

## CHALLENGES OF INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS) IN THE ISLAMIC ACCOUNTING WORLD, CASE OF MIDDLE EASTERN COUNTRIES

**Ph.D. Candidate Amged Abd El Razik**

The Bucharest Academy of Economic Studies Bucharest  
amged\_abdelrazik@hotmail.com

***Abstract:** This paper presents the case of representing the Middle Eastern countries on the International Accounting Standards Board (IASB). It can give MEC countries the chance to participate in setting up the IFRS that go along with their economic environments and Islamic rules rather than just apply what other world regions agree on. It shows the benefits of the region to the world and the main different in culture, economic and accounting system.*

**Key words:** International financial reporting standards (IFRS), IASB, MEC

**JEL codes:** M41; H3; F5

### 1. INTRODUCTION

While 15 out of the 21 Middle Eastern Countries – which information is available- require or allow companies under their financial authorities to use the globally known international financial reporting standards (IFRS), only three countries – out of the 21 countries - have developed their national generally accepted accounting principles (GAAP), are still asking companies under their financial authorities to follow them, and are not allowing any company to use other standards.

In addition, 2/3 of the Arab countries are members of the international federation of accountants.

**Table 1. IFRS in MEC**

Country	Membership of IFAC	Accounting principles used	Notes
Morocco	Yes	National GAAP	IFRS are permitted
Tunisia	Yes	National GAAP	IFRS are permitted
Algeria	No	National GAAP	IFRS are permitted
Libya	Yes	National GAAP	IFRS are permitted
Egypt	Yes	IFRS	
Jordan	Yes	IFRS	
Israel	Yes	National GAAP	IFRS are not permitted
Lebanon	Yes	IFRS	
West Bank and Gaza	No	IFRS	
Syria	Yes	National GAAP	IFRS are not permitted

Iraq	Yes	No Information	
Saudi Arabia	Yes	IFRS	
Oman	No	IFRS	
Yemen	No	No Information	
UAE	No	IFRS	
Qatar	No	IFRS	
Bahrain	Yes	IFRS	
Kuwait	Yes	IFRS	
Iran	Yes	IFRS	IFRS are not permitted

In spite the positive relationship between IASB and the Middle Eastern countries, they still don't have any role or present or special consideration as any other country or region, within the agenda and the timetable of the IASB as well as during any standard setting process engaged by it. The current regional representatives are mainly from EU, NA, Japan, Australia and South Africa.

The Middle Eastern countries heading that, their region should take more concern in order to achieve better convergence while understanding and enforcing accounting standards around the globe.

According to the Chairman of the IFRIC, Robert Garnett "with oil revenues being directed into large investments, the region is increasingly being seen as a potential partner".

Taking into consideration the rule the middle east countries play over the whole world policy, investments, capital market which shows how important for IFRS to adapt because the totally different environmental factors that are considered by the IASB while setting IFRS. The decision of which standards to choose, for a nation, usually depends on the culture (Askary, 2006), legal system, taxation, business organizations and ownership, as well as on the accounting profession within a country or a region. Previous researches have proved that all these factors are indeed significantly different between the Middle East countries and the whole other world. Thus, if the IASB is talking about global convergence of accounting standards, it needs to understand that there are vibrant and evolving markets in other parts of the world, other than Europe and North America, which have special features which need to be addressed.

IASB main duties are preparing, generating, reviewing and exposing IAS and IFRS. The goal of IASB is attached to the idea of globalization and is simply a hope that the whole business world will follow one set of accounting standards. It is also important to notice that each standard must be approved by at least 8 members of the IASB, out of the IASB 14's members, in order to be considered for issuance.

The accounting professionals and experts of the MEC (Middle Eastern Countries) can point to various cultural factors as well as to key interests at stake and international concerns while discussing their right of being represented on the IASB.

## 2. CULTURAL FACTORS

### 2.1 ISLAM AND EMERGENCE OF ISLAMIC FINANCE

First, Islam's role in the world is becoming much more influential. 1.6 billion people, currently representing 25% of the world total population, are Muslims (According to CIA fact sheet and [www.islamicpopulation.com](http://www.islamicpopulation.com)). Second, among the 18 oil producing countries, ten are Muslims countries and provide 40% of the aggregate world oil production. Third, in addition to the role of Muslims countries in the international trade, Islamic Finance is emerging as a major

force in the banking and investment world and is still in its growth stage. The Islamic bank of Britain, Amana Mutual Funds Trust, American Finance House- LARIBA Bank, MSI financial services corporation and Manzail are just few examples of the various finance institutions that are engaged in this field of finance. Furthermore, MEC are members of the World Bank, UN, WTO, and most other international organizations. These organizations are giving special attention in their periodic reports to Islam as a religion and to its followers' needs and demands because of their belief about their current and prospective potential. However, we find that MEC was represented by 2 members only in the Standard Advisory Council (SAC) from 2001 till 2005, among 49 members of the SAC of the IASB, recently the MEC are not represented at all by any member!

