Berhad**

Balance Sheet (RM000)	1999	1998	1997	1996	1995
<b>Assets</b>					
Total assets excluding contra	68,034,807	24,417,055	23,781,079	18,277,901	17,084,668
Total assets including contra	76,663,039	28,718,201	27,720,878	21,695,240	29,279,454

e. Islamic Banking Act 1983

To make it stronger, special Act is required for Islamic bank. This Act is for the licensing and regulating the Islamic banking business. The Act arranges some regulation for example, provisions on the financial requirements, duties of an Islamic Bank, powers of supervision and control over Islamic bank (Bank Negara Malaysia).

f. Islamic Banking Scheme 1994

Islamic Banking Scheme replaces SPTF and it is an interest free service that conventional financial institutions provide (Syed Musa, 2002).

**The Role of National Shari'ah Board**

The National Syariah Advisory Council on Islamic Banking and Takaful (NSAC) was established on 1 May 1997. The primary objectives of the NSAC are as follows:

- a. To act as the sole authoritative body to advise BNM on Islamic banking and takaful operations;
- b. To co-ordinate *Shari'ah* issues with respect to Islamic banking and finance (including takaful); and
- c. To analyze and evaluate *Shari'ah* aspects of new products/schemes submitted by the banking institutions and takaful companies.

The NSAC members are appointed by Bank Negara Malaysia Board of Directors. Suppose that the National Syariah Advisory Council (NSAC) is not under Bank Negara Malaysia authority, because it will make it independent. However, the NSAC should not be able to be interfered by others because in the Islamic state, it was put as so called the highest authority in the state. The position is almost equal to the leader or *amir*, as consultative and supervised body.

**After Some Years**

**What is Islamic Accounting Standards?**

Many statements said that Islamic accounting standards are referred to what have AAOIFI prepared. However, other scholars will comment that what AAOIFI has done are not so called "Islamic accounting standards". But, it is only "accounting for Islamic financial institutions". These both difference phrases actually do not bother for the practitioners, but it will become a serious discussion for academics.

Islamic accounting standards can be defined as accounting standards that are derived directly from the Islamic teaching. Unfortunately, the real Islamic accounting standards are still on the theory and concepts. Because, there is a gap between Islamic financial practices and theory, or there is no complete Islamic financial implementations (Taheri, 2000).

**Past Recommendation: The future directions of Malaysian Islamic Accounting Standards**

As the consequences that Malaysian Accounting Standards Board (MASB) seemed has chosen the second approach in setting up their conceptual framework. They should have strong filters and qualifications to determine whether the accounting treatments and principles in line with Islamic teaching or other wise.

The notion that Islamic banks merely act as financial intermediaries between customers and investors may shift to other Islamic services. Therefore, MASB should have a team which studies the probable issues in Islamic accounting standards. For example, what Financial Accounting Standards Board (FASB) has been done in the forming Emerging Issues Task Forces (EITF). This team should be independent and free from other intervention.

Finally, MASB can study the implementation of accounting standards in existing Islamic banks and financial institutions, then group them based on distinguished and functional institutions. For example, profit and non-profit organization will have different emphasis on the financial statements. The conceptual framework should not be too flexible, but they can accommodate various Islamic financial institutions. In addition, specified accounting treatments for different characteristics and purposes will be presented separately and specifically. Only time that will answer to this problem.

**ANALYSIS: DEVELOPMENT AND IFRS'S CONVERGENCE**

**The Development**

Since the MASBi-1 issued and effective since 1 January 2003, no further or additional standard for other Islamic financial transactions have not been released (see table 1). Similar standard under Technical Release was issued TRi-1 about Accounting for *Zakat* on Business and TRi-2 about *Ijarah* on 1 July 2006. Other standards such as Statement of

Principles, Technical Releases and Interpretation Bulletin issued due to local need for accounting issues. They state that ([www.masb.or.id](http://www.masb.or.id)),

The MASB may issue technical pronouncements other than MASB Standards, including technical pronouncements such as Statement of Principles, Technical Releases and Interpretation Bulletin. Nothing in the technical pronouncements is to be construed as amending or overriding the MASB Standards or other statements issued by the MASB. These technical pronouncement are developed with due regard to both local and international treatments and within the framework of the law and the standards prescribed in MASB Standards and other statements issued by the MASB. The purpose of a technical pronouncement is to provide guidance on the application of generally accepted accounting principles to the resolution of a particular accounting issue. The issue of a pronouncement may also represent an interim measure prior to the issue of a MASB Standard.

