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Full Length Article

A survey on Islamic Finance and accounting standards

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Abstract

This review presents Islamic financial standards from inception to recent developments. The review discusses issues relating to the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), Islamic Financial Services Board (IFSB), and International Islamic Financial Markets standards (IIFM). Beyond institutional financial standards, this article proposes other perspectives that focus on the socio-economic impacts to the system. Consequently, the functional activities and standards development process of the reviewed bodies are discussed. The paper also highlights other challenges that need further strengthening within the system and concludes with suggestions for future studies.
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1. Introduction

Islamic finance is mainly practiced within emerging and developing economies, though recent developments in the industry have seen its services enter into developed nations (IFSB, 2015). Thus, the soaring growth of Islamic finance, which covers 60 countries of 14 jurisdictions, has concurrently increased its complexity in size and operations (Shabsigh et al., 2017). Although Islamic finance assets are small compared to the global financial industry, its wide extent and inclusive objective require additional regulations and standards that can accommodate uniformity across territories. The Islamic financial principles of transactions emerge from the primary sources of Sharia and differ from conventional global practices. Islamic finance operates within the boundaries of prohibitions against interest, gambling, excessive speculation, and complex derivatives, among others. The foundation of these regulations are earlier sources such as the Quran, Sunnah, Ijma, and Qiyas (Maghrebi, Mirakhor, & Iqbal, 2016). Adherence to the root principles underlying the Islamic financial system requires that its products and services take into account many social and environmental considerations. For instance, Islamic finance gives sufficient protection to have-nots in lending contracts; as such, any transaction that involves payment or receipt of interest is null and void. Consequenly, the system aims to protect not only humankind but also the environment through socially and environmentally concerned investment. Additionally, Islamic finance has a comprehensive structure that relates coexisting contractual relationships with binding standards. That is, it consists of elements of recording transactions, corporate and individual functions, transactional moral ethics and exchange, all combined with accountability that has interrelational links to

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attain a sustainable Islamic finance system (Aliyu, Hassan, Yusof, & Naiimi, 2017a; Aliyu, Yusof, & Naiimi, 2017b). Despite the existing provisions of Sharia financial decrees, the complexity of modern businesses and dynamic changes to human nature necessitate the creation of standing bodies for setting further regulations that are Sharia-compliant. Before the emergence of modern Islamic financial standard bodies, conventional institutions had established such institutions to complement best practices.

Historically, the countries that set the financial standards bodies were not far from the US, EU, and Japan. However, the recent role of emerging and developing nations requires that other regulations be devised regarding not only financial stability but also inclusiveness and economic development (Jones & Knaack, 2017). This goal is in accordance with the foundational guidelines of the Islamic financial system that emphasizes the institutional and welfarist school of thoughts, which are closer to the Ismaili and Chapra models (Aliyu et al., 2017a; Hassan & Aliyu, 2018). The former prioritizes firms' value maximization through institutional survival and solvency which are integral to financial stability, while the latter extends its contribution to enhancing societal well-being. Consistent with the objectives guiding the formation of Islamic financial institutions, the standard setters must balance goals beyond financial stability and reporting—they must uphold the *maqasid* objectives that focus on the enhancement of societal well-being. Societal prosperity must be the priority of the Islamic financial industry since it aims to achieve the objective of Sharia (Ahmed, Mohieldin, Verbeek, & Aboulmagd, 2015; World Bank and Islamic Development Bank Group 2017). Similarly, Islamic financial standards are required to cover not only an intermediation role that focuses on enhancing stability, but also to augment other conditions and provide guidance that will improve inclusiveness and resource mobilization towards economic development (Shabsigh et al., 2017). Thus, the providing of standards that respond to global changes is accommodated in the core principles of the Islamic finance regulations crafted by the Islamic Financial Services Board-IFSB (IFSB, 2015). As such, the recent global financial trends focus not only on stability and soundness, but also include factors that can potentially enhance societal well-being, with a target of transforming the world by 2030 (United Nations, 2015). At the same time, Islamic finance is emulated mostly by emerging and developing countries that require additional standards to develop their economic conditions. Therefore, it is in keeping with the Islamic financial context of *maqasid* and the practicing jurisdictions to prioritize inclusiveness that aims to enhance the well-being of society. It is of paramount importance to provide standards that are proactive towards encouraging Islamic regulatory and supervisory authorities to address prospective challenges the industry may face due to its high expansion volume. These prospective challenges are closely identified as those associated with financial stability, risk assessment, and capability for addressing financial crunch (IFSB, 2015).

In the first place, Islamic finance places emphasis on standards that prohibit interest, in all its ramifications, in order to reduce selfishness and greed within society. This also extends to risk sharing (Hassan, Aliyu, Paltrinieri, & Khan, 2018). Risk-sharing contracts provide avenues to sustain entrepreneurs that do not have sufficient funds to establish a business. Again, the Islamic financial consideration to the time value of money is only related to the deferred exchange and not to loanable transactions (Shafii et al., 2013). At the same time, Islamic finance aims to protect the excess exploitation of the lender and agrees that the debtor pay back the principal without any additional amount as interest. This reflects true benevolent loans that promote the welfare of society. In consideration of the poor in society, there is a provision to extend the loan period in the event that the borrowing agent has difficulty paying back the loan in the agreed-upon time, so that the lender can give more opportunity for the going concern of the entrepreneurial business (Q2:280). In this regard, Islamic financial institutions must monitor the quality of the financing as not to distress their capital viability. Therefore, a capital adequacy standard is necessary to keep the lending agent within the possible range of avoiding failure. Thus, Islamic finance that is built on the partnership agreement between *sahibul maal* and *mudarib* is liable to face other conditions of uncertainty since the return depends on the outcome of the transaction, which is based heavily on trust among parties and the fluctuation between profit and loss. In this regard, the accounting estimate of insolvency is a product of the uncertain return on investment and the proportion of equity to assets over the volatility of the return on assets (Beck, Demirgüç-Kunt, & Merrouche, 2013; Cihak, Demirgüç-Kunt, Feyen, & Levine, 2012, pp. 1−58). Thus, a firm can be deemed insolvent when the volatility variation increases to a level where its capital strength is deflated. Therefore, providing capital adequacy standards will likely protect the business from distress. Similarly, other standards, which will be thoroughly discussed in the subsequent sections, have implications in maintaining prudential transactions between the stakeholders involved.