In 2001 there were two members representing the middle East, Mr Adir Inbar (Israel) and Mr. Rifaat Ahmed Abdel Karim ( Bahrain) taking into consideration that Israel don't represent any of the Muslim population and the fact that all the Arab countries-except two- don't have any direct connections with Israel, which means one of the two members representing middle east.

## **2.2 RELATIONSHIP OF THE MEC WITH ISLAMIC FINANCIAL INSTITUTIONS**

Currently, Islamic financial institutions are represented on the SAC by an Islamic services Board (IFSB) member, without any consideration for the MEC and the accounting and Auditing organizations for Islamic financial institutions (AAOIFI).

Both of them – the AAOIFI and the IFSB- should be represented, this is because, in reality, while the IFSB is concerned with finance issues related to Islamic financial institutions, the AAOIFI deals with the accounting standards issues related to these institutions.

As long as most of the members of IFSB and AAOIFI are from the ME countries, Thus, IASB should consider the accounting policies, practices, and concerns of the MEC while reviewing, merging and interpreting the previously issued IAS or establishing the new (updated) ones.

## **2.3 EFFECT OF CULTURE ON ACCOUNTING STANDARD SETTING PROCESS**

Accounting standards-IFRS or any National GAAP- are influenced by the surrounding culture to a great extent, after 1972, the main concern of the accounting world's professionals has been to reduce the differences between the different accounting principles among the different countries. The IASCF and IASB were created for this purpose.

MEC and any other country, regardless of its representation status on the IASB, should have the right to bring up its concerns and discuss them with one of the IASB affiliates ( mainly IASCF, IFRIC, and SAC). Definitely, the IASB will remain the only body, and final decision maker, that decide which financial reporting standard to issue and recognize. This opinion is being mentioned because the MEC are facing many significant regulatory difficulties in the current situation. They consider they can bring these difficulties to the attention of IASB in case they are represented.

These difficulties may include the IAS 24 that requires all the transactions with "close family members of a related party" to be disclosed. Differences in cultures and type of family bonds make it more challenging for MEC accountants to adopt such standards. This fact is not very obvious to the current IASB team of representatives because close family ties and similar levels are not the same in all the world, they differ from region to another. At the same time, the IASB does not consider these facts because no one can, or will, bring this type of concerns to their agenda if those who are influenced by them and concerned are not represented, following up, or attending the IASB meetings on a regular basis. A presentation of this type of

cultural differences by MEC accountants professionals, will lead IASB to be more convinced with the idea of inviting a MEC representative to its structure because such action will enhance the degree of understanding of new standards and make them more relevant to the interested users.

### **3. ECONOMIC FACTORS**

#### **3.1 ECONOMIC SIGNIFICANCE OF MEC COUNTRIES**

The MEC region is known for its economic diversity, it has resource-rich and resource scarce countries. In aggregate, all of them- as a group- are doing well. Internationally, Growth in the Middle East and North Africa was robust in 2006, with real GDP rising 6.3% (2007). This extraordinary growth- the strongest in more than 10 years-occurred despite the difficult conditions affected many countries, particularly the conflict-affected areas of Iraq, Lebanon and the west bank and Gaza. Strong oil revenues and the ongoing European recovery provided the momentum for growth, allowing per capita GDP to rise 4.2 % despite large increase in the population.

According to the World Bank annual report real GDP of Middle east and North Africa reach 5.3%, depending on the oil revenues, the region is enjoying large trade and current account surpluses. The current account surpluses as a share of GDP rose from 9.1 % in 2004 to 16.8 % in 2006. This all means that the region is within the range of the economic expectations, regarding the increase in the rate of population- which fell from 2.5 % annual to 2 %, still higher than the international rate 0.5 %. Unemployment dropped from more than 15 percent in 2000 to 11 percent in 2007. This all allows the MEC members and accounting experts to be represented in order to bring up their geographic diversity of professional backgrounds, present and protect their interests at stake and provide their advice to the IASB.

#### **3.2 BUSINESS ENVIRONMENT IN THE MEC**

If the IASB would like to base the representation criteria on the percentage of global participation, then again the MEC will not do badly. The business environment is attracting more investors day after day. With the establishment of new industrial cities and new property holding laws, according to a survey made by CONNECT-World CEO, the middle east will lead the world out of the current economic slowdown, according to 76 % of business leaders, almost two third of respondents say they are very optimistic about the long term prospect for their company in the middle east, with another 33 % optimistic.

