IMPLEMENTATION OF AAOIFI STANDARD NO.35 BY SAUDI ISLAMIC BANKS: OPPORTUNITIES AND CHALLENGES

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ABSTRACT

Purpose of the study: The research aims to study and analyze the reality of reserves in Islamic banks in light of Financial Accounting Standard No. 35 issued by AAOIFI in 2018. In addition to determining the accounting irregularities or errors, in the practice of accounting and disclosure related to reserves in Saudi Islamic banks.

Theoretical Framework: The research is based on the financial standards of the Islamic banks. Recent financial crises have prompted increased attention from the international community on the need for domestic financial institutions to be strengthened in order to better withstand subsequent emergencies. To ensure national and international financial stability, standards have been developed and implemented to encourage better policies and stronger institutional and market foundations. The international standards community's initiatives provide a comprehensive approach to promote the financial standards of the Islamic banks. It is crucial that self-assessments be supplemented with an impartial external check on conformity with standards.

Design/Methodology/Population: The researchers applied the inductive analytical approach for evaluating the financial standards of the Islamic banks. The study population consists Islamic banks in Saudi Arabia: Bank Albilad, Al-Rajhi Bank, and Alinma Bank. The research analyzed the financial statements of three Islamic banks.

Findings: The research concluded that all Saudi Islamic banks do not apply the accounting standards issued by AAOIFI. These bank's financial statements do not reflect the reality of their financial position, because they only apply traditional accounting standards. The Saudi Islamic banks do not apply the accounting standard issued by AAOIFI Standard No.35. The reasons behind the non-application of Islamic accounting standards issued by the AAOIFI in Saudi Islamic banks are the Saudi Banking Law and the instructions of the Saudi Central Bank. In addition, shareholders in Islamic banks bear all reserves and provisions.

Research, Practical and Social Implications: The research suggests that banking supervisory authorities in the Kingdom of Saudi Arabia have to take the necessary measures to amend the laws and instructions related to Islamic banks, and to follow up efforts by AAOIFI with central banks in the countries in which Islamic banks operate to oblige Islamic banks to the accounting standards issued by AAOIFI.

Originality/Value: The research is unique in identifying the importance of the AAOIFI standards in improving the financial standards of the Islamic banks.

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IMPLEMENTAÇÃO DA NORMA AAOIFI NO.35 POR BANCOS ISLÂMICOS SAUDITAS: OPORTUNIDADES E DESAFIOS

RESUMO
Objetivo do estudo: A pesquisa visa estudar e analisar a realidade das reservas em bancos islâmicos à luz da Norma de Contabilidade Financeira n.º 35 emitida pela AAOIFI em 2018. Além de determinar as irregularidades ou erros contáveis, na prática de contabilidade e divulgação relacionados a reservas em bancos islâmicos sauditas.

Quadro Teórico: A pesquisa é baseada nos padrões financeiros dos bancos islâmicos. As recentes crises financeiras suscitaram uma maior atenção por parte da comunidade internacional quanto à necessidade de reforçar as instituições financeiras nacionais, a fim de melhor resistir a emergências subsequentes. A fim de assegurar a estabilidade financeira nacional e internacional, foram desenvolvidas e aplicadas normas para encorajar melhores políticas e fundações institucionais e de mercado mais fortes. As iniciativas da comunidade de normalização internacional proporcionam uma abordagem abrangente para promover as normas financeiras dos bancos islâmicos. É fundamental que as autoavaliações sejam complementadas por um controlo externo imparcial da conformidade com as normas.


Constatações: A investigação concluiu que todos os bancos sauditas islâmicos não aplicam as normas contabilísticas emitidas pela AAOIFI. As demonstrações financeiras destes bancos não refletem a realidade da sua situação financeira, uma vez que apenas aplicam as normas contabilísticas tradicionais. Os bancos sauditas islâmicos não aplicam a norma contabilística emitida pela Norma AAOIFI n.º 35. As razões subjacentes à não aplicação das normas contabilísticas islâmicas emitidas pela AAOIFI nos bancos islâmicos sauditas são a Lei Bancária saudita e as instruções do Banco Central Saudita. Além disso, os acionistas dos bancos islâmicos suportam todas as reservas e provisões.

Investigação, implicações práticas e sociais: A investigação sugere que as autoridades de supervisão bancária no Reino da Arábia Saudita têm de tomar as medidas necessárias para alterar as leis e instruções relacionadas com os bancos islâmicos, e para acompanhar os esforços da AAOIFI com os bancos centrais dos países em que os bancos islâmicos operam para obrigá-los a obter mais de um padrão dos bancos islâmicos às normas contabilísticas emitidas pela AAOIFI.

Originalidade/valor: A investigação é única na identificação da importância das normas da AAOIFI para a melhoria das normas financeiras dos bancos islâmicos.

Palavras-chave: Bancos Islâmicos, Norma AAOIFI, Demonstrações Financeiras, Lei Bancária Saudita.

APLICACIÓN DE LA NORMA Nº 35 DE LA AAOIFI POR LOS BANCOS ISLÁMICOS SAUDITAS: OPORTUNIDADES Y PROBLEMAS

RESUMEN
Objetivo del estudio: La investigación tiene como objetivo estudiar y analizar la realidad de las reservas en los bancos islámicos a la luz de la Norma de Contabilidad Financiera N.º 35 emitida por la AAOIFI en 2018. Además de determinar las irregularidades o errores contables, en la práctica de la contabilidad y la divulgación de información relacionada con las reservas en los bancos islámicos sauditas.

