

**FINANCIAL ACCOUNTING ORGANIZATION
FOR ISLAMIC BANKS AND FINANCIAL INSTITUTIONS**

**SUMMARY OF THE ACTIVITIES OF THE
FINANCIAL ACCOUNTING STANDARDS BOARD FOR
ISLAMIC BANKS AND FINANCIAL INSTITUTIONS**

**9.6.1411H - 4.7.1412H
(26.12.1990 - 8.1.1992)**

**Shaban 1412
(February 1992)**

**P. O. Box 1176 Manama - Bahrain
Tel: 244496 Fax: 250194 Tlx: 7585**

(Available in Arabic)

IN THE NAME OF

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INDEX

SUMMARY OF THE ACTIVITIES OF THE
FINANCIAL ACCOUNTING STANDARDS BOARD FOR
ISLAMIC BANKS AND FINANCIAL INSTITUTIONS
FROM ITS FIRST MEETING ON
9.6.1411h TO 4.7.1412h
(26.12.1990 TO 8.11.1992)

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PREFACE:

It is the pleasure of the Financial Accounting Standards Board for Islamic Banks and Financial Institutions to present a summary of its activities in the period from its first meeting on 9.6.1411H corresponding to 26.12.1990. The Board invites those concerned with the development and promotion of accounting thought for Islamic Banks and Financial Institutions and the preparation of accounting standards for it, to furnish the Board with their comments in general and on the studies and researches summarised in this report in particular. These include:

1. Objectives of financial accounting for Islamic Banks and Financial Institutions (Appendix (1) includes summaries of papers presented on the topic).
2. Financial accounting concepts for Islamic Banks and Financial Institutions (Appendix (2) includes summaries of papers prepared on the topic).
3. Presentation and general disclosure standard (Appendix (3) includes summaries of papers prepared on the topic).
4. Objectives concepts and standards of Financial Accounting in the countries where there are Islamic Banks and Financial Institutions. And the role of governmental, national and professional bodies in the preparation of Financial Accounting objectives, concepts and standards (Appendix (4) includes summaries of the papers presented on the topic)

Comments are to be sent to the following address:

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Islamic Banks and Financial Institutions
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**Financial Accounting Standards Board for
Islamic Banks and Financial Institutions**

**SUMMARY OF THE ACTIVITIES OF THE FINANCIAL ACCOUNTING
BOARD FOR ISLAMIC BANKS AND FINNCIAL INSTITUTIONS FROM
THE FIRST MEETING ON 9.6.1411H CORRESPONDING TO
26.12.1990 TO THE 4.7.1412H CORRESPONDING TO
9TH JANUARY 1992.**

INTRODUCTION

Steps were taken in relation to the preparation of the financial accounting standards for Islamic Banks and Financial institutions since the agreement of association was signed on 30.3.1410H corresponding to 29.10.1989 and the first meeting of the Supervisory committee on 9.6.1411 corresponding to 26.2.1990 and its registration as a legal entity in Bahrain under No. 24524 on 12.9.1411H corresponding to 27.3.1990. The agreement of association and the constitutions and the due process are shown in appendix (5), (6), (7) and (8).

Decisions have been taken so that the board will take the necessary steps to implement the duties assigned to it and to achieve the objectives of the the Financial Accounting Organization for Islamic Banks and Financial Institutions. The following meetings and the discussions resulted in a number of papers, studies, researches and reports which were bound in five volumes and deposited with the Islamic Research and Training Institute of IDB. These assisted in specifying the idea of standards preparation and determining the organizational framework for preparing the bylaws which regulate the activities of the Board and its committees. Consultants in Sharia and accounting are assisting the Board's efforts as will be detailed in section (1) on the products of studies and technical research.

The Financial Accounting Standards Board held two meetings todate. The first one was held in Bahrain on the 9.6.1411H corresponding to 26 December 1990. The second one was held in Cairo on the 12.11.1411H corresponding to the 26th of May 1991. A detailed report on the activities of this period was prepared and sent to the board members. This report may be consulted at the organization's HQ in Bahrain.

The planning committee held 17 meetings since the first meeting on 9.6.1411 corresponding to 26.12.1990. In those meetings a number of decisions concerning the administrative and the organizational matters have been

taken, also decisions pertaining to the technical activities have been taken. Those decisions laid down the basis and the framework within which the different papers and studies have to be conducted and presented.

Each paper or study passes through certain channels in order to reach the final shape which would allow the standards to be promulgated.

In order to focus attention on the results of those studies and researches and to draw light on the efforts made the subjects concerned are listed below. A brief on each topic is given in section (1) and an appendix on each paper of what was prepared is attached.

Objectives of financial accounting for Islamic Banks and Financial Institutions (Appendix (1) includes summaries of papers presented on the topic).

Financial accounting concepts for Islamic Banks and Financial Institutions (Appendix (2) includes summaries of papers prepared on the topic).

Presentation and general disclosure standards (Appendix (3) includes summaries of papers prepared on the topic).

The role of governmental, national and professional bodies in the preparation of Financial Accounting objectives, concepts and standards (Appendix (4) includes summaries of the papers presented on the topic)

The report also includes a brief on the administrative affairs of the financial accounting organization as shown in (2) and the financial position of the financial accounting organization as shown in (3).

1. PRODUCTS OF STUDIES AND RESEARCH

1.1 OBJECTIVES OF FINANCIAL ACCOUNTING FOR ISLAMIC BANKS AND FINANCIAL INSTITUTIONS

1.1.1 Methodology of the Study

From the methodological discussions to prepare the objectives, two approaches were presented; one of those approaches is by induction from the users of financial accounting reports for Islamic Banks and the second one

is deduction of what is considered has an objective in the Islamic perspective. This last methodology allows going into two directions; looking to the objectives as known in the western accounting thought and adapting it to the Islamic principles. The other one is a more original path, i.e. to take from Islamic knowledge what is considered as objectives of accounting and from human thought what does not contradict with Islamic principles. This is in line with the fact that wisdom is the fact sought by the believer who takes it wherever he finds it. It has been decided that the second method and the second path is the most appropriate. It will ensure the originality of the product and will make it responsive to the needs of the present time.

1.1.2 A brief on the papers prepared on objectives of accounting

The planning committee has commissioned a number of consultants in Sharia and in accounting (who formed a joint team), to prepare papers on financial accounting objectives. This involved exchange of views between consultants in Sharia and in accounting, commenting on papers and providing alternatives to determine a number of objectives which have been surveyed as a subject of discussion and as a preliminary unified paper. This initial paper was discussed in a joint meeting which included the members of the joint team, the members of the planning committee, some of the members and the Sharia Fuqaha who are members in the accounting standards board.

Those who were present reached the conclusion that one of the consultants in accounting should edit the paper, in the light of the comments which were presented in the meeting. The editing was presented to a small committee which was selected from amongst those who were present in the meeting. That small committee reviewed the paper introduced. The objectives were specified in 13 objectives. The same paper was presented in a number of meetings which included consultants in Sharia and Accounting.

It is hoped that this paper after final review and editing will be the final proposal for approval from the Accounting Standards Board. The paper is highlighted in the following:

1.1.3 A brief view on the paper on objectives which has been presented to the meeting of the planning committee

1.1.3.1:

The paper has been called (Accounting Objectives and Financial reports) January 1992.

1.1.3.2:

The number of pages of the paper were (22) and it included the objectives and related matters as follows:

1.1.3.2.1:

Historical Study and definition of the approach the paper is prepared.

1.1.3.2.2:

Users of Financial Reports.

1.1.3.2.3:

Differences in the objectives of Accounting and Report in Islamic Banks and Financial Institutions.

1.1.3.2.4:

Objectives of Accounting and Reports for Islamic Banks and Financial Institutions.

1.1.3.2.5:

Arabic references.

1.1.3.2.6:

Foreign references.

1.1.3.3:

Some explanations were attached to some of the objectives to show why they have been chosen or why they are distinguished. Quotations to demonstrate the importance of the objectives are made.

1.1.3.4:

The 13 objectives are arranged as much as possible according to their importance.

1.1.4 **Summary**

Inspite of the major differences between the western system, and the Islamic system and inspite of the positive effects of Islamic financing there are still a number of shared aspects between the two systems. Islam is a reforming revolution having the wisdom of taking from the experience of mankind and building on it. Based on the fact that the human being is originally good and also because taking from human experience is one of the sources of Islamic Jurisprudence. The fact that Riba is forbidden does not necessarily mean that we should refuse all that is in banking business. This should just be limited to deviations and contradiction with Islam. There are things which may be accepted and accommodated in Islamic banking in view that it is of the good human experiences. We should take all that into consideration in the process of preparing objectives for accounting and reports in Islamic Banks and financial Institutions. As we look into the origins of Islam we should consider the results of human experience in this field.

1.1.5 **The present cost of preparing the study on the objectives of financial accounting for Islamic Banks and Financial institutions**

The total cost for this study is 29,200.91 Dollars paid to six consultants who prepared papers and/or participated in the discussion.

1.2 **CONCEPTS OF FINANCIAL ACCOUNTING FOR ISLAMIC BANKS AND FINANCIAL INSTITUTIONS**

1.2.1 **Fiqh terms-A brief on the papers prepared**

It has been proposed to present some preparatory papers in the field of accounting concepts, by choosing from amongst a large number of Fiqh terms and concepts relating to financial transactions, based on the need for finding channels of communication between those concerned with accounting and those concerned with Islamic Fiqh. The Sharia consultants were assigned this task. They selected approximately 300 Fiqh terms having

a close relationship with the topics of financial accounting. Definitions for those terms are included references showing their details are mentioned and explanations of the differences between similar terms are shown.

The list of terms was revised by exchanging it between the Sharia Consultants. It is arranged in its final shape in two ways; 1) according to the topics to facilitate finding terms relating to single topics 2) it is arranged alphabetically to facilitate going back directly to the required term.

1.2.2 Accounting terms

It was decided to put before the Sharia Consultants the important Accounting Terms used in financial reports. The Accounting Consultants were assigned to prepare accounting terms and general definitions to them.

1.2.3 Concepts of financial accounting

Methodology of the study and brief on the papers prepared on it:

One of two of the consultants (in accounting and Sharia) was assigned to present the papers on financial accounting concepts for Islamic Banks and Financial Institutions. The paper has been reviewed in a meeting which included the joint team and some of the members of the planning committee and the standards board. Some comments were presented regarding the editing of the paper and others related to the references on Sharia contained in the paper.

It has been requested from the Consultants in Sharia and in Accounting, Board members. And the planning committee members who attended the discussion of this paper to send their comments so that it will be taken into consideration to prepare a final draft which is assigned to one of the consultants who participated in the preparation of the paper.

1.2.4 A brief review on the draft paper on concepts prepared to the meeting of the planning committee

A brief of this paper is shown hereunder. Currently the paper is being finalized in preparation for its approval.

1.2.4.1:

The paper is called (Financial Accounting Concepts for Islamic Banks and Financial Institutions) Jan 1992.

1.2.4.2:

The total number of pages is 40. It included the following six items.

1.2.4.2.1:

Definition of the basic items of financial statements.

1.2.4.2.2:

Concepts of the quality of accounting information.

1.2.4.2.3:

Accounting assumptions.

1.2.4.2.4:

Accounting principles.

1.2.4.2.5:

Principles presenting constraints or exceptions.

1.2.4.2.6:

Concepts on the characteristics of financial accounting measurement.

The present cost for preparing the study on the concepts of financial accounting.

The present cost of this study is 27,718.42 Dollars paid to five consultants who prepared papers and/or participated in discussion.

1.3 GENERAL PRESENTATION AND DISCLOSURE STANDARDS

1.3.1 Purpose of the study

The purpose of this standard in the field of banks and financial institutions is to show how information is presented, the nature and kind of information which should be disclosed when preparing financial reports.

1.3.2 Brief on the papers prepared on the general presentation and disclosure standard

Two consultants in accounting were assigned to prepare papers on the general presentation and disclosure standards. Each of the two papers is distinguished by certain features. The first one is to make the copy easier for the Sharia consultants and the other paper was concerned with including certain issues from an Islamic perspective. In discussing the two papers in the meeting of the joint team, it has been decided that the two papers should be combined in one detailed paper. The combined paper was referred to one of the consultants in accounting to crystalize the concepts presented in the previous papers. When he finishes that, the consultants and the members of the planning committee were requested to send their comments which will be taken into consideration to prepare the final draft which will be presented to the board for approval. Another consultant has prepared a proposal on the general presentation and disclosure standard. This was presented to the meeting of the planning committee held in Bahrain on 8.1.1992. As the proposal is based on the concepts of Financial Accounting for Islamic Banks and Financial Institutions which still requires more study, the general presentation and disclosure standard remains as a proposal. The following is a review of the paper:

1.3.3 A brief on the paper on the general presentation and disclosure standard

1.3.3.1:

The name of the paper is "General Presentation and Disclosure in Islamic Banks and Financial Institutions".

1.3.3.2:

The total number of pages is 22 and it included the following:

1.3.3.3.1:

Standard

1.3.3.3.2:

Text of the standard.

1.3.3.3.3:

Requirements of presentation of financial statements.

1.3.3.3.4:

General disclosure.

1.3.3.3.5:

General explanations.

With the standard a sample income statement and financial position for Islamic Banks are attached. Appendix No. (3) shows a detailed proposal of the general presentation and disclosure standard.

1.3.4. The financial cost of preparing a general presentation and disclosure standard

The total cost for this study is 6,000.64 Dollars paid to the consultants who prepared papers and/or participated in discussion.

1.4 FINANCIAL ACCOUNTING IN COUTRIES WHERE THERE ARE ISLAMIC BANKS

1.4.1 Objectives and methodology of the study

The purpose of presenting studies on financial accounting in countries where there are Islamic Banks is:

1.4.1.1:

To review the objective, concepts and standards of accounting available in it.

1.4.1.2:

To understand the role of Governmental, national and professional bodies in preparing financial accounting objectives, concepts and standards and description of the role of those bodies;

1.4.1.3:

To understand the possibility of making use of each experience in preparing financial accounting standars for Islamic banks and financial institutions.

1.4.1.4:

To explore possible ways of cooperating between those agencies and the financial accounting organization to facilitate the implementation of standards which the organization will promulgate. It has been decided that the studies will be based on:

- Interviews with related persons
- Referring to the materials prepared in this topic
- Reference to all laws which govern the bodies and institutions concerned with the organization of the accounting profession in the country which will be studied.

To achieve this objective it has been proposed that the contents of this study should include the following:

1. A review of the political development and the position of the local economy.
2. The legal forms of economic enterprises.
3. Historical development of the financial profession.
4. The supervisory bodies of the accounting profession.
5. The major features of the accounting education.
6. The accounting standards used in the country under study and the possibility of implementing standards which the accounting organization for Islamic banks and financial institutions will promulgate.

1.4.2 A brief on the papers prepared on the study on financial accounting in countries where there are Islamic Banks

The consultants in accounting were assigned to prepare a plan, a methodology for the study, an approach to the collection of the information, time schedule for the study and a budget. The consultants were also assigned to study the objectives standards and financial concepts of Islamic banks and financial institutions from the user of financial reports prepared by these institutions. To achieve this purpose, the following was prepared:

* A questionnaire addressed accountants and those working in financial banks, university lecturers in accounting, supervisory or professional bodies organizing the accounting profession.

