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**Comparative Analysis of Accounting Treatments Between the IFRS's and
AAOIFI for The Islamic Financial Leasing Provided by Islamic Banks**

PhD Dissertation

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Abstract

The study aims to discuss the problem of conflict financial reporting between the banks to improve the accounting treatment of the IFI, Islamic banks and conventional bank, within the same country that adopted the IFRS's as the formal accounting standards for the financial reporting. The research methodology put together the four methods. Comparative theoretical analysis between IFRS16 and FAS 32 at the accounting treatment. Physical review and comparison for the Islamic banks' financial reports. Using the T-test to compare the effects of applying IFRS16 and FAS 32, that will be by extracting the available years' financial reports of Islamic and conventional banks. Structured interviews with the experts of Islamic accounting and IFRS's, the interviews designed according to the literature reviews influences on the research problem in addition to the results of the comparative theoretical analysis and the analysis of the annual reports. the dissertation approached that the expected problems have existed, Islamic banks are not entirely complying with the AAOIFI accounting standards, and the IFRS's could be suitable for the Islamic banking financial reporting.

Key Words: Financial leasing, Islamic finance, Islamic banks, IFRS's, AAOIFI.

Contents

1. Introduction	1
2. Research Aim and Objectives.....	2
3. The Research Questions	3
4. Research Methodology	3
4.1 Comparative theoretical analysis between IFRS16 and FAS 32	4
4.2 Physical review and comparison of the Islamic banks' financial reporting.....	5
4.3 The T-test is to compare the effects of applying IFRS16 and FAS 32	6
4.4 Structured interviews.....	7
5. Results	9
6. Conclusion.....	13
7. Bibliography of the Author.....	15

list of figures and tables

Figure (1) research methodology sequences (own work).....	4
Table (1) banks sample (own work)	6
Table (2) Questions summery (own work)	12

1. Introduction

Islamic finance has been utilized as an alternative and supportive financial tool in the market since the establishment of the first Islamic bank for commercial purposes, which is Dubai Islamic Bank in 1975 (Bakar, 2015). The term "Islamic finance" is defined as the alignment of financing procedures in line with Islamic teachings. The basic principles of Islamic finance activities are interest prevention (usury) in all transaction contracts that engage in commercial activities, based on fair and legal sharing of profits and losses (Tara et al., 2014). Since the Islamic finance started as an initial financial model, it was obligated to work in a dual banking system which is still being ruled by the conventional banks (Khattak, 2010). During the first stage of Islamic finance development, Islamic banks provided many financial products similar to the conventionally offered ones. These new products, called Shari'a compliance products, complied with Islamic Shari'a rules and included Islamic personal loans and Islamic credit cards (Bakar,2015). After almost a decade, these banks started to provide independent products based on Shari 'rules called "Shari 'based products"; for example, Mudarabah deposits "partnership investment deposits" and Ijarah Muntahia Bittamleek "Islamic Financial leasing" (Cebeci, 2012).

However, Islamic financial leasing and Murabaha commodity (buy and resale of products) are considered the most frequently used Islamic financial products (Mnif Sellami & Tahari, 2017). Ijarah Muntahia Bittamleek is like a finance leasing in a conventional bank, where the tenant has the option to own the asset upon the termination of the lease. Murabaha refers to a sale where the seller discloses the cost of the commodity and amount of profit charged. Therefore, Murabaha is not a loan given on interest; instead, it is a sale of a commodity at a profit.

Recently many organisations have been established to develop and govern Islamic finance. The most important of them is the Islamic Financial Services Board (IFSB) which has considered issuing the Islamic financial risk management standards (Aydın, 2017). Besides, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) which is an international Islamic organization which issued standards relating to Islamic financing practices from the legal and professional aspects of Islamic financial institutions (Mnif Sellami & Tahari, 2017). The AAOIFI issued the Islamic accounting standards to cover the differences of Islamic finance

which are related to Islamic rules from conventional banking. Notably, the standard (No 8) Ijarah Muntahia Bittamleek (leasing) are issued with due regard to the principal compliance with the leased financial assets, from which the ownership of the asset is not transferred directly to the lessee following the IFRS's. This criterion of financial leased assets recognition may affect the creditor (lessor) accounting treatment when utilizing the Islamic financial leasing. Currently, some countries still require Islamic banks to apply international accounting standards, and others have committed Islamic banks to apply accounting standards issued by the AAOIFI. The application of a standard other than IFRS 16 as applying the AAOIFI standards to address the accounting operations for the finance leasing product will lead to differences in the financial statements of the Islamic bank (Siswantoro, 2018).