Marco teórico: La investigación se basa en las normas financieras de los bancos islámicos. Las recientes crisis financieras han hecho que la comunidad internacional preste más atención a la necesidad de fortalecer las instituciones financieras nacionales para que puedan resistir mejor las emergencias posteriores. A fin de garantizar la estabilidad financiera nacional e internacional, se han elaborado y aplicado normas para fomentar mejores políticas y bases institucionales y de mercado más sólidas. Las iniciativas de la comunidad internacional de normalización proporcionan un enfoque integral para promover las normas financieras de los bancos islámicos. Es fundamental que las autoevaluaciones se complemenen con un control externo imparcial de la conformidad con las normas.

Diseño/Metodología/Población: Los investigadores aplicaron el enfoque analítico inductivo para evaluar los estándares financieros de los bancos islámicos. La población de estudio está compuesta por bancos islámicos en Arabia Saudita: Bank Albilad, Al-Rajhi Bank, y Alinma Bank. La investigación analizó los estados financieros de tres bancos islámicos.

Conclusiones: La investigación concluyó que todos los bancos islámicos sauditas no aplican las normas de contabilidad emitidas por la AOIFI. Los estados financieros de esos bancos no reflejan la realidad de su situación financiera, porque sólo aplican las normas tradicionales de contabilidad. Los bancos islámicos sauditas no aplican la norma de contabilidad emitida por la norma No. 35 de la AAOIFI. Las razones de la no aplicación de las normas
Implementation of AAOIFI Standard No. 35 by Saudi Islamic Banks: Opportunities and Challenges

INTRODUCTION

Interest has recently been increased by the accounting standards issued by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the use of these standards by Islamic banks together with the application of international accounting standards. AAOIFI was issued Financial Accounting Standard No. 35 to standardize the accounting treatment of reserves per the regulations of Shari’a (The Islamic Religion) (Mnif & Tahari 2020). Islamic banks have been - and are still in some countries - using traditional accounting concepts and international accounting standards for the accounting treatment of these reserves, which may lead to a lack of understanding of the process of creating reserves and disclosing them in the financial statement (Samhan, 2016). It also leads to the non-standardization of the fundamentals of preparing financial statements for Islamic banks, which makes it difficult to compare them if some Islamic banks comply with Standard No. 35 and the noncompliance of others.

AAOIFI’s standards have been adopted in Bahrain, Dubai International Financial Centre, Jordan, Lebanon, Qatar, Sudan, and Syria (Zakarneh, 2017). Guidelines that are based on the norms and pronouncements of AAOIFI have been issued by the competent authorities in the countries, including Australia, Indonesia, Malaysia, Pakistan, and the Kingdom of Saudi Arabia, and South Africa.

In 1987, during the Islamic Development Bank’s annual conference, with the backing of established Islamic banks, it began the process of establishing Islamic financial reporting standards. As a result, in 1991, representatives of working accountants and Sharia scholars came together to create the Financial Accounting Organisation for Islamic Banks and Financial Institutions (FAOIBFI). The name of the organisation that was formerly known as the FAOIBFI has been changed to the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI). The fiqh muamalat provided the foundation for the contextual values of...
Islamic financial norms, which hold that all relationships are acceptable with the exception of haram ones. Ethical principles for making interactions fair and transparent are provided by the code of Islamic financial dealings. As such, Islamic standard-setters employ a Sharia scale to evaluate existing international standards before deciding whether to accept, amend, or create a new standard to replace an existing one.

Many financial changes that occurred during the current century, which required the issuance of new accounting standards at the international level. Financial risk management and asset evaluation had a good share of the mentioned updates and releases. This led to an increase in AAOIFI activity in the last ten years regarding issuing new standards and canceling previous standards.

The most important feature of this research is that it analyzes the reality of reserves in Islamic banks in light of Financial Accounting Standard No. 35 issued by AAOIFI in 2018, and study the extent to which Saudi Islamic banks adhere to this standard and identify the advantages and challenges facing these banks in this field. This research can help encourage and facilitate the application of Islamic Accounting Standard No. 35 in Saudi Islamic banks.

The most important difficulties facing this research are the lack of sufficient studies in the same field and the need for information from within the Saudi Islamic banks that may sometimes interfere with the confidentiality of banking sector.

Research Objectives

The research aims to:

1. Highlight the reality of accounting reserves in Islamic banks.
2. Determine the accounting irregularities or errors, if any, in the practice of accounting and disclosure related to reserves in Saudi Islamic banks in light of Accounting Standard No. 35 issued by AAOIFI.
3. Suggest the correct accounting treatment and the best way to disclose these reserves in light of Islamic accounting standards.
4. Determine the opportunities provided by compliance with this standard for Islamic banks, as well as identify the problems and challenges of implementing Standard No. 35 and proposing appropriate solutions.
Literature Review

From a theoretical perspective, some researchers believe in the accounting standards issued by AAOIFI that some Islamic banks are committed by the standard of reserves and provisions (AAOIFI No. 11).

