

Conformity Level of AAOIFI Accounting Standards by Six Islamic Banks of Bangladesh

Nazmus Sakib

Masters of Business Administration, Department of Business Administration, International Islamic University
Chittagong, Chittagong 4000, Bangladesh
E-mail: nsakib624@gmail.com

Abstract

In response to this global rise in Islamic financial organism and banking, the need for setting up a common standard for the accounting function in Islamic Banks, became an unuttered need. Addressing this need, in the year 1991, the global institute for setting accounting standards for Islamic financial institutes, Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) has been established in Bahrain. This study tries to find out the conformity level of the Islamic Banks in Bangladesh with these standards. This study analyses the annual reports of six Islamic banks from Bangladesh of the year 2012. The Reports are collected from the Banks' website sources. It is found that these six banks conform with the AAOIFI standards by 53.79% on average in financial statements. A 2.79 standard deviation in case of total conformity refers to the low level of difference among these banks in case of disclosure. This study suggests that it is highly of importance for the banks to increase the level of conformity of the AAOIFI standards to ensure the stakeholders about their sincerity and determination to comply with Islamic Shari'ah. Analysis of AAOIFI standard compliance is relatively new in Bangladesh. This research study may provide some new insights into the existing Islamic literature.

Keywords: Islamic Banking, Islamic Finance, AAOIFI Standards.

1. INTRODUCTION

Compared to other financial institutes, Islamic Banks are obliged to disclose certain facts in the annual reports and financial statements. This disclosure practice is a bit more crucial for the Islamic institutions than other non-Islamic ones in the sense of Islamic obligation. However, the disclosures practice of these Islamic Institutions should comply with the global accounting standard. Currently AAOIFI is one of the trusted standards setting body for the Islamic Institutes and complying with the standard of which reveals much of the actual practices of these institutions. The need for the scrutiny of the degree of conformity with AAOIFI standard has seen a rise recently, be it for the investors', creditors' pressure or from the clients' Islamic demand.

The study scrutinizes the disclosure items in the annual reports. This study will hopefully contribute to the knowledge and will provide some motivation for those preparing the annual reports, various groups of accounting standard setter organizations as well as statutory bodies in Bangladesh. Again, the findings in the degree of compliance in case of each disclosure item generated from the study might help those preparing the annual reports of Islamic Financial Institutions, to improve and upgrade the quality of the information disclosed in respective annual reports. In addition, the findings of the study might constitute a further contribution to the area of the study and try to lessen the empty space of the accounting literature. Another essential contribution of this study might be to raise the awareness for those who are responsible for the preparation of financial statements on the importance of disclosing truthful and reliable information in the institutes' annual reports.

2. OBJECTIVE

The core objective of this study is to check out the degree of conformity of six Islamic Banks of Bangladesh with the Accounting standards set by AAOIFI. However, to fulfill the core objective, these specific objectives are to be fulfilled.

- Cross checking the compliance level of AAOIFI Accounting standards by these banks in case of disclosure
- Tracing out the gaps between the disclosures and information required by AAOIFI
- To put forward some suggestions upon reporting the whole scenario

3. REVIEW OF LITERATURE

Thea Vinnicombe (2012), in his research 'A study of compliance with AAOIFI accounting standards by Islamic banks in Bahrain' attempted to provide an extension of a previous study by the author into compliance by Islamic banks in Bahrain with accounting standards issued by the AAOIFI. In his findings, he concluded that, compliance is found to be higher for some Islamic issues than for others. In a relative sense, compliance is found to be similar to that for the region with standards issued by the International Accounting Standards Board.

Sarea (2012), we find in his research work titled 'The Level of Compliance with AAOIFI Accounting Standards: Evidence from Bahrain' that he has done evaluation on the concepts regarding the level of compliance

with AAOIFI Accounting standards. The finding of that study refers that Islamic banks in Bahrain have completely adopted the accounting standards set by AAOIFI. According to the data analysis, the accountants perceive that the compliance level of these banks in Bahrain is high. The credit goes to the regulatory bodies like Central Bank of Bahrain who imposed regulations to comply with the standards.

