

# THE FACTORS AFFECTING THE ADHERENCE OF ISLAMIC ACCOUNTING STANDARDS AAOIFI IN JORDAN

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## Abstract

**How to cite this paper:** Alqaraleh, M. H., Thuneibat, N. S. M., & Nour, A. I. (2020). The factors affecting the adherence of Islamic accounting standards AAOIFI in Jordan. *Journal of Governance & Regulation*, 9(4), 69-75. <http://doi.org/10.22495/jgrv9i4art6>

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**ISSN Print:** 2220-9352

**ISSN Online:** 2306-6784

**Received:** 03.11.2020

**Accepted:** 11.12.2020

**JEL Classification:** M480, D02, G21

**DOI:** 10.22495/jgrv9i4art6

The aim of this paper is to knowledge the problems faced by Islamic banks in Jordan towards the adherence to AAOIFI accounting standards. And to study the problems faced with adherence to AAOIFI accounting standards, a meticulous market survey was conducted from banking (employees of the financial department) in Islamic banks in Jordan - their number 4 - banks. A structured questionnaire was designed and distributed in person among respondents - their number 80 - employees in the financial departments. We are found towards adherence to AAOIFI accounting standards. Internal and external problems are found to adherence Islamic banks to AAOIFI accounting standards. The sample is limited to Islamic banks in Jordan. This is necessitated by the lack of adaptation elsewhere. Also, there is little research in Jordan on adherence to AAOIFI accounting standards developed by this body. This paper, along with the previous study, helps to address this gap.

**Keywords:** AAOIFI, Accounting Standards, Problems, Islam, Banks, Central Bank of Jordan, Securities Commission

**Authors' individual contribution:** Conceptualization - M.H.A.; Methodology - A.I.N.; Resources - A.I.N.; Data Curation - N.S.M.T.; Writing - Original Draft - M.H.A.

**Declaration of conflicting interests:** The Authors declare that there is no conflict of interest.

## 1. INTRODUCTION

Islamic banking has been emerging and expanding very rapidly since the last years, not only inside but outside the Islamic sphere as well. As explained in Maali, Casson, and Napier (2006), the financial products offered by Islamic banks are those that comply with the Islamic law of human conduct called the *Sharia*. Additionally, Islamic banks denote the vast portion of Islamic financial institutions (IFIs), and these IFIs have proliferated all over the world, both in- and outside of the Muslim and the Islamic nations. Islamic banking has come into existence following the expanding demand from the Muslim communities all over the world, for financial products

and services (among others) that are Sharia-compliant (Sarea & Hanefah, 2013). Consequently, to assist the preparation and promulgation of accounting standards in accordance with the principles of Sharia for IFIs, a private standard-setting organization known as the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) was established by the Islamic banks and other parties of interest (Karim, 2001).

But owing to the dearth of a legal framework in addition to the irregularity of financial reporting, some Islamic institutions in developing nations are facing obstacles in adopting the unique accounting standards. As an example, in Qatar and the UAE, financial institutions are formally required to follow

the International Accounting Standards (IAs), whereas, in Saudi Arabia, financial organizations are required to comply with both IAS and local accounting standards. Meanwhile, in the context of Malaysia, Ahmed (2002) reported the presence of the national accounting standards grounded upon IAS.

Relevantly, in the context of Sudan, El Fath (2016) reported that Islamic banks are facing obstacles in the actual use of Islamic accounting standards and the banks' financial performance has been impacted because of this. Meanwhile, in the context of Palestinian Islamic banks, Zammar (2015) reported that to a large degree, the banks demonstrate compliance with the requirements of Financial Accounting Standard No. 1. On the other hand, to some other requirements (e.g., statement of sources and utilization of the loan fund, statement of changes in restricted investments, and statement of sources and utilizations of the Zakat Fund), the banks showed no compliance.

Studies on Islamic have also been carried out in Jordan and generated some notable findings. For instance, Al-Zu'bi, Al-Qadi, and Al-Arian (2013) reported the non-existence of the appropriate solution to the problems of the last lender aside from the problem associated with the application of the compulsory reserve for Jordanian Islamic banks. For this reason, Islamic banks in Jordan are facing difficulties in implementing its accounting and legitimacy standards. Not only that, the Jordan Securities Commission (JSC) as observers and regulators did not appear to contribute to obliging the Islamic banks to issue their financial statements following the Islamic financial accounting standards.