Bado et al., (2023) revealed the influence of financial management and Generation Z in business development. They applied quantitative analysis and evaluated the relationship between financial management and Generation Z. Jasim and Ibrahim (2023) reported the importance of adopting international financial standards in order to improve the business quality. They followed the deductive and inductive approaches and analyzed the unified accounting system in the Iraq stock exchange.

Zakarneh determined the commitment of Jordanian Islamic banks based on the previous standard of provision and reserve No. 11 issued by AAOIFI (before amendment). The researcher concluded that Jordanian Islamic banks are generally committed to applying Standard No. 11 but differ in procedures for determining the investment risk reserve from the Standard (Zakarneh, 2017). He did not show how the investment risk reserve is calculated in the Jordanian Islamic banks and did not show the Shari'a approach for calculating this reserve.

For the investment risk fund (or investment risk reserve), Samhan aims to identify the practical and accounting aspects of the investment risk fund (IRF) in Islamic banks and the extent to which the reality conforms to the requirements of Shari'ah. The researcher concluded that the IRF is a risk reserve. The jurists agreed on the permissibility of establishing the fund to face the investment risks. It is not allowed to deduct from the Islamic bank share of profit because it will be as a guarantee of Mudaraba capital. The Jordanian Mufti council premises the deduction from the bank and the unrestricted investment accounts holders to donate to the IRF. Accordingly, the IRF is not owned by any of the parties and is given to the Zakah fund in the case of bank liquidation (Samhan, 2016).

Additionally, in a paper entitled:” Income smoothing behavior and the procyclical effect of loan loss provisions in Islamic banks: global evidence” Pramono, Rossieta and Soedarmono analyze income smoothing behavior and the procyclical effect of loan loss provisions in Islamic banks. The model includes the use of loan loss provisions for discretionary and nondiscretionary purposes in Islamic banks and relates it to the ways Islamic banks disburse loans. The empirical results show that Islamic banks use loan loss provisions for nondiscretionary purposes but not for discretionary purposes (i.e., capital management, income smoothing, or signaling). However, well-capitalized banks and banks focusing on lending
activities may use loan loss provisions for income smoothing to a lesser extent (Pramono, Rossieta & Soedarmono 2018). Despite the importance of what this paper discussed, it did not deal with the Islamic accounting standards issued by AAOIFI. It did not mention anything about the AAOIFI Accounting Standard No. 11.

Jaber Al-Seliti and his colleagues aimed at their paper entitled: "The compliance of disclosure with AAOIFI financial accounting standards: a comparison between Bahrain and Qatar Islamic banks" to examine the compliance of Islamic banks in Bahrain and Qatar with the accounting standards issued by AAOIFI. The researchers found that Islamic banks in Bahrain and Qatar are generally committed to the accounting standards issued by AAOIFI concerning financing and investment instruments such as Murabahah, Mudarabah and Musharakah. The paper found that this commitment did not reach the required level, and it was the highest level of commitment in the field of Murabaha (Al-Sleiti, Ousama & Hamammi 2018). However, the researchers did not address the issue of the commitment of Islamic banks in these countries to apply AAOIFI standards in the field of reserves.

Other researchers investigated the issue of the impact of compliance with AAOIFI standards of the revenues of Islamic banks, Sherif Al-Halabi and his colleagues aimed to determine the impact of adopting the AAOIFI standards on revenue management in Islamic banks. In general the authors measure, the impact of AAOIFI for the adopter and nonadopter banks. This paper further investigates whether Islamic banks (IBs) adopting AAOIFI as compulsory or as voluntary adopters, in general, are being less engaged in earnings manipulation. The researchers found that the adoption of AAOIFI is associated with a reduction in the earning management level. Furthermore, adopter Islamic banks for AAOIFI are less involved in earning management than nonadopter Islamic banks. In addition, the findings of this paper indicate that IBs across countries that mandate AAOIFI standards are less engaged in earnings manipulation than other IBs in countries that adopt AAOIFI as voluntary standards (Al-Halabi, Albarrak & Grassa 2020).

On the other hand, some researchers have discussed the issue of Islamic banks' compliance with AAOIFI standards and their relationship to the social responsibility of Islamic banks. Nugraheni and Nur Khasanah aimed to discuss the extent to which Indonesian Islamic banks (IBs) disclose corporate social responsibility (CSR) according to the AAOIFI index. They also empirically examine the determinants of CSR disclosure in Indonesian IBs, based on disclosure from the AAOIFI index, which is based on Islamic principles. (Nugraheni & Khasanah, 2018).
Mnif and Tahari have aimed at their paper entitled: "Corporate governance and compliance with AAOIFI governance standards by Islamic banks" aimed to examine the effect of the main corporate governance characteristics on compliance with (AAOIFI) governance standards (GSs) disclosure requirements by Islamic banks that adopt AAOIFI standards in Bahrain, Qatar, Jordan, Oman, Syria, Sudan, Palestine and Yemen. The findings reveal that compliance with AAOIFIs’ GSs’ disclosure requirements is positively influenced by audit committee (AC) independence, AC accounting and financial expertise, industry expertise, auditor industry specialization, IB size and IB listing status. On the other hand, it is negatively influenced by the ownership concentration (Mnif & Tahari 2020). Disclosure related to investment risk reserves (IRRs) or profit equalization reserves (PERs) is not addressed in this study.

