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**THE APPLICATION OF THE AAOIFI ACCOUNTING
STANDARDS BY THE ISLAMIC BANKING SECTOR IN
SAUDI ARABIA**

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by

Sultan Abdullah Al-Abdullatif

**Thesis Submitted in Fulfillment of the Requirements of the
Degree of the Doctor of Philosophy at Durham University**

Durham University

April 2007

17 OCT 2007



بِسْمِ اللَّهِ الرَّحْمَنِ الرَّحِيمِ
الْحَمْدُ لِلَّهِ الَّذِي
خَلَقَ السَّمَوَاتِ وَالْأَرْضَ
وَالَّذِي يُضَوِّبُ الْمَوْتَى
إِنَّ رَبَّهُ لَسَدِيدٌ
إِلَىٰ عَرْشِهِ الرَّحِيمُ
الَّذِي يُرْسِلُ الرِّيَّاحَ
تُحْمَلُهُ السَّحَابُ
وَيُنزِلُ مِنْ سَحَابِهِ
مَاءً يَسْرُبُ إِلَيْهِ
يُجِئُ السَّاعَةَ يَوْمَ
يُكْفَىٰ السُّعُودُ أَلْفًا
وَمِائَةً وَسِتِّ مِائَةً
وَالَّذِينَ كَفَرُوا لَهُمْ
عَذَابٌ أَلِيمٌ

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I hereby declare that no portion of the work that appears in this study has been used in support of an application of another degree in qualification to this or any other university or institution of learning.

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ABSTRACT

In 1990, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), a private standard setting body, was established by Islamic banks and other interested parties to prepare and promulgate accounting, auditing and governance standards based on the Shari'ah precepts for Islamic financial institutions. In Saudi Arabia, AAOIFI accounting standards have not been implemented yet. This research, therefore, attempts to investigate and explore the awareness of AAOIFI accounting standards among academics, external auditors and Islamic bank's employees in Saudi Arabia. In addition, this study aims to explore the respondents' preference of adopting AAOIFI accounting standards for Islamic banks in Saudi Arabia. Moreover, the usefulness and importance of the Islamic banks' annual report is investigated through the opinions of the participants. Lastly, respondents' perceptions regarding Islamisation of conventional banks in Saudi Arabia were examined.

The three samples of this study were obtained from the Saudi universities, auditing firms, Islamic banks and Islamic windows in conventional banks in Saudi Arabia. To serve the above purposes, a research questionnaire was designed. A total of 499 questionnaires were distributed among the three samples.

The analysis revealed that the awareness of AAOIFI accounting standards was less than expected among those considered as knowledgeable respondents coming from the areas related to the sector. The study also provides evidence that the more education and experience respondent has the more he/she is aware of the AAOIFI accounting standards. The research also concludes that the vast majority of the respondents prefer AAOIFI accounting standards to be adopted in Islamic banks in Saudi Arabia. The results of the analysis also indicate that traditional items of the IBs' annual report such as the balance sheets and income statements perceived as the most important and useful material and data for making decisions. The study also provides evidence that harmonizing Islamic banks' accounting standards and regulation will facilitate comparability of financial reports among Islamic banks in Saudi Arabia and the financial performance measurement will be much robust as a result. Lastly, participants in this study are in the opinion that Islamic windows in conventional banks in Saudi Arabia are the first step towards Islamizing the financial system.

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DEDICATION

This thesis is dedicated to my beloved parents who provided me with love, care, unlimited support and prayers.

I dedicate this work also to my brother and sisters for their supports and encouragements.

I dedicate this work also to my beloved wife, who provided me with unlimited support in taking care of our family during my study, and who gave me the encouragement I needed to achieve my goal.

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LIST OF ABBREVIATIONS

AAOIFI	Accounting and Auditing Organization for Islamic Financial Institutions
AGC	Audit & Governance Committee
AICPA	American Institute of Certified Public Accountants
APB	Accounting Principles Board
ASB	Accounting Standards Board
ASIFI	Auditing Standards for Islamic Financial Institutions
ASSC	Accounting Standard Steering Committee
BCL	Banking Control Law
CAL	Company Act Law
CDs	Certificates of Deposits
CFA	Chartered Financial Analysts
CICA	Canadian Institute of Chartered Accountants
CIPA	Certified Islamic Professional Accountant
FAOIBFI	Financial Accounting Organization for Islamic Banks and Financial Institutions
FASB	Financial Accounting Standards Board
GAAP	Generally Accepted Accounting Principles
GSIFI	Governance Standard for Islamic Financial Institutions
HIA	Holders of Investment Accounts
IAS	International Accounting Standards
IASC	International Accounting Standards Committee
IDB	Islamic Development Bank
IFAC	International Federation of Accountants
IFIs	Islamic Financial Institutions
IFSB	Islamic Financial Services Board
IIBI	Institute of Islamic Banking and Insurance
IMF	International Monetary Fund
IOB	Institute of Banking
IPO	Initial Public Offering
NCB	National Commercial Bank
REDF	Real Estate Development Fund
SAAB	Saudi Arabian Agricultural Bank
SABB	Saudi British Bank
SAMA	Saudi Arabian Monetary Agency
SCB	Saudi Credit Bank
SCI	Specialized credit institutions
SFAC	Statement of Financial Accounting Concept
SIDF	Saudi Industrial Development Fund
SOCPA	Saudi Organisation of Certified Public Accountants

CHAPTER 1

INRODUCTION

1.1 INTRODUCTION

Islamic banks and financial institutions are relatively new organizations and they face a great challenge to successfully serve the societies in which they function. This has led them, together with specialists in Islamic *Shari'ah* and accounting, to seek the most appropriate means through which accounting standards could be developed and implemented to present adequate, reliable, and relevant information to users of the financial statements of such organizations. The presentation of such information is critical to the economic decision making process by parties who deal with Islamic banks and also has a significant effect on the distribution of economic resources for the benefit of society (Shariff and Abdul Rahim 2003).

The transactions of Islamic banks are unique in nature and have no equivalent in conventional banking practice. This has raised the issue of relevant accounting treatments for Islamic bank transactions (Maali 2005). Mirza and Baydoun (2000) quoted from Sprouse (1987) that:

“The need for accounting standards is not very different from the need for any other kind of standards, whether it be standards for weights and measures, or standards for clothing sizes, grades of beef, or baseball statistics. The goal or objective is to facilitate comparisons and thereby minimise the social and economic costs of assessing the alternatives with which one is faced in making rational decisions”

It is argued that disclosure with regard to financial reporting, the underlying *Shari'ah* principles and the accounting methods adopted must be taken into account. The information contained in the financial statement will not be useful for a comparison of

the performance of different Islamic banks due to the differences in the working mechanism of Islamic finance. A insufficient disclosure of the underlying *Shari'ah* principles will subject the Islamic banks' activities to a lot of questions with regard to their Islamic credentials. Therefore, the need for standard accounting practices in the reporting of Islamic banks' operations is very obvious (Shariff and Abdul Rahim 2003).

The process of financial reporting in an Islamic society should be more detailed than what is currently prevalent in Western societies. In an Islamic society, because of the moral emphasis on reporting, financial reports are likely to be free of creative accounting techniques. There would be an emphasis on transparency and manipulation of asset values and performance results would be avoided. Apart from the emphasis on the profit and loss statement, balance sheet, and cash flow statement, a considerable amount of further information would be provided. This would include a value-added statement and disclosure about social performance activities of the firm. Last, but not least, detailed account is likely to be provided about the *Zakat* fund, *Qard*, and charitable contributions (Mirza and Baydoun 2000).

1.2 PROBLEM AND OBJECTIVES OF THE STUDY

The need to develop accounting standards that adequately and appropriately reflect the nature of Islamic financial transactions was considered by some experts as an important step to enhance the reliability, consistency, clarity and credibility of financial reporting by Islamic financial institutions, which would also enhance investor confidence in Islamic finance. Thus, intensive efforts were made by the Islamic Development Bank (IDB) to establish a formal entity to address Islamic accounting issues. This led to the establishment of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) which was registered on March 27, 1991 in the Kingdom of Bahrain, as a non-profit making independent international organization. The objective of the organization is to prepare and develop accounting, auditing, governance and ethical standards relating to the activities of Islamic financial institutions, taking into consideration international standards and practices and the need to comply with *Shari'ah* rules.

At present, the AAOIFI has neither the consent of regulatory bodies (e.g. central banks) nor the power to force Islamic banks to implement its proposed standards. Hence, to ensure compliance with its standards, the AAOIFI may have no choice but to obtain the support of the regulatory bodies concerned or to try to secure the cooperation of at least the major Islamic banks and their auditors (Karim 1994).

Karim (2001) argues that the supervisory authorities in countries in which Islamic banks operate have not appreciated the implications of the unique characteristics of Islamic banks. Until now the issue of what standards used for conventional banks should apply to Islamic banks has received little attention, even in countries where all banks follow Islamic principles (Errico and Farahbakash 1998).

Some central banks and monetary agencies in some Muslim countries such as the Kingdom of Bahrain, Jordan and Sudan require Islamic banks to comply with AAOIFI accounting standards. On the other hand, AAOIFI regulations are not adopted by any Saudi banks even those banks that claim to be Islamic banks, such as Al-Rajhi Bank, Aljazira Bank and Bank Albilad. However, as Saudi Banks, they have to follow the Saudi Arabian Monetary Agency (SAMA) regulations and requirements which do not consider AAOIFI accounting standards as one of the accounting standards that should be adopted in Saudi Arabia. Therefore, Karim (2001), mentioned that Saudi Arabia has not so far enacted laws to regulate Islamic banks. Rather, Islamic banks operate within the laws that govern all the banks in the Kingdom. These laws mainly focus on commercial banking.

The main problem which this study aims to find a solution for is that SAMA requires all banks to prepare their financial statements according to SAMA's accounting standards and the International Accounting Standards (IAS). There is no distinction between Islamic banks and conventional banks in terms of the accounting standards used for preparing the financial reports, despite the fact that Islamic banks in Saudi Arabia are the most important members of AAOIFI.

The implementation of the accounting standards, however, as a new phenomenon would be expected to receive considerable attention from professionals such as academics in

the accounting field, external auditors and preparers of financial statements in Islamic banks (e.g. managers and employees) (Mustafa 2003). Therefore, successful implementation of AAOIFI accounting standards in Islamic banks in Saudi Arabia as new accounting standards needs to be evaluated by exploring the perceptions of the academics and professionals regarding the importance of adopting such standards. Thus, the main purpose of this thesis is to examine the awareness and preference of AAOIFI accounting standards from the opinion of the academics, external auditors and IBs' employees as they are considered the most important and knowledgeable groups regarding the issue of preparing financial statements. In addition, the respondents' perception of the Islamisation of conventional banks in Saudi Arabia will be explored as well as their perceptions of the importance and usefulness of IBs' financial report in Saudi Arabia.

1.3 RESEARCH QUESTIONS AND HYPOTHESES

The main aim of this study is to explore and evaluate the awareness and preference of AAOIFI accounting standards in Saudi Arabia. In order to achieve this objective, the researcher used different methods to collect data including library research, a field survey, and observation. The empirical research was based on a field study carried out in Saudi Arabia. One set of questionnaires were distributed to the most knowledgeable three groups associated with preparing accounting standards in Saudi Arabia. Those groups were the following: academics, external auditors and Islamic banks' employees (accountants and internal auditors). The questionnaire aims to explore the respondents' perceptions regarding the problem of this research and to find sufficient answers for the following research questions:

- 1- To what extent Islamic bank's financial statements are important to its users?
- 2- To what extent specialist in Islamic banking & Accounting in Saudi Arabia are aware of The Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI)?

3- To what extent specialist in Islamic banking & accounting in Saudi Arabia prefer AAOIFI accounting standards to be implemented in Islamic banks in Saudi Arabia?

4- Do specialist in Islamic banking & accounting in Saudi Arabia support the idea of harmonizing accounting standards which used to prepare the Islamic banks' financial statements?

5- Are Islamic windows in the conventional banks in Saudi Arabia the first step towards Islamisation of all conventional banks?

In addition, six hypotheses were designed to explore whether or not there are relations between the respondents' education, professional qualifications and experience variables with their awareness and preference of AAOIFI accounting standards. Possible relationships between variables will be investigated using the Pearson chi-square and cross-tabulation statistical functions of the SPSS package. The first three hypotheses aim to investigate the relations between the variables with the respondents' awareness of AAOIFI accounting standards, whereas the second set of hypothesis aims to explore the relations between the variables with the respondents' preference of AAOIFI accounting standards. These null hypotheses are:

Hypothesis on Awareness:

Hypothesis No. 1 education

H0: There is no significant relationship between the education of the respondents and their awareness of AAOIFI accounting standards.

H1: There is a significant relationship between the education of the respondents and their awareness of AAOIFI accounting standards.

Hypothesis No. 2: Professional qualifications

H0: There is no significant relationship between the professional qualifications of the respondents and their awareness of AAOIFI accounting standards.

H1: There is a significant relationship between the professional qualifications of the respondents and their awareness of AAOIFI accounting standards.

Hypothesis No. 3: Experience

H0: There is no significant relationship between the experience of the respondents and their awareness of AAOIFI accounting standards.

H1: There is a significant relationship between the experience of the respondents and their awareness of AAOIFI accounting standards.

Preference hypothesis:

Hypothesis No. 4: Education

H0: There is no significant relationship between the education of the respondents and their preference of AAOIFI accounting standards.

H1: There is a significant relationship between the education of the respondents and their preference of AAOIFI accounting standards.

Hypothesis No. 5: Professional qualifications

H0: There is no significant relationship between the professional qualifications of the respondents and their preference of applying AAOIFI accounting standards.

H1: There is a significant relationship between the professional qualifications of the respondents and their preference of applying AAOIFI accounting standards.

Hypothesis No. 6: Experience

H0: There is no significant relationship between the experience of the respondents and their preference of applying AAOIFI accounting standards.

H1: There is a significant relationship between the experience of the respondents and their preference of applying AAOIFI accounting standards.

1.4 ORGANISATION OF THE THESIS

The study is organised into eleven chapters (see figure 1.1). Chapter one, the introductory chapter, provides a framework for the study, provides a statement of the problem, states the study's objectives, and outlines the research questions and hypothesis of this study.

Chapter Two focuses on the theory and practice of Islamic banking. In addition, the main Islamic financial contracts are discussed as well as the main differences between Islamic and conventional banking.

Chapter Three provides a general background about the Islamic accounting and AAOIFI, based in Bahrain, accounting and auditing standards as well as a brief overview about the Islamic Financial Services Board (IFSB), based in Malaysia.

Chapter Four is a general overview about the financial and accounting development in Saudi Arabia. This research focuses on the importance of Islamic banks' financial statements and the need for applying AAOIFI accounting standards in the Islamic banks in Saudi Arabia. Thus, it is necessary to provide introductory remarks as an explanation about the Kingdom, to understand its internal dynamics. The main elements examined in this chapter are the politics, economics, financial and accounting system in the kingdom.

Chapter Five, explores the usefulness and importance of Islamic banks' financial reporting to its users in Saudi Arabia. This is done through providing a theoretical framework and a review of the literature on the usefulness of financial reports. Two research areas are reviewed. The first relates to the discussion of theoretical foundations relevant to the "usefulness" of financial reports in general. The second provides a review of academic literature on the importance of financial reports as a source of information to investors. Also, this chapter discusses the objectives of financial reporting, the characteristics of accounting information, and the users of financial statements information. Previous studies are cited which have dealt with financial reporting and its importance to shareholders and investors in general, and investment analysts in particular.

Chapter Six presents the research approach adopted in this study by presenting the factors, which influenced the choice of questionnaire technique and approaches and its advantages and disadvantages. It also reports the procedures followed in the design and development of the close-ended questionnaire. This was the study's main collection instrument. Finally, it gives details of the questionnaire fieldwork procedure, which

started at the beginning of January 2004 until May 2004 and it reports the achieved response rate.

Chapter Seven presents the descriptive analysis for the survey gathered- primary data from the academics, which will be conducted in this research. This is considered to be the first stage in the process of data analysis in this research. The response of the academics will be illustrated through the use of percentages and frequencies, demonstrated through the use of tables.

Chapter Eight provides a descriptive analysis of the data collected through a survey of the external auditors by taking into consideration their opinions and providing an insight into their perceptions regarding accounting practices and standards in Islamic Banks in Saudi Arabia.

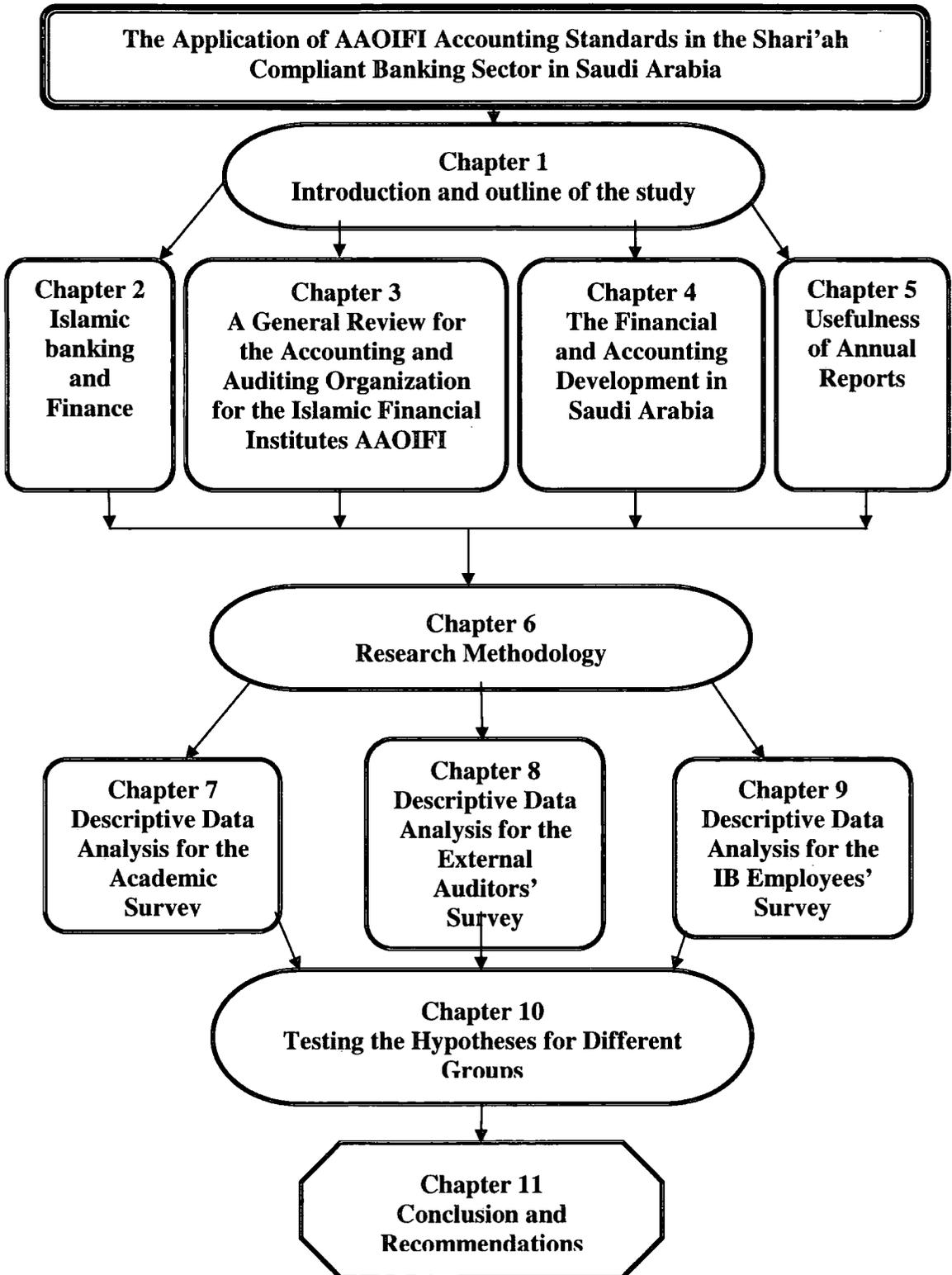
Chapter Nine presents a analysis of the primary data collected through a questionnaire from the Islamic banks employees', which is the final chapter in a series of chapters on descriptive analysis. This concludes the analyses of data collected from the actors in the field of financial reporting.

The last three chapters, aimed to present a descriptive analysis of the primary data collected through the questionnaires distributed to all the samples. Chapter Ten provides more empirical evidence and presents the results of the analysis and testing of the hypotheses and attempts to answer the research questions, as the main objective of this study is to explore the awareness and preference of AAOIFI accounting standards from the academics', external auditors' and Islamic bank employees' points of view. In particular, the primary objective of this part of the study is to survey and ascertain the usefulness of Islamic banks' financial reports in Saudi Arabia. Accordingly, Chapter Ten is divided into five parts. The first part presents the result of analysis of respondents' perceptions of Islamisation of conventional banks in Saudi Arabia. The second shows the respondents' perceptions regarding the usefulness of IBs' annual reports and the importance of the sources of information to indicate the performance of IBs. In the third part, adopting AAOIFI accounting standards in Islamic banks in Saudi Arabia is discussed by exploring the awareness and preference related to the AAOIFI accounting

standards to discover the respondents' perceptions towards harmonising IBs' financial statements. The fourth section presents and discusses the importance and need for training for IBs' accountants. The final part, the hypotheses of this study are examined with an attempt to explore the relation between the respondents' education, professional qualifications and experience variables with the awareness and preference of AAOIFI accounting standards. The statistical methods employed in this chapter range from frequency distribution, ranking according to the mean value, factor analysis, to cross-tabulation and chi-square to test the validity of the hypotheses.

Finally, Chapter Eleven presents the conclusions of this study. The main findings and results are summarised, the limitations of the study are discussed, and some recommendations for Saudi policy makers are put forward as well as implications of the research on the Islamic banks in Saudi Arabia. There are also suggestions made concerning areas where further research is needed.

Figure 1.1: Structure of the thesis



CHAPTER 2

ISLAMIC BANKING AND FINANCE

2.1 INTRODUCTION

Islamic banking started on a modest scale in the early 1970s and has shown tremendous growth over the last 30 years (Iqbal and Molyneux 2005). The practice of Islamic banking has now spread from East to West, the size of the industry that amounted to a few hundred thousands of dollars in 1975 has now reached US\$250 billion by May 2005 as stated by Qatar Central Bank governor HE Abdullah Khalid Al-Attiah¹ (Islamic Financial News 2005).

As the main objective of this study is to consider Islamic accounting standards and its implementation in the kingdom of Saudi Arabia, this chapter will provide a general view about the theory and practice of Islamic banking. In addition, the main Islamic financial contracts will be discussed as well as the main differences between Islamic and conventional banking.

2.2 BACKGROUND TO ISLAMIC BANKING

Islam, with estimated followers of one-fifth of the world's population, provides a comprehensive way of life. In addition to human relations with God, it regulates economic, social, and political affairs. The *Qur'an* (the holy words of God), and *Sunah* (the Prophet Mohammed's saying and deeds pbuh) are the main sources of Islamic *Shari'ah*. This represents the Islamic law of human conduct, which regulates all matters of the lives of Muslims. On the economic side, Islam does not recognise the dichotomy between spiritual and daily life including the economic affairs. Islam encourages commerce and trade, but requires that any transaction should be conducted in accordance with *Shari'ah*, which prohibits - among other things -

¹ This news found in an electronic journal called "Islamic Finance News" and their website is: www.islamicfinancenews.com.

transactions involving *riba* (interest), unlawful and speculative trade. Islam also requires Muslims to pay *Zakah*, the compulsory alms giving.

After fourteen centuries since the emergence of Islam, the increase in the number of Muslims around the world who wanted to conduct their business transactions according to *Shari'ah*, along with the increase of wealth in many Islamic countries after the oil boom in the early 1970s, led to the emergence and expansion of what is known as Islamic banking. Islamic banks provide financial services to Muslims who are keen to adhere to their religious principles in their financial dealings (Karim 1990a) and to non-Muslims who like to engage in ethical finance. Islamic banks rule out interest from their transactions; instead of receiving and charging interest, they utilise alternative types of investment and financing based on profit and loss sharing, and mark-up arrangements. Islamic banks usually utilise *Shari'ah* Supervisory Boards (SSB) to make sure that religious principles have been followed in the bank's transactions.

2.3 THE PRINCIPLE OF ISLAMIC BANKING

Khan and Mirakhor (1986) argue that Islamic economy defines a complete system, which prescribes specific patterns of economic behaviour for all individuals within an Islamic way of life. The strict ban on interest and the identification of no-business areas represent the cornerstone and the nucleus of the Islamic economic system (Iqbal 1997). However, the prohibition of interest is not the only distinguishing principle. Some of the core principles of the Islamic economic system, which represents the basis upon which Islamic banks operate, are discussed in the following section.

2.3.1 Prohibition of Interest Rate (Riba)

Definition of *Riba*

Islam strictly proscribes *riba* or usury, as mentioned in many parts of the *Quran* and the sayings of Prophet Mohammed (pbuh). Literally, *riba* means growth, but this does not imply that any growth of money is prohibited in Islam; growth from trading

is allowed, and encouraged. In the context of Islamic economy, *riba* refers to "the premium that must be paid by the borrower to the lender along with the principal amount as a condition for the loan or for the extension of its maturity" (Talip and Phay 1998). This definition suggests that *riba* is the same as interest, as God says in the Holy *Quran* "[278] O you who believe! Be afraid of Allah and give up what remains (due to you) from *riba* (usury) (from now onward), if you are (really) believers. [279] And if you do not do it, then take a notice of war from Allah and His Messenger but if you repent, you shall have your capital sums. Deal not unjustly (by asking more than your capital sums), and you shall not be dealt with unjustly (by receiving less than your capital sums)"(*Quran*, 2:278-9)². This verse explicitly prevents the act of *riba*; the use of the word principal, El-Ashker (1987) suggests, defines clearly the meaning of *riba* as the difference between the amount borrowed (the principal) and the amount due to be paid back. It should be noted that in 1965, the second conference of the Islamic Research Centre issued a *fatwa*, the religious ruling, stating that banking interest is the same as *riba* (Al-Salouse 1997).

Riba and Profit

A distinction between *riba* and profit should be made. *Riba*, as discussed above, refers to the act of lending money for a specific period and charging a fixed amount on the capital. Profit, on the other hand, results from trading activity, including a real transaction that includes exchange of goods or services for money or other goods or services. According to the *Qur'an*: "God has permitted trading and forbidden *riba*" (*Quran*, 2:275). The trade includes a risk or loss factor, which differentiates it from the guaranteed nature of interest (Taylor and Evans 1987), while interest is contractually fixed, predetermined and does not depend on the utilisation of the amount borrowed; profit is the result of taking risk and uncertainty (Ara Huq, Islam et al. 1997). Siddiqi (1983) argues that profit from the Islamic perspective belongs to both enterprise and capital; should both entrepreneurship and money capital come from one person, all profit should go to that person. Should enterprise and capital

² These two verses from The Holy Quran "The Cow chapter, verses 278-279" and quoted from <http://quran.muslim-web.com/sura.htm?aya=002278>.

come from separate parties, they should share profits as well as losses according to an agreed proportion.

The Time Value of Money

The prohibition of interest raises questions about the time value of money, a controversial issue in the Islamic literature. It is worth noting that charging higher prices for objects if payments are deferred is permissible according to many Islamic scholars.

Many researchers, including Gambling and Karim (1991) and Khan (1994), are of the opinion that Islam does not recognise the time value of money. The basis of their argument is that time is not a production factor like labour and capital, thus it cannot generate a yield by itself. Khan (1994) argues that the concept of the time value of money has rational difficulties and violates the *Sharia* prohibition of interest. On the other hand, other scholars such as Saadallah (1994) and El-Gamal (2000) argue that the acceptance of increased prices for deferred sales implies that Islam recognises the time value of money, but *Shari'ah* requires that such increases in price should result from an actual exchange transaction that includes a risk factor. This includes not just money for money exchange, but money for goods or services. El-Gamal (2000) suggests that jurists justify price increase as compensation to traders or financial commercial intermediaries for the opportunity cost of deferring the receipt of payments. Among others, Aisa (1993) and Daoud (1997) have accepted the concept of the time value of money on the basis that, in the case of inflation, the lender of the money will be deprived. They recommend the use of indexation, which is seen by other scholars as "it will open the floodgates of interest" (Siddiqi 1983) and "being unjust for borrowers" (Al-Jundi 1996).

Rationale for the Prohibition of *Riba*

The rationales behind the prohibition of *riba* in Islam are mostly social rationales; the Islamic prevention of unfair dealing and exploitation of the needy are mentioned in many parts of the *Quran* and the Prophet Mohammed's (pbuh) sayings. Mirza and Baydoun (2000) argue that the use of *riba* violates the principle of social justice, which is very important in Islam, because *riba* leads to rewards not justified by

effort; those who lend money on interest do not make efforts, or participate in the risks of financed projects. Interest based transactions allow the lenders to receive the advantages associated with lending their money, while avoiding the risks and losses attached to their ownership. This is what Gambling and Karim (1991) refer to as "unfair trading". Siddiqi (1983) questioned the rationale of shifting all the risks associated with a project to the entrepreneur, while the supplier of capital is guaranteed a fixed positive return. Siddiqi (1976) argues that consumption loans, which involve interest, violate the basic function for which God created wealth, which envisages that the needy be supported by those who have surplus wealth. Mulhem (2002) further argues that *riba* kills the mercy between Muslims and prevents cooperation among them.

Talip and Phay (1998) suggest that the most apparent reason for the banning of *riba* is to enforce the spirit of brotherhood. The Islamic interest free loan called *Qard Hassan* is widely used to finance social activities. In this kind of loan, the lender does not charge interest, which enhances the spirit of brotherhood between Muslims. Interest based loan may lead to exploitation of the needy, usually in the favour of the wealthy; lenders increase their wealth in an easy and secure way, while borrowers have to repay a higher amount, whether they can afford to or not, which is not acceptable from the Islamic point of view.

2.3.2 Prohibition of (*Gharar*)

Gharar can be defined as trade with excessive risk emerging from unknown factors, and it deals with issues concerning contractual uncertainty arising from factors with unknown outcome. An example of this is gambling or any transaction in which the buyer pays much less than what the object is worth, and then takes the object at this cheap price or loses the money; thus, the results depend on chance. Such transactions are highly risky and may lead to undesirable consequences and enmity, besides getting something for nothing, which is a sort of injustice (Al-Suwailem 2000). *Gharar* also includes any type of transactions in which the object may not yet exist, such as the purchase of an unborn animal because in such transactions the buyer does not know what he or she is buying. Sale before possessing (even after ownership) may involve *Gharar*, because the seller may fail to deliver the object in the future for reasons not under his or her control. It is worth mentioning that contracts involving a

risk factor are not necessarily void from the Islamic point of view; profit and loss modes of finance, such as *Mudaraba*, in which one party provides funds, and the other invests these funds, includes a risk factor, and are Islamically acceptable and indeed preferable. However, it is forbidden to undertake excessive risk on unpredictable outcomes.

2.3.3 Zakah

Zakah literally means purification; it is one of the five pillars of Islam, and is mentioned in many parts of the *Qur'an* and the Prophet Mohammed's (pbuh) sayings. It presents an annual payment that every Muslim who owns a minimum specified by *Shari'ah* is obligated to make. The Islamic state may assume responsibility for collecting and distributing *Zakah*, but where this is not the case, the individual is still obliged to pay it. The *Zakah* should be paid to certain recipients specified in the *Qur'an*, including the poor and needy, workers who collect *Zakah*, debtors in financial difficulty who are not able to pay their debt, and volunteers who dedicate their efforts and time to spreading the Islamic religion. It can be seen from this that *Zakah* has social objectives, which implies that if individuals or businesses pay any other type of tax to the state; they are still obliged to pay *Zakah*.

Whether Islamic businesses or only individuals should be obliged to pay *zakah* is a controversial issue in Islamic literature. Gambling and Karim (1991) argues that *zakah* is levied on individuals who are Muslims; entities should not be liable to *zakah*. The Islamic *Fiqh* (religious ruling) Academy, at its first *zakah* conference held in Kuwait in 1984, reached the conclusion that businesses, unless required by law or by shareholders, are not required to pay *zakah* (Shihadah 1987). However, the law may require Islamic banks to pay *zakah*, such as the case of Saudi Arabia, or shareholders and/ or depositors may ask the bank to pay *zakah* on their behalf.

2.3.4 Legitimate Transactions

As for individuals, businesses are not allowed to engage in activities that violate the *Shari'ah*. Islamic banks, for example, cannot provide finance or other services to assist in the manufacture of alcohol, pornographic production, gambling or casino activities, since Islam prohibits them. In addition, Islam emphasises the concept of

fair trade; any contract undertaken by the banks should not include injustice to the other party. Most Islamic banks have *Shari'ah* Supervisory Boards (SSBs), which ensure that the activities of Islamic banks comply with *Shari'ah*.

2.3.5 Social Responsibility

Islamic businesses as well as individual have responsibilities towards the communities in which they operate. The social roles of every Muslim are mentioned in many parts of the *Qur'an* and Prophet Mohammed's (pbuh) saying; all Muslims are seen as brothers and should help each other communally. Islamic banks usually undertake activities that reflect their social role in the community. Social activities are emphasised in Islamic banks' articles of association as part of their objectives and functions (El-Ashker 1987). Islamic banks are described as having a "social face" (Mashhour 1996). Their social role is reflected in their provision of the *Qard Hassan*, which helps borrowers to achieve social goals such as marriage, also in other charitable social activities.

2.4 ISLAMIC FINANCING CONTRACTS

Islamic banks have many contracts, which can be distinguished from conventional banks. In this section, the most important Islamic financial contracts will be discussed by underlying the concept for each technique and can be compared to an existing Western financial instrument.

2.4.1. Musharakah

The *Musharakah* mode is based on both parties, the bank and the entrepreneur (the owner manager) agreeing to establish a new partnership that may take the form of a company; the capital of this partnership will be provided by the two parties. The owner manager will be entitled to get a salary for his work, while the remaining profit will be distributed as agreed upon at the time of affecting the contact between the parties, which may not coincide with the ratio of financing input (Usmani 2002). In the case of loss, there are unanimous views among Islamic scholars on the share of loss for each partner, which should be based on the share of each partner in the

investment (Lewis and Algaoud 2001). Presley (1988) argues that the *Musharakah* contract is well suited for financing private or public companies and participating in project financing for short, medium and long-term periods. Errico and Farahbaksh (1998) state that this kind of contract is usually employed in long-term investment projects.

Musharakah contracts give the bank the right to participate in the management of the project and monitoring its performance. This form of financing enables the banks to get more information and enrich the experience of the management of the project with financial experiences. It is like venture capital in the conventional system which involves a higher degree of risk, and the partners may lose in addition to their profit all or part of their capital. However, partners' losses are limited to their investment in the case of insolvency and the manager's personal assets and the bank's other assets will not be called upon (Wilson 1997). Since there is no market for such shares; therefore, the partners may agree to terminate. If one of the parties wants the termination of *Musharakah*, while the other partner or parties wish to continue in the business, this can be achieved by mutual agreement of the two parties, where the partner who wants to continue will buy the share of the terminated partner. *Musharakah* may take several forms of agreements; financing of a single transaction, diminishing *Musharakah*, working capital, and fixed capital.

2.4.2. Mudarabah

Mudarabah is a trust based financing agreement whereby an investor (Islamic bank), entrusts capital to an agent (*Mudarib*) for a project. Profits are based on a pre-arranged and agreed on ratio. *Mudarabah* agreement is akin to western-style limited partnership, with one party contributing capital while the other runs the business, and profit is distributed based on negotiated percentage of ownership. In case of a loss, the bank earns no return or a negative return on its investment and the agent receives no compensation for his (her) effort.

Mudarabah contracts take two forms: restricted *Mudarabah* where the contract is in a particular business, and unrestricted *Mudarabah*, where the *mudarib* is authorised to invest in any business he deems fit (Usmani 2002).

2.4.3. Murabahah

Murabahah is the most commonly used financing mode in Islamic banking. It was originally a sale contract. In this contract the client asks the bank to buy a specific product for him, the bank buys and possesses the product and re-sells it to the client in a separate contract. The cost of the product will be disclosed and the bank adds-up in a form of a predetermined mark up. The mark up represents the bank profit, and a reward for the risk inherent in the financing; in a case where the customers refuse to buy the product, the bank bears the loss. However, the sale should be on the spot, while the payment may be discharged by instalment or on a lump sum basis (Presley 1988).

2.4.4. Bai'-al-Salam

Through this agreement the Islamic bank may enter into a contract with a client for the advance purchase of his products, specifying complete details of the commodity, its quality, its price and the place and time of delivery, and make the payment of the agreed amount at the time of entering into the agreement. When the commodity is produced and supplied to the bank on the specified date, the bank has the right to sell the commodity. *Bai'-al-Salam* is a special type of trading agreement which is subject to strict conditions as laid down in the Holy *Qur'an* and *Sunnah* (Ba-Owaidan 1994).

2.4.5. Istisna'a

Istisna'a is a sale contract in which the seller (Islamic banks in this case) undertakes to manufacture or construct a commodity (which is usually a long-term asset) ordered by the buyer. If the seller does not have the capacity to manufacture or construct the commodity, it may contract it to a third party, which is known as parallel *Istisna'a*. *Shari'ah* requires that the price should be agreed when signing the contract, and cannot be changed for reasons such as increase in prices, but allows change in price if it is due to change in the specification. Even though the bank is not itself involved in construction, it still has the sole responsibility for fulfilment of its obligations against the buyer; the obligation cannot be transferred to another party (Maali 2005).

2.4.6. Ijara

Ijara is an Islamic leasing concept, which is similar to the western operating and finance leases. It is similar to a conventional operating lease, where in an Islamic bank (lessor) leases the asset to a client (lessee) for agreed on lease payments for a specified period of time, but with no option of ownership for the lessee (Zaher and Hassan 2001).

There are two main forms of leasing: direct leasing finance, and lease and purchase (Presley 1988). Direct leasing finance allows the client to use the equipment without the need to own it, which facilitates getting new equipment after the end of the hiring period. While a lease and purchase contract requires the bank to purchase the equipment on behalf of the clients and retain the ownership until the end of the hire purchase period. This kind of lease is called *Ijara-wa-iqtina*. The rental of the leasing is pre-determined for the whole period of the contract. In the case of *Ijara-wa-iqtina* the rentals should be sufficient to amortize the leasing bank's investment and provide an element of profit (Lewis and Algaoud 2001).

Leasing financing has widely been used in Western institutions, but there are significant differences between Islamic leasing contracts based on *Ijara* and conventional leasing. Under the *Shari'ah* law it is necessary for management, maintenance and insurance of the leased assets to be the responsibility of the lessor, while under conventional leasing contracts these matters are usually the responsibility of the lessee (Wilson 1997).

2.4.7. Qard Hasan

Qard Hasan is a beneficence loan. It represents a non-interest bearing loan, indeed to allow the borrower to use the loan for a period of time on the basis that the same amount of money would be repaid at the end of the period (AAOIFI 1999). The Islamic banks provide such loans for welfare purposes; usually, they are provided to those embarking on a social activity, such as marriage or study, or those incurring exceptional expenses arising from illness or accidents. Khan (2000) points out that these loans can also be exceptionally provided for commercial purposes to clients in difficulty who are already receiving some other kind of financing. The bank may ask

for collateral to ensure repayment, and may charge the borrower fees as administrative expenses for handling the loan, which are not proportional to the period or the amount of the loan.

2.5 DIFFERENCES BETWEEN ISLAMIC AND CONVENTIONAL BANKS

The relationship between Islamic banks and their customers is not that of debtors and creditors, or vice versa, but one of participation in risk and rewards. In addition, the role of conventional banks is to attract financial resources and to lend them with interest, so as to make a profit, the emphasis of Islamic banks is on using their financial resources to develop them as a whole. Although they, no doubt, keep profit in sight, that is not the focus of their activities, at least theoretically. The main objective is to achieve socioeconomic objectives while conforming to the injunctions of the *Shari'ah* (Al-Askar 2005).

While conventional banks are satisfied with traditional reviews by certified auditors, Islamic banks are subjected to additional reviews by the religious supervisory board to ensure that funds are being raised and invested in ways that conform to Islamic principles (Khan 2000). Table 3.1 shows the main differences between Islamic and conventional banking.