Also, in the context of Jordan, Almatarneh (2011) proposed forcing the Islamic banks to abide by the requirements of the standard, and the Sharia committee has been suggested to shoulder the task. Additionally, examining Jordanian Islamic banks, Samhan (2012) found that the banks do not sufficiently comply with accounting standards for IFIs.

Considering, the present study will attempt to ascertain the problems faced by the Jordanian Islamic financial institutions concerning the accounting standards of Islamic financial institutions, by answering the following study questions:

*RQ1: What are the external problems in Islamic banks in Jordan affecting the adherence to AAOIFI accounting standards?*

*RQ2: What are the internal problems in Islamic banks in Jordan affecting the adherence to AAOIFI accounting standards?*

By having the research questions addressed, this study accomplishes two primary research objectives, as follows:

1. To explore the external problems faced by Islamic banks in Jordan towards the adherence to AAOIFI accounting standards.

2. To explore the internal problems faced by Islamic banks in Jordan towards the adherence to AAOIFI accounting standards.

This study is considered one of the rare studies of its kind in Jordan. So, it will provide a helpful basis to banks engaged in Islamic based operations with their convergence policies, and knowing the problems facing the application of Islamic accounting standards in these banks. In addition,

institutional and individual investors who pose to have a Sharia-compliant portfolio will benefit from the insights provided in the study.

Another aspect of the study is the addition to the existing actual research done on a relevant topic and providing some new insights to academia and scholars. The study also incorporates the level of impact of AAOIFI on various associated areas. It augments the importance and need of adopting AAOIFI accounting standards in Jordanian Islamic banks and identifies the merits in its adoption.

Furthermore, a total of five sections are included in this paper. Section 1 provides an introduction to the topic under the study. Section 2 reviews the literature on Islamic accounting standards AAOIFI. Section 3 comprises the details of the research methodology. Specifically, this chapter provides details on the sampling, the validity and reliability of the employed data gathering tool, the research design, the population of the study, the unit of analysis, and the plan of data analysis. This chapter also provides comprehensive details on the sample population. In Section 4, the obtained findings, in relation to the research hypotheses, are discussed in detail. In Section 5, the findings are recapped, the limitations of this study are deliberated, as well as the conclusion formulated.

## 2. LITERATURE REVIEW

The survival of IFIs within the industry is highly impacted by the quality of financial statement, where high-quality financial statement can increase the confidence of the public that the products are compliant with the principles of Sharia (Archer & Karim, 2007). In this regard, the issuance of a standard accounting methodology for the regulation of numerous internationally acceptable types of patterns or systems of Islamic banking finance needs to be determined particularly in terms of its method.

Relevantly, in an attempt to differentiate the products of IFIs and those of conventional banking, AAOIFI introduced the "Islamic accounting standards". Additionally, some have argued that the unique transactions of Islamic banks have caused their incompatibility with the conventional accounting rules, for instance, the International Financial Reporting Standards (IFRSs) (Maali & Napier, 2010). As an example, funds of depositors are not guaranteed in the IFIs, while in Islamic banks' balance sheets, customer deposits are not categorized as liabilities. In Maali and Napier (2010), it was reported that the adoption of the accounting standards set by AAOIFI can be recently observed among many Islamic banks.

In the context of Bangladesh, Sakib (2015) stressed the great necessity for banks in increasing the compliance level of the AAOIFI standards as an assurance to stakeholders of the banks' genuineness and determination in adhering to the Islamic Sharia. In a related study by Suryanto and Ridwansyah (2016), it was found that the Sharia financial accounting standards impact fraud deterrence in Islamic banks. Further, Ullah (2013) reported that on average, Islamic banks comply with 44.68% (90.71 of 203 items) of the AAOIFI Guidelines concerning the general presentation and disclosure in the financial statements, which is deemed as low.