Other researchers have linked compliance with the accounting standards issued by AAOIFI with the performance of Islamic banks In their paper entitled "The impact of AAOIFI governance disclosure on Islamic banks performance". Elgattani & Hussainey aimed to investigate the impact of (AAOIFI) governance disclosure on the performance of Islamic banks (IBs). They found an insignificant relationship between AAOIFI governance disclosure and IB performance (Elgattani & Hussainey 2018). The researchers did not discuss the disclosure regarding investment risk reserves or profit equalization reserves. Osama Samih and Abdallah Barakat (2023), paper aims to evaluate the effectiveness of internal audit standards as a foundation for carrying out and promoting a wide variety of value added-tasks in emerging markets. Three Jordanian telecommunications firms were the subject of the study.

Others discussed the issue from the approach to profit distribution policy in Islamic banks, Issa " aims to Determine the approaches of calculating and distributing profits in Islamic banks, and how to calculate the provisions and reserves in these Islamic banks. The most important results of the study were the proposal of a new accounting model for the distribution of profits between the bank and the investment account holders to be more fairer (Issa, 2010).

While Al-Shara discussed the benefits of adhering to AAOIFI standards in general. His paper was entitled "The positive aspects of Islamic banking in the light of the accounting standards for Islamic financial institutions "Applied Study" aimed to shedding light on Islamic banking in all its facets, making it as personal as possible of the positive aspects of the substantive relationship with the other parties concerned in light of the processes that reflect the fact of mutual benefit sought by those parties. The researcher concluded that Islamic banks are still below the level of ambition they should have. There is a shortage in these banks' training
sides, especially in terms of the quality and comprehensiveness of the training and focus on programs related to Islamic banking. Working under the financial accounting standards of Islamic financial institutions will help Islamic banks reach the level of ambition (Al-Shara 2003).

Honestly, very little scientific research discussing Islamic accounting standards exists because this requires the researcher to understand the accounting science and the concepts of transactions in Islam (Fiqh Al-Muamalat). Therefore, you find that these standards need to be constantly updated and renewed. This can only be done by subjecting these standards to scientific research by researchers who understand "FIQH" and the science of financial accounting.

MATERIALS AND METHODS

The researcher follows the inductive analytical approach to arrive at the answer to the study's questions, thus to the conclusions and recommendations through the extrapolation of what was written in this area and what is stated in financial accounting standard No. 35 in addition to studying and analyzing what is happening in some Islamic banks in this field.

Theoretical Framework

It is necessary to indicate the meaning of the types of profits achieved by the Islamic Bank and then indicate the beneficiaries of these reserves. Profits achieved by the Islamic Bank can be classified as follows: (Samahan, 2017)

A. Profits are realized through the operation of its funds (shareholders' funds), which are owned by shareholders only.

B. Profits are realized through the operation of joint funds (shareholders' funds & Investment account holders). Most of these profits are distributed between the investment account holders as the "Rabualmal" (Money owner) and the Islamic bank as a "Mudareb" (investment funds Manager). This distribution is carried out according to agreed rates in the account contract.

Reserves mean the amounts that the bank saves from its net profits to shareholders in the form of compulsory, voluntary, general or special goals to strengthen the financial position. Islamic banks create various reserves to support their financial positions, maintain the safety of their capital, maintain the stability of the value of their deposits and balance their profits.
Reserve in FAS (35) "is a component of equity (i.e., pertaining to shareholders, or noncontrolling interest) or quasi-equity (i.e., pertaining to participating stakeholders such as unrestricted investment account holders) set aside by way of appropriations from respective earnings or retained earnings as well as value adjustments for the benefit of such respective stakeholders by way of managing various risks posed to such equity or quasi-equity balances or off-balance sheet items;" (AAOIFI, 2018)

The standard explains the meaning of participatory investors (AAOIFI, 2018) "they are the investors investing in an Islamic Banks on the basis of a participatory arrangement e.g. Mudaraba, Musharaka or Al-Wakala Bi Al-Istithmar (investment agency) including Investment Account Holders (IAH), Sukuk holders etc.;"

Types of Reserves in Islamic Banks

There are two main types of reserves in IBs: (Samhan, 2016)

1. Corporation reserves: Islamic banks are corporations, which makes them subject to the law of companies, which requires them to prepare multiple reserves, including:
   - Optional reserves: It is a part of equity deducted from profits for future use in financing the bank's needs such as expansion.
   - Legal reserves: This the amount deducted from the net annual profits under the law and is the proportion of the total accumulated and does not exceed a percentage of the capital.
   - Other reserves: Bank owners sometimes resort to other types of reserves, deducted from net profits to cope with emergencies, crises and sudden financial changes.

All these reserves are deducted from the shareholders' profits and are not related to the investment account holders.

2. Joint Investment Reserves: These reserves are deducted from the joint profits with the participatory investors (especially investment account holders contracted by the bank on the basis of the Mudaraba contract). According to the Mudaraba contract, the funds of the investment account holders are invested in their guarantee (they receive a share of the profits and bear all losses. The Islamic Bank loses its efforts only upon loss).