2. Research Aim and Objectives

The general aim of the research is to improve the accounting treatment of the IFI. To approach this aim, the research will emphasize the following.

1. Discuss the need for exceptional accounting standards for the Islamic banking industry.
2. Measure the commitment of Islamic banks to the specific accounting standards, which is AAOIFI accounting standards, in the financial reporting process.
3. Recognize and understand the negative consequences in the financial reporting process when adopting two different sets of accounting standards in the national financial market or between the same Islamic bank branches when the Islamic bank has global branches.
4. Focus on the negative consequences in the financial reporting process when adopting two different sets of accounting standard when these Islamic banks are utilizing the Islamic financial lease.
5. Discuss the suggested results that have been nominated by the previous studies for avoiding the mentioned negative financial reporting consequences.

3. The Research Questions

1. Dose the Islamic banking industry need private accounting standards, Do the IFRS's improve the Islamic banking accounting treatments and make it more universally acceptable?
2. What are the differences between the IFRS's and AAOIFI of the financial leasing accounting treatment for the lessor?
3. What are the consequences of the accounting treatments differences, if found, on the financial market?

4. Research Methodology

The research methodology put together the four methods. They are:

1. Comparative theoretical analysis between IFRS16 and FAS 32 at the accounting treatment.
2. Physical review and comparison for the Islamic banks' financial reports.
3. Using the T-test to compare the effects of applying IFRS16 and FAS 32, that will be by extracting the available years' financial reports of Islamic and conventional banks.
4. Structured interviews with the experts of Islamic accounting and IFRS's, the interviews designed according to the literature reviews influences on the research problem in addition to the results of the comparative theoretical analysis and the analysis of the annual reports.

The sequence of the research methods is described in the followed paragraph:

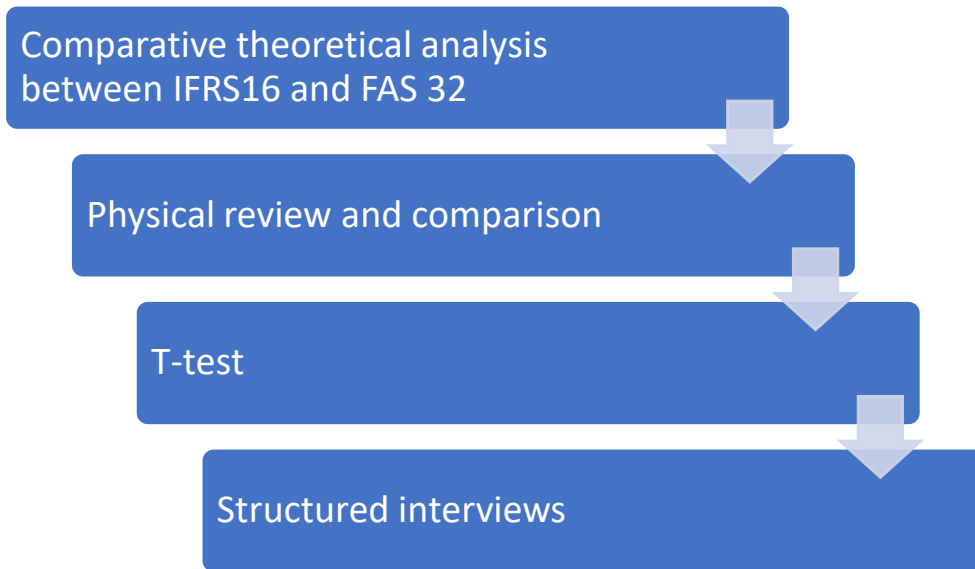


Figure (1) research methodology sequences (own work)