This finding has been attributed to the fact that AAOIFI has no authority to fully impose and mandate its standards. Apart from that, Sarea and Hanefah (2013) reported that some countries including Malaysia have their own accounting standards (e.g., IFSB) which can replace AAOIFI. Hence, the authors mentioned the need for accounting standards which could link groups and individuals, as proposed in stakeholder theory. The authors further highlighted the need for Islamic accounting standards that bridge the gap in the Organization of Islamic Conference (OIC) countries. By the paper of Brahim and Arab (2020), it intends to explore the consistency of Islamic manages an account with the AAOIFI Standard No. 7, in Center East and North Africa territory during the period of 2010-2014. The creators look to recognize, among the 15 nations and 72 banks, those which adjust more to this norm. The experimental outcomes show that despite the fact that the worldwide divulgence file has been improved over the perception period, it has remained moderately low. The outcomes likewise permitted them to see that the worldwide, compulsory, and deliberate cultural divulgences fluctuate as indicated by the nation and banks. Further, it has been seen that banks permit more regard for the required divulgence suggestions of AAOIFI Administration Standard No. 7, in examination with the intentional CSR. Likewise, the investigation could be stretched out to different nations to more readily control the strict framework and social impacts. Since in our cutting edge time, customary laws in the Muslim world have been broadly supplanted by rules propelled by European models. In examining AAOIFI, Jabr (2017) found harmonization as the most significant challenge. In particular, the author found no harmony between the Islamic accounting standards and a number of Generally Accepted Accounting Principles (GAAP). Additionally, in the issuance of financial statements, many Islamic banks have opted to employ the International accounting standards which have no capacity in dealing with certain aspects of Islamic banking. Further, the author found no united and realistic model that can govern the transactions of banking particularly in the portion of Sharia and accounting. However, the investigation of Andari (2019) intends to dissect the amicability level of Islamic bookkeeping in Indonesia to FAS gave by the AAOIFI. The investigation covers by law (formal or administrative) harmonization and accepted (useful) harmonization. It includes content examination using FAS No. 27 of speculation records to Indonesian PSAK at by law examination, and to thirteen of Indonesian Islamic banks yearly report in 2016 for true investigation. Wilcoxon marked position test is directed to quantify the noteworthiness of agreement to AAOIFI principles. The outcome shows that there is no concordance in by right and true level.

Considering that the development of IFIs is for fostering compliance with the Sharia principles, Vinnicombe (2010) stressed the value of having the standards of Islamic accounting that could address the difference between the transactions of IFIs and those of conventional banks. Not only that, this distinctive set of Islamic accounting standards can tackle the problems faced by IFIs particularly the problem associated with the lack of conventional

accounting standards, as can be exemplified in the IFRSs or local GAAP in accounting for transactions associated with IFIs (Archer & Karim, 2007). Napier (2009) further added that the standards can become the fulfillment of the Muslims' aspiration in observing the principles of Islam in all their life aspects including the aspect of accountability to God. Not only that, Archer and Karim (2007) mentioned the need for IFIs to attain the trust and confidence of the public, and this is possible through reporting a faithful representation of the economic transactions or events.

As indicated by Mohammed, Fahmi, and Ahmad (2019) study, the intention was of this paper is to look at perspectives on budget summaries preparers with respect to the practices in detailing Islamic financial institutions, subsequently adding to answer whether there is, in reality, a requirement for a different arrangement of Islamic bookkeeping principles for IFIs.

Drawing upon seven top to bottom semi-organized meetings led by IFIs' driving officials who are profoundly engaged with getting ready budget summaries in Malaysia, the paper offers proof on the current position of announcing the activity of IFIs, the impact of AAOIFI bookkeeping principles, and the practical use of IFRSs in revealing IFIs.

The discoveries show that to persuade the public that they offer Sharia consistence items endorsed by Sharia Advisory Council, there is a requirement for explicitness rules or guidelines for IFIs inside the IFRS structure. The fundamental concern brought up in the paper is that different Islamic bookkeeping standard isn't required, rather the choice should be inside the IFRS system with the joint effort work of accounting and auditing for Islamic Financial Institutions (AAOIFI) and the International Accounting Standard Board (IASB). The reason of the paper by El-Halaby, Albarrak, and Grassa (2020) is to address the inquiry whether the selection of Islamic principles that are given by Accounting and Auditing Organization for Islamic Financial Institutions positively affects the degree of profit the executives in the Islamic banks setting. The outcomes revealed in this paper give bits of knowledge to national banks and controllers with respect to the noticeable quality of orders of AAOIFI principles for IBs to upgrade the trust level of partners by lessening the untrustworthy conduct profit the board. Also, this paper underpins the appropriateness of AAOIFI principles for IBs instead of the traditional norms, for example, IFRS or neighborhood GAAP.