* An interview addressed to those dealing with Islamic banks and financial institutions.

The interview stage will be followed by the analysis stage, writing research and documenting it.

The following countries have been chosen to be the subject of the study.

- The Gulf Estate
- Egypt, Sudan, Jordon
- Tunis, Algeria, Sengal,
- Britain, Switzerland, Al Bahama, Denmark
- Pakistan, Iran
- Malasia, Turkey

The consultants were given letters to facilitate their duties in the countries under study. Those letters were addressed to the Islamic Banks and financial institutions and to the members of the Financial Accounting Standards Board for Islamic Banks and Financial Institutions and also to the other related agencies which will help achieving the purposes of the studies.

1.4.3 The present cost to prepare the study on the role of governmental, national and professional bodies in preparing financial standards

The present cost for the study of the role of Governmental, national and professional bodies in preparing accounting objectives, concepts and standard is US\$ 40,321.54 paid to five consultants who prepared papers and/or participated in discussion.

2. ADMINISTRATIVE AFFAIRS OF THE ORGANIZATION

2.1 ADMINISTRATIVE SUBJECTS

2.1.1: Registration of the Organization

The organization has been registered in the state of Bahrain under No. 24524 on 27.3.1991.

2.1.2: Appointment of the Executive Director and the Consultants

It has been agreed in the meeting of the planning committee No. 13 held on 1st to 2nd August 1991 to appoint Dr. Mohammad Fidauddin as an Executive Director to the Organization and Dr. Hazim Yasin and Dr. Rifaat Abdul Karim as consultants. Dr. Rifaat will be in Bahrain and Dr. Hazim Yasin will be in Jeddah. Dr. Rifaat has already commenced his work on 4th September 1991. The appointment of Dr. Mohammad Fidauddin is still pending the approval of his employer. The appointment of Dr. Hazim Yasin in Jeddah is postponed.

2.1.3: Renting premises and preparations

An office has been rented for the organization in the center of Manama city in Bahrain. It has been supplied with furniture, office equipments. Also telephone, telex and fax services were connected to the office.

2.2 CORRESPONDENCE AND DOCUMENTS SENT TO THE MEMBERS OF THE BOARD, PLANNING COMMITTEE AND THE CONSULTANTS

A lot of correspondence and documents were exchanged with the members of the standards board, the planning committee and the consultants on the issues relating to the activities of the board and the committee.

In Appendix No. (9), there is an index of the documents and studies which were prepared by the consultants.

3. FINANCIAL AFFAIRS OF THE ORGANIZATION

The total contributions estimated in the budget of the first year of the organization is 542,400 US\$. The contributions paid to the organization is 291,200 US\$ detailed as follows:

Islamic Development Bank	135,600
Al Rajhi Banking Co.	67,800
Al Baraga Investment Co.	67,800
Faisal Islamic Bank	20,000

Total	291,200
	=====

The total estimated expenses for the first year is 452,000 dollars and the actual expenses for the first year 201,965.17 dollars. The details of the total major items are as follows:

Capital expenses	20,481.34
Administrative expenses	15,158.40
Expenses of the cost of promulgating the standards	166,325.43

	201,965.17
	=====

It is clear from the above that the surplus in the funds of the organization for the first year from the beginning of the activities of the organization is 250,034.83 US\$ and this is due to a number of factors:

3.1 The committee made every possible effort to reduce costs. Also the offices of the members of the planning committee took the responsibility of administrative affairs. This continued even after the appointment of the organization's consultant in Bahrain due to the big volume of work.

3.2 The administrative body is not fully recruited and one of the consultants has been appointed in the headquarters of the organization in Bahrain starting September 1991.

3.3 Some items were not spent i.e. the supervisory committee did not hold any meeting in the last year and the accounting standards board held only one meeting.

3.4 It is expected that there will be a deficit in the budget of the second year amounting to 250,000 dollars and this is because of a number of factors including:

3.4.1:

It is expected that the complete administrative body will be appointed.

3.4.2:

It will be expected to recruit the research body which was approved in the second meeting of the financial accounting board for Islamic banks and financial institutions held in Cairo on 26.5.1991.

3.4.3:

The expected increase in the cost of promulgating accounting standards to be in line with expected volume of work.

APPENDIX (1)

APPENDIX NO. (1)
SUMMARIES OF PAPERS PREPARED ON THE OBJECTIVES

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In The Name of ALLAH, Most Gracious, Most Merciful

A Summary of A Study on

**THE CHARACTERISTICS OF ISLAMIC BANKING SYSTEM [IBS]
VIS-A-VIS
THE USURIOUS BANKING SYSTEM [UBS]**

by

**Dr Ahmed Ali Abdullah
Deputy General Manager
Tadamon Islamic Bank
Khartoum, SUDAN**

Introduction

There is a general belief that UBS is the basic system and that it has been well entrenched in the Muslim world. This is erroneous because usury, which is the basic parameter on which the Western banking system is established, does not have its origin in the West. Rather, it was initiated in Judaism and Christianity which both prohibited it. Muslims had neither experienced the flagrant dealings in usury nor with its institutions before the Western colonial invasion to their territories.

If, however, some people showed a tendency or perhaps an enthusiasm towards usurious transactions, others have strongly opposed its introduction, struggled to prevent its expansion and sought for alternatives. Usury and its institutions are, therefore, some of the evils imposed upon the Muslim societies by the colonial forces and culture. Yet, Muslims have their own values and economic system which would enable them to get rid of the evils of usury and establish their banking system.

Similarities Between IBS and UBS

The similarities between the two systems may well be exemplified by two important aspects, namely:

- 1- the functions of the two systems are almost identical;
- 2- the banking system is divided into two main branches. These are the banking services and investments. The two systems carry out the banking services in almost the same manner. The services are based on the contracts of hire and agency which are valid in Shari'a and man-made laws. Banking services are, therefore, acceptable in Shari'a except where they are not consonant with Shari'a rules.

Differences Between IBS and UBS

The main differences between the two systems revolve around 1- the philosophy of each system; and 2- the modes through which investment is undertaken.

With regard to the philosophical difference, usury has become the order of the day in Western civilization despite its prohibition in Judaism and Christianity. This was possible due to the historical struggle between the Church and the reformists during the renaissance. Such a struggle ended in the victory of the reformists. From that time onward religion lost its grip in the West and withered away from the mundane life of man.

Secularism took over the role of the Church in this wide field and the institutionalization of usury has been one of its major effects. The process has gradually helped the evolution and supremacy of UBS in the West as well as elsewhere.

On the other hand, in the eyes of true Muslims, Islam is the perfect, complete and intact message covering and governing all human activities. It does not, therefore, accept believing in parts of the message while rejecting others. That would rather amount to infidelity. This has clearly been expressed in the Quran in chapter II verse 85.

The economic sector is an important area of human endeavours. Indeed, it falls within the scope and governance of Shari'a rules. In this vital area usury in particular has unequivocally been condemned and prohibited. Thus, the main difference between UBS and IBS is that the former depends largely, if not solely, on usury whereas the latter strongly prohibits any indulgence in it.

The prohibition of usury in Islam denotes that loan should cease to be a mode (sigha) of investment. Yet, Islam made it possible for investors to utilize their resources through a number of lawful means which include sale, leasing, partnership and Mudharaba. These risk-bearing modes are quite different in nature from usurious loans, thus marking the second difference between the two systems.

Advantages and Effects of Islamic Finance

- 1- Islamic modes of transactions safeguard against the damaging effects of usurious finance.
- 2- The positive effects of Islamic finance are:
 - a- The finance goes directly to the assigned project because the legality of the transaction and its economic success depends on that reality.

b- The risk-bearing nature of Islamic finance prompts the institutions to establish qualified and well equipped departments of control and follow up. The redemption of capital and the procurement of profit rest on the success of the profit. This in turn has far reaching effects.

Despite the differences and positive effects of Islamic finance, there is still much in common between the two systems. Islam is a reformatory revolution. Its perfection and practicability are derived, inter alia, from its ability to accommodate the positive experiences of humanity and build on it on the ground that virtue is a trait built in man. The prohibition of usury does not, therefore, mean the condemnation of the human experience in formulating the banking system, but rather the rejection of that much of it which contravenes the Islamic rules.

Hence, in attempting to formulate the objectives of financial reporting researchers should seriously take this reality into consideration. They definitely need to dig deep into the sources of Shari'a; however, the human positive experience is also a source which could not be ignored.

In The Name of ALLAH, Most Gracious, Most Merciful

A Summary of A Study on

**THE OBJECTIVES OF ACCOUNTING AND FINANCIAL REPORTING
IN THE ISLAMIC CONTEXT**

by

**Professor Yousif Qassim
Professor and Head of Islamic Shari'a Department
Faculty of Law
Cairo University**

The Importance of Accounting in The Islamic Context

Accounting has significant importance in all matters of life and humanity. In accounting, and in all other fields of knowledge, we see the concise verses of Allah challenging the intellectuals of this discipline. Allah says in the Quran "On no soul doth God place a burden greater than it can bear. It gets every good that it earns, and suffers every ill that it earns. (Bagara:286).

We realize that on the good side, the individual is credited with all his minute good deeds even if they were mere intentions. On the evil side, the individual is only debited with the sin which s/he has actually committed. However, the latter does not include mere intentions because according to the saying of the Prophet, peace be upon him, "Allah has pardoned for the Muslims the sinful thinking so long as it has not been expressed or manifested in deeds and utterness".

Accountability of Human Beings to Allah

This is conducted along the same merciful and caring attitude and with the same balance with which the minute good and evil deeds are judged. But the good deeds are rewarded ten times and "God giveth manifold increase to whom He

Accountability of the Individual to His/Herself

The accountability of one's self is his/her path to salvation on the day of judgement. According to the Prophet "A prudent Muslim is he who takes himself seriously and geared his deeds towards the hereafter whereas the helpless Muslim is he who follows his whim and caprices and confines himself to wishful thinking".

Ibn Alqium provided a succinct explanation of the good and bad deeds and argues that each individual has rights and obligations and each should receive his right.

Double Entry

The origin of accounting in the modern age is what is known as double entry. It is claimed that this originated with accounting in Italy and that the first person to write about it was Luca Pacioli. However, this was well antedated by what was written by Ibn Alqium who explained this principle well before it was recognized by modern science.

Broad Objectives of Accounting

The broad objectives of financial accounting can be summarized as follows:

First Objective: To achieve the worship of God. This objective is so broad that it applies to every deed undertaken by the Muslim including the learning, practicing, and academic and professional development of Islamic accounting. Two characteristics can be derived from this objective.

These are:

First, the obedience of God and His Prophet should be put before any other party whether that be capital owner, a shareholder or otherwise.

Second, the objectives of accounting in the Islamic context cannot be changed or replaced.

Second Objective: To determine the right of each of the parties concerned and to ensure that each one receives his own right. This objective is in line with the saying of the Prophet and in accordance with the explanation of Ibn Alqium.

The Direct Objectives of Financial Accounting In The Islamic Context

The direct objectives can be summarized as follows:

- 1- To determine all the rights and obligations in a manner compatible with reality and in accordance with the Shari'a.

- 2- To determine the growth of wealth and the shares of those who are eligible to it due to ownership or other rights of eligibility.

- 3- To determine the losses and the factors which caused it whether that be due to negligence, carelessness, deliberate action or any other reason.

- 4- To determine the financial rights that should be paid in the name of God. This includes determining the funds that are liable to Zakah from those that are not.

- 5- To determine the rights of the parties concerned either at the end of operations or at liquidation.

6- To determine the rights of the parties concerned due to transfer of ownership either by means of inheritance, will or any other means.

7- To determine the unlawful or suspicious earnings so as to get rid of them and not to mix them with the funds of the organization or distribute them. Instead they should be spent on charitable works.

8- To provide all the scientific facts and real accounting information to users of financial statements.

9- To provide useful information to investors and creditors to enable them to take rational decisions in the field of investment and credit and other aspects.

10- To provide relevant information to help investors and creditors and other parties in estimating the cash returns from their investments in the organization, the timing of these returns, and the uncertainties that surround them.

11- To provide information that relates to the economic resources of the organization which represent sources of cash flows.

This study is a summary of papers presented by the following:

- 1- Dr Yousif Tobbal
- 2- Dr Abdel Satar Abu Qoda
- 3- Dr Ahmed Ali Abdalla and Dr Rifaat Abdel Karim
- 4- Dr Yousif Qassim

SUMMARY
OBJECTIVES OF FINANCIAL ACCOUNTING AND REPORTING OF
ISLAMIC BANKS AND FINANCIAL INSTITUTIONS

PREPARED BY : DR MOHAMED FIDAUDDIN

JANUARY 1992

This paper is a Summary of the subject : Objectives of financial accounting and reporting for Islamic Banks and financial Institutions. It has been prepared on the request of the Planning Committee of the Financial Accounting Standards Board for Islamic Banks and Financial Institutions. The assignment was to summarize, coordinate and rewrite the subject matter taking into consideration the several papers which were prepared for the Board under the same title and the discussions emerging from them.

The paper contains a basic background on the subject matter which includes an introduction and an explanation of the methodology of deducing the objectives of financial accounting and reporting for Islamic Banks and financial institutions. The latter is basically the joint and coordinated dialogue between Sharia and accounting scholars with input from accounting practitioners, central banks representatives, Islamic bank Senior Management and other concerned groups. The dialogue also took into consideration the contemporary literature on the subject matter.

The idea of having objectives for financial accounting and reporting for Islamic Banks and financial Institutions is to start the process of formulating a conceptual framework of which the objectives are the first part. The conceptual framework guides the setting of accounting standards.

The paper also discusses briefly the following topics:

The objectives of economic altivities in Islam, financial accounting, financial statements and financial reporting, historical developments of setting objectives for financial accounting, the importance of determining objectives of accounting and financial reporting of Islamic banks and Financial Institutions, users of accounting and financial reports, limitations of information that are produced by financial accounting, individual decisions and their effect on economic developments, why objectives of financial accounting and reporting differ in Islamic banks and financial institutions.

The tentatively agreed upon objectives are:

1. Providing information regarding the compliance of the Islamic Banks and financial institution (referred to hereafter as the accounting entity) with Islamic Sharia in all its activities and transactions and documenting this compliance.
2. Determining the resources and obligations of the accounting entity and the changes in them during the accounting period in a way that is supported factually and complies to the Islamic Sharia.
3. Providing information that is useful in determining the rights and obligations of all parties dealing with the entity without prejudice and with full compliance with the rules of Islamic Sharia.
4. Providing information that is useful in determining the Zakat payable by the accounting entity.
5. Providing useful information for making (lawful) economic decisions.
6. Providing information that is useful in assessing the expected cash flow that can be transfered to the parties dealing with the entity and the timing and uncertainty associated with this cashflow.