Table 3.1: Differences between Islamic & Conventional Banking

<u>Characteristics</u>	<u>Islamic Banking System</u>	<u>Conventional Banking System</u>
Business Framework	Based on <i>Shari'ah</i> laws - <i>Shari'ah</i> scholars ensure adherence to Islamic laws and provide guidance.	Not based on religious laws or guidelines - only secular banking laws
Balance between moral and material requirement	The requirement to finance physical assets which banks usually take ownership of before resale reduces over extension of credit.	Excessive use of credit and debt financing can lead to financial problems.
Equity financing with risk to capital	Available. Enables several parties, including the Islamic Bank to provide equity capital to a project or venture. Losses are shared on the basis of equity participation while profits are shared on a pre-agreed ratio. Management of the enterprise can be in one of several forms depending on whether the financing is through <i>Mudarabah</i> , <i>Musharaka</i> , etc.	Not generally available through commercial banks, but through venture capital companies and investment banks which typically take equity stakes and management control of an enterprise for providing start-up finance.
Prohibition of <i>Gharar</i>	Transactions deemed <i>Gharar</i> are prohibited. <i>Gharar</i> denotes varying degrees of deception pertaining to the price and quality of goods received by a party at the expense of the other. Derivatives trading e.g. options are considered as having elements of <i>Gharar</i> .	Trading and dealing in derivatives of various forms is allowed.
Profit and Loss Sharing	All transactions are based on this principle. Returns are variable, dependent on bank performance and not guaranteed. But the risks are managed to ensure better returns than deposit accounts. Consumers can participate in the profit upside i.e. in a more equitable way than receiving a predetermined return.	This principle is not applied. Returns to depositors are irrespective of bank performance and profitability. The customer as depositor is like a lender and does not share in the success of the enterprise beyond receiving a fixed rate of predetermined interest. Unlike the Islamic system the depositor cannot theoretically gain subject to improved bank performance.

*Source: Abu Dhabi Islamic Bank (2006).

2.6 CONCLUSION

This chapter introduced the concept of Islamic banking. The principles upon which Islamic banking operates were discussed, especially the strict ban on interest. Different kinds of Islamic contracts were briefly discussed. This chapter also highlighted the main differences between Islamic and conventional banks.

The next two chapters will complete the picture of Islamic banks and its regulations especially in Saudi Arabia. Chapter 4 will present the establishment of the Accounting & Auditing Organization for Islamic Financial Institute and discuss the main achievements & Standards issued, while chapter 5 is more concerned about Saudi Arabia and its financial system.

CHAPTER 3

A GENERAL REVIEW OF THE ACCOUNTING AND AUDITING ORGANISATION FOR ISLAMIC FINANCIAL INSTITUTIONS (AAOIFI)

3.1 INTRODUCTION

Accounting is a discipline that plays a significant role in the business world, but remains rather inconspicuous in its importance, because almost always the task of recognizing, measuring and recording of transactions gets mired in the debate of the standards applied in giving birth to the end report. Hence, to facilitate the business world to comprehend and analyze the transactions and economic health of organizations and firms within local boundaries and across international borders, there was a credible need for standardization. The standardization of accounting practices promotes the ability to compare international financial information, and hence eliminates the misunderstandings about the reliability of foreign financial statements to allow greater flow of international funds. An important development in the discipline of standardization and internationalization of accounting practices happened in the 1970s, when two of the most important international accounting standard setters were founded. In 1973, the International Accounting Standards Committee (IASC) was created by agreement between professional accounting organizations in nine countries. It later grew into an organization representing more than a hundred professional organizations in more than seventy countries. Meanwhile in 1977 the International Federation of Accountants (IFAC) was founded, whose main function is the international coordination of professional activities as well as the development and promulgation of international auditing guidelines (Sultan, 2006).

The development of Islamic finance within the modern banking system also took place at about the same time. Karim (1990a) claims that Islamic banks have taken the initiative to self-regulate their financial reporting for fear that the regulatory bodies in the countries in which they operate may otherwise intervene and mandate the

accounting policies of Islamic banks. In 1990, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), a private standard setting body, was established by Islamic banks and other interested parties to prepare and promulgate accounting, (and recently) auditing and governance standards based on the Shari'ah precepts for Islamic financial institutions (Karim, 2001). The main purpose of this chapter is to present a general background about the Islamic accounting and AAOIFI, based in Bahrain, accounting and auditing standards as well as a brief overview about the Islamic Financial Services Board (IFSB), based in Malaysia.

3.2 ISLAMIC ACCOUNTING

Islamic accounting can be defined as the 'accounting process' which provides appropriate information to stakeholders of an entity which will enable them to ensure that the entity is continuously operating within the bounds of the Islamic *Shari'ah* and delivering on its socioeconomic objectives (Ibrahim, 2003).

The meaning of Islamic accounting would be clearer if we compare it with the definition of 'conventional' accounting. Conventional accounting as it is known is defined to be the identification, recording, classification, interpreting and communication of economic events to permit users to make informed decisions (AAA, 1966). The objectives of accounting information of Islamic banks are different from those of conventional banks for two main reasons:

- (i) Islamic banks deal within a *Shari'ah* framework. As a result, the nature of their transactions is different from that of conventional banks;
- (ii) The users of the information generated by Islamic banks have different needs from the users of the information published by conventional banks (Khan, 1994).

Al-Mehmadi (2004) outlined the following reasons taken from Omar (1997) to describe the need for special accounting standards for Islamic banks. The relationship between investors and the Islamic banks that they invest in is different from that of conventional banks. In relation to Islamic banks, the relationship is based on profit and loss sharing instead of the interest rate. Therefore, investors in

Islamic banks may need to be more concerned about the accounting methods used for revenue recognition. In Islamic law, there are details about when the revenue should be recognised and when the title of the assets should be transferred. These details might be measured differently in conventional accounting, and therefore may have to be taken into account when preparing an Islamic bank's financial statements.

The type of information that Islamic accounting is required to provide is different from the information provided by conventional accounting. For example, holders of the investment account need to know their exact investment returns and the banks' efficiency and effectiveness in managing their investments. If negligence or misconduct can be proven on the part of the bank or the losses are more than the capital then the bank is liable for the investors' capital and all debt over the capital. It might also be important for them that the accounting information shows the bank's compliance with *Shari'ah*. Unlike conventional banks, Islamic banks have to comply with *Shari'ah*, which has a complete code for running a business; therefore, their accounting standards need to reflect that law. The *Qur'an* also requires Muslims to record all contracts in writing as well as all their daily business transactions to ensure the society is free of personal problems¹.

¹ The longest verse in Quran states: [282] O ye who believe! When ye deal with each other, in transactions involving future obligations in a fixed period of time, reduce them to writing let a scribe write down faithfully as between the parties; let not the scribe refuse to write: as Allah has taught him, so let him write. Let him who incurs the liability dictate, but let him fear his Lord Allah, and not diminish aught of what he owes. If the party liable is mentally deficient, or weak or unable himself to dictate, let his guardian dictate faithfully. And get two witnesses, out of your own men, and if there are not two men, then a man and two women, such as ye choose, for witnesses, so that if one of them errs, the other can remind her. The witnesses should not refuse when they are called on (for evidence). Disdain not to reduce to writing (your contract) for a future period, whether it be small or big: it is juster in the sight of Allah, more suitable as evidence, and more convenient to prevent doubts among yourselves but if it be a transaction which ye carry out on the spot among yourselves there is no blame on you if ye reduce it not to writing. But take witnesses whenever ye make a commercial contract; and let neither scribe nor witness suffer harm. If ye do (such harm), it would be wickedness in you. So fear Allah; for it is Allah that teaches you. And Allah is well acquainted with all things. (Al-Quran,2:282). <http://quran.al-islam.com/Targama/dispTargam.asp?l=arb&t=eng&nType=1&nSora=2&nAya=28>

Nonetheless, Islamic banks face problems when attempting to record some transactions according to *Shari'ah*, where there is no consensus among Islamic banks on accounting methods that should be used (Al-Mehmadi, 2004). As a result, there are some difficulties when comparing the performance of different Islamic banks. Consequently, a number of Islamic banks have raised the issue for the need of Islamic accounting, because they claim that they have some Islamic financial instruments and transactions that are not addressed in the Generally Accepted Accounting Principles (GAAP). In order to resolve this issue, some of the Islamic banks created AAOIFI in Bahrain, which is discussed in the following section.

3.3 THE ACCOUNTING AND AUDITING STANDARDS FOR ISLAMIC FINANCIAL INSTITUTIONS (AAOIFI)²

The interest in developing financial accounting standards for Islamic banks started in 1987, which resulted in the publication of several studies (AAOIFI 2002). In 1991, several practicing accountants and central banks involved in setting up the Financial Accounting Organization for Islamic Banks and Financial Institutions (FAOIBFI) (Karim 1994), more recently known as the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), which is an international, independent non-profit making Islamic institution based in the Kingdom of Bahrain. AAOIFI prepares accounting, auditing, governance, ethical and *Shari'ah* standards for Islamic financial institutions. The objectives of the AAOIFI are:

² Most of the information in this section has been taken from AAOIFI accounting and auditing standards published in 2002.

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- (i) To develop accounting and auditing thoughts relevant to Islamic financial institutions;
 - (ii) To disseminate accounting and auditing thoughts relevant to Islamic financial institutions and its applications through training, seminars, publication of periodical newsletters, carrying out and commissioning of research and other means;
 - (iii) To prepare, promulgate and interpret accounting and auditing standards for Islamic financial institutions;
 - (iv) To review and amend accounting and auditing standards for Islamic financial institutions.

The organization structure of AAOIFI consists of a general assembly of 123 Islamic institutions from 29 countries, 10 from Saudi Arabia alone. The AAOIFI is managed by a board of trustees and a board of accounting and auditing standards, each consisting of 15 members. It also has a *Shari'ah* board consisting of no more than 15 part-time members, an executive committee, and a secretary-general who is a full-time executive and handles the general secretariat (Mustafa, 2003). Like the International Accounting Standards Boards (IASB), AAOIFI is a self-regulatory body; which does not have the power to enforce its respective standards. The AAOIFI depends on the quality of its pronouncements to persuade governments, central banks, monetary authorities, and stock exchanges to support the implementation of its accounting standards in some Islamic countries. Mustafa (2003) added that it would not be an easy jobs for AAOIFI to have all Islamic countries adhere to its standards, because of existing different legislation and regulatory requirements.

According to the Secretary General of AAOIFI, Dr. Mohammed Al Chaar, as mentioned on their website, AAOIFI have now issued 56 standards on accounting, auditing, governance, ethical, and *Shari'ah* standards, including a statement on capital adequacy. Over the years, AAOIFI has taken significant steps to encourage the application and enforcement of its standards throughout the world for the Islamic finance industry. He added that (Al-Chaar 2006):

“We have done so by producing high-quality standards that are internationally recognised and we have made particular effort to ensure that

our standard setting process constitutes strong cooperation amongst interested parties. Recently, the General Assembly has approved the increase of our technical boards, from 15 to 20 members. This decision will further boost the adoption and implementation of AAOIFI's standards where they are either mandatory or used as a guideline by the regulators in jurisdictions such as Bahrain, Sudan, Jordan, Malaysia, Qatar, Saudi Arabia, Dubai and Lebanon. Most recently, Syria has signed an agreement to mandate and adopt AAOIFI's standards.”

In the following sections some of the standards issued by AAOIFI are presented in a brief review.

3.3.1 Accounting Standards Prepared by AAOIFI

The Accounting standards as listed in AAOIFI (2002) are twenty in number; two of them are for the statements of financial accounting; the objectives and the concepts. The rest are about the financial accounting standards. In the following sections, a brief background about each standard issued until 2002 is presented.

3.3.1.1 Standards of objectives of financial accounting for Islamic banks and financial institutions

Human experience proved that any work which does not have clear objectives encounters limitations, conflicts and blurred vision in its implementation. Financial accounting and financial reporting are no exception to this percept. Accounting scholars and practitioners alike have found that the process of developing financial accounting standards without establishing objectives leads to inconsistent standards, which may not be suitable for the environment in which they are expected to be applied. Agreement on the objectives of financial accounting for Islamic banks would achieve many benefits such as:

- 1- The objective will be used as a guide by the Financial Accounting Standards Board for Islamic Banks and Financial Institutions when developing financial accounting standards. This should assure consistency in developing standards;
- 2- The objectives will assist Islamic banks, in the absence of accepted accounting standards, in making choices among alternative accounting treatments;
- 3- The objectives will be available as a guide and a regulator of subjective judgment made by management when preparing the financial statements and other financial reports;
- 4- Establishing objectives should lead to the development of accounting standards which are likely to be consistent with each other. This should increase users' confidence in the financial reports of Islamic banks;

Although there are common objectives between Muslim and non-Muslim users of accounting information such as their desire to increase wealth and realise acceptable returns on their investment and making a good decision, there are differences between the objectives of financial accounting and financial reports for Islamic banks and objectives of financial accounting for conventional banks. Some of the reasons why different objectives of financial accounting should be established for Islamic banks are:

- 1- Islamic banks must comply with the principles and rules of *Shari'ah* in all their financial and other dealings;
- 2- The functions of Islamic banks are significantly different from those of traditional banks who have adopted the western model of banking;
- 3- Unlike conventional banks, Islamic banks do not use interest in their investment and financing transactions, and mobilize funds through investment accounts on the basis of *Mudaraba*, *Musharakah* or deferred payment methods consistent with the *Shari'ah*.

Hence, accounting standards developed for conventional banks may not be relevant to Islamic banks. Nevertheless, in developing accounting standards for Islamic banks, the Board may be guided by clear objectives and concepts which are appropriate for other banks provided they are in compliance with the *Shari'ah*

precepts. As a result, AAOIFI has issued 42 paragraphs to establish the objectives of financial accounting and financial reporting for Islamic banks and financial institutions. In this study, the perceptions of the academics and professionals in the accounting field regarding those objectives of Islamic financial reporting are explored, which could be summarised as the following:

- 1- To provide information about compliance with the Islamic *Shari'ah*;
- 2- To provide information about the Islamic bank's financial resources and related obligations;
- 3- To provide information about sources and uses of the *Zakah* fund;
- 4- To provide information about adequacy of Islamic banks' capital, the risk inherent in its investments and the degree of its liquidity;
- 5- To provide information about ability to generate income and convert it into cash flows;
- 6- To provide information about Islamic bank's discharge of its social responsibilities.

3.3.1.2 Standards of financial accounting concepts for Islamic banks and financial institutions

The statement of concepts of financial accounting of Islamic banks has been prepared to express basic principles of financial accounting. These concepts or basic principles are consistent with the broader view of Islamic principles – a view which does not require that a concept need always to be derived from the *Shari'ah*. Islamic thought accommodates principles, not specifically stated in the *Shari'ah*. Provided that such principles are beneficial or harmless to society and do not violate any precept of *Shari'ah* (AAOIFI, 2002: 26). AAOIFI has issued 135 paragraphs for this standard.

3.3.1.3 Standards of general presentation and disclosure in the financial statements of Islamic banks and financial institutions

This standard consists of 85 paragraphs and is applicable to the financial statements published by Islamic banks to meet the common information needs of the main users of such statements. This standard is applicable to all Islamic banks regardless of their legal form, countries of incorporation, or size (AAOIFI, 2002:64).

Al-Askar (2005) mentioned that the financial statements should reveal several important facts that affect the ability of the user to benefit from the financial statements when making investment decisions and utilizing funds according to the principles of Islamic law (*Shari'ah*). The standard requires that financial statements should reveal details of the usage of *Zakah* and the charitable fund, and usage of the lone fund, as well as other essential information about the bank, the standard currency of accounting, important accounting policies and accounting charges and their affects.

3.3.1.4 Standard of *Murabaha* and *Murabaha* to the purchase orderer

This standard contains 18 paragraphs, is applied to the assets available for sale by *Murabaha* and *Murabaha* to the purchaser, the revenues, expenses, gains and losses attributable to such an asset as well as *Murabaha* receivables. This shall apply whether the Islamic bank buys these assets exclusively from its own funds, from the pool of commingled funds comprising the Islamic bank's own funds and unrestricted investment accounts, or from restricted investment account funds (AAOIFI, 2002:121).

3.3.1.5 Standard of *Mudaraba* financing

This standard contains 21 paragraphs, which is applied to *Mudaraba* financing transactions carried out by the Islamic bank as a provider of funds and the transactions related to the capital provided by the Islamic bank to be used in a

Mudaraba, from the time of its inception to the time of its completion. This applies whether the Islamic bank finances the *Mudaraba* capital exclusively from its own funds, from the pool of commingled funds comprising the Islamic bank's own funds and unrestricted investment accounts or from restricted investment accounts. The standard shall also apply to the transactions pertaining to the Islamic bank's share in *Mudaraba* profits or losses (AAOIFI, 2002:145).

3.3.1.6 Standard of *Musharaka* financing

This standard consists of 19 paragraphs, which is applied to *Musharaka* financing transactions carried out by Islamic banks whether by means of a constant *Musharaka* (short or long-term) or a diminishing *Musharaka* (one which ends in transferring ownership to one party). This shall apply whether the Islamic bank finances its share in *Musharaka* capital exclusively from its own funds, from the pool of commingled funds comprising the Islamic bank's own funds and unrestricted investment accounts or from restricted investment accounts. The standard also applies to the transactions pertaining to the Islamic bank's share in *Musharaka* profits or losses (AAOIFI, 2002:168).

3.3.1.7 Standard of disclosure of basis for profit allocation between owners' equity and investment account holders

This standard consisting of 17 paragraphs is aimed at disclosure for profit allocation between owners' equity and investment account holders and is applicable to the financial statements published by Islamic banks to meet the common information needs of the main users of such statements. This standard is applicable to all Islamic banks regardless of their legal form, countries of incorporation or size (AAOIFI, 2002:192).

3.3.1.8 Standard of equity of investment account holders and their equivalent

This standard addresses the accounting rules relating to funds received by the Islamic bank for investment in its capacity as a *Mudarib* at the Islamic bank's discretion, either in whatever manner the Islamic bank deems appropriate (equity of unrestricted investment account holders) or subject to certain restrictions (equity of restricted investment account holders). This standard consists of 19 paragraphs (AAOIFI, 2002:204).

3.3.1.9 Standard of *Salam* and Parallel *Salam*

This standard contains 21 paragraphs addressing the accounting rules of *Salam* financing and parallel *Salam* transaction. This includes the treatment of *ras-almal* paid by the Islamic bank in a *Salam* transaction or what it receives in a parallel *Salam* transaction, the receipt and sale of *al-muslam fihi* in *Salam* transaction or the delivery of its like in a parallel *Salam* transaction. The standard also includes the treatment of revenues, expenses, gains and losses relating to *Salam* financing and parallel *Salam* transactions (AAOIFI, 2002:223).

3.3.1.10 Standard of *Ijarah* and *Ijarah* ending with ownership (*Muntahia Bittamleek*)

This standard consists of 88 paragraphs, addresses the accounting rules relating to *Ijarah* and *Ijarah muntahia bittamleek* in which the Islamic bank is a lessor or a lessee, including the acquisition of assets for *Ijarah*, *Ijarah* expenses, revenues, gains and losses (AAOIFI, 2002:243).

3.3.1.11 Standard of *Zakah*

This standard contains 21 paragraphs which is applied to the accounting treatments related to the determination of the *Zakah* base, measurement of items included in the

Zakah base and disclosure of *Zakah* in the financial statements of the Islamic bank (AAOIFI, 2002:276).

3.3.1.12 Standard of *Istisna'a* and Parallel *Istisna'a*

This standard contains 47 paragraphs addressing the accounting rules of *Istisna'a* and Parallel *Istisna'a* contracts in the financial statements of Islamic banks relating to measuring and recognizing the costs and revenues from *Istisna'a* and Parallel *Istisna'a*, the gains and losses accruing there from, and their presentation and disclosure in the financial statements of the Islamic bank (AAOIFI, 2002:300).

3.3.1.13 Standard of Provisions and Reserves

The standard of provisions and reserves aims to set out accounting rules for recognising, measuring, presenting and disclosing the provisions which are formed by Islamic banks and financial institutions to revalue their receivables, financing and investment assets. In addition, the standard aims at setting out the accounting rules for the reserves which the Islamic bank assets aside, either from the *Mudaraba* income, before allocating the *Mudarib* share, to maintain a certain return on investment (profit equalisation reserve) or from the profit of the investment account holders, after allocating the *Mudarib* share, to cater against future losses for investment account holders (investment risk reserve). This standard is applied to the provisions formed by the Islamic bank to revalue its receivables, financing and investment assets. However, if losses have occurred relating to off-balance sheet items, provisions are made for such losses. The standard is also applied to the reserves set aside by the Islamic bank, either from the *Mudaraba* income, before allocating the *Mudarib* share (profit equalisation reserve), or from the profit of investment account holders, after allocating the *Mudarib* share (investment risk reserves). This standard consists of 30 paragraphs (AAOIFI, 2002:332).

3.3.1.14 Standard of general presentation and disclosure in the financial statements of Islamic insurance companies

This standard, which contains 79 paragraphs, defines the financial statements that should be periodically published by the companies to satisfy the common information needs of users of financial reports. The standard also establishes the general principles for the presentation of information and defines certain information that should be disclosed in the financial statements of the companies in order to achieve the objectives of accounting and financial reports within the mechanism of financial accounting (AAOIFI, 2002:352).

3.3.1.15 Standard of disclosure of basis for determining and allocating surplus or deficit in Islamic insurance companies

This standard consists of 20 paragraphs and the purpose of these standards is to establish the rules that regulate the disclosure of the basis for determining and allocating surplus or deficit in Islamic insurance companies in order to present reliable and relevant information to assist users of financial statements in their economic decision making (AAOIFI, 2002:393).

3.3.1.16 Standard of investment funds

This standard containing 67 paragraphs and is applied to funds, which are established and managed in accordance with Islamic *Shari'ah* rules and principles, and are financially independent of the institutions that establish them. The funds may or may not be managed by the institutions that establish them, and may or may not be separate legal entities. Various investors contribute to the capital of these funds in the form of shares or units of equal value, which represent ownership claims to the assets of the funds and entitlement to profits or losses (AAOIFI, 2002:409).

3.3.1.17 Standard of provisions and reserves in Islamic insurance companies

This standard consists of 23 paragraphs, which is applied to the main technical provisions that are established by the companies for general insurance operations (property and casualty insurance). The standards are also applied to:

- a) The deficit reserves which are set aside by the company from the surplus before it is allocated to policyholders, to make provision against future losses;
- b) The equalisation reserves which are established by the company to mitigate the effect of exceptionally high loss ratios for classes of insurance operations displaying a high degree of claims volatility (AAOIFI, 2002:438).

3.3.1.18 Standard of foreign currency transactions and foreign operations

This standard contains 29 paragraphs and sets out the accounting rules for recognizing, measuring, presenting and disclosing transactions in various currencies other than the reporting currency of the Islamic bank, whether such transactions relate to assets, liabilities, off-balance sheet items, revenues, expenses, gains or losses in the financial statements. The standard also covers accounting for net investments in foreign operations of an Islamic bank which prepares its financial statements in a currency which is different from the reporting currency of the Islamic bank (foreign operations). The examples of such foreign operations are branches, subsidiaries which prepare their financial statements in a currency which is different from the reporting currency of the Islamic bank. The standard also applies to foreign currency transactions and foreign operations in the statements of changes in restricted investments (AAOIFI, 2002:454).

3.3.1.19 Standard of investments

The standard consisting of 46 paragraphs is applied to the institution's investments, whether in the form of direct investments, investment funds or investment portfolio,

in *sukuk* (Islamic bonds), shares, and real estate. The funds invested represent either the institutions' own funds, the funds of unrestricted investment accounts or both or the funds of restricted investment accounts (AAOIFI, 2002:473).

3.3.1.20 Standard for Islamic financial services offered by conventional institutions

This standard contains 17 paragraphs, which is applied to the institutions which offer Islamic financial services in addition to their conventional services. This standard sets out the accounting rules only for the Islamic financial services offered by these institutions (AAOIFI, 2002:493). The researcher used this standard to measure the perceptions of academics and professionals towards the AAOIFI accounting standards especially for Islamic windows in the conventional banks in Saudi Arabia. The researcher listed three statements in the questionnaire which reflects paragraph 6, 11 and 12 of this standard to assess their view regarding it. The statements in the questionnaire are as follows:

- 1- Islamic windows in Saudi Arabia must prepare supplementary statements to be published in the notes of the financial statements of the conventional banks;
- 2- Islamic windows in Saudi Arabia must disclose whether or not they mingle funds relating to Islamic financial services with funds relating to conventional financial services;
- 3- Islamic windows in Saudi Arabia must disclose, in detail, the sources and applications of funds mobilised and invested by their Islamic financial services.

3.3.2 Auditing Standards Prepared by AAOIFI

Auditing standards as listed in AAOIFI (2002) has 4 standards: the first one is about objectives and principles of auditing; the second is about the auditors' report; the

third is about terms of auditing engagement and the last standard is about testing for compliance with *Shari'ah* rules and principles by an external auditor. In the following, a brief background about each standard issued until 2002 is given.

3.3.2.1 Standard of objectives and principles of auditing

This standard contains 14 paragraphs, the purpose of which is to develop the basis for instructions regarding the objectives and general principles that govern the auditing of financial statements prepared by Islamic banks and Islamic financial institutions. This standard relates to the auditing of financial statements, with the aim of allowing the auditor to declare his opinion on whether or not the financial statements have been prepared according to the regulations and rules of Islamic *Shari'ah* and the accounting standards which have been issued by AAOIFI, as well as the related local accounting standards and practices, and related laws and regulations that are applied in the country in which the financial institution is operating (Al-Askar 2005).

3.3.2.2 Standard of the auditor's report

This standard consists of 47 paragraphs, the purpose of this Auditing Standard for Islamic Financial Institutions (ASIFI) is to establish standards and provide guidance on the form and content of the auditor's report issued as a result of an audit performed by an independent auditor of the financial statements of a financial institution which conducts business in conformity with Islamic *Shari'ah* principles. Much of the guidance provided can be adapted to the auditor's reports on financial information other than financial statements.

The auditor should review and assess the conclusions drawn from the audit evidence obtained as the basis for the expression of an opinion on the financial statements. This review and assessment involves considering whether the financial statements have been prepared in accordance with the accounting standards of the Accounting

and Auditing Organization for Islamic Financial Institutions (AAOIFI) and relevant national standards or practices. It will also be necessary to consider whether the financial statements comply with statutory requirements. The auditor's report should contain a clear written expression of opinion on the financial statements taken as a whole (AAOIFI, 2002:11).

3.3.2.3 Standard of terms of audit engagement

The ASIFI consists of 29 paragraphs, the main points are:

- 1- Agreeing the terms of engagement with the Islamic financial institution (client);
- 2- The auditor's response to a request by a client to change the terms of an engagement to one that provides a lower level of assurance;
- 3- The auditor and the client should agree on the terms of the engagements;
- 4- The agreed terms would need to be recorded in an audit engagement letter or other suitable form of contract.

This ASIFI is intended to assist the auditor in the preparation of engagement letters relating to audits of Islamic financial institutions' financial statements. The standard is also applicable to related services. When other services such as tax, accounting, or management advisory services are to be provided, separate letters may be appropriate to distinguish clearly the statutory audit from other services (AAOIFI, 2002:25).

3.3.2.4 Standard of testing for compliance with *Shari'ah* rules and principles by an external auditor

The purpose of this Auditing Standard for Islamic Financial Institutions (ASIFI), which consists of 18 paragraphs, is to establish standards and provide guidance on the subject of testing for compliance with *Shari'ah* rules and principles by an external auditor in connection with the audit of the financial statements of a financial institution which conducts business in conformity with Islamic *Shari'ah* rules and principles. When testing for *Shari'ah* compliance, the auditor shall obtain sufficient appropriate audit evidence that provides the auditor with reasonable assurance that

the Islamic financial institution (IFI) has complied with Islamic *Shari'ah* rules and principles. As discussed in ASIFI, reasonable assurance is “the concept relating to the accumulation of the audit evidence necessary for the auditor to conclude that there are no material misstatements in the financial statements taken as a whole. Reasonable assurance relates to the whole audit process.” ASIFI also states that, “Reasonable assurance also means that the auditor has satisfied himself that the transactions he examined during his audit comply with Islamic *Shari'ah* Rules and Principles as determined by the *Shari'ah* Supervisory Board of the financial institution” (AAOIFI, 2002:38).

3.3.3 Governance Standards Prepared by AAOIFI

Governance standards as listed in AAOIFI (2002) are four standards. The first one is about appointment, composition and report of the *Shari'ah* Supervisory Board. The second is about the *Shari'ah* review. The third is about the internal *Shari'ah* review and the last standard is about the audit and governance committee for Islamic Financial Institutions. In the following, the researcher will give a brief background about each standard issued until 2002.

3.3.3.1 Standard of appointment, composition and report of the *Shari'ah* supervisory board

Consisting of 27 paragraphs, the purpose of this Governance Standard for Islamic Financial Institutions (GSIFI) is to establish standards and provide guidance on the definition, appointment, composition, and report of the *Shari'ah* supervisory board for ensuring compliance of Islamic financial institutions in all its dealings and transactions with Islamic *Shari'ah* rules and principles (AAOIFI, 2002:5).

3.3.3.2 Standard of *Shari'ah* review

Consisting of 18 paragraphs, the purpose of this Governance Standard for Islamic Financial Institutions (GSIFI) is to establish standards and provide guidance to assist *Shari'ah* Supervisory Boards (SSB) of Islamic Financial Institutions (IFIs) in performing *Shari'ah* reviews to ensure compliance with Islamic *Shari'ah* rules and principles as reflected in the *Fatwas*, rulings and guidelines issued by them (AAOIFI, 2002:15).

3.3.3.3 Standard of internal *Shari'ah* review

Consisting of 30 paragraphs, the purpose of this Governance Standard for Islamic Financial Institutions (GSIFI) is to establish standards and provide guidance on the internal *Shari'ah* review in institutions which conduct business in conformity with Islamic *Shari'ah* rules and principles. The standard covers the following:

- 1) Objectives;
- 2) Internal *Shari'ah* review;
- 3) Independence and objectivity;
- 4) Professional proficiency;
- 5) Scope of work;
- 6) Performance of the internal *Shari'ah* review work;
- 7) Management of the internal *Shari'ah* review;
- 8) Quality assurance and
- 9) Elements of an effective internal *Shari'ah* review control system.

The standard also covers responsibility for its implementation (AAOIFI, 2002:23).

3.3.3.4 Standard of audit and governance committee for Islamic financial institutions

Consisting of 15 paragraphs, the purpose of this Governance Standard for Islamic Financial Institutions (GSIFI) is to define the role and responsibilities of an Audit & Governance Committee (AGC) for an Islamic financial institution (IFI). In addition, the standard outlines the conditions for forming the committee and specifies the requirements necessary for the committee to be deemed effective (Al-Askar 2005).

3.3.4 Ethics Codes Prepared by AAOIFI

AAOIFI issued two codes of ethics, the first code is for accountants and auditors of Islamic financial institutions and the second code is for the employees. In the following two sections, the researcher will give a brief background about each code of ethics issued until 2002.

3.3.4.1 Code of ethics for accountants and auditors for Islamic banking and financial institutions

Accounting is one of the professions that are required by *Shari'ah* as *fard kifayah* (a collective religious duty which, if performed by some, would exempt others from performing it. However, if it is not performed by any, the entire community is sinful). In addition to its technical definition, accounting is a means to fulfil a *Shari'ah* requirement, namely to record, measure and allocate rights fairly among claimants. The concept of fairness (justice) is mentioned in the Holy *Qur'an* in the following verses:

“Allah commands justice, the doing of good; and Allah doth command you to render back your trusts to those to whom they are due; And when ye judge between people that ye judge with justice.”

The concept of fairness has a counterpart in accounting thought known as 'freedom from bias'. Though accounting and auditing standards lead, in principle, to the realisation of this concept, fairness is an ethical value and hence there is a need for a code of ethics that guides professional accountants in the performance of their professional duties and services. In order for the code of ethics to have moral persuasion, there must be a solid and legitimate source from which its ethical foundations and principles may be derived. This will provide the necessary grounds for complying with the code's requirements. The currently available codes of professional ethics for accountants are based purely on human thought. Enforceability of these codes hinges on professional commitment, desire for the flourishing of the profession and for gaining the trust of clients and the public at large; or it may be a legal requirement. From an Islamic perspective, the ethics of accountants or auditors (accountants) depends primarily (in addition to all previous bases) on the principles and rules of Islamic faith and *Shari'ah*. Furthermore, *Shari'ah* principles and rules confer on these ethics potential enforceability which stems from the permanent and constant religious incentives that surpass in their purposes all other incentives. Moreover, ethical principles derived from *Shari'ah* enjoy certain attributes which characterise *Shari'ah* such as universality and both permanence and flexibility. Because accounting is a profession that is sensitive to the values and ethics of society, the values and ethics of Islamic society must affect the profession in such a society or community. Therefore, in such a society or community Islamic values and ethics must be reflected in the personal profile as well as the formal education and professional training of the accountant and in observed practice. The rules of ethical conduct stated in this code shall apply to internal accountants and internal auditors of Islamic financial institutions (IFI) as well as to external auditors alike, except where the wording of the rules indicate otherwise. Professional accountants shall be held responsible for compliance with the rules of this code on the part of their assistants and subordinates (AAOIFI, 2002:5).

3.3.4.2 Codes of ethics for the employees of Islamic financial institutions

Working for Islamic financial institutions is one of the professions which, according to Islamic *Shari'ah*, should be established and given due consideration. This is

because all useful and legitimate professions are required by the *Shari'ah* as *fardh kifaya* (a collective religious duty such as that, if it is performed by some person or persons in a community, other members of that community are exempted from the need to perform it; however, if it were not performed by anybody, the entire community would be sinful). Furthermore, associated with this profession is the duty of implementing the rules and principles of Islamic *Shari'ah* in managing the funds and investing them in a lawful manner, in order to both benefit the owners of the funds and to pay from the investment proceeds the financial obligations (*Zakah*) and other voluntary dues (*sadaqat*), without the risk of being subjected to these obligations.

In order to fulfil the requirements of this profession, it is necessary to comply with the rules and principles of Islamic *Shari'ah*, and to follow a code of ethics that gives guidance to the employees working in the institutions regarding the values which they must observe in their professions.

A lack of ethical conduct is likely to lead to the non-fulfilment of the obligations of the job and may lead to misappropriation of assets which are held in trust, whether the assets are from public funds or from private funds that belong to third parties (shareholders or investment account holders). Ethics which are derived only from materialistic concepts are insufficient in the context of religious ethics. In addition to realizing commercial objectives, the ethics drawn from the Islamic *Shari'ah* rules and principles requires personal compliance which is safeguarded by self-control and self-accountability as well as accountability in the hereafter.

This Code of Ethics is aimed at all employees of the institutions at all levels. It lays down a framework for the ethics of these employees which is derived from the rules and principles of Islamic *Shari'ah*. It is also based on the code of ethics currently in use by the banking profession insofar as it does not conflict with the rules and principles of Islamic *Shari'ah*. This should motivate the employees of the institutions to comply with the Code, as they will be driven by their religious conviction and desire to observe the commandments of God and to avoid what he has prohibited (AAOIFI, 2002:19).

3.4 ISLAMIC FINANCIAL SERVICES BOARD (IFSB)

As an additional regulatory body, the IFSB has been created in Kuala Lumpur, Malaysia, in 2002 at the end of a two year process of collaboration between several governors of Central Banks, the Islamic Development Bank (IDB), the International Monetary Fund (IMF) and the AAOIFI. It has a role similar to Basel Committee on banking supervision in conventional banking, for the regulation and supervision of Islamic banking. The proposed establishment of a standard-setting body for introducing new or adopting existing international prudential standards for IFIs is the result of the efforts of AAOIFI, the IDB, the IMF and the central banks of several Islamic countries. The primary objective of the IFSB is to develop uniform regulatory and transparency standards similar to Basel Committee standards that are targeted to address characteristics specific to IFIs. Consequently, the fundamental areas where the IFSB is active are risk management, capital adequacy, corporate governance and market discipline (Danneaux 2005).

Keeping in mind the national financial environments, international standards, core principles, and good practices, the AAOIFI took the lead in defining regulatory standards. It is hoped that AAOIFI's lack of enforcement powers will be mitigated by the IFSB (Iqbal and Mirakhor 2002). The IFSB have issued three standards and exposure drafts of another two standards as the following:

- 1- Guiding Principles on Corporate Governance for Institutions Offering Only Islamic Financial Services (Excluding Islamic Insurance (*Takaful*) Institutions and Islamic Mutual Funds);
- 2- Guiding Principles of Risk Management for Institutions (other than Insurance Institutions) offering only Islamic Financial Services (IIFS);
- 3- Capital Adequacy Standard for Institutions (other than Insurance Institutions) offering only Islamic Financial Services (IIFS).

Standards Exposure Drafts:

- 1- Disclosures to Promote Transparency and Market Discipline for Institutions Offering Islamic Financial Services (excluding Islamic Insurance (*Takaful*) Institutions and Islamic Mutual Funds);
- 2- Guidance on Key Elements in the Supervisory Review Process of Institutions Offering Islamic Financial Services (excluding Islamic Insurance (*Takaful*) Institutions and Islamic Mutual Funds).

3.5 CONCLUSION

This chapter presented a general background about Islamic accounting and AAOIFI accounting and auditing standards as well as a brief overview about Islamic financial services boards (IFSB). The implementation of AAOIFI's accounting standards has recently received considerable attention from professionals such as preparers of financial statements like the managers and external auditors and academics in the field of accounting. The main purpose of this study is to examine the academics, external auditors and employees in the Islamic banks, in particular their perceptions and attitudes towards the implementation of AAOIFI accounting standards in Saudi Arabia.

Chapter 4

THE FINANCIAL & ACCOUNTING DEVELOPMENT IN SAUDI ARABIA

4.1 INTRODUCTION

This research concerns the importance of Islamic banks' financial statements and the need to for apply AAOIFI accounting standards in the Islamic banks in Saudi Arabia. It is, therefore, necessary to present background information on the Kingdom of Saudi Arabia, to understand its dynamics. This chapter, hence, focuses on the politics, economics, financial and accounting system in the Kingdom.

4.2 AN OVERVIEW OF THE KINGDOM OF SAUDI ARABIA

The Kingdom occupies approximately 2,250,000 square kilometres (868,730 square miles), is bounded on the north by Jordan, Iraq and Kuwait; on the east by the Gulf, Bahrain, Qatar and the United Arab Emirates; on the south by the Sultanate of Oman and Yemen; and on the west by the Red Sea. Riyadh is the capital city. However, Makkah and Medina are also important cities due to the location of the two holy sites in Islam. Based on a population and housing census taken in 2004, the population of the Kingdom of Saudi Arabia is 23.08 million, 16.83 million are nationals and 6.25 million are foreigners who work and live in the country.

4.2.1 THE POLITICAL SYSTEM

The governmental system in the Kingdom of Saudi Arabia is monarchy. In August, 2005, Abdullah bin Abdul-Aziz became the sixth King of Saudi Arabia and the Prime

Minister. Prince Sultan Bin Abdul-Aziz is the Crown Prince and the Deputy Prime Minister.

The government structure consists of the Council of the Ministers and Majlis Al-Shura (The Consultative Council), which are the main legislative bodies that have the authority to introduce and approve public policy (Basheikh 2002).

4.2.1.1 THE COUNCIL OF MINISTERS

The Council of Ministers was established in 1953 by King Abdul Aziz bin Abdul-Rahman Al Saud. Under the bylaws promulgated in September 1993 by King Fahd bin Abdul-Aziz, the Council has responsibility for drafting and overseeing the implementation of internal, external, financial, economic, educational and defense policies,. The Council meets weekly, currently on Mondays, and is presided over by the King or his deputy¹.The council of Ministries includes the King, the Prime Minister, Crown Prince and first deputy Prime Minister, and Ministers of the following departments: Ministry of Agriculture, Ministry of the Civil Service, Ministry of Commerce and Industry, Ministry of Communications and Information Technology, Ministry of Culture and Information, Ministry of Defense and Aviation, Ministry of Economy and Planning, Ministry of Education, Ministry of Finance, Ministry of Foreign Affairs, Ministry of Hajj, Ministry of Health, Ministry of Higher Education, Ministry of the Interior, Ministry for Islamic Affairs, Endowment, *Dawa* and Guidance, Ministry of Justice, Ministry of Labor, Ministry of Municipal and Rural Affairs, Ministry of Petroleum and Mineral Resources, Ministry of Social Affairs, Ministry of Transport and Ministry of Water and Electricity².

¹This info taken from "The Saudi Arabian Information Resource" [<http://www.saudinf.com/main/c51.htm>] accessed on 6/7/2007.

² This info taken from "The Saudi Arabian Information Resource" [<http://www.saudinf.com/main/c6.htm>] accessed on 6/3/2007.