Ariss and Saredidine (2007) reported that accounting standards adoption by Islamic banks will facilitate their credibility improvement, while also stimulating their global growth. Nonetheless, the fast IFIs progress calls for the standards for information disclosure in order to fulfill the requirements of both the general disclosure standards and those of Islamic values (Harahap, 2003). At present, there has been no affirmation regarding the real practice and the implementation level of the Islamic accounting standards (e.g., AAOIFI requirements) among Islamic banks. Still, Ariss and Saredidine (2007) were of the view that the use of accounting standards by Islamic banks will increase their credibility and stimulate their global progression.

Notably, the quick IFIs development calls for the standards that could be perused in information disclosure, in order that both the standards of general disclosure and those of Islamic values can be fulfilled (Harahap, 2003). Relevantly, considering the voluntary status of these requirements in certain countries, combined with the lack of authorities in the Islamic accounting standards implementation, different standards of accounting are being employed by IFIs in their financial reporting. In other words, Choi and Meek (2005) indicated that there appear to be differences in regards to their political systems, legal systems, financial systems, educational systems, and how business and business ownership are carried out by them. Besides that, this issue may be factored in by the dearth of the representative of the various environmental factors resulting from the adoption and adherence to the diverse standards of accounting by Islamic banks.

Nonetheless, all over the world, Islamic banks employ various standards of accounting, local or international, in the preparation of their financial statements, and this may lead to issues relating to the practices and the comprehension level of accountants as well as the compliance level of Islamic banks globally (ACCA & KPMG, 2010). Maali and Napier (2010), therefore, mentioned the prospect of Islamic accounting standards as the appropriate solution to these issues.

### 3. RESEARCH METHODOLOGY

In any study, the research design comprises the master plan that provides the details of the methods and procedures to be employed in the gathering and analysis of the required information (Zikmund, Babin, Carr, & Griffin, 2009). The problems faced by Islamic banks in Jordan in their AAOIFI accounting standards compliance were determined in this study and the quantitative approach was employed for the purpose. Meanwhile, the obtained data from the survey was analyzed using Statistical Package for the Social Sciences (PLS-Smart) and a number of statistical analyses, for the production of meaningful information. Relevantly, the survey employed in this study comprises three parts as below:

Part 1: General information covering the study sample.

Part 2: External requirements for transformation to the AAOIFI accounting standards among Jordanian Islamic banks.

Part 3: Internal requirements for transformation to the AAOIFI accounting standards among Jordanian Islamic banks.

The items of the questionnaire used in this study were adapted from Khan, Khan, and Iqbal (2018) and Al-Zu'bi et al. (2013). The items were all in the form of close-ended questions, supplemented with a five-point Likert scale comprising values from 1 to 5. The values denote the answer choices to a given factor. PLS-Smart was used for analysis purposes. Percentage analysis was included in this study, and it denotes the gathered observations in simple and comprehensible form. The highest number of responses in each category of the five-point Likert scale was used in the data ranking.

For internal consistency, this study employed Cronbach's alpha, and this demonstrates the inter-linkage of the items. Cronbach's alpha has been

regarded as a measure of scale reliability, and as for the attained value, it has to be within a range between 0.70 and 0.90, in order to have reliability. Cronbach's alpha is regarded as a coefficient of reliability, and it is not a statistical test. Meeker and Escobar (2014) indicated that one statistical aspect is that it employs a statistical method to attain reliability. For any given measurement, reliability is the measurement's degree of consistency with a concept. Kimberlin and Winterstein (2008) described Cronbach's alpha as a way to measure consistency strength.

The internal auditors and employees of the Finance Department of Jordanian Islamic banks took part in this study and their selection was appropriate due to their full knowledge of their work. These participants were randomly chosen to answer the questionnaire. There were 80 participants altogether. Accordingly, a total of four Islamic banks from the Association of Banks were involved in this study because there are no Islamic banks other than the study sample. As shown in the table and through the annual reports of banks, the value of the assets of the four Islamic banks in 2019 reached 9858040326 JD, representing 20% of the total banking assets in Jordan. (Addustour, 2019). The details can be viewed in Table 1.