4.1 Comparative theoretical analysis between IFRS16 and FAS 32

According to the literature review the articles that examined the accounting treatment of Ijarah Muntahia Bittamleek under both IFRS's and AAOIFI accounting standards adopted only the comparative theoretical review for the accounting treatments, despite this methodology is limited and relay on the researcher opinion. It had been the first method in this research. The comparison has been done in:

Leasing revenues: How the Islamic bank recognize the revenue of financial and operational leasing under IFRS16 and FAS 32, and what are the differences and the effects on the financial statements.

The leased asset: What are the accounting treatments of the assets used in the Islamic financial and operational leasing by the Islamic banks under IFRS16 and FAS 32.

Repairs and maintenance: Which part of the Islamic financial agreement (lessor and lessee) should burden these expenses under IFRS 16 and FAS 32, and what are the effects on the income statement of each part.

Depreciation: The recognition of the leased assets will entirely influence this item under the financial leasing agreement; therefore, determine which part of the Islamic financial leasing

agreement (lessor and lessee) should burden these expenses under IFRS 16 and FAS 32, and what are the effects on the financial statement of each part.

Impairment loss of assets: The recognition of the leased assets will entirely influence this item under the Islamic financial leasing agreement; therefore, determine which part (lessor and lessee) has to apply the impairment loss test under IFRS's and AAOIFI accounting standards on the leased assets and what are the consequences on the financial statements of the part which apply this test.

Expected credit loss model: The leased revenue recognition will ultimately influence this item under the financial leasing agreement; therefore, determine the consequences on the financial statements of the Islamic bank (lessor) when apply and do not apply this model. This comparative analysis provides the information needed to identify elements of the T-test analysis.

What makes this research unique when compared with the literature review of Ijarah Muntahia Bittamleek are that it adopted other methods, analysis of the annual reports of Islamic banks, the T-test to provide statistical data and it has not been applied by other research yet and individual interviews with experts in Islamic finance, accounting and IFRS's.

4.2 Physical review and comparison of the Islamic banks' financial reporting

In this part, a physical review had been conducted among the financial reports of the Islamic bank, which apply the AAOIFI accounting standards in Jordan, Bahrain, and Qatar. These banks had been selected according to the literature review. The financial statement had been downloaded from the banks' websites for the past ten years to examine the stability of the accounting treatment. The physical examination focused on:

- Recognition of the leased assets.
- Recognition of investment in the lease.
- Depreciation and maintenance expenses.

The sample was selected as two Islamic banks from each country, since in Jordan the Islamic banks are four but two of them has ten or more years of financial statements. Therefore, only two banks selected from the other countries to keep consistency of the comparison; moreover, during the reviewing of the financial statements of the Islamic banks in Bahrain and Qatar, the banks in the same country use the same accounting treatments.

The sample was as the following table:

Country	Bank
Jordan	Jordan Islamic Bank
	Islamic International Arab Bank
Qatar	Masraf Al Rayan
	Qatar Islamic Bank
Bahrain	Bahrain Islamic Bank
	Albarrak Bank – Bahrain

Table (1) banks sample (own work)

4.3 The T-test is to compare the effects of applying IFRS16 and FAS 32

That had been done by extracting ten years' financial reports of Islamic banks. The comparison had been between; financial statements of Islamic bank which apply the AAOIFI accounting standards and financial statements of which apply the AAOIFI accounting standards and financial statements of Islamic bank but apply the methodology of IFRS's for Islamic financial leasing.