7. Providing information that is useful in assessing the performance of management in their discharge of responsibility toward funds providers, including their compliance with Islamic Sharia.
8. Providing Information that is in separating the "un Islamic" or suspicious earnings - if it happened.
9. Providing information that is useful in assessing the profits, attributable to incomplete earnings cycles and the uncertainty surrounding it.
10. Providing information that is useful in assessing the extent to which the entity participated in the development of the Muslim society in which it operates and other Muslim societies.
11. Providing information about the contribution of the entity to the concept of "Imarat Alard" or preserving and developing the earth, which requires that man and his deads to be useful to him and to others. This includes not polutting the earth, not wasting the scarce resources, etc.
12. Providing information about the contribution of the entity to charitable activities.
13. Providing information about the human resources available in the entity and the efforts spent in their development technically and Islamically.

SUMMARY OF PAPER: OBJECTIVES OF ISLAMIC ACCOUNTING
PREPARED BY DR. ABDUL STTAR ABU GHUDDAH

The paper includes a preface on accounting and argues that it is one of the Sciences on which Allah has given guidance to human beings to achieve His religious and worldly interests. This is part of wisdom which is the objective of the believer who abides by it wherever it is found, and if it is diverted from its purpose he brings it back to its purity.

Muslims have been concerned with accounting and have given it the Islamic flavour by investigating its facts and giving importance to its ethics. It is agreed that learning accounting is a non-obligatory duty (Fard Kifaya); however, it becomes obligatory for those who deal in businesses because of the need for it in giving the rights to those who deserve it. Imam Al-Ghazali confirmed that the requirements of trading should be studied to differentiate the permissible from the forbidden and to distribute profit or loss. He also explained that the transaction could be correct but it may contain injustice or harm because it does not take in consideration the required ethics.

The paper also refers to the fact that there is a general objective to all deeds which is to ensure voluntary obedience and submission (obudiyya) to Allah to be in harmony with the actual obedience. Reference is made to Al-Shatiby's statement in his Maqсад Al-Taklif: "Bring out the designate from his personal interest to willingly be a servant of Allah as he is compulsory his servant." Hence, such generalization is sufficient to connote that obudiyya should be one of the objectives of accounting.

The paper lists the objectives of accounting from an Islamic perspective. These are:

1. Providing information to determine, measure and control all resources and obligations of the project in a way which is in line with Sharia.
2. Determine the growth of funds and the shares of its owners or any other claims including Zakat.
3. Determine the rights of all parties commenced at the end of the activity, its liquidation or its transfer by heritage, will or acquisition.

4. Determine unlawful or doubtful earning to get rid of it by spending it on charities and not mixing it with the assets of the project or distributing it (while realizing that in principle bad earnings should not be made but if they happen occasionally it must be eliminated.

5. Draw the ways of kindness and the ethics of Sharia in transacting business in order o complete the ways of justice and the need for peace, generosity, consent and spending on public intrests and charities.

In The Name of ALLAH, Most Gracious, Most Merciful

A Summary of A Study on

**TOWARDS THE DETERMINATION OF THE OBJECTIVES OF
FINANCIAL REPORTING OF ISLAMIC BANKS AND FINANCIAL
INSTITUTIONS**

by

**Dr Ahmed Ali Abdullah
Deputy General Manager
Tadamon Islamic Bank
Khartoum, SUDAN**

and

**Dr Rifaat Ahmed Abdel Karim
The Financial Accounting Organization for
Islamic Banks and Financial Institutions**

Obudhiyya (obedience and submission to the will of Allah Almighty High) is the central function of man. Allah Almighty High has, however, paved the way for man to discharge the duties of that function and consequently attain his freedom by providing ample ways and means. The right of ownership and the incentives to work hard - for self-sufficiency and rendering services to others - are some of those ways and means. Hence, the abuse of material wealth is today claimed to be greatly responsible for the prevalent evils and more especially the increasing disparity between the haves and haves-not.

However, the wealth that would enable a person to achieve his/her goals and to discharge with the duties arising thereof must conform, in acquisition and dispensation, to the norms and rules of Shari'a. In Islam, the ownership of everything is vested in Allah High Almighty. Fortunately, this was delegated by Allah to man but on condition that he has to administer the wealth bestowed upon

him in accordance with the rules laid down in Shari'a. Accordingly, wealth has to be acquired from a lawful source, by lawful means and spent in the same manner.

In addition to providing man with the necessary tools to achieve his goals, the Shari'a also imposes upon him duties, which involves his wealth, towards himself, his family and the community at large. Such duties are meant to serve the same purpose of helping man to achieve his objectives. The following are some of those duties which relate to wealth.

- 1- Investment and management of one's wealth should be in accordance with the rules and regulations stipulated in the Shari'a;
- 2- payment of Zakah and other social co-operation (*takafuf*) duties;
- 3- payment of tax as need arises;
- 4- the right of the government to demand loans from its citizens;
- 5- *nafaqah* - the duty to pay for the needs of the dependents, wives, children, parents and other relatives; and
- 6- the rights of investors, clients, creditors and employees.

In the light of the above, if we examine the objectives of financial reporting in the West, particularly in the U.S.A., we would realize that these objectives are geared to

- 1- providing useful information to investors, creditors and other users to help them in making rational investment, credit, and similar decisions;
- 2- providing information to the users in 1 above to assess the amounts, timing, and uncertainty of prospective cash receipts from dividends, depositors' profits and the proceeds from sale, redemption, or maturity of securities or loans; and

3- providing information about the economic resources, the claims to those resources, and the effects of transactions, events and circumstances that change resources and claims to those resources.

However, in Islam the economic activities are characterized and directed by moral values. This moral dimension widens the objectives of financial reporting for Islamic settings as well as the list of the users of these reports. The latter would include the institutions of Zakah, investment depositors, shareholders, clients, creditors, social and charitable organizations, government bodies, management, employees and others.

Accordingly, the objectives of financial reporting for Islamic banks and financial institutions would be:

- 1- to authenticate that the acquisition and disposition of the entity's resources and the transactions arising from such a process were conducted in accordance with the Shari'a;
- 2- to provide adequate and useful information about the funds liable to Zakah;
- 3- to provide useful information to investors, investment depositors and other users to help them in making rational investment and similar decisions;
- 4- to provide information to investors, investment depositors and creditors to assess the amounts, timing, and uncertainty of prospective cash receipts from dividends, depositors' profits and the proceeds from sale, redemption, or maturity of securities;

5- to provide information about the economic resources, the claims to those resources, and the effects of transactions, events and circumstances that change resources and claims to those resources;

6- to provide information that is useful to managers and directors in assessing their past performance and in making decisions in the interests of owners and concerned parties;

7- to provide information about the tax commitments of the organization;
and

8- to provide information about the contribution of the organization in the economic and social development of the country and in enhancing the social co-operation and charitable works.

APPENDIX (2)

APPENDIX NO. (2)

SUMMARIES OF PAPERS PREPARED ON
THE CONCEPTS

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**Definitions of Legal Terminology
(Mustalahat Fiqhiyya)
Covering The Activities of Islamic
Banks & Financial Institutions**

compiled by

**Professor Youssif Qassim
Dr Abdel Satar Abu Qoda
Dr Ahmed Ali Abdullah**

A committee comprising the above Shari'a experts has been asked to select legal terminologies covering the activities of Islamic banks and financial institutions. The rationale behind this work was to furnish non-Shari'a researchers with the necessary tools which would help them in formulating the objectives and concepts of financial reporting as well as accounting standards of Islamic banks and financial institutions.

The committee selected over two hundred terminologies to be defined. These were discussed in a number of meetings which were attended by the members of the Planning Committee and the Shari'a and accounting consultants.

The approved list of terminologies was divided between the three Shari'a experts to define them. Dr Abu Qoda was asked to organize the submitted definitions. In discussing the list compiled by Dr Abu Qoda, it was realized that the references, from which the definitions were quoted or derived, ought to be recorded and that some of the more relevant definitions needed more elaboration. This was assigned to Dr Ahmed Ali Abdullah who took into consideration the two observations and compiled two lists.

One list was arranged in alphabetical order as originally compiled by Dr Abu Qoda. The other list was prepared in accordance with the substance of the

terminology. The latter list was developed with two objectives in mind. First, to show the relationship between the terminologies. Second, to highlight the similarities and differences between the terminologies.

In The Name of ALLAH, Most Gracious, Most Merciful

A Summary of A Study on

**THE CONCEPTS OF FINANCIAL ACCOUNTING OF
ISLAMIC BANKS AND FINANCIAL INSTITUTIONS**

by

**Dr Rifaat Ahmed Abdel Karim
The Financial Accounting Organization for
Islamic Banks and Financial Institutions**

and

**Dr. Abdul Sattar Abu Ghuddah
Sharia Adviser
Dalla Al-Baraka Group**

The paper includes the following topics

- 1- Elements of Financial Statement
- 2- Qualitative Characteristics of Accounting Information
- 3- Accounting Assumptions
- 4- Basic Principles of Accounting
- 5- Accounting Principles That Constitute Constraints
- 6- Measurement Concepts of Financial Accounting

1- Elements of Financial Statement

The elements of financial statements of Islamic banks and financial institutions comprise the following: assets, liabilities, revenues, expenses, gains, losses, equity and investment deposits. These elements are most directly related to measuring the performance and financial status of an enterprise.

Assets: probable future economic benefits obtained or controlled by a particular accounting unit as a result of past transactions or events. In Islamic *fiqh* (jurisprudence) an asset can be defined as whatever can

produce services or benefits whose results would be realized now or in the future.

Liability: Probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other accounting units in the future as a result of past transactions or events.

Equity: Residual interest in the assets of an accounting unit that remains after deducting its liabilities.

Investment Deposits: Funds provided to the accounting unit by outsiders to be invested in accordance with the established *Mudaraba* rules. Profits arising from the investment of these funds should be shared by both the fund providers and the accounting unit; however, losses would solely be borne by the former.

Revenues: Inflows or other enhancements of assets of an accounting unit or settlement of its liabilities (or a combination of both).

Expenses: Outflows or other using up of assets or incurrences of liabilities (or a combination of both).

Gains: Increases in equity (net assets) from peripheral or incidental transactions of an entity.

Losses: Decreases in equity (net assets) from peripheral or incidental transactions of an entity.

2- Qualitative Characteristics of Accounting Information

These include:

Relevance: To be relevant, accounting information must be capable of making a difference in a decision.

Reliability: Accounting information is reliable to the extent that users can depend on it to represent the economic conditions or events that it purports to represent.

Neutrality: In formulating or in implementing accounting standards, the primary concern should be the relevance and reliability of the information that results, not the economic consequence of the standard or rule.

Comparability: Information that has been measured and reported in a similar manner for different accounting units are considered comparable:

Timeliness: For information to be relevant, it must also be available to decision makers before it loses its capacity to influence their decisions. This could be one lunar year because it is relevant for the calculation of Zakah.

Understandability: Is the quality of information that permits reasonably informed users to perceive its significance. This is consonant with the

saying of the Prophet, peace be upon him, "address people according to their level of understanding".

3- Accounting Assumptions

Economic Entity Assumption: The activity of an accounting unit can be kept separate and distinct from its owners and any other business unit. This assumption has been approved by a number of Shari'a scholars and endorsed in many Islamic conferences and seminars.

Going Concern Assumption: Accounting methods are based on the assumption that the accounting unit will have a long life. Acceptance of this assumption provides credibility to the historical cost principle and gives significance to the current-noncurrent classifications of assets and liabilities.

Periodicity Assumption: This assumption implies that the economic activities of an accounting unit can be divided into artificial time periods. These time periods vary, but the most common are monthly, quarterly, and yearly. The latter would match the lunar year which would enable the determination of the funds liable for Zakah.

Monetary Unit Assumption: Accounting is based on the assumption that money is the common denominator by which economic activity is conducted, and that the monetary unit provides an appropriate basis for accounting measurement and analysis.

Shari'a experts have taken a prudent decision to ignore the phenomenon of price-level change (inflation and deflation) to cater against the risk of accommodating usury in this process.

4- Basic Principles of Accounting

Historical Cost: Cost is generally the most useful basis for accounting measurement and reporting. Assets and liabilities are accounted for and reported on the basis of acquisition price i.e. their historical cost. This has the advantage of being definite and verifiable.

Other costs include selling price, replacement cost and present value of future cash flows.

Revenue Recognition Principle: Revenue is generally recognized when 1- realized or realizable and 2- earned. In the Islamic context, these two conditions equally apply.

Revenue is usually recognized at the point of sale. However, recognition of revenue is also allowed on the basis of percentage-of-completion, end of production, receipt of cash.

Matching Principle: This principle indicate that the efforts (expenses) should be matched with accomplishment (revenues) whenever it is reasonable and practicable to do so. If expenses cannot be associated with particular revenues, then an allocation of cost on some systematic and rational basis might be appropriate. Where, however, this method does not seem desirable, the cost may be expensed immediately.

Full Disclosure Principle: This principle recognizes that the nature and amount of information included in financial reports should 1- reflect sufficient details to disclose matters that make a difference to users; and 2- provide adequate combination and condensation to make the information understandable, while keeping in mind costs of preparing and using it. This principle is so important that it justifies a standard by itself.

5- Accounting Principles That Constitute Constraints

Materiality: An item is material if its inclusion or omission would influence or change the judgment of a reasonable person. In other words, it must make a difference or it need not be disclosed.

The point involved here is one of relative size and importance. If the amount involved is significant when compared with other relevant items of the financial statements, sound and acceptable standards should be followed. Alternatively, if it is quite unimportant when compared with other items, application of a particular standard may be considered of less importance.

Conservatism: This principle indicates that when in doubt he should choose the solution that will least likely to overstate assets and revenues and understate liabilities and expenses. It does NOT urge the accountant to understate assets or revenues or overstate liabilities and expenses.

Alqorm-bil-qonm: *Alqorm* is liability and *qonm* is profit. This principle advocates that whoever will benefit from the profit of a transaction should also bear the costs and losses pertaining to the transactions. Hence, in effect, this principle calls for the matching between the beneficiary of a

transaction and benefits and obligations arising thereof from the same transaction.

Cost-Benefit Relationship: This principle indicates that the cost of providing the information must be weighed against the benefits that can be derived from using the information.

6- Measurement Concepts of Financial Accounting

Capital Maintenance: Earnings result only after capital has been maintained or costs have been recovered. The concept of capital maintenance divides return *on* capital (earnings) from return *of* capital (capital recovery). There are two major concepts of capital maintenance: the financial capital concept and the physical capital concept.

In the Islamic context, capital maintenance is given considerable importance, particularly in partnership. The concept of financial capital seems to be more in line with Shari'a precepts.

Valuation Approaches To Accounting: There are three valuation system in addition to historical cost. These are:

1- Exit valuation: Assets are valued at the net realizable amounts that the enterprise would expect to obtain from them if they were disposed of in the normal course of operations. Liabilities would be similarly valued at the amounts it would take to pay them off as of the statement date.

2- Replacement Cost or Entry Value: This is the amount that would be paid now to produce an asset identical to the one used presently.

3- Net Present Value: According to this system, valuation of assets is a function of discounted cash flows and income is measured by the change in the present value of cash flows arising from operations during the period. However, in practice this system is applied to a very restricted group of assets and liabilities.