4.2.1.2 THE CONSULTATIVE COUNCIL (*MAJLIS AL-SHURA*)

The Consultative Council, known as the *Majlis Al-Shura* (established by Royal Decree No. A/91, dated 27-8-1412) marked a significant move towards the formalization of a participative nature of government in Saudi Arabia. The Consultative Council was inaugurated by King Fahd himself in December, 1993. The announcement of the establishment of the Council coincided with the tenth anniversary of the accession of King Fahd to the throne and was accompanied by details of a new "basic law", which clearly marked the first steps towards a more broadly based involvement in the Kingdom's political processes. The primary function of the *Majlis Al-Shura* is to provide the King with advice on issues of importance in the Kingdom³.

Majlis Al-Shura consists of a chairman, deputy chairman, the secretary-general of the *Majlis Al-Shura* and sixty well-educated and qualified members to be selected by the King (Basheikh 2002). In 2005, the Council increased its number to 150 and gave more powers designed to mark a significant step in moving the Council beyond its purely advisory role. *Majlis Al-Shura* may express its opinion on the general policies of the State referred to it by the Prime Minister. It may in particular:

- (a) Discuss and express its opinion of the general economic and social development plan;
- (b) Study laws, regulations, treaties, international agreements and concessions, and offer its comments thereon;
- (c) Interpret laws;
- (d) Discuss and make suggestions concerning the annual reports submitted by various ministries and other government bodies.⁴

³This info taken from "The Saudi Arabian Information Resource" [<http://www.saudinf.com/main/c52.htm>] accessed on 6/3/2007.

⁴ *Majlis Al-Shura* Article 15.

4.3 THE FINANCIAL SYSTEM IN SAUDI ARABIA

The Kingdom of Saudi Arabia has an advanced banking system in terms of quality of service and efficiency of regulation. Its stock market is one of the largest in terms of market capitalization in the Arab and Islamic worlds after overtaking the Kuala Lumpur Stock Exchange in 2003. Despite this impressive achievement which culminates in the various achievements realized during the previous development plans, particularly the Seventh Plan, the financial services sector will continue to face some internal and external developments which involve many challenges.

At the internal level, the major challenge lies in the growing need to increase the sources of finance for the private sector to enable it to contribute to economic growth, development and the creation of more job opportunities for Saudi nationals. This will entail the enhancement in terms of widening and deepening of bank finance operations as well as funding of the private sector through the domestic capital market. The new Capital Market Law is expected to address this challenge through provision of an efficient regulatory framework for capital market operations.

At the external level, the most pressing and immediate challenges are represented by the Kingdom's accession to the WTO, the need for the banking sector to meet the requirements of the new Basel Capital Accord (Basel II), currently being developed by the Bank of International Settlement (BIS), as well as the process of Gulf integration including the use of a unified currency by 1430 (2010). To address these challenges, the financial services sector should be enhanced to make it more competitive at national and international levels. Another challenge lies in the ability to absorb the Saudi private capital repatriated during 2002 and 2003 following the remarkable improvement in performance of the Saudi stock market. The Capital Market Law is expected to facilitate the absorption of the increasing level of domestic private savings in the desired fields of investment (Saudi Arabian Ministry of Planning 2005).

In the following section, a brief profile will be presented about the Saudi Arabian Monetary Agency (SAMA), banking system and regulation including Shari'ah compliant banks in Saudi Arabia. Lastly, a general view of the Saudi stock market and the Capital Market Authority will be provided.

4.3.1 THE SAUDI ARABIAN MONITORY AGENCY (SAMA)

Saudi Arabian Monetary Agency (SAMA), the central bank of Saudi Arabia, was established in 1952. SAMA has been playing a crucial role in the consolidation and development of the Saudi financial system. At the time of its establishment, the Kingdom did not have a monetary system exclusively of its own. Foreign currencies circulated in the Kingdom as a medium of exchange, along with Saudi silver coins. Saudi banknotes had not yet been issued. There was no Saudi bank in existence and the banking business was being conducted by foreign bank branches. One of the foremost tasks of SAMA in its early stage was the development of a Saudi currency.

SAMA paid special attention to the need for promoting the growth of a national banking system. From 1960 to 1972, SAMA focused on banking regulations against the background of expanding banking business and the Kingdom's acceptance of full convertibility of the Riyal in March 1961 in accordance with the Article VIII of the Articles of Agreements of the IMF. From 1973 to 1982, SAMA's preoccupation was to contain inflationary pressures in the booming economy, expansion of the banking system and manage the massive foreign exchange reserves. From the mid 1980s, SAMA's priorities have been to introduce financial market reforms. Over the years, due to the growth of the economy and expansion of the financial system, SAMA's responsibilities have increased several folds.⁵

⁵ This info has been taken from SAMA website: [<http://www.sama.gov.sa/en/about/history.htm>].

4.3.1.1 THE INSTITUTE OF BANKING (IOB)

SAMA has supported the banking industry through developing human resources by establishing the Institute of Banking, which contributes to training and qualifying a large number of national cadres in the financial services sector. The Institute continues to professionally exercise this role and makes efforts to cope with the developments in the financial and banking sector by providing information solutions and diverse educational programs consistent with individual bank needs (Al-Sayari 2006).

The Institute was first established by the Saudi Arabian Monetary Agency in 1965 under the name of "Institute of Banking Training" At that time, the institute provided only conventional academic education where the trainees, who were banking sector employees, were granted a diploma in banking and financial studies after successfully passing the courses. With the acceleration of the development of the banking business and the increasing introduction of advanced technologies in the banking sector, it became essential to change the Institute's goals and strategies to respond to such changes and to cope with the expectations of the leaders of the banking and financial sectors. In 1989, SAMA established the present institute under the new name of "The Institute of Banking" (IOB).⁶

The objectives of the institute of Banking (IOB) are:

- (i) To be the recognized qualification and accreditation body in the Kingdom of Saudi Arabia for professional practitioners in the banking and financial services sector;
- (ii) To design, develop, and deliver need-based, professional education and training programs in the field of banking and finance;
- (iii) To engage in need-based applied research and provide information services to the financial services sector;

⁶ This info has been taken from IOB website: [<http://www.iobf.org/content/aboutiob.asp>].

- (iv) To develop a pool of Saudi experts capable of creating, adapting, and diffusing innovative knowledge and skills in the area of banking and finance;
- (v) To become an active member of an international network of experts and institutions in the field of banking and finance.

The issue of *Shari'ah* (Islamic Law) compliant banking is increasingly drawing attention of those concerned with financial stability, including international financial institutions such as the International Monetary Fund (IMF), World Bank (WB), development banks, Basel Committee on Banking Supervision as well as supervisory authorities in the countries where Islamic banks operate. This is the result of rapid growth in the volume and scope of Islamic services offered in many countries. Those entities have shown a great interest in the growth and expansion of finance businesses compliant with the principle of avoiding interest and its impact in relation to world markets and the global economic system. Currently, *Shari'ah* compliant banking transactions have spread in most countries of the world through banks that totally comply with *Shari'ah* or through *Shari'ah* compliant windows offering all services, investment and commercial activities, leasing, investment funds and joint liability products.

The Kingdom has been a forerunner country in supporting and encouraging Saudi banks to offer such products required by the Saudi market. All Saudi banks now provide a range of products that are compliant with *Shari'ah* requirements and with financial engineering specifications of the highest levels under the supervision of well-reputed *Shari'ah* committees and top class financial professionals.

In the context of supporting such efforts, SAMA's IOB has offered many programs, courses and symposia's in the area of developing, marketing and supervising *Shari'ah* compliant products. The number of bankers benefiting from those programs stood at 6,300 who participated in 374 programs during the last seven years. These endeavors have considerably helped in developing Islamic banking in Saudi Arabia without undermining compliance with Islamic *Shari'ah* or the technical flexibility needed by an

emerging and dynamic market (Al-Sayari 2007). The courses in Shari'ah-Compliant Banking provided by IOB covers the following subjects:

Principles of Shari'ah-Compliant Banking;
Forms of Shari'ah-Compliant Financing;
Accounting Standards for Shari'ah-Compliant Banking;
Budget Preparation and Follow-up for Shari'ah-Compliant Banking;
Shari'ah-Compliant Mutual Funds;
Leasing Under Shari'ah-Compliant Financing;
Forms of Murabahah;
Letters of Credit under Murabahah and Musharakah;
Internal Audit for Shari'ah-Compliant Banking;
Introduction to Shari'ah Audit;
Marketing and Selling Shari'ah-Compliant Banking Products;
Credit Cards in Shari'ah Compliant Banking;
Shari'ah Compliant Investment Sukuk;
Risk Management According to Basel II Workshop;
Shari'ah Compliant Banking Products Developments.

4.3.2 HISTORY OF BANKS IN SAUDI ARABIA

There were no banks during the pre-oil period in the kingdom of Saudi Arabia. The Ottoman Bank, a Franco-British institution which had expanded throughout the Arab world in the late nineteenth century and established a branch in Alexandria in 1867, did not see it as worthwhile to expand its branch network to the Hejaz or al-Hasa, the major centres of Ottoman commerce in the west and the east of the Arabian peninsula. Barter and cash transactions were widespread and prevailed, but supplier credits were normal in trade and money changers often provided loans on an unofficial basis. The latter were an established part of the *souk* economy, particularly in the cities of the Hejaz, Jeddah, Makkah and Medina, where there was much demand from pilgrims performing *Hajj* to

change coins and valuable metals, primarily gold, into Saudi Arabian silver riyals (Wilson, Al-Salamah et al. 2004).

The Kingdom's founder (King Abdulaziz), was doubtful of banks and saw little need for such institutions, and the *Shari'ah* scholars were both aware of the prohibition of *riba* and hostile to the notion of foreign institutions serving local Muslims. By the early twentieth century there was in any case an expansion in the number of money changers in the Heijaz with an increasing volume of pilgrims visiting Makkah and Medina as transportation by road, rail and sea became easier and quite cheaper. Most money changers operated from a single company, but some – remarkably the Mahfouz and Musa Kaki families – had several outlets in different geographical locations. Like many of the money changers and traders in the Heijaz, they originated from Yemen (Wilson, Al-Salamah et al. 2004).

The first foreign banking institution in Saudi Arabia was Dutch and opened in 1928 largely to provide money-changing facilities for pilgrims setting out from Java in the then Dutch East Indies, it was referred to as a trading company – the Netherlands Trading Society – rather than a bank as the King objected to that designation, because of its *riba* connotations, though it actually performed a range of banking functions including trade-financing facilities. The financing of imports from Britain was handled from the Jeddah office of the trading firm of Gellatly Hankey, which from the 1920s acted as agent for the British overseas banks. In 1936 Bank Misr of Egypt applied for permission to open a bank in Jeddah to serve both Egyptian pilgrims and Red Sea trade, however its request was rejected due to suspicions among the ruling family regarding Egyptian intentions; it was felt that if a banking licence was to be granted for a substantial operation this should be to Saudi Arabian nationals (Wilson, Al-Salamah et al. 2004).

The Mahfouz and Musa Kaki families petitioned the King for permission to establish the first locally owned bank in 1937, with the result that the following year the Kaki Salih

Company (later renamed the National Commercial Bank) opened for business in Jeddah, with 51.5 per cent of its capital owned by Bin Mahfouz and the remaining share by the Musa Kaki family, in many respects the new institution was similar to the traditional money changers with whom it competed, but as a formal bank it was able to issue letters of credit on behalf of Saudi Arabian merchants which represented guarantees to Western exporters that payments would be made, either by the importers or by the bank itself in case of default. Although the bank was unregulated, foreign banks, knowing it had the King's support, were prepared to accept its letters of credit on behalf of their exporting clients (Wilson, Al-Salamah et al. 2004).

The government of Saudi Arabia itself conducted much of its foreign exchange business through the Netherlands Trading Company, mainly because it was able to secure longer deferred payments terms, as in the early years of oil production revenues were not large. However, oil revenues increased noticeably in the late 1940s, and although some payments were received in the form of silver and gold there was an increasing supply of dollar notes. The French Banque de l'Indochine, which had extensive dealings in precious metals in South-East Asia, offered to exchange the dollar notes for gold sovereigns and silver riyals at favourable rates of exchange for the King. The bank already had offices in Djibouti on the African side of the Red Sea, as well as in Lebanon and Syria, and in 1947 the King gave his permission – to its representative, Christian Delaby – to open a branch in Jeddah the following year (Wilson, Al-Salamah et al. 2004).

King Abdulaziz's Finance Minister (Sheikh Abdullah Sulayman) gradually realised that this haphazard approach of relying on foreign banks for the government's own financing needs was insufficient, but there was also a disinclination to favour one group of local financiers such as the Bin Mahfous family, over others. The main problem facing the government was the variation in the price of silver, on which the riyal was based, and gold, on which the Saudi sovereign was based. Britain's ambassador advocated the setting up of a currency board similar to those existing in many British colonies, and a

treasury official was dispatched from Whitehall to make the case for a Saudi dinar, to be a parity with the British pound, with the Kingdom – like its neighbours, Iraq and Egypt – as part of the sterling area (Wilson, Al-Salamah et al. 2004).

The King distrusted the British, and was not keen about either paper money or links to the sterling area that would have curtailed convertibility. He, therefore, turned to the Americans for advice as they provided much of the oil revenue and was already heavily involved in the Kingdom. The financial expert from California (Arthur Young) arrived Saudi Arabia in 1951 to head a mission on currency reform. He recommended the establishment of a monetary agency, which would serve the government, regulate the banks, and issue a new currency, the Saudi Riyal, to be linked to the dollar and hence directly to gold. This proved much more attractive to the King and Sheikh Abdullah Sulayman than the British plan as sterling was not linked to gold and sterling had just been devalued (from 4 dollars to 2.8 dollars to the pound). The Saudi Arabian Monetary Agency (SAMA) opened in 1952 and functioned successfully along the lines envisaged by Young (Wilson, Al-Salamah et al. 2004).

It is clear from these developments that the King was mainly concerned with not being exploited by foreign colonial interests, but also that a degree of practicality was involved when it came to securing deals with Dutch and French institutions plus a willingness to listen to American advice. Nevertheless, Islamic rules on the *haram* or unlawful nature of interest transactions were respected, and there was much debate on how the new monetary agency advocated by Young should be designated. Sheikh Sulayman indicated to Young that the King would need to be assured that the new agency would not deal in interest, and that the designation ‘bank’ could not be used. Young suggested the term ‘financial agency’ but the King rejected this proposal, and in the end ‘monetary agency’ was agreed upon. Under Article 3.7 of the new agency’s charter all paying or receiving of interest was prohibited as was the issue of currency notes, though the latter was subsequently dropped (Wilson, Al-Salamah et al. 2004).

4.3.3 RECENT DEVELOPMENT OF BANKS IN SAUDI ARABIA

The banking sector in the Kingdom is comprised of 10 national and joint venture (foreign and domestically owned) banks, in addition to two bank branches from Gulf⁷. Moreover, a Saudi joint-stock company was established under the name of "Albilad Bank" and branches for six foreign banks were granted licenses to operate. These branches are expected to start operation by the beginning of the Eighth Development Plan. The number of bank branches increased rapidly reaching a peak of 1,229 branches in 1998, then declined to 1,196 branches in 1999 and then increased again to 1,208 branches in 2003, which was below the 1998 level. This is mainly attributed to the fact that the number of the Automated Teller Machines (ATMs) doubled over the period 1999-2003 to reach 3,676 ATMs by the end of the period and point of sales transactions continued to grow rapidly thereby reducing the pressure on the bank branch networks.

Despite the widespread existence of bank branches in the Kingdom, the average number of branches which amounts to 54.5 branches per million inhabitants is still low compared to 244.9 in the United Kingdom, 272.9 in the USA and 303.4 in Japan. As in most developing countries, the reason is attributed to the fact that banking awareness among the people is still at a low level. Cash rather than credit is still widely used for personal and commercial payments in the Kingdom. Most people use bank cards to obtain cash and not to make direct payments. The ATM cards are more popular than credit cards where the former is used to withdraw cash directly from the holder's current account. People often hold large amounts of cash, using ATMs less than 10 times (per person) per year compared to 36.6 times in the UK and 52 times in the USA. The average withdrawal in the Kingdom is \$ 166.5 compared to \$84 in the UK and \$ 68 in the USA. This situation indicates the significance of enhancing banking awareness among the citizens to enable the banking system to play a more prominent

⁷ The information of this section is mainly from "The Eighth Development Plan: 2005-2009".

developmental role, acting as a channel for mobilizing and utilizing the potential financial resources of the society. Table 4.1 shows the performance indicators of the banking sector.

Table 4.1
Performance Indicators of the Banking Sector
(1999 and 2003)

	1999 (SR billion)	2003 (SR billion)	Increase (%)
Total Bank Assets	415.2	545.2	31.3
Total Bank Deposits	246.1	356.3	44.8
Bank Loans	166.3	247.0	48.5
- Public Sector	14.3	25.9	81.1
- Private Sector	152.0	221.1	45.5
Investment in Securities	112.5	158.1	40.5
- Government	102.3	150.7	47.3
- Private	10.2	7.4	-27.5
Total Capital	42.3	47.0	11.1
Bank Profits (SR billion)	6.3	12.1	92.1
Rate of Return on Capital	14.9%	25.7%	--
Rate of Return on Assets	1.5%	2.2%	--

Source: Saudi Arabian Monetary Agency, Quarterly Statistical Bulletins

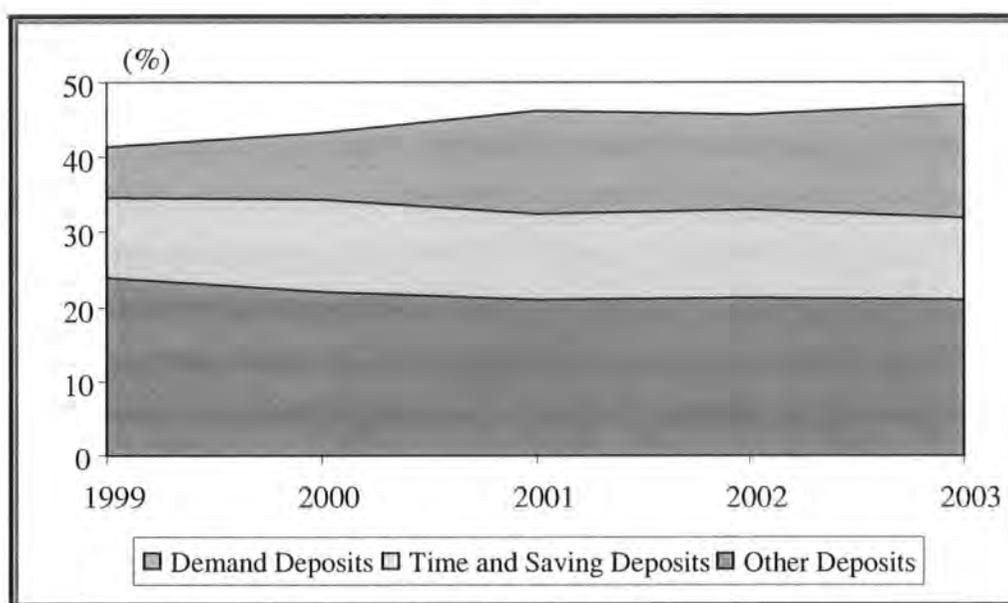
4.3.3.1 BANK DEPOSITS

Bank deposits increased substantially during the Seventh Development Plan, from SR 246.1 billion in 1999 to SR 356.3 billion by the end of 2003. Although the ratio of bank deposits to GDP remained relatively stable during the past decade, it increased from 40.8 percent in 1999 to about 44.3 percent by the end of 2003 due to the significant increase

in banking resources resulting from the transfer of worker salaries in the public sector and some workers of the private sector directly into bank accounts.

The ratio of demand deposits to time and saving deposits rose from 119 percent in 1999 to 126 percent in 2000 and to 148 percent by the end of 2003, therefore increasing the percentage share of demand deposits from 41.3 percent in 1999 to about 47 percent of total deposits in 2003. Meanwhile, the shares of other types of deposits has dropped. These trends are shown in Figure 4.1.

Figure 4.1
Structure of Bank Deposits
(1999 – 2003)



Source: (Saudi Arabian Ministry of Planning 2005) .

The low level of inflation (less than 1 percent on average during the Seventh Plan period) and the stability of the foreign exchange rate minimized the cost of funding in the Kingdom. Nevertheless, banks are reluctant to provide medium and long-term loans due to concerns about mismatch between the maturity terms of assets and liabilities. A higher proportion of time deposits will encourage banks to support more business

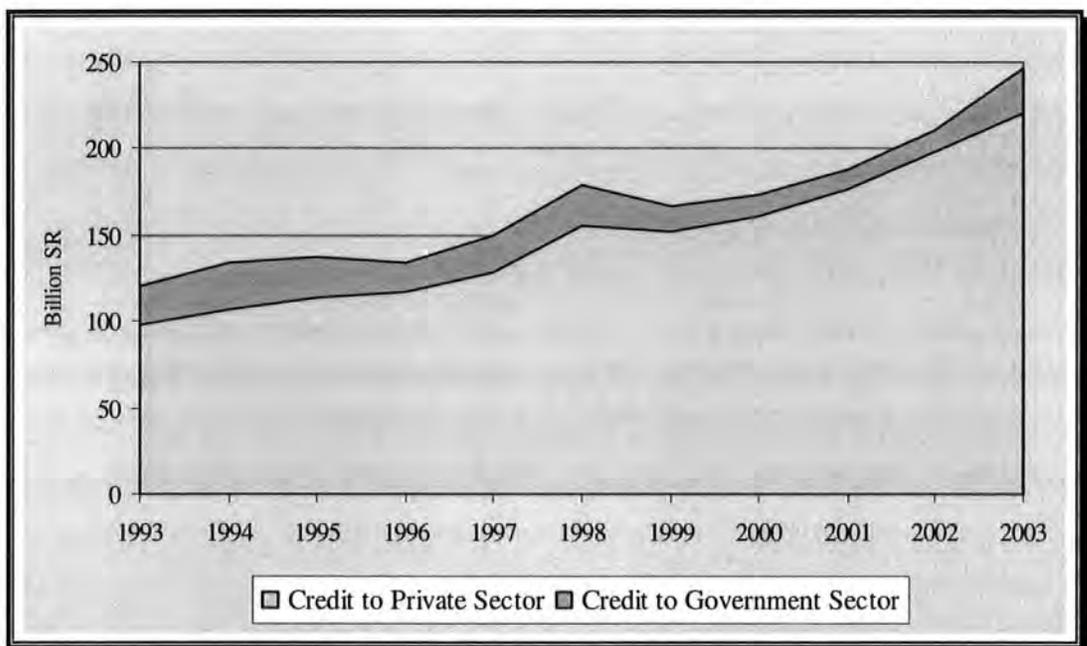
ventures through development of new saving instruments in conformity with Islamic teachings and values as well as the creation of the market for certificates of deposit (CDs) to enable depositors to obtain cash by selling their certificates rather than making withdrawals from banks. Recently, total bank deposits registered an increase of 5.3 percent (SR 29.9 billion) to SR 591.3 billion during the fourth quarter of 2006, compared to a rise of 4.8 percent (SR 25.8 billion) during the preceding quarter, achieving an annual rise of 20.8 percent (SR 101.9 billion). At the end of the fourth quarter of 2006, the ratio of total bank deposits to total broad money supply (M3) stood at 89.5 percent compared with 88.4 percent at the end of the same period of the previous year. A review of the developments of the components of deposits by type during the fourth quarter of 2006 indicates that time and savings deposits rose by 6.6 percent (SR 14.0 billion) to SR 226.0 billion compared to an increase of 11.2 percent (SR 21.4 billion) in the preceding quarter. Demand deposits went up by 5.1 percent (SR 11.8 billion) to SR 243.4 billion compared to a decline of 2.4 percent (SR 5.8 billion) during the preceding quarter. Other quasi-monetary deposits rose by 3.4 percent (SR 4.0 billion) to SR 121.8 billion against an increase of 9.4 percent (SR 10.1 billion) during the preceding quarter. Time and savings deposits, demand deposits and other quasi-monetary deposits recorded an annual rise of 36.8 percent (SR 60.8 billion), 11.0 percent (SR 24.2 billion), and 16.2 percent (SR 16.9 billion) respectively (SAMA 2006).

4.3.3.2 BANK CREDIT

Bank credit increased significantly, over the last decade, from SR 120 billion in 1993 to about SR 247 billion by the end of 2003, as shown in Figure 4.2. Such credit contributes, *inter alia*, to creation of job opportunities either directly through business lending or indirectly through personal lending, which stimulates consumer demand for goods and services and eventually creates job opportunities in different fields. Bank credit granted to the government accounted for about 10.5 percent of the total bank credit in 2003, whereas 89.5 percent of total bank credit was granted to the private sector. Credit provided to the private sector covered many activities. The trade sector received a

significant share with almost SR 52 billion by the end of 2003 or 20 percent of total credit provided to the private sector. The largest share of these loans is used to finance the stock of imported goods. The construction sector received about SR 22 billion and the manufacturing sector more than SR 26 billion. Consumer loans also exceeded SR 63 billion of which more than SR 27 billion was used to finance vehicle purchases. Loans for finance of real estate amounted to about SR 5.2 billion. Although finance for the purchase of consumer goods is profitable for banks, there is an increasing amount of payment defaults, most of which is related to credit card advances and personal loans. This indicates the need for enhancing awareness among the citizens with respect to the significance of proper personal financial management including fraudulent activities. Banks themselves should make sure their clients are not taking on excessive financial commitments and that lending risks are properly appraised.

Figure 4.2
Development of Bank Credit
(1999 - 2003)



Source: (Saudi Arabian Ministry of Planning 2005)

Short-term loans accounted for over 59 percent of total bank credit by the end of 2003 while long-term loans (more than three years) accounted for 25.6 percent only. However, there has been a decline in the percentage share of short-term credit over recent years, which accounted for about 80 percent of the total credit in 1996 compared to less than 9 percent for long-term credit. One factor encouraging the lengthening of the term structure of lending has been the rise of consumer credit. Over half of personal loans extend for periods of three years or more. This is partly attributed to the fact that finance of vehicle purchase usually extends over such a period. On the other hand, loans granted to businesses for financing of stocks are typically for one year or less. It is expected, during the Eighth Development Plan, to reconsider the legal framework related to property mortgages. The largest part of housing and real estate development in the Kingdom is currently financed on a cash basis. Hence, a significant portion of capital is locked up in real estate. The ability to purchase property through mortgages and re-mortgaging will free more capital for investment. The Kingdom will work to develop a mortgage system which conforms to *Shari'ah* law. In this respect, much can be learnt from international experiences with Islamic mortgages, including *Murabahah* and *Ijara* mortgage. This trend may also enhance the role of the Real Estate Development Fund (REDF) through gradual conversion from a lending institution to a one focusing on mortgage guarantees. Small scale enterprises, and to some extent, the medium scale enterprises, face difficulties in obtaining finance due to many reasons, such as, failure of such businesses to keep adequate accounts, lack of separation between family and business finances, and lack of sufficient knowledge on the preparation of business plans. To address this situation, the commercial banks are expected to establish units to offer practical guidance to small and medium size firms, possibly in cooperation with the Saudi Industrial Development Fund (SIDF) in the case of industrial firms. Recently, total claims of commercial banks on the private and government sectors (bank credit and investments) rose by 2.1 percent (SR 12.8 billion) to SR 635.1 billion during the fourth quarter of 2006 compared with a rise of 2.1 percent (SR 12.8 billion) in the preceding quarter. At the end of the fourth quarter of 2006, they recorded an annual rise of 6.6 percent (SR 39.1 billion) to constitute 107.4 percent of total bank deposits compared

with 121.8 percent at the end of the same quarter of the preceding year. Total claims of commercial banks on the government and quasi-government sector rose by 3.3 percent (SR 5.0 billion) to SR 158.2 billion during the fourth quarter of 2006 compared with a decline of 0.9 percent (SR 1.4 billion) in the previous quarter. At the end of the fourth quarter of 2006, they registered an annual decline of 0.8 percent (SR 1.3 billion). Their ratio to total bank deposits stood at 26.8 percent at the end of the fourth quarter of 2006, compared with 32.6 percent at the end of the same period of the preceding year. Total claims of commercial banks on the private sector rose during the fourth quarter of 2006 by 1.8 percent (SR 8.2 billion) to SR 476.0 billion compared to an increase of 3.0 percent (SR 13.8 billion) during the preceding quarter. They registered an annual rise of 9.2 percent (SR 40.1 billion) at the end of the fourth quarter of 2006. The ratio of commercial banks' claims on the private sector to total bank deposits was 80.5 percent at the end of the fourth quarter of 2006 compared to 89.1 percent at the end of the same period of the previous year.

An analysis of bank credit by maturity (private and government sectors) shows that medium-term credit rose by 3.5 percent (SR 2.2 billion) to SR 64.6 billion during the fourth quarter of 2006 compared to a rise of 2.2 percent (SR 1.4 billion) during the preceding quarter. Long-term credit went up by 1.8 percent (SR 2.8 billion) to SR 156.2 billion compared to a decrease of 1.9 percent (SR 2.9 billion) during the preceding quarter. Short-term credit also increased by 0.7 percent (SR 2.0 billion) to SR 276.2 billion compared to a rise of 5.9 percent (SR 15.2 billion) during the preceding quarter. Total bank credit by economic activity rose by 1.4 percent (SR 7.0 billion) to SR 497.1 billion during the fourth quarter of 2006 compared to an increase of 2.9 percent (SR 13.7 billion) during the preceding quarter, recording an annual rise of 9.8 percent (SR 44.6 billion) at the end of the fourth quarter of 2006, compared to the end of the same period of the preceding year. A breakdown of bank credit by different economic activities during the fourth quarter of 2006 indicates that bank credit extended to the commerce sector went up by 13.0 percent (SR 12.8 billion), manufacturing and processing by 6.7 percent (SR 2.4 billion), water, electricity and other services by 6.2 percent (SR 0.2

billion), agriculture and fishing by 3.6 percent (SR 0.2 billion), building and construction by 3.4 percent (SR 1.2 billion), government and quasi-government sector by 3.1 percent (SR 1.1 billion), services sector by 2.7 percent (SR 0.4 billion), transport and communications by 0.9 percent (SR 0.06 billion). In contrast, bank credit extended to mineral and mining went down by 9.8 percent (SR 0.2 billion), financing by 5.6 percent (SR 3.6 billion), and miscellaneous services sector by 4.1 percent (SR 7.5 billion) (SAMA 2006).

4.3.3.3 SIZE AND COMPETITIVENESS OF BANKS

The capital and reserves of commercial banks went down by 0.6 percent (SR 0.5 billion) during the fourth quarter of 2006. The ratio of commercial banks' capital and reserves to total bank deposits at the end of the fourth quarter of 2006 stood at 13.5 percent compared to 13.6 percent at the end of the same period of the preceding year. Their annual growth rate rose by 20.0 percent (SR 13.3 billion). Commercial banks' profits declined to SR 7.3 billion during the fourth quarter of 2006 compared to SR 8.3 billion in the preceding quarter, recording a decrease of 12.4 percent (SR 1.0 billion) and an annual growth rate of 35.3 percent (SR 9.1 billion). The number of banks operating in the Kingdom of Saudi Arabia in 2006 amounted to sixteen, including the branches of the Gulf International Bank, Emirates Bank, BNP Paribas, National Bank of Kuwait and Deutsche bank. The number of banks' branches operating in the Kingdom went up by 3.3 percent to 1,289 at the end of the fourth quarter of 2006 against 1,248 in the same quarter of the preceding year (SAMA 2006). Table 4.2 shows the ranking of banks in the Kingdom according to size of capital. It indicates the need to support the capital base of the national banks to enable them to develop and compete globally. This situation may encourage the tendency towards overseas expansion by the national banks rather than their concentration on the domestic market. Moreover, the smallest banks in the Kingdom find it increasingly difficult to obtain an adequate return on investment in a widespread domestic banking services network. This will entail considering further bank

mergers to increase the size of banks and their capabilities for development and provision of more services. Bank mergers will also increase the capabilities of banks to meet the financial requirements of large projects (petrochemicals and gas utilization) from self-resources or through the conclusion of joint-finance agreements. This will widen the scope of banking activities, enhance the role of banks in utilizing national savings and provide more profitable funding opportunities with lower risks. It is worth mentioning that the recent increase in the capital of Al-Rajhi Bank which approved in the March 3/3/2007. This approval was recommended by the board of directors to increase the capital of the bank from 6750 to 13500 million riyals by granting free shares for each existing share through the conversion of the amount of 6750 million riyals from two items of the balance sheet, which are the retained earnings and the general reserves. This increase made Al-Rajhi Bank in the front position of the banks operating in Saudi Arabia in terms of the size of capital and the number of branches (see table 4-2 below). Al-Rajhi bank is expected to continue in the lead until the Initial Public Offering (IPO) of "Bank Al-Enmaa" which is expected to be during 2007. It is noteworthy that King Abdullah Bin Aziz has ordered the establishment of "Bank Al-Enmaa" with a capital of SR 15000 Million. Thus, Bank Al-Enmaa will become the largest bank in the Kingdom of Saudi Arabia, and this certainly will increase the pace of competition between all banks. It is noteworthy that the banks of the Kingdom have a comparative advantage in Islamic banking, which could contribute, if deemed necessary, to enhancement of their competitive advantage at the Arab and Islamic levels and eventually at the international level.

Table 4.2
Capital & Branches of Banks in Saudi Arabia, 2007

Banks	Capital (SR million)	Branches
Al-Rajhi Bank	13.500	390
National Commercial Bank	9.000	260
Riyadh Bank	6.250	198
Samba Financial Group	6.000	63
Saudi Investment Bank	3.910	23
SABB	3.750	61
Saudi French Bank	3.375	68
Arab National Bank	3.250	116
Bank Al-Bilad	3.000	40
Saudi Hollandi Bank	2.205	41
Al-Jazira Bank	1.125	23
Gulf International Bank	n.a*	2
Emirate Bank	n.a	1
BNP Paribas	n.a	1
National Bank of Kuwait	n.a	1
Deutsche Bank	n.a	1
<u>TOTAL</u>		<u>1289</u>

Note: *n.a = not available in Saudi Riyal.

Sources: SAMA monthly statistical bulletin January 2007, (Banks branches operating in Saudi Arabia); Saudi Financial Market's website: [<http://www.tadawul.com.sa>]; Bank's annual reports.

4.3.4 SPECIALIZED CREDITS INSTITUTIONS

The government has established five specialized credit institutions (SCIs) to meet the needs of the private sector firms and public enterprises for long-term loans on favorable terms in such vital fields as industry, agriculture and housing where loans are not usually

provided in sufficient amounts by the commercial banks. The five Specialized Credit Institutions (SCIs) are:

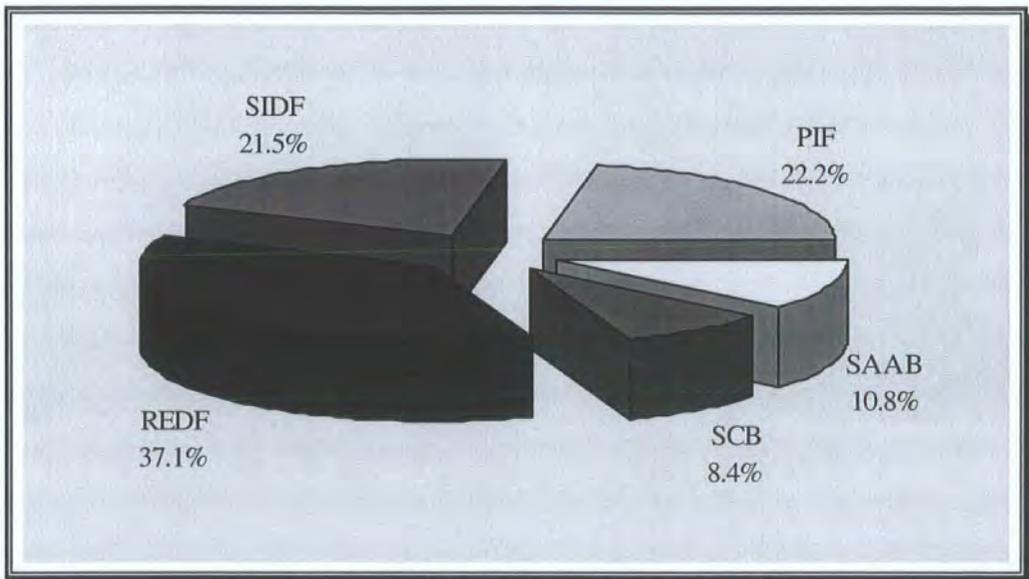
- (i) The Saudi Arabian Agricultural Bank (SAAB) which was established in 1962, and the main objective is to provide loans to promote the agriculture and farm sector.
- (ii) The Saudi Credit bank (SCB) was established in 1971, and the main objective is to offer loans (interest free) to low income citizens for social purposes.
- (iii) The Public Investment Fund (PIF) was established in 1971, and the two main objectives are to finance commercial and industrial production undertaken by the government agencies and to invest on behalf of the government in joint stock companies with the intention of reselling the shares to the public after these companies prove to be profitable.
- (iv) The Saudi Industrial Development Fund (SIDF) was established in 1974, and the main objective is to assist and encourage the private sector in undertaking industrial projects.
- (v) The Real Estate Development Fund (REDF) was established in 1974, and the main objective is to offer financial encouragement to the private sector for residential and commercial construction (Basheikh 2002).

These institutions, the capital of which are fully financed by the State and are supported continually by the annual State budgets, have contributed to the expansion of agricultural, industrial and business (crafts) activities as well as financing private housing in various regions of the Kingdom. The total capital of these institutions amounted to SR 201.65 billion in 2003⁸ and the total value of loans granted since the establishment of these institutions until 2003 exceeded SR 312.6 billion.

⁸ To further support their activities, capital increases have been approved for SIDF (SR. 13 billion), REDF (SR. 18 billion) and Saudi Credit Bank (SR. 5 Billion).

The net balance of loans increased by SCIs from SR 148.9 billion in 1419/20 (1999) to about SR 153.4 billion in 2003 at a growth rate of 3.0 percent. This reflects keenness by these institutions to keep the size of loans within the limit of repayments (self-finance policy) to avoid any further burden on the State budget due to provision of new loans to individuals and companies. The total value of loans provided by the SCIs in 2003 amounted to about SR 6.1 billion while repayments amounted to about SR 4.9 billion during the same year. Figure 4.3 shows the distribution of such loans. REDF came first with a share of 37.1 percent of total loans. SIDF and the Public Investment Fund (PIF) accounted for 21.5 percent and 22.2 percent respectively while loans provided by the Saudi Arabian Agricultural Bank (SAAB) accounted for 10.8 percent. Those provided by the Saudi Credit Bank (SCB) represented 8.4 percent of total loans provided by the SCIs. The capital base of REDF and SCB will be increased by SR 9 billion and SR 2 billion, respectively, during the Eighth Development Plan (Saudi Arabian Ministry of Planning 2005).

Figure 4.3
**Distribution of Loans Granted by the Specialized
 Credit Institutions, 2003**



Source: (The Eighth Development Plan 2005:325)

4.3.5 THE STATUS OF ISLAMIC BANKS IN SAUDI ARABIA

The Saudi government and the Saudi people have supported and encouraged the movement towards Islamic banking continuously. This support is manifested in the establishment of the Islamic Development Bank (IDB) in Jeddah, Saudi Arabia (Abdeen and Shook 1984), which acts in the same manner as World Bank. Al-Mehmadi (2004) mentioned that the absence of Islamic commercial banking within Saudi Arabia raised some eye brows from experts in Islamic banking including Wilson (1983). As previously mentioned in this chapter, that Saudi Arabia was formed to be an Islamic country practicing Islamic law only and, as a result, all banks should be Islamic (Vogel and Hayes 1998; Lewis and Algaoud 2001). Therefore, all businesses in Saudi Arabia should be consistent with *Shari'ah* and there should be no need to write the word "Islamic" before the name of the banks (Al-Mehmadi 2004). Hence, SAMA does not allow banks

which operate according to *Shari'ah* in Saudi Arabia to be called as "Islamic Bank" in order not to give the impression that other banks are usury (Vogel and Hayes 1998; Lewis and Algaoud 2001). Nowadays, when the business of Islamic banking proved to be successful, Saudi Arabia is witnessing a growing demand for banking product and services that conform to the principles of Islam. On the basis of such demand, the government is encouraging banks in Saudi Arabia to provide non-interest based system for banking products and services. Now, all banks in Saudi Arabia are providing fast-growing Islamic banking services (Al-Askar 2005). Most banks in the Kingdom have launched Islamic banking products, either through a separate Islamic window or an Islamic subsidiary, as Islamic banking is a fast-developing and highly profitable business. In addition, the division between Islamic banks and conventional banks is becoming less significant, as many banks have a large parts of their deposits as non-interest bearing (Salim 2007).