The most important types of these reserves, according to standard No. 35 issued by AAOIFI:

- Profit Equalization Reserve (PER) –" is the amount appropriated by an Islamic Financial Institutions (IFI) out of the income arising from the assets pertaining to participatory investors, in order to maintain a certain level of return on investment for
such stakeholders (and the shareholders, as applicable) and hence is a tool for managing the rate of return risk (including the displaced commercial risk);

- Investment risk reserve (IRR) – "is the amount appropriated by an IFI out of the income arising from the assets pertaining to relevant participatory investors, in order to cushion against credit risk, market risk and equity investment risk mainly pertaining to residual future possible losses (after impairment and credit losses accounted for in line with the requirements of FAS 30 “Impairment, Credit Losses and Onerous Commitments”) for the respective stakeholders arising from the respective assets and investments;"

By studying what was stated in the AAOIFI accounting standards and the annual reports of Islamic banks, it can be said that these reserves are found according to the following methods:

1. It is deducted from the share of investment account holders. Therefore, it appears within the financial statement's equity of investment account holders.
2. It is deducted from the share of the owners of the Islamic bank (shareholders). Therefore, it appears within the equity in the financial statement.
3. It is deducted from the profits of the joint investment before it is distributed between the bank and account holders. Each of them maintains their right to the deducted part. Therefore, each party’s share of these reserves appears within his rights in the financial statement.
4. It is deducted from the profits of the joint investment before it is distributed between the bank and account holders based on the two parties donating the amount. Therefore, these reserves appear in a special part on the credit side of the financial statement (they are neither equity nor the rights of investment account holders, and they are not liabilities). This method was not mentioned in the standards issued by AAOIFI, although it was used in some Islamic banks such as Jordanian Islamic banks until 2019.

Factors of FAS (35)

The Accounting Board (AAB) of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) has officially issued financial accounting standard (FAS) No. 35 “Risk Reserves”. "This standard was finalized by AAB after extensive discussion, due to deliberations and with wide-ranging industry consultations that included inviting and evaluating industry and regulators comments through the public hearing events and incorporating comments received in writing from industry experts”. (https://aaoifi.com)
The accounting of voluntary and compulsory reserves and other reserves in Islamic banks is no different from conventional banks, therefore, the new FAS 35 focuses on accounting for risk reserves only. One of the most important elements of FAS 35 was: (AAOIFI 2018)

- Contributions to risk reserves shall be accounted for as a charge against the income of the respective pool attributable to such stakeholders (commonly referred to as the “participatory pool” or “investment pool”). (P17).
- Contributions to risk reserves shall be attributed to respective stakeholders and shareholders in line with the contractual and Shari’ah requirements. (P18)
- PER shall always be created from and attributed to the income attributable to both the relevant stakeholders and the shareholders (in the capacity of Mudarib or working partner, as well as, in the capacity of investor in case of commingling of funds). (P19)
- IRR shall, in line with the relevant contractual and Shari’ah requirements: a. created from and attributed to the income attributable to the relevant stakeholders and the shareholders (in capacity of Mudarib or working partner, as well as, in the capacity of investor in case of commingling of funds); or b. created from and attributed to the income attributable to the relevant stakeholders and the shareholders (in the capacity of investor in case of commingling of funds but not in the capacity of Mudarib or working partner).(P20)
- The share of risk reserves attributable to each class of stakeholders shall be shown as an addition to the equity of the respective class of stakeholders (normally appearing as different categories of quasi equity). In Contrast any portion of the same attributable to the shareholders shall be shown in the owners’ equity. (P26)
- The risk reserves attributable to investments kept off-balance sheet shall be disclosed in the statement of off-balance sheet investments. (P27)
- An IFI, with respect to each type of risk reserve with respect to each category of stakeholders to whom they relate, shall disclose the following: a. the accounting policies adopted for the risk reserves and any changes to it; b. a movement, providing the summary of opening and closing balances, along with the amounts attributed to such reserves by respective classes of stakeholders (as well as shareholders where applicable), utilization of such reserves and reversals, if any, to maintain the adequate level as well as any other adjustment including transfers duly describing the nature of the same; and c. the shortfall against the adequate level and the defined plan through which the same shall be recognized.(P28)

The AAOIFI has asked Islamic banks to apply this standard since 1/1/2020, which means that the financial statements published by Islamic banks after this date will show the effect of this standard if it is applied.
Analytical View of the New Standard No. 35

There is a very important point regarding reserves and those who have rights. The shareholders of conventional banks have reserves. Therefore, if a shareholder wants to leave, he will sell his shares at the market price, reflecting the shareholder's right to these reserves. Therefore, the shareholder will take his right to reserves when he leaves the company.

For example, if the percentage of profit achieved in a year is 4%, the owner of the investment account, with an average balance of $10000, will receive a profit of $400. If the Islamic Bank creates a reserve of 0.5% of profits and a reserve investment risk of 0.5%, it means that this client will receive profits estimated at 300 $ not his full right of 400 $. The problem here happens if this client wants to withdraw the full balance, he will withdraw only $10300, while he should withdraw $10400.

To overcome the previous problem, some Islamic banks, such as Jordan Islamic Bank, created investment risk reserves (until 1/5/2019), which are deducted from the profits of the joint investment as a donation from both sides of the Mudaraba contract (Annual report, JIB, 2018).