Section two of this paper provides a brief historical account of Islamic financial standards, while section three highlights relevant institutions such as the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), the Islamic Financial Services Board (IFSB), and the International Islamic Financial Market (IIFM). Section four compares the activities of these three Islamic financial standard setters. Finally, the last section presents challenges and comments and concludes the paper.

2. Islamic financial standards

The perspectives on financial standards are linked to appropriate channels of recording, reporting, and interpreting financial transactions by either national, regional, or global standards. These can bring a standing harmonization to a particular standard and enable comparison of accounting reports in different locations. The use of a common format and language makes it easier for those in the profession to understand and make judgements on financial activities. The contemporary global financial standard-setting bodies issue standards beyond those related to recording transactions. Nowadays, there are standards regarding financial stability and soundness of the institutions, trades, and product exchange, among others. The soaring growth of Islamic financial institutions has drawn the attention of regulators, practitioners, and investors to ensure that the system will not be neglected out of certain regulations and standards to maintain good practices (Hassan & Aliyu, 2018; Hassan, Aliyu, & Hussain, 2019). The differences between the modes of business transactions found in the Islamic and conventional financial systems necessitate the former to pursue complementary standards to guide its transactional affairs. Consequently, Mohamed Ibrahim (2007, pp. 1–10) asserts that Islamic standard setters review the conventional international guidelines and accept those in conformity with Sharia and develop others that are considered necessary for financial institutions.

The Islamic Development Bank initiated the formation of Islamic financial reporting standards at its annual meeting in 1987 and was supported by existing Islamic banks (Abdel Karim, 1990). Subsequently in 1991, a standard setter called the Financial Accounting Organization for Islamic Banks and Financial Institutions (FAOIBFI) was formed through representatives of practicing accountants and Sharia scholars (Abdel Karim, 1995). The FAOIBFI was transformed and later became the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)[1]. The contextual values of the Islamic financial standards originated from the *fiqh muamalat*, as every relationship is permissible except those that are prohibited. The code of Islamic financial transactions provides ethical guidelines that make relationships fair and transparent. In this regard, Islamic standard setters have a Sharia scale that weighs the international standards before adopting, adapting, or developing a standard that can replace those issued, based on the global context. Presently, the Islamic financial standard bodies include the AAOIFI, IFSB, and IIFM, which are discussed in the following section.

3. The institutions

The major Islamic financial institutions responsible for issuing standards include the AAOIFI, which focuses on financial accounting standards. Meanwhile, the IFSB provides Islamic financial regulators with guidance and technical notes, along with other regulatory standards, to enhance the stability and soundness of the system. Finally, the IIFM provides standards on products and documentation on finance and trade. Each of the institutions is detailed below:

3.1. Accounting and Auditing Organization for Islamic Financial institutions (AAOIFI)

As the Islamic financial industry is growing across borders and promoting financial inclusion, regulators and practitioners have recognized the need for harmonious financial standards. The Islamic financial system has some unusual transactions that are not considered within the frame of the International Financial Reporting Standards (IFRS), which, among other things, necessitated the establishment of AAOIFI. However, AAOIFI was not enacted to replace the IFRS; rather, it provides a complement that fills in gaps between conventional and Islamic finance transactions (Abdel Karim, 1995). For instance, the treatment of zakat distribution, protection of unrestricted investment account holders' principal, and reserve funds for profit smoothing are some of the issues absent from the IFRS that are accounted for by AAOIFI (Grais & Pellegrini, 2006b, pp. 1–46; 2006a, pp. 1–46). Further, Islamic financial institutions have other characteristics that differ from the conventional practices of financial transactions, especially in the case of investment account holders of Islamic banks. Investment account holders have quasi-ownership without voting rights. Therefore, establishing standard-setting bodies that focus on these and many other concealed issues has become necessary for fair treatment and accountability in the industry. The ratification of the Algiers agreement on March 26, 1990 by Islamic financial institutions established AAOIFI as the non-profit organization responsible for issuing standards. AAOIFI was registered a year later, on March 27, 1991 in Bahrain (AAOIFI, 2010). Prior to that, Islamic banks used their in-house Sharia committee, management, and auditors to arrange their accounting treatment in accordance with Sharia norms and values (Abdel Karim, 1990).

The general assembly of AAOIFI consists of the executive committee, board of trustees, and general secretariat. Meanwhile, the technical board of Sharia, accounting and auditing, governance, and ethics forms the working standard committees of the organization. In addition, the body engages in standards-related activities such as promotional events through conferences and training, standards and journal publications,[2] membership, and professional exam-based certifications. As an international standards-setting body, it harmonizes accounting procedures and provides clear interpretations and policies for Islamic financial institutions that operate across different borders (Iqbal & Molyneux, 2005). As the Quran ordains that transactions must be recorded (Q2:282- "write it down"), AAOIFI develops standards about accounting, auditing, ethics, and governance for Islamic financial institutions. These standards are necessary for sustaining Islamic financial transactions in accordance with the primary sources of Sharia (Aliyu et al., 2017a,b). Presently, the organization has issued more than 94 standards to Islamic financial institutions, which were adopted by over 45 countries throughout the world.[3] AAOIFI has issued 27 Financial Accounting Standards (FAS), of which FAS five and six were revised and updated, and FAS 23 was reviewed to improve the understanding of the

[1] http://aaoifi.com/development/our-history/?lang=en.