Al-Abdullatif, Sultan Abdullah (2007), in the study titled 'The application of the AAOIFI accounting standards by the Islamic banking sector in Saudi Arabia' made an attempt to find out the level of consciousness about AAOIFI accounting standards among different academics, auditors and employees of Islamic banks in KSA and tried to investigate the respondents' inclination towards adopting AAOIFI accounting standards. The study revealed that the consciousness about AAOIFI accounting standards was not up to the mark of expectation among the academic and knowledgeable who are from this sector. The study claims that the more a person is educated on AAOIFI standards, he is more inclined towards implementing it.

Salah (2011) in his research, 'Islamic Finance: The Impact of the AAOIFI Resolution on Equity-Based Sukuk Structures' tried to study the Sukuk murabaha in the Islamic financial market under equity based structure of sukuk and how it has been developing by being influenced by the AAOIFI resolutions.

Haniffa and Hudaib (2004) In their study titled 'Disclosure Practices of Islamic Financial Institutions: An Exploratory study' reported that only two Islamic financial institutes out of five, have followed AAOIFI standards. Surprisingly both of them are from the birthplace of AAOIFI, Bahrain. Despite their adoption, they have still some missing disclosures that were required by AAOIFI standards.

Ullah (2013) in his research titled 'Compliance of AAOIFI Guidelines in General Presentation and Disclosure in the Financial Statements of Islamic Banks in Bangladesh' commented that the Islamic Banks of Bangladesh are not bound to follow the standards of AAOIFI but despite that it is their duty to follow it as long as sharia'ah compliance is concerned. The study found on average 40.68% compliance of 7 Islamic banks in case of general disclosure. The standard deviation among these banks are 3.14.

4. RESEARCH METHODOLOGY

4.1. Data Resource

As this is a study of the disclosure practice, main source for the study was secondary data found in the annual reports of the banks. Annual reports of 6 selected Islamic banking institutes of Bangladesh have been analysed.

Sample Banks

1. Islamic Bank Bangladesh Limited
2. Al Arafah Islamic Bank Limited
3. Export Import Bank Limited
4. ICB Islamic Bank Limited
5. Shahjalal Islamic Bank limited
6. Social Islamic Bank Limited

4.2. Focusing Period

Informations from the year 2012 was collected from the reports.

4.3 Analysis Tool

Analysis of the data was done through Mean, Standard Deviation and Variance.

4.4 Contents under analysis

The disclosure contents which this study attempts to evaluate are stated below.

General Provisions

General disclosures in the financial statements

Statement of Financial position

Income statement

Statement of cash flows

Statement of changes in Owner's Equity

Statement of changes in restricted investments

Statement of sources and uses of funds in the Zakah and charity fund

Statement of sources and uses of funds in the Qard fund

Treatment of changes in accounting policies

Treatment of changes in non-routine accounting estimates

Format of Financial statements Notes to Financial statements

5. OVERVIEW OF AAOIFI

The Accounting and Auditing Organization for Islamic Financial Institutions(AAOIFI) is an Islamic

international self-governing non profit body that prepares accounting, auditing, governance, ethics and Shari'a standards for Islamic financial institutions and the industry. Professional qualification programs are also offered by AAOIFI for enhancing the industry's human resources base and governance structures. AAOIFI was established in conformity to the Agreement of Association; signed by Islamic financial institutions on 26 February, 1990 in Algiers. It was then registered on 27 March, 1991 in the State of Bahrain. AAOIFI is backed by institutional members, numbering around 200 from 40 different countries which includes central banks, Islamic financial institutions, Islamic Banks and others from international Islamic banking and finance industry around the globe.