According to the majority of Muslim scholars, this system of valuation is in consonance with the Shari'a precepts.

APPENDIX (3)

APPENDIX NO. (3)

**SUMMARIES OF PAPERS PREPARED ON THE
GENERAL PRESENTATION AND DISCLOSURE STANDARD**

In The Name of ALLAH, Most Gracious, Most Merciful

A Summary of A Study on

**GENERAL REPORTING AND DISCLOSURE STANDARD
FOR ISLAMIC BANKS AND FINANCIAL INSTITUTIONS**

by

**Dr Rilfaat Ahmed Abdel Karim
The Financial Accounting Organization for
Islamic Banks and Financial Institutions**

and

**Dr Yousif Tobbal
King Abdel Aziz University**

The study comprises 6 pages and includes the following:

- * Introduction
- * Financial Statements General Reporting Requirements

This study reflects the preliminary thoughts of its authors concerning the requirements of the reporting and disclosure standard for Islamic banks and financial institutions.

The paper starts by defining the concept of disclosure and illustrates the tools which are used in financial reporting to convey financial information about the organization to outside users of financial statements.

The paper states the financial statements that are currently used to convey the necessary information to users of financial statements. It also examines the list of users of the financial reporting of Islamic banks and financial institutions. It is argued that, with the exception of the institutes of Zakah and the institutes of solidarity and charitable works, the information which helps users of financial reporting in their decision making can be obtained from the financial statements that are currently prepared by Islamic banks and financial institutions. Accordingly, the

paper proposes that a statement of the uses and applications of Zakah funds and a financial report of good faith loan fund to be prepared in addition to the current financial statements.

The requirements of the balance sheet of Islamic banks and financial institutions are examined. These included the elements that should be included in the balance sheet, their order and the items of each element. This is followed by the requirements of the income statement and the type of revenues, expenses, gains and losses which should be reported. The paper proposes the elements should be included in the statement of the uses and applications of Zakah funds and the financial report of good faith loan fund.

**PRESENTATION AND DISCLOSURE OF FINANCIAL
INFORMATION IN THE FINANCIAL STATEMENTS
OF ISLAMIC BANKS AND ISLAMIC FINANCIAL
INSTITUTIONS**

(A draft)

Prepared by:

Abdullah M. Al-Faisal (Ph.D)

1.1 INTRODUCTION

- A) This standard is applicable to published financial statements of Islamic banks and Islamic Financial Institutions.
- B) Financial statement objectives, accounting concepts for Islamic Banks and Islamic Financial Institution are a background of this standard.
- C) This standard is divided into two main parts as follows:
 - Ist Part: General Presentation in the financial statements of Islamic banks and Islaamic financial Institutions.
 - 2nd Part : General disclosure in the financial statements of Islamic banks and Islamic Financial Institutions.
- D) This standard covers the following three terms which refer to varying levels of classification with regard to presentation in the financial statements:
 - a) ITEM -- This represents the lowest possible level of detail for the preparation of assets, liabilities, income, expenses, gains and losses. Each such item is assigned a separate line in the appropriate financial statement.

- b) CAPTION -- This covers a number of items that are presented together. A caption represents an intermediate level of grouping for purposes of presenting various assets, liabilities, income, expenses, gains and losses. Each caption will be assigned a separate line in the appropriate financial statement.

- c) GROUP -- It covers a number of captions that are presented together. A group represents the highest possible level of grouping for the purpose of presenting various assets, liabilities, income, expense, gains and losses. Each group will be assigned a separate line in the appropriate financial statement.

1.2 SCOPE

- A) This standard defines the requirements of general presentation and disclosure in Islamic bank general purpose financial statements.

- B) This standard deals with certain considerations related to the level of materiality which defines items, captions and groups as well as respective notes that must be separately presented in the financial statements and those which must be combined with other items, captions, or groups. These considerations do not apply to the other issues that are handled by the standard of general presentation and disclosure for commercial banks.

- C) It should be noted that more accounting standards commercial bank would be provided for presentation and disclosure requirements of the respective subjects of those standards.

1.3 TEXT

A) General Presentation

This section defines the general requirements for the presentation of information in the financial statements generally and for each statement.

A.1 General Requirements:

1.1 The Integrated Group of Financial Statements:

- o An integrated Group of Financial Statements consists of the following:
 - Statement of financial position
 - Statement of Income

These statements and related notes represent the minimum requirements for the preparation and presentation of Islamic bank financial statements.

1.2 Arrangements of financial statements presentation: Financial statements must be presented in the following order:

- o Statement of Financial Position
- o Statement of Income

Notes to financial statements must be presented immediately after the last statement and are considered to form an integral part of the financial statements.

1.3 Materiality Consideration:

An item, caption or group is considered to be of material value if its omission, non-presentation, failure to provide notes or wrong phrasing of those notes leads to misinterpretation of information which will impact the feasibility of these statements to users. To determine the level of materiality of given item, caption or group for purposes of a presentation in the financial statements or attached notes, the nature and relative value of such item, caption or group must be taken into consideration. These two factors are usually evaluated altogether. However, either of these two factors may be the decisive factor in certain circumstances.

a) Nature of item, caption or Group:

In studying the nature of financial data to determine if it needs to be presented as an item, caption or group in the financial statements or attached notes, the following should be taken into consideration:

- 1) The basis for accounting measurement or recognition of the item, caption or group.
- 2) The degree of reliability in accounting measurement.
- 3) The item, caption or group's relationship/non-relationship with the bank's major operations.

- 4) Significance of the item, caption or group with respect to the decisions made by the users on the basis of information contained in the financial statements.

b) Relative Value:

To study the relative value of a given item, caption or group, it must be compared on a sound basis by employing the following principles:

- 1) Each item caption or group in the statement of income must be compared with net income for the current year or with the average net income for the past five years (including the current year), whichever is more appropriate for the measurement of net income, with due consideration to the trend of net results during the said period.
- 2) Each item, caption or group in the statement of financial position must be compared with the total assets of the bank.
- 3) Contingent assets and liabilities are not to be considered part of the bank's total assets or liabilities.

1.4 General principles for the presentation of information in the financial statements:

- a) The financial statements must be in a form which would allow a clear presentation of the bank's assets, liabilities, owners' equity and results of operations. Terminology must be used in a manner which would facilitate comprehension on part of the general user of information contained in the financial statements.
- b) Items, captions and groups of no significance must be grouped together and classified according to type or relationship to the bank's major operations.
- c) Amounts presented in the financial statements and attached notes should be rounded to the nearest thousand Saudi Riyal.
- d) Financial statements of, at least the prior financial period must be presented for comparison with those of the current period. Any change in form or contents of the financial statements and the corresponding notes must be disclosed.
- e) Each statement must contain:
 - o Full name of the bank
 - o Legal status of the bank
 - o Date/s of the statement of financial position and period/s covered by other financial statements.
- f) Notes must have distinctive titles and numbers. Note numbers must also be cross referenced with related captions in the respective financial statement. Each financial statement must be footnoted with the following statement: "The attached notes form an integral part of the financial statements."

- g) Financial statements and attached notes must be properly numbered.
- h) Subtotals must be presented in a separate column in each statement.

A) General Presentation Requirements of Individual Financial Statements:

2.1 General

- 1) Islamic bank statements of financial position must contain all assets, liabilities and stockholders equity. These items must be prepared in a vertical and comparative manner. Assets must be balanced with liabilities plus stockholders' equity.
- 2) Each item, caption or group presented in the statement of financial position must provide for easy comparison with that of prior period. Comparative figures must be adjacent to current year's figures to facilitate comparison on part of the general user. Reference must also be made to any change in accounting policy between the current period and prior period.
- 3) Each item, caption or group in the statement of financial position must be described in an accurate and clear manner.
- 4) Items, captions or groups contained in the statement of financial position must be presented in the following order:
 - o Assets
 - o Liabilities
 - o Stockholders' equity

- 5) Assets and Liabilities cannot be clasified as current and noncurrent in the statement of financial position of an Islamic bank. No offsetting shall also be allowed between assets and liabilities unless otherwise required by law, if any.
- 6) Debit and credit (contingent) memorandum accounts shall not be presented in the body of the statement of financial position.
- 7) Article 4 of accounting concept, for Islamic bank, and Islamic financial Institutions Implies that invested fund by investor other than Shareholders of the bank is not a liability of the bank. On the contraries Assets which are financed by that fund are not assets of the Islamic bank. For this reason assets of an

Islamic bank should not include such assets and liabilities of an Islamic bank should not include such investment.

B. Assets

- 1) Total bank assets must be presented in the body of the statement of financial position.
- 2) As a minimum, the following groups of assets must be individually presented in the body of the statement of financial position in the following order:
 - o Cash and balances with central bank and other banks.
 - o Securities portfolio

- o Inventory of goods
 - o Morabaha receivables (short term)
 - o Net Loans (Qard husan)
 - o Investment Securities portfolio
 - o Morabaha receivables (Long term)
 - o Real Estate Investment (Long term)
 - o Bank Shares of corporations and Mosharakah
 - o Net fixed assets (bank premisses, furniture and fixtures)
 - o Other assets
3. Deposits with Central bank must be disclosed as follows:
- o Legal deposits
 - o Call deposits
 - o Other deposits
4. Deposits with other banks must be disclosed as follows:
- o Call deposits with other domestic banks
 - o Call deposits with foreign offices of other domestic banks
 - o Call deposits with foreign banks
- 5) Inventory of commercial goods, should be disclosed. Disclosure should include, quantity, cost, value and account of Policy.
- 6) Loans "Qard Husan" should be disclosed according to loan's forth coming Standard.
- 7) Trading portfolio and investment securities portfolio must be disclosed in accordance with the requirements of the standard for trading and investment securities portfolio.

- 8) Morabaha receivable should be disclosed. It should be divided into short term (less than one year) and long term (more than one year). Morabaha activities should be disclosed, and allowance for doubtful receivable, are to be disclosed too.
- 9) Long term investment and accounting policies should be disclosed.
- 10) Real estate long term investment should be disclosed.
- 11) Islamic bank's Share in corporations, firms and Mosharakat should be disclosed. Each type should be disclosed separately. Information about Mosharakats cost, subject, and bank Share should be disclosed.

Information about Mosharakats cost subject and bank Share should be disclosed.
- 12) Fixed assets (bank premises, equipment and fixtures) and other real estate must be disclosed in compliance with the requirements of the standard of fixed assets and other real estate.
- 13) Other asset items or captions of material value must be disclosed.

2.3 Liabilities

- 1) As a minimum the following groups of liability items must be separately presented in the body of the statement of financial position in the following order:
 - o Depositss (Individuals and corporations)
 - o Deposits (Banks)
 - o Other liabilities.
- 2) Deposit (liabilities) must be disclosed in compliance with the standard of deposits.
- 3) Fund Invested by Investors is not a bank liability (Article 4 of concepts).

- 4) Other liability items or captions of material value such as zakat and dividords must be disclosed.

2.4 Stockholders Equity

- a) As a minimum, component items of stockholders' equity must be presented in the body of the statement of financial position in the following order:
 - * Paid up capital: This includes the owners' investment against their equity or the face value of shares issued by the bank and actually paid by owners or shareholders. Declared capital must also be disclosed.
 - o Statutory reserve in compliance with the provisions of the Companies Law or the Bankin Control Law in the home country of an Islamic bank.
 - o Other reserves: This includes reserves other than statutory reserve, that are deducted from retained earnings and allocated to a specific purpose.
 - o Retained earnings.
- b) Total stockholders' equity must be presented in the body of the statement of financial position.

2.5 Memorandum Accounts

- a) Memorandum (contingent) accounts are to be presented after total assets and total liability and stockholder's equity vertically in group totals. The amounts are to be shown in the middle of the statement of financial position in a singular column.

A.3 Presentation of Information in the Statement of Income

3.1 The bank's results of operations must be presented in a multi-staged statement which differentiates between net income from major operations and other income, gains and losses.

3.2 Comparative figures for a minimum of one prior financial period must be presented and effect of changes in accounting policy must be disclosed in compliance with relevant standard.

c) The following groups of items must be presented in the statement of income of the bank, if available, and in the following order:

1. Net income from major operations
2. Other gain (loss)/ revenue (expense)
3. Net income before extraordinary items.
4. Extraordinary items
5. Net income

1) Components of net income from major operations must be disclosed as follows:

- Income from commercial activities.
- Income from Morabaha
- Income from Modarabah and Mosharakah
- Investment income
- Income from leased assets
- Income from banking services
- Income from exchange
- Other income
- Morahabah bad debt expenses
- Administrative and general expenses

- e) Again it should be noticed that income and expenses of the above, should be income and expenses of the bank according to accounting concepts Article-5.
- f) Items or captions of material value from other gain (loss) revenue (expense) must be disclosed. The following items form part of this group:
 - o Gain (loss) on investment portfolio
 - o Gain (loss) on sale of fixed assets
 - o Return on trading portfolio
- g) Components of extraordinary items of material value must be disclosed.

B) GENERAL DISCLOSURE

B.1 Islamic banks must comply with the following requirements of disclosure.

1.1 General Information on the bank

Notes to the financial statements must contain general information on the bank covering:

- o Legal form, articles and memorandum of association and licence.
- o Geographical distribution of bank's activities.
- o Brief description of major services supplied by the bank.

1.2 Extraordinary Supervisory Control
Imposed on the Bank.

Disclosure must be made in the financial statements of extraordinary supervisory controls imposed on the bank by regulatory authorities which limited the authority of the bank's management of its funds pending the approval of those regulatory authorities. Such disclosure must cover the following:

- a) Date, validity and nature of controls
- b) Type of decisions affected by those controls.