Al-Mehmadi (2004) categorised the Saudi banks into three types according to their involvement with Islamic banking. The first category is the completely Islamic banks, whether from the commencement such as Al-Rajhi Bank and Bank Albilad, or by converting from a conventional bank into an Islamic bank as in the case of Aljazira Bank. The second category of Islamic banking practiced in Saudi Arabia are those banks that started by having Islamic branches within their conventional banks such as the Saudi Arabian British Bank (SABB) and the National Commercial Bank (NCB). The third category of Islamic banking involvement is the "windows on Islamic banking" practiced by the rest of conventional banks in Saudi Arabia which are establishing divisions for Islamic banking within conventional banking.

It should be noted that there are some international Saudi Islamic banks that cannot operate in Saudi Arabia because they were not granted license by the SAMA. They were established by a number of wealthy Saudi Arabian merchant families (Presley and Wilson 1991). These were established in Bahrain and have many branches around the world. In Saudi Arabia, they have some representative offices that cannot operate as

commercial banks, but do deal with their investors. Some of these banks are the Dallah Al-Barakah Group, Dar Al-Maal Al-Islami Trust, Shamil Bank, Arab Banking Corporation (ABC) Islamic Bank and First Islamic Bank (recently known as “ARCAPITA”) (Al-Mehmadi 2004).

4.3.6 BANKING REGULATION IN SAUDI ARABIA

According to Iqbal et al (1998), there are three reasons for regulating banks:

- (i) To increase the information available to investors,
- (ii) To ensure soundness of the financial system, and
- (iii) To improve control of the monetary policy.

In addition to these reasons, Iqbal et al (1998) argued that *Shari’ah* supervision of Islamic banks’ activities should be another dimension of supervision in Islamic banks. Currently, the banks are working closely with the Saudi Arabian Monetary Agency (SAMA) towards the implementation of the Basel II Capital Accord. All banks operating in Saudi Arabia are expected to put into operation the standardized approach for credit risk by the 1st January 2008, preceded by a move towards more sophisticated internal ratings-based approaches. For operational risk all banks are likely to move to a standardized approach, with one or two banks experimenting with the advanced management approaches (Salim 2007). Banking in Saudi Arabia is regulated by the Banking Control Law of 1966. SAMA, established in 1952, is the country’s Central Bank. SAMA issues and controls the currency, regulates the money supply, regulates and monitors commercial banks (including deposits, loans and investments) and manages foreign assets. The Banking Control Law provides for state-owned and private banks. There are 16 banks operating in the Kingdom currently. These include branches of Gulf and foreign banks, such as the Gulf International Bank, Emirates Bank, BNP Paribas, International Bank of Kuwait and the Deutsche Bank. In addition, licenses have also been granted to several Gulf and foreign banks to open branches in the Kingdom. A

new Saudi bank with a paid-up capital of SR15 billion (US\$4 billion) has been approved by SAMA and preparations are currently underway to finalize the procedures of its establishment under the name of “Bank Al-Enmaa” (Salim 2007).

SAMA paid special attention to the need for promoting the growth of a national banking system. According to Almuhanha (1995), in 1966, the Banks Control Law (BCL) was issued; this was one of the most important laws issued to regulate banks in Saudi Arabia. SAMA has focused on banking regulations and on controlling the expansion of the banking business. Over the years, with the growth of the economy and the expansion of the financial system, SAMA’s responsibilities have increased several folds. The charter of SAMA stated the following functions and objectives of SAMA:

- To stabilize and maintain the external and internal value of the currency;
- To hold and operate any monetary reserve funds as separate funds earmarked for monetary purposes only;
- To buy and sell for Government account gold and silver coin and bullion;
- To advice the Government about new coinage and handle the manufacture, shipment and issue of all coins, it being understood that coins would be issued only through and at the request of the Agency;
- To regulate commercial banks, exchange dealers and money changers as may be found appropriate (Young 1983).

The BCL constitutes the supervisory framework under which banks operate. This law gives SAMA power over the commercial banks in Saudi Arabia. The BCL has 26 articles related to the regulation of commercial banks from the establishment of the bank through to the daily operations up until the end of the bank in extreme cases. The law specifies the type of business the bank can or cannot be involved in, the limitation of the loans given, and the minimum reserve requirements with the SAMA (Almuhanha 1995).

4.3.7 CAPITAL MARKET AUTHORITY

The Capital Market Authority (CMA) was established by the Capital Market Law, issued by Royal Decree No. (M/30) dated 2/6/1424 H (16th June, 2003). The CMA is a government organization with financial, legal and administrative independence. It reports directly to the Prime Minister. The CMA functions are to regulate and develop the Saudi Arabian Capital Market. It issues the required rules and regulations for the implementation of the provisions of Capital Market Law aimed at creating an appropriate investment environment⁹.

4.4 ACCOUNTING DEVELOPMENT IN SAUDI ARABIA

In order to know the brief background about accounting development in Saudi Arabia, this section presents a brief background about the Saudi Organization for Certified Public Accountants, financial reporting requirements and interest groups of sitting accounting standards.

4.4.1 THE SAUDI ORGANIZATION FOR CERTIFIED PUBLIC ACCOUNTANTS (SOCPA)

The efforts made by the Saudi Ministry of Commerce culminated in the issue of Royal Decree No. M/12 dated 13.05.1412H (1992 G) authorizing the passage of the new CPA Regulations. Article (19) of these Regulations stated that an Organization shall be established under the name of (Saudi Organization for Certified Public Accountants "SOCPA"). It shall operate under the supervision of the Ministry of Commerce in order to promote the accounting and auditing profession and all matters that might lead to the

⁹ This info is taken from Capital Market Authority's website [<http://www.cma.org.sa>].

development of the profession and improve its status. The following presents an executive summary of the SOCPA objectives, responsibilities and management:

Objectives:

- Review, develop and approve accounting standards;
- Review, develop and approve auditing standards;
- Establish the necessary rules for fellowship certificate examination (CPA exam.) including professional, practical and scientific aspects of audit profession and applicable regulations;
- Organize continuous education programs;
- Establish an appropriate quality review program in order to ensure that Certified Public Accountants implement professional standards and comply with the provisions of Certified Public Accountants Regulations and relevant by-laws;
- Conduct special research work and studies covering accounting, auditing and other related subjects;
- Publish periodicals, books and bulletins covering accountancy and audit related subjects;
- Participate in local and international committees and symposiums relating to the profession of accounting and auditing.

Management:

The Board of Directors practices the powers required for realizing its objectives. The Secretary General of SOCPA executes and follows up Board decisions and practices authorities of executive management. Technical committees prepare general rules organizing the profession, including establishing and developing accounting and auditing standards, professional ethics, organizing SOCPA fellowship exams, practicing the monitoring of programs. These committees are formed from experts and members

of high specialization; University staff, practitioners from companies and government departments.¹⁰

4.4.2 FINANCIAL REPORTING REQUIREMENT IN SAUDI ARABIA

The financial reporting requirements of banks in Saudi Arabia are mainly prescribed by SAMA, which is in the line with international accounting standards. Beside that, the banks also follow other standards and regulations from SAMA and the ministry of commerce. Banks as companies have to follow the ministry of commerce regulations and as banks they have to follow SAMA guidance (Al-Mehmadi 2004).

SAMA has issued eight accounting standards for commercial banks. In addition, SAMA allows the banks to adopt the accounting standards issued by the ministry of commerce for any other accounting issues not covered by its standards (Al-Mehmadi 2004). The Ministry of Commerce Accounting Standards are issued by the Saudi Organisation of Certified Public Accountants (SOCPA). Compliance with SOCPA accounting standards is required for all companies except banks. However, Al Rajhi pointed out that they used SOCPA standards alongside the others. The other banks never mentioned SOCPA accounting standards. Al Mehmadi (2004) mentioned that SOCPA argues that there should be only one accounting organization in the country responsible for issuing accounting standards for commercial organization including banks.

- (i) The Banking Control Law (BCL) issued and monitored by SAMA.
- (ii) The Regulations for Companies: the Company Act Law (CAL) was introduced by royal decree number M6 in 1965 which is also considered the bases for accounting standards.

¹⁰ This info is on the SOCPA website: [http://www.socpa.org.sa/inedx_en.htm].

- (iii) International Accounting Standards (IAS) issued by the International Accounting Standards Committee.
- (iv) The financial statements presentation and disclosure requirements of the ministry of commerce Standards for Presentation and Disclosure (SPD).
- (v) The Bank's Article of Association (BAA) with respect to the preparation and presentation of financial statements. These are the internal preparation and presentation requirements within each bank (Al-Mehmadi 2004).

Essayyad and Madani (2003) mentioned that banks in Saudi Arabia required to comply with the International Accounting Standards (IAS). Al Mehmadi (2004) investigated the accounting practice of nine Saudi Banks as stated in their annual reports for five years from 1997-2001 and his investigation revealed that all Saudi Banks had adopted SAMA accounting standards, the BCL, and the Regulation for Companies (Company Act Law). And from 1999-2001 all banks followed the International Accounting Standards (IAS). The Islamic accounting standards issued by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) are not adopted by any Saudi banks even those banks that claim to be Islamic banks, such as Al Rajhi Bank, Aljazira Bank, National Commercial Bank and Bank Albilad. The first three banks were among the Founding Members of the AAOIFI, and all of them including bank Albilad have more desire to adopt AAOIFI standards. It could be argued that the problem in accounting regulations in Saudi Arabia come from the fact that there are two government ministers concerned with financial disclosure, namely, the Ministry of Commerce and the Ministry of Finance. Banks have to follow the accounting standards for commercial banks issued by SAMA, which is part of the ministry of finance. On the other hand, the accounting standards in Saudi Arabia are issued and enforced by Saudi Organisation of Certified Public Accountants (SOCPA) for all companies including banks. However, banks do not implement these standards because SAMA does not require them to do so (Al-Mehmadi 2004).

4.4.3 INTERESTS GROUPS IN SETTING ACCOUNTING STANDARDS

Al-Rumaihi (1997) stated that the diversity of accounting practices in the Kingdom of Saudi Arabia and its consequences on accounting practice in general, acquired the attention of some interested groups who have the feeling that action should be taken to overcome such consequences, which includes interested individual; academics, and practitioners.

As this research is about applying AAOIFI accounting standards for the Islamic banks in Saudi Arabia, the researcher believes that the best groups to know the perceptions about the implementation of AAOIFI accounting standards are the professionals and academics. Therefore, academics, external auditors and Islamic banks employees in accounting departments are the main groups of this study.

4.5 CONCLUSION

This research is about the importance of Islamic banks' financial statements and the need for applying AAOIFI accounting standards in the Islamic banks in Saudi Arabia. Thus, it is necessary to present an explanation about the kingdom, in order to understand its internal dynamics. This chapter, hence, is a general overview about the financial and accounting development in Saudi Arabia. The main elements examined in this chapter are the politics, economics, financial and accounting system in the Kingdom of Saudi Arabia.

CHAPTER 5

THE PERCEIVED USEFULNESS OF ISLAMIC BANKS' FINANCIAL REPORTING IN SAUDI ARABIA

5.1 INTRODUCTION

One of the main aspects of this study is to explore the usefulness and importance of Islamic banks' financial reporting to its users in Saudi Arabia. The purpose of this chapter, therefore, is to provide a theoretical framework and to review the literature on the usefulness of financial reports. To achieve this objective, two research areas will be covered. The first relates to the discussion of theoretical foundations relevant to the "usefulness" of financial reports in general. The second provides a review of academic literature on the importance of financial reports as a source of information to investors.

This chapter discusses the objectives of financial reporting, the characteristics of accounting information, and the users of financial statements information. Previous studies are cited which have dealt with financial reporting and its importance to shareholders and investors in general, and investment analysts in particular. In this part of the chapter previous studies conducted in Saudi Arabia are also reviewed.

5.2 OBJECTIVES OF FINANCIAL REPORTING

Many attempts have been made to examine the objectives of financial reports. For instance, Barton, (1982) stated that "the fundamental objective of accounting systems and of financial reports should be to satisfy the need of users for financial information on the economic affairs of a firm". In a similar manner, International Accounting Standards (1999) "Framework for the Preparation and Presentation of Financial Statements" enunciated that: "The objective of financial statements is to provide

information about the financial position, performance and changes in financial position of an enterprise that is useful to a wide range of users in making economic decisions”.

Belkaoui (1985:171) cited Statement no. 4 from the Accounting Principles Board (APB) which identifies the following as general objectives of financial accounting and statements:

1- “To provide reliable financial information about economic resources and obligations of a business enterprise in order to (1) evaluate its strengths and weaknesses, (2) show its financing and investments, (3) evaluate its ability to meet its commitments, and (4) show its resource base of growth.

2- To provide reliable information about changes in net resources resulting from a business enterprise’s profit-directed activities in order to (1) show expected dividend return to investors, (2) demonstrate the operation’s ability to pay creditors and suppliers, provide jobs for employees, pay taxes, and generate funds expansion, (3) provide management with information for planning and control, and (4) show its long-term profitability.

3- To provide financial information that assists in estimating the earning potential of an enterprise.

4- To provide other needed information about changes in economic resources and obligations.

5- To disclose, to the extent possible, other information related to the financial statement that is relevant to users’ needs”.

Belkaoui (1985:173-179) also mentioned that ‘Trueblood Committee’ composed of nine members, representing accounting profession, the academic world, industry, and the Financial Analysts Federation. This committee reached a number of conclusions on the desirable goals of the financial accounting process:

“No.1: The basic objective of financial statements is to provide information in which to base economic decisions.

No.2: An objective of financial statements is to serve primarily those users who have limited authority, ability, or resources to obtain information and who rely on financial statements as their principal source of information about an enterprise’s economic activities.

No.3: An objective of financial statements is to provide information useful to investors and creditors for predicting, comparing, and evaluating potential cash flows to them in terms of amount, timing, and related uncertainty.

No.4: An objective of financial statements is to provide users with information for predicting, comparing, and evaluating an enterpriser s earning power.

No.5: An objective of financial statement is to supply information useful in judging management’s ability to utilize enterprise resources effectively in achieving the primary enterprise goal.

No.6: An objective of financial statements is to provide factual and interpretive information about transactions and other events that is useful for predicting, comparing, and evaluating enterprise-earning power. Basic underlying assumptions with respect to matters subject to interpretation, evaluation, prediction, or estimation should be disclosed.

No.7: An objective is to provide a statement of financial position that is useful for predicting, comparing, and evaluating enterprise-earning power. This statement should provide information concerning enterprise trans- actions and other events that are part of incomplete earnings cycles. Current values should also be reported when they differ significantly from historical cost. Assets and liabilities should be grouped or segregated by the relative uncertainty of the amount and timing of prospective realization or liquidation.

No.8: An objective is to provide a statement of periodic earnings useful for predicting, comparing, and evaluating enterprise-earning power. The net result of completed earnings cycles and enterprise activities resulting in recognizable progress toward completion of incomplete cycles should be reported. Changes in the values reflected in successive statements of financial position should also be reported, but separately, since they differ in terms of their certainty of realization.

No. 9: An objective is to provide a statement of financial activities useful for predicting, comparing, and evaluating enterprise-earning power. This statement should report mainly on factual aspects of enterprise transaction having or expected to have significant cash consequences. This statement should report data that require minimal judgment and interpretation by the preparer.

No.10: An objective of financial statement is to provide information useful for the prediction process. Financial forecasts should be provided when they will enhance the reliability of users' predictions.

No. 11: An objective of a financial statement for governmental and not-for-profit organizations is to provide information useful for evaluating the effectiveness of the management of resources in achieving the organization's goals. Performance measures should be quantified in terms of identified goals.

No.12: An objective of financial statement is to report on those activities of enterprise Affecting society which can be determined and described or measured and which are important to the role of the enterprise in its social environment.”

Finally, it is noticeable that financial reporting is mainly used as a tool for decision-making, control and accountability. The information provided will assist users to re-evaluate the investment decisions of the past in order to make better decisions in the future.

5.3 INFORMATION CHARACTERISTICS OF FINANCIAL STATEMENTS

Many attempts have been made to classify the qualitative characteristics of financial statements and accounting information viewed as desirable for the fulfillment of their fundamental objective.

The main purpose of the published financial report is to serve the need of various groups of users. The messages in it must be useful and relevant in order that rational decision can be made (Streuly 1994). Several accounting bodies and individual authors have identified a number of characteristics of useful information. Among them are:

- Relevance
- Understandability
- Reliability
- Comparability
- Consistency

These characteristics are discussed in the following sections in detail:

5.3.1 Relevance

It is said that only the information which is relevant to the user's need can be useful; irrelevant information can be misleading and hence cause incorrect decisions. Davies et al. (1999) defined predictive value as "the quality of information that helps users to increase the likelihood of correctly forecasting the outcome of past or present events", whilst feedback value is defined as "the quality of information that enables users to confirm or correct prior expectations". Moreover, the timeliness of information is another aspect of relevance. Hence, Barton (1982) argued that accounting information must be measured and reported within appropriate time periods for it to be relevant to

users' needs. If information does not become available when it is needed, it quickly loses its usefulness. Furthermore, Snavely (1967) categorised relevance as a second-level criterion following usefulness. In his opinion, for information to be relevant it must be able to assist in:

- Valuing a firm;
- Evaluating management, or
- Evaluating management's policies.

5.3.2 Understandability

Understandability is considered to be the key quality for accounting information to achieve "decision usefulness" (Davies et al. 1999).

Ijiri et al. (1966) suggested that accounting disclosure should be presented in a clear and understandable form in order to enable users of the financial reports to make the right decisions. Buzby (1974) argued that to make disclosure adequate and readable, information should be presented in an understandable way and organised appropriately.

Understandability is measured by the ability of users of information to comprehend the messages being communicated. Wolk et al (1992), therefore, argues that even if users are assumed to be knowledgeable, information itself can have different degrees of comprehensibility. The quality of understandability is a characteristic influenced by both users and designers of accounting information. Barton (1982) argues that understandability does not mean that the information has to be simple, as complex circumstances cannot normally be reduced to simple data. The information should not be understandable only by highly sophisticated users, as this introduces a bias in its use.

Smith and Smith (1971) used readability formulas as measurements of the understandability of selected pieces of financial information. They believed that the purpose of financial reporting is to communicate written matters in such a way that the users are able to understand the meanings intended by the information source.

5.3.3 Reliability

Reliability means that users of accounting information can depend on the information included in the financial statements with high degree of confidence and trust. According to Barton (1982) reliable information must possess several characteristics:

- Representational faithfulness;
- Verifiability;
- Neutrality and completeness.

While faithful representation refers to the correspondence or agreement between accounting data and resources and events that the data is purported to present, verifiability refers to an attribute that allows qualified individuals working independently to reach similar measures or conclusions. Moreover, Neutrality refers to the absence of bias in the presentation of accounting data, as the information should not favour one set of users or interested group over another.

Ijiri and Jaedicke (1966) expressed reliability, objectivity and bias in mathematical terms. They conclude that reliability is definitely a two-way street. It can either be improved by changing the measurement system or changing the manner in which the output from the system is used. The degree of reliability is the key criterion, and it determines the extent to which the decision-making public will accept and use accounting measurement. Thus, the reliability characteristic differs among users,

depending on the extent of each individual's knowledge and the level of information sought.

5.3.4 Comparability

According to Davies et al. (1999) comparability enhances the usefulness of accounting information. Information provided on a consistent basis from one period to the next can be compared with corresponding information from the same enterprise for some other period, or with similar information about some other enterprise. The measurement units, assumptions, data processing and measurement techniques and reporting intervals must be consistently applied throughout the accounting system so that similarities and differences can be detected and explained (Barton 1982).

5.3.5 Consistency

Consistency is considered as a fundamental quality, as Solomons (1989) defines it as accounting policies and procedures that do not change from one period to another. This means that there is consistency of accounting treatment from period to period. Consistency at a point in time is usually referred to as comparability. Consistent use of accounting policies from one accounting period to another facilitates analysis and understanding. Consistency in financial statements may be better accomplished through a full and detailed disclosure of the measurement methods used, and should be an integral part of every financial report (Bedford and Lino 1968).

5.4 THE USERS OF FINANCIAL STATEMENTS INFORMATION

One of the main objectives of financial reporting is to provide information that is useful to decision-making. However, the information to be provided may depend on the nature

of the users concern, since different users have different objectives and require a different degree of difficulty and depth about information need.

Several authoritative standard-setting bodies and researchers identified different user groups. Among them is Barton (1982), who identifies the following groups of users:

- Investors and capital market institutions;
- Management;
- Trade creditors;
- Employees and their associations;
- Customers;
- The government and its instrumentalities; and,
- The public.

Chetkovich (1955) points out that the primary user is the standard reader and he/she can be defined as someone who is somewhere between the unskilled and skilled users. For instance, Lee (1976) and Gray et al (1996) have identified shareholders as the primary users of financial reports. Similarly, Buzby (1974) identify the average investors with limited skills as the primary users.

Samuels et al (1995) mentioned that users could be classified in a number of ways depending upon their relationship with the company and/or the type of information they require. One possible classification would be: “‘Outside’ users who would be include shareholders, lenders, suppliers and customers; ‘intermediary’ users, for example security analysts and the financial press; and ‘inside’ users who would be mainly managers and employees or their representatives”.

Another suggested division is between ‘contractual claimers’, who are mainly interested in information relating to the default risk of the company, and ‘residual claimers’ with claims on residual profits and net worth. The first group would include creditors, suppliers and staff while most important members of the second group would be shareholders and the tax authorities”.

Similarly, Berry and Jarvis (1991) have placed users of the financial information in two board categories: users inside the enterprise: managers or owners; and users outside the enterprise: banks, the government, tax authorities etc.

5.5 SURVEYING THE LITERATURE ON THE USEFULNESS OF FINANCIAL REPORTS

This section provides a review of a sample of previous studies on the perception of different groups of annual reports’ users. Since this study based on Saudi Arabia, a special section will be set to review any previous studies related to financial reports in Saudi Arabia. However, the rest of the literatures will be mentioned in another section.

5.5.1 Previous Studies in US, UK and Other Countries

In 1965, Bradish conducted a study aiming at determining the types of information provided in the annual reports of firms that financial analysts consider insufficiently disclosed. He interviewed financial analysts working in security brokers, trust and loan departments of banks any insurance companies. Bradish (1965) tried to elicit proposed solutions from interviews with financial analysts to improve disclosure. His analysis indicated that there is a lack of communication between users and preparers of financial statements, concluding “our major failure as accountants may be in our communication with those increasingly important gentlemen, the financial analysts” (p. 766).

Baker and Haslem (1973) conducted a study where they distributed 1623 questionnaires to individual stockholders in Washington D.C. They asked the respondents to indicate the most important source of information that they use in evaluating share prices. They concluded that the most important source of information was stockbrokers (46.8 percent) while only 7.9 percent of the respondents considered annual reports as their most important source of information. In addition, they found that individual investors might have different information needs from professional users. Individual investors depend on stockbrokers and advisory services for the investment decision. As a result, they attach less importance to financial statements as a source of information.

Briggs (1975) interviewed 25 stockbrokers and officials of unit trusts and trust departments of banks in the United Kingdom. He found that the interviewees almost agreed that accounting data reported in financial statements was quintessential for investment analysts. Briggs concluded that analysts have an important role as interpreters and digesters of published accounting reports. Hence, information contained in financial statements should not be geared to the needs of unsophisticated non-professionals at the expense of the efficient operation of the capital market.

Lee and Tweedie (1975) conducted a study to examine whether or not shareholders use information from company financial reports, and if they understand the accounting terminology used in these reports. They distributed 1594 questionnaires to individual shareholders of one of the largest industrial companies in UK. The study results indicated that financial press reports were the most important source of information about companies. Most respondents regarded annual financial statements as an important source of information for investment decisions. Many investors read the stockbroker' reports, but they were not as important source as the half-yearly financial report. Lee and Tweedie (1975) reported that shareholders with no knowledge of accounting more interested in the chairman's report than in any other section, as respondents rated the chairman's report as the most useful part of the annual report for investment decision-making purposes. Shareholders who have some form of training in accounting read annual report more carefully and paid particular attention to the profit and loss account

than those without such knowledge. They also rated the profit and loss account and the balance sheet as the most useful section.

Benjamin and Stanga (1977) compared the views of bank loan officers with the views of financial analysts regarding a set of information items that could be disclosed in a company annual report. Specifically, they analysed the responses of 208 bankers and 207 financial analysts who were asked to rate the importance of 79 information items companies may disclose in their annual reports. Using the chi-square test, Benjamin and Stanga (1977) found significant differences between the bankers and financial analysts in 51 of the 79 items presented to them. The authors' use of the Chi-square test is, however, questionable. The authors stated that they asked the respondents to express their opinions using a scale of five points extending from "unimportant" to "very important". The appropriate statistical tests are those that incorporate the ranking property of an ordinal scale. The Chi-square test, on the other hand, is appropriate when the data are collected on a nominal or categorical scale. It is clear that the data of Benjamin and Stanga (1977) was collected using an ordinal scale.

Contacting a wider range of possible interested parties in corporate discourse in the U.K., Firth (1978) attempted to measure a multi-grope consensus of the perceived importance of a set of information items that could be disclosed in a company annual report. Using a questionnaire survey, Firth (1978) analysed the responses of 302 subjects including finance directors, auditors, financial analysts, and bank loan officers. The respondents to Firth's (1978) survey were asked to rate the importance of each of the 75 information items in the questionnaire, which could be disclosed in an annual corporate report. The major finding of the Firth's study is the similarity of views of finance directors and auditors on the one hand and the similarity of the views of financial analysts and bank loan officers on the other hand. Another finding of Firth's study is that the users (i.e., financial analysts and bank loan officers) attach, in general, higher level of importance to the disclosure of most of the items presented to them.

Anderson (1981) investigated the usefulness of Australian financial reports to institutional investors by surveying a sample of 300 institutional investors. Anderson found that those institutional investors perceived annual reports as the most important source of information for investment decisions, followed by the advice of stockbrokers and company visits. Moreover, the study showed that the most important sections of the annual report for making investment decisions are the profit and loss account, balance sheet and notes to the accounts.

McNally et al. (1982) examined the importance of a set of voluntary information items to the financial editors and stock exchange members in New Zealand. Among the 41 items in the questionnaire, McNally et. al. (1982) reported that the information about future dividends and dividing policies is the most important piece of information for both groups of users followed by information on profit forecast for next year. On the other side of the spectrum, they reported that the information about corporate social responsibility, advertising, and personnel development are among the least important items. They found that the stockbrokers assigned higher importance for most of the items (28 out of 41) than the financial editors. The difference, however between the two groups is marginally significant for only five items. Instead of using a non-parametric test, which is more appropriate for ranked data, McNally et. al. (1982) used the *t test* to examine the differences in the perceptions of the user groups. Finally, they did not disclose the size of the sample of the user groups in their study.

Stanga and Tiller (1983) conducted an empirical study to determine whether the informational needs of bank loan officers are the same from large or small companies. They analysed the responses of 230 loan officers in the U.S.A. who were asked to rate the importance of 40 information items that could be disclosed in a company annual reports. About half of their sample (111) consists of loan officers from large banks and are instructed to complete the questionnaire as they were making a term loan to a large publicly held company. The other half of the respondents (119) consists of loan officers from small banks and were instructed to complete the questionnaire as they are making a term loan to a small privately held company. Using the Mann-Whitney U test, Stanga

and Tiller (1983) found high similarity between the two groups of lean officers in terms of their rating of the importance of the selected information items. According to the results they found, Stanga and Tiller (1983) suggested that the users' informational needs are not affected by the size of the companies. They further concluded that there is no need for two sets of GAAP to differentiate between large and small companies.

Day (1986) conducted a project to investigate the use and usefulness of information contained in annual reports to investment analysts. The usefulness of current cost accounting information to investment analysts was the focus of the study. Fifteen financial analysts were interviewed. Day found that the majority of financial analysts agreed that the annual report is an important source of information about companies. She also concluded that there was an agreement between analysts about the need for additional and more detailed disclosures in segment report.

Wallace (1988) conducted a study to measure the consensus of various Nigerian users of annual corporate reports on the importance of a set of disclosure items in the annual corporate reports. He analysed 470 responses to questionnaires received from accountants, financial analysts, civil servants, other professionals, managers, and investors. The respondents were asked to state their perceptions about the importance of 102 information items that could be disclosed in a company annual report. Wallace (1988) found that majority of significant differences in the users' perceptions are between the accountants on the one hand and other professionals, managers, and investors on the other hand. The author, however, did not indicate those items that accountants have different views than each of the other groups. Also, he did not classify the information items as mandatory and voluntary disclosure.

Gniewosz (1990) investigated the use of accounting information and information from other sources in the share investment decision process of institutional investors, by using an in-depth exploratory case study. He concluded that, although there is extensive use of all information sources, the use of the annual report represents the main routine information event over the financial year. However, the use of actual report changes

during the year; sometimes, it is used as a primary source of information, while at other times, it is used for affirmation.

Pike et al (1993) conducted a study to investigate changes in the methods of appraising ordinary shares used by UK investment analysts over the past decade. They also compared the method used, and information employed by UK analysts to evaluate shares with German analysts. They concluded that there has been a great shift in attitudes towards personal contacts and meeting with company officials as the most important source of information. The authors argued that a possible reason for the change to personal contacts might be due to a lack of communication between institutional investors and company management.

Ibrahim and Kim (1994) attempted to measure the perceptions of various user groups of annual corporate reports in Egypt about the importance of a set of information items that could be disclosed in an annual corporate report. Using a questionnaire survey, they analysed the responses of 311 individuals representing accountants, shareholders, managers, and financial analysis. The respondents were asked to rate the importance of 42 information items that could be disclosed in an annual corporate report. Ibrahim and Kim (1994) found significant differences in the perceptions of the different users group, arranged in pairs, regarding many information items. These differences ranged from 14 items between accountants and managers, and 31 items between financial analysts and investors. Ibrahim and Kim (1994) did not, however, explain which items of information users have differences in their rating of the importance of such items. Further, they did not explain whether users have differences in rating of compulsory or voluntary items. They concluded their study by the asserting that “the consensus among users groups in Egypt, as a developing country, are not as significant as in developed countries” (p. 69). The authors, however, did not substantiate this assertion by any means (for example, they did not compare the results with those of the other studies conducted in the developed countries).

Epstein and Freedman (1994), as part of a larger study, attempt to assess the individual investors demand for socially oriented information in the annual corporate reports. They summarised the responses of 246 individual investors in the United States. Epstein and Freedman (1994) found that majority of individual investors demand more disclosure on activities other than economic performance, such as product safety (85%), environmental activities (82%), and corporate ethics (72%). Interestingly, they found that the investors believe that companies should direct more company funds toward stopping environmental pollution and improving the safety of products than paying higher dividends.

Streuly (1994) investigated the importance, adequacy and the usefulness of corporate annual reports. He distributed 928 questionnaires to a random sample of chartered financial analysts in the United States. A response rate of 55 percent was achieved by receiving 508 useable questionnaires. Streuly concluded that the primary objective of financial reporting is being fulfilled, since the study results indicate that financial analysts perceived information disclosed in annual reports as adequate to investment decision. They also considered the balance sheets profit and loss account, and the cash flow statement as very useful in investment decisions.

Bence et al (1995) investigated the intonation sources of sophisticated users who were interested in the chemical and pharmaceutical sector. Three objectives were emphasised in the study: (1) to determine whether the different clusters of financial information sources are used by different groups of sophisticated users; (2) to investigate whether a specific relationship would provide a better understanding of the financial reporting process, and; (3) to develop a structure of information sources by using statistical techniques. The results indicated that there is a general conformity between financial analysts and institutional investors on the importance of each source of Information. However, cluster analysis showed that users use a limited range of information sources. Financial analysts used most routinely published information, such as corporate annual and interim reports with emphasis on short-term information. Institutional investors used

information sources that are of less short-term nature, such as company visits and personal interviews with company official.

Idris (1996) investigated the items to be disclosed in Islamic banks' annual report and its usefulness to investors. He designed two types of questionnaires, the first questionnaire for the bankers and the second for the investors. Questionnaires were sent to 47 Islamic banks in different parts of the world, and 27 Islamic widows in Malaysia. Another set of questionnaires was distributed to 58 institutional investors. The analysis of this study revealed that the annual report is considered by the Institutional investors as the most important source of information for investment decisions. The study also provides evidence that the traditional items such as the balance sheet and profit and loss account are the most important and useful for making investment decisions, and should be included in the annual report. Apart from these items, respondents also indicated the need for the Sources and Uses of *Zakat* and Charity Fund, and a detailed report by the *Shari'ah* Supervisory Board. The results of the analysis also indicate that there is need for accounting information to be regulated, and if this is done, it will facilitate comparability of financial reporting amongst the Islamic banks.

Abu-Nassar and Rutherford (1996) conducted a study to discover the view of external users of annual corporate reports in Jordan. They targeted different groups of corporate reports' external users, namely individual shareholders, institutional shareholders, bank loan officers, stockbrokers, and academics. Their sample consists of 224 respondents. All of their analyses are of a univariate type. In terms of the usage of the annual report, Abu-Nassar and Rutherford (1996) found bank loan officers to be the heaviest users of the annual reports in Jordan while individual shareholders and academics are the least. They also found income statement and balance sheet to be the most widely read parts of the annual corporate report by all kinds of users. The Abu-Nassar and Rutherford (1996) study documented the low degree of users' satisfaction about many qualitative characteristics of corporate reports in Jordan. In terms of the importance of the various sources of corporate information, the Abu-Nassar and Rutherford (1996) study found the annual corporate report to be the most important source of information for all user

groups except bank loan officers who indicated that the most important source of information is visit to companies followed by the annual report. Abu-Nassar and Rutherford (1996), however, did not perform any statistical test to determine whether the differences in the perceptions of different users are significant, which form a basis to conclude whether such users are homogenous or heterogeneous.

Following the methodology of the Lee and Tweedie (1975) study, Bartlett and Chandler (1997) conducted a survey study to re-examine the private shareholders' usage of annual corporate reports in the United Kingdom. Their study was justified by the fact "that much has changed within the financial reporting environment" since the Lee and Tweedie (1975) study (Bartlett and Chandler, 1997, p. 246). Bartlett and Chandler (1997) analysed the responses of seventy-six individual shareholders of one multi-national company. They found that the most widely read section of the annual corporate report is the chairman's statement, a result similar to that found by Lee and Tweedie twenty years ago. Similarly, Bartlett and Chandler (1997) found the auditor's report to be one of the sections that are read the least by individual shareholders. They, however, found a noticeable decline in the shareholders' interest in the profit and loss account and balance sheet since the Lee and Tweedie (1975) study. One of the expected results of Bartlett and Chandler's (1997) study is the association between the rate of usage and degree of importance that individual shareholders place on each section of the annual report. They, in examining shareholders' usage of other sources of information, found financial press reports to be the most widely read, a similar observation indicated by Lee and Tweedie (1975). An interesting finding of Bartlett and Chandler's study is the majority desire for less information in form of a summary report rather than the annual report itself. Like the Lee and Tweedie (1975) study, the Bartlett and Chandler's (1997) study did not allow the respondents to rate the importance of the annual report when it is compared with other possible sources of information about their company.

Al-Hajji (2003) investigated the usefulness of annual reports produced by Islamic financial institutions to investors. In particular, the study is concerned with the perceptions of both institutional investors and customers in Kuwait about the annual

reports of Islamic financial institutions. In addition, the study investigated the opinions of the preparers of annual reports of Islamic financial institutions in GCC countries regarding various aspects of the annual reports that could help investors make their investment decisions. Al-Hajji designed two types of questionnaires and interview schedules. The first type of questionnaire was carried out to solicit the investors' perceptions of annual reports, the importance they attached to them and the uses of these reports in their investment activities. The second type of questionnaire was specifically used to investigate the opinions of the preparers of annual reports regarding various aspects of annual reports that could help investors make their investment decisions. The interview method was mainly used to identify the customers' perceptions of Islamic financial institutions in Kuwait about the usefulness of these annual reports. The results of the questionnaire and the interviews indicated that the annual reports are considered by customers and investors to be the main source of information for investment decisions. The results also revealed that the timeliness and credibility of information were perceived by respondents as the most important qualitative characteristics that might affect the usefulness of information sources about the performance of Islamic financial institutions. Regarding the accounting regulation of financial information of Islamic financial institutions, the results indicated that there is a need for accounting information to be regulated in order to enhance the credibility of financial statements produced by these institutions and increase their comparability and transparency to the users.

5.5.2 Surveying The Previous Studies On Saudi Arabia

This section reviews literature related to the usefulness of financial reports in Saudi Arabia. As one of the earlier studies on Saudi Arabia, Ba-Owaidan (1994) examined the role of accounting information system in promoting the share trading activity in the Saudi Stock market by analysing individual investors' use and understanding of published information in annual reports when making investment decisions. He distributed 300 questionnaires to small investors, of which 135 were returned. He also

interviewed some investors who agreed to be interviewed. The results of the study showed that the majority of the respondents were long-term investors. They also believed that information contained in financial statements helps investors in making investment decision. Furthermore, investors agreed that the purpose of financial statements was to give investors data for use in investment decisions. Finally, investors ranked company annual report as the most valuable and useful source of intonation, followed by SAMA's share price list, news in the financial and daily press.

Al-Bogami (1996) also studies the usefulness of interim financial statements to investors in the Saudi Stock Market. The objective of the study was to investigate the usefulness of quarterly financial statements by analysing the attitudes of users and preparers towards interim financial statements. He distributed 437 questionnaires to three groups: institutional investors, private investors, and financial managers. The study results showed that institutional and private investors do use the quarterly financial statement in their investment decisions. Furthermore, both the users and preparers feel that the quarterly financial statements are useful in making investment decisions.

Al-Mubarak (1997) examined the usefulness of Sands corporate actual reports to investment analysts in Saudi Arabia. He distributed 249 questionnaires, from which 126 were returned. The study results indicated that the corporate annual report is the single most important source of information for investment analysts in their investment activities. It also revealed that respondents rated the profit and loss account as the most important section of the annual report, followed by the balance sheet. Furthermore, the results showed that the most important use of corporate annual report is to provide primary data for investment activities. Finally, the majority of investment analysts understand information contained in the corporate annual reports and consider it relevant to their investment activities.

Al-Razeen (1999) conducted a study to examine the quality of the annual financial reports of the Saudi corporations. He distributed 636 questionnaires, from which 303 were returned. Al-Razeen (1999) has chosen five major user groups for his study:

individual investors, institutional investors, creditors, governmental officials, and financial analysts. The main finding of the study was that the corporate annual report was the most important source of information to all of participating groups. However, the user groups were dissatisfied with either the quantity or quality of the voluntary disclosure.

Al-Mahmoud (2000) examined the usefulness of annual reports information of Saudi corporations to participants in the Saudi Stock Market. He distributed 680 questionnaires to three groups: institutional investors, individual investors, and financial analysts. Finally, the study results show that annual report is perceived as the main source of information for investors in the Saudi Stock Market in making informed decisions. The Empirical results show that participants in the Saudi Stock Market used the annual report information to make investment decisions, as share prices reacted differently upon the release of these annual reports.

Basheikh (2002) investigated aspects of financial reporting and bank lending decisions in Saudi Arabia. He focused on the perceptions of financial reporting and its objectives by representatives of banks, companies and auditors; the role and the importance of financial reporting in negotiating loan contracts; and the influence of the 1997 update standard on the process of negotiating loan contracts. The types of financial ratio covenants that are usually included in private lending agreements in Saudi Arabia are described and compared with practice in 'Anglo-Saxon' countries. The main contributions of empirical work were: (1) there is very low awareness of accounting standards by lending officers; (2) the chairman's report is not important in bank lending decisions; (3) bank lending officers are the main users of financial reports in Saudi Arabia.

Al-Razeen and Karbhari (2004) examined the perceptions of the users of annual corporate reports in Saudi Arabia. The focus was on the use and importance of the seven different sources of corporate information contained in Saudi annual reports. This includes the board of director's report, the auditor's report, the balance sheet, the income

statement, the statement of retained earnings, cash flow statements and the notes to the financial statements. They distributed 363 questionnaires, which comprises five major user groups, namely individual investors, institutional investors, creditors, government officials, and financial analysts. They found that the balance sheet and the income statement are the most important sections of the annual report to most of the Saudi users' groups. The board of directors' report was found to be the least popular. As far as the cash flow statement is concerned, the individual investors were found to place much less importance to this statement.

Al-Mehmadi (2004) investigated the external reporting need of investors in Islamic banks in Saudi Arabia. He used the questionnaire survey as the main method to collect data besides interviewing some managers and *Shari'ah* members in some Islamic banks. He distributed 370 questionnaires to the holder of investment accounts (HIA) in Islamic banks. The main results revealed that the HIA believe that the annual reports are the most important source of information. Within the annual report, the *Shari'ah* auditors report is the most important and the most understood section. The cash flows statements are the least understood section. The audit report is considered the least important. His study also revealed that the investors who use the annual reports are better to judge the Islamic banks' compliance with *Shari'ah* than investors who do not use the annual reports. Finally, he discovered that investors seek to increase their wealth but this objective is considered within the boundary of *Shari'ah*.