Thus, the withdrawing client does not deserve any amount from the investment risk reserve. We did not notice that FAS (35) was exposed to the basis on which the reserves are deducted. The basis on which the reserve was cut will affect the presentation and disclosure of reserves:

- If a donation appears in a private area on the "credit" side of the bank's balance sheet (neither equity nor investment account holders’ rights nor liabilities)
- If it's not done as a donation it must appear in the parties rights that have been deducted from them.

In our opinion, there is great importance in using the basis for the donation of the parties to the Mudaraba contract when we talk about the investment risk reserve in light of Standard No. 35.

The standard stated that the investment risk reserve is deducted from the profits shared between the bank and investment account holders. The part pertaining to account holders must also be shown within the rights of investment account holders, which is a good thing, still Islamic banks will not give the owner of the investment account his right from this reserve when withdrawing his deposit from the bank under the pretext that it is not practically possible (this needs detailed research to prove this Argument). This confirms that using the principle of donation by the parties to the contract in forming or establishing an investment risk reserve is
preferable in light of the inability of the investment account holder to withdraw his right to the investment risk reserve as Islamic banks claim. The real problem here is that Accounting Standard No. 35 and the old Accounting Standard No. 11 did not address this basis or disclose this reserve if the donation principle is used.

**FINDINGS AND DISCUSSIONS**

Financial statements for Saudi Islamic banks were issued only once these banks were required to apply Standard No.35. Therefore, we will analyze the financial statements of the main Saudi Islamic banks, namely: Bank Albilad, Al-Rajhi Bank, and Alinma Bank to determine the extent of the commitment of these Islamic banks to the application of standard No.35, and access to the search results.

Through our study of the new standards issued by (AAOIFI), we noticed that the most important difference between the two standards (No. 11 and No. 35) is that new Standard No. 35 is not exposed to provisions. In contrast Standard No. 11 was subject to provisions due to the issuance of Standard No. 30, which deals with provisions and impairment in detail.

When analyzing the financial statements of Saudi Islamic banks, the focus was on investment risk reserves and profit equalization reserve (PER) in light of the following:

- Islamic bank commitment to AAOIFI standard No.1 General Presentation and Disclosures in the Financial Statements of Islamic Banks and Financial Institutions.
- Method of disclosure of the rights of investment account holders and its components.

In reviewing the annual reports of Saudi Islamic banks for 2020, the most important observations on the investment risk reserve and profit equalization reserve are as follows:

1. The annual reports of Saudi Islamic banks indicate that these reports were prepared in accordance with the international financial reporting standards approved in the Kingdom of Saudi Arabia. Standards and other publications issued by the Saudi Organization for Certified Public Accountants, Provisions of the Banking Control Law and the Companies Law in the Kingdom (Annual Report, 2020, Alinma Bank p., Al Rajhi Bank, p. 152, Bank Albilad, p. 92). We note that these banks did not refer to the use of the accounting standards issued by AAOIFI in any way, even though Al-Rajhi Bank is one of the most important founders of AAOIFI (https://aaoifi.com).

2. There is no indication of the existence of the EPR in the 2020 annual reports issued by the Saudi Islamic banks.

4. By analyzing the consolidated income statement for these Islamic banks in 2020, we note that all provisions are only taken from the shareholders’ profits (Annual Report, 2020, Alinma Bank, p. 74, Al Rajhi Bank, p. 147, Bank Albilad, p. 119). The bank’s annual report clarified that the bank makes provisions related to credit losses in light of IFRS9 (Annual Report, 2020, Alinma Bank, p. 81, Al Rajhi Bank, p. 152, Bank Albilad, p. 113). These Islamic banks have shown in the financial statements notes how expected credit risk is measured (Annual Report, 2020, Alinma Bank, p. 90, Al Rajhi Bank, p. 193, Bank Albilad, p. 128).

In the notes about the financial statements, the annual report for this clarified how the provision for expected credit risk is presented in the statement of financial position. We have noticed that some assets for which a provision is created may be jointly owned by investment account holders, although investment account holders do not bear any part of these provisions. These provisions are all deducted from the shareholders’ share, as we mentioned when analyzing the bank’s consolidated income statement (Annual Report, 2020, Alinma Bank, p. 91, Al Rajhi Bank, p. 169, Bank Albilad, p. 129).

We note the large size of these provisions. We also note that these provisions were charged only to the shareholders’ share of profits, despite the existence of assets jointly owned by account holders who are considered “Rabualmal” in a “Mudaraba” contract in which Islamic banks are "Mudareb". Therefore, we can say that the application of these banks to international financial reporting standards and traditional accounting rules is the reason for this. This leads to the financial statements not expressing the accuracy of the relationship between the “Rabualmal” and the “Mudareb” At the same time it leads investment account holders not being charged any part of this provision despite Their ownership of the assets affected by these provisions.