The Technical Release, however, refer to the conventional accounting standard for TRi-1 about Accounting for Zakat on Business (TRi-1),

MASB 1 *Presentation of Financial Statements* and FRS 108 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

While, Statement of Principle, actually is not an accounting standard,

This Statement is not an MASB approved accounting standard and is not a Shariah standard (SOPi-1, para 14)

This Statement shall complement, and be read in conjunction with, the *Framework for the Preparation and Presentation of Financial Statements* (SOPi-1, para 19)

If we look into the statement, they even do not use both methods as AAOIFI suggested above. This is because they interpret that the conventional from the Islamic perspective



and seems there is no violation in Islamic teaching. However, we should look from the objective and foundation of the concept. Even though, it has the similar or the same name, but it may be created from the different philosophy background and objectives (Shahul, 2000).

**Table 2.**  
**The Development of “Islamic” Accounting “Standards” in Malaysia**

No	Items	Description	Effective
1	TR <i>i</i> -1	Accounting for Zakat on Business	1 July 2006
2	TR <i>i</i> -2	Ijarah	1 July 2006
3	SOP <i>i</i> -1	Financial Reporting from an Islamic Perspective	2009
4	TR <i>i</i> -3	Presentation of Financial Statements of Islamic Financial Institutions	1 Jan 2010
5	TR <i>i</i> -4	Shariah Compliant Sale Contracts	1 Jan 2011

#### **Islamic Accounting Standard and IFRS’s Convergence issues?**

Some reasons of the withdrawal of MASBi-1 (FRSi-1) are (TRi-3),

IN5. The Board has adopted a principle of accounting for Shariah compliant transactions and events in accordance with MASB approved accounting standards in the absence of any Shariah prohibition to doing so.

IN6. In the event that there are issues relating to accounting for Shariah compliant transactions that require additional guidance not provided for in the approved accounting standards, such guidance would be provided in the form of other technical pronouncements.

IN7. Since much of the material in FRS *i*-1<sup>2004</sup> are already dealt with by FRS 101, the Board decided to eliminate duplication by retaining only guidance not found in FRS 101. The additional guidance would be issued as a Technical Release, and FRS *i*-1<sup>2004</sup> would be withdrawn.

From explanation above, there are some analyses due to this withdrawal such as:

- a. They assume that conventional accounting standard, the *Framework for the Preparation and Presentation of Financial Statements* already in line to the Islamic teaching as it does not violate it explicitly. In term of IFRS, actually there are big different from AAOIFI such as restricted account, *mudharabah*, etc (AAOIFI, 2008).
- b. The accounting treatment for Islamic financial transactions is regulated under Technical Release and Statement of Principle. However, it seems that Islamic accounting only occurs in the local context, Malaysia. Actually, AAOIFI can be a reference in the international scale.
- c. The withdrawal of MASBi-1 (FRSi-1) or removing from the Malaysian accounting standard (putting in the TR and SOP) seems that Islamic accounting is not just supporting tools for the whole accounting standard. However, the reason of FRSi-1's withdrawal may be caused that the duplication. This may not occurred if they build the standard based on the first approach as discussed before.

The characteristics of Islamic Financial Institutions may be different inherently. Investors and stakeholders would question if IFIs followed the IFRS directly without any deep consideration. However, some implications of following IFRS for IFIs,

- a. Many Islamic financial transactions do not have IFRS standards for example, *musharaka*, *mudharaba*, *murabahah*, *istisna'a*, and *salam*.
- b. The deposit side of the balance sheet of IFIs is different from conventional banks due to contractual differences. Investment accounts based on *mudharaba* is not liabilities but hybrid between equity and liability which the IFRS does not recognize.
- c. Restricted Investment Accounts according AAOIFI is off the balance sheet due to contractual restrictions of prohibition of pooling of funds with shareholders funds. AAOIFI provides for entirely different financial statements.
- d. *Takaful* is not an insurance; it is a mutual protection scheme where the underwriting fund does not belong to the insurer, but to the policy holders hence we actually have two accounting entities.