AAOIFI has achieved support for the implementation of its standards in Dubai International Financial Centre, the Kingdom of Bahrain, Lebanon, Jordan, Qatar, Syria and Sudan. The relevant authorities in Australia, Indonesia, Malaysia, Pakistan, Kingdom of Saudi Arabia, and South Africa have also prepared guidelines basing on AAOIFI's standards.

A total of 88 standards issued till now by AAOIFI - 48 on Shari'a, 26 on Accounting, 5 on Auditing standards, 7 on Governance and 2 on Codes of ethics.

6. FINDINGS AND ANALYSIS

6.1. General Provision

General Provision on general presentation and disclosure in the financial statements requires a complete set of financial statements that comprises of seven different statements, notes for those statements, way to present the statements and precise form and classification used in that to ensure understandable and comprehensive information presentation for the users.

Table 1

Showing General Provision of General Presentation and Disclosure in the Financial Statements require in AAOIFI Financial Accounting Standard No. 1.

	Total	IBBL	ICBIBL	AIBL	SHJIBL	SIBL	EXIM	Mean
Frequency	14	11	11	11	11	11	11	11
Percentage	100	78.571	78.571	78.571	78.571	78.571	78.571	78.571
Standard Deviation	0							
Variance	0							

In General Provision on general presentation and disclosure in the financial statements, all the selected Banks complied 78.571 percent.

6.2. General Disclosure

General disclosure in the financial statements needs disclosure of information about the bank, the activities it undertakes, it's Shari'ah board, its subsidiaries and affiliates, disclosure policies, consequences of changes in the policies, investment mode etc.

Table 2

Showing General disclosure in the financial statements

	Total	IBBL	ICBIBL	AIBL	SHJIBL	SIBL	EXIM	Mean
Frequency	50	24	23	19	23	22	26	22.83
Percentage	100	48	46	38	46	44	52	45.66
Standard Deviation	2.115							
Variance	4.472							

In case of General disclosure, IBBL, ICBIBL, AIBL, SHJIBL, SIBL, and EXIM respectively complied 48, 46, 38, 46, 44 and 52 percent. The selected Islamic banks on an average complied 45.66 percent. Standard Deviation is 2.115 with variance of 4.472.

6.3. Disclosure in Statement of Financial Position

Statement of Financial Position is maintained to disclose complete financial position of the bank by showing the information on assets, liabilities and equities. AAOIFI classified assets, liabilities and equities to present with addition of necessary Islamic values. These disclosures show sector-wise investments of the banks that add to the banks' profit orientation.

Table 3

Showing disclosure in statement of Financial Position								
	Total	IBBL	ICBIBL	AIBL	SHJIBL	SIBL	EXIM	Mean
Frequency	16	9	9	8	9	9	9	8.83
Percentage	100	56.25	56.25	50	56.25	56.25	56.25	55.21
Standard Deviation	0.495							
Variance	0.245							

The sample banks on an average complied with 55.21 percent.

6.4. Disclosure in Income Statement

Income statement requirement in AAOIFI Financial Accounting Standard No. 1 suggests that the profit or loss with source of income and nature of expenses should be presented. Analyzing these statement users can easily identify the level of Halal or Haram income as all revenue and expenses are disclosed with their nature and sources.

Table No. 4

Showing Disclosure in Income statement

	Total	IBBL	ICBIBL	AIBL	SHJIBL	SIBL	EXIM	Mean
Frequency	19	10	9	10	10	10	10	9.83
Percentage	100	52.63	47.36	52.63	52.63	52.63	52.63	51.73
Standard Deviation	0.368							
Variance	0.136							

In case of income statement, the selected Islamic banks on an average complied with 51.73 percent.

6.5. Statement of Cash flow

Cash flow statements present the cash inflows and outflows. According to AAOIFI standards, cash flows need to disclose activity group wise statements and disclose the transactions that do not end it cash so that involmnet activites of the bank might be known.