**Table 1.** Islamic banks in Jordan

	<i>Islamic Banks in Jordan</i>	<i>Number of samples</i>	<i>Value of the assets</i>
1	Jordan Islamic Bank	29	4970000000
2	Islamic International Arab Bank	21	2300388811
3	Safwa Islamic Bank	18	1131473515
4	Alrajhi Bank	12	1456178000
	<i>Total</i>	<i>80</i>	<i>9858040326</i>

*Source: Association of Banks in Jordan, ABJ (2015).*

Out of the 80 questionnaires distributed to the selected hotels, 74 were returned, 4 were omitted due to incompleteness. Hence, the total amount of usable questionnaires in this study was 70.

In this study, the main construct measures were in accordance with the prevailing instruments.

**Table 2.** Summary of the constructs and their relative measurement items

<i>First-order construct</i>	<i>Number of items (18)</i>
AAOIF	1
External problem	8
Internal problem	9

A total of 18 items were employed in the measurement of 3 first-order constructs (AAOIF, External problem, Internal problem). They are as follows: AAOIF included 1 item, External problem included 8 items and Internal problem included 9 items. In the evaluation of the measurement model of the research model, the study employed the confirmatory factor analysis. Figure 1 highlights the measurement model.

The confirmatory factor analysis for the measurement models is shown in Table 3.

Table 3 displays the evaluation outcomes of the standardized factor loadings of model items. As can be observed, the standardized factor loadings were all greater than 0.6 (the loadings range from

0.634 to 1.00). As can be seen in Table 3, the values of AVE for all constructs ranged from 0.555 to 1.00. These values were all greater than the cut-off value of 0.5 as proposed in Hair, Black, Babin, and Anderson (2010). Furthermore, the values of composite reliability for all constructs were ranged

from 0.884 to 1.00, and these obtained values all surpassed the proposed value of 0.7 for all constructs as in Hair et al. (2010).

The current study obtained variable correlation – Fornell-Larcker and HTMT for the model constructs (Henseler, Ringle, & Sarstedt, 2015).

Figure 1. The measurement model

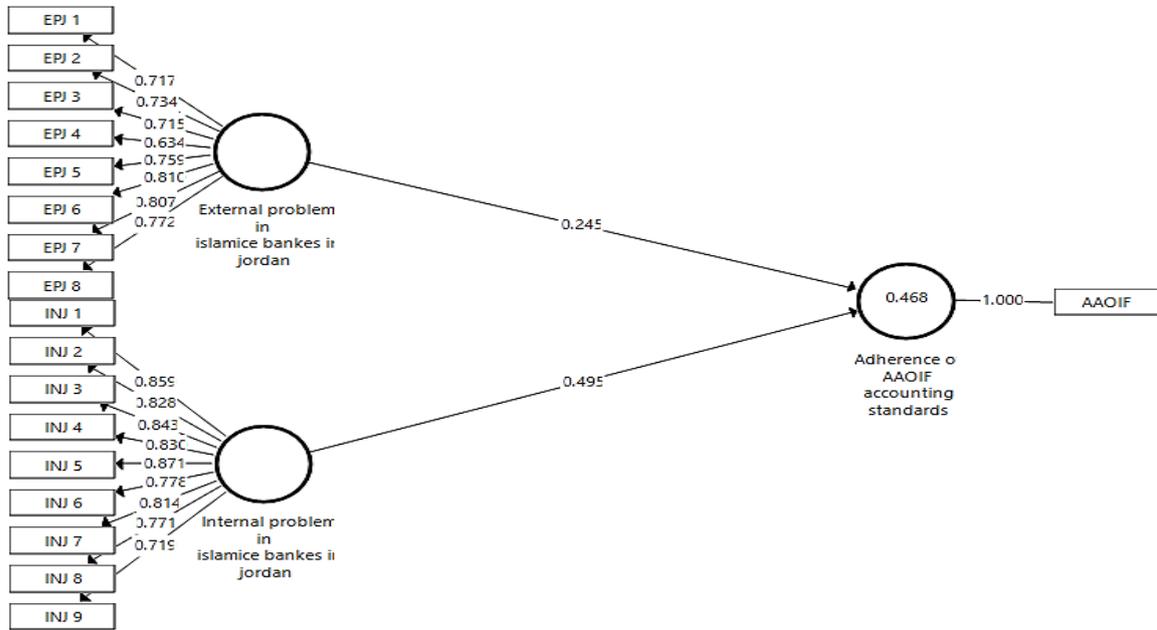


Table 3. The result of Cronbach’s alpha and convergent validity for the CFA model on the research model