Regarding the stock market which is getting bigger having Saudi Arabia the largest listed foreign stock in the MEC region, reaching more than \$ 26.5 billion followed by Egypt \$ 14.5 billion. Despite the financial crisis which affect the whole world market especially the stock market the level of profits that is being made in the region along with the successful strategies that are being set are launching partnerships of the MEC region with the rest of the world and are attracting new entrepreneurs to the MEC. Thus, it will be much better if MEC is represented on the IASB the same as each interested global business player, respecting their corporate laws, corporate acts and code of corporate governance.

## **4. MEC KEY INTERESTS**

### **4.1 FOREIGN INVESTMENT CONCERNS**

Planning is the 1<sup>st</sup> step for any international company before investing in any other country or region all over the world, one step of this planning is making a study of the accounting system in the country they are interested in investing at it.

Due to the location of the MEC between the East and west, it is an important location for most of the international companies. Which they are faced by the accounting system in the MEC countries which use various accounting system

It needs to satisfy the foreign investors' interests by using set of financial reporting standards (and not one set in each country) because this will reduce confusion, as well as error and fraud, which will lead to an increase in the degree of governance and trust. This transparency and trust can lead to better corporate governance that cannot be underestimated by investors who are targeted for providing foreign capital flows that cause growth, which is main concern for the region.

Thus, it is an advantage for the MEC to follow IFRS and not to establish their own set of united reporting standards, however, the importance of transmitting the concerns of its countries to the IASB should be understood. That is why inviting a MEC representative to the IASB structure will solve the adaptation problem, ensure that the IFRS will not harm it – but will only help it- and will serve the global accounting harmonization movement at the same time, instead of establishing new regional sets of IFRS.

### **4.2 ACCOUNTING STANDARD DIFFERENCES BETWEEN IASB, AAOIFI AND MEC**

The accounting and auditing standards that are adopted by Islamic financial institutions are an obvious reflection of the different financial instruments, contracts, insurance and interest laws, ethical standards, and types of business organization that are used by them. These standards, which slightly differ from those set by the IASB, are set by the AAOIFI which currently has 115 members from 27 countries. Specifically, they differ in five issues that are related to leases, restricted contracts, and specialty investment account (where the investors bear part of the business risk).

Having a representative from the MEC in the IASB will facilitate a lot of issues as he will understand these differences and MEC nation's common sources of finance, accounting regulations and framework, level of industrial development, as well as many other factors that are relevant, according to his experience and exposure.

### **4.3 CHALLENGES OF COMPLYING FULLY WITH THE IASB**

IASB requires each organization to comply fully with IFRS in order to be considered as following IAS. Full compliance with each IFRS by the MEC is a real challenge at the current moment. First, complying with the IFRS mean that the MEC are ready to abandon their particularities, replace their business reporting culture, lose the control process of standard setting, and use the one that is accepted by the IASB. The second challenge is the current unavailability of high qualified IFRS auditors and accounting staff in the MEC countries in the same level as in the western regions of the world. Third, until now the IFRS are not proving to be workable within the MEC context of national standards and that is why many standards have not yet been adopted in many countries.

## 5. CONCLUSION

In conclusion, the above observations show that on the basis of any representation criteria (geographical location, GDP level or population) MEC will be capable of gaining a seat on the IASB structure as it is doing in other reputable international financial organizations such as the world bank and international monetary fund.

If the world want to apply one accounting standards, IASB should recognize the importance of the Middle East countries in their structure, having a representative in the IASB will allow the MEC to apply IFRS in all the countries and allow the IASB to apply the IFRS in a very important region of the world, because otherwise the MEC will be supporting the current available ideas of establishing the Association of Gulf Cooperation Council (AGCC) accounting system or MEC accounting system. Finally, it can be said that IASB and MEC have to recognize and respect each other because of the simple fact that each of them creates a benefit for the other. Definitely this can be appreciated and considered more after acknowledging the number of Middle Easter countries that are currently complying with IFRS and also after concentrating more on the idea of perfect harmonization.

## REFERENCES

1. Askary, S (2006) '*Accounting professionalism – cultural perspective of developing countries*'
2. Mizra, A.M. 1991. '*Social reporting and managers*' self-interest Accounting Research Journal.7-17
3. Shahul Hameed bin Hj.' '*From conventional to Islamic accounting*' 1996
4. AAOIFI, '*Annual report 2006, 2007, 2008*