Table 5

	Total	IBBL	ICBIBL	AIBL	SHJIBL	SIBL	EXIM	Mean
Frequency	5	4	4	4	4	4	4	4
Percentage	100	80	80	80	80	80	80	80
Standard Deviation	0							
Variance	0							

In Statement of cash flows the selected banks complied 80 percent of the required provisions. These banks complied with 4 of 5 items.

6.6. Statement of Changes in Owner's Equity

The Statement of Changes in Owner's Equity is needed to disclose the equity, distribution against equity, retained earnings etc. to inform the users about the degree of owners' equity.

Table 6

	Total	IBBL	ICBIBL	AIBL	SHJIBL	SIBL	EXIM	Mean
Frequency	6	6	6	6	5	6	6	5.83
Percentage	100	100	100	100	83.33	100	100	97.16
Standard Deviation	0.373							
Variance	0.139							

In case of the Statement of Changes in Owner's Equity, all of the selected Islamic banks in Bangladesh complied 100 percent except for Shahjalal Islamic Bank Limited which complied 83.33 percent.

6.7. Non-compliance of Financial Statements

Not a single one of these selected Islamic banks conformed with the disclosure requirements in case of Statement of changes in restricted investments, Statement of sources and uses of funds in the Zakah and charity fund, Statement of sources and uses of funds in the Qard fund, Treatment of changes in accounting policies and Treatment of changes in non-routine accounting estimates.

6.8. Format of Financial Statement

AAOIFI prepares specific formats as guidelines to prepare financial statement in case of disclosing general information regarding activities and position of Islamic banks.

Table 7

	Total	IBBL	ICBIBL	AIBL	SHJIBL	SIBL	EXIM	Mean
Frequency	7	2	2	2	2	2	2	2
Percentage	100	28.57	28.57	28.57	28.57	28.57	28.57	28.57
Standard Deviation	0							
Variance	0							

All of the selected banks complied 28.6 percent of the formats given for disclosing in the Financial Statements.

6.9. Notes to the Financial Statements

Notes to the financial statements are important requirement to complete financial statements. Notes mean details of the information that are presented in the statements in brief. Notes serve enough information for the users of these statements.

Table 8

Showing Notes to the Financial Statements

	Total	IBBL	ICBIBL	AIBL	SHJIBL	SIBL	EXIM	Mean
Frequency	45	27	28	25	25	24	24	25.5
Percentage	100	60	62.2	55.6	55.6	53.3	53.3	56.6
Standard Deviation	1.541							
Variance	2.375							

In case of disclosure of Notes to financial statements, IBBL, ICBIBL, AIBL, SHJIBL, SIBL, and EXIM respectively complied with 60, 62.2, 55.6, 55.6, 53.3, and 53.3. These banks on an average compliance with 55.68 percent. Standard deviation is 1.541 and variance is 2.375.

6.10. Total General Disclosure

In AAOIFI Financial Accounting Standard No. 1, the guidelines of General disclosure in financial statements of Islamic institutions direct Islamic banks to disclose their general information to the users. A sum total of 167 items of general disclosure in financial statements required by AAOIFI was considered for this particular study. These items can represent the total picture of the banks including its financial position, income and expenses and other issues of the banks in the light of Shari'ah.

Table 9

Banks	Total Disclosure	Total Disclosure in Percentage
IBBL	93	55.68
ICBIBL	92	55.08
AIBL	85	50.89
SHJIBL	89	53.30
SIBL	88	52.70
EXIM	92	55.08
Mean	89.83	53.79
St Deviation	2.794	
Variance	7.805	

The selected Islamic Banks on an average disclosed 89.83 items of 167 items in their annual report of 2012, which is 53.79%. Standard deviation of their total disclosure is 2.794 and Variance is 7.805.

IBBL complied the highest 55.68 % of the required items by the standard. The lowest compliance is performed by AIBL which is 50.89 %.