Construct	Items	Factor loading	CR	AVE	Cronbach's alpha
AAOIF	AAOIF 1	1	1	1	1
External problem	EPJ 1	0.717	0.908	0.555	0.884
	EPJ 2	0.733			
	EPJ 3	0.714			
	EPJ 4	0.634			
	EPJ 5	0.759			
	EPJ 6	0.809			
	EPJ 7	0.806			
	EPJ 8	0.771			
Internal problem	INJ 1	0.858	0.946	0.662	0.935
	INJ 2	0.828			
	INJ 3	0.842			
	INJ 4	0.829			
	INJ 5	0.871			
	INJ 6	0.778			
	INJ 7	0.814			
	INJ 8	0.770			
	INJ 9	0.718			

Table 4. The variable correlation for model constructs

Construct	AAOIF	External problem	Internal problem
AAOIF	1.000		
External problem	0.577	1.000	
Internal problem	0.660	0.671	1.000

According to Fornell and Larcker (1981), discriminant validity is being when the value of the correlation between the factors that make each pair is less than the value of the AVE. This implies that the value must be greater than that of the other off-diagonal elements in the columns and rows in the correlation matrix. This result established the DSV of the employed measurements. As shown in Table 4.

Table 5. The HTMT for constructs

Construct	AAOIF	External problem	Internal problem
AAOIF			
External problem	0.608		
Internal problem	0.679	0.735	

As shown in Table 5, all the HTMT values of the constructs in the CFA model were below 0.90, ranged from 0.608 to 0.735. Therefore, it confirms that each latent construct measurement was totally discriminating to each other (Henseler et al., 2015). Upon examining convergent validity and discriminant validity of the measurement model, it can be concluded that the measurement scale to assess the constructs and their relative items in the CFA model was reliable and valid.

#### 4. RESEARCH RESULTS AND DISCUSSION

The hypothesis test and relationship in this section are shown in Table 6.

As can be observed in Table 6, the values of  $R^2$  for AAOIF was 0.46. This indicates, for example, 46 percent of variations in AAOIF is explained by its predictors (External problem, Internal problem) as together through showed that the  $R^2$  values satisfy the requirement for the 0.19 cut off value as recommended by Chin (1998). The values of  $Q^2$  for AAOIF were 0.45, far greater than zero, which refers

to predictive relevance of the model as suggested by Chin (2010), the model exhibits an acceptable fit and high predictive relevance. While the  $VIF$  value were 1.817, 1.722 which was less than 5 (Hair et al., 2010). Further in the prediction AAOIF, the p-value of the External problem was 0.001, also the p-value of the Internal problem was 0.000. This means that the probabilities of achieving through absolute p-value are 0.001 and 0.000. Hence, lending support to  $H1$ ,  $H2$ . Further, the path coefficient ( $S$ ,  $B$ ) values for External problem and Internal problem were 0.245, 0.495 respectively, and this denotes relationships that are positive.

This study proves that there is a significant positive relationship between external problems and adherence to Islamic accounting standards AAOIFI in Jordan, it contributes to weakening the role of banks in adhering to Islamic accounting standards AAOIFI.

Similar to previous studies, this research provides evidence that internal problems in Jordanian banks replete positively on the adherence of Islamic accounting standards AAOIFI.

**Table 6.** Hypothesized direct effects structural model

Path	S, B	S, D	$R^2$	$Q^2$	$F^2$	VIF	T-value	P-value
External problem > AAOIF	0.245	0.074	0.46	0.45	0.07	1.817	3.277	0.001
Internal problem > AAOIF	0.495	0.069			0.11	1.722	7.176	0.000

#### 5. CONCLUSION

AAOIFI is providing specific accounting standards for Islamic banks and Islamic financial institutions, but very few Islamic banks in the world are following this set of rules. So, this study is conducted in order to know the problems faced by Islamic banks in Jordan towards adherence to AAOIFI accounting standards. This study found that there are internal problems facing the Islamic banks towards the application of Islamic standards are embodied in the employees and their passion to work under the umbrella of these standards also by the bank's management and encourage them to employees through the courses that the employee lacks. Also found that there are external problems facing Islamic banks towards the application of Islamic standards are represented in government bodies such as the Central Bank of Jordan and the Jordan Securities Commission. Also, there are no specialized chartered accountants with professional and legal licenses that qualify them for auditing according to the AAOIFI accounting standards.

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