5.6 CONCLUSION

The main purpose of this chapter was to review the literature related to the usefulness of financial information. In doing so, the chapter was divided into four sections. The first section dealt with the objectives of financial reporting. The second section discussed the characteristics of accounting information. These characteristics included relevance, understandability, reliability, comparability, and consistency. The users of financial



information and their classification as primary and secondary user groups were presented in section three. The main conclusion of this section was that investment analysts are reviewed as the primary users of corporate reports.

Finally, previous studies involving the usefulness of accounting information were reviewed in the last section of this chapter. The review included both studies of the usefulness of accounting information for individual investors, and studies involving investment analysts' uses and evaluation of accounting information provided in corporate reports. A review has also been presented of studies, which surveyed Saudi investors' attitudes toward accounting information.

CHAPTER 6

RESEARCH METHODOLOGY

6.1 INTRODUCTION

The previous chapters presented the theoretical framework of this study as a whole. This chapter deals with the main research method used in the study and how the data are analysed in order to reach the main objectives of the study. These issues are discussed in this chapter and the following three chapters.

The discussion in this chapter has been organised in to nine sections. The first section describes the meaning of research methodology. This is followed by section three which provides details of the data collection methods of this research. The fourth section describes the questionnaire method and its advantages and disadvantages, while section five discusses the design of the questionnaire. This is followed by section six, which explains the pilot test conducted. Section seven outlines the research population and the fieldwork followed by section eight which explains the data analysis methodology. Finally, section nine presents the conclusion to the chapter.

6.2 RESEARCH METHODOLOGY

The term methodology in its original and proper usage refers to “the systematic and logical study of the principles guiding scientific and philosophical investigation” (Gould and Kolb, 1964, p.425). Others refer to methodology as the study of utility and validity of methods of investigation, in the context of a particular scientific

discipline or area under consideration. It also refers to the selection of such methods, in advance of an investigation, that are considered likely to be appropriate and fruitful (Roberts, 1971). On the other hand, Scruton (1982) argues that methodology is a word that should mean the study of methods, but is often used simply to mean 'method', as in 'the methodology of social sciences'. If there is a subject then there is a method of investigation to be determined by it. However, there may be more than one method used to discover some matter, and in this case it is possible to speak of methodology, as the discipline which attempts to describe the method which best achieves the required result. In short, methodology is a system of explicit rules and procedures on which research is based and against which claims of knowledge are evaluated (Frankfort-Nachmias and Nachmias, 1996).

Overall, a methodology is concerned primarily with various models, classifications, and conceptual schemes that exist, the techniques that are available for investigatory purposes, research procedures used in the past, and their validity. This allows for discovering new knowledge and ordering it meaningfully, in order to test existing propositions (Roberts, 1971).

In social sciences, two main types of empirical research can be identified: the quantitative approach and the qualitative approach. Quantitative research is mainly deductive; therefore researchers deal directly with operationalisation, the manipulation of empirical variables, prediction, and testing. Quantitative research, therefore, places great emphasis on methodology, procedure, and statistical measures of validity. Consequently, quantitative research reports should be organised to show a clear progression from theory to operationalisation of concepts; from choice of methodology and procedures to the data collected; from statistical tests to findings and ultimately conclusions (Frankfort-Nachmias and Nachmias, 1996).

Qualitative research, on the other hand, is inductive in nature. Qualitative researchers use field research methods, primary case studies and participant observation within

natural settings. A given report using a qualitative approach will present much descriptive material. The report should also show how the observations prompted the researcher to analyse and isolate variables (induction) and how, in turn, these variables may be developed into a theory (Frankfort-Nachmias and Nachmias, 1996).

Since the framework of this study is related to analysing the perceptions and opinions of the participants in their own natural settings, this research is constructed within qualitative methodology.

6.3 RESEARCH METHOD: DATA COLLECTION METHODS

Research method normally refers to tools and instruments used to assemble data for the research; and it can be qualitative or quantitative. As the names suggest, qualitative data is concerned with qualities and non-numerical characteristics, whilst quantitative data is all data that is collected in numerical form (Hussey and Hussey, 1997).

Qualitative data collection methods can be expensive and time consuming. Although it can be argued that qualitative data in business research provides a more 'real' basis for analysis and interpretation. Moreover, a qualitative approach presents problems relating to rigour and subjectivity (Hussey and Hussey, 1997). However, one of the main advantages of a quantitative approach to data collection is the relative ease and speed with which the research can be conducted. In a descriptive study, the use of quantitative methods can give a false objectivity to information, which can lead to reductionism. This means that the richness of the data and its contextual implications may be lost, therefore contributing to a narrower and less real interpretation of phenomena (Hussey and Hussey, 1997).

Many researchers such as Sekaran (2000), and Churchill and Iacobucci (2002) point out that quantitative research, while being very useful, is greatly improved when used in conjunction with other qualitative research methods such as case studies,

interviews and observations. When qualitative and quantitative research approaches are combined, we have what is called triangulation in action (Frankfort-Nachmias and Nachmias, 1996; Easterby-Smith et al 2002). Triangulation is used by researchers to improve the accuracy of their judgement by collecting different kinds of data bearing on the same phenomenon. Triangulation allows researchers to be more confident of their results (Morgan, 1998).

According to Morgan (1998), the main purpose of combining qualitative research with quantitative research is to achieve one or more of the following:

to arrive at a better understanding of the topic being studied;

to design a research methodology;

to learn from specialists about certain issues related to the subject matter;

to become acquainted with problem areas or constraints; to assess the feasibility of the topic being researched.

This research utilises a number of research method. For assembling primary data, it utilises qualitative research method, namely questionnaire survey, which is discussed in detail in the following section. However, in analysing the data assembled through questionnaire survey, it utilises qualitative and quantitative research methods, interpretive and statistical analysis respectively. In addition, it utilises descriptive research method in collecting secondary data and information for literature survey.

6.4 QUESTIONNAIRE SURVEY

A questionnaire is a highly structured data collection technique whereby each respondent is asked the same set of reformulated written questions. The questionnaire can be distributed either by mailing it to respondents or by personal administration. In the latter approach the questionnaire is presented to the respondents with an explanation of the purpose of the enquiry, and then the

respondent is left to complete it; the questionnaire will be picked up later (Oppenheim, 2000). The questionnaire technique is not a risk free method of collecting data. There are advantages and disadvantages of the questionnaire, which will be highlighted next.

6.4.1 Advantages and Disadvantages of Questionnaire Method

A self-administrated questionnaire is the best technique for collecting data when we are dealing with a survey that is confined to a local area. This method of data collection ensures a high response rate within a short period of time. Using this method also gives the researcher the chance to introduce the research topic and motivates the individual participant in the survey. Another advantage associated with the self-administrated questionnaire is that it is less expensive in terms of costs and less time-consuming than interviewing and it requires fewer skills to administer than to conduct interviews (Sekaran, 2000).

A related advantage of a postal survey questionnaire is that they can reach isolated areas and those members of the population whom interviewers find it difficult to catch at home. When people to be surveyed are spread geographically a questionnaire maybe the obvious method for making contact since interviews, could well be expensive and impractical. The mail questionnaire is usually used when the survey covers a wide geographical area. Major advantages of this method are the low cost of data collection when compared with interview surveys and the low cost of processing. When we are dealing with respondents that request complete secrecy when answering the questions, the mail questionnaire is, again, the best method. Using the mail survey will also result in the elimination of the major problem associated with interview survey, namely, interviewer error and bias (Al-hajraf, 2002). In addition, a mail questionnaire allows for more time when questions demand a considered rather than immediate answer, especially if the answer requires the consultation of documents. Moreover, the mail questionnaire is considered to be

the least demanding in terms of its implementations such as staffing requirements, compared with all other methods (Moser and Kalton, 1993, and Oppenheim, 2000).

On the other hand, there are a number of disadvantages attached to the mail questionnaire. It requires simple questions. The mail questionnaire can be used as an instrument for data collection only when the questions are straightforward enough to be comprehended solely on the basis of printed instructions and definitions (Frankfort-Nachmias and Nachmias, 1996).

Another disadvantage associated with the mail questionnaire, is the low response rate in general. For many mail questionnaire surveys, the response rates are much lower than for personal interviews. As no personal contact is involved, mail questionnaires have difficulty in coping with boring questions and non-response items and there is no opportunity to correct misunderstanding or probe, or to offer explanation or help (Oppenheim, 2000). The answers have to be accepted as final. Also, there is no opportunity to appraise the non-verbal behaviour of the respondents (Frankfort-Nachmias and Nachmias, 1996). Also with a mail questionnaire, researchers have no control over the respondent's environment. Hence, they cannot be sure that the appropriate person completes the questionnaire. An individual other than the intended respondent may complete it (Frankfort-Nachmias and Nachmias, 1996).

The response rate is very important in any survey and it is the proportion of replies to numbers of questionnaires that really matters, not just numbers. One must also be careful not to overload a questionnaire with too many, or too complicated, questions. Every respondent can look through the whole of the questionnaire before even answering the first question, and if it seems too much and too complicated, then the response may well be lost all together. Also, in reading through all questions, the respondent may read into the whole questionnaire certain implications that were never intended. In the absence of the interviewer to keep the responses on the right

lines, the self-completed questionnaire has a lot of work to do on its own. There are always some people who are unwilling to commit themselves to paper anyway and, no matter how much the covering letter may assure them that the replies are anonymous and the forms will be destroyed, recipients may still remain suspicious and reluctant (Al-hajraf, 2002).

6.5 QUESTIONNAIRE DESIGN

The conducting of a questionnaire survey is the process of translating concepts into measurable variables (Saunders et al, 2000). The questionnaire is designed and developed after the review-survey of prior studies in the same field. The aim of the questionnaire in this study, as sample of which can be found in the Appendix section, is to collect the data necessary to evaluate Islamic banks financial reports and to explore the need for applying AAOIFI standards in Islamic banks in Saudi Arabia. Each section of the questionnaire aims at providing answer for each research question and hypothesis developed in the beginning of the research.

The questionnaire was designed to be closed-ended and specific enough to reveal answers to the instrument's questions. However at the same time general enough, to allow respondents, not to reveal any sensitive information. A close-ended question offers a selection of answers from which the respondent is asked to select one. Among others, Alreck and Settle (1995) and Oppenheim (2000) have found this method acceptable for collecting data in relation to the study of cause and effect in social studies.

All questions in this instrument were constructed according to the Five-Point Likert Scale with a value of 1 indicating that the respondent strongly disagrees with that factor and the highest number 5 indicating that the respondent strongly agrees with that factor. Before translating the instrument to the Arabic language, the researcher discussed its questions with a statistician from King Saud University in Riyadh, for their suitability to test the research hypotheses. The questionnaire was then

translated, pilot tested, edited and coded for the purpose of computer processing in the later stage of analysis.

The purpose of the Arabic version of the questionnaire was to permit respondents with little or no knowledge of English to participate in the survey. This was a very important stage in this study since any mistakes in translation could change the meaning and context of the questionnaire. The translation was then checked and reviewed by a specialist in Arabic language, an external auditor, and an internal auditor. The purpose of the review was to correct any grammatical errors and any mistakes in usage of accounting or auditing terms. After minor corrections had been made, the questionnaire was ready for pilot testing.

6-6 THE PILOT STUDY OF THE QUESTIONNAIRE SURVEY

In the field of social sciences, researchers emphasise the importance of conducting a pilot study to establish that the proposed questionnaire is understandable and clear to the members of the targeted population. As Salant and Dillman (1994: 120) mentioned that pre-testing a questionnaire is like test-driving. This is a time-consuming process but absolutely essential. Similarly Alreck and Settle (1995: 178) note that even well trained and highly experienced researchers find some changes that will improve the performance of the questionnaire by conducting a pilot study. Sometimes the pre-testing of the questionnaire will reveal very serious errors, oversights, or problems that would have spelled disaster if they had not been detected and corrected before going into the field or the mail. As well, Stebbins (2001: 29) claimed that “the rise of quantitative research brought with it the need to pre-test measuring instruments and conduct pilot studies to iron out kink in procedures and sharpen precision so the main study could proceed as flawlessly as possible.”

The revised questionnaires were then sent to five academics in Saudi Universities, ten external auditors, twenty employees in Saudi Islamic banks and five colleagues who are studying Ph.D. in accountancy in Australia and in the UK. The aim of this stage is to assess whether the research instrument is valid for the task or not. As Hussey and Hussey (1997) mentioned that validity is the extent to which the research findings accurately represent what is really happening in the situation. An effect or test is valid if it demonstrates or measures what the researcher thinks or claims it does. In other words, in the validity assessment, the basic question that we try to answer is: 'Are we in fact measuring what we think we are measuring?' (Diamantopoulos and Schlegelmilch, 2000: 34). In addition, the other objective of piloting is to detect the validity and reliability of the questionnaire. According to Diamantopoulos and Schlegelmilch (2000: 34), a measure that is valid is also reliable but the reverse is not necessarily true.

All of the piloting samples had a covering letter explaining the nature, and objectives of research. The reviewers were requested to note their observations, and then make recommendations to the questionnaire and comment on the ways to develop it as well as making suggestions that could facilitate the analysis of data.

In all, forty questionnaires were sent out of which thirty-one were returned. Three responses were received out of the five questionnaires from Saudi academics. And seven questionnaires were returned from external auditors and sixteen questionnaires from employees in Saudi Islamic banks. Finally, all five questionnaires were returned from colleagues in Australia and UK.

It should be noted that the researcher received many useful suggestions from all the parties who took part in the pilot study. Some of these corrections were about rephrasing the words in some of the statements while others were suggestions about shorten the questionnaire in order to get more responding.

6-6-1 Validity

The level of validity and reliability are the two major issues that a researcher must take into consideration when he or she uses a data gathering or measurement instrument. The importance of validity and reliability has been well documented within the research methodology literature. Spector (1994) asserts that one of the most vital steps in developing and/or validating a scale is the conceptual task of defining the construct. In other words, the construct of interest must be clearly and precisely defined. There are different kinds of validity. Generally, however, there are three types of validity of measurement that most researchers are concerned with. They are content validity; criterion-related validity and construct validity (Churchill and Iacobucci, 2002).

6-6-1-1 Content validity:

The content validity of an instrument is the extent to which it provides adequate coverage of the topic under study. To evaluate the content validity a researcher must first agree on what elements constitute adequate coverage of the problem. The determination of content validity is judgemental. The designer may determine the validity through a careful definition of the topic of concern, the items to be scaled, and the scales to be used (Sekaran, 2000). Diamantopoulos and Schlegelmilch (2000) argue that the procedure for this way is the agreement between expert and / or non-expert judges as to the suitability of the measure. Also, during the pilot study, the duration taken to complete the questionnaire was checked and timed to ensure that it was not too long as to make the participants shy away from completing it and answering all the questions.

The content validity of the instrument of this study was established through the pilot study as discussed earlier. During this period, the questionnaire was distributed to five academicians, ten external auditors, twenty employees in Saudi Islamic banks

and five PhD students in accountancy as discussed earlier. The results showed that the questionnaire covered the important aspects identified within the literature review. The results also showed that minor modifications were needed before the questionnaire could be finally used in the main study.

6-6-1-2 Construct validity:

Construct validity deals with the degree to which the scale represents the concept being measured (Tull and Hawkins, 1993). Attitude scales and personality tests generally are concerned with concepts that fall into this category. Even though, this validation situation is much more difficult, researchers still want assurance that their measurement has an acceptable degree of validity. The questionnaire used in this study contained clear and direct questions. This was reflected from the piloting tests, which showed that the construct validity is acceptable. Finally, using the Likert scale with its 5 categories also contributed to improving the construct validity.

6-6-2 Reliability

Reliability is concerned with the accuracy and precision of a measurement procedure (Sekaran, 2000). It is distinguished from validity in that validity is represented in the agreement between two attempts to measure the same trait through *maximally different* methods. Whereas reliability is the agreement, between two efforts to measure the same trait through *maximally similar* methods (Churchill and Iacobucci, 2002: 413), or as Oppenheim (2000: 159) described reliability as “consistency.” Reliable instruments are refined to the degree that they can be used over and over and work well at different times and under different conditions. In general, the researcher can improve reliability if external sources of variation are minimised and the conditions under which the measurement occurs are standardized. There are three common methods of estimating reliability (Frankfort-Nachmias and Nachmias, 1996):

- the test-retest;

- the parallel-forms and
- the split-half.

The test-retest method is used to administer the instrument to the same group at two different times and to compute the correlation in the two sets of scores. The coefficient that the researcher obtains is the reliability estimate. This method, error is defined as anything that leads a person to get different scores from the two different measurements (Alreck and Settle, 1995; Oppenheim, 2000).

In the parallel-forms method, the researcher develops two parallel versions of a measuring instrument. These two versions are administered to the same group of people, and then the two sets of results must be correlated in order to obtain an estimate of reliability. The split-half method estimates reliability by treating each of two or more parts of a measuring instrument as a separate scale. Each of the two parts is treated separately and scored accordingly. The two parts are then correlated (Frankfort-Nachmias and Nachmias, 1996).

Another method to test the reliability of the instrument is to use similar questions in different parts of the questionnaire. This is called items' internal-consistency reliability test. It means, "multiple items, designed to measure the same construct, will interrelate with one another" (Spector, 1994). This reliability procedure when run for each scale shows how the individual items of that specific scale compete to be incorporated in it whilst maintaining an acceptable level of reliability. Churchill and Iacobucci (2002) noted that an appropriate way to assess the internal homogeneity of a set of items is to look at all the items simultaneously, using coefficient alpha. One reason is that coefficient alpha has a direct relationship to the most accepted and conceptually appealing measurement model, the *domain-sampling model*.

The key assumption in the domain sampling model is that all items, if they belong to the domain of the concept, have an equal amount of common core. This statement implies that the average correlation in each column of the hypothetical matrix is the same, and in turn equals the average correlation in the whole matrix. That is, if all the items in a measure are drawn from the domain of a single construct, responses to those items should be highly inter-correlated. Low inter-item correlations, in contrast, indicate that some items are not drawn from the appropriate domain and are producing error and unreliability. Coefficient alpha provides a summary measure of the inter correlations that exist among a set of items. Coefficient alpha routinely should be calculated to assess the quality of measure. If alpha is low, this outcome suggests that some items do not share equally in the common core and should be eliminated (Churchill and Iacobucci, 2002).

The reliability for the scale and items of the instrument used in this study were tested to ensure that satisfactory internal consistency was present. This was done by constructing some of the questions to collect similar answers or to check the correctness of the answers given for each question in the instrument as suggested by Wentland and Smith (1993). According to Diamantopoulos and Schlegelmilch (2000: 34) who claimed that a measure that is valid is also reliable but the reverse is not necessarily true. It should be noted that when the completed questionnaires were received, they were checked for correct completion. This process of editing and checking was conducted to ensure maximum reliability and validity of the data gathered.

6.7 THE RESEARCH POPULATION AND FIELDWORK

The population is the entire group of organisations, people, events, or things of interest that the researcher wishes to investigate. The population frame is a listing of all elements in the population from which the sample is to be drawn (Sekaran, 2000). The process of sampling is very important for researchers engaged in survey studies.

Sekaran (2000) defines sampling as “a subgroup or subset of the population. By studying the sample, the researcher would be able to draw conclusions that would be generalisable to the population of interest.” Moreover, Salant and Dillman (1994) stated that the power of sample surveys is their ability to obtain information from a relatively few respondents to describe the characteristics of an entire population. However, Weisberg et al (1996: 39) pointed out “if the population we are interested in is so small then we can easily interview the entire population”. As well, Salant and Dillman (1994: 53) mentioned that “Sampling is not always necessary. When the study population is very small, efficiency may not be a big concern.”

The fieldwork of this study started at the beginning of January 2004 and lasted for a period of four months with the collection of data from three samples. The choice of the samples was mainly based on the groups' knowledge of Islamic banking and Accounting environment in Saudi Arabia. The samples chosen in this study are as follows:

- (i) Academics specialised in Accounting and Finance in Saudi Universities,
- (ii) External auditors in Saudi Arabia, and
- (iii) Employees in Islamic Banking and Islamic windows in Saudi Arabia (Head offices only).

6-7-1 QUESTIONNAIRE DISTRIBUTION

In the beginning of the fieldwork, academics, external auditors and employees in Islamic Banking and Islamic windows received an introductory letter explaining the nature and aim of this study and the method to answer questions. All individuals were informed that their responses would remain confidential. In addition, all respondents were offered a summary of the results upon request. At the end of the questionnaire, the respondent was thanked for the time he/she spent filling out the

questionnaire and were reminded to mail it back using the self-addressed stamped envelope or by personal collection.

An introduction letter was prepared by the researcher's sponsor (Department of Accounting in Umm Al-Qura University in Saudi Arabia), which was very useful since many respondents mentioned the importance of the letter in their comments. The original signature of the Head of the Department along with the official college stamp was placed on the official college paper and attached to every questionnaire. The researcher called the respondents who did not respond after three weeks by phone to remind them and to encourage them to send their response. The second telephone call to the respondents was made six weeks after the questionnaire was first administered. In addition, the researcher offered online questionnaire to all the respondents who claimed that they had not received the questionnaire yet. The effort to get more responses was made by the researcher after ten weeks to remind the respondents and to inform them that they could still respond before the deadline. Nevertheless, some responses received after 1st May 2004 have been ignored. The researcher used three approaches for distributing the questionnaire. They are the following:

Distributing the questionnaire by mail.

Personally delivered questionnaire.

Online questionnaire (<http://www.al-abdullatif.net>).

6-7-1-1 Distributing the Questionnaire by Mail

According to the address list released on 7-4-2003 by the Saudi Organisation of Certified Public Accountants (SOCPA), the numbers of registered external auditors in Saudi Arabia are 164 members. The researcher decided to distribute the questionnaire by mail to all registered external auditors in Saudi Arabia. Every

external auditor received an introductory letter explaining the nature and aim of this study and the method to answer questions, a copy of the research tool and a self-addressed stamped return envelope. The envelopes were marked with control numbers to enable the researcher to identify and call those that failed to respond at the specified time.

The responses in total were 55, out of which 51 were useable responses since it was discovered that 3 respondents did not seem to be careful in choosing their answers. Whereas the fourth one refused to answer the questionnaire claiming that Islamic banks in Saudi Arabia do not exist.

6.7.1.2 Personally delivered questionnaire

It should be noted that this method gained the highest responding rate, 39.25% for the Academics and 40% for the employees of Islamic banks and windows. Whereas, the responding rate for the previous method was 31% only. This of course shows that people in Saudi Arabia do not show interest in answering mail questionnaires comparing with other methods.

The researcher distributed 135 questionnaires to all academics working in accounting departments in the following universities:

- Umm Al-Qura University in Makkah
- King Abdul Aziz University in Jeddah
- King Saud University in Qassem
- Al-Immam Muhammed Ibn Saud Islamic University in Riyadh , Qassem and al-Ahsaa
- King Fisal University in Al-Ahsaa
- King Fahd University of Petroleum and Minerals

The responses were 58, out of which 53 were useable responses. On the other hand, 200 questionnaires were handed to six leading banks in Saudi Arabia in the field of Islamic banking and Islamic windows as following:

- Al-Rajhi Bank
- Al-Jazira Bank
- Saudi American Bank
- Saudi British Bank
- Commercial Bank
- Riyadh Bank.

The responses were 88, out of which 80 were usable.

6.7.1.3 Online questionnaires

The researcher designed a website to allow respondents from far distance to answer the questionnaire online. For instant, some Saudi postgraduate students which are study in the UK, the US and Australia specialising in the accounting field participated via filling the questionnaire online. Moreover, this method increased the response rate by 10% approximately and it should be noted that the online questionnaire helped the researcher in targeting important people with only their e-mail address available. The following table presented the total of distributed, responses, usable, and response rates for the three samples.

Table 6-1: Overall response rates for the three samples

Samples	Total distributed	Total responses	Usable responses	Response rate
Academics	135	58	53	39.25%
External auditors	164	55	51	31%
Employees in Islamic	200	88	80	40%
<u>TOTAL</u>	<u>499</u>	<u>201</u>	<u>184</u>	<u>36.87%</u>

6.8 DATA ANALYSIS METHODOLOGY

Although data was analysed after conducting the questionnaire survey, much thought was given to the testing and analysis of results during the questionnaire design. Normally, the first step in analysis, especially in surveys, is the editing and coding of collected data. The researcher has checked the data to make sure it is as accurate as possible, consistent with other facts secured, uniformly entered, as complete as possible and arranged to facilitate coding and tabulation. The analysis of responses was carried out on a personal computer using statistical package for social science (SPSS), which is a popular statistical software often used in social studies (Bryman and Cramer, 1997). All the answers given to the questionnaire were coded and entered into SPSS for various analysis.

The statistical analysis in this study has been divided into four chapters. In the first three chapters (chapters 7, 8 and 9), the descriptive statistical analysis (i.e. frequencies, percentages, and the mean values) of the research questions for the academics, external auditors and Islamic banks employees sequentially are presented. These three chapters will be followed by a chapter (Chapter 10) devoted to the comparison of the responses of the academics, external auditors and Islamic bank employees. In addition to this, appropriate procedures will be applied to test the related research hypotheses.

The data description is normally the first step in any data analysis project. Diamantopoulos and Schlegelmilch (2000) mentioned that data description is an important, self-standing activity in providing a descriptive focus of the analysis objectives. In addition descriptive analysis provides a very useful initial examination of the data even when the ultimate concern of the investigator is inferential in nature (i.e. involving estimation and/or hypothesis-testing). Specifically, the purpose of descriptive analysis is to (Diamantopoulos and Schlegelmilch 2000) : -

- Provide preliminary insights as to the nature of the responses obtained, as reflected in the distribution of values for each variable of interest.
- Help detect errors in the coding process.
- Provide a means for representing the data in a digestible manner, through the use of tables and graphs.
- Provide summary measures of ‘typical’ or ‘average’ responses as well as the extent of variation in responses for a given variable.
- Provide an early opportunity for checking whether the distributional assumptions of subsequent statistical tests are likely to be satisfied.

Nevertheless as (Hussey and Hussey 1997) mentioned that “statistics texts commonly draw a distinction between:

- a) Exploratory data analysis or descriptive statistics, which is used to summarise or display quantitative data, and
- b) Confirmatory data analysis or inferential statistics, which involves using quantitative data collected from a sample to draw conclusions about a complete population.”

In this study, chapters 7, 8 and 9 presents exploratory descriptive results, while Chapter 10 presents conformity data analysis or inferential statistics.

The statistical analysis in this study involves descriptive statistics including frequencies, t-test and Chi-square test for statistical significance, and cross-tabulation for more analytical statistics.

Cross-tabulation is possibly one of the most popular of all the basic bivariate statistical procedures. A cross-tabulation is used when we wish to establish if there is a link or association between two categorical variables. The most useful (and easy to understand) bivariate analysis is usually presented in tables. These are often called contingency tables because the values of one variable are contingent upon the values of the other variable.

Cross-tabulation is used in this study to test the hypothesis and discover the link between the experience, education and the professional qualifications of the respondents.

For inferential statistics, factor analysis was utilised, the results of which presented in Chapter 10. Factor analysis refers to a range of techniques, the aims of which are to describe a large number of (metric) variables by means of a smaller set of composite variables (so called 'factor') and to aid the substantive interpretation of the data (Diamantopoulos and Schlegelmilch 2000). In other words, it concisely analyse the questions which provides a list of factors or items defining the question. In the questionnaire used for this research, there are 5 questions containing factorability items or a list of potential factors, which determine the dependent variable or the question variable. These questions are:

Question No: 4 (What is your opinion regarding the importance of the following factors that might affect the quality and adequacy of the accounting information disclosed by Islamic banks?) with a list of 8 factors;

Question No: 5 (What is your opinion regarding the importance of the following sources of information in indicating Islamic banks' performance?) with a list of 6 factors or variables

Question No: 6 (What is your opinion regarding the importance of the following sections of the Islamic bank's annual report?) with a list of 12 factors;

Question No: 10 (Do you agree or disagree that the following problems might be caused by using different accounting standards?) with a list of 8 factors or variables

Question No: 11 (Do you believe that applying Islamic accounting standards in Saudi Arabia might help in achieving the following objectives?) with a list of 6 variables.

Factor analysis is deemed to be appropriate for this particular analysis because the above questions have many variables. Vaus (2002) mentioned that observable variables can be clustered into factors by using factor analysis, each reflecting an underlying property (such as social objectives) which is commonly shared by a certain group of variables. It also helps to validate that respondents are able to distinguish between the two variables despite the similarity of the items questioned (Hair, Anderson et al. 1998).

To test the factorability of the data, the Kaiser-Meyer-Olkin (KMO) test will be used to measure the sample adequacy while Bartlett's test is a test of sphericity. According to Dusuki (2005), Bartlett's test of sphericity is a test statistic used to examine the hypothesis that the variables are uncorrelated in the population. In other words, the population correlation matrix is an identity matrix, each variable correlates perfectly with itself ($r=1$) but has no correlation with the other variables ($r=0$) (Dusuki 2005:167).

Lastly, interpretative method was utilised to give further meaning for the data analysis, as part of the qualitative data analysis. Because, presenting the raw findings of statistical analysis does not necessarily provide us with the best understanding of the analysis, and therefore an attempt should be made to interpret the data to gain further understanding of the data analysis.

6.9 CONCLUSION

This chapter explained the research approach adopted in this study by presenting the factors, which influenced the choice of questionnaire technique and approaches and its advantages and disadvantages. Since the study aims to analyse the perception and opinions of three category of participants in accounting and standard related tasks in Islamic banking, questionnaire survey were considered to be the best method to collect the necessary primary data to fulfil the aim and objectives of this study.

This chapter also reported the procedures followed in the design and development of the close-ended questionnaire. This was the study's main collection instrument. This chapter also explained how the pilot study was carried out to develop the questionnaire and how it was conducted and the benefits that had been gained from parties of piloting. Finally, it gives details of the questionnaire fieldwork procedure, which started at the beginning of January 2004 until May 2004 and it reports the achieved response rate.

The following chapter presents in more details the descriptive data analysis of this study and the different techniques and tests that are carried out to achieve its objectives.

CHAPTER 7

PERSPECTIVES OF ACADEMICS ON ADOPTING AAOFI STANDARDS IN SAUDI ARABIA: DESCRIPTIVE DATA ANALYSIS

7.1 INTRODUCTION

This chapter presents the descriptive analysis for the academics survey which will be conducted in this research. This is considered to be the first stage in the process of data analysis in this research. The response of the academics will be illustrated through the use of percentages and frequencies, demonstrated through the use of tables.

In this chapter and the following two chapters, descriptive statistics will be performed to describe the frequencies of data collected. On the other hand, chapter eleven will present the confirmatory data analysis. In this chapter, descriptive analysis for the first group of respondents which are academics will be presented.

7.2 DEMOGRAPHIC CHARACTERISTICS OF THE PARTICIPANT ACADEMICS

The analysis in this section covers the level of education, professional qualifications and experience of the academics. As mentioned in the previous chapter, a total of 135 questionnaires were distributed to academics working in accounting departments in the following universities in Saudi Arabia:

Umm Al-Qura University in Makkah.

King Abdul Aziz University in Jeddah.

King Saud University in Qassem.

Al-Immam Muhammed Ibn Saud Islamic University in Riyadh, Qassem and al-ahsaa.

King Faisal University in Al-Ahsaa.

King Fahd University of Petroleum & Minerals in Dhahran.

A total of 58 responses were received, out of which 53 were useable responses. 5 responses were ignored as the responses were not complete or they alleged ignorance of the subject of the research or returned the questionnaire blank as they alleged that there are no Islamic banks in Saudi Arabia.

7.2.1 Academics' Level of Education

In relation to question 19 of the questionnaire distributed, respondents were asked to identify their education level and they were given four educational choices:

1. Below Bachelor level
2. Bachelor
3. Master
4. PhD

Table 7-1 indicates the educational level of 53 academics who participated in this study. All academics have a bachelor degree and above. It is obvious that the majority of the academics (39 academics) hold a PhD degree (73.6%), whereas 10 of them hold a master's degree (18.9%), and only 4 academics hold a bachelor's degree (7.5%).

It is worth mentioning that this group has been selected from higher education institutes in Saudi Arabia, specifically from accounting and finance departments at the Saudi universities listed above. Thus, this group is considered as highly educated and knowledgeable.

As almost three quarters of the academics who are specialized in the field of accountancy hold a PhD, it is believed that the perceptions of this group will support confidence in generalizing the results of this research.

Table 7-1: Level of Education of the Participant Academics

Level of education	Frequency	Percent
Bachelor	4	7.5
Master	10	18.9
PhD	39	73.6
Total	53	100.0

7.2.2 Level of Professional Qualifications

Question 20 of the questionnaire asked the academics to identify the professional qualifications which they might hold. They were given four professional qualification choices:

1. Chartered Accountants (CA)
2. American Certified Public Accountants (CPA)
3. Saudi Organisation of Certified Public Accountants (SOCPA)
4. Other...

It is worth mentioning that from the 53 academics who responded to this questionnaire only 6 of them were holding professional qualifications. As can be seen from table 7-2, two academics were holding CPA (3.8%) and the same number were holding SOCPA (3.8%) and the last two academics were holding other professional qualifications.

These results reveal that the majority of academics did not have professional qualifications. In spite of the importance of professional qualifications for accountants, the researcher believes that academics are mainly specialized in aspects of academic research rather than practical aspects. This gives an explanation as to why only 6 academics out of 53 respondents were holding such professional qualifications.

Table 7-2 presents the academics professional qualifications as follows:

Table 7-2: Academics Level of Professional Qualifications

Level of professional qualifications	Frequency	Percent
CPA (USA)	2	3.8
SOCPA (KSA)	2	3.8
Other	2	3.8
<u>Total academics holds professional qualifications</u>	<u>6</u>	<u>11.3</u>
Academics without professional qualifications	47	88.7
<u>Total</u>	<u>53</u>	<u>100.0</u>

7.2.3 Level of Experience

Question 21 of the questionnaire asked the academics to identify their years of work experience by choosing one of the following categories:

1. Less than 5 years
2. 5-10 years
3. 10-15 years
4. 15-20 years
5. More than 20 years

The result of this section shows that all 53 academics who participated in this survey had stated their work experience. As it can be seen from table 7-3, the majority of academics have been working for more than 20 years (49%). And the minority (5.66%) of the academics had worked for less than 5 years.

Almost 17% of the academics have an experience ranging from 5 years to 10 years and another 17% of academics have an experience between 15 years to 20 years. In addition, the academics that have experience between 10 to 15 years the percentage was 11.32%. It can be concluded that academics who participated in this study have adequate experience since approximately 49% of them have experience of up to 20 years and more.

Table 7-3: Academics' Level of Experience

Level of experience	Frequency	Percent
Less than 5 years	3	5.7
5- 10 years	9	17.0
10- 15 years	6	11.3
15- 20 years	9	17.0
More than 20 years	26	49.1
Total	53	100.0

7.3 ACADEMICS' PERCEPTIONS TOWARDS ISLAMIC FINANCIAL STATEMENTS IN SAUDI ARABIA

In this section, academics' perceptions towards usefulness of Islamic financial statements in Saudi Arabia will be investigated by asking them different questions related to this issue.

7.3.1 Academics' Response towards the Objectives of the Islamic Banks' Financial Statements Reporting

The first question of the questionnaire in this section aimed at finding out the views of academics on the objectives of the Islamic banks' financial statements reporting. Academics were given seven objectives where six of them were taken from the first AAOIFI accounting standards (AAOIFI, 2002, paragraph 37-42, p.17). In addition, the last objective "It helps to compare the performance between Islamic banks and conventional banks" was suggested by the researcher. The frequencies and percentage of respondents of this question will be presented in table 7-4 below.

Table 7-4 Academics responses' opinion: "Do you agree or disagree with the following objectives of the Islamic banks' financial statements reporting?"

Objectives	Strongly disagree		Disagree		Neutral		Agree		Strongly agree		Mean	Rank
	No	%	No	%	No	%	No	%	No	%		
To provide information about compliance with the Islamic Shari'ah	2	3.8	1	1.9	8	15.1	22	41.5	20	37.7	4.08	4
To provide information about the Islamic bank's financial resources and related obligations	—	—	2	3.8	3	5.7	25	47.2	23	43.4	4.30	1
To provide information about sources and uses of the Zakah fund	—	—	3	5.7	5	9.4	25	47.2	20	37.7	4.17	2
To provide information about adequacy of Islamic banks' capital, the risk inherent in its investments and the degree of its liquidity.	2	3.8	1	1.9	10	18.9	29	54.7	11	20.8	3.87	6
To provide information about ability to generate income and convert it into cash flows	—	—	4	7.5	10	18.9	25	47.2	14	26.4	3.92	5
To provide information about Islamic banks' discharge of its social responsibilities	5	9.4	5	9.4	14	26.4	21	39.6	8	15.1	3.42	7
It helps to compare the performance between Islamic banks and conventional banks.	—	—	4	7.7	6	11.5	22	42.3	20	38.5	4.12	3

It can be seen from table 7-4 above that most of the academics agreed with all the objectives of the Islamic banks' financial reporting. However, according to the ranks, the second objective, which is about "providing information about the Islamic bank's financial resources and related obligations" seems to be the most important objective to academics with a mean of (4.30). The third objective, which is about "providing information about sources and uses of the *Zakah* fund" came in the second place with a mean of (4.17). Whereas the objective suggested by the researcher, which is that "Islamic banks' financial reporting might help in comparing the performance between Islamic banks and conventional banks" came in third place with a mean of (4.12). This result shows that academics in Saudi Arabia agreed with the objectives of the Islamic banks' financial reporting although it is not yet applied in Saudi Arabia.

7.3.2 Academics Response towards the Importance of the Islamic Banks' Financial Statements for its Users

The second question of the questionnaire aims to explore the opinion of the academics regarding the importance of the Islamic banks' financial statements for its users. The users of the Islamic banks' financial statements listed on the questionnaire were as following:

1. Shareholders/investors
2. Management of the Islamic banks
3. Employees of the Islamic banks
4. Auditors
5. Customers
6. Government

Table 7-5 will present the frequency and percentage of academic responses to the importance of Islamic banks' financial statements for each user.

Table 7-5 Academics respondents' opinion: "What is your view regarding the importance of Islamic banks' financial statements for each group of the following users?"

The group of users	Not important At all		Not important		Neutral		Important		Very important		Mean	Rank
	No	%	No	%	No	%	No	%	No	%		
Shareholders/investors	—	—	—	—	1	1.9	—	—	52	98.1	4.96	1
Management	—	—	—	—	2	3.8	5	9.4	46	86.8	4.83	2
Employees	—	—	7	13.2	8	15.1	30	56.6	8	15.1	3.74	6
Auditors	1	1.9	2	3.8	1	1.9	9	17.3	39	75.0	4.60	3
Customers	2	3.8	2	3.8	9	17.0	19	35.8	21	39.6	4.04	5
Government	—	—	—	—	5	9.6	22	42.3	25	48.1	4.38	4

It can be seen from table 7-5 that Islamic banks' financial statements are very important for most of the users from an academic point of view. Academics believe that the shareholder and investors are the most important users of the Islamic banks' financial statements with the highest mean (4.96) followed by the management of the Islamic banks with a mean of (4.83) and the third important user were the auditors with a mean of (4.60). However, employees of the Islamic banks are considered as the least important users although they get a mean of (3.74) which is still important.

This result shows that academics in Saudi Arabia consider Islamic banks' financial statements to be an important source of information for all of the above users and it is very helpful for decision making.

7.3.3 Academics' response towards the qualitative characteristics of the Islamic banks' financial information

The third question of the questionnaire attempted to explore the academics' view regarding the qualitative characteristics of the Islamic banks' financial statements in Saudi Arabia. Academics were give five qualitative characteristics as follows:

1. Relevance
2. Reliability
3. Comparability (between other banks and Islamic banks)
4. Consistency
5. Understandability

Table 7-6 below shows the frequency and percentage of the academics responses towards the qualitative characteristic of the Islamic banks' financial statements.

Table 7-6 Academics respondents' opinion:" Do you agree or disagree that the financial information disclosed by the Islamic banks has the following qualitative characteristics?"

The Qualitative Characteristics	Strongly disagree		Disagree		Neutral		Agree		Strongly agree		Mean	Rank
	No	%	No	%	No	%	No	%	No	%		
Relevance	—	—	2	3.8	13	24.5	27	50.9	11	20.8	3.89	3
Reliability	—	—	1	1.9	16	30.2	18	34.0	18	34.0	4.00	1
Comparability (between other banks and Islamic banks)	—	—	7	13.2	12	22.6	23	43.4	11	20.8	3.72	5
Consistency	—	—	2	3.8	16	30.2	19	35.8	16	30.2	3.92	2
Understandability	—	—	3	5.7	16	30.2	25	47.2	9	17.0	3.75	4

It is very obvious from table 7-6 that academics could hardly agree about the qualitative characteristics of the Islamic banks financial statements with the highest mean of only 4.00 for the reliability, 3.92 for the consistency, 3.89 for the relevance, 3.75 for the understandability and only 3.72 for the comparability, this result might provide an indication that academics believe that Islamic banks' financial statements which exist in Saudi Arabia nowadays do need some changes to enhance some of the qualitative characteristics of the Islamic banks' financial statements in Saudi Arabia especially for the comparability level.