5. The investment accounts are shown in the statement of the financial position of all Saudi Islamic banks as liabilities. These accounts did not appear after liabilities and before equity in a separate title called “Equity of Investment Account Holders” (Annual Report, 2020, Alinma Bank, pg. 73, Al Rajhi Bank, 149, Bank Albilad, p. 118). We
noted that the annual report of these banks very briefly indicated the clarifications. They pointed out that one of the types of clients’ deposits is “customer term investments” and that these investments represent clients’ Murabaha and Mudaraba. In our opinion this clarification is not sufficient in light of showing these deposits as liabilities (Annual Report, 2020, Alinma Bank, p. 109, Al Rajhi Bank, p. 180, Bank Albilad p. 144). Here, too, the financial statements do not reflect the reality of these accounts, because they are not liabilities for Islamic banks and are not owner-equity. These accounts are accepted on the basis of the Mudaraba, Musharaka or Agency for Investment contract. These accounts are accepted based on a Mudaraba, Musharaka or Wakala investment contract, which means that these accounts are investments on the responsibility of their owners. For this reason, Standard No. 1 issued by AAOIFI requires Islamic banks to include investment accounts in a special area in the statement of financial position in Islamic banks (after liabilities and before owners' equity) under the title “Equity of investment account holders”.

Noncompliance by Saudi Islamic banks issue Standard No. 1 by AAOIFI means that Saudi Islamic banks will not comply with the new Standard No. 35 concerning to investment risk reserves of:

- a. The reserves, if any, shall not appear in the balance sheet of the Islamic bank as stated in paragraphs No. 19 and 20 in Standard No. 35.
- b. Saudi Islamic banks will not be able to comply with Paragraph No. 26 of Standard No. 35.
- c. Reserves, if any, related to off-balance-sheet accounts will not appear in the financial reports of Saudi Islamic banks, as stated in paragraph No. 27 of Standard No. 35.

Many countries in which Islamic banks operate, such as Jordan, Malaysia, Libya, Sudan and others, have amended their laws to accommodate the nature of the work of these banks. Attention to the nature of this work is in the instructions issued to banks by the supervisory authorities - especially central banks. Therefore, the financial statements must reflect the reality of the financial status of these banks. This financial situation is greatly affected by the nature of investment accounts and the method of measuring and distributing profits between Islamic banks and investment account holders.
Through the above analysis of the financial statements of the Saudi Islamic banks, it is clear that the Saudi Islamic banks use the same model as the traditional banks for the statement of financial position and as the basis for financial statements preparation.

To confirm this, we analyzed the financial statements of some Islamic banks in the Islamic world. In short, we found that some of these Islamic banks do not adhere to or use the Islamic accounting standards issued by AAOIFI, but we found that some banks adhere to these standards to different degrees:

- Most of the banks in the Arab Gulf do not adhere to AAOIFI Standard No. 1. Also the Kuwait Finance House and Dubai Islamic Bank do not adhere to AAOIFI Standard No.1. These Islamic banks used international accounting standards. These banks do not independently disclose the rights of investment account holders (neither liabilities nor equity) as required by AAOIFI Standard No. 1. Therefore, no reserve appears within the equity of investment account holders. We conclude that these banks deduct reserves from the rights of shareholders only, and no reserve is deducted from the rights of investment account holders. This means that these banks did not comply with standard No. 35 because they did not adhere to AAOIFI standards.

- Qatar Islamic Bank is the only bank in the Arabian Gulf that adheres to AAOIFI Standard No. 1. It discloses the rights of investment account holders as requested by the standard (in a separate item after liabilities and before equity). However, there are no reserves for investment account holders. There are reserves within equity only. We conclude that this bank does not implement the AAOIFI Standard No. 35.

- Like most banks in the Arab Gulf, the Bank Malaysia Berhad also, does not adhere to AAOIFI Standard No. 1. It was found that it discloses the rights of investment account holders in the financial statement as liabilities. This bank used international accounting standards. It does not independently disclose the rights of investment account holders (neither commitment nor equity) as required by AAOIFI Standard No. 1. Therefore, no reserve appears within the equity of investment account holders, and this bank shows reserves within equity. This leads us to conclude that reserves are deducted from the rights of shareholders only, and no reserve is deducted from the rights of investment account holders. This means that it was not committed to standard No. 35, as it simply does not adhere to AAOIFI standards. This statement applies to all Islamic banks in Malaysia that use the same accounting method.
• Islamic banks in Jordan are committed to AAOIFI Standard No. 1, whereby they disclose the rights of investment account holders as requested by the standard (in a separate item after liabilities and before equity). Likewise, these banks deduct part of the profits of its joint investment with investment account holders as an investment risk reserve (Investment Risk Fund). Jordanian Islamic banks continued with this deduction until 1/5/2020. They then stopped due to the amendment of the Jordanian Banking Law on 1/4/2019 (Article 55 of the Jordanian Banking Law which stipulated that Islamic banks deduct at least 10% of net investment profits was canceled). The new Article 13 of the amended Jordanian Banking Law stipulates that it is permissible for Jordanian Islamic banks, according to instructions from the Central Bank of Jordan, to create a profit equalization reserve (PER) (Amended Jordanian Banks Law No. 7 of 2019). By analyzing the financial statements of the Jordan Islamic Bank. Reading the clarifications about these statements, it can be said that the Jordan Islamic Bank is committed to Standard No. 1 and Standard No. 35 issued by AAOIFI. We believe that this commitment is the result of two things:

a. Amending the Jordanian Banking Law regarding the article that discuss the investment risk reserve and the profit rate reserve. This amendment was made after the issuance of AAOIFI Standard No.35.

b. Amending the instructions of the Central Bank of Jordan regarding the preparation of reserves and provisions in Jordanian Islamic banks.

c. The response of the Jordanian supervisory authorities to the demands of Islamic banks is the need to concede the nature of Islamic banking work when issuing banking instructions and laws.