ISLAMIC BANK
 INCOME STATEMENT FOR THE ACCOUNTING PERIOD
 ENDED 12-31-1992

Income Item:	1992	1991
Income from commercial activities	x	x
Income from Morabahah	x	x
Income " Modaraban of Mosharakah	x	x
Income from Investments	x	x
Lease's Income	x	x
Income from bankino services	x	x
Income from exchange	x	x
Other income	x	x
	-----	-----
Total Income	XX	XX
 Expense Items:		
General and administration exp:	x	x
Morabahah had dirt expenses	x	x
	-----	-----
Total expenses	XX	XX
Net income befor taxes	XX	XX
Income taxes	x	x
	-----	-----
Net income after taxes	XX	XX
	-----	-----

ISLAMIC BANK
 DETAINED EARNINGS STATEMENT
 AT 12 - 31 -1992

Retained earnings 1-1-1992	x	
Net income of 1992	x	

Retained Earning before distributions	xx	
Retained earnings distribution:		
Statutory reserve	x	
Dividend	x	
Researves	x	

		xx

Retgained earnings	x	
		=====

ISLAMIC BANK
STATEMENT OF FINANCIAL POSITION AT 12-31-1992

	Note	1992	1991
Assets:			
Cash and Deposits in banks		x	x
Securities Investment		x	x
Inventory of goods		x	x
Morabaha receivable, (shortterm)		x	x
Investement (long term)		x	x
Morabaha receivables (longterm)		x	x
Real estatge investment		x	x
Bank' share of corporations firms and Mosharakah		x	x
Fixed assets		x	x
Other asets		x	x
		-----	-----
Total Assets		xx	xx
		=====	=====
Liabilities:			
Bank deposits (demand)		x	x
Nonbank deposits		x	x
Short term liabilities		x	x
Deffered tax		x	x
Payable Aiudemd		x	x
Pensions		x	x
		-----	-----
Other liabilities		x	x
		-----	-----
Total liabilities			
Stickholder equity:			
paid in capital		x	x
Statutory reserve		x	x
" "		x	x
Retained Earnings		x	x
		-----	-----
Total stockholders equity		x	x
		-----	-----
Total liabilities and Stockholder equity.		x	x
		=====	=====

APPENDIX (4)

APPENDIX NO. (4)

SUMMARIES OF PAPERS PREPARED ON
FINANCIAL ACCOUNTING IN COUNTRIES WHERE
THERE ARE ISLAMIC BANKS

TC23109.024

Role of governmental, national and professional bodies in the preparation of financial accounting standards - in selected countries

PREPARED BY KHALID JINAH

1. This research has been carried out by reviewing the background information and the process of standard setting in the following countries -
 - England
 - Switzerland
 - The Bahamas
 - Denmark
2. In respect of each of the countries the following background information has been researched -
 - historical, political and economic information
 - forms of business enterprise and requirements with regard to accounting and audit
 - * Forms of business enterprise are fairly similar in the countries researched. Basically these comprise limited liability companies, partnerships, branches of foreign companies, joint ventures and sole proprietorships.
 - * Audit requirements vary from country to country. In England, all companies are required to have their accounts audited. In Switzerland, independent audits are required by law in respect of corporations with capital over SFr 5 million and by companies having bonds and debentures outstanding. Independent auditors report to the Board of Directors and not to the shareholders. In addition, statutory audits are required for corporations but not for Swiss branches of foreign companies. In the Bahamas statutory audit requirements exist for banks, trust companies and insurance companies but not for other types of businesses. In Denmark, all business entities are required to maintain accounting records, but an audit is only required for corporations, private companies, banks, savings associations, insurance companies, pension companies, real estate bond issuing institutions and investment pooling companies. Banks, insurance companies and corporations whose shares or bond issues are quoted on the Copenhagen Stock Exchange must be audited by two independent statutory auditors.
 - stock exchanges and listing requirements
 - * England and Switzerland have well developed and internationally recognised stock exchanges. There is no official stock exchange in the Bahamas but shares of several public companies are traded in the unofficial stock market.
 - * In England, the securities market is regulated by the Financial Services Act, the primary purpose of which is the establishment of a framework of regulations for investment services which give effective protection to investors. Companies seeking a full listing are required to comply with quotation requirements of the stock exchange (described in the "Yellow Book") and must enter into an appropriate listing agreement. Companies listed on the stock exchange are required to publish half-yearly or interim reports which are required to be circulated to all shareholders. In terms of accounting practice, the stock exchange does not prescribe any specific standards of its own although it expects all companies (except foreign companies) to comply with SSAPs and for foreign companies to comply with IASs.

- * In Switzerland, the main stock exchanges are based in Zurich, Basle and Geneva. The stock exchanges are subject to cantonal rules and by the Federal Stock Exchange Association. There are no specific requirements with regard to the accounting standards that the companies seeking listing are required to follow. Both domestic and foreign corporations may be listed. Foreign corporations are basically subject to the same listing requirements as domestic corporations except that a specific approval is required from the Swiss Administration Board prior to approaching the Stock Exchange Association.
- * There is only one stock exchange in Denmark, based in Copenhagen. Stocks are listed in three categories (the "Bors 1", "Bors 2" and "Bors 3") depending upon the size of the company and its trading record. Securities may be listed, if in the opinion of the Stock Exchange Board, the listing is of public interest.

- development of the accountancy profession

- * In England the accounting profession is regulated by the four licensing bodies of chartered or certified accountants (which qualify their members to act as auditors) i.e. The Institute of Chartered Accountants in England and Wales, The Institute of Chartered Accountants of Scotland, The Chartered Association of Certified Accountants and The Institute of Chartered Accountants in Ireland ; and two other institutes associated with the profession i.e. The Institute of Cost and Management Accountants and The Chartered Institute of Public Finance and Accountancy.
- * The principal association of the accounting profession in Switzerland is The Swiss Chamber of Trustees and Auditors which formulates and supervises the maintenance of ethical rules of the profession and requires its members to adhere to minimum auditing standards. In the Bahamas the accountancy profession is about 20 years old with the formation in 1971 of the Bahamas Institute of Chartered Accountants. The Bahamas does not have any qualifying route of its own and membership is limited to members of nine specified foreign institutes (eg AICPA, ICAEW, etc).
- * There are two well-established accounting bodies in Denmark - The Institute of State-Authorised Public Accountants and the Society of Registered Public Accountants. These bodies are governed by their own separate laws. The former is the senior body and issues pronouncements on accounting and auditing matters.

- regulatory framework, especially central bank regulations

- * In England the responsibility for basic legal framework rests with the Department of Trade and Industry. Banks operating within the country are regulated by the Bank of England. Financial institutions which do not hold a full banking license are governed by Self Regulatory Organisations ("SROs") under the Financial Services Act. In Switzerland the Government has set up a multitude of agencies for the regulation of business activities. The Federal Banking Commission located in Berne supervises the banking sector, the Federal Insurance Commission regulates the insurance industry, the Federal Monopolies Commission deals with monopoly related matters. There are a number of direct and indirect taxes which are levied at the national and cantonal levels. Nevertheless Switzerland is committed to a free enterprise system and government interference is kept to a minimum. Business in the Bahamas, however, is not subject to stringent regulations. There are no monopoly or antitrust laws. Banks and trust companies are regulated by the Central Bank of the Bahamas and insurance companies fall under the supervision of the Registrar of insurance companies.

Responsibility for the basic legal framework rests with the Ministry of Industry in Denmark. The attitude of the authorities is to allow and encourage free trade. In 1990, the Monopolies Board was closed down and replaced by the Competitive Board. Banking activities are regulated by the Banking Act and monitoring is the responsibility of the Banking Inspectorate.

- procedures for setting accounting standards

- The situation with regard to accounting standards varies between countries. Whilst England and Denmark have their own standard setting bodies (the Accounting Standards Board and the Institute of State-Authorised Public Accountants respectively), in Switzerland the Swiss Foundation for Accounting and Reporting Recommendations issues guidelines governing recommended accounting practice covering only a few major areas. At the other end of the scale, the Bahamas does not have any accounting standards of its own. Instead the Bahamas Institute of Chartered Accountants recommends that its members follow International Accounting Standards.

- financial reporting standards

- In England the disclosure requirements for companies are set out in the Companies Act which sets out a prescribed format for accounts. Certain other disclosures are required by the SSAPs/FRSs issued by the ASC/ASB and by the rules of the Stock Exchange. In Switzerland, annual financial statements prepared by Swiss-controlled companies are required to include only a balance sheet, income statement and statement of retained earnings with a minimum amount of disclosure. There are no legal requirements to produce consolidated financial statements. In the Bahamas, disclosure requirements for banks, trust companies and insurance companies are set out in the laws that govern them. In respect of other companies, disclosures are generally restricted to those required by International Accounting Standards.

In Denmark, accounting principles together with reporting, disclosure and consolidation requirements are contained in the Accounting Law of 10 June 1981 which follows the EC Fourth Directive. The EC Seventh Directive on consolidated financial statements were integrated in the Danish Accounting Law effective 1 January 1991. Generally Danish accounting standards do not deviate significantly from International Accounting Standards.

3. For the purpose of the research paper I have utilised a vast body of published information as well as the information obtained by personal interviews of select individuals (which I carried out during my visits to the above mentioned countries).
4. Based upon the above, I have discussed in my research paper my findings covering the following areas -
 - The need for a technical assistance agreement between the Islamic Accounting Standards Board (the "Board") and certain other Western accounting standard setters.
 - How the experience of the researched countries in setting standards or adopting existing accounting standards may be utilised by the Board for its purposes. It is felt that as a starting point, Islamic Accounting Standards should be issued as non-enforceable statements of best accounting practice. Compliance with these standards may be made mandatory with the help of governmental and other national bodies once their credibility has been established and the Board has gained sufficient first-hand experience of its own.

- The possible areas which urgently need to be addressed by Islamic standards
 - The role of governmental and other national bodies in the setting up of Islamic standards and in ensuring their acceptability both in the Muslim and outside world.
5. The paper has been prepared in the following manner -
- Introduction setting out the purpose and *modus operandi* of the research
 - findings and points for discussion
 - conclusions (which are summarised below) on the manner in which Islamic Accounting standards may be set -
 - * Board enlists governmental support (major countries in the Islamic world) for its activities.
 - * Board establishes a conceptual framework dealing with matters such as objectives of financial reporting, qualitative characteristics of financial information, recognition of financial items, valuation and measurement, etc.
 - * Board enters into technical consultative agreement with recognised standard setting bodies in the Western world (IASB, ASA).
 - * Areas are identified in which Islamic standards are desirable. Care should be taken at this stage to ensure that areas that are already covered under existing accepted standards such as IAS, SSAP, FRS or FAS are not duplicated.
 - * After due consideration and debate, the Board issues an "exposure draft" for discussion. In accordance with the agreement with other standard setting bodies, this is circulated to them as well. At this stage care should be taken to ensure that the recommendations included therein do not contravene any Islamic laws or commercial laws of major Islamic countries.
 - * Upon receipt of comments from all quarters, Board issues a draft statement of recommended practice to be ultimately issued in final form.
 - * In order to ensure acceptability in the Western world, the Board should negotiate with accountancy bodies (such as the ASA in England, Swiss Chamber of Trustees and Auditors or the Bahamas Institute of Chartered Accountants) and Central Banks of countries outside the Islamic world with concentrations of Islamic financial services entities on a one-to-one basis regarding "adoption" of Islamic SORPs.
 - * Once Islamic SORPs gain credibility over a period of time and once Islamic banking becomes a force to reckon with in the world financial markets, the long term aim should be to make the Board's pronouncements mandatory standards.
 - * Islamic SORPs should be included as part of the curriculum in accountancy studies within the Islamic world.

Islamic Banks & Financial Institutions In the Western World - Issues, challenges and objectives of their financial reporting

PREPARED BY KHALID JINAHI

- 1 In this paper I have addressed the question of the objectives of financial reporting and the need for accounting standards by reviewing the fundamentals of accounting theory.
- 2 Additionally I have reviewed the experience of Islamic banks and financial institutions in the four countries that I researched as part of my discussion paper on the role of governmental, national and professional bodies in the preparation of financial accounting standards i.e. England, Switzerland, the Bahamas and Denmark. The purpose of this exercise is to gain an understanding into the problems faced by Islamic banks in operating in the countries researched and also the problems faced by them in the accounting for certain Islamic transactions.
- 3 Problems faced by Islamic banks in Western countries are plentiful. First of all the biggest problem is one of perception. The general feeling is that Islamic banks and financial institutions have hidden elements of interest in their dealings even though dealings in riba are prohibited by Islam. Accordingly Islamic banks are viewed as being hypocritical. It's for this reason that even Muslims tend to deal with them only if the services offered by Islamic banks are competitive.

This leads to the next problem. Islamic banks are viewed as being uncompetitive compared to conventional banks. Customer's share of profits is very often lower than interest rates offered by non-Islamic banks.

Another problem faced by Islamic banks is the attitude of regulatory authorities. They do not regard Islamic banks as being any different from conventional ones and are uncomfortable with the idea that under Islamic banking, depositors stand a chance to lose their money in case the bank issues a loss on the investment of customer funds. Regulatory authorities require Islamic banks to classify profit as interest in their returns, thus ignoring the fundamental concept of Islamic banking.

- 4 The following Islamic banks and financial institutions operate in the countries I have researched.

England

- * Al Baraka International Bank Limited
- * Cavendish Traders Limited
- * Al Baraka Investment Company Limited
(registered in the Isle of Man)
- * Al Rajhi Banking and Investment Corporation

Switzerland

- * Bank Al-Taqwa (a Bahamian company)
- * Dar Al-Maal Al-Islami (DMI) SA
- * Faisal Finance (Switzerland) SA

The Bahamas

- * Dar Al-Maal Al-Islami Trust
- * Massarf Faysal Al-Islami (Bank & Trust) Bahamas Ltd
- * Pan Islamic Consultancy Trust
- * Bank Al-Taqwa

Denmark

- * Islamic Bank International of Denmark

In The Name of ALLAH, Most Gracious, Most Merciful

A Summary of A Study on

**THE ROLE OF GOVERNMENTAL, PROFESSIONAL AND PRIVATE
ORGANIZATIONS IN THE PREPARATION OF OBJECTIVES, CONCEPTS
AND STANDARDS FOR FINANCIAL ACCOUNTING IN
THE REPUBLIC OF THE SUDAN**

by

**Dr Rifaat Ahmed Abdel Karim
The Financial Accounting Organization for
Islamic Banks and Financial Institutions**

The study comprises 7 pages and includes the following:

- * Introduction
- * Highlights of the Political Developments and the Status Quo of the Economy
- * Legal Forms of Economic Entities
- * Accounting Profession
- * Supervisory Bodies of Accounting Profession
- * Accounting Education
- * Prevailing Accounting Standards

The paper starts by presenting its objectives and contents. It briefly highlights the political development in the Sudan since its independence in 1956 and up to the 1989 when the Sudanese armed forces assumed power. A short description of the status quo of the economy is presented and two factors are stated as having contributed to its present condition. The paper also reviews the legal forms of the economic entities that are available under the 1925 Companies Act.

The study gives a brief illustration of the history of the Sudanese professional training in accounting. It also points out the attempts that have been made to

establish a body to look after the interests of certified accountants and the obstacles which had confronted such efforts until the government approved the establishment of a council for certified accountants in 1988.

The paper states that the supervisory bodies of accounting profession in the Sudan comprised the taxation chamber and the auditor general chamber. Later on the council of certified accountants was given this right as well as other broader rights which included specifying jobs that can be undertaken by accountants, the development of the code of ethics of the accounting profession and its concepts and objectives.

The certification requirements to become professional accountant are also considered. These include membership in one of the recognized professional accounting bodies and a period of three years training.

The study points out that academic qualification in accounting is provided by Sudanese universities. The accounting syllabus differ from one university to the other. Some universities teach Islamic courses beside the accounting courses while others attempt to make a balance between the academic and professional requirements. In addition, some universities have designed their syllabus to match those of the Association of Certified Accountants in England.

Although there are two universities which use the Arabic language as a means of instruction, all the other universities have already started the process of teaching in Arabic. The appointment of university staff in the position of lecturer requires a doctorate degree.

The paper points out that currently there are no standards that govern accounting and auditing practices in the Sudan and that in the absence of such standards the decision is left to the external auditor. The study further reports that there are attempts to adopt the international accounting standards, however, this does not match with the present Islamic orientation of the state. Such an orientation, the paper argues, would help in the implementation of the financial accounting standards which will be promulgated by the Financial Accounting Organization of Islamic Banks and Financial Institutions.