- e. The socially responsible financing (i.e. qard hassan) is not catered for by conventional accounting standards. AAOIFI requires a separate statement for control of this important function of Islamic banks. Failure to give importance to this will result in Islamic banks becoming totally capitalist financing institutions without the socio economic objectives of Islamic finance not being met.
- f. There are differences from a shariah point of view on ijarah which cannot be accounted for as leases (even IFRS does not seem to make up its mind).

## **CONCLUSION**

As discussed above, we can see that generally Muslims still cannot solve their simple problem easily, in this case is the Islamic accounting standards. However, as long as serious efforts are done in order to improve the Islamic accounting standards, it will give better results at the end. The problems that appeared usually are caused by the inability by Muslim themselves in overcoming such basic problems. For example, lack of Muslim scholars and established studies and sciences that are in line with Islamic teaching.

The difference of direction in Islamic accounting standards is unavoidable. However, at least, they should have common perceptions in order to be comparable. On the other hand, the harmonization between Islamic accounting standards in different countries is not so difficult compared to in the conventional accounting. Because, in Islam we have already similar basic financial transactions that have so significant differences. For example, *mudharabah* (profit and loss sharing), *murabahah* (buying and selling contracts), *musharakah* (partnership) and others. All of them, actually, have been in practice in the Islamic state in the past.

Putting Islamic Accounting concepts and treatment in supporting tools such as Technical Release and Statement of Principle may show that Islamic accounting has no different from the conventional ones. In addition, the withdrawal of MASBi-1 (FRSi-1) in 2010 may indicate the convergence of IFRS. Even though, there is no explicit strong evidence on this. In this case, they assume current conventional is in line with the Islamic teaching. Even though, if we dig deeper the accounting concepts and principles there are big differences in term of philosophy and foundations.

Some pointers for MASB from Indonesia that can be learnt,

- a. In Indonesia, there are Islamic Economic Society (Masyarakat Ekonomi Syariah – MES) and Islamic Economic Expert Institution (Ikatan Ahli Ekonomi Islam-IAEI) as informal control body that address Islamic economic issues to be complied with (people power).
- b. Islamic accounting standards that issued are based on Islamic main financial principles which can be used for all Islamic transactions

## REFERENCES

- AAOIFI. (1998). *Accounting and Auditing Standards for Islamic Financial Institutions*. Manama: Accounting and Auditing Organization for Islamic Financial Institutions.
- AAOIFI. (2008). International Standards for Islamic Finance. At [www.imanet.org](http://www.imanet.org)
- Abdel-Magid, Moustafa. (1981). The Theory of Islamic Banking: Accounting Implications. *The International Journal of Accounting Education and Research*. Vol. 17, No. 1, pp. 79-102.
- Adnan, Mohammad Akhyar, & Michael Gaffikin. (1997). The Shari'ah, Islamic Banks and Accounting Concepts and Practices. *Accounting, Commerce and Finance: the Islamic Perspective*. Sydney: University of Western Sydney Macarthur.
- Agrawal, Surendra P. (1987). On the Conceptual Framework of Accounting. *Journal of Accounting Literature*, Vol. 6, pp. 165-178.
- Ainley, Michael. (1997). Of Regulation. *The Banker*. October/  
*Annual Report Islamic Bank of Yemen*. 2000. At [www.islamicbankymn.com](http://www.islamicbankymn.com)
- Archer, Simon & Karim, Rifaat Ahmed Abdel. (2001). Presuppositions behind Accounting Standards and the Issue of Economic Reality: The Case of Islamic Financial Instruments. *EIASM Workshop on Accounting and Regulation Siena*.