The T-test used the data of the result of the following percentage:

- a) **The financial leasing revenue- expenses/ Assets using for financial leasing,**

4.4 Structured interviews

According to the results of the comparative theoretical analysis, the analysis of the annual reports and the T-test results the research built structured questions to conduct interviews. Based on what is clarified in the literature reviews, it is indicated that the research community should have a deep understanding of the IFRS's features and importance furthermore the accounting effects on the shariah validity of Islamic finance products. Therefore, the interviews were conducted with two segments of participants consisting of experts in Islamic accounting (professors of Islamic accounting and managers of Islamic banks.) and International Financial Reporting Standards experts (audit managers and financial accounting professors) in Jordan and Qatar. All the persons interviewed above are actively involved in the preparation, review and teaching of the financial statements of IFIs, Islamic accounting and IFRS. They can, therefore, provide a rich interpretation of reporting practices. Most of them represent the major financial institutions in the banking sector. Those interviewed found an ardent desire for Islamic banking and thus produced a fruitful penetration in this current paper.

The sample was selected according to specific principles. The twelve experts in Islamic accounting; three of them are famous fully professors of Islamic accounting in Jordan, five of head financial departments in the Islamic banks in Jordan and what they mentioned from the staff as a professional in the topic. Finally, the last four participators were the financial managers of the Islamic banks in Bahrain and Qatar as what mentioned in the physical examination parts.

The thirteens IFRS's experts as follow, five professors their concentration field on IFRS's, two of them have a professional book of IFRS's issued annually, the others have a huge academic contribution in the IFRS's. The rest are audit supervisor and managers form the big four audit firms; theses auditors are involving in the audit job of Islamic banks. Theses auditors were asked about their interest and ability to participate in the topic.

These principles of selecting the sample are for keeping the high qualified information without any distraction from unappropriated data came from information lack.

Consequently, the structured interviews envisioned to capture the crucial evidence concerning the research purpose. Structured interviews were done within a reasonably organized context; hence, the questions asked were necessarily prepared in advance only some question for more explaining during the conversation asked.

Numerous questions automatically asked through the interview, with the structured question, to provide elasticity to both the interviewer and the participant to investigate and explain additional details or to consider other relevant points. The meetings were in the form of a conversation in addition to the question-and-answer method. All of the interviews were conducted face to face to consider the face expression and sound of the interviewed. The interviews were Arabic and translated into English. They recorded and then transcribed and were then coded manually by the researcher.

The interviews began with the Islamic accounting experts in the purpose of discussing the need for particular accounting standard to the Islamic banking industry and the trend of the financial reporting process does not produce that volume of unfavourable effect on the validity of Islamic finance product. Additionally, finding what is acceptable by the Islamic finance rules in the IFRS 16 to be applied to the Islamic financial leasing.

The next stage was for discussing the result of the theoretical comparison analysis and T-test results with Islamic accounting and IFRS's experts in the purpose of providing more interpretation of the result and finding the solution for this dilemma. The researcher also authenticated that their interviews are strictly confidential, as no one identity will be published. Researchers will end the conversations by asking interviewees whether they had any problems for discussion. The process will continue with the analysis of interview transcripts and documentary data using qualitative coding and manual recoding researchers this technique depends on the researcher qualifications of the subject since the researcher has an eleven years' experience in Islamic finance and auditing; additionally, professional certificates in Islamic finance and IFRS's.

This type of conversation, in many ways, differs from the structured questionnaire. First, the relationship between the researcher and the participant is not rigidly formulated. There is no questionnaire containing the complete list of questions to be posed to a participant. The researcher will have a mental framework of study questions, and his success will depend on his professional experience and qualifications in Islamic finance and accounting (Cassell, 2015). Specifically, questions posed to any participant will differ according to the context and setting of the interview. Second, the qualitative researcher should not adopt any uniform behaviour for an interview. Preferably, the qualitative interview is shaped in a conversational mode, and the conversation itself will lead to a sort of social relationship, where the quality of this relationship

is unique to every participant. Third, every interviewed can add information to the research has other choices, and the value of the interviewer answers depend on his personality, experience, awareness, knowledge, and understanding of the subject(Cassell, 2015).