In The Name of ALLAH, Most Gracious, Most Merciful

A Summary of A Study on

**ISLAMIC BANKS AND FINANCIAL INSTITUTIONS AND
THE OBJECTIVES OF THEIR FINANCIAL REPORTING:
A FIELD STUDY ABOUT
THE REPUBLIC OF THE SUDAN**

by

**Dr Rifaat Ahmed Abdel Karim
The Financial Accounting Organization for
Islamic Banks and Financial Institutions**

The study comprises 13 pages and includes the following:

- * Introduction
- * The Banking Industry in the Sudan.
- * The Establishment and Development of Islamic Banks in the Sudan.
- * Suspicions about the Practices of Islamic Banks in the Sudan.
- * Sources of Funds of Islamic Banks and Their Profits and Losses Sharing Methods.
- * The Objectives of Financial Reporting of Non-Islamic Organizations.
- * The Objectives of Financial Reporting of Islamic Banks and Financial Institutions From The Perspective of Users of Financial Statements.
- * A List of the Individuals Who Were Interviewed.
- * Accounting Standards that Should Be Promulgated.

The paper starts by giving a brief description of the methodology which it pursued and the contents of the study. The structure of the banking industry in the Sudan is briefly outlined and followed by the names of the banks that are currently operating in the country. These are classified according to their types (commercial, branch of foreign banks, specialized banks).

The paper then provides a brief description of establishing the first Islamic bank in the Sudan, the objectives for which it was established, the political factors which helped in its establishment, and the possible reasons behind its success and the impact this had on establishing other Islamic banks.

The paper also considers the size of the three largest Islamic banks in the Sudan and the growth strategies which they pursued. In addition, it presents the views of those who were interviewed concerning whether Islamic banks in the Sudan have achieved their objectives or not and the possible factors which might have impacted that.

The suspicions that are attributed to the practices of Islamic banks in the Sudan also are examined. These include the acquisition that

- 1- the boards of directors of Islamic banks are dominated by big investors;
- 2- transactions are rarely financed by Musharaka and Mudaraba whereas Murabaha financing is heavily used;
- 3- in the application of Murabaha transactions, Shari'a rules are not adhered to ; and
- 4- the supervision of Shari'a supervisory boards are not effective in some Islamic banks.

The replies given to the above suspicions are also provided.

The sources of funds of Islamic banks and the characteristics of each source are described as well as the profits and losses sharing methods that are used by Islamic banks in the Sudan. The revenue recognition method used by Islamic banks in Murabaha transactions is also presented.

The paper reports the objectives of financial reporting in the U.S.A and makes some remarks on them. It also states the objectives of financial reporting of Islamic banks as perceived by users of financial statements. These included the supply of information about the spiritual and social aspects of the bank and the amounts that are liable to Zakah. In addition, the reservations expressed by some of the interviewee regarding the inadequate disclosure of information in the financial reports that are currently published by Islamic banks are presented. The paper also points out that few of those interviewed revealed that they use the financial reports of Islamic banks in their decisions.

The paper ends by giving a list of what the interviewee perceived to be the important accounting standards that should be promulgated in order of their preference.

In The Name of ALLAH, Most Gracious, Most Merciful

A Summary of A Study on

**ISLAMIC BANKS AND FINANCIAL INSTITUTIONS AND
THE OBJECTIVES OF THEIR FINANCIAL REPORTING:
A FIELD STUDY ABOUT
THE ARAB REPUBLIC OF EGYPT**

by

**Dr Rifaat Ahmed Abdel Karim
The Financial Accounting Organization for
Islamic Banks and Financial Institutions**

The study comprises 15 pages and includes the following:

- * Introduction
- * The Banking Industry in Egypt.
- * The Establishment and Development of Islamic Banks in Egypt.
- * Suspicions about the Practices of Islamic Banks in Egypt.
- * Sources of Funds of Islamic Banks and Their Profits and Losses Sharing Methods.
- * The Objectives of Financial Reporting of Non-Islamic Organizations.
- * The Objectives of Financial Reporting of Islamic Banks and Financial Institutions from the Perspective of Users of Financial Statements.
- * A List of the Individuals Who Were Interviewed.
- * Accounting Standards that Should Be Promulgated.

The paper starts by giving a brief description of the methodology which it pursued and the contents of the study. The structure of the banking industry in Egypt is briefly outlined and is followed by an illustration of the types of banks which are permitted by the law (commercial banks, investment and business banks, specialized banks). A diagram is also included which shows the number of each type of banks and their branches.

The paper then provides a brief description of establishing the first Islamic bank in Egypt, the objectives for which it was established, the political factors which helped in its establishment, and the possible reasons behind its success and the impact this had on establishing other Islamic banks.

The response of the interest-bearing banks to the success of the Islamic banks' experiment is presented together with the strategy pursued by the central bank to limit the expansion of Islamic banks by allowing non-Islamic banks to open a branch for Islamic transactions.

The paper also considers the size of the largest Islamic bank in Egypt and the growth strategy which it pursued. In addition, it presents the views of those who were interviewed concerning whether Islamic banks in Egypt have achieved their objectives or not and the possible factors which might have impacted that.

The paper sheds light on the phenomenon of the Islamic financial institutions in Egypt or what is known as investment funds companies. It reports the factors which are believed to have led to the establishment of these organizations and those which have contributed to their success as well as the mistakes they appear to have committed.

The suspicions that are attributed to the practices of Islamic banks in Egypt also are examined. These include the acquisition that

- 1- the practices of Islamic banks are dominated by interest-bearing banks' thought;

- 2- Islamic banks do not disclose in advance the share of investment accounts in the profits to be achieved by the bank;
- 3- lack of awareness by both top management and Shari'a supervisory board of unlawful practices done by junior staff; and
- 4- some members of boards of directors receive financing from the banks for their personal benefits.

The sources of funds of Islamic banks and the characteristics of each source are described as well as the profits and losses sharing methods that are used by Islamic banks in Egypt. The paper presents the views of those who believe that the currently used profits and losses sharing methods are favouring investment deposits owners.

The paper reports the objectives of financial reporting in the U.S.A. and makes some remarks on them. It also highlights some of the arguments voiced by the users of the financial statements of Islamic banks and financial institutions which advocate that the objectives of the financial reporting of these organizations should not be developed in isolation from the objectives which they are expected to achieve. Consideration is also given in the paper to the debate on whether there are differences between the objectives of the financial reporting of Islamic banks and financial institutions and other types of non-Islamic organizations.

The paper presents the concern of some of the users of the financial statements of Islamic banks and financial institutions regarding the lack of adequate disclosure of information in the financial reports and the type of information which they would like to be disclosed.

In The Name of ALLAH, Most Gracious, Most Merciful

A Summary of A Study on

**THE ROLE OF GOVERNMENTAL, PROFESSIONAL AND PRIVATE
ORGANIZATIONS IN THE PREPARATION OF OBJECTIVES, CONCEPTS
AND STANDARDS FOR FINANCIAL ACCOUNTING IN
THE ARAB REPUBLIC OF EGYPT**

by

**Dr Rifaat Ahmed Abdel Karim
The Financial Accounting Organization for
Islamic Banks and Financial Institutions**

The study comprises 11 pages and includes the following:

- * Introduction
- * Highlights of the Political Developments and the Status Quo of the Economy
- * Legal Forms of Economic Entities
- * Stock Market
- * Accounting Profession and Its Supervisory Bodies
- * Accounting Education
- * Prevailing Accounting Standards
- * Conclusion
- * Reporting Forms of the Financial Statements of Companies Operating in Investment Funds
- * Reporting Forms of the Financial Statements of Holding Companies

The paper starts by presenting its objectives and contents. It briefly highlights the political development in Egypt since 1952 and up to the present era of President Husni Mubarak. A short description of the status quo of the Egyptian economy is presented together with the policies currently pursued by the government to increase production and the economic development plans it is implementing. The

study reviews the legal forms of the economic entities that are available under Egyptian Companies Law number 159.

The paper states the information required by the Financial Market Organization (the body responsible for the stock market) and the role it plays with other concerned parties in promulgating accounting and auditing standards. Consideration is also given to the disclosure standard for holding companies which was issued by the organization.

A review of the historical development of the accounting profession in Egypt is presented together with the laws which were issued to regulate it. In addition, the paper examines the role of the Association of Egyptian Accountants and Auditors and the Egyptian Institute for Accountants and Auditors in training and qualifying accountants as well as the academic qualifications and practical experience required to practice the accounting profession.

It is stated that almost all Egyptian universities offer a bachelor degree in accounting and a number of them register students for master and doctorate degrees in accounting. Arabic is the means of instruction except in one university. The requirements for the appointment of staff members are also mentioned.

At present, there are no standards that govern accounting and auditing practices in Egypt. In the absence of such standards the decision is left to the external auditor, however, practicing members of the Association of Egyptian Accountants and Auditors tend to adhere to the published international auditing guidelines. The paper highlights the attempts currently undertaken to adopt the international accounting standards which are relevant to the Egyptian environment. These would

be applied to the private sector only since the public sector comply with the uniform accounting system. There is a permanent technical committee which studies the problems of the latter system and issues recommendations for it.

The paper ends by pointing out the opportunities available for adopting the accounting standards which will be published by the Financial Accounting Organization of Islamic Banks and Financial Institutions. It is expected that such standards would help the banking authorities in Egypt in its dealings with the Islamic banks and financial institutions sector which is expanding every now and then.

OBJECTIVES OF THE FINANCIAL ACCOUNTING FOR ISLAMIC BANKS AND FINANCIAL INSTITUTIONS IN THE GULF STATES AND THE ROLE OF GOVERNMENTAL, NATIONAL AND PROFESSIONAL BODIES IN THE PREPARATION OF FINANCIAL ACCOUNTING OBJECTIVES, CONCEPTS AND STANDARDS

Prepared by: Dr. Abdullah Al Faisal

The Planning committee of the Financial Accounting Standards Board for Islamic Banks and Financial Institutions commissioned a number of professionals to undertake field studies on the objectives of financial accounting in Islamic Banks and Financial Institutions and the role of governmental, national and professional bodies in the preparation of accounting objectives, concepts and standards. The areas in which there are Islamic Banks and Financial Institutions have been classified as follows:

1. The Gulf States
2. Egypt, Sudan and Jordan
3. North and West Africa
4. Asia (Malaya, Pakistan and Iran)
5. Europe and the Caribbean

Each member of the research team is assigned a specific area for his study. The team members worked independently to prepare their research plans and the questionnaires required. A meeting was held in which the research plans and questionnaires were unified. The planning committee approved them in its meeting in Bahrain on Thursday and Friday, 21st, 22nd Muharram 1412.

The objectives of the study included:

1. Define the objectives of financial accounting in Islamic Banks and Financial Institutions. This is done in two ways. The first relates to conceptual framework of financial accounting for Islamic Banks and Financial Institutions. The second relates to the needs of the users of Financial Statements for Islamic Banks and Financial Institutions.
2. Define in detail the reality of the accounting and auditing profession and the role of governmental, national and professional bodies in preparation of financial accounting objectives, concepts and standards.

The study plan also identified as an objective of this study, the definition of the possible or expected role of these bodies in affecting the objectives and concepts of financial accounting for Islamic Banks and Financial Institutions and questioning the possible or expected role of these bodies in the preparation of financial accounting standards for Islamic banks and financial institutions operating in the countries selected for the study.

The writer has undertaken a field surveying in the Gulf States where there are Islamic Banks and Financial Institutions. The survey included interviews with:

- Managements of Islamic Banks and Financial Institution
- A number of dealers with Islamic Banks and Financial Institutions
- Banking regulatory agencies (Central Banks or Monetary Agencies)
- Certified Public Accountants specially those auditing Islamic Banks and Financial Institutions.
- Governmental and professional bodies concerned with accounting and auditing.

Questionnaires were also distributed to a number of dealers with Islamic Banks and Financial Institutions. In addition to that a number of documents were collected, these include:

1. General ledgers held by Islamic Banks and Financial Institutions including all accounts in the chart of account of the Bank or the Financial Institutions. These accounts show the activities undertaken by the Islamic Bank or Financial Institutions.

2. Articles of Association of Islamic Banks and Financial Institutions and its constitutions. These documents reveal each Islamic Financial Institution in a clear and detailed manner.

3. The financial statements prepared by Islamic Banks and Financial Institutions at the end of financial year. These reports show that the information which these banks and financial institutions present have a general purpose.

4. Reports requested by Regulatory Agencies (Central Banks and Monetary Agencies). These reports show the role played by the Regulatory Agencies in knowing the activities of the Islamic Banks and directing those activities according to the objectives required by the Regulatory Agency.

5. The constitutions of the companies under which the Islamic Banks and Financial Institutions operate as a shareholding companies.

6. The accounting laws adopted in the countries where there are Islamic Banks and Financial Institutions. These laws show the duties and responsibilities of the auditors and the role expected from them.

The writer is studying these documents and analysing the information contained in the questionnaires. This will hopefully assist in achieving the objectives of the study.

APPENDIX (5)

APPENDIX NO. (5)

AGREEMENT OF ASSOCIATION OF THE
FINANCIAL ACCOUNTING ORGANIZATION FOR
ISLAMIC BANKS & FINANCIAL INSTITUTIONS

TC23109.024

AGREEMENT OF ASSOCIATION
THE FINANCIAL ACCOUNTING ORGANIZATION FOR
THE ISLAMIC BANKS AND
FINANCIAL INSTITUTIONS

ARTICLE I

ESTABLISHMENT OF THE ORGANIZATION

The undersigned agreed to establish a non-profit judicial organization which shall be known as "The Financial Accounting Organization For The Islamic Banks And Financial Institutions." They agreed to apply the Financial Accounting Standards issued by the said Organization. The Organization shall be composed of a Supervisory Committee and a Financial Accounting Standards Board in accordance with the constitutions thereof attached hereto.

ARTICLE II

OBJECTIVES OF THE ORGANIZATION

The Organization aims at developing the accounting theory and practice in the field of Islamic Banks and Financial Institutions, preparing, issuing and amending the Accounting Standards for such Banks and Institutions. In achieving its objectives the Organization shall have the right to conduct researches and studies, contract the services of experts, convene seminars and undertake all measures leading to the achievement of its objectives in accordance with the provisions of this Agreement and the Constitutions of both the Committee and the Board.

ARTICLE III

The duration of this Agreement is unlimited and it shall be effective as of Rabi Al-Awal 1410 corresponding to 29 October 1989.

ARTICLE IV

Any Islamic Bank or Islamic Financial Institution may join this Agreement. A letter of intent to this effect may be sent to the Chairman of the Supervisory Committee and thereon the original copy of the Agreement lodged in the Headquarters of the Organization may be signed.

ARTICLE V

The Headquarters of the Organization shall be in the city of _____ in the _____. The Organization shall have the right to establish branches or offices in other countries.