[2] http://aaoifi.com/introduction-to-joifa/?lang=en; The Journal of Islamic Finance Accounting covers vast areas of Islamic finance and accounting scientific research.

[3] The 94 issued standards are published in two volumes and comprise 54 on Sharia, 26 on accounting, 5 on auditing, 7 on governance, and 2 on ethics.

Table 1
Status of AAOIFI adoption in different Jurisdictions.[6,7]

S/N	Country/Jurisdiction	Mandatory	Voluntary	Adopted	Sharia guideline	Remarks
1	Afghanistan					AS***
2	Bahrain					SS***
3	Brunei					AS
4	Central Asia					AS
5	Dubai International financial center					AS**
6	Egypt					AS
7	France					AS
8	Indonesia					SS
	Iraq					AS**
9	Islamic development bank					SS**
10	Jordan					AS***
	Kazakhstan[7]					SS
	Kyrgyz Republic					SS***
11	Kuwait					AS
12	Lebanon					AS
13	Malaysia					SS
14	North America					AS
15	Oman					SS***
	Palestine					AS**
16	Pakistan					SS***
17	Qatar					AS***
18	Qatar financial center					AS***
19	Saudi Arabia					AS
20	South Africa					AS
21	Sudan					SS***
22	Syria					SS***
23	United Arab Emirates					AS
24	United Kingdom					AS
	Yemen					SS***

AS-Accounting Standards; SS-Sharia Standards; ** Combined AS & SS; *** Combined AS, SS, & Auditing Standards

AS-Accounting Standards; SS-Sharia Standards; ** Combined AS & SS; *** Combined AS, SS, & Auditing Standards.

content (AAOIFI, 2014).[4] AAOIFI develops and reviews standards through five stages which require setting up the working committee composed of board members and in some cases employing external consultants. The process begins with a working agenda, preliminary study, consultation draft, and the release of an exposure draft before the last copy.[5]

Table 1 illustrates the status of AAOIFI standards applications based on jurisdiction. The standards are not uniformly

[4] The additional accounting standards are the FAS 27 on investment account, FAS 5 and 6 on disclosure of the profit allocation bases between capital owners and IAHs, and equity of IAHs and their equivalent are replaced details retrieved on 8/5/2017- http://www.reuters.com/article/us-islam-financing-accounts-idUSKBN0TQ12D20151207 and http://aaoifi.com/adoption-of-aaoifi-standards/?lang=en.

[5] Details of the process as explained by the AAOIFI: http://aaoifi.com/standards-development-and-revision-processes/?lang=en.

[6] http://aaoifi.com/adoption-of-aaoifi-standards/?lang=en; Note that AAOIFI updated this information based on the current survey. The information in this paper was generated in 2017 and 2019 respectively.

[7] Kazakhstan is a country where Astana Financial Service Authority practices the Shariah Standard.

implemented across boundaries (Kammer, Norat, Piñón, Prasad, & Towe, 2015; Lukonga, 2015). Most countries have liberalized the standards on a voluntary basis, whereas Malaysia and Indonesia have adopted them as their national Sharia guideline. The Islamic Development Bank (IsDB), a multilateral institution, has also adopted the standards. The increasing number of jurisdictions adopting the standards is consistent with the prodigious development of Islamic finance across the globe. Therefore, integrating and strengthening the standards is an essential function that will provide accountability, fairness, and disclosure in financial transactions.

Compliance with AAOIFI standards is fully acknowledged in Bahrain (Sarea & Hanefah, 2013). Some countries' compliance with Islamic financial accounting standards is voluntary, while other nations domesticate the Sharia part. The fourth column of Table 1 represents jurisdictions that combine the Sharia and accounting standards as voluntary internal guidelines to major Islamic financial institutions, except for Malaysia, which has nationalized Sharia guidelines. Similarly, jurisdictions such as Qatar, Jordan, and North America only use Sharia standards voluntarily. Column three highlights jurisdictions with mandatory adoption of both Sharia and accounting standards, except Pakistan, whose standards are nationally adopted.

3.2. Islamic Financial Service Board (IFSB)

The Islamic Financial Service Board (IFSB), established in 2002, is an organization that provides supervisory and regulatory standards designed with the close support of the International Monetary Fund (IMF) and Basel Committee (Kammer et al., 2015). The body resumed full operations in 2003 and provides standards to regulatory and supervisory organizations of Islamic financial institutions to ensure soundness and stability in the industry (Dusuki, 2012). The establishment of this institution concurs with the earlier assertions of Islamic financial scholars that the system has the potential to operate within an efficient and stable environment (Darrat, 1988; Hassan & Aldayel, 1998; Khan, 1986), whereas the complexity of the present financial system distorts the earlier predictions (Shabsigh et al., 2017). In view of this, one Islamic financial sustainability study highlights the aftershock effect that resulted in incapacitating positions of some Islamic banks, despite those that failed before the recent global financial crisis (Aliyu et al., 2017a). In this regard, the soundness of Islamic financial institutions is of paramount importance not only to prevent failure, but also to efficiently allocate resources and promote financial decisions that focus on the well-being of society and environmental protection. Thus, IFSB promotes prudential guidelines for the industry by adopting international standards, developing new standards, and reviewing standards to ensure that they serve Sharia objectives. The body also publishes working papers and reports as part of its scientific research documents for in-depth reviews and surveys on the performance of member countries' practices.[8] The responsibility for issuing standards to Islamic Financial Institutions (IFIs) to strengthen institutional survival and stability through risk management, corporate governance, capital adequacy, market discipline, and transparency is a heavy burden to the IFSB (Dusuki, 2012). Implementing IFSB and AAOIFI standards has the potential of enhancing disclosure and governance that will protect the public interest (Lukonga, 2015). Apart from standards issuance, the body also delivers Islamic financial stability reports and technical notes, organizes seminars and conferences, and provides training. IFSB complements other conventional regulatory bodies with 30 standards and has 180 members comprising 94 market participants in 57 jurisdictions, 78 regulatory and supervisory institutions, and eight intergovernmental institutions.[9] In a similar process to that of AAOIFI, IFSB prepares and issues exposure drafts before finalization and passes eighteen rigorous stages that include working committee assignment, consultation, proofreading, and other reviews.[10]