5. Results

The research aims to improve the financial reporting of Islamic banks. Therefore, sub-aims have been set as follows,

- 1- Discuss the need for exceptional accounting standards for the Islamic banking industry.
- 2- Measure the commitment of Islamic banks to the specific accounting standards, which is AAOIFI accounting standards, in the financial reporting process.
- 3- Recognize and understand the negative consequences in the financial reporting process when adopting two different sets of accounting standards in the national financial market or between the same Islamic bank branches when the Islamic bank has global branches.
- 4- Focus on the negative consequences in the financial reporting process when adopting two different sets of accounting standard when these Islamic banks are utilizing the Islamic financial lease.
- 5- Discuss the suggested results that have been nominated by the previous studies for avoiding the mentioned negative financial reporting consequences.

After the literature review, the research approached the questions that achieved the research aims. The discussion will be for each question.

Question one: Dose the Islamic banking industry need private accounting standards, Do the IFRS's improve the Islamic banking accounting treatments and make it more universally acceptable?

This question had been answered focusing on the interviews because according to the literature review, these issues are only qualitative and need to experts' opinions (professional judgment). The interviews answers concentrated on the availability of applying the IFRS's by the Islamic banks. The situation that the Islamic banks in Qatar that they apply the IFRS 16

methodology; additionally, the adoption of IFRS's by the Islamic banks in Malaysia, the UAE and the UK afford an Image that the IFRS's could be suitable for the Islamic financial products. Moreover, the discussions needed that the Islamic bank which adopting the IFRS's are keen about international acceptance. Moreover, using the theoretical comparison method, IFRS16 adds further detail to the treatment of leasing revenue, making it clear that both operational and financial leases are treated differently. The physical examination for compliance showed that the Qatari Islamic banks apply the IFRS16 methodology for Islamic financial leasing accounting treatments. **The realized opinion is:** Private accounting standards are not required in the Islamic banking industry and the IFRS's will improve the IFI accounting treatments.

Question two: What are the differences between the IFRS's and AAOIFI of the financial leasing accounting treatment for the lessor?

This question had been answered by the methodology steps. The theoretical comparison: The principal difference is connected to the AAOIFI's recognition of tangible non-current assets, as the financial reporter can and must only recognize these assets when they own them. The contradiction between AAOIFI's recognition criteria resulted in an increase in lease expenses, lowering the net financial leasing profit. Maintenance, depreciation, and impairment losses are all included in these costs. The AAOIFI rejects using the interest rate as an impairment factor, ignoring the positive impacts of the projected credit loss model. The unambiguous evidence was the T-test since it provided a statistical assurance that the AAOIFI accounting standards increase the Islamic financial leasing profitability because it recognises the assets and do not recognise the credit. The interviews have confirmed these results and provided more clarification. **The realized opinion is:** There are differences in the financial leasing accounting treatment between IFRS and AAOIFI.

Question three: What are the consequences of the accounting treatments differences, if found, on the financial market?

This question has been answered by the methodology as follow. the first method theoretical comparison; accounting interest conflict because almost all lessees are in the commercial sector and use IFRS, implementing the AAOIFI by the lessor and IFRS by the lessee will result in both parties recognizing leased assets, maintenance expenses, depreciation expenses, and impairment losses in the financial statement, inflating assets, losses, and expenses. AAOIFI accounting standards on the leasing accounting treatments as ignoring the influence of

the expected credit loss model and apply the impermeant loss of the non-current assets. The interviews discussions approached that the AAOIFI has issued the FAS 30 Impairment loss to replace the expected credit loss model that accrued by the IFRS 9 and set the criteria of assets impairment. However, this action does not resolve the problem of burdening more expenses related to the impairment loss that arises from the recognition of the leased assets as non-current assets. Additionally, the benefit of the expected credit loss model is ignored since the FAS 32 does not recognize the Ijarah income from the Ijarah Muntahia Bittamleek as a long-term investment caused by the finance providing. Implementing the FAS 32 by Jordanian Islamic banks cause the problem of recognition both non-current assets and long-term investment (Ijarah receivable) exists since the central bank require to apply the expected credit loss model with all loan's accounts. Moreover, the central banks consider the Islamic financial leasing is a funding tool and any revenue related to it is loan receivable. Additionally, provided more explanations for these problems. The themes as inflation in the assets in the financial market, taxation problems and consolidation difficulties are considerable unfavourable consequences. **The realized opinion is:** These differences cause many problems in the financial market that lead to apply the IFRS's.