NAME	SIGNATURE	ADDRESS
_____	_____	_____

APPENDIX (6)

APPENDIX NO. (6)
THE CONSTITUTION OF THE SUPERVISORY COMMITTEE

TC23109.024

FINANCIAL ACCOUNTING ORGANIZATION
FOR ISLAMIC BANKS & FINANCIAL INSTITUTIONS

CONSTITUTION OF THE
SUPERVISORY COMMITTEE

CONSTITUTION OF THE SUPERVISORY COMMITTEE
FOR FINANCIAL ACCOUNTING STANDARDS
FOR ISLAMIC BANKS

ARTICLE - 1

NAME AND ENTRY INTO FORCE

This constitution shall be known as "The Constitution of the Supervisory Committee for Financial Accounting Standards for Islamic Banks and Financial Institutions" and shall come into force in accordance with Article - XXI hereof.

ARTICLE - II

DEFINITIONS

In this Constitution unless the context otherwise requires, the following words shall have the meaning shown against each of them hereunder:

The Committee:

The Supervisory Committee for Financial Accounting Standards for Islamic Banks and Financial Institutions set-up in accordance with the provisions hereof.

The Board:

The Financial Accounting standards Board for Islamic Banks and Financial Institutions to be set-up by the Committee in accordance with the provisions hereof and the provisions of the Constitution of the Board.

The Bank:

The Islamic Bank which is a bank operating according to the principles of Islamic Shariah.

The Financial Institution:

The Islamic Financial Institution which is a financial institution operating according to the principles of Islamic Shariah.

The First Committee:

The Supervisory Committee of which the members were selected in accordance with the provisions hereof by the Representatives of the Islamic Banks at the Meeting of the Heads of Islamic Banks held in Jeddah on the 30th Rabi A1 Awwal 1410H (29 October, 1989).

Regulatory Agency:

A Central Bank or a similar entity which regulates the financial reporting and monitoring of banks and financial institutions.

ARTICLE - III

COMPOSITION OF THE COMMITTEE

Section 3.01:

The committee shall consist of seventeen (17) members, including the Chairman.

Section 3.02:

Members of the committee shall be drawn from the specializations, and as far as reasonably possible, shall satisfy the criteria herein below stipulated:

- A) Six members shall be Bankers or Financial Institutions Officials. A person eligible for Membership under this category shall preferably be:
- i) A founder or a senior executive of a Bank or a Financial Institution, and shall,
 - ii) Have reasonable knowledge of:
 - a) The contents of the financial statements and the disclosure requirements
 - b) The financial means commonly used by Banks and Financial Institutions, together with existing legislation governing those means in, at least, one country.
 - c) Existing accounting standards.

- B) Five members shall be Auditors in public practice. Preferably, a person eligible for Membership under this category shall:
- i) Possess the necessary qualifications for practicing as an auditor as may be required in his country of origin.
 - ii) Be a partner or director of a reputable Accounting Firm.
 - iii) Have expert knowledge of:
 - a) Existing financial accounting standards.
 - b) Existing legislation in some Islamic or other countries where Islamic Banks operate, and of the impact of such legislation on banks and financial transactions.
 - c) Islamic banking and shall have, preferably, contributed to the literature on Islamic Banks.
 - d) The financial accounting standards setting process.
 - iv) Have reasonable knowledge of Islamic economic concepts and, preferably, experience in a Bank or an International Financial Institution.
- C) Two members shall be users of financial statements of Banks and Financial Institutions. A person eligible for membership under this category preferably shall;
- i) Predominantly deal with one or more or Banks or Financial Institution, either as a depositor or investor.
 - ii) Fair knowledge of:
 - a) The basic concepts of Islamic banking.
 - b) A knowledge of financial statements of Banks and Financial Institutions.
- D) Two members shall be officials of Regulatory Agencies. Preferably, a person eligible for Membership under this category shall:
- i) Be in the senior managerial level of a Regulatory Agency,

- ii) Have a long practical experience in Islamic banking, and be well-acquainted with government policies and procedures, particularly legislation pertaining to economic policies.
 - iii) Have expert knowledge of how existing working financial means are applied.
 - iv) Fair knowledge of:
 - a) Existing accounting standards.
 - b) Financial Statements and their uses.
- E) One member shall be a renowned scholar of Shariah who shall preferably have:
- i) Contributed to the literature on Islamic Banking through the publication of books, articles and papers on related subjects.
 - ii) Experience in Islamic banking, preferably, gain experience through membership of a Shariah Supervisory Board.
- F) One member shall be a scholar in accounting and finance at a distinguished university. Under this category this member shall preferably have:
- i) Conducted and published research on Islamic banking.
 - ii) Knowledge of:
 - a) Use of financial statements and financial means.
 - b) Existing financial accounting standards.

ARTICLE - IV

SELECTION OF THE FIRST COMMITTEE

Section 4.01:

Without prejudice to the provisions of Article III hereof, the First Committee shall be selected for three years.

Section 4.02:

Without prejudice to the generality of article - IX hereof, the First Committee

shall approve the Constitution of the Board and appoint the members of the First Board.

ARTICLE - V

APPOINTMENT OF MEMBERS TO FILL VACANCIES IN THE COMMITTEE

Before the expiry of the term of service of the particular group of members including members of the First Committee or upon the death, resignation, disability or removal of a member pursuant to Article-VIII hereof, the vacancy or vacancies which will occur or which have occurred shall be filled by the Committee provided that:

- A) A member appointed to fill a vacancy shall be appointed by the majority vote of the members of the Committee and shall be drawn from the same category of the outgoing member.
- B) A member appointed to fill a vacancy shall serve until the expiry of the original term of the member who is being replaced.
- C) A member is eligible for reappointment for a second term provided that no member shall serve for more than two consecutive terms. For the execution thereof, a member appointed to continue a term of service of a member whose place has become vacant shall be regarded as having served a term.

ARTICLE - VI

THE CHAIRMAN OF THE COMMITTEE

Section 6.01:

The Committee as herein provided for, shall by majority vote designate a member to serve as Chairman for the Committee.

Section 6.02:

The Committee may designate one or two members to act as Vice Chairmen for the Committee.

Section 6.03

The Committee shall delegate power to the Chairman as the Committee shall deem necessary for the discharge of the objectives of the Committee.

ARTICLE - VII

MEMBERSHIP RULES

Section 7.01:

With the exception of the provisions of Articles 8 and 14 hereof, Membership of the Committee shall be personal to the members thereof, and no member shall have power of substitution or delegation to another person.

Section 7.02:

No person can be a member both of the Committee and of the Board simultaneously.

Section 7.03:

A member shall be reimbursed for expenses pertaining to his membership of the Committee in accordance with the basis established by the Committee.

ARTICLE - VIII

REMOVAL OF MEMBERS

A member of the Committee, including the Chairman, may be removed by the majority vote of, at least, two-thirds of the members for malfeasance or similar misconduct deemed by the Committee to be detrimental to the

objectives or reputation of the Committee, or the Board, or for ineligibility for the Committee's membership.

ARTICLE - IX

POWERS AND FUNCTIONS OF THE COMMITTEE

Section 9.01:

The committee shall have the functions, and be entrusted with the powers, as herein below stipulated:

- i) To set-up the Board and appoint its members, Chairman and Vice-Chairman in accordance with Articles X, XI, XII and XIII hereof, and remove such members in accordance with article XIV hereof.
- ii) To arrange for the financing of the Board and to approve its annual budget.
- iii) To determine the bases for reimbursement of the members of the Committee and of the Board, other than Bankers referred to in clauses 3.02 (A) and 10.02 (B) hereof, respectively, in respect of expenses pertaining to their membership in the Committee or the Board, as the case may be.
- iv) To appoint an external auditor annually to examine the Annual Financial Statements of the Committee and of the Board and submit his audit report to the Committee.
- v) Approve annual financial statements of the Committee and of the Board and the external auditor's report on them; within four month from the Financial year end of the Committee and of the Board.
- vi) To review periodically the activities, accomplishments, operating procedures and project plans of the Board and to publish the results of such review.

- vii) To review periodically the overall framework of establishing and improving standards of financial accounting and reporting to Banks and Financial Institutions.
- viii) To consider and approve a proposal for the amendment of the constitution of the Board.
- ix) To exercise all authority and power and perform all functions necessary for the achievement of the objectives of the Organization.

Section 9.02:

The Committee shall not direct the Board to undertake, or to refrain from undertaking, any assignment, project or activity, or otherwise affect the exercise by the Board of its authority, functions or powers in respect of preparing, approving and publishing standards of financial accounting to Banks and Financial Institutions.

ARTICLE - X

COMPOSITION OF THE BOARD

Section 10.01:

The Board shall consist of twenty-one members who shall be appointed by the majority vote of the members of the Committee.

Section 10.02:

Members of the Board shall be drawn from the specialisations herein below indicated and the Committee shall set the selection criteria for each specialization:

- A) Six members shall be auditors in public practice.
- B) Six members shall be Bankers or Financial Institutions Officials.
- C) Three members shall be scholars of Shariah.
- D) Two members shall be users of financial statements of Banks and Financial Institutions by virtue of being depositors of funds or

investors in one or more Banks and Financial Institutions.

- E) Two members shall be scholars with teaching experience in Accounting and Finance.
- F) Two members shall be from Regulatory Agencies.

ARTICLE - XI

APPOINTMENT OF MEMBERS OF THE BOARD

Section 11.01:

Except for appointment to the First Board as provided for in Article-XII hereof, a member of the Board shall be appointed for a period which shall expire on December 31 of the Fourth Gregorian Year of his appointment.

Section 11.02:

Before the expiry of the term of service of the particular group of members of the Board, including members of the First Board or upon the death, resignation, disability or removal of a member pursuant to Article - XIV hereof a vacancy or vacancies in the Board, which will occur or which have occurred shall be filled by the Committee provided that:

- A) A member appointed to fill a vacancy shall be appointed by the majority vote of the members of the Committee and shall be drawn from the same category as that of the outgoing member.
- B) A member appointed to fill a vacancy shall serve until the expiry of the original term of the member who is being replaced.
- C) A member is eligible for reappointment for a second term provided that no member shall serve for more than two consecutive terms. For the

execution thereof a member appointed to continue a term of service of a member whose place has become vacant shall be regarded as having served a term.

ARTICLE - XII

APPOINTMENT OF MEMBERS TO THE FIRST BOARD

Without prejudice to the generality of Article-XI hereof, members of the First Board shall be appointed for a term of four years.

ARTICLE - XIII

APPOINTMENT OF THE CHAIRMAN AND VICE-CHAIRMAN OF THE BOARD

Section 13.01:

The committee shall as herein provided appoint by a majority vote of the members present a Chairman for the Board from amongst the members thereof.

Section 13.02:

The Committee may appoint one or more members as Vice-Chairmen.

ARTICLE - XIV

REMOVAL OF MEMBERS OF THE BOARD

A member of the Board, including the Chairman, may be removed by the majority vote of, at least, two-thirds of the members of the Committee for malfeasance or other misconduct deemed by the Committee to be detrimental to the objectives or reputation of the Board or for ineligibility for the Board's membership.

ARTICLE - XV
SUB-COMMITTEES

The committee may establish any number of sub-committees to exercise any or all powers, authority and functions of the Committee. A sub-committee may consist of any number of members as the Committee deems fit.

ARTICLE XVI
PROCEDURE

Section 16.01:

The Committee shall meet at least once a year. At the end of each meeting the Committee shall decide on the venue and date of the next meeting.

Section 16.02:

The presence of the majority of the members shall constitute a quorum for a meeting of the Committee.

Section 16.03:

Each member shall have one vote, whether given in person or by proxy, and all matters before the Committee shall be decided by a majority vote of the members, except for the amendment of this constitution and removal of members of the Committee or members of the Board which shall require the vote, of at least, two-thirds of the members of the Committee.

ARTICLE - XVII
RESOURCES OF THE COMMITTEE

The Resources of the Committee shall consist of contributions of: Banks, users of financial statements, Accounting firms and as well as of the proceeds of sales of publications, donations and contributions.

ARTICLE - XVIII

THE FINANCIAL YEAR OF THE COMMITTEE

The financial year of the Committee shall commence on the First of January and end on 31 December of each Gregorian year, except for the First financial year which shall end on 31 December of the year following its establishment.

ARTICLE - XIX

INTERPRETATION

Without prejudice to Article XX hereof, all matters concerning the interpretation and application of the provisions of this Constitution shall be decided and settled by the majority vote of the members of the committee present.

ARTICLE - XX

LANGUAGES

This constitution shall be available in Arabic and English. The Arabic text shall be regarded as the authoritative text for both interpretation and application.

APPENDIX (7)

APPENDIX NO. (7)
CONSTITUTION OF THE ACCOUNTING STANDARD BOARD

TC23109.024

FINANCIAL ACCOUNTING ORGANIZATION
FOR ISLAMIC BANKS & FINANCIAL INSTITUTIONS

CONSTITUTION OF THE
FINANCIAL ACCOUNTING STANDARDS BOARD

CONSTITUTION OF THE FINANCIAL ACCOUNTING STANDARDS BOARD
FOR ISLAMIC BANKS & FINANCIAL INSTITUTIONS

ARTICLE - I

NAME AND ENTRY INTO FORCE

This constitution shall be known as "The Constitution of the Financial Accounting Standards Board for Islamic Banks and Financial Institutions" and shall come into force in accordance with Article-XVI hereof.

ARTICLE - II

DEFINITIONS

In this constitution, unless the context otherwise requires, the following terms shall have the meanings shown against each of them:

"THE COMMITTEE"

The Supervisory Committee for Financial Accounting Standards for Islamic Banks and Financial Institutions set-up in accordance with its Constitution.

"THE BOARD"

The Financial Accounting Standards Board for Islamic Banks and Financial Institutions set-up in accordance with the provisions hereof and of the Constitution of the Committee.

"THE BANK"

The Islamic Bank which is a bank operating according to the principles of Islamic Shariah.

"THE FINANCIAL INSTITUTION"

The Islamic Financial Institution which is an institution operating according to the principles of Islamic Shariah.

ARTICLE - III
COMPOSITION OF THE BOARD

Section 3.01:

The Board shall consist of twenty-one members, including the Chairman.

Section 3.02:

Members of the Board shall be appointed by the Committee and shall be drawn from the specializations, and be removed, in accordance with terms and conditions provided for in the constitution of the Committee.

Section 3.03:

Members may be reimbursed for expenses pertaining to their membership in the Board in accordance with the basis established by the Committee.

ARTICLE - IV
POWERS AND FUNCTIONS OF THE BOARD

Section 4.01:

The Board shall establish, amend and interpret Standards and Practice Guides of Financial Accounting for Banks and Financial Institutions.

Section 4.02:

In the discharge of its function hereunder the Board shall have power:

- A) To approve, issue, in accordance with the provisions of this constitution or any other rules, regulations, by-laws or procedures consistent therewith, as the Board may deem necessary to establish, statements of Financial Accounting Standards and Practice Guides, and to disseminate the same to Banks and Financial Institutions.