7.3.4 Academics' Response towards the Factors which might Affect Quality and Adequacy of the Islamic Banks' Financial Information

Question 4 of the questionnaire tries to find out the opinion of the academics regarding the importance of eight factors which might affect quality and adequacy of the Islamic Banks financial information. The following table, 7-7, will present the eight factors with the frequency and percentage of the academic responses

Table 7-7 Academics Respondents' opinions:" What is your opinion regarding the importance of the following factors that might affect the quality and adequacy of the accounting information disclosed by Islamic banks?"

Factor	Not important At all		Not important		Neutral		Important		Very important		Mean	Rank
	No	%	No	%	No	%	No	%	No	%		
The external auditor is a national firm	2	3.8	7	13.2	9	17.0	9	17.0	26	49.1	3.94	6
The external auditors is national firm affiliated with international firm	7	13.2	18	34.0	7	13.2	11	20.8	10	18.9	2.98	8
Capability of Islamic bank's management	—	—	—	—	2	3.8	12	22.6	39	73.6	4.70	2
Bank size and its products and services	—	—	1	1.9	12	22.6	19	35.8	21	39.6	4.13	5
Accounting standards adopted in preparing the financial statements	—	—	—	—	5	9.4	15	28.3	33	62.3	4.53	3
The level of education and professional qualification that employees hold	—	—	—	—	2	3.8	21	39.6	30	56.6	4.53	3
An effective system of internal control in the bank	—	—	—	—	—	—	8	15.1	45	84.9	4.85	1
Ownership structure (e.g. percentage of government ownership, percentage of private ownership and foreign participation)	—	—	11	20.8	12	22.6	14	26.4	16	30.2	3.66	7

As is clear from table 7-7 all factors listed were important in the opinion of academics except the second factor "The external auditors is a national firm affiliated with an international firm" in which they were not sure whether it is important or not important with a mean of (2.98).

Academics believed that the most important factor which might affect the quality and adequacy of the accounting information disclosed by Islamic banks were factor number 7 which is "An effective system of internal control in the bank" with a mean of (4.85) followed by the third factor "capability of Islamic bank's management" with a mean of (4.70). The fifth factor which is "Accounting standards adopted in preparing the financial statements" and sixth factor which is "The level of education and professional qualification that employees hold" were equally ranked third between all factors with a mean of (4.53).

This result demonstrate that academics believe that accounting standards adopted in preparing the financial statements is one of the most and very important factors which might affect the quality and adequacy of the accounting information disclosed by Islamic banks. This result is very important and is a prelude to any discussion of what accounting standards should be adopted for the preparation of Islamic banks' financial statements in Saudi Arabia.

7.3.5 Academics' Response towards which Source of Information is more important in Indicating Islamic Banks' Performance

Question 5 of the questionnaire attempts to discover which source of information academics believe is important in indicating the performance of Islamic banks. Table,7-8 depicts the opinion of the academics regarding the importance of each one of the six sources of information listed below.

Table 7-8 Academics respondents' opinion:" What is your opinion regarding the importance of the following sources of information in indicating Islamic banks' performance?"

The information sources	Not important At all		Not important		Neutral		Important		Very important		Mean	Rank
	No	%	No	%	No	%	No	%	No	%		
Islamic bank's financial reports	—	—	—	—	4	7.7	12	23.1	36	69.2	4.62	1
Islamic bank's interim financial statements	—	—	—	—	5	9.6	11	21.2	36	69.2	4.60	2
Newspapers and Specialist magazines	1	1.9	1	1.9	29	55.8	14	26.9	7	13.5	3.48	5
Direct information from the Islamic bank	2	3.8	—	—	4	7.7	24	46.2	22	42.3	4.23	3
Market's rumours	5	9.6	16	30.8	17	32.7	10	19.2	4	7.7	2.85	6
Government's publications	1	2.0	3	5.9	12	23.5	18	35.3	17	33.3	3.92	4

Table 7-8 shows that academics believe that Islamic bank' financial reports are the most important source of information in indicating their performance with a mean of 4.62 followed by the Islamic banks interim financial statements with a mean of 4.60. Direct information from the Islamic bank is in third place with a mean of 4.23, government information is in fourth place with a mean of 3.92 and finally the newspapers and specialist magazines with a mean of 3.48. On the other hand, academics do not believe that market's rumours are an important source of information with a mean of 2.85.

This result demonstrates the importance of Islamic banks' financial statements as a major source of information. Therefore, attention must be given to the ways in which these statements are prepared.

7.3.6 Academics' Response towards the Importance of each Section of the Islamic Bank's Annual Report

In this question, academics present what is the most important section of the Islamic bank's annual report in their opinions. The following table, 7-9, depicts the opinion of the academics regarding the importance of each section of the Islamic bank's annual report listed below.

Table 7-9 Academics' respondents' opinion: "What is your opinion regarding the importance of the following sections of the Islamic bank's annual report (if available)?"

Section of the report	Not Important At all		Not important		Neutral		Important		Very important		Mean	Rank
	No	%	No	%	No	%	No	%	No	%		
Board of Directors' report	—	—	1	1.9	4	7.5	15	28.3	33	62.3	4.51	8
Auditor's report	—	—	—	—	3	5.7	4	7.5	46	86.8	4.81	3
Balance sheet	—	—	—	—	1	1.9	3	5.7	49	92.5	4.91	1
Income statement	—	—	—	—	1	1.9	6	11.3	46	86.8	4.85	2
Statement of changes in owners' equity (statement of retained earnings)	—	—	—	—	3	5.7	11	20.8	39	73.6	4.68	6
Statement of cash flow	—	—	—	—	1	1.9	9	17.0	43	81.1	4.79	4
Note of the financial statements	—	—	—	—	2	3.8	8	15.1	43	81.1	4.77	5
Shari'ah supervisory board's report	—	—	—	—	5	9.4	13	24.5	35	66.0	4.57	7
Summary of annual activities	—	—	—	—	8	15.1	30	56.6	15	28.3	4.13	12
Report about internal control	—	—	3	5.8	4	7.7	22	42.3	23	44.2	4.25	9
Statement of changes in restricted investments	—	—	2	3.8	8	15.1	21	39.6	22	41.5	4.19	11
Statement of sources and uses of funds in the Zakah and the charity fund	—	—	—	—	11	20.8	19	35.8	23	43.4	4.23	10

As can be seen from table 7-9 academics considered all sections as being important. This result shows the importance of every section of the Islamic bank's annual report although some of them do not appear in the annual report in Islamic banks in Saudi Arabia, which might lead one to consider applying AAOIFI standards in Islamic banks in Saudi Arabia.

7.4 ACADEMICS' AWARENESS OF AAOIFI ACCOUNTING STANDARDS

In this section awareness of AAOIFI accounting standards is tested by asking the participants whether they are aware of it and have heard about it or not. Table 7-10 below will present the frequency and percentage of academics towards this particular issue.

Table 7-10 Academics respondents' opinion: "Are you aware of the Islamic Accounting Standards which are issued by AAOIFI?"

Choices	Academics	
	Frequency	Valid Percent
I am aware of it	26	50.0
I have heard about it	14	26.9
I have never heard about it	12	23.1
Total	52	100.0

As can be seen from table 7-10, 52 out of 53 academics, answered this question. 26 academics representing 50% of the responses confidently revealed that they have knowledge and awareness of AAOIFI standards, while 12 academics representing 23.1% of the responses were completely ignorant of the existence of Islamic accounting

standards. Only 14 academics representing 26.9% of the responses have a little knowledge of these standards. Although 50% of the academics are aware of AAOIFI standards, the researcher believes that this percentage is not enough especially for academics who are supposed to be the most knowledgeable group of respondents. The researcher believes that ignorance of AAOIFI standards among academics is because AAOIFI is not recognized by SAMA and therefore not implemented yet.

7.5 ACADEMICS' PERCEPTIONS TOWARDS APPLYING AAOIFI ACCOUNTING STANDARDS IN SAUDI ARABIA

In this section, academics' perceptions towards applying AAOIFI accounting standards in Saudi Arabia are investigated by asking them different questions related to this issue.

7.5.1 Academics Opinion Regarding AAOIFI Accounting Standard No.18

Question 8 in the questionnaire aims to find out the perceptions of academics towards AAOIFI accounting standard as indicated article No.18, and to what extent they agree or disagree with it. This question is considered as being an example to assess the willingness of academics to apply Islamic accounting standards.

According to table 7-11 below, all statements which have been taken from AAOIFI accounting standard No.18 were strongly agreed with. Actually, this is a strong indication that academics prefer AAOIFI accounting standards to be implemented in Islamic banks and Islamic windows in conventional banks in Saudi Arabia.

Table 7-11 Academics respondents' opinion towards AAOIFI Standard No. 18

Statements	Strongly disagree		Disagree		Neutral		Agree		Strongly agree		Mean
	No	%	No	%	No	%	No	%	No	%	
Islamic windows in Saudi Arabia must prepare supplementary statements to be published in the notes of the financial statements of the conventional banks.	—	—	1	1.9	1	1.9	6	11.3	45	84.9	4.79
Islamic windows in Saudi Arabia must disclose whether or not they mingle funds relating to Islamic financial services with funds relating to conventional financial services.	—	—	—	—	—	—	7	13.2	46	86.8	4.87
Islamic windows in Saudi Arabia must disclose, in detail, the sources and applications of funds mobilised and invested by their Islamic financial services.	—	—	—	—	—	—	6	11.5	46	88.5	4.88

7.5.2 Academics' Response towards Harmonizing Accounting Standards used for the Islamic Banks' Financial Statements

Question 9 of the questionnaire aimed to find out the academics perceptions regarding the idea of harmonizing accounting standards used for the Islamic banks' financial statements. Table 7-12 below will presents the frequency and percentage of the respondents regarding this matter.

Table 7-12 Academics' respondents' opinion: "Do you support the idea of harmonizing the Accounting standards used for the Islamic bank's financial statements?"

Choices	Academics	
	Frequency	Valid Percent
Yes	49	94.2
No	2	3.8
I Don't Know	1	1.9
<u>Total</u>	<u>52</u>	<u>100.0</u>

There is no doubt table 7-12 shows that the vast majority of academics (94.2%) support the idea of harmonizing accounting standards used in the preparation of Islamic banks' financial statements.

7.5.3 Academics' Response towards the Problems Expected when using Different Accounting Standards

The use of different accounting standards to prepare Islamic banks' financial statements could cause some problems. In this section, potential problems of using different accounting standards will be evaluated by asking the academics whether they agree or disagree with them. Table 7-13 below will present frequency and percentage of the respondents and will provide a rank for each potential problem.

Table 7-13 Academics' respondents' opinion: "Do you agree or disagree that the following problems might be caused by using different accounting standards?"

Potential problems of Using Different Accounting Standards	Strongly disagree		Disagree		Neutral		Agree		Strongly agree		Mean	Rank
	No	%	No	%	No	%	No	%	No	%		
Difficulty in comparing financial statements	—	—	3	5.8	1	1.9	11	21.2	37	71.2	4.58	1
Variations in the users' interpretation of the financial information	—	—	2	3.8	6	11.5	12	23.1	32	61.5	4.42	2
Difficulty in making decisions	—	—	6	11.5	8	15.4	15	28.8	23	44.2	4.06	4
Decreased user trust in accounting information	1	1.9	9	17.3	8	15.4	15	28.8	19	36.5	3.81	6
Loss of trust in the audit reports	5	9.6	9	17.3	10	19.2	12	23.1	16	30.8	3.48	8
Expand the range of the work done by the external auditors	1	1.9	7	13.5	13	25.0	21	40.4	10	19.2	3.62	7
Difficulties for accountants to deal with different accounting standards	—	—	2	3.8	9	17.3	20	38.5	21	40.4	4.15	3
Cost of training accountants to be familiar with different accounting standards	—	—	4	7.7	8	15.4	29	55.8	11	21.2	3.90	5

Generally speaking, academics agreed with all potential problems listed in table 7-13. However, they believe that difficulty in comparing financial statements is the most important problem which might be caused by using different accounting standards in preparing Islamic banks' financial statements with the highest mean of 4.58. The second

problem was “the variations in the users’ interpretation of the financial information” with a mean of 4.42. The third problem was “the difficulty for accountants to deal with different accounting standards” with a mean of 4.15.

This result demonstrate how important it is to harmonize accounting standards to prepare Islamic banks’ in Saudi Arabia in order to eliminate all problems which might be caused by using different accounting standards.

7.5.4 Academics’ Response towards the Objectives that Might be Achieved if AAOIFI Accounting Standards Applied in Saudi Arabia

Applying AAOIFI accounting standards in Islamic banks in Saudi Arabia might achieve some of the objectives listed in table 7-14. In this section, academics’ perceptions regarding this matter are presented.

As can be seen from table 7-14, academics strongly agree on all objectives which might be achieved when AAOIFI accounting standards are implemented in Saudi Arabia. Promoting adequate disclosure of comparable financial information was the most important objective in the academics’ point of view with a highest mean of 4.85 followed by “harmonizing financial statements between Islamic banks” in second place with a mean of 4.83.

The result of this question confirms the results in the previous questions that applying AAOIFI and harmonizing accounting standards will lead to comparing Islamic banks’ financial information.

Table 7-14 Academics respondents' opinion: "Do you believe that applying Islamic accounting standards in Saudi Arabia might help in achieving the following objectives?"

Objectives	Strongly disagree		Disagree		Neutral		Agree		Strongly agree		Mean	Rank
	No	%	No	%	No	%	No	%	No	%		
Harmonizing financial statements between Islamic banks	—	—	—	—	—	—	9	17.0	44	83.0	4.83	2
Promoting adequate disclosure of comparable financial information	—	—	—	—	—	—	8	15.1	45	84.9	4.85	1
Providing definitive criteria for the guidance of accountants in the process of the preparation of Islamic bank's financial statements	—	—	—	—	2	3.8	12	22.6	39	73.6	4.70	3
Providing reasonable consistency in Islamic bank's financial reporting over time	—	—	1	1.9	3	5.7	20	37.7	29	54.7	4.45	5
Increase user trust in Islamic bank's financial information	1	1.9	—	—	5	9.4	15	28.3	32	60.4	4.45	5
Providing definitive criteria for the guidance of external auditors through the process of auditing Islamic bank's financial statements	—	—	—	—	3	5.7	11	20.8	39	73.6	4.68	4

7.5.5 Academics' Preference of which Accounting Standards should be used for preparing Islamic Banks' Financial Statements in Saudi Arabia

This section aims to explore which accounting standards the academics prefer to be adopted for setting accounting standards for Islamic banks in Saudi Arabia. This question is considered being one of the key aspects of this research. Therefore academics were given five different alternatives of accounting standards to choose from. This is listed in table 7-15.

Table 7-15 Academics respondents' opinion: "What is your preference for other alternatives that might be adopted for setting accounting standards for Islamic banks in Saudi Arabia?"

The alternative	Strongly dislike		Dislike		Neutral		Prefer		Strongly prefer		Mean	Rank
	No	%	No	%	No	%	No	%	No	%		
International accounting standards only with modification to suit	7	13.5	10	19.2	5	9.6	15	28.8	15	28.8	3.40	3
American accounting standards only with modification to suit	15	29.4	15	29.4	12	23.5	7	13.7	2	3.9	2.33	4
British accounting standards only with modification to suit	14	27.5	16	31.4	12	23.5	8	15.7	1	2.0	2.33	4
SOCPA Accounting Standards	3	5.8	8	15.4	8	15.4	17	32.7	16	30.8	3.67	2
AAOIFI Accounting Standards	2	3.8	—	—	2	3.8	5	9.6	43	82.7	4.67	1

It can be noted from table 7-15 that academics strongly prefer AAOIFI accounting standards to be adopted in Islamic banks in Saudi Arabia with a highest mean of 4.67. On the other hand, American and British accounting standards seem to be equally disliked by academics with a lowest mean of 2.33.

This result is considered to be one of the main outcomes of this survey as it shows clearly which accounting standards academics in Saudi Arabia prefer to be applied in Islamic banks.

7.5.6 Academics' Opinions for who is Responsible for Applying AAOIFI Accounting Standards in Saudi Arabia

Question 14 of the questionnaire aims to explore the academics' perceptions regarding the role of SAMA, SOCPA, Ministry of Commerce, Islamic banks' management, auditing firms and academics in the accounting field for applying AAOIFI accounting

standards in Saudi Arabia. Table 7-16 depicts the summary of opinions regarding this issue.

Table 7-16 Academics' respondents' opinion: " What is your opinion regarding the importance of each group in applying Islamic accounting standards (AAOIFI) in Saudi Arabia?"

Groups	Not important At all		Not important		Neutral		Important		Very important		Mean	Rank
	No	%	No	%	No	%	No	%	No	%		
SAMA	—	—	2	3.8	—	—	14	26.4	37	69.8	4.62	2
SOCPA	—	—	2	3.8	4	7.5	7	13.2	40	75.5	4.60	3
Ministry of Commerce	—	—	2	3.8	6	11.3	21	39.6	24	45.3	4.26	6
Islamic banks' management	—	—	—	—	2	3.8	9	17.0	42	79.2	4.75	1
Auditing firms	1	1.9	1	1.9	6	11.3	15	28.3	30	56.6	4.36	5
Academics in the accounting field	—	—	1	1.9	6	11.5	18	34.6	27	51.9	4.37	4

It is very clear from table 7-15 above that all groups have an important role in applying AAOIFI accounting standards in Saudi Arabia from the academics point of view. Islamic banks' management ranked first with a mean of 4.75 in terms of its role in applying AAOIFI accounting standards in Islamic banks in Saudi Arabia, followed by SAMA with a mean of 4.62. SOCPA ranked third with a mean of 4.60, followed by academics in the accounting field with a mean of 4.37. The auditing firm and Ministry of Commerce came at the bottom of the list respectively with a mean of 4.36 and a mean of 4.26.

7.5.7 Academics' Response towards which Obstacle might Prevent Implementation of AAOIFI Accounting Standards in Saudi Arabia

In question 15 of the questionnaire, three factors have been listed in order to gather the perceptions of academics regarding the effectiveness of each factor in applying AAOIFI accounting standards in Saudi Arabia. Table 7-17 presents frequency and percentage as well as the rank of each factor.

Table 7-17 Academics' respondents' opinion: "What is your opinion regarding the impact of each of the following factors in applying Islamic accounting standards (AAOIFI) in Saudi Arabia?"

Factor	Not effective at all		Not effective		Neutral		Effective		Very effective		Mean	Rank
	No	%	No	%	No	%	No	%	No	%		
The newness of AAOIFI Standards and its lack of experience	2	3.8	3	5.7	4	7.5	24	45.3	20	37.7	4.08	2
AAOIFI Standards are not compulsory	—	—	—	—	3	5.7	16	30.2	34	64.2	4.58	1
AAOIFI Standards are not internationally acceptable	2	3.8	3	5.7	6	11.3	21	39.6	21	39.6	4.06	3

As can be seen from table 7-17, academics believe that all 3 factors affect the implementation of AAOIFI accounting standards in Islamic banks in Saudi Arabia. The fact that it is not compulsory was regarded as the biggest obstacle in applying AAOIFI accounting standards from academics' point of view with a mean of 4.58. The second obstacle was the newness of AAOIFI standards and its lack of experience with a mean of 4.08. The last obstacle was that AAOIFI standards are not internationally acceptable with a mean of 4.06.

7.6 ACADEMICS' ATTITUDE TOWARDS ISLAMIZING CONVENTIONAL BANKS IN SAUDI ARABIA

Question 16 of the questionnaire asked academics about their view regarding the probability of Islamizing conventional banks in Saudi Arabia. Respondents' frequencies and percentage are depicted in the following table, 7-18.

Table 7-18 Academics' respondents' opinion: "Do you believe that Islamic windows in the conventional banks in Saudi Arabia are the first step towards Islamisation of all conventional banks?"

Choices	Academics	
	Frequency	Valid Percent
Yes	36	67.9
No	17	32.1
I Don't Know	—	—
Total	53	100.0

It can be seen from table 7-18 above that all 53 academics gave their opinion regarding this issue. The majority of academics 67.9% believe that Islamic windows in the conventional banks in Saudi Arabia are the first step towards Islamisation of all conventional banks, whereas only 32.1% do not believe so. This result gives a clear indication that academics assume that recent developments and changes in the conventional banks, by providing Islamic products through Islamic windows, might be the first step towards Islamizing it.

7.7 ACADEMICS' ATTITUDE TOWARDS TRAINING ISSUES FOR ACCOUNTANTS IN ISLAMIC BANKS

This section attempts to shed light on the training issue for accountants in Islamic banks or windows in Saudi Arabia by asking the respondents about their views on whether Islamic banks are concerned about accounting issues in Islamic banking, and are they making sufficient efforts in training their accountants. Table 7-19 depicts opinions of academics regarding this matter.

Table 7-19 Academics' respondents' opinion: "Do you believe that Islamic banks are very concerned about their accountants, and they usually organise training courses regarding "Accounting Issues in Islamic Banking"?"

Choices	Academics	
	Frequency	Valid Percent
Yes	7	13.2
No	12	22.6
I Don't Know	34	64.2
Total	53	100.0

It can be seen from table 7-19 that most of the academics 64.2% were not sure whether Islamic banks in Saudi Arabia provide a training course for their accountants regarding accounting issues in Islamic banking or not. On the other hand, 22.6% of academics believe that Islamic banks are not making enough effort in order to train their accountants to develop the ability to deal with Islamic accounting issues. A minority of the academics, 13.2%, believe that Islamic banks *are* providing the necessary training for their accountants.

These results provide an indication that the vision is not clear for academics regarding the training of accountants in Islamic banks. This is something natural as we know that the accounting standards are not applied in Saudi Arabia.

7.8 CONCLUSION

This chapter has presented the descriptive analysis of the survey conducted with academics to find their opinions and preferences related to accountings, financial statements and AAOIFI standards related to Islamic banks in Saudi Arabia. This is considered to be the first stage in the process of data analysis in this research.

The responses of the academics were presented in details, and the academics provided important information regarding accounting practices in Saudi Arabia but as expected the response of the academics varied depending upon their qualification, experience and educational level. Despite this variation their insight into accounting standards and practices in Islamic banks in Saudi Arabia has been extremely useful and an important step in the process of data analysis, which forms a key component of this research. Given the outcomes through the answers of the academics, it is now important to look at the responses of external auditors and the employees of Islamic banks. This will allow a holistic understanding into accounting standards and practices in Islamic banks in Saudi Arabia. As a result, the following chapters will present the responses of the external auditors and the surveys of Islamic banks' employees.

CHAPTER 8

SEARCHING FOR THE PERCEPTIONS OF THE EXTERNAL AUDITORS: DESCRIPTIVE DATA ANALYSIS

8.1 INTRODUCTION

This chapter presents a descriptive analysis of the data collected through a survey of the external auditors by taking into consideration their opinions and providing an insight into their perceptions regarding accounting practices and standards in Islamic Banks in Saudi Arabia. This, therefore, constitutes the second chapter in relation to descriptive analysis of the actors surveyed in this research. This sets the platform in order to proceed to examine the final sets of actors, the Islamic bank employees, and their understanding of accounting standards in Islamic banks.

8.2 CHARACTERISTICS OF EXTERNAL AUDITORS

The analysis in this section covers the level of education, professional qualifications and experience for the external auditors. As mentioned in the methodology chapter, according to the address list released on 7-4-2003 by the Saudi Organisation of Certified Public Accountants (SOCPA), the numbers of registered external auditors in Saudi Arabia is 164 members. The researcher decided to distribute the questionnaire by mail to all registered external auditors in Saudi Arabia. The responses received were 55, out of which 51 were useable responses, since it was discovered that 3 respondents did not seem to be careful in choosing their answers, whereas the fourth one refused to answer the questionnaire claiming that Islamic banks in Saudi Arabia do not exist.

8.2.1 External Auditors Level of Education

According to article No: 2 from the certified public accountants' regulations, which have been imposed by royal decree¹ No M/12 on (1412H/1992), the following is stated:

To be registered as a certified Public Accountant, an applicant shall be:

1. of Saudi nationality;
2. of full legal capacity;
3. of Good conduct: not convicted of doctrinal punishment or of an offence involving moral turpitude or breach of trust, unless rehabilitated; not subjected to a disciplinary decision discharging him from governmental service, unless three years have lapsed since the taking of such disciplinary decision;
4. Holder of a Bachelor's degree in accountancy or any other equivalent certificate as may be deemed acceptable by the competent authorities in charge of equivalency of degrees.
5. Practically experienced in the field of accounting after graduation, as referred to in clause (4) above, with any of the following bodies:
 - a. Certified Public Accountants' Office duly approved by the SOCPA herein provided for in the present regulations and according to the conditions specified in the executive bylaws. This period of service shall be for a minimum of three years, reducible to two years, if the applicant is a holder of a Master's degree in accountancy or an equivalent

¹ Royal decree No M/12 (1992) is published on Saudi Organization for Certified Public Accountants website, [http://www.socpa.org.sa/inedx_en.htm].

degree, and to one year if the applicant is a holder of a Ph.D. in accountancy or an equivalent degree.

b. Government bodies, companies or sole proprietorships according to the conditions and terms stipulated in the Executive Bylaws, provided that such terms are no less than those stated in paragraph (a) above.

6. Full member of the SOCPA.

7. Fully dedicated to practice the profession. However, a Certified Public Accountant may practice other types of activities provided that such activities are not incompatible with the code of ethics of this profession according to the conditions laid down by the executive bylaws;

Against this regulative background, respondents were asked to identify their education level in question 19 of the questionnaire, and they were given four choices:

1. Below bachelor level
2. Bachelor
3. Master
4. PhD

It is worth mentioning that all 51 external auditors had answered this part of the questionnaire. Table 8-1 depicts the educational level of the 51 external auditors who participated in this study.

Table 8-1: External Auditors' Level of Education

Level of education	Frequency	Percent
Bachelor	35	68.6
Master	8	15.7
PhD	8	15.7
Total	51	100.0

As shown in table 8-1, all the external auditors have a bachelor degree and above. This is expected, since external auditors must hold at least a bachelor degree in accounting and auditing to become an external auditor in Saudi Arabia as stated in the royal decree No: M/12. It can be seen from table 8-1 as well that more than two thirds of external auditors (35) hold a bachelor degree (68.6%), whereas the rest hold a master degree and PhD with equal numbers of participants (8 external auditors respectively, or 15.7% in each group).

8.2.2 Level of Professional Qualifications

Question 20 of the questionnaire asked the external auditors to identify their professional qualifications. They were given four professional qualification choices:

1. Chartered Accountants (CA)
2. American Certified Public Accountants (CPA)
3. SOCPA
4. Other...

It is worth mentioning that from 51 external auditors that responded to this questionnaire only 17 of them did not identify their professional qualifications. The rest of the respondents, namely 34, identified their professional qualifications. The majority hold at least one professional qualification, whereas some of them hold more than one. As can be seen from table 8-2, the vast majority of external auditors hold SOCPA by 39.2%. Nine external auditors or 17.6% hold CPA (US). Four external auditors had mentioned that they hold more than one professional qualification, two of them (3.9%) said they hold CPA and SOCPA and the other two (3.9%) said they hold CPA, SOCPA and Other. Finally, only one external auditor mentioned that he holds a professional qualification not listed (Other).

These results reveal that the majority of external auditors have professional qualifications. This result indicates that external auditors who participated in this survey are well qualified and this certainly gives full confidence in generalising the outcomes from this survey.

Table 8-2: External Auditors' Level of Professional Qualifications

Level of professional qualification	Frequency	Percent
CPA (USA)	9	17.6
SOCPA (KSA)	20	39.2
Other	1	2.0
CPA+SOCPA	2	3.9
CPA+SOCPA+Other	2	3.9
Total external auditors holds professional qualifications	34	66.7
External auditors without professional qualifications	17	33.3
Total	51	100.0

8.2.3 Level of Experience

Question 21 of the questionnaire asked the external auditors to identify their years of work experience by choosing one of the following categories:

- Less than 5 years
- 5-10 years
- 10-15 years
- 15-20 years
- More than 20 years

The result of this section shows that all 51 external auditors who participated in this survey stated their work experience. As can be seen from table 8-3, the majority of the external auditors have been working for more than 20 years (43.1 %). On the other hand, approximately 6% of the external auditors worked for less than 5 years.

The results indicate that 29.4% of the external auditors have an experience range from 10 years to 15 years; about 11.8% had experience between 15-20 years, while about 9.8% of them had professional experience ranging from 5 years to 10 years. It can be concluded that external auditors who participated in this study have adequate professional experience in their own field, since the largest percentage of 43.1% of them have experience of up to 20 years and more.

Table 8-3: External Auditors' Level of Experience

Level of experience	Frequency	Percent
Less than 5 years	3	5.9
5- 10 years	5	9.8
10- 15 years	15	29.4
15- 20 years	6	11.8
More than 20 years	22	43.1
Total	51	100.0

8.3 EXTERNAL AUDITORS' PERCEPTIONS TOWARDS FINANCIAL STATEMENTS OF ISLAMIC BANKS IN SAUDI ARABIA

In this section, the external auditors' perceptions towards usefulness of financial statements prepared according to Islamic principles in Saudi Arabia, is investigated.

8.3.1 External Auditors' Response towards the Objectives of the Islamic Banks' Financial Statements Reporting

The questionnaire also aimed at finding the views of external auditors on the objectives of the Islamic banks' financial statements reporting. External auditors were given seven objectives, six of them were taken from the first AAOIFI accounting standards (AAOIFI, 2002: paragraph 37-42, p.17). In addition, the last objective was introduced by the researcher. The frequencies and percentage of respondents of the answer given to this question presented in table 8-4.

Table 8-4 External auditors' opinions about following objectives of the Islamic banks' financial statements reporting

OBJECTIVES	STRONGLY DISAGREE		DISAGREE		NEUTRAL		AGREE		STRONGLY AGREE		MEAN	RANK
	NO	%	NO	%	NO	%	NO	%	NO	%		
To provide information about compliance with the Islamic Shari'ah	1	2	6	12	10	20	19	38	14	28	3.78	5
To provide information about the Islamic bank's financial resources and related obligations	—	—	4	8	2	4	18	36	26	52	4.32	1
To provide information about sources and uses of the Zakah fund	—	—	4	8	5	10	25	50	16	32	4.06	4
To provide information about adequacy of Islamic banks' capital, the risk inherent in its investments and the degree of its liquidity.	2	3.8	1	1.9	10	18.9	29	54.7	11	20.8	3.74	6
To provide information about ability to generate income and convert it into cash flows	—	—	1	2	11	22	19	38	19	38	4.12	2
To provide information about Islamic banks' discharge of its social responsibilities	1	2	6	12	15	30	19	38	9	18	3.58	7
It helps to compare the performance between Islamic banks and conventional banks.	1	2	3	6	4	8	25	50	17	34	4.08	3

It can be seen from table 8-4 that most of the external auditors agreed about all the objectives of the Islamic banks' financial reporting. However, according to the ranks, the second objective which is about "providing information about the Islamic bank's financial resources and related obligations" seems to be the most important objective to external auditors with a mean value of 4.32, which is very close to absolute significance of mean value of 5. The fifth objective which is "providing information about ability to generate income and convert it into cash flows" came in the second place with a mean of 4.12, whereas the objective introduced by the researcher that "Islamic banks' financial reporting might help in comparing the performance between Islamic banks and conventional banks" came in third place with a mean of 4.08.

Overall, this result indicates that external auditors like academics in Saudi Arabia agree with the objectives of the Islamic banks' financial reporting despite the fact that such objectives as part of the AAOIFI standards are yet to be applied in Saudi Arabia.

8.3.2 External Auditors' Response towards the Importance of the Islamic Banks' Financial Statements for its Users

The second question of the questionnaire aims to explore the opinion of the external auditors regarding the importance of the Islamic banks' financial statements for its users. The users of the Islamic banks' financial statements listed on the questionnaire were as follows:

- Shareholders/investors
- Management of the Islamic banks
- Employees of the Islamic banks
- Auditors
- Customers
- Government

Table 8-5 presents the importance attributed by external auditors' to each of the users of the Islamic banks' financial statements.

Table 8-5 Responses of the external auditors toward the importance attributed to the users of Islamic bank's financial statements

THE GROUP OF USERS	NOT IMPORTANT AT ALL		NOT IMPORTANT		NEUTRAL		IMPORTANT		VERY IMPORTANT		MEAN	RANK
	NO	%	NO	%	NO	%	NO	%	NO	%		
Shareholders/investors	—	—	—	—	3	5.9	7	13.7	41	80.4	4.75	2
Management	—	—	—	—	1	2.0	8	15.7	42	82.4	4.80	1
Employees	2	3.9	5	9.8	17	33.3	20	39.2	7	13.7	3.49	6
Auditors	—	—	1	2.0	—	—	14	27.5	36	70.6	4.67	3
Customers	—	—	3	5.9	16	31.4	17	33.3	15	29.4	3.86	5
Government	—	—	1	2.0	5	10.0	12	24.0	32	64.0	4.50	4

It can be seen from table 8-5, that it is recognised that Islamic banks' financial statements are very important for most of the users from the external auditors' point of view. External auditors believe that the management of the Islamic banks are the most important users of the Islamic banks' financial statements with the highest mean value of 4.80, followed by the shareholder and investors with a mean value of 4.75 and the third important users are perceived to be the auditors themselves with a mean value of 4.67. However, employees of the Islamic banks are considered as the least important users although they get a mean value of 3.49 which is still important.

The result also shows that external auditors consider Islamic banks' financial statements as an important source of information for all of the above users, which is perceived to be very helpful for decision-making, just as the academics do.

8.3.3 External Auditors' Response towards the Qualitative Characteristics of the Islamic Banks' Financial Information

The third question of the questionnaire attempted to explore the external auditors' opinions regarding the qualitative characteristics of the Islamic banks' financial statements in Saudi Arabia. External auditors were given five qualitative characteristics of the financial information of the Islamic banks as follows:

- Relevance
- Reliability
- Comparability (between other banks and Islamic banks)
- Consistency
- Understandability

Table 8-6 depicts the frequency and percentage of the external auditors' responses towards the qualitative characteristic of the Islamic banks' financial statements.

Table 8-6 Opinions of the external auditors about the qualitative characteristics of financial statements

THE QUALITATIVE CHARACTERISTICS	STRONGLY DISAGREE		DISAGREE		NEUTRAL		AGREE		STRONGLY AGREE		MEAN	RANK
	NO	%	NO	%	NO	%	NO	%	NO	%		
Relevance	—	—	—	—	6	12	22	44	22	44	4.32	2
Reliability	—	—	2	3.9	4	7.8	22	43.1	23	45.1	4.29	3
Comparability between other banks and Islamic banks	—	—	2	3.9	7	13.7	24	47.1	18	35.3	4.14	5
Consistency	—	—	1	2.0	5	9.8	24	47.1	21	41.2	4.27	4
Understandability	—	—	3	5.9	3	5.9	19	37.3	26	51.0	4.33	1

It is very obvious from table 8-6 that external auditors agreed about all qualitative characteristics of the financial statements of the Islamic banks, with the highest mean value of 4.33 for their understandability; with 4.32 mean value for their relevance; with mean value of 4.29 for the reliability; with mean value of 4.27 for their consistency.

The results indicate that like academics, external auditors ranked the “comparability between other banks and Islamic banks” at the bottom of the qualitative characteristics with a mean value of 4.14.

8.3.4 External Auditors' Response towards the Factors Affecting the Quality and Adequacy of the Islamic Banks' Financial Information

Question four of the questionnaire tried to find out the opinion of the external auditors regarding the importance of eight factors which might affect quality and adequacy of the Islamic banks' financial information, the result of which is depicted in table 8-7.

Table 8-7 External auditors' opinions towards factors affecting the quality and adequacy of the accounting information disclosed by Islamic banks

FACTOR	NOT IMPORTA		NOT IMPORTANT		NEUTRAL		IMPORTANT		VERY IMPORTANT		MEAN	RANK
	NO	%	NO	%	NO	%	NO	%	NO	%		
The external auditor is a national firm	7	14	6	12	8	16	5	10	24	48	3.66	6
The external auditors are a national firm affiliated with international firm	4	8.2	8	16.3	15	30.6	12	24.5	10	20.4	3.33	8
Capability of Islamic bank's management	—	—	—	—	—	—	12	23.5	39	76.5	4.76	2
Bank size and its products and services	—	—	—	—	6	11.8	25	49.0	20	39.2	4.27	5
Accounting standards adopted in preparing the financial statements	—	—	—	—	—	—	13	25.5	38	74.5	4.75	3
The level of education and professional qualification that employees hold	—	—	—	—	4	7.8	14	27.5	33	64.7	4.57	4
An effective system of internal control in the bank	—	—	—	—	2	3.9	6	11.8	43	84.3	4.80	1
Ownership structure (e.g. percentage of government ownership, percentage of private ownership and foreign participation)	3	6	3	6	20	40	13	26	11	22	3.52	7

As can be seen in table 8-7, external auditors believe that the most important factor which might affect the quality and adequacy of the accounting information disclosed by Islamic banks is factor number 7, namely “an effective system of internal control in the bank” with a mean value of 4.80 followed by the third factor “capability of Islamic bank’s management” with a mean value of 4.76. The fifth factor which is “accounting standards adopted in preparing the financial statements” was ranked third with a mean value of 4.75, whereas the sixth factor which is “the level of education and professional qualification that employees hold” was ranked fourth with a mean of 4.57.

It should be stated that it looks impossible to differentiate this result from the opinions of the academics on the same question. This provides confidence to believe that accounting standards adopted in preparing the financial statements is one of the most important factors, which might affect the quality and adequacy of the accounting information disclosed by Islamic banks.

8.3.5 External Auditors' Opinions towards the Importance of the Source of Information in Relation to Islamic Banks' Performance

Question 5 of the questionnaire attempts to discover which source of information external auditors believe is important in indicating the performance of Islamic banks. The following table, 8-8 displays the opinion of the external auditors regarding the importance of each one of the six sources of information.

Table 8-8 shows that external auditors believe that Islamic banks' financial report is the most important source of information in indicating Islamic banks' performance with a mean value of 4.65, which is followed by the “Islamic banks' interim financial statements” with a mean value of 4.43. “Direct information from Islamic banks” is in third place with a mean value of 4.04; the government information is in fourth place with a mean value of 3.96 and finally the newspapers and specialist magazines with a mean value of 3.61. On the other hand, external auditors do not believe that “market's rumours are an important source of information” with a mean value of 2.75.

It should be noted that again, as in the previous section, external auditors' opinions look similar to the opinions of the academics, as they all see the Islamic banks' financial statements as a major source of information. Therefore, attention must be given to the ways in which these statements are prepared.

Table 8-8 Opinions of the external auditors toward the importance of the sources of information in indicating Islamic banks' performance

THE INFORMATION SOURCES	NOT IMPORTANT		NOT IMPORTANT		NEUTRAL		IMPORTANT		VERY IMPORTANT		MEAN	RANK
	NO	%	NO	%	NO	%	NO	%	NO	%		
Islamic banks' financial reports	—	—	3	5.9	—	—	9	17.6	39	76.5	4.65	1
Islamic banks' interim financial statements	—	—	3	5.9	1	2.0	18	35.3	29	56.9	4.43	2
Newspapers and Specialist magazines	1	2.0	6	11.8	11	21.6	27	52.9	6	11.8	3.61	5
Direct information from the Islamic bank	—	—	3	5.9	11	21.6	18	35.3	19	37.3	4.04	3
Market's rumours	6	11.8	15	29.4	19	37.3	8	15.7	3	5.9	2.75	6
Government's publications	1	2.0	3	5.9	12	23.5	18	35.3	17	33.3	3.96	4

8.3.6 External Auditors' Response towards the Importance of Each Section of the Annual Reports of the Islamic Banks

This part of the analysis aimed at locating the opinions of the external auditors regarding the most important section of the Islamic banks' annual reports, the result of which is depicted in table 8-9.

As can be seen from table 8-9 external auditors considered all sections of the financial reports as being important, although some of them do not appear in the annual report in Islamic banks in Saudi Arabia, which might lead one to think about applying AAOIFI standards in Islamic banks in Saudi Arabia.