Question	Methods	Opinion
<p>Dose the Islamic banking industry need private accounting standards, Do the IFRS's improve the Islamic banking accounting treatments and make it more universally acceptable?</p>	<ul style="list-style-type: none"> - Theoretical comparison - Physical review - Interviews 	<p>Private accounting standards are not required in the Islamic banking industry and the IFRS's will improve the IFI accounting treatments.</p>
<p>What are the differences between the IFRS's and AAOIFI of the financial leasing accounting treatment for the lessor?</p>	<ul style="list-style-type: none"> - Theoretical comparison - T-test - Interviews 	<p>There are differences in the financial leasing accounting treatment between IFRS and AAOIFI.</p>
<p>What are the consequences of the accounting treatments differences, if found, on the financial market?</p>	<ul style="list-style-type: none"> - Theoretical comparison - Interviews 	<p>These differences cause many problems in the financial market that lead to apply the IFRS's.</p>

Table (2) Questions summery (own work)

6. Conclusion

The dissertation focused on the problem in Islamic finance, which is financial reporting. Since the researcher expected some difficulties and problems in the accounting treatment of Islamic financial leasing. When the AAOIFI accounting standards were released, several problems occurred. The disparities between these standards and the International Financial Reporting Standards (IFRS), the uncertainties about the AAOIFI accounting standards' global acceptability, and the interest accounting conflict when the lease agreement parties use different standards. As a result, avoiding the anticipated obstacles and difficulties benefits Islamic banks' financial reporting. The researcher applied a multivariate methodology consist of four methods: theoretical comparison, physical examination, T-test and finally, the structured interviews. The research limitations are related to the methodology and the research sample. The difficulties of quantifying the data since the sample is not fit to implement the questionnaires since the number of experts in Islamic accounting is small. Moreover, in the research topic, there are no regression or correlation between two sets of numbers. Additionally, the constraints that have been met when applying the T-test.

On the other hand, according to the small sample size, the research turned to use the qualitative methods consisting of the semi-structure's interviews. Despite the positive interview's aspect, the challenges that encountered with the meeting comprised several limitations of the study. Setting up the meeting with the participators; most of the sample apologized in the first attempt, later many efforts the acceptance to conduct the meeting has been awarded. This situation has complicated the research timetable and imposed the researcher to extend the research time plan to keep the methodology flow. Some meetings were time-restricted; therefore, gaining information to suggest other research paths was not in a perfect manner.

Overcoming the mentioned limitations; the dissertation approached that the expected problems have existed, the dissertation answered the research question as follow:

1. Private accounting standards are not required in the Islamic banking industry. The International Financial Reporting Standards (IFRS) improve Islamic banking accounting methods and make them more widely accepted.
2. There are differences in the financial leasing accounting treatment between IFRS and AAOIFI.
3. When Islamic banks use a different accounting standard on the financial markets, there are problems in the provided information.
4. Demonstrated the impact of accounting treatment discrepancies on the financial accounts of Islamic banks.

This study opens up new avenues for investigation, such as the impact of central banks on Islamic banks' financial reporting, the relationship between two sets of accounting standards and available income tax, and the procedures for financial reporting consolidation when subsidiaries use different accounting standards.

Further research and discussion on the links of Islamic financial instruments to international accounting and reporting rules are needed, according to this study, in order to increase the spread of Islamic finance in the international financial markets.

It is hoped that the International Financial Reporting Standards (IFRS) will take into account the characteristics of Islamic financing. This will contribute to Islamic finance's goal of improving the global Islamic financial system as a whole by making it more appealing to international investors. One feasible solution to this conundrum is to provide guidelines or possibilities for Islamic financial institutions within the framework of the International Financial Reporting Standards (IFRS). An Islamic institution, such as AAOIFI, can collaborate closely with the International Accounting Standards Board (IASB) to implement these recommendations globally

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