Table 2 illustrates 27 standards issued by the IFSB. Some are technical and guiding notes, while others incorporate extension and revision of earlier published standards.[11] For instance, IFSB-7 contains special issues of capital adequacy and extends IFBS-2 on the same matter, while IFSB 15 is the revised version of the previous standard. IFSB-6 extends the issue of governance (IFSB-3) in a collective investment scheme (such as Islamic unit trust, mutual funds, and investment funds) which is not covered in the earlier document. Another standard, IFSB-10, was subsequently issued to cover the recommendations in IFSB-1, 2, and 5, which focus on the "principle of the Sharia corporate governance system." Meanwhile, some standards are peculiar to a specific sector, such as insurance (IFSB-8, 11, and 14) and capital market disclosure principles (IFSB-19). Consequently, another governance principle (IFSB-8) on Takaful was issued as a separate document, since the earlier governance standards excluded it due to differences in rating and corporate structure. The revision of the supervisory review process (IFSB-16) and capital adequacy standards (IFSB-15) details the earlier issued IFSB-5 and IFSB-2 on the same subjects. Additionally, the standing body acknowledged the importance of liquidity risk management to Islamic financial institutions immediately after the financial crisis and issued IFSB-12 to complement the IFSB-1 on risk management. The issued standards are supported by guiding and technical notes for easy implementation. For instance, guidance on the quantitative measurement for liquidity risk management (GN-6) was issued to promote uniformity across Islamic financial institutions. The IFSB has provided six guiding notes and two technical notes. The guiding notes are related to risk management and capital adequacy, smoothing profit, and Takaful and re-Takaful. The technical notes pertain to Islamic money market development and stress testing. The

[8] https://www.ifsb.org/sec03.php; Details of the working papers and reports can be found here.

[9] http://www.ifsb.org/background.php is based on December 2018 information.

[10] http://www.ifsb.org/standard.php.

[11] http://www.ifsb.org/background.php.

Table 2
IFSB Standards.[13]

S/N	Standards	Year	Title	Remarks
1	IFSB-1	2005	Risk Management	STD[a]
2	IFSB-2	2005	Capital Adequacy	STD[a]
3	IFSB-3	2006	Corporate Governance	STD[a]
4	IFSB-4	2007	Transparency and Market Discipline	STD[a]
5	IFSB-5	2007	Supervisory Review Process	STD[a]
6	IFSB-6	2008	Governance for Collective Investment Schemes	Ex-STD[b]
7	IFSB-7	2009	Special Issues in Capital Adequacy	Ex-STD[a]
8	IFSB-8	2009	Guiding Principles on Governance for Islamic Insurance (Takaful) Operations	Ex-STD[c]
9	IFSB-9	2009	Conduct of Business for Institutions offering Islamic Financial Services (IIFS)	STD[d]
10	IFSB-10	2009	Guiding Principles on Sharia Governance System for IIFS	Ex-STD[d]
11	IFSB-11	2010	Standard on Solvency Requirements for Takāful (Islamic Insurance) Undertakings	STD[c]
12	IFSB-12	2012	Guiding Principles on Liquidity Risk Management	Ex-STD[a]
13	IFSB-13	2012	Guiding Principles on Stress Testing	STD[a]
14	IFSB-14	2013	Standard on Risk Management for Takāful (Islamic Insurance) Undertakings	STD[c]
15	IFSB-15	2013	Revised Capital Adequacy Standard	Re-STD[a]
16	IFSB-16	2014	Revised Guidance on Key Elements in the Supervisory Review Process	Re-STD[a]
17	IFSB-17	2015	Core Principles for Islamic Finance Regulations (Banking Segment)	STD[a]
18	IFSB-18	2016	Guiding Principles for Retakāful (Islamic Reinsurance)	STD[c]
19	IFSB 19	2017	Guiding Principles on Disclosure Requirements for Islamic Capital Market Products	STD[b]
	IFSB-20	2018	Key Elements in the supervisory Review Process of Takaful/Retakaful undertaking	STD[c]
	IFSB-21	2018	Core Principle for Islamic Finance Regulation (Islamic Capital Market Segment)	STD[b]
	IFSB-22	2018	Revised Standard on Disclosure to Promote Transparency and Market Discipline for Institutions offering Islamic Financial Services (Banking Segment)	Re-STD[a]
20	GN-1	2008	Recognition of Ratings on Sharia-Compliant Financial Instruments	GN[a]
21	GN-2	2010	Guidance Note in Connection with the Risk Management and Capital Adequacy Standards: Commodity Murābahah Transactions	GN[a]
22	GN -3	2010	Guidance Note on the Practice of Smoothing the Profits Payout to Investment Account Holders	GN[a]
23	GN-4	2011	Guidance Note in Connection with the IFSB Capital Adequacy Standard: The Determination of Alpha in the Capital Adequacy Ratio	GN[a]
24	GN-5	2011	Guidance Note on the Recognition of Ratings by External Credit Assessment Institutions (ECAIS) on Takāful and ReTakāful Undertakings	GN[c]
25	GN-6	2015	Quantitative Measures for Liquidity Risk Management	GN[a]
26	TN-1	2008	Development of Islamic Money Markets	TN[a]
27	TN-2	2016	Stress Testing	TN[a]

STD- originated Standard; Ex-STD-extended standards due to either addition or exclusion of Takaful, mutual fund, and collective investment scheme; Re-STD-revised Standard; GN-Guiding note; TN-Technical note. The remarks in the last column contain superscripts of four different letters that indicate the different sector applicable to each standard; a-banking, b-capital market, c-Takaful, and d-a combination of sectors.