Table 8-9 Opinions of the external auditors toward importance of the various sections of the Islamic banks' annual reports

SECTION OF THE REPORT	NOT IMPORTANT AT ALL		NOT IMPORTANT		NEUTRAL		IMPORTANT		VERY IMPORTANT		MEAN	RANK
	NO	%	NO	%	NO	%	NO	%	NO	%		
Board of Directors' report	1	2.0	—	—	4	7.8	13	25.5	33	64.7	4.51	7
Auditor's report	—	—	—	—	1	2.0	2	3.9	48	94.1	4.92	4
Balance sheet	—	—	—	—	—	—	2	3.9	49	96.1	4.96	1
Income statement	—	—	—	—	—	—	2	3.9	49	96.1	4.96	1
Statement of changes in owners' equity (statement of retained earnings)	—	—	—	—	3	5.6	4	7.8	44	86.3	4.80	6
Statement of cash flow	—	—	—	—	2	3.9	4	7.8	45	88.2	4.84	5
Note of the financial statements	—	—	—	—	—	—	2	3.9	49	96.1	4.96	1
Shari'ah supervisory board's report	—	—	1	2.0	6	11.8	10	19.6	34	66.7	4.51	7
Summary of annual activities	—	—	2	3.9	6	11.8	24	47.1	19	37.3	4.18	11
Report about internal control	3	5.9	—	—	4	7.8	20	39.2	24	47.1	4.22	10
Statement of changes in restricted investments	—	—	—	—	8	15.7	22	43.1	21	41.2	4.25	9
Statement of sources and uses of funds in the Zakah and the charity fund	—	—	2	3.9	16	31.4	17	33.3	16	31.4	3.92	12

8.4 AWARENESS OF AAOIFI ACCOUNTING STANDARDS AMONG EXTERNAL AUDITORS

In this section awareness of AAOIFI accounting standards by the external audits are analysed. Table 8-10 presents the opinions of external auditors towards this particular issue.

Table 8-10 Opinions of external auditors toward the awareness of the Islamic Accounting Standards issued by AAOIFI

CHOICES	EXTERNAL AUDITORS	
	FREQUENCY	VALID PERCENT
I am aware of it	18	36.7
I have heard about it	25	51.0
I have never heard about it	6	12.2
Total	49	100.0

As it can be seen from table 8-10, only 49 out of 51 external auditors, answered this question. 36.7% of the participants confidently revealed that they have knowledge and awareness of AAOIFI standards, while the majority of external auditors representing 51% (25) of the respondents have a little knowledge of these standards. Only 6 external auditors representing 12.2% of the respondents are completely ignorant of the existence of Islamic accounting standards.

The result shows that external auditors are not really aware of AAOIFI accounting standards. This might be due to the fact that some external auditors were not working previously as auditors for banks so they only dealt with international accounting standards and SOCPA standards. Also as mentioned in chapter 7 for the academics, the researcher believes that ignorance of AAOIFI standards among external auditors might also be due to the fact that AAOIFI is not recognized by SAMA and not implemented yet in Saudi Arabia.

8.5 EXTERNAL AUDITORS' PERCEPTIONS TOWARDS APPLYING AAOIFI ACCOUNTING STANDARDS IN SAUDI ARABIA

In this section, external auditors' perceptions towards applying AAOIFI accounting standards in Saudi Arabia are investigated by asking them various related questions.

8.5.1 External Auditors' Opinion Regarding AAOIFI Accounting Standards No.18

Question 8 in the questionnaire aims to find the perceptions of external auditors towards AAOIFI accounting standards No.18. This question is considered as being an example to assess the willingness of external auditors to apply Islamic accounting standards.

Table 8-11 Opinions of external auditors toward AAOIFI Standards No:18

STATEMENTS	STRONGLY DISAGREE		DISAGREE		NEUTRAL		AGREE		STRONGLY AGREE		MEAN
	NO	%	NO	%	NO	%	NO	%	NO	%	
Islamic windows in Saudi Arabia must prepare supplementary statements to be published in the notes of the financial statements of the conventional banks.	1	2.0	8	15.7	4	7.8	14	27.5	24	47.1	4.02
Islamic windows in Saudi Arabia must disclose whether or not they mingle funds relating to Islamic financial services with funds relating to conventional financial services.	1	2.0	2	4.0	5	10.0	14	28.0	28	56.0	4.32
Islamic windows in Saudi Arabia must disclose, in detail, the sources and applications of funds mobilised and invested by their Islamic financial services.	1	2.0	6	11.8	4	7.8	20	39.2	20	39.2	4.02

According to table 8-11, all statements, which have been taken from AAOIFI accounting standards No.18, were agreed by the participants. This is an indication that external auditors prefer AAOIFI accounting standards to be implemented in Islamic banks and Islamic windows in conventional banks in Saudi Arabia.

8.5.2 External Auditors' Response towards Harmonizing Accounting Standards Used for the Financial Statements of the Islamic Banks

This section aims to find the perceptions of external auditors regarding the idea of harmonizing accounting standards used for the Islamic banks' financial statements. Table 8-12 presents frequency and percentage distribution of the respondents regarding this matter.

Table 8-12 Perceptions of external auditors toward harmonizing the accounting standards used for financial statements of Islamic banks

CHOICES	EXTERNAL AUDITORS	
	FREQUENCY	VALID PERCENT
Yes	45	93.8
No	2	4.2
I Don't Know	1	2.1
Total	48	100.0

There is no doubt table 8-12 shows that the vast majority of external auditors (93.8%) support the idea of harmonizing accounting standards used in the preparation of Islamic banks' financial statements.

8.5.3 External Auditors' Responses towards the Problems Expected When Using Different Accounting Standards

The use of different accounting standards to prepare the financial statements of Islamic banks could cause some problems. In this section, potential problems in using different accounting standards are evaluated by asking the external auditors whether they agree or

disagree with them. Table 8-13 presents frequency and percentage distribution of the respondents and provides ranking of importance.

Table 8-13 Opinions of external auditors toward problems that might be caused by using different accounting standards.

POTENTIAL PROBLEMS OF USING DIFFERENT ACCOUNTING STANDARDS	STRONGLY DISAGREE		DISAGREE		NEUTRAL		AGREE		STRONGLY AGREE		MEAN	RANK
	NO	%	NO	%	NO	%	NO	%	NO	%		
Difficulty in comparing financial statements	—	—	2	4.2	3	6.3	20	41.7	23	47.9	4.33	1
Variations in the users' interpretation of the financial information	—	—	5	10.4	1	2.0	21	43.8	21	43.8	4.21	2
Difficulty in making decisions	1	2.1	7	14.6	10	20.8	18	37.5	12	25.0	3.69	5
Decreased user's trust in accounting information	1	2.0	12	25.0	11	22.9	18	37.5	6	12.5	3.33	7
Loss of trust in the audit reports	6	12.5	17	35.4	8	16.7	11	22.9	6	12.5	2.88	8
Expand the range of the work done by the external auditors	1	2.1	12	25.0	6	12.5	15	31.3	14	29.2	3.60	6
Difficulties for accountants to deal with different accounting standards	1	2.1	6	12.5	5	10.4	19	39.6	17	35.4	3.94	3
Cost of training accountants to be familiar with different accounting standards	—	—	5	10.4	11	22.9	20	41.7	12	25.0	3.81	4

Generally speaking, external auditors agreed with most of the potential problems listed in table 8-13, except losing trust in the audit reports with a mean value of 2.88. In other words, external auditors believe no matter what accounting standards are used, their audit reports will not lose trust. However, they believe that difficulty in comparing financial statements is the most important problem, which might be caused by using different accounting standards in preparing Islamic banks' financial statements. This ranked as the most important problem by the external auditors with the highest mean value of 4.33. The second important problem was found to be "the variations in the users' interpretation of the financial information" with a mean value of 4.21. The third important problem was found to be "the difficulty for accountants to deal with different accounting standards" with a mean value of 3.94.

The results, thus, show how important it is to harmonize accounting standards to prepare Islamic banks in Saudi Arabia in order to eliminate most of the problems which might be caused by using different accounting standards.

8.5.4 External Auditors' Responses towards the Objectives that Might be Achieved if AAOIFI Accounting Standards are Applied in Saudi Arabia

Applying AAOIFI accounting standards in Islamic banks in Saudi Arabia might achieve some of the objectives listed in table 8-14. In this section, external auditors' perceptions regarding this matter are presented.

Table 8-14 Opinions of external auditors toward applying Islamic accounting standards in Saudi Arabia in achieving the following objective

OBJECTIVES	STRONGLY DISAGREE		DISAGREE		NEUTRAL		AGREE		STRONGLY AGREE		MEAN	RANK
	NO	%	NO	%	NO	%	NO	%	NO	%		
Harmonizing financial statements between Islamic banks	—	—	2	3.9	1	2.0	17	33.3	31	60.8	4.51	3
Promoting adequate disclosure of comparable financial information	—	—	1	2.0	1	2.0	20	39.2	29	56.9	4.51	3
Providing definitive criteria for the guidance of accountants in the process of the preparation of Islamic bank's financial statements	—	—	—	—	—	—	24	48.0	26	52.0	4.52	2
Providing reasonable consistency in Islamic bank's financial reporting over time	—	—	—	—	2	3.9	27	52.9	22	43.1	4.39	5
Increase users' trust in Islamic bank's financial information	—	—	3	5.9	9	17.6	14	27.5	25	49.0	4.20	6
Providing definitive criteria for the guidance of external auditors through the process of auditing Islamic bank's financial statements	—	—	—	—	2	3.9	19	37.3	30	58.8	4.55	1

As can be seen from table 8-14, external auditors strongly agree on most of the objectives as listed in the table, which might be achieved when AAOIFI accounting standards are implemented in Saudi Arabia. Unlike academics, external auditors believe that “providing definitive criteria for the guidance of external auditors through the Islamic bank’s financial statements” is the most important objective with a highest mean value of 4.55 followed by the third objective which is “providing definitive criteria for

the guidance of accountants in the process of the preparation of Islamic bank's financial statements" with a mean value of 4.52. "Promoting adequate disclosure of comparable financial information" came third in the rank equally with the objective of "harmonizing financial statements between Islamic banks" with a mean value of 4.51. The result of this question confirms the results in the previous sections that applying AAOIFI and harmonizing accounting standards will lead to easier comparisons of Islamic banks' financial information.

8.5.5 External Auditors' Responses Towards their Preference of Accounting Standards to be Used for Preparing Islamic Banks' Financial Statements in Saudi Arabia

This section attempts to explore which accounting standards the external auditors prefer to be adopted for setting accounting standards for Islamic banks in Saudi Arabia. This question is considered as being one of the key aspects of this research. Therefore external auditors were given five different alternatives of accounting standards to choose from. The opinions of the participants for the listed preferences are depicted in table 8-15.

It can be noted from table 8-15 that external auditors strongly prefer AAOIFI accounting standards to be adopted in Islamic banks in Saudi Arabia with a highest mean value of 4.31. On the other hand, American and British accounting standards seem to be both disliked by external auditors, as they all got very low mean values of 2.45 and 2.39 respectively.

It should be stated that this result is considered to be one of the main outcomes of this survey as it shows clearly that AAOIFI accounting standards are the most preferred among external auditors in Saudi Arabia to be applied in Islamic banks.

Table 8-15 Opinions of external auditors toward preference for other alternatives that might be adopted for setting accounting standards for Islamic banks in Saudi Arabia

THE ALTERNATIVE	STRONGLY DISLIKE		DISLIKE		NEUTRAL		PREFER		STRONGLY PREFER		MEAN	RANK
	NO	%	NO	%	NO	%	NO	%	NO	%		
International accounting standards only with modification to suit Islamic bank's needs	—	—	5	9.8	5	9.8	23	45.1	18	35.3	4.06	2
American accounting standards only with modification to suit Islamic bank's needs	10	19.6	17	33.3	16	31.4	7	13.7	1	2.0	2.45	4
British accounting standards only with modification to suit Islamic bank's needs	10	19.6	18	35.3	16	31.4	7	13.7	—	—	2.39	5
SOCPA Accounting Standards	1	2.0	6	11.8	8	15.7	26	51.0	10	19.6	3.75	3
AAOIFI Accounting Standards	1	2.0	2	3.9	6	11.8	13	25.5	29	56.9	4.31	1

8.5.6 External Auditors' Response towards Identifying the Responsible Official Body for Applying AAOIFI Accounting Standards in Saudi Arabia

Question 14 of the questionnaire aimed to explore the external auditors' perceptions regarding the role of SAMA, SOCPA, Ministry of Commerce, Islamic banks' management, auditing firms and academics in the accounting field for applying AAOIFI accounting standard in Saudi Arabia. Table 8-16 presents frequency and percentage distribution of the responses.

Table 8-16 shows that all groups are considered by the external auditors as having an important role in applying AAOIFI accounting standards in Saudi Arabia. SOCPA and auditing firms are ranked equally first with a mean value of 4.49 in terms of their role in applying the AAOIFI accounting standards in Islamic banks in Saudi Arabia. This is followed by SAMA with a mean value of 4.45. Islamic bank's management was ranked fourth with a mean value of 4.29. Ministry of Commerce and also academics in the accounting field came at the bottom of the list with a mean of 4.27 and 3.78 respectively.

Table 8-16 Opinions of external auditors toward the assigned role and importance to various groups in applying Islamic accounting standards (AAOIFI) in Saudi Arabia

GROUPS	NOT IMPORTANT		NOT IMPORTANT		NEUTRAL		IMPORTANT		VERY IMPORTANT		MEAN	RANK
	NO	%	NO	%	NO	%	NO	%	NO	%		
SAMA	—	—	5	9.8	3	5.9	7	13.7	36	70.6	4.45	3
SOCPA	—	—	1	2.0	8	15.7	7	13.7	35	68.6	4.49	1
Ministry of Commerce	—	—	1	2.0	6	11.8	22	43.1	22	43.1	4.27	5
Islamic bank's management	1	2.0	1	2.0	9	17.6	11	21.6	29	56.9	4.29	4
Auditing firms	—	—	1	2.0	5	9.8	13	25.5	32	62.7	4.49	1
Academics in the accounting field	—	—	3	5.9	17	33.3	19	37.3	12	23.5	3.78	6

8.5.7 External Auditors' Response towards the Impact of Obstacle Factors in Preventing Implementation of AAOIFI Accounting Standards in Saudi Arabia

In question 15 of the questionnaire, three factors have been listed to gather the perceptions of external auditors regarding the effectiveness of each factor in applying AAOIFI accounting standards in Saudi Arabia. Table 8-17 presents the frequency and percentage distribution regarding these factors and also of the ranking of each factor.

As it can be seen from table 8-17, external auditors believe that all the listed factors affect the implementation of AAOIFI accounting standards in Islamic banks in Saudi Arabia. The fact that AAOIFI is not compulsory became the biggest obstacle from external auditors' point of view in applying AAOIFI accounting standards with a mean value of 4.59. The second obstacle is the newness of AAOIFI standards and its lack of experience with a mean value of 4.29. The last obstacle was that "AAOIFI standards are not internationally acceptable" with a mean value of 4.24.

Table 8-17 Opinions of external auditors toward the question of the impact of each of the following factors in applying Islamic accounting standards (AAOIFI) in Saudi Arabia.

FACTOR	NOT EFFECTIVE AT ALL		NOT EFFECTIVE		NEUTRAL		EFFECTIVE		VERY EFFECTIVE		MEAN	RANK
	NO	%	NO	%	NO	%	NO	%	NO	%		
The newness of AAOIFI Standards and its lack of experience	—	—	—	—	6	11.8	24	47.1	21	41.2	4.29	2
AAOIFI Standards are not compulsory	—	—	—	—	4	7.8	13	25.5	34	66.7	4.59	1
AAOIFI Standards are not internationally acceptable	—	—	—	—	7	13.7	25	49.0	19	37.3	4.24	3

8.6 EXTERNAL AUDITORS' ATTITUDE TOWARDS ISLAMIZING CONVENTIONAL BANKS IN SAUDI ARABIA

Question 16 of the questionnaire asked external auditors about their opinions regarding the possibility of Islamizing conventional banks in Saudi Arabia. Respondents' frequencies and percentage are shown in the following Table 8-18.

Table 8-18 Opinions of external auditors toward Islamic windows in the conventional banks in Saudi Arabia as the first step for the Islamization of all conventional banks.

CHOICES	EXTERNAL AUDITORS	
	FREQUENCY	VALID PERCENT
Yes	26	51.0
No	19	37.3
I Don't Know	6	11.8
Total	51	100.0

It can be seen from table 8-18 that all 51 external auditors rendered their opinion regarding this issue. The majority of academics, with 51%, believe that Islamic windows in the conventional banks in Saudi Arabia are the first step towards Islamization of all conventional banks, whereas only 37.3% do not believe so.

The results, thus, indicate that similar to academics, external auditors assume that recent developments and changes in the conventional banks by providing Islamic products through Islamic windows might be the first step towards Islamizing it.

8.7 EXTERNAL AUDITORS' ATTITUDE TOWARDS TRAINING ISSUES FOR ACCOUNTANTS IN ISLAMIC BANKS

Question 17 attempts to shed light on the training issue for accountants in Islamic banks or windows in Saudi Arabia by asking the respondents about their opinions on whether Islamic banks are concerned about accounting issues in Islamic banking, and whether they are making sufficient efforts in training their accountants. Table 8-19 displays the frequency and percentage of external auditors regarding this matter.

Table 8-19 Opinions of the external auditors toward the importance given for the developments of accountants in "Accounting Issues in Islamic Banking" in the Islamic banks

Choices	External auditors	
	Frequency	Valid Percent
Yes	15	29.4
No	18	35.3
I Don't Know	18	35.3
Total	51	100.0

It can be seen from table 8-19 that there are almost the same percentage distribution for all choices with the mean value of 29.4%. The external auditors believe that Islamic banks in Saudi Arabia provide a training course to their accountants regarding accounting issues in Islamic banking. In addition, 35.3% of external auditors believe that

Islamic banks are not doing enough in order to train their accountants to develop the ability to deal with Islamic accounting issues. The above results provide an indication that the vision is not clear for external auditors like the academics in relation to the training of accountants in Islamic banks. This is something natural when we know that the accounting standards are not applied in Saudi Arabia.

8.8 CONCLUSION

This chapter presented a descriptive analysis of the external auditors' survey, which was conducted by this research. This chapter is considered to be the second chapter in descriptive analysis following the chapter which viewed the perceptions of academics towards accounting practices and standards in Islamic banks. The findings and the responses of the external auditors were illustrated through the use of percentage and frequency distributions demonstrated through the use of tables and figures.

The external auditors provided important and useful information regarding accounting practices in Saudi Arabia. Despite this variation, their insight into accounting standards and practices in Islamic banks in Saudi Arabia has been extremely useful and an important step in the process of data analysis, which forms a key component of this research.

Given the results through the answers of the academics and external auditors, it is now important to look at the responses of the employees of Islamic banks. This will complete the analysis of the opinions of a set of actors (i.e. academics, external auditors and Islamic bank employees) involved in Islamic banking and also in Islamic accounting to further the analysis and judgements to be made upon accounting practices and standards in Islamic banks.

CHAPTER 9

ANALYSING THE PERCEPTIONS OF THE EMPLOYEES OF THE ISLAMIC BANKS ON AAOFI STANDARDS IN SAUDI ARABIA: DESCRIPTIVE DATA ANALYSIS

9.1 INTRODUCTION

The objective of this chapter is to present a descriptive analysis based on the Islamic banks employees' survey, with which descriptive chapters providing empirical analysis comes to an end. The previous two chapters, namely chapter 7 and 8, explored the perceptions and perspectives of the academics and external auditors relating to accounting practices in Islamic banks in Saudi Arabia who participated in this study.

9.2 EMPLOYEES' CHARACTERISTICS OF THE ISLAMIC BANKS

The analysis in this section covers the level of education, professional qualifications and experience of the Islamic banks' (IBs') employees. A total of 200 questionnaires were distributed to six leading banks in Saudi Arabia in the field of Islamic banking and Islamic windows, which are: Al-Rajhi Bank; Al-Jazira Bank; Saudi American Bank; Saudi British Bank; the National Commercial Bank; and Riyadh Bank.

Out of 200, only 88 responses were received, and 80 were useable responses, as 8 responses were ignored due to not being complete.

9.2.1 Islamic Bank Employees' Level of Education

In relation to question 19 of the questionnaire conducted concerning level of education, respondents were asked to identify their education level.

It is worth mentioning that 79 out of 80 IBs' employees had answered this part of the questionnaire. Table 9-1 depicts the distribution of the educational level of IBs' employees who participated in this study, which shows that the majority of them (71.3%) hold a bachelor degree, whereas 14 of them, corresponding to 17.5% hold a master degree. It is obvious that only 3.8% of the IBs' employees were below bachelor level, and 6.3% of them held a PhD degree. Since this group is working in professional environments, this result looks acceptable as most companies and banks in Saudi Arabia prefer to recruit employees who hold a bachelor or a master degree as a minimum level of qualification.

Table 9-1: Islamic Bank employees' Level of Education

Level of education	Frequency	Percent
Below bachelor level	3	3.8
Bachelor	57	71.3
Master	14	17.5
PhD	5	6.3
Total	79	98.8
Did not mention his/her level of education	1	1.3
Total	80	100.0

9.2.2 Level of Professional Qualifications

In identifying the professional qualifications of the IBs' employees, respondents were given four professional qualifications to choose from: Chartered Accountants (CA); American Certified Public Accountants (CPA); Saudi Organisation of Certified Public Accountants (SOCPA); and Other.

The findings show that out of 80 IBs' employees, only 28 of them held professional qualifications. As can be seen from table 9-2, 15 or 18.8% of the IBs employees were holders of SOCPA; 8.8% of them had CPA and only 1.3% of IBs employee had a

combination of CPA and SOCPA qualification. However, 6.3% of the IBs employees held other professional qualifications. These results reveal that a high percentage of IBs employees (65%) did not have professional qualifications. This provides the rationale for the effort needed by IBs in order to train and develop the accounting ability of employees, which enables them to perform their duties efficiently. This point is also discussed in the responses given to question 17 in the questionnaire and will determine to what extent Islamic banks are concerned about training their employees.

Table 9-2: Islamic Bank Employees' level of Professional qualifications

Level of professional qualifications	Frequency	Percent
CPA (USA)	7	8.8
SOCPA (KSA)	15	18.8
Other	5	6.3
CPA+SOCPA	1	1.3
Total IBs employees holds professional qualifications	28	35.0
IBs employees without professional qualifications	52	65.0
Total	80	100.0

9.2.3 Level of Experience

Regarding the experience level of the IBs' employees in terms of identifying their years of work experience, the findings show in table 9-3 that 23.8% of the respondents have been working for more than 20 years; and the same percentage of them had 10-15 years work experience. 16 IBs employees or 20% have an experience within the range from 5 years to 10 years, whereas 14 or 17.5% of them have an experience ranging from 15-20 years, and finally 12 or 15% of them had worked for less than 5 years. It can, therefore, be concluded that IBs' employees who participated in this study have various degrees of

experience with almost equal percentage. This enhances the findings of the results, as various opinions based on various experiences are presented.

Table 9-3: Islamic Bank Employees' Level of Experience

Level of experience	Frequency	Percent
Less than 5 years	12	15.0
5- 10 years	16	20.0
10- 15 years	19	23.8
15- 20 years	14	17.5
More than 20 years	19	23.8
Total	80	100.0

9.3 ISLAMIC BANK EMPLOYEES' PERCEPTIONS TOWARDS ISLAMIC FINANCIAL STATEMENTS IN SAUDI ARABIA

In this section, the respondents' perceptions towards the usefulness of Islamic financial statements in Saudi Arabia are investigated through a number of questions.

9.3.1 Islamic Bank Employees' Opinions on the Objectives of the Islamic Banks' Financial Statements Reporting

The first question of the questionnaire in this section aims to find out the views of IBs' employees on the objectives of the Islamic banks' financial statements reporting. The respondents were given seven objectives; six of them were taken from the first AAOIFI accounting standards (AAOIFI, 2002) paragraph 37-42, p.17, and the last objective was suggested by the researcher. The distribution of the opinions is presented in table 9-4.

Table 9-4 Distribution of opinions towards the objectives of the Islamic banks' financial statements reporting

Objectives	Strongly disagree		Disagree		Neutral		Agree		Strongly agree		Mean	Rank
	No	%	No	%	No	%	No	%	No	%		
To provide information about compliance with the Islamic Shari'ah	3	3.8	7	8.8	5	6.3	36	45.0	29	36.3	4.01	5
To provide information about the Islamic bank's financial resources and related obligations	—	—	1	1.3	2	2.6	34	43.6	41	52.6	4.47	1
To provide information about sources and uses of the Zakah fund	—	—	2	2.5	7	8.8	39	48.8	32	40.0	4.26	2
To provide information about adequacy of Islamic banks' capital, the risk inherent in its investments and the degree of its liquidity.	—	—	4	5	12	15	32	40	32	40	4.15	3
To provide information about ability to generate income and convert it into cash flows	—	—	4	5.0	8	10.0	42	52.5	26	32.5	4.12	4
To provide information about Islamic banks' discharge of its social responsibilities	1	1.3	20	25.0	21	26.3	27	33.8	11	13.8	3.34	7
It helps to compare the performance between Islamic banks and conventional banks.	1	1.3	7	8.8	10	12.5	35	43.8	27	33.8	4.00	6

As can be seen from table 9-4 most of the employees agreed with all of the objectives of the Islamic banks' financial reporting. However, according to the ranks, the second objective, which is about "providing information about the Islamic bank's financial resources and related obligations", seems to be the most important objective to IBs' employees with a highest mean value of 4.47. The third objective namely "providing information about sources and uses of the Zakah fund" came in second place with a mean value of 4.26. Unlike academics and external auditors, the objective suggested by the researcher which is about whether "Islamic banks' financial reporting, might help in comparing the performance between Islamic banks and conventional banks" came in sixth place with a mean value of 4.00.

9.3.2 Responses of Employees towards the Importance of the Islamic Banks' Financial Statements for its Users

The second question of the questionnaire in this section aims to explore the opinion of the IBs' employees regarding the importance of the Islamic banks' financial statements for its users. The users of the Islamic banks' financial statements listed on the questionnaire were as follows: shareholders/investors; management of the Islamic banks; employees of Islamic banks; auditors; customers; and lastly government.

Table 9-5 shows that Islamic banks' financial statements are very important for most of the users from the employees' point of view. IBs' employees believe that the management of the Islamic banks are the most important users of the Islamic banks' financial statements with the highest mean value of 4.93 followed by the shareholder and investors with a mean of 4.86 and the third important users were identified as the auditors with a mean of 4.68. However, IBs' employees consider themselves as the least important users of financial statements among all groups with a mean value of 4.04, which is still important. Thus, similarly to academics and external auditors, IBs' employees in Saudi Arabia consider Islamic banks' financial statements as an important

source of information for all of the above users and they find the financial statements very helpful in decision making.

Table 9-5 Distribution of opinions regarding the importance of Islamic bank's financial statements for each group of the following users

The group of users	Not important At all		Not important		Neutral		Important		Very important		Mean	Rank
	No	%	No	%	No	%	No	%	No	%		
Shareholders/investors	—	—	—	—	1	1.3	9	11.3	70	87.5	4.86	2
Management	—	—	—	—	3	3.8	—	—	77	96.3	4.93	1
Employees	—	—	3	3.8	14	17.5	40	50.0	23	28.8	4.04	6
Auditors	—	—	1	1.3	5	6.4	12	15.4	60	76.9	4.68	3
Customers	1	1.3	4	5.0	17	21.3	20	25.0	38	47.5	4.13	5
Government	—	—	1	1.3	13	16.3	25	31.3	41	51.3	4.33	4

9.3.3 The Responses of Islamic Banks' Employees towards the Qualitative Characteristics of the Islamic Banks' Financial Information

The third question of the questionnaire in this section attempted to explore the IBs' employees views regarding the qualitative characteristics of the Islamic banks' financial statements in Saudi Arabia. The employees were given five qualitative characteristics as follows: relevance; reliability; comparability (between other banks and Islamic banks; consistency; understandability. Table 9-6 shows the frequency and percentage of the responses towards the qualitative characteristic of the Islamic banks' financial statements.

Table 9-6 Distribution of the opinions regarding the nature of the financial information disclosed by the Islamic banks

The Qualitative Characteristics	Strongly disagree		Disagree		Neutral		Agree		Strongly agree		Mean	Rank
	No	%	No	%	No	%	No	%	No	%		
Relevance	—	—	1	1.3	6	7.7	42	53.8	29	37.2	4.27	2
Reliability	—	—	1	1.3	6	7.5	37	46.3	36	45.0	4.35	1
Comparability (between other banks and Islamic banks)	—	—	9	11.3	9	11.3	44	55.0	18	22.5	3.89	5
Consistency	—	—	2	2.5	12	15.0	43	53.8	23	28.8	4.09	4
Understandability	—	—	1	1.3	10	12.7	47	59.5	21	26.6	4.11	3

It is very obvious from table 9-6 that IBs' employees agreed about the qualitative characteristics of the Islamic banks' financial statements by assigning the highest mean value of 4.35 to reliability. They assigned the relevance as the second most important quality with a mean value of 4.27, while understandability was ranked third with the mean value of 4.11. The IB employees recognised the importance of consistency with a mean value of 4.09 by ranking it fourth, while comparability as a quality was assigned to be the last quality with a mean value of 3.89. This result shows all the groups responded to this questionnaire ranked the comparability between other banks and Islamic banks at the bottom of qualitative characteristics.

9.3.4 Opinions of Employees of Islamic Banks on the Quality and Adequacy of the Islamic Banks' Financial Information

Question 4 of the questionnaire in this section attempts to find the opinions of the IBs' employees regarding the importance of eight factors which might affect quality and adequacy of the Islamic banks' financial information. Table 9-7 presents the distribution of the opinions for the eight factors.

Table 9-7 Distribution of opinions regarding the importance of the factors that might affect the quality and adequacy of the accounting information disclosed by Islamic banks

Factor	Not important At all		Not important		Neutral		Important		Very important		Mean	Rank
	No	%	No	%	No	%	No	%	No	%		
The external auditor is a national firm	3	3.8	7	8.8	15	18.8	29	36.3	26	32.5	3.85	6
The external auditor is a national firm affiliated with an international firm	3	3.8	16	20.0	14	17.5	27	33.8	20	25.0	3.56	8
Capability of Islamic bank's management	—	—	—	—	3	3.8	12	15.0	65	81.3	4.78	2
Bank size and its products and services	—	—	2	2.5	11	13.8	32	40.0	35	43.8	4.25	5
Accounting standards adopted in preparing the financial statements	—	—	—	—	5	6.3	20	25.0	55	68.8	4.63	3
The level of education and professional qualification that employees hold	—	—	2	2.5	7	8.8	30	37.5	41	51.3	4.38	4
An effective system of internal control in the bank	—	—	—	—	1	1.3	15	18.8	64	80.0	4.79	1
Ownership structure (e.g. percentage of government ownership, percentage of private ownership and foreign participation)	1	1.3	4	5.0	29	36.3	22	27.5	24	30.0	3.80	7

It is clear from table 9-7 that all factors listed were important in the opinion of IBs' employees. They believed that the most important factor which might affect the quality and adequacy of the accounting information disclosed by Islamic banks were factor number 7 or "an effective system of internal control in the bank" with a mean value of 4.79 followed by the third factor "capability of Islamic bank's management" with a mean value of 4.78. The fifth factor which is "accounting standards adopted in preparing

the financial statements” ranked as third important factor with a mean value of 4.63. This result shows that IBs’ employees are like academics and external auditors as they believe that accounting standards adopted in preparing the financial statements is one of the most important factors which might affect the quality and adequacy of the accounting information disclosed by Islamic banks. As mentioned in the previous two chapters, this result is very important and is a prelude to any discussion of which accounting standards should be adopted for the preparation of Islamic banks’ financial statements in Saudi Arabia.

9.3.5 Islamic Bank Employees’ Responses towards the Source of Information Indicating Islamic Banks’ Performance

Question 5 of the questionnaire attempts to discover which source of information IBs’ employees believe is important in indicating the performance of the bank itself. Table 9-8 provides an analysis of the opinions of the employees regarding the importance of each one of the six sources of information listed.

Table 9-8 Distribution of opinions regarding the importance of the sources of information indicating Islamic banks' performance

The information sources	Not important At all		Not important		Neutral		Important		Very important		Mean	Rank
	No	%	No	%	No	%	No	%	No	%		
Islamic bank's financial reports	—	—	—	—	1	1.3	14	17.5	65	81.3	4.80	1
Islamic bank's interim financial statements	—	—	—	—	6	7.5	29	36.3	45	56.3	4.49	2
Newspapers and Specialist magazines	—	—	2	2.5	32	40.0	40	50.0	6	7.5	3.63	4
Direct information from the Islamic bank	—	—	2	2.5	7	8.8	44	55.0	27	33.8	4.20	3
Market's rumours	8	10.0	30	37.5	25	31.3	13	16.3	4	5.0	2.69	6
Government's publications	—	—	10	12.5	21	26.3	39	48.8	10	12.5	3.61	5

Table 9-8 shows that IBs' employees believe that Islamic bank's financial reports are the most important source of information in indicating Islamic banks' performance with a mean value of 4.80 followed by the interim financial statements with a mean value of 4.49. Direct information from Islamic bank is in third place with a mean value of 4.20, the newspapers and specialist magazine is in the fourth place with a mean value of 3.64 and finally the government information with a mean of 3.61. On the other hand, IBs' employees do not believe that market's rumours are an important source of information, as the mean value is only 2.69. This result shows identical responses from all three groups towards the importance of Islamic banks' financial statements as a major source of information. Therefore, attention must be given to the ways in which these statements are prepared.

9.3.6 Islamic Bank Employees' Responses towards the Importance of Sections of the Islamic Banks' Annual Report

This section presents the employees' opinions regarding the importance of each section of the Islamic bank's annual report listed; the result of the analysis is presented.

As can be seen from table 9-9 that IBs' employees considered all sections as being important, as academics and external auditors had stated. Again as mentioned in the previous two chapters, this result shows the importance of every section of the Islamic bank's annual report, although some of them do not appear in the annual report in Islamic banks in Saudi Arabia, which might lead one to think about applying AAOIFI standards in Islamic banks in Saudi Arabia.

Table 9-9 Distribution of opinions of Islamic banks' employee toward the importance of the sections of the Islamic bank's annual reports

Section of the report	Not important At all		Not important		Neutral		Important		Very important		Mean	Rank
	No	%	No	%	No	%	No	%	No	%		
Board of Director's report	—	—	1	1.3	10	12.5	24	30.0	45	56.3	4.41	8
Auditor's report	—	—	1	1.3	—	—	9	11.4	69	87.3	4.85	4
Balance sheet	—	—	—	—	—	—	5	6.3	75	93.8	4.94	2
Income statement	—	—	—	—	—	—	4	5	76	95	4.95	1
Statement of changes in owners' equity (statement of retained earnings)	—	—	—	—	—	—	12	15	68	85	4.85	4
Statement of cash flow	—	—	—	—	1	1.3	9	11.3	70	87.5	4.86	3
Note of the financial statements	—	—	—	—	3	3.8	12	15.4	63	80.8	4.77	6
Shari'ah supervisory board's report	—	—	1	1.3	3	3.8	11	13.8	65	81.3	4.75	7
Summary of annual activities	—	—	3	3.8	6	7.5	44	55.0	27	33.8	4.19	10
Report about internal control	2	2.5	1	1.3	8	10.0	34	42.5	35	43.8	4.24	9
Statement of changes in restricted investments	—	—	4	5.0	11	13.8	33	41.3	32	40.0	4.16	11
Statement of sources and uses of funds in the Zakah and the charity fund	2	2.5	4	5.0	18	22.5	24	30.0	32	40.0	4.00	12

9.4 ISLAMIC BANK EMPLOYEES' AWARENESS OF AAOIFI ACCOUNTING STANDARDS

In this section awareness of AAOIFI accounting standards among the participants is tested to locate whether they are aware of it, heard about it or never heard about it. Table 9-10 presents the frequency and percentage of IBs' employees towards this particular issue.

Table 9-10 Distribution of opinions regarding the awareness of the Islamic Accounting Standards issued by AAOIFI

Choices	Islamic banks' employee	
	Frequency	Valid Percent
I am aware of it	38	48.7
I heard about it	30	38.5
I have never heard about it	10	12.8
Total	78	100.0

It can be seen from table 9-10, 78 out of 80 IBs' employees, answered this question, which indicate that 38 IBs' employees representing 48.7% of the responses confidently revealed that they have knowledge and awareness of AAOIFI standards, while 10 IBs employees representing 12.8% of the responses were completely ignorant of the existence of Islamic accounting standards. 30 employees representing 38.5% of the responses have little knowledge of these standards.

Although 48.7% of the IBs employees are aware of AAOIFI standards, the researcher is in the opinion that this is not enough, especially considering that IBs' employees are supposed to know and deal with such standards. The researcher believes that ignorance of AAOIFI standards among IB employees is because AAOIFI is not recognized by SAMA and AAOIFI's standards are not implemented yet as well as the lack of training courses offered to them regarding AAOIFI standards.

9.5 PERCEPTIONS OF THE ISLAMIC BANKS' EMPLOYEES TOWARDS APPLYING AAOIFI ACCOUNTING STANDARDS IN SAUDI ARABIA

In this section, IB employees' perceptions towards applying AAOIFI accounting standards in Saudi Arabia are investigated by asking them different questions related to this issue.

9.5.1 Islamic Bank Employees' Opinion Regarding AAOIFI Accounting Standards No. 18

This subsection aims to find the perceptions of IBs' employees towards AAOIFI accounting standards No.18 and to what extent they agree or disagree with it. This question is considered as being an example to assess the willingness of employees in applying Islamic accounting standards.

Table 9-11 Distribution of opinions towards AAOIFI Standard No. 18

Statements	Strongly disagree		Disagree		Neutral		Agree		Strongly agree		Mean
	No	%	No	%	No	%	No	%	No	%	
Islamic windows in Saudi Arabia must prepare supplementary statements to be published in the notes of the financial statements of the conventional banks.	—	—	5	6.3	6	7.5	13	16.3	56	70.0	4.50
Islamic windows in Saudi Arabia must disclose whether or not they mingle funds relating to Islamic financial services with funds relating to conventional financial services.	1	1.3	—	—	7	8.8	11	13.8	61	76.3	4.64
Islamic windows in Saudi Arabia must disclose, in detail, the sources and applications of funds mobilised and invested by their Islamic financial services.	3	3.8	2	2.5	5	3.6	15	18.8	55	68.8	4.46

According to table 9-11, all statements which have been taken from AAOIFI accounting standard No.18 were strongly agreed with. This is a strong indication that IBs' employees, in addition to academics and external auditors prefer AAOIFI accounting standards to be implemented in Islamic banks and Islamic windows in conventional banks in Saudi Arabia.

9.5.2 Opinions of Islamic Bank Employees' towards Harmonizing Accounting Standards used for the Islamic Banks' Financial Statements

Question 9 of the questionnaire aimed at finding the employees' perceptions regarding the idea of harmonizing accounting standards used for the Islamic banks' financial statements. Table 9-12 presents the frequency and percentage of the respondents regarding this matter.

Table 9-12 Distribution of opinions of Islamic banks' employees toward the idea of harmonizing the accounting standards used for Islamic bank's financial statements

Choices	Islamic banks' employees	
	Frequency	Valid Percent
Yes	77	97.5
No	1	1.3
I Don't Know	1	1.3
Total	79	100.0

There is no doubt table 9-12 shows that the vast majority of IBs' employees (97.5%) support the idea of harmonizing accounting standards used in the preparation of Islamic banks' financial statements.

9.5.3 Opinions of Islamic Banks' Employees towards Problems Expected in using Different Accounting Standards

The use of different accounting standards to prepare Islamic banks' financial statements could cause some problems. In this section, potential problems of using different accounting standards are evaluated by asking the IBs' employees whether they agree or disagree with them. Table 9-13 presents the results of the analysis by providing ranking for each potential problem.

Table 9-13 Distribution of opinions of Islamic banks' employees towards the problems that might be caused by using different accounting standards?

