

Islamic accounting: A fundamental element in the growing industry



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Since its inception in the 1970s, the Islamic finance industry continues to flourish into new horizons, the ethical-based concept was founded to meet the demand of a select group (yet a large population) of consumers and investors and is now recognized as a leading global segment within the global financial services industry. Islamic banking has driven much of this growth, due to the advancement and enabling infrastructure of the banking system, in addition to the collective efforts of bankers and scholars.

AAOIFI pioneered the steps towards accounting for Islamic financial institutions, which addressed the specific Shariah compliant structures utilized by the subject entities. The broader definition of Islamic accounting is: "Accounting process which provides appropriate information, not necessarily limited to financial data, to stakeholders of an entity which will enable them to ensure that entity is continuously operating within the boundaries of Shariah and delivering on its socioeconomic objectives." (AAOIFI Conceptual Framework).

Review of 2018

The year 2018 saw several events which directly and indirectly impact the state of Islamic accounting. As the industry continued its growth pace within the year, with an expected year-on-year growth exceeding 30% according to the State of Global Islamic Economy Report 2018, initiatives from several global stakeholders influenced the direction toward the development of Islamic accounting. The AAOIFI accounting standards issued from 1991 and onwards remain the sole benchmark for best practice in Islamic accounting. An example of recent developments in 2018 would be AAOIFI's own "IFRS and the Shari'ah Based Reporting: A Conceptual Study", a significant attempt in reviewing the Islamic-based reporting with the globally-recognized standard-setting bodies. One of the main obstacles that stood in the way of Islamic accounting increasing its reach is potential reporting discrepancies with globally-recognized standards (such as IFRS and GAAP). The efforts of AAOIFI aim to bring forward an Islamic conceptual framework that will integrate a designated reporting methodology by Islamic financial institutions.

An indirect motion by AAOIFI as well, was the introduction by the UAE on the requirement of all Islamic financial institutions to comply with AAOIFI Shariah standards starting in 2019. While such a motion does not address the accounting standards per se, but it may be a door opener for a global Islamic finance pioneer such as the UAE to address the financial reporting element on a harmonized level for Islamic financial institutions.

Preview of 2019

The future of Islamic accounting demonstrates promising potential and this will see the light when the current efforts taken by the subject matter experts are translated into deliverables on a corporate and sovereign level. As stated by the conceptual framework; AAOIFI has always been open to dialogue and collaboration with global

standard-setters and regulators in the relevant areas. AAOIFI has initiated dialogue with International Accounting Standards Board (IASB) in the recent years, with the outcome of a much larger work is completed. Going forward, harmonization will be critical. Accounting standards and GAAP are ultimately a means of communicating performance and it is important that everyone can do this in the same language whether in established markets such as the GCC and Malaysia or in emerging markets in Central Asia and Africa.

Another significant element pertaining to the 2019 preview on Islamic accounting, is the adaptation of the newly-issued global standards (IFRS 9 Financial Instruments, IFRS 15 Revenue from Contracts with Customers and IFRS 16 Leases to particular). While the synchronization between such standards and Shariah compliant rulings remains to be a priority to the relevant standard-setting bodies, the element of complying with the Islamic principles in the case in hand remains to be the precedent factor. The Islamic Finance Consultative Group containing key stakeholders from Islamic finance standard-setting bodies (AAOIFI and IFSB) in addition to major Islamic financial institutions concluded that such an implementation must take place on case-to-case basis, depending on the relevant contract, in addition to setting up the upcoming progressive meeting in the first quarter of 2019.

Conclusion

The progression of Islamic accounting maybe on a slower pace in comparison to the overall industry, nevertheless, the collective efforts on individual and institutional bodies provide the necessary push for the field to prosper and compliment the missions and visions of global Islamic finance. Embracing the challenges and adapting to progression is key, while maintaining the authentic infrastructure of Shariah governance and compliance. Whether the application takes place on a fully-fledged Islamic financial institution or an Islamic window operation within a conventional entity, the unification of Islamic accounting methodologies is of crucial necessity for the craft to move forward, and we look forward to further developments. Watch this space. 📺