- Banking and Financial Institutions Act 1989*. (1997). Malaysia: MDC publishers printers SDN BHD.
- Baydoun, Nabil. & Willet, Roger. (1997). Islamic and Accounting: Ethical Issues in the Presentation of Financial Information. *Accounting, Commerce and Finance: the Islamic Perspective*. Sydney: University of Western Sydney Macarthur.
- Baydoun, Nabil. & Willet, Roger. (2000). Islamic Corporate Report. *ABACUS*. Vol. 36, No. 1, pp. 71-90.
- Brownlee, E.R., Ferris, K.R. & Haskins, M.E. (2001). *Corporate Financial Reporting*. USA: McGraw Hill.
- Cash flow Statements MASB 5*. (1999). *Malaysian Accounting Standards Board*.
- Companies act 1965*. (1997). Malaysia: MDC Publishers Printers SDN BHD.
- Davidson, R.A., Gelardi, A. M.G., & Li, F. (1996). Analysis of the Conceptual Framework of China's New Accounting System. *Accounting Horizons*. Vol. 10, No. 1, pp. 58-74.
- Dopuch, Nicholas & Sunder, Shyam. (1980). FASB'S Statements on Objectives and Elements of Financial Accounting: a Review. *The Accounting Review*. Vol. 55, No. 1, pp. 1-21.
- Encarta Encyclopedia*. 2002
- Financial reporting of Islamic Banks: Research Highlights. (2000). *Akauntan Nasional*. November-December.
- Foster, J. M. & Johnson, L. T. (2001). Why does the FASB have a Conceptual Framework?. Financial Accounting Standards Board.
- Gambling, Trevor, Rowan Jones & Karim, Rifaat Ahmed Abdel. (1993). Credible Organizations: Self Regulations External Standard-Setting in Islamic Banks and British Charities. *Financial Accountability & Management*. Vol. 9, No. 3, pp. 195-207.
- Global developments in Islamic finance – challenges & opportunities*. (2001). The 8th Annual Symposium & Awards Program in Islamic Banking & Finance Pasadena. HSBC.

- Hamat, Mustapha. (1994). Accounting System, Need for Accounting Standards and the Implications of Islamic Banking on the Current Tax Law. Proceeding of conference of managing and implementing dual banking system.
- Harahap, Sofyan Syafri. (1997). Akuntansi Islam. Jakarta: Bumi Aksara.
- Haron, Sudin & Shanmugam, Bala. (2001). Islamic Banking *System*. Malaysia: Pelanduk Publications.
- Hendriksen, E. S. & Van Breda, M.F. (1992). *Accounting Theory*. USA: McGraw Hill Companies, Inc.
- Holy Qur'an.
- Hussin, Awang Adek . (1999). The Islamic Financial Landscape in Malaysia. *International Conference on Islamic Economics in the 21st Century*.
- Islamic Banking: tracing its history. (2000). *Akauntan Nasional*. November-December.
- Islamic Banking act 1983*. (1995). Malaysia: MDC Publishers Printers SDN BHD.
- Jermakowicz, E. K., & Gornik-Tomaszewski, S. (2006). Implementing IFRS from the Perspective of EU Publicly Traded Companies. *Journal of International Accounting, Auditing and Taxation*. Vol. 15, pp. 170–196.
- Karim, R.A.A. (1990). Standard Setting of the Financial Reporting of Religious Business Organization: the Case of Islamic Banks. *Accounting and Business Research*. Vol. 20, No. 80, pp. 299-305.
- Karim, R.A.A. (1995). The Nature and Rationale of a Conceptual Framework for Financial Reporting by Islamic Banks. *Accounting and Business Research*. Vol. 25, No. 100, pp. 285-300.
- Karim, R.A.A. (1996). The Impact of the Basel Capital Adequacy Ratio Regulation on the Financial Strategy of Islamic Banks. *The International Journal of Bank Marketing*. Vol. 14, No. 7, pp. 32 – 44.
- Karim, R.A.A. (1996). Economic Consequences of Accounting Standards and Islamic Banks. *Research in Accounting Regulation*. Vol. 10, pp. 111-138.