- B) To issue communications on Financial Accounting Standards and to prepare and publish progress reports on the Board's activities including a quarterly news letter for the purpose of informing the public of the activities of the Board.
- C) To establish any number of sub-committees to exercise any or all powers, authority and function of the Board within the guidelines, regulations or procedures set by the Board.
- D) To review a statement of Financial Accounting Standards or Practice Guide for additions, deletions or amendments either on its own initiative or on the recommendation of the Planning Committee which is set-up in accordance with the provisions of Article VI hereof.
- E) To develop regulations and procedures for the work of the Board.
- F) To exercise all powers and carry out all necessary tasks consistent with this constitution for achieving the objectives of the Board.

ARTICLE - V

POWERS AND FUNCTIONS OF THE CHAIRMAN

The Chairman fo the Board shall be the principal officer of the Board and shall have the powers and carry out the functions as hereinafter stipulated:

- A) To oversee the general discharge by the Board of its function.
- B) To chair the meetings of the Board and of the Planning Committee.
- C) To prepare the short and long term operating and project plans for the Board, including project priorities, and to submit the same for approval by the Planning Committee.

- D) To prepare annual reports on the activities of the Board, for approval by the Board and thereafter to submit such reports to the Committee.
- E) To prepare and issue the quarterly newsletter referred to in Section 4.02 (C) hereof and to issue public announcements therein, or in any other publications as he may deem necessary, pertaining to:
 - i) The venue and date for every meeting of the Board.
 - ii) Additions or other changes to agenda for the Board.
 - iii) Draft and final texts of practice guides.
 - iv) The intention of the Board to review an effective statement of Standards or Practice Guides.
- F) To take any measures he deems necessary for ensuring that reports on the activities of the Board are available to the public after approval thereof by the committee.
- G) To prepare the budget of the Board with the assistance of the Planning Committee and to submit the same for approval by the Board.
- H) To hire and contract the services of Technical Staff, other than the Director of the Technical Staff, for the purpose of performing technical duties to the Board and to fix their salaries and other financial benefits.
- I) To contract the services of consultants or organizations to conduct research for, or perform technical assistance to the Board after consulting with the Planning Committee and approval of the Board.

- J) To prepare staff rules and rules and regulations pertaining to the setting up of ad hoc committees, task forces and procedures for meetings of the Board and to submit the same for approval by the Board.
- K) To designate a member of the technical staff to act as Secretary to the Board.
- L) To assign to members of the Board, sub-committees or task forces or to the Director of the technical staff, the performance of any particular function as the Chairman may deem necessary for achieving the objectives of the Board.
- M) To attend the meetings of the Committee and to participate in the discussion of any of its agenda as the Committee may require appropriate provided that he shall have no right of vote in such meetings.
- N) To inform the Committee and the Board in writing of the expiry of the term of service of any member of the Committee or the Board, in sufficient time before the date of such expiry.

The Chairman of the Board shall have the right to delegate any of the powers or functions aforementioned to any Board member or to the Director of the technical staff subject to approval of the Board.

ARTICLE - VI

SUB-COMMITTEES

Section 6.01:

Without prejudice to the generality of Section 4.02(D) hereof, the Board shall set up from amongst the members thereof a planning sub-committee which shall be known as "The Planning Committee" and a Shariah Sub-Committee which shall be known as "The Shariah Committee."

Section 6.02:

The planning committee shall consist of four members to be appointed by the Board and shall be chaired by the Chairman of the Board, or the Vice-Chairman, as the case may be.

Section 6.03:

The planning committee shall have the following functions:

- A) To assist the Chairman in the preparation of the budget of the Board.
- B) To prepare the Board's plan of action and set its priorities so as to submit the same for approval by the Board.
- C) To follow up the implementation of the resolutions of the Board.
- D) To authorise-in principle-the development of Practice Guides and to submit its recommendations thereon to the Board.
- E) To appoint the Director of the Technical Staff.

Section 6.04:

The presence of two members of the Planning Committee and the Chairman or the Vice Chairman of the Board, as the case may be, shall constitute a quorum for any meeting of the Planning Committee.

Section 6.05:

At the meetings of the Planning Committee each member shall have one vote and all matters before the Planning Committee shall be decided by the majority vote of the members. In case of a tie vote the Chairman or the Vice-Chairman shall have the casting vote.

ARTICLE - VII
THE SHARIAH COMMITTEE

Section 7.01:

The Shariah Committee shall consist of two members to be appointed by the Board from the members referred to in Section 10.02(c) of the Constitution of the Committee, and the Director of the technical staff.

Section 7.02:

The function of the Shariah Committee shall be to review the proposed statements of Financial Accounting Standards and Practice Guides and to advise the Board on the conformity of such statements or guides to the Principles of Islamic Shariah.

ARTICLE - VIII
RULES PERTAINING TO STATEMENTS OF FINANCIAL ACCOUNTING
STANDARDS

Section 8.01:

The objectives of statements of Financial Accounting Standards shall be to explain the bases for the establishment and development of the Standards of Financial Accounting and the Standards' texts.

Section 8.02

Before a statement of Financial Accounting Standards is approved a draft thereof shall be circulated to Banks and Financial Institutions to obtain their observations and the Public shall have the right to have access to such observations.

Section 8.03:

Draft and final statements of Financial Accounting Standards shall include:

- A) The proposed alternatives of the Standards considered and the final Standards approved and reasons for their selection.
- B) The Standards date of effectiveness and the methods of application thereof.
- C) Background information in connection with the bases of the establishment and development of the Standards.
- D) A summary of the more significant observations and comments communicated to the Board on the particular draft statement of the Standards.

ARTICLE - IX
PRACTICE GUIDES

Section 9.01:

The objective of Practice Guides shall be to interpret Accounting Standards or resolve accounting issues resulting therefrom.

Section 9.02:

A Practice Guide may not be issued unless the particular problem sought to be resolved can be so resolved ensuring that:

- A) The guide is not likely to cause a major change in accounting practices for a significant number of Banks and Financial Institutions, nor is it likely to conflict with fundamental accounting concepts or create a new accounting practice.
- B) The administrative cost of implementing the guide is reasonable.

Section 9.03:

Draft Practice Guides shall be prepared by the Technical Staff on the direction of the Planning Committee and shall be circulated to Banks and Financial Institutions to get their observations prior to the approval thereof by the Board.

Section 9.04:

No Practice Guide shall be issued by the Board unless the Guide shall have been cleared by the majority vote of the members of the Board present.

ARTICLE - X

REVIEW PROCEDURES OF STANDARDS AND PRACTICE GUIDES

Section 10.01:

Any natural or judicial person may, in accordance with the provisions of this Article, request the Board in writing to review an effective statement of Financial Accounting Standards or Practice Guide, provided that such request shall:

- A) Identify the statement, or the relevant part thereof, which is the subject of the request.
- B) State in sufficient detail the reason or reasons for the request.
- C) Set forth specific alternative proposals or solutions.

Section 10.02:

The request for review shall be addressed to the Director of the Technical Staff who shall provide copies thereof to the members of the Planning Committee for consideration.

Section 10.03:

In considering a request for review the Planning Committee shall:

- A) Ensure that the Board has been informed of the request for review and of the justification for such request.
- B) Consider whether:
 - i) The reasoning upon which the request is based had been considered by the Technical Staff prior to the issuance of the Standard or Practice Guide sought to be reviewed.
 - ii) Events or circumstances attending the request are such as to warrant review by the Board.

Section 10.04:

Where the Planning Committee concludes that no adequate consideration has been given by the Technical Staff to the principle upon which the request is based, or that events or circumstances are such as to warrant review, the Planning Committee shall add the request to the agenda of the Board.

Section 10.05:

Whether the request for review or re-examination is added to the agenda of the Board pursuant to section 10.04 hereof, or is not so added as aforesaid, the Planning Committee shall reply in writing to the person or entity who has made the request as to the course of action which the Committee intends to take in respect of the request.

ARTICLE - XI
P R O C E D U R E

Section 11.01:

The Board shall meet, at least three times a year. Meetings of the Board shall be held at such date and venue as may have been agreed upon by the majority of the members in the preceeding meeting. Meetings of the Board shall be announced in the newsletter referred to in Articles 4.02(C) and 5(E) hereof. The Board's meeting shall be open to the public unless otherwise deemed appropriate by the Board, and specified reasons thereof shall be recorded in the Board's minutes.

Section 11.02:

Without prejudice to section (11.01), adequate notice of the meeting and the proposed agenda thereof shall be furnished to all members of the Board in sufficient time before the meeting.

Section 11.03:

Meetings of the Board shall be chaired by the Chairman of the Board or the Vice-Chairman, as the case may be, and shall be properly documented.

Section 11.04:

Without prejudice to the generality of the foregoing, at the meetings of the Board:

- A) The presence of the majority of the members shall constitute a quorum for any meeting of the Board.
- B) Each member shall have one vote, and all matters before the Board, except as provided for in Section 9.04 and Article-XIII hereof, shall be decided by a majority vote of the members of the Board present.

ARTICLE - XII

THE FINANCIAL YEAR OF THE BOARD

The Financial year of the Board shall commence on the First of January and end on 31 December of each Gregorian year, except for the first financial year which ends on 31 December of the year following the establishment of the Board.

ARTICLE - XIII

AMENDMENT OF THE CONSTITUTION

This Constitution may be amended by the vote, whether cast in person or by proxy, of at least, two-thirds of the members of the Board. The amendment shall be effective only after being approved by the Committee.

ARTICLE - XIV

I N T E R P R E T A T I O N

Without prejudice to article XV hereof, all matters concerning the interpretation and application of the provisions of this Constitution shall be decided and settled by the majority vote of the members of the Board present.

ARTICLE - XV

LANGUAGES

This Constitution shall be available in Arabic and English. The Arabic text shall be regarded as authoritative for both interpretation and application.

APPENDIX (8)

APPENDIX NO. (8)
DUE PROCESS AND REVIEW PROCEDURES

TC23109.024

DUE PROCESS AND REVIEW PROCEDURES AND ITS REQUIREMENTS

Following is the due process for establishing the financial accounting standards for Islamic Banks. Item (A) indicates the due process of establishing the standards. Item (B) illustrates the relevant requirements. Item (C) shows examples of the subject for the Standards Board agenda.

A. DUE PROCESS:

1. PHASE-1: PREPARATION OF STUDY:

1.1 The consultant shall prepare a study which shall comprise:

1.1.1 Theoretical aspects of standards from all sources, particularly:

- o Fiqh rules governing transactions and companies based on references approved by the books of Fiqh.
- o Objectives and concepts of the financial accounting standards for Islamic Banks which are to be prepared.
- o A comparative note on matters related to standards from the accounting concept prevailing in the world and from a number of authorities responsible for preparation of accounting standards in Islamic countries and elsewhere.

1.1.2 A note on the current application in force in general and of five banks where the standard shall be applied when it is approved.

1.1.3 Details on the need for laying down standards and problems expected upon implementation.

1.1.4 Review of legislative, procedural, technical and other anticipated problems related to standards and preliminary statement of possible options which may be considered as

solutions prior to their discussion by the Board and formulation of tentative projections for solving them as guidance in the implementation of subsequent phases.

1.1.5 Review of alternative standards and their applications.

1.2 The Secretary shall go through the study referred to above and refer it to the Board with his views.

2. PHASE-2: DISCUSSION OF THE STUDY BY THE BOARD AND APPROVAL OF THE FINAL PRINCIPLES:

2.1 The study and the Secretary's Memorandum shall be distributed to the Members of the Board, for study and comments.

2.2 The Board shall meet to consider the findings of the study, adopt resolutions on any issues which might have been raised and lay down a plan of action for the post study phase.

2.3 The consultant shall make a summary of research undertaken in the previous phases comprising what is contained in phase-1. He shall also make a summary of resolutions adopted by the Board.

3. PHASE-3: VIEWS OF SPECIALISTS AND INTERESTED PARTIES:

3.1 The Secretary shall distribute the summary referred to in Phase 2.3 above among the members of the Board, specialists like Fuqahas and university professors and other interested parties like officials of Islamic Banks and others. They shall be requested to participate as appropriate in the field of accounting standards.

3.2 The Secretary shall receive the replies and keep the original. (The secretary shall prepare detailed procedures to receive it and keep it to ensure safety and easy reference). He shall give a copy to the consultant.

4. PHASE-4: CLASSIFICATION AND STUDY OF VIEWS OF SPECIALISTS AND INTERESTED PARTIES:

- 4.1 The consultant shall classify the replies in a scientific way so as to facilitate comparison and easy reference. He shall study and analyse them and submit the classification together with his study, analysis, findings and proposals to the Secretary. Neither he nor the Secretary may discard any view for any reason whatsoever.
- 4.2 The secretary shall study the classification, analysis and findings received from the consultant 4.1 and submit them with his views to the Board for decision on issues on which the consultant requires guidance from the Board.
- 4.3 The memorandum referred to in Phase 4.2 above shall be discussed at a meeting attended by members of the Board and any other specialist or interested party the Board may deem appropriate to convene.
- 4.4 The consultant shall prepare a summary record of the meeting referred to in Phase (4.3) above, highlighting the main points and showing whether they are useful or not, giving his reasons for that. He shall submit his proposals to the Secretary.
- 4.5 The Secretary shall study the summary record 4.4 and submit it to the Board with his views.
- 4.6 Each Board Member shall study the summary record 4.5 and send his views to the Secretary.
- 4.7 The Board shall meet to take the appropriate decision. It may call the consultant for discussions.
- 4.8 The Secretary shall give the consultant the Board's decisions.

5. PHASE-5: PREPARATION OF A DRAFT STATEMENT OF STANDARDS:

5.1 The consultant shall prepare a statement of standards and submit it to the Secretary. The statement shall include provisions listed in section 8.2 below. (i.e. "Details which the statement of standards should contain").

5.2 The consultant shall give the statement of standards to the Secretary who, in turn, shall study it and submit it to the Board with his observations, for approval.

6. PHASE-6: VIEWS OF SPECIALISTS AND INTERESTED PARTIES

6.1 After the Board approves the draft statement of standards, the Secretary shall send the statement to specialists and interested parties for their observations. The replies received shall be classified and those which the Board approves shall be adopted.

7. PHASE-7: PREPARATION OF STATEMENT OF STANDARDS AND ITS APPROVAL BY THE BOARD:

7.1 The Secretary shall send to the consultant the views of specialists and interested parties which the Board decides to adopt. The consultant shall prepare the text of the final statement and forward it to the Secretary.

7.2 The Secretary shall send the draft statement of standards in its final form to the members of the board. If the members have any observations which require a modification, such observations shall be forwarded to the consultant for study.

7.3 The draft statement of standards shall be submitted to the Board for approval as a final standard.

8. PHASE-8: EXTENT OF ADHERENCE TO THE STANDARD:

- 8.1 The Board shall study examples o financial statements after the issue of the standard to determine the extent to which adherence is made to it.
- 8.2 The Board shall receive from all intersted parties and special-ists any observations or problems met during the implementation period. These shall be studied and modifications shall be made to the standard, if necessary. Unless otherwise indicated, procedures governing modification shall be similar to those regarding the preparation of the standard.

APPENDIX (9)

APPENDIX NO. (9)

INDEX OF STUDIES AND DOCUMENTS PREPARED
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TC23109.024

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