6.11. Level of St Deviation and Variance

Table 10

Table 10 shows the level of standard deviation and variance of different provisions by the selected sample banks as a whole.

	GP	GD	DFP	DIS	SCF	SOW	FFS	NFS
St Deviation	0	2.115	0.0495	0.368	0	0.373	0	1.541
Variance	0	4.472	0.245	0.136	0	0.139	0	2.375

6.12. Level of Satisfaction through St Deviation

Table 11

Table 11 shows the level of satisfaction in case of standard deviation among the selected Islamic Banks.

Here, If Standard Deviation is more than or equal to 1, the satisfaction level is 0. If standard deviation is less than 1, the satisfaction level is 1.

	St Deviation	Satisfactory level
GP	0	1
GD	2.115	0
DFP	0.0495	1
DIS	0.368	1
SCF	0	1
SOW	0.373	1
FFS	0	1
NFS	1.541	0

7. ANALYSIS

From the above table, it can be stated that, in case of compliance of General Disclosure and Notes to financial statements, the selected banks vary the most, which means, the banks are not unanimous in nature, when it comes to compliance with these two standards.

8. RECOMMENDATIONS OF THE STUDY

On the basis of the study and analysis, I would like to make some recommendation for the selected Islamic Banks of Bangladesh to pave the way of actual Islamic Banking.

- The Banks should take necessary steps to prepare the untouched statements, namely - Statement of changes in restricted investments, Statement of sources and uses of funds in the Zakah and charity fund, Statement of sources and uses of funds in the Qard fund, Treatment of changes in accounting policies and Treatment of changes in non-routine accounting estimates. These are vital statements that need to be prepared and disclosed for perfect reporting.
- The banks should start following the standard formats of AAOIFI to prepare the two most important statements – the statement of financial position and the statement of comprehensive income.
- Restricted and Unrestricted investment accounts are suggested to be opened and disclosed. The banks should focus on AAOIFI guiding principles more and take it seriously and act accordingly. For being an Islamic Bank, a company is obliged to carry out not only corporate responsibility, but also the Islamic responsibility which demands for clear cut truthfulness and transparency. 53.79% level of compliance is not at all satisfactory for the banks which have the capability to comply more. The banks should consider it seriously to try to increase the level of compliance in the future.

9. CONCLUSION

In a Muslim majority populated country like Bangladesh, Islamic banking has seen rapid growth. It is important for the Islamic banks in Bangladesh to comply with the Islamic Accounting standards prepared by trusted authorities like AAOIFI. They should also try to direct all their actions according to the ruling of Shari'ah. This study puts effort to measure the degree of compliance of the Islamic banks in Bangladesh in case of general presentation and disclosure in the financial statements with the standards set by AAOIFI. Even if it is not obligatory for Islamic banks in Bangladesh to follow the standards but yet, they should; as it is important to inform the stakeholders that they are acting according to Islamic value. This study recommended the banks to rise the degree of conformity with the standards to make the reports more Islamically informative.

10. REFERENCES

AAOIFI (2008). Financial accounting standard. Accounting and Auditing Organization for Islamic Financial

Institutions.