- Karim, R.A.A. (1999). Accounting in Islamic financial institutions. *Accounting and business: The Journal of the Association Chartered Certified Accountants*, July/August 1999.
- Karim, R.A.A. (2001). International Accounting Harmonization, Banking Regulation and Islamic Banks. *The international Journal of Accounting*. Vol. 36, No. 2, pp. 169-193.
- Khan, Muhammad Akram. (1994). Accounting Issues and Concepts for Islamic Banks. In *Development of an Accounting System for Islamic Banking*. London: The Institute of Islamic Banking and Insurance.
- Lane, D. A. & Terry, T. (1990). Limitations on the Value of the Conceptual Framework in Evaluating Extant Accounting Standards. *Accounting Horizons*. Vol. 4, No. 1, pp. 15-25.
- Lock, Lee Hock. (1987). *Central banking in Malaysia*. Singapore: Butterworths.
- Malaysian Accounting Standard Board. (1999). *Presentation of Financial Statement MASB 1*
- Malaysian Accounting Standard Board. (2001). *Presentation of Financial Statements of Islamic Financial Institutions MASBi-1*
- Malaysian Accounting Standard Board. (2009). *Statement of Principles i-1 Financial Reporting from an Islamic Perspective*
- Malaysian Accounting Standard Board. (2009). *Technical Release i-3 Presentation of Financial Statements of Islamic Financial Institutions*
- Miller, Paul B.W. (1990). The Conceptual Framework as Reformation and Counterreformation. *Accounting Horizons*, June.
- Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies MASB 3*. (1999). *Malaysian Accounting Standards Board*.
- On Account of Islam. (2001). *Malaysian Business*.
- Parera, M. H. B. (1989). Towards a Framework to analyze the Impact of Culture on Accounting. *The International Journal of Accounting*. Vol. 24, pp. 42-56.

- Peasnell, K.V. (1982). The Function of a Conceptual Framework for Corporate Financial Reporting. *Accounting and Business Research*, pp. 243-256.
- Pomeranz, F. (1997). The Accounting and Auditing Organization for Islamic Financial Institutions: An Important Regulatory Debut. *Journal of International Accounting, Auditing and Taxation*. Vol. 6, No. 1, pp. 123-130.
- Rahman, Shadia. (1998). Islamic Accounting Standards. *Journal of Islamic Foundation for Education and Welfare*. Vol. 13, No. 36.
- Related Party Disclosures MASB 8*. (2000). *Malaysian Accounting Standards Board*.
- Sarkar, Sudeshna. (2000). Premier Bahrain Institute announces 2000 Schedule. At [www.ifds.net](http://www.ifds.net)
- Shahul, Hameed bin Mohamed Ibrahim. (2000). [The Need for Islamic Accounting: Perceptions of its Objectives and Characteristics of Islamic Accounting: Perceptions of Malaysian Muslim Accountants and Accounting Academics](#). Phd Dissertation. University of Dundee, UK
- Siswanto, Dodik. (2004). The Need of Accounting Standards for Islamic Banks in Indonesia. *Mini Economica* Vol. 34, pp. 36-51
- Sunder, Shyam. (1988). Political Economy of Accounting Standards. *Journal of Accounting Literature*. Vol. 7, pp. 31-41.
- Syed Musa. (2002). A personal discussion through e-mail.
- Taheri, Mohammad R. (2000). The Basic Principles of Islamic Economy and their Effects on Accounting Standards-Setting.
- The Financial Sector Masterplan. (2001). Bank Negara Malaysia.
- The Future of Islamic Banking. (2000). *Akauntan Nasional*. November-December.
- Triuwono, Iwan. (2000). Shari'ate Accounting: an Ethical Construction of Accounting Discipline. *Gadjah Mada International Journal of Business*. Vol. 2, No. 2, pp. 233-251.
- Zaid, Omar Abdullah & Tibbits, Garry. (1998). The Islamic Perspective of Accounting Foundations and Principles. *Accounting, commerce & finance: the Islamic perspective. International conference*.