IFSB also added three standards (IFSB-19, 20, and 21) in 2018 and an exposure draft was available for public hearing in 2019.[12] Part of this exposure draft is consistent with a proposed claim on Islamic deposit insurance pricing possibilities (Sabah & Hassan, 2019).

3.3. International Islamic Financial market (IIFM)

The International Islamic Financial Market (IIFM) provides standards for Islamic capital and money markets, especially regarding their contract and product templates. Market unification is one of the primary roles of the IIFM to ensure efficient and transparent global best practices in Islamic financial markets (IIFM, 2016). This standard-setting body was established in 2002 under the combined efforts of the Central Bank of Bahrain, Islamic Development Bank, Bank Indonesia, Central Bank of Sudan, Bank Negara Malaysia (which was represented by Labuan Financial Service Authority), and Autoriti Monetari Brunei Darussalam as founding members. Nowadays, the body reaches a global membership of 62 banks and other finance-related organizations (IIFM, 2016). The persistent increase in the IIFM's support by international financial and non-profit organizations expresses its vital role towards harmonizing market practices and efficiently delivering a transparent system. The role of IIFM includes creating product agreement templates, offering seminars and training, and providing a comprehensive general report on the Islamic financial market. In accordance with other Islamic financial standards-setters, IIFM has issued fourteen different standards.

Table 3 presents IIFM standards along with the year of issue and title of each. Of the fourteen issued standards, IIFM collaborated with the International Swaps and Derivatives Association (ISDA) to develop all except standards 1, 5, and 6. All standards were carefully issued after taking due consideration of necessary revisions and other opinions that are in

[12] https://www.ifsb.org/exposure.php; ED-GN-7: Guidance note on Shariah-compliant Lender-of -last — Resort facilities and exposure draft: Core principles for effective Islamic Deposit in Islamic Insurance System. The public hearing on these exposure drafts is scheduled between 22 May 2019 to 5 July 2019.

[13] https://www.ifsb.org/published.php; for detail.

Table 3
IIFM Standards.[14]

Standards	Year	Title
IIFM Standard-1	2008	IIFM Master Agreements for Treasury Placement
IIFM Standard-2	2010	ISDA/IIFM Tahawwut (Hedging) Master Agreement
IIFM Standard-3	2012	ISDA/IIFM Islamic Profit Rate Swap (Mubadalatul Arbaah) Standard Product Templates I
IIFM Standard-4	2012	ISDA/IIFM Islamic Profit Rate Swap (Mubadalatul Arbaah) Standard Product Templates II
IIFM Standard-5	2013	IIFM Inter-Bank Unrestricted Master Investment Wakalah Agreement
IIFM Standard-6	2014	IIFM Master Collateralized Murabahah Agreement
IIFM Standard-7	2015	ISDA/IIFM Islamic Cross Currency Swap (Himaayah Min Taqallub As'aar Assarf) Standard Product Template
IIFM Standard-8	2016	ISDA/IIFM Wiqayah Min Taqallub As'aar Assarf (Islamic Foreign Exchange Forward)-Single Binding Wa'ad based standard
IIFM Standard-9	2016	ISDA/IIFM Wiqayah Min Taqallub As'aar Assarf (Islamic Foreign Exchange Forward)-Two Unilateral and Independent Wa'ad Standard
IIFM Standard-10	2017	ISDA/IIFM 2017 Credit Support Deed for Cash Collateral (VM)
IIFM Standard-11	2019	IIIIFM-BAFT Master Unfunded Participation Agreement
IIFM Standard-12	2019	IIIIFM-BAFT Master Funded Participation Agreement
IIFM Standard-13	2019[a]	IIFM 2019 Sukuk Al Ijarah
IIFM Standard-14	2019[a]	IIFM 2019 Al Mudarabah

[a] not publicly available.

conformity of Sharia. Four of the standards (IIFM 11−14) are particularly recent, being added in 2019.

4. Similarities and differences of the institutions

The AAOIFI, IFSB, and IIFM are all international organizations that provide standards, guidelines, technical notes, and regulations for the operations of Islamic financial institutions. These bodies publish their standards in accordance with Sharia guidelines. They do adopt other international standards that are accepted within the premise of Sharia and develop other standards that are deemed necessary for institutions providing Islamic financial services. The oldest body is the AAOIFI, which has published a higher number of standards compared to the IFSB, while the IIFM has issued the least among them. Increasing concern about regulation standards is a global phenomenon, reflected in the fact that IMF staff proposed formally recognizing the “core principle of Islamic banking regulations” issued by the IFSB (Shabsigh et al., 2017). Further, the recent global financial crisis explicitly indicates the possibility of Islamic financial institutions to absorb the shock of crisis, despite recent argument of the aftermath effect in GCC countries (Alqahtani, Mayes, & Brown, 2016). Therefore, the guiding principles will help in maintaining good practices for coexistence among the parties involved in Islamic financial transactions.

The differences between the three Islamic financial standard setters can be recognized by their functions and activities. For instance, AAOIFI focuses on providing financial accounting standards in conformity with Sharia guidelines. Apart from financial accounting standards it also publishes governance, Sharia, and ethical standards. Comparatively, IFSB issues corporate governance standards in addition to other stability and soundness standards that include capital adequacy, market discipline, stress testing procedures, and core principles for regulating Islamic finance. IFSB standards are more concerned with institutional solvency and less concerned about direct socio-economic impacts that have a short-term effect on society. The stability and soundness of a financial institution protect the clients' interest, but the benefits are more pertinent to the capital owners than to society and the environment in the short-run. AAOIFI standards deal with zakat treatment, benevolent loans, and other disclosures to promote societal benefit through corporate responsibility. However, there is a need for extra effort in prioritizing societal and environmental standards rather than capitalist-oriented financial institutions.