- Adams, C. A., (2004) ‘The ethical, social and environmental reporting performance portrayal gap’, *Accounting, Auditing, and Accountability Journal*, 17(5), 731-757.
- AI-Abdullatif, Sultan Abdullah (2007) ‘The application of the AAOIFI accounting standards by the Islamic banking sector in Saudi Arabia’, PhD Theses, Durham University, accessed at <http://etheses.dur.ac.uk/2594/>
- AI-Baluchi, A. E. A., (2006) ‘The Impact of AAOIFI Standards and Other Bank Characteristics on the Level of Voluntary Disclosure in the Annual Reports of Islamic Banks’, School of Management University of Surrey.
- Che, Pa, A. (2006) ‘An exploratory study on the understanding and accounting for Islamic bonds: perspective of Malaysian bank managers’, unpublished thesis, International Islamic University Malaysia.
- Guthrie, J. and Parker, L. D. (1990) ‘Corporate social disclosure practice: A comparative international analysis’, *Advances in Public Interest Accounting*, 3, 159–175.
- Haniffa, R. & Hudaib, M. (2004) *Disclosure Practices of Islamic Financial Institutions: An Exploratory Study*, Working paper series, Bradford University of School Management.
- Harahap, S. S., (2002) ‘The Disclosure Of Islamic Values – Annual Report The Analysis Of Bank Muamalat Indonesia's Annual Report’, *IQTISAD Journal of Islamic Economics*, 3(1), 33-45.
- Hossain, M. M., (2012) ‘Financial Statements of banks under Islamic Shari’ah: Status of Regulatory Compliance’, *Thoughts on Economics*, 22(1), 53-67.
- Ibrahim, S. H. B. M. et al., (2006) *Alternative Disclosure & Performance Measures for Islamic Banks*, Department of Accounting, International Islamic University Malaysia
- Nadzri, F. (2006) *Roles and impacts of accounting and auditing organization for Islamic financial institutions (AAOIFI) in dealing with the accounting and disclosure of Zakah and interest (Riba)*, unpublished thesis, AUT University.
- Salah, M., (2011), *Islamic Finance: The Impact of the AAOIFI Resolution on Equity-Based Sukuk Structures*, TISCO Working Paper Series No. 2 on Banking, Finance and Services, TISCO Bank PLC.
- Sarea, A. M., (2012) ‘The Level of Compliance with AAOIFI Accounting Standards: Evidence from Bahrain’, *International Management Review*, 8(2), 27- 32.
- Singh, D. R. and Ahuja, J. M. (1983) ‘Corporate social reporting in India’, *International Journal of Accounting Education and Research*, 18(2), 151–169.
- Ullah, M. H. (2013) ‘Compliance of AAOIFI Guidelines in General Presentation and Disclosure in the Financial Statements of Islamic Banks in Bangladesh’
- Zaini, N. (2007) *An exploratory study on the understanding of AAOIFI accounting standards for investment in Islamic bonds: The case of Malaysian’s accounting academics*, unpublished thesis, International Islamic University Malaysia.

11. APPENDIX

Compliance of provisions by the bank at a glance

Provisions	BANKS					
	IBBL	ICBIBL	AIBL	SHJIBL	SIBL	EXIM
GP	11	11	11	11	11	11
GD	24	23	19	23	22	26
DFP	9	9	8	9	9	9
DIS	10	9	10	10	10	10
SCF	4	4	4	4	4	4
SOW	6	6	6	5	6	6
FFS	2	2	2	2	2	2
NFD	27	28	25	25	24	24
Total	93	92	85	89	88	92

The IISTE is a pioneer in the Open-Access hosting service and academic event management. The aim of the firm is Accelerating Global Knowledge Sharing.

More information about the firm can be found on the homepage:

<http://www.iiste.org>

CALL FOR JOURNAL PAPERS

There are more than 30 peer-reviewed academic journals hosted under the hosting platform.

Prospective authors of journals can find the submission instruction on the following page: <http://www.iiste.org/journals/> All the journals articles are available online to the readers all over the world without financial, legal, or technical barriers other than those inseparable from gaining access to the internet itself. Paper version of the journals is also available upon request of readers and authors.

MORE RESOURCES

Book publication information: <http://www.iiste.org/book/>

Academic conference: <http://www.iiste.org/conference/upcoming-conferences-call-for-paper/>

IISTE Knowledge Sharing Partners

EBSCO, Index Copernicus, Ulrich's Periodicals Directory, JournalTOCS, PKP Open Archives Harvester, Bielefeld Academic Search Engine, Elektronische Zeitschriftenbibliothek EZB, Open J-Gate, OCLC WorldCat, Universe Digital Library, NewJour, Google Scholar