• All the banks whose financial statements we analyzed do not have a profit equalization reserve (PER).

Institutional stability, socioeconomic progress, and environmental preservation are the goals of Islamic financial concepts. Despite AAOIFI guidelines on zakat and waqf, standard-setting agencies have placed fewer efforts for developing standards that have a direct relation to social development. Additional study has to be done to establish guidelines on how institutions should report on and account for waqf. Therefore, the fairness and openness required to achieve social and environmental business responsibility can be improved by issuing other regulations regulating disclosure on waqf. From its theoretical underpinnings, Islamic finance is growth-oriented since it seeks to promote social and economic harmony in
accordance with Sharia law. Islamic microfinance institutions can help reach this goal by providing services to the working and middle classes. Customers of microfinance institutions are distinct from those of conventional banks. These customers call for VIP service. Successfully empowering society and creating progress that will boost economic development requires, first and foremost, eliminating poverty. Therefore, it is important to consider both the institutional and welfarist perspectives while establishing standards so as not to tip the system too much in favour of the privileged.

The discrepancies among Sharia experts on diverse commercial and transactional interpretations create additional difficulties for Islamic finance and have a detrimental impact on their ability to unite on specific problems. Although the development of standard setters has mitigated these effects to some extent, there are certain scholarly disagreements that can hinder complete conformity. One of the major problems facing the sector, especially during its development, is the lack of specialists who are fluent in both Islamic and conventional contractual operations. This raises the possibility of ineffective standard use in most areas where qualified specialists are scarce. Islamic finance experts are needed in both regulatory and business contexts. In addition, several reports detail the need for specialists outside of the banking sector. To mitigate systemic risks facing Islamic financial institutions, authorities must be well-versed in both Sharia and financial technicalities.

CONCLUSION

The inductive analytical approach revealed that the Saudi Islamic banks do not apply the accounting standards issued by AAOIFI, although one of them is a founders of AAOIFI. These banks' financial statements do not reflect the reality of their financial position because they only apply traditional accounting standards. Some Islamic banks – not only in Saudi Arabia - still use international accounting standards and do not rely on the standards issued by the AAOIFI. The use of traditional accounting concepts and international accounting standards for the accounting treatment of reserves in Islamic banks leads to a mismatch between the treatment of reserves accounting and its disclosure in these banks. It also leads to a lack of standardization of the principles of preparing the financial statements of Islamic banks. This makes it difficult to compare them if some Islamic banks comply with Standard No. 35, and others do not comply. Saudi Islamic banks do not apply the accounting standard issued by AAOIFI No1. nor Standard No.35. The reasons for the nonapplication of Islamic accounting standards issued by the AAOIFI in Saudi Islamic banks are as follows:
a. The Saudi Banking Law and the instructions of the supervisory authorities, especially the Saudi Central Bank. These instructions oblige all Saudi banks to use traditional standard forms for financial statements.
b. Shareholders in Islamic banks bear all reserves and provisions. There are assets funded from investment accounts holders, but they do not bear the provisions related to them.
c. The lack of universality of Islamic accounting standards issued by AAOIFI.
d. The lack of influence of Islamic banking bodies, including AAOIFI, on the supervisory authorities of Islamic banks, so that the application of the standards issued by them becomes mandatory.

All Islamic banks in this study do not have profit equalization reserves (PERs), and we have not yet seen any other banks that maintain this reserve.

RECOMMENDATIONS

1. We advise the banking supervisory authorities in the Kingdom of Saudi Arabia to take the necessary measures to amend the laws and instructions related to Islamic banks. This helps Islamic banks to implement Islamic accounting standards. The application of Islamic banks to Islamic accounting standards (AAOIFI) contributes to the issuance of financial statements that reflect the reality of the financial position of these banks.
2. It is possible to benefit from the countries experiences that have amended their central banks’ laws and instructions to enable Islamic banks to issue financial statements that reflect the reality of their financial positions.
3. The Saudi supervisory authorities can also cooperate with international institutions related to Islamic banks (such as AAOIFI, CIBAFI, IFSB, etc.) to enable Islamic banks to work in a better legal environment to improve their performance and compliance with the provisions of Sharia’a, in addition to adhering to Islamic accounting standards that will contribute to the issuance of financial statements expressing the reality of the financial situation.
4. Issuing new instructions to Saudi Islamic banks to prepare provisions and reserves in a way that ensures justice between shareholders and investment account holders. Each party must bear its share of these provisions and reserves.
5. Follow-up efforts by AAOIFI with central banks in the countries in which Islamic banks operate to oblige Islamic banks to the accounting standards issued by AAOIFI.
6. AAOIFI must work to be global to enable Islamic banks to adhere to the accounting standards issued by AAOIFI.

7. Preparing research by those interested to find a scientific and practical method that enables Islamic banks to calculate the share of the investment account holder from the investment risk reserve when withdrawing his deposit in case of adherence to the FAS35.

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