All these bodies provide seminars and training on their respective standards and other related matters and follow rigorous procedures before issuing standards. A close view of their rigorous processes indicates that IFSB is more detailed and stricter in their stages compared to the other two institutions, though AAOIFI has stricter reviewing stages compared to IIFM.[15] The functional objectives of the institutions make them vary despite working with similar motives. In some cases, AAOIFI and IFSB are working on a similar issue or product (e.g. governance, Sukuk, etc.); thus, the synergizing cooperation of each is required between the institutions.

5. Challenges and comments

The functional efforts of Islamic financial standard setters are commendable considering the process of issuing guiding and technical notes for practicing institutions. The setter bodies provide additional standards that focus on

[14] http://www.iifm.net/.

[15] IFSB-Preparation for standards procedure http://www.ifsb.org/standard.php; AAOIFI-standards development and revision process http://aaoifi.com/standards-development-and-revision-processes/?lang=en; IIFM-brief on the standards http://www.iifm.net/about_iifm/brief-iifm.

market discipline, reporting, governance, and stability. These are expected to influence fair and transparent coexistence among contractual parties. Nonetheless, the institutions are not without other challenges that need to be addressed:

5.1. Sovereign power and fatwa shopping

The earlier suggestions of El-Hawary, Grais, and Iqbal (2007) towards providing guiding principles to regulators on the license and capitalization requirements of Islamic financial institutions have received the utmost consideration. As such, the standards issued by the IFSB on capital adequacy (IFSB-2, 7, and 15), risk management (IFSB-1, 12, and 14) and the supervisory review process (IFSB-5 and 16), coupled with their guiding notes (GN1-6), have shed light on the best practices in the industry. Nonetheless, full adoption of the standards is not guaranteed due to lack of sovereignty of the standard-setting bodies, especially in less financially developed jurisdictions. Although it is a global practice that financial accounting standards are adopted to suit jurisdictional purposes for transparency and accountability, the Islamic finance world has to consider their peculiarity on transactions. It is a known fact that not all countries operating in Islamic finance comply with established standards and that most countries consider them voluntary. This is consistent also with the challenges identified by the AAOIFI, as it lacks the power to enforce Islamic financial institutions' compliance with its standards (Karim, 2001). Limitations of the standard-setters' enforcement ability has also been highlighted regarding the prudential guideline on the profit reserve treatment. This issue is linked to the IFSB standards regarding the disclosure of displaced commercial risk and the treatment of profit smoothing in which institutions tend to be faced with moral hazard problems that can undermine the purpose of the guideline (Hussain, Shahmoradi, & Turk, 2015a). Taking a closer look, Kammer et al. (2015) assert that of the countries that practice Islamic finance, few jurisdictions actually comply with AAOIFI and IFSB standards. Therefore, strengthening collaboration between the countries practicing Islamic finance and the standard-setting bodies will enhance compliance and good practices.

Islamic finance has other binding regulations that are based on Sharia principles and require unanimous compliance. However, fatwa shopping has been identified as one of the hindering factors affecting the industry (Azmat, Skully, & Brown, 2014; Malik, Malik, & Mustafa, 2011; Oseni, Umar, Ahmad, & Hassan, 2016). Managers of Islamic financial institutions move around various schools of thought to suit their investment needs. As such, Oseni (2013) claims that despite the efforts of standards setters, there is a need for improvement in uncovered areas to suit the contemporary requirements of the industry. In view of this, Azmat et al. (2014) suggest harmonizing Sharia standards and supporting regulators to achieve unified guidelines for Islamic financial transactions.

5.2. Social and environmental negligence

It is conspicuous that the practice of Islamic finance is found predominantly among the emerging and developing countries of the world. This assertion is evident as the industry is more functional in MENA and Southeast Asian countries. These countries require standards that will not only support their financial stability but also improve their inclusive growth and development. This view corresponds closely to the welfarist perspective of Islamic finance which incorporates maqasid considerations. The maqasid objective of Islamic finance aims to enhance societal well-being, but the accounting processes of the industry neglect issues relating to poverty and environmental difficulties in Muslim-majority countries (Kamla & Alsoufi, 2015). Even though the content of the issued standards is in compliance with Sharia, the emphasis is unwisely placed on institutional stability rather than societal and environmental considerations. For instance, the 27 standards and guiding notes issued by the IFSB have less emphasis on the developmental issues of Islamic finance-practicing countries. Of course, it is an indisputable fact that long-term institutional instability might do real damage to society and the environment. Thus, establishing a sound and stable financial environment is a necessary condition, whereas the sufficient condition for Islamic financial institutions to achieve their goals is through effecting positive change in society. This argument is supported by the recent paradigm shift to Sustainable Development Goals (SDGs), which blend the objective of improving countries' economic growth with enshrining societal and environmental protections. In this respect, welfarist scholars (Asutay, 2008; Asutay & Harningtyas, 2015; Mohammad & Shahwan, 2013; Shamsudin & Mohammed, 2015; Zaman, 2013; Zaman & Asutay, 2009) of Islamic finance argue that the system has yet to fulfill its required maqsid objective. Therefore, providing standards that uphold societal values and environmental considerations while financing investments will improve the welfarist performance of the industry.

5.3. The issue of lender of last resort

There is an immense need for a Sharia-compliant Lender of Last Resort (SLOLR) to fulfill the *maqasid* requirement of protecting wealth from damage, risk, or harm, as well as to promote public policy that has a beneficial effect on the public interest (Islamic Financial Service Board & International Shariah Research Academy for Islamic Finance, 2016). Recently, there has been a call to consider conventional guidelines in providing such services to Islamic financial institutions. Shabsigh et al. (2017) highlight various issues that need to be considered by Islamic financial institutions, such as deposit insurance, Islamic banking resolution regime, anti-money laundering, and the use of conventional principles by an Islamic financial lender-of-last-resort. These are critical issues that must be addressed by providing strong standards that cater to Islamic financial institutions. Islamic standards-setters must provide prudential and guiding notes coupled with other regulations within the Sharia framework. Regarding this issue, a joint report between IsDB and IFSB has proposed the establishment of a Sharia-compliant lender of last resort (Hussain et al., 2015a). However, the consideration of non-Sharia compliant guidance in providing this service requires additional validation and conditions that will warrant such a practice to exist as proposed recently by the IMF staff (Shabsigh et al., 2017). The earlier claim explicitly concludes that a conventional lender of last resort to Islamic finance may not be easily implemented due to the structure of the institution (Grais & Pellegrini, 2006b, pp. 1–46). This claim is subject to the conclusions of the various Sharia standard bodies as they critically assess this issue and come out with a unified stand. The recent efforts of IFSB on the safety net are remarkable, though more efforts have to be implemented towards compliance, adoption, and fast-track process of standards issued.

5.4. Harmonization with international practices

Although most countries practicing Islamic finance comply with Islamic standards voluntarily (Lukonga, 2015), full compliance is the only solution to possible issues that may arise regarding stability and soundness (Hussain, Shahmoradi, & Turk, 2015b; Shabsigh et al., 2017). A divergence emerges as a result of domesticating international standards other than those within the context of Islamic finance, which may necessitate further adjustment in some countries. For instance, some jurisdictions are in the process of considering Islamic financial institutions as legitimate channels for intermediation, which mandates that they provide provisions that will ease such practices in their territories. Given this, Shafii et al. (2013) recommend international Islamic standard setters to harmonize and converge their accounting standards at an international level that will suit the majority of the member countries. This will provide a consolidated approach to various issues that can be resolved with a single clear focus. Hassan and Dridi (2011) argue that most Islamic banks across territories and even within countries have differences regarding products as well as a mixture of accounting standards, despite the efforts of Islamic financial standards institutions to harmonize standards. Therefore, extending international cooperation, especially with less-Muslim populated countries, will enhance the performance of Islamic financial institutions. At the same time, the harmonization of Islamic financial standards is also required to foster efficiency that will increase compliance, transparency, and fairness in the system. Thus, Awadzi, Chartouni, and Tamez (2015, p. 34) argue that uniformity of accounting procedures and prudential guidelines is required within the industry.

5.5. Islamic financial contracts issues

The IFSB capital adequacy standards fail to categorize profit sharing investment accounts as institutional capital, so the investment risk and profit equalization reserves cannot be treated as regulatory capital (Awadzi et al., 2015, p. 34). This assertion revolves around the claim that investment accounts neither fulfill the “core” nor “additional” capital of global standards. Consequently, the two reserves highlighted above are related to investment account holders, not to banks, except in the event that the bank has a share in the profit equalization reserve. The clarity of the treatment and specifying accountable instruments related to additional Tier I and II capital is of utmost importance (Kammer et al., 2015). In this regard, the standard setters of Islamic financial institutions have to collaborate because the treatment of investment accounts varies across boundaries, while the classification of the reserves related to the accounts is another issue related to the capital adequacy requirement, which is nearer to the functions of IFSB. In some cases, there is a need to invite the IIFM since documentation and product promotion are elements relevant to executing transactions, especially those that span borders. Awadzi et al. (2015) further argue that a deposit insurance scheme can be problematic for Islamic banks due to unclear classification of transactions that constitute wadiah and qard contracts, caused by differences across jurisdictions. These issues can be mitigated through extending international collaboration and thorough exploration of the means to harmonize the process and treatment of every agreed transaction.

5.6. Cooperation towards adoption

The growth of Islamic financial institutions in recent times is another development in the industry that is not without possible obstacles concerning resilience, stability, and customer protection (IFSB, 2015). For instance, Islamic finance is now receiving acceptance not only in Muslim-majority countries, but also many other parts of the world are amending their financial regulations to give room for flexibility, which inevitably results in idiosyncrasies that arise due to differences in geography, customs, and culture. Thus, Islamic financial standard-setting organizations must take care that stringent conditions do not exclude prospective Islamic financial institutions in less-Muslim countries. Increasingly seeking these countries' cooperation in adopting Islamic finance standards will create an enabling environment for the further penetration of Islamic finance into other jurisdictions. Therefore, harmonizing Islamic financial standards with other international standards will ease foreign adoption of Islamic finance. At the same time, the inconsistencies that exist within Islamic finance practicing countries regarding full adoption of standards has motivated the recent IMF move towards implementing cross-border comparisons based on macroeconomic and financial statistics (Shabsigh et al., 2017).

5.7. Insufficiency of experts

Another obstacle is that the number of experts in the field is inadequate to meet the high growth rate of the Islamic finance industry. This can lead to many Islamic financial firms resorting to calling on Sharia advisors to oversee their affairs. Overburdening the Sharia advisers' workload may undermine their efficiency in intensively reviewing financial transactions.

Therefore, it is suggested that a central Sharia advisory board with rigorous selection criteria be established. This board can be used across the globe for each country and the ruling of each state's board must be available for other comments. Some jurisdictions have embraced the use of Islamic financial standards (Kammer et al., 2015), and most countries practicing Islamic financial services are urged to follow suit. Ansari (2016) proposes that the roles of the central Sharia board should be to provide rulings, to issue interpretations of Islamic financial standards, and to stand as overseer to Islamic financial practices in each jurisdiction. This will reduce management costs and enhance future research for product innovations (Hussain et al., 2015a). However, some product innovations may lead to complexity that requires an intensive risk management framework in the system. For instance, the recent expansion of innovative financial technology (FinTech) that combines various product features requires further consideration and review of its Sharia legitimacy to preserve customer protection and improve social finance. Therefore, Islamic financial standard-setting organizations must monitor all product development and issue related guidelines, with particular attention to product innovation.

Islamic finance faces other challenges regarding Sharia scholars' differences on various commercial and transactional interpretations, which negatively affects their unification on certain issues. Although the establishment of standard-setters has reduced these impacts to some degree, some scholars still have differing perceptions on certain matters, which can undermine full compliance. The insufficiency of versatile experts who are proficient in both Islamic and conventional contractual transactions is among the biggest challenges facing the industry, particularly in the period of its expansion (Hassan & Dridi, 2011). This increases the likelihood of poor utilization of standards in most jurisdictions with a shortage of skilled experts. Experts on Islamic financial transactions are needed in regulatory settings as well as in the industry. Further, many studies outline the demand for expertise in the industry beyond banking staff. Islamic financial regulators are also required to be equipped with Sharia and financial technical know-how to reduce endemic risks affecting institutions (Archer & Haron, 2013; Archer & Karim, 2013; Mallin, Farag, & Ow-Yong, 2014; Nienhaus, 2013; Aliyu, 2014).

5.8. Balanced approach

Islamic financial paradigms concentrate on institutional stability as well as socioeconomic development and environmental protection aimed at achieving maqasid objectives. Nonetheless, standard-setting bodies have placed less emphasis towards issuing standards that have a direct link to societal development, despite AAOIFI standards on zakat and waqf. The standards on institutional disclosure and accounting treatment regarding waqf require further development (Suhaimi Nahar & Yaacob, 2011). Thus, issuing other provisions mandating disclosure on waqf will enhance the fairness and transparency needed to attain social and environmental corporate responsibility. Islamic finance is a growth-focused system from its foundational theory, since it aims to improve socio-economic coexistence through justice, fairness, and ethical provisions that are in line with Sharia principles. In furtherance of this objective, Islamic microfinance institutions have the potential to serve those in the lower and middle classes. Microfinance banks have a different set of clients than do commercial banks. These clients require special treatment. At this point, eradicating poverty stands as the first goal to successfully empower society and create growth that will enhance economic development. Therefore, when setting standards, taking both the institutional and welfarist views into account will tend to balance the system without neglecting the less privileged in society.

5.9. Adopting issue

Even though some accounting and financial procedures of transactions have been adopted from conventional finance, a careful review is always required at the time of accepting any treatment procedure. Recent studies recommend revisions to some financial valuations that they found constitute other interest elements (Ahmed, Sabirzyanov, & Rosman, 2016; Elnahas, Hassan, & Ismail, 2017; Gharbi, 2016). Shafii and Abdul Rahman (2016) argue that fair value treatment has a tendency of containing Gharar and inaccurate valuation of assets and liabilities. This may lead to mismanagement of financial procedures, which can lead to deception and manipulation of financial statements.

5.10. Money laundering issue

To date, there has been no identified money laundering issue relating to the Islamic financial industry. Additionally, financial terrorism is against the dictates of the Sharia guidelines according to which Islamic finance was established. Nonetheless, recently Shabsigh et al. (2017) pinpoint money laundering as one of the issues that Islamic financial standards bodies must consider. Kammer et al. (2015) had earlier discussed the need for the industry to craft regulations and standards to this effect, considering the complex nature of Islamic finance and the inexperience of supervisors.

Islamic financial standard setters and various countries are therefore advised to address these and other identified challenges that are facing the system. The identified challenges in this paper are not exhaustive; rather they highlight timely issues that require urgent attention. The Islamic finance industry is in need of a sound and stable financial system that can enhance prosperity through fair and transparent transactions, which is possible only if standard-setters continue issuing appropriate guidelines.

6. Conclusion

This paper reviews the historical background of Islamic financial standards with a focus on AAOIFI, IFSB, and IIFM. Although Islamic financial standards initiatives began less than three decades ago, the system has guiding principles that command other transactional norms. Islamic financial transactions are within the dictates of Sharia laws that mandate recording transactions, fairness, justice, and benevolence. The Islamic financial system considers not only capital owners; it also takes into account other stakeholders that are linked with transactions. We argue that Islamic financial standard-setters should focus more on socio-economic factors that affect the majority of their member countries. In view of this, a link is established between the welfarist approach to Islamic finance, which prioritizes the enhancement of societal well-being, and the institutional approach, which concentrates on the soundness and stability of the system.

Nonetheless, the complexity of business contracts and soaring growth of Islamic finance necessitate the development of additional standards within the Sharia frame. Thus, AAOIFI was established, followed by IFSB and IIFM, with the aim of providing standards for Islamic finance that are harmonized with global practices. However, the standard-setters are not without some challenges that will require consolidated efforts to overcome them. For instance, the lack of sovereign power of the Islamic financial standards bodies undermines their enforcement of some guiding regulations. The recent move of the IMF to officially recognize Islamic financial principles can improve the adoption and spread of the system to other developed nations. However, the influx of IMF has other implications and stakeholders have to strengthen their efforts towards maintaining the earlier principles established within the system. In this regard, issues related to using conventional guidelines for an Islamic finance lender of last resort require thorough debate and review from a Sharia perspective. Consequently, the harmonization of Islamic standards with conventional ones is a good idea so long as the Islamic financial tenets are substantially upheld without deviation. For instance, an expansion of innovative hybrid products such as Financial Technology (FinTech), among others, requires careful consideration as to their legitimacy in order to protect consumers' interests, Sharia compliance, and financial inclusiveness. Therefore, Islamic finance must focus beyond stability and soundness and incorporate social and environmental development to reflect its prime objectives. At the same time, standards relating to money laundering are required for Islamic finance to avoid any underground practices that are not in conformity with Sharia principles. Islamic finance is growing at a time when the global financial system is facing many challenges, a situation that calls for reforms, emerging policies, and adjustments that require technical inputs. As an emerging discipline, Islamic finance continues to need experts that have diverse skills from both an Islamic and a conventional background. Therefore, it is worth recommending that standard-setting bodies should endeavor to translate their publications in languages other than English and Arabic. Specifically, AAOIFI must translate their certification modules into at least English so that non-Arabic experts will be acquainted with the contents therein. Additionally, the establishment of an international standard body for accrediting Islamic finance courses to universities and other centers of learning is necessary to guide the creation of modules that combine both theory and practice.

Conflict of interest

None declared.

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