Potential problems of Using Different Accounting Standards	Strongly disagree		Disagree		Neutral		Agree		Strongly agree		Mean	Rank
	No	%	No	%	No	%	No	%	No	%		
Difficulty in comparing financial statements	1	1.3	9	11.4	—	—	26	32.9	43	54.4	4.28	1
Variations in the users' interpretation of the financial information	—	—	7	8.9	3	3.8	32	40.5	37	46.8	4.25	2
Difficulty in making decisions	—	—	9	11.5	16	20.5	34	43.6	19	24.4	3.81	6
Decreased user's trust in accounting information	3	3.8	19	24.1	15	19.0	27	34.2	15	19.0	3.41	7
Loss of trust in the audit reports	5	6.3	30	38.0	17	21.5	13	16.5	14	17.7	3.01	8
Expand the range of the work done by the external auditors	1	1.3	8	10.1	12	15.2	32	40.5	26	32.9	3.94	4
Difficulties for accountants to deal with different accounting standards	1	1.3	7	8.9	11	13.9	34	43.0	26	32.9	3.97	3
Cost of training accountants to be familiar with different accounting standards	1	1.3	7	9.0	14	17.9	33	42.3	23	29.5	3.90	5

The analysis indicates that IBs employees agreed with most of the potential problems listed in table 7-13 above. However, they believe that difficulty in comparing financial statements is the most important problem which might be caused by using different accounting standards in preparing Islamic banks' financial statements with the highest mean value of 4.28. The second important problem was found to be "the variations in the users' interpretation of the financial information" with a mean value of 4.25; and the third important problem was assigned to be "the difficulty for accountants to deal with different accounting standards" with a mean value of 3.97. On the other hand, IBs' employees seem to be not sure about two of the positional problems; decreased user's trust in accounting information with mean value of 3.41; and loss of trust in the audit reports with a mean value of 3.01.

Overall, again this result supports the idea that using specific accounting standards will help in sorting out most of the positional problems listed above.

9.5.4 Opinions of Islamic Banks' Employees towards the Consequences of Applying AAOIFI Accounting Standards in Saudi Arabia

Applying AAOIFI accounting standards in Islamic banks in Saudi Arabia might achieve some of the objectives listed in table 9-14, which presents the IB employees' perceptions regarding this matter.

As can be seen from table 9-14, IBs' employees strongly agree with most of the objectives, which might be achieved when AAOIFI accounting standards are implemented in Saudi Arabia. Harmonizing financial statements between Islamic banks was opted to be the most important objective in the employees' point of view with a highest mean value of 4.68 followed by "promoting adequate disclosure of comparable financial information" in second place with a mean value of 4.63. The result of this question confirms the results in the previous question that applying AAOIFI and harmonizing accounting standards will make comparison of Islamic bank's financial information possible.

Table 9-14 Opinions of Islamic banks' employees towards the consequences of applying Islamic accounting standards in Saudi Arabia

Objectives	Strongly disagree		Disagree		Neutral		Agree		Strongly agree		Mean	Rank
	No	%	No	%	No	%	No	%	No	%		
Harmonizing financial statements between Islamic banks	1	1.3	1	1.3	2	2.5	15	18.8	61	76.3	4.68	1
Promoting adequate disclosure of comparable financial information	—	—	1	1.3	3	3.8	21	26.3	55	68.8	4.63	2
Providing definitive criteria for the guidance of accountants in the process of the preparation of Islamic bank's financial statements	—	—	2	2.5	3	3.8	25	31.3	50	62.5	4.54	3
Providing reasonable consistency in Islamic bank's financial reporting over time	—	—	3	3.8	7	8.8	22	27.5	48	60.0	4.44	5
Increase users' trust in Islamic bank's financial information	—	—	3	3.8	4	5.0	34	42.5	39	48.8	4.36	6
Providing definitive criteria for the guidance of external auditors through the process of auditing Islamic bank's financial statements	1	1.3	1	1.3	3	3.8	26	32.5	49	61.3	4.51	4

9.5.5 Islamic Bank Employees' Preference Regarding Accounting Standards for Preparing Islamic Banks' Financial Statements in Saudi Arabia

In this section, the researcher tries to explore which accounting standards the IBs' employees prefer to be adopted for setting accounting standards for Islamic banks in Saudi Arabia. This question is considered as being one of the key aspects of this research. Therefore IBs' employees were given five different alternatives of accounting standards to choose from. This is listed in table 9-15.

Table 9-15 Preferences of Islamic banks' employees towards alternative accounting standards for Islamic banks in Saudi Arabia

The alternative	Strongly dislike		Dislike		Neutral		Prefer		Strongly prefer		Mean	Rank
	No	%	No	%	No	%	No	%	No	%		
International accounting standards only with modification to suit Islamic bank's needs	4	5.0	12	15.0	17	21.3	28	35.0	19	23.8	3.58	2
American accounting standards only with modification to suit Islamic bank's needs	5	6.4	25	32.1	29	37.2	19	24.4	—	—	2.79	4
British accounting standards only with modification to suit Islamic bank's needs	6	7.7	25	32.1	33	42.3	14	17.9	—	—	2.71	5
SOCPA Accounting Standards	4	5.1	10	12.7	18	22.8	30	38.0	17	21.5	3.58	2
AAOIFI Accounting Standards	—	—	2	2.5	11	13.9	21	26.6	45	57.0	4.38	1

As table 9-15 demonstrates IBs' employees strongly prefer AAOIFI accounting standards to be adopted in Islamic banks in Saudi Arabia with a highest mean value of 4.38. In addition, American and British accounting standards seem to be disliked by employees with a lowest mean value of 2.79 and 2.71 respectively. As mentioned earlier in chapter 7 and 8, this result is considered to be one of the main outcomes of this survey as it shows clearly which accounting standards academics in Saudi Arabia prefer to be applied in Islamic banks i.e. AAOIFI standards.

9.5.6 Islamic Bank Employees' Opinions towards Identifying the Application of AAOIFI Accounting Standards in Saudi Arabia

Question 14 of the questionnaire aimed at exploring the IB employees' perceptions regarding the role of SAMA, SOCPA, Ministry of Commerce, Islamic banks'

management, auditing firms and academics in the accounting field for applying AAOIFI accounting standard in Saudi Arabia. Table 9-16 presents frequency and percentage of respondents regarding this issue.

Table 9-16 Distribution of opinions of Islamic banks' employees in identifying the important group in applying Islamic accounting standards (AAOIFI) in Saudi Arabia

Groups	Not important At all		Not important		Neutral		Important		Very important		Mean	Rank
	No	%	No	%	No	%	No	%	No	%		
SAMA	—	—	2	2.5	3	3.8	10	12.7	64	81.0	4.72	1
SOCPA	—	—	2	2.6	5	6.5	18	23.4	52	67.5	4.56	3
Ministry of Commerce	—	—	4	5.1	13	16.7	28	35.9	33	42.3	4.15	5
Islamic bank's management	—	—	1	1.3	5	6.3	14	17.7	59	74.7	4.66	2
Auditing firms	—	—	1	1.3	9	11.4	27	34.2	42	53.2	4.39	4
Academics in the accounting field	1	1.3	1	1.3	14	17.9	33	42.3	29	37.2	4.13	6

As can be seen from table 9-16 all groups were considered to have important role in applying AAOIFI accounting standards in Saudi Arabia from the IB employees' point of view. SAMA ranked first with a mean value of 4.72 in terms of its role in applying AAOIFI accounting standards in Islamic banks in Saudi Arabia followed by Islamic bank's management with a mean value of 4.66. SOCPA ranked third with a mean value of 4.56, followed by auditing firms with a mean value of 4.39. The Ministry of Commerce and academics in the accounting field came at the bottom of the list respectively with a mean value of 4.15 and 4.13.

This result shows that IBs' employees appreciate the role of SAMA in applying AAOIFI accounting standards in Saudi Arabia. This result should not be surprising as all banks in Saudi Arabia are subject to the regulations of SAMA.

9.5.7 Opinions of Islamic Banks' Employees towards Obstacles in Implementing the AAOIFI Accounting Standards in Saudi Arabia

In question 15 of the questionnaire, three factors were listed in order to gather the perceptions of IBs' employees regarding the effectiveness of each factor in applying AAOIFI accounting standards in Saudi Arabia. Table 9-17 presents the results of the analysis.

Table 9-17 Opinions of the Islamic banks' employees regarding the impact of certain factors in applying AAOIFI Islamic accounting standards in Saudi Arabia

Statements	Not effective at all		Not effective		Neutral		Effective		Very effective		Mean	Rank
	No	%	No	%	No	%	No	%	No	%		
The newness of AAOIFI Standards and its lack of experience	—	—	1	1.3	15	19.7	36	47.4	24	31.6	4.09	2
AAOIFI Standards are not compulsory	—	—	2	2.6	2	2.6	25	32.9	47	61.8	4.54	1
AAOIFI Standards are not internationally acceptable	—	—	6	7.9	19	25.0	24	31.6	27	35.5	3.95	3

As it can be seen from table 9-17, IBs' employees believe that all three factors affect the implementation of AAOIFI accounting standards in Islamic banks in Saudi Arabia. The fact of being not compulsory became the biggest obstacle from IB employees' point of view in applying AAOIFI accounting standards with a mean value of 4.54. The second obstacle came out to be the newness of AAOIFI standards and its lack of experience - with a mean value of 4.09. Among these, the last obstacle opted was that AAOIFI standards are not internationally acceptable, which received a mean value of 3.95. It is worth mentioning that all the three groups of respondents have agreed with each other in this question and they gave the same rank for each factor.

9.6 ATTITUDES OF THE ISLAMIC BANK EMPLOYEES TOWARDS ISLAMIZING CONVENTIONAL BANKS IN SAUDI ARABIA

Question 16 of the questionnaire asked IBs' employees about their view regarding the probability of Islamizing conventional banks in Saudi Arabia. The results are shown in table 9-18.

Table 9-18 Distribution of opinions towards Islamic windows in the conventional banks in Saudi Arabia as the first step towards Islamisation of all conventional banks

Choices	Islamic banks' employees	
	Frequency	Valid Percent
Yes	47	58.8
No	28	35.0
I Don't Know	5	6.3
Total	80	100.0

It can be seen from table 9-18 that the majority of IBs' employees (58.8%) believe that Islamic windows in the conventional banks in Saudi Arabia are the first step towards Islamization of all conventional banks, whereas only (35%) do not believe so. This result gives a clear indication that most of the IBs' employees assume that recent developments and changes in the conventional banks by providing Islamic products through Islamic windows might be the first step towards Islamizing it. It should be noted that this result is identical to results of the previous two categories of participants in chapters 7 and 8.

9.7 ISLAMIC BANK EMPLOYEES' OPINION TOWARDS TRAINING OF THE ACCOUNTANTS IN ISLAMIC BANKS

This research attempted to shed light on the training issue for accountants in Islamic banks or windows in Saudi Arabia by asking the respondents about their views whether Islamic banks are concerned with accounting issues in Islamic banking, and whether

they are making sufficient efforts for training their accountants. Table 9-19 shows the distribution of the opinions of the IBs' employees regarding this matter.

Table 9-19 Distribution of opinions of the employees of Islamic banks towards training of the accountants in the Islamic banks

Choices	Islamic banks' employees	
	Frequency	Valid Percent
Yes	34	42.5
No	34	42.5
I Don't Know	12	15.0
Total	80	100.0

It can be seen from table 9-19 that IBs' employees are equally split into two groups regarding the trainings provided to the accountants working in the Islamic banks in Saudi Arabia. 42.5% of the respondents believed that Islamic banks in Saudi Arabia provided training courses to their accountants regarding accounting issues in Islamic banking, whereas, the other half of the same percentage do not believe that Islamic banks make such provisions. This finding indicates that there is an imbalance in the opportunities for training provided to them.

9.8 CONCLUSION

The aim of this chapter is to present an analysis of the primary data collected through a questionnaire from the Islamic bank employees' survey, which is the final chapter in a series of chapters on empirical analysis. The previous two chapters explored the views and perceptions of academics and external auditors relating to accounting practices in Islamic banks in Saudi Arabia. This final discussion on the views and perceptions of Islamic bank employees sets the ground to examine the results of the three chapters, as well as to analyze the hypotheses of this research. This discussion and analysis will proceed in the following chapters.

CHAPTER 10

ANALYTICAL EMPIRICAL FINDINGS ON THE PERCEIVED USEFULNESS OF AAOIFI STANDARDS AND THE PERCEPTIONS

10.1 INTRODUCTION

This chapter presents the results of the analysis and testing of the hypotheses and attempts to answer the research questions which were mentioned in the introduction chapter.

Recalling that the main objective of this study is to explore the awareness and preference of AAOIFI accounting standards from the academics', external auditors' and Islamic bank employees' points of view, the primary objective of this chapter is to survey and ascertain the usefulness of Islamic banks' financial reports in Saudi Arabia. Accordingly, this chapter is divided into five parts. The first presents the result of analysis of respondents' perceptions of Islamisation of conventional banks in Saudi Arabia. The second shows the respondents' perceptions regarding the usefulness of IBs' annual reports and the importance of the sources of information indicates the performance of IBs. In the third part, adopting AAOIFI accounting standards in Islamic banks in Saudi Arabia is discussed by exploring the awareness and preferences of AAOIFI accounting standards to discover the respondents' perceptions towards harmonising IBs' financial statements. The fourth presents and discusses the importance and need for training IBs' accountants, and in the final part, the hypotheses of this study are examined with an attempt to explore the relation between the respondents' education, professional qualifications and experience variables with the awareness and preference of AAOIFI accounting standards. The statistical methods employed in this chapter range from frequency distribution, mean value ranking, factor analysis, to cross-tabulation and chi-square to test the hypotheses.

10.2 TOWARDS ISLAMISATION OF CONVENTIONAL BANKS IN SAUDI ARABIA

In the last few decades Islamic banking has emerged as a new concept of banking, which attracts a number of customers in Muslim countries. Conventional banks are now starting to feel the effects of competition from Islamic banks and to cope with this situation most of the conventional banks in Western countries are starting to offer Islamic products (Mehmood 2005) through Islamic windows.

The idea of Islamising conventional banks was derived from the principle of transformation. The meaning of transformation or the Islamisation of the conventional bank comes from a sincere desire to put forward alternatives to the legitimacy of the financial and banking services in accordance with the provisions and principles of Islamic *Shari'ah*.

The phenomenon of the Islamisation of conventional banks is clear evidence that Islamic banking and its tools are successful. According to Al-Khalifi (2004), the transformation of conventional banks to fully become Islamic banks takes a long time and effort. However, in the Gulf region, most of conventional banks which moved towards Islamic banking noticed that their revenues jumped significantly (Al-Khalifi 2004). It is worth mentioning that AAOIFI *Shari'ah* Standard No.6 is about the transformation of conventional banks to Islamic banks. The objective of this standard is to describe the procedures, mechanisms and processes to be taken into account to transform from a conventional bank to an Islamic bank (AAOIFI 2002).

The development of the banking system in Saudi Arabia is discussed in chapter 4. However, Islamisation of conventional banks in Saudi Arabia nowadays has become more obvious and rapidly spreading. Therefore, this study attempted asking the respondents about their views regarding whether or not the spread of Islamic windows in the conventional banks in Saudi Arabia are considered as the first step towards Islamisation of all conventional banks?

In this section, the results of Question 16 of the questionnaire to all respondents is presented and discussed. The results of each group of respondents were illustrated in the last three chapters. However, the view of all respondents as to whether they believe Islamic windows in Saudi Arabia are the first step towards Islamizing conventional banks or not is revealed in table 10-1 below.

Table 10-1: Respondents' view regarding the Islamisation of conventional banks in Saudi Arabia.

Respondents' view regarding the Islamisation of conventional banks in Saudi Arabia	Frequency	Valid Percent
Yes	109	59.2
No	64	34.8
I Don't Know	11	6.0
Total	184	100.0

As can be seen from the table 10-1, the majority of respondents (59.24%) agreed that Islamic windows in the conventional banks in Saudi Arabia are the first step towards Islamizing them. However, 34.78% do not believe so. If we look at the results of each group of respondents separately, the percentage of respondents believe that Islamic windows in conventional banks in Saudi Arabia are the first step towards Islamisation of all conventional banks were as follows (See tables 7.15, 8.15 and 9.15 respectively from the previous empirical chapters): academics 67.9%; external Auditors 51%; and IB employees 58.8%.

From this research's point of view, the result of each group is consistent with the result for all groups in total. Generally speaking, this result is consistent with the general trend towards Islamisation of conventional banks as we are witnessing a tremendous shift in recent years in the Kingdom of Saudi Arabia. In addition to Al Rajhi Bank, Bank Aljazira and Bank Albilad, which are already known as the only Islamized banks in Saudi Arabia, there are some conventional banks which have announced that they would Islamize their banking operations, such as the national commercial bank (AlAhli) and SAMBA.

Issa Al-Issa the executive chairman of SAMBA, for instance, announced that SAMBA has the intention and is going ahead with the Islamisation of all branches, but this requires time, according to the possibilities available to SAMBA, he added that a research indicated that more than 95% of customers prefer the traditional Islamic product (Al-Hamazani 2006). In addition, in an interview with the Executive Chairman of the National Commercial Bank, when he was asked about the transformation of the bank to fully Islamic, he replied:

“Let me assure you that the beginning of the growth in the demand for Islamic banking in the Kingdom rapidly promising further proliferation, especially if we take into account the entry of new banks in this area accompanied by offering innovative and sophisticated products, and this will provide the market dynamic and keep the high demand for funding Islamic versions. Proceeding from our period in the Islamic banking work for more than 16 years, the bank has taken a strategic decision to convert all its branches to Islamic banking. We will continue our approach based on the gradual adoption of the course with respect to the conversion of our Islamic banking and progress will depend primarily on providing products compatible with the Islamic Shari’ah to meet the needs of the corporate sector and the rest of the business units.” (Abu Al-Nasr 2007)

It should also be noted that King Abdullah bin Abdul Aziz announced the intention of establishing a new bank called (Al-Enma) with a capital of 15 billion Saudi riyals. The bank is expected to be an Islamic bank, which will be considered as the biggest bank in Saudi Arabia and will add more competition in the field of the Islamic banking in the Kingdom.

Banking experts, such as Mr. Zaqzouq, stated in a television interview that Islamic banking in the Saudi market is the foundation and could constitute 65-70% of the banking industry in the Kingdom. He added that conventional banks are due to disappear gradually with the emergence of alternative Islamic modes of banking (Shobokshi 2007).

With these rapid developments in the industry, regulation and accommodation of Islamic banks within the financial system can be problematic. For example, Al-Martani (2005) argues that lack of clarity or perhaps lack of a relationship between the Islamic banks, or the practice of the Islamic banking act and the central bank organization of the banking industry and regulating it. With the exception of a few cases, some central banks have only one banking regulation to deal with all banks operating in the country, without any distinction between Islamic banking and the conventional banking system. This is due to the fact that some of these countries do not allow a license to Islamic banks. In addition, those countries do not provide Islamic banks with the facilities normally offered to conventional banks, which means Islamic banks are not in a position to compete with conventional banks (Al-Martani 2005).

Saudi Arabia is one of those countries, which deals with Islamic banks as “*Shari’ah* compliant banks”. Therefore, Saudi Arabian Monetary Agency or SAMA does not have an Islamic banking regulation. Thus, “*Shari’ah* compliant banks” in Saudi Arabia follow the same regulations as other conventional banks. SAMA does not want to give the impression that there are some non-Islamic banks in Saudi Arabia by authorising a single Islamic bank, so all banks in Saudi Arabia are considered Islamic. In fact, this positioning is not shared by this research, as this research is in the opinion that that the time has come to recognize Islamic banking in Saudi Arabia as different than the conventional banking and impose specific laws and legislations to regulate Islamic banks.

To sum up, Islamic banking is spreading very quickly in Saudi Arabia and the majority of respondents believe that more Islamic banking is to come whether they are newly established like “Bank Al-Enma” or through Islamisation of conventional banks such as the national commercial bank (Al-Ahli) and SAMBA. Therefore, SAMA has to move quickly in order to regulate Islamic banking in Saudi Arabia, like some other Muslim countries. This result is considered to be the entrance to such a debate about the importance of adopting AAOIFI Accounting standards in Saudi Arabia, which is discussed later in this chapter.

10.3 THE IMPORTANCE OF ISLAMIC BANKS' FINANCIAL STATEMENTS

Many researchers have examined the importance of the financial statements. However, to the knowledge of the researcher, only Al-Mehmadi (2004) has examined the usefulness of the Islamic banks' annual report in Saudi Arabia from the investors' point of view. In this section, the importance of Islamic banks' financial statements in Saudi Arabia is examined from the financial preparers' point of views.

This section consists of four sub sections in which the qualitative characteristics of IBs financial reporting will be reviewed, its importance as a source of information, the importance and usefulness of the annual report items and finally, factors that affect the quality and adequacy of information disclosed by Islamic banks. Factor analysis tests are used also in this section, as well as comparing the respondents' views with each other and with previous studies in this area.

10.3.1 The Qualitative Characteristics of Islamic Bank Financial Reporting in Saudi Arabia

In this section, the respondents' views regarding the qualitative characteristics of Islamic banks financial reporting in Saudi Arabia is examined, which as mentioned and discussed in chapter 5, consists of five characteristics as follows:

- 1-Relevance
- 2-Understandability
- 3-Reliability
- 4-Comparability
- 5-Consistency

Question No.3 of the questionnaire aimed at exploring the view of the respondents regarding whether or not IBs' financial reports in Saudi Arabia have the above characteristics. Table 10-2 shows the ranking according to the mean values of all respondents towards the qualitative characteristics of the Islamic banks' financial statements.

Table 10-2: Ranking of the qualitative characteristics according to the opinions for all respondents

The Qualitative Characteristics	N	Mean	Rank	Std. Deviation
Reliability	184	4.23	1	.772
Relevance	181	4.17	2	.721
Consistency	184	4.09	3	.780
Understandability	183	4.07	4	.785
Comparability	184	3.91	5	.891
Valid N (listwise)	180			

It is very obvious from table 10-2 that academics, external auditors and IB employees agreed about the qualitative characteristics of the Islamic banks' financial statements by assigning the highest mean value of 4.23 to 'reliability'. They assigned the 'relevance' as the second most important quality with a mean value of 4.17, while 'consistency' was ranked third with the mean value of 4.09. The respondents recognised the importance of the 'understandability' with a mean value of 4.07 by ranking it fourth, while 'comparability' as a quality was assigned to be the last quality with a mean value of 3.91. This result shows all the groups that responded to this questionnaire ranked the 'comparability' between other banks and Islamic banks at the bottom of qualitative characteristics. This result is also consistent with the results presented in the previous empirical chapters for each group individually.

It should be noted that Idris (1996) has examined the qualitative characteristics of the financial reports of the Bank Islam Malaysia Berhad (BIMB), who found that 'understandability' is ranked first by the investors whereas in this study the respondents ranked it fourth. 'Relevance' was ranked the second qualitative characteristic in Idris's study, which is consistent with this study. Idris found that 'reliability' was ranked third whereas in this study it was first. Finally, 'consistency' and 'comparability' came at the bottom of the ranking in his study, which is consistent with the results of this study, as 'comparability' is ranked last.

To summarise, as the results indicates so far, the respondents of this study are in the opinion that IBs' financial reports in Saudi Arabia have the qualitative characteristics

which make the accounting information useful. However, 'comparability' was ranked as the least qualitative characteristic implying that comparability in IBs' financial reports needs to be enhanced. Later in this chapter, comparability is discussed to explore whether or not adopting AAOIFI accounting standard in IBs in Saudi Arabia will help in enhancing this very important qualitative characteristic.

10.3.2 The Importance of Islamic Banks' Annual Reports as a Source of Information

It is argued that the annual reports are considered to be very important in most of the studies, as many researchers consider the annual reports or financial statements as the most important source of information for investment decisions. There appears also to be a consistency, with regard to investors' perceptions of the usefulness of accounting information for their investment decisions, between the Western studies and the studies involving investors in Islamic countries. Most of the studies conducted in Islamic and in Western countries ranked the annual reports as the first source of information. Examining the importance of the annual reports to Muslim users should, therefore, contribute to knowledge, particularly since most of the studies to date were conducted in the Western world subject to different economic and cultural circumstances (Al-Mehmadi 2004). Furthermore, it should be mentioned that, to the best of the researcher's knowledge, there are only two such studies, Idris (1996) and Al-Mehmadi (2004), which were concerned with the usefulness of annual reports of Islamic banks and the Muslim users' need. Therefore, the researcher seeks to expand the literature on the use of annual reports by studying the usefulness of annual reports of Islamic banks from the academics, external auditors and IB employees' point of view in Saudi Arabia.

The main objective of studying the usefulness of the Islamic banks financial statements in Saudi Arabia is to evaluate the importance of these financial statements from the viewpoint of academics, external auditors and IBs' employees. Assuring the usefulness of financial statements certainly will lead to think about the accounting standards used for its preparation, and whether these standards meet the requirements of Islamic banks as well as the users of the IBs financial statements in Saudi Arabia. This section examines the importance of annual reports of Islamic banks as a source of information.

The respondents were asked in question 5 in the questionnaire to give their opinion regarding the importance of the 6 sources of information which are:

- 1-Islamic banks' financial reports;
- 2-Islamic banks' interim financial statements;
- 3-Newspapers and specialist magazines;
- 4-Direct information from the Islamic bank;
- 4-Market's rumours; and lastly
- 5-Government publications.

In the last three chapters, empirical analyses were presented individually for each group of respondents, namely academics, external auditors and IB employees respectively. However, this section compares the result given by all respondents as well as comparing the results in relation to the previous studies. Ranking is used to illustrate the findings, and factor analysis is employed to explore the relation between the sources of information given.

10.3.2.1 Factor analysis: classifying the sources of information which help the decision maker

This section discusses the results of the factor analysis that was run on six items that are considered as the main source of information, which indicate the Islamic banks' performance and help the decision maker to make the most efficient decision. These six variables were carefully chosen based on the review of the usefulness of annual report literatures, which were listed above.

To test the factorability of the data, the Kaiser-Meyer-Olkin (KMO) test used to measure the sample adequacy while Bartlett's test is a test of sphericity. According to Dusuki (2005), Bartlett's test of sphericity is a test statistic used to examine the hypothesis that the variables are uncorrelated in the population. In other words, the population correlation matrix is an identity matrix, each variable correlates perfectly with itself ($r=1$) but has no correlation with the other variables ($r=0$) (Dusuki 2005).

Kaiser (1974) as quoted in Vaus (2002) suggests that if KMO measures 0.90+, then sample adequacy is considered “marvellous”. If 0.80-0.89, then the sample is “meritorious”; if 0.70-0.79 then the sample is “middling”; if 0.60-0.69 then the sample is “mediocre”; if 0.50-0.59 then the sample is “miserable”; and if less than 0.50 the sample is “unacceptable”(Dusuki 2005). On the other hand, for the factor analysis to proceed, Bartlett’s test of sphericity should be significant (that is $p < 0.05$) (Vaus 2002). Table 10-3 presents the results of the statistical tests, which support the use of factor analysis, albeit only on the margin.

Table 10-3: KMO and Bartlett's Test Results for 6 items combined (IBs source of information)

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		.565
Bartlett's Test of Sphericity	Approx. Chi-Square	165.652
	df	15
	Sig.	.000

From table 10-3, the KMO measure the sources of information that indicates the Islamic banks’ performance and helps the decision maker to make the right decision showed a value of 0.565 (rounded). This indicates that the sample adequacy according to the Kaiser (1974) scale is above 0.50 which is acceptable, and hence is deemed appropriate for use in further factor analysis. The Bartlett’s Test of Sphericity also reached statistical significance (0.000), supporting the factorability of the correlation matrix.

Based on results achieved in table 10.2, factor analysis proceeds to conduct principal component analysis (PCA) and varimax rotation with Kaiser Normalisation. The PCA is concerned with specifying a number of factors to account for the maximum amount of variance in the data. PCA with an Eigenvalue greater than 1.0 is regarded as significant and can be used to determine the factors to extract (Pallant 2001). An Eigenvalue is a statistics that relates to a factor which indicates the amount of variance in the pool of initial items which that particular factor explains (Vaus 2002).

Table 10-4: Total variance explained (IBs source of information)

Component	Initial Eigenvalues			Rotation Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	2.029	33.812	33.812	1.833	30.554	30.554
2	1.258	20.963	54.775	1.453	24.222	54.775
3	.998	16.636	71.412			
4	.812	13.540	84.951			
5	.566	9.431	94.382			
6	.337	5.618	100.000			

Extraction Method: Principal Component Analysis.

In table 10-4, there are two factors with an Eigenvalue greater than 1 (2.029 and 1.258). This initial analysis therefore resulted in a two-factor solution. That is, these 6 items can be simply reduced to two groups. Each group explains a particular amount of variance in the items. In this case, group 1 explains 33.81% and group 2 explains 20.96% of the pooled variance. Together these two groups explain 54.77% of the variance. According to Vaus (2002), the more variance that is explained by the factors, the better factor solution and the more comfortable the study is in reducing the initial 6 items to two groups. The Scree plot in Figure 10.1 depicts that the Eigenvalue slopes steeply downwards from the factor one to factor two before moving slowly towards the horizon line.

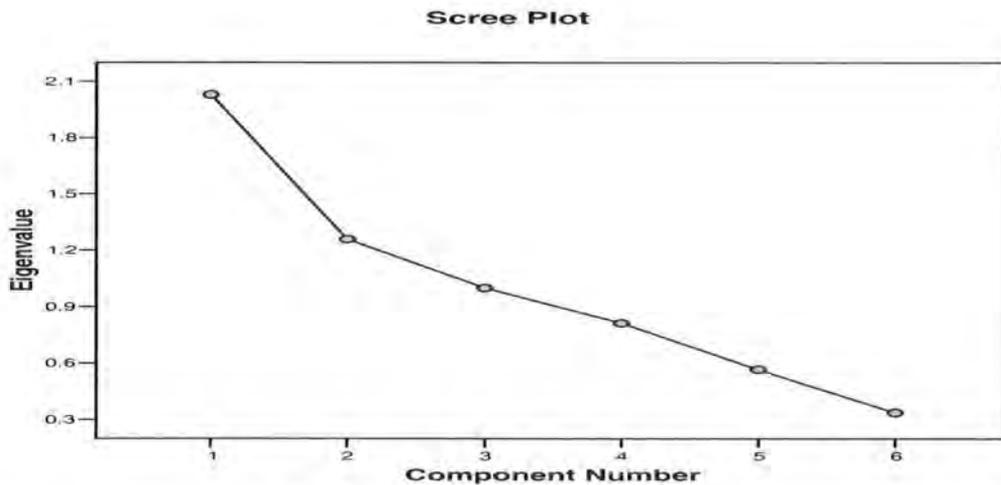


Figure 10.1: Scree plot for the IBs source of information

An inspection of the Scree plot (figure 10.1) reveals a clear break after the second factor. The rotated solution (presented in table 10-5 below) revealed the presence of two factors with a number of strong loadings. The interpretation of the two factors is based on the loading of six variables of these items. A factor loading is a correlation coefficient showing how much weight is assigned to that factor. The higher the loading, the more that variable (or item) belongs to that factor (Vaus 2002). A normal loading of at least 0.3 is considered significant before the item can be said to belong to the component (Vaus 2002). It should be noted that where a variable has an acceptable loading on more than one factor, one of these loadings can be reduced to the factor with the highest loading (Vaus 2002).

Table 10-5: Rotated Component Matrix (a) on IBs source of information

IBs source of information	Component		Communalities
	1	2	
Islamic banks' financial reports	.905		.821
Islamic banks' interim financial statements	.832		.700
Newspapers and specialist magazines	.515	.573	.593
Direct information from the Islamic bank		.635	.438
Market's rumours		.598	.371
Governments Publications		.595	.363

Extraction Method: Principal Component Analysis. Rotation Method: Varimax with Kaiser Normalization. A Rotation converged in 3 iterations.

The results in table 10-5 indicate that all 6 items of the IBs' source of information exhibit large factor loading (above 0.3). Variables with a factor loading smaller than 0.3 are normally considered not significant and can be ignored from the factor. The two factor solution explains a total of 54.77% of the variance, with factor 1 contributing 30.55% and factor 2 contributing 24.22% (see table 10.3 above). Table 10-5 also depicts the communality of each variable. Communalities measure correlations among the 6 variables to be factor analysed. A higher correlation among the variables implies the more they have in common or the higher their communalities would be. For example, a

communality of 0.821 for the variable No.1 'Islamic banks' financial reports' indicates that the variable has 82.1% of its variation in common with other variables in forming a factor or group. On the other hand, a variable having a very low communality (close to zero), is not likely to be associated with any other variables in defining a factor or group.

The result of the factor analysis shows that IBs' source of information can be divided into two main groups, the first group includes:

- 1- Islamic banks' financial reports.
- 2- Islamic banks' interim financial statements.

The second group includes:

- 1- Newspapers and specialist magazines.
- 2- Direct information from the Islamic bank
- 3- Market's rumours
- 4- Government's Publications

From the two groups above we can observe that 'Newspapers and specialist magazines' has been represented in both groups. However, because the highest load of this variable is 0.573; therefore, 'Newspapers and specialist magazines' should be included in the second group. It can be observed that the first group concentrates on the financial statements both 'financial reports' and 'interim financial statements' with highest communalities of 0.821 and 0.700 respectively. The second group includes the 'Newspapers and specialist magazines' with highest communality of 0.593 in this group followed by the 'direct information from the IBs' with 0.438. However, in the bottom of this group we can find the 'Market's rumours' and 'Government's publications' with a communality of 0.371 and 0.363 respectively.

This result assures the importance of the Islamic banks' financial reports as a source of information in indicating the IBs' performance and to help the decision maker to make their decisions. To support this conclusion, the results of all respondents together and individually compared with previous studies are discussed in the next section.

10.3.2.2 Comparing the results among the three samples regarding the importance of each source of information in IBs in Saudi Arabia

In this section, tables 10-6 and 10-7 will present the ranking of the importance of each source of information in IBs in Saudi Arabia according to the respondents' opinion, as a whole and individually.

Table 10-6: The ranking of importance of each source of information in IBs in Saudi Arabia according to all respondents' views.

Source of information	Mean	Std. Deviation	Analysis N	Rank
Islamic banks' financial reports	4.70	.604	182	1
Islamic banks' interim financial statements	4.50	.695	182	2
Newspapers and specialist magazines	3.58	.788	182	5
Direct information from the Islamic bank	4.16	.825	182	3
Market's rumours	2.74	1.048	182	6
Government's Publications	3.80	.915	182	4

Table 10-6 shows that the 'IBs' financial reports' are the most important source of information according to the mean of 4.70 which is "very important". While the 'IBs' interim financial statements' is found to be the second important source with a mean of 4.50 which is also "very important". 'Direct information for IBs' ranked third important source of information with a mean value of 4.16 as "very important" as well. It should be noted that all respondents individually have the same ranking for the first three important sources of information (see table 10-7). It is also worth mentioning that academics and external auditors have the same ranking for the importance of source of information as stated in table 10.6. However, IBs employees have different views for two of the sources of information as they ranked 'Newspapers and specialist magazine' as fourth in ranking and gave the fifth rank to the 'Government's publications'. It is noteworthy that all the respondents jointly and individually have classified the 'market's rumors' at the bottom of the ranks.

This findings regarding the annual reports as the first source of information is consistent with the findings of much of the literature mentioned in chapter 5 (Lee and Tweedie, 1975a and 1975b; Anderson, 1981; Gniewosz, 1990; Ba-Owaidan, 1994; Idris, 1995; Abu-Nassar and Rutherford, 1996; Al-Bogami, 1996; Al-Mubarak, 1997; Al-Razeen, 1999; Al-Mahmoud, 2000; and Al-Mehmadi, 2004). After the annual reports, the interim financial statements come as second in importance which ranked similarly as some of the literature (such as Al-Bogami, 1996; Al-Razeen, 1999; Al-Mahmoud, 2000; Al-Mehmadi, 2004). The direct information was ranked third similarly as in Anderson (1981), Al-Razeen (1999) and Al-Mehmadi (2004). 'Government publications' was ranked fourth while it was ranked third in Al-Mubarak 1997 and just before the last in Al-Mahmoud (2000) and Al-Mehmadi (2004). The fifth source of information in this study was the 'Newspapers and specialist magazines' similarly as in (Pike et al, 1993; Al-Mubarak, 1997; Al-Razeen, 1999). The last ranked source of information was the 'Market's rumors' which is consistent with the findings of (Al-Mubarak, 1997; Al-Razeen, 1999; Al-Mehmadi, 2004).

In summing, these findings show how important the annual reports as a source of information is, which gives an indication as to the performance of the Islamic banks and helps the decision makers to make the right decisions from the respondents' point of view. This result is consistent with the result of the factor analysis, which showed that the most important group contains the following source of information: 'IBs financial statements' and 'IBs interim financial statements'. In addition, this result shows how important it is to look at how these annual reports have been prepared and according to which accounting standards.

Table 10-7: Comparing the ranking of importance of each source of information for IBs in Saudi Arabia among the respondents

Source of information	The Ranking		
	Academics	External Auditors	IBs employees
Islamic banks' financial reports	1	1	1
Islamic banks' interim financial statements	2	2	2
Newspapers and specialist magazines	5	5	4
Direct information from the Islamic bank	3	3	3
Market's rumours	6	6	6
Government's Publications	4	4	5

10.3.3 The Importance and Usefulness of Islamic Banks' Annual Report Items

Financial statements are intended to provide information to different users who make decisions relating to profitability and liquidity of the organization. The main outputs of the financial statements are the profit and loss accounts and balance sheets which are the most commonly used by investors to make their decisions. The related literature on the usefulness of financial statements was reviewed in chapter 5, among which the two most important studies that evaluate the usefulness of Islamic banks' financial statements are (Idris 1996; Al-Mehmadi 2004). Al-Mehmadi (2004) claims that his study is the first in contributing to the literature on the usefulness of Islamic banks' annual reports from the investors' point of view . Unlike Al-Mehmadi's research, this present study aims at contributing to the literature on the usefulness of Islamic banks' annual reports from the academics', external auditors' and IB employees' point of view.

Since the main objective of this study is to explore the perception of the academics, external auditors and IBs employees regarding AAOIFI accounting standards and whether or not they prefer it to be adopted in IBs in Saudi Arabia, the researcher is in the opinion that the importance and usefulness of IBs annual report should be evaluated from the respondents' point of view before discussing their awareness and preference of AAOIFI accounting standards. The respondents, therefore, were asked to give their opinion regarding the importance of each section of the IBs annual report. In order to evaluate their answers and explore which sections they believed are the most important, factor analysis tests will be used as well as using the mean to rank the importance of each section for all respondents together and individually and will be compared with the previous studies.

10.3.3.1 Factor analysis: classifying the Islamic banks' annual report items

This section discusses the results of the factor analysis that was run on 12 items that IBs' annual reports would normally contain. These twelve variables were carefully chosen

based on the review of the usefulness of annual report literatures and AAOIFI accounting standards. The variables included for this study are¹:

- 1-Board of directors' report
- 2-Auditor's report
- 3-Balance sheet (a statement of financial position)
- 4-Income statement
- 5-Statement of changes in owners' equity (statement of retained earnings)
- 6-Statement of cash flow
- 7-Note of the financial statements
- 8-*Shari'ah* supervisory board's report
- 9-Summary of annual activities
- 10- Report about internal control
- 11- Statement of changes in restricted investments
- 12- Statement of sources and uses of funds in the *Zakah* and charity fund

To test the factorability of the data, the Kaiser-Meyer-Olkin (KMO) test is used to measure the sample adequacy while Bartlett's test is a test of sphericity. Table 10-8 below presents the results of the statistical tests, which support the use of factor analysis.

Table 10-8: KMO and Bartlett's Test results for the 12 items combined (IBs annual report items)

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		.732
Bartlett's Test of Sphericity	Approx. Chi-Square	881.132
	df	66
	Sig.	.000

From table 10-8, the KMO measure of the IBs' annual report items showed a value of 0.732 (rounded). This indicates a "middling" sample adequacy according to the Kaiser (1974) scale, and hence is deemed appropriate for use in further factor analysis. The

¹ See the complete set of financial statements (AAOIFI, 2002:64).

Bartlett's Test of Sphericity also reached statistical significance (0.000), supporting the factorability of the correlation matrix.

Based on results achieved in table 10-8, factor analysis proceeds to conduct principal component analysis (PCA) and varimax rotation with Kaiser Normalisation. Table 10-9 presents the total variance explained for IBs' annual report items.

Table 10-9: Total Variance Explained (IBs annual report items)

Component	Initial Eigenvalues			Rotation Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	4.141	34.512	34.512	2.841	23.677	23.677
2	1.984	16.534	51.046	2.672	22.270	45.947
3	1.244	10.368	61.414	1.856	15.467	61.414
4	.948	7.896	69.311			
5	.721	6.006	75.317			
6	.667	5.555	80.872			
7	.597	4.976	85.848			
8	.531	4.422	90.271			
9	.512	4.267	94.537			
10	.294	2.453	96.990			
11	.244	2.035	99.025			
12	.117	.975	100.000			

Extraction Method: Principal Component Analysis.

In table 10-9, there are three factors with an Eigenvalue greater than 1 (4.14; 1.98 and 1.24). This initial analysis therefore resulted in a three-factor solution. That is, these 12 items can be simply reduced to three groups. Each group explains a particular amount of variance in the items. In this case, group 1 explains 34.51%; group 2 explains 16.53% and group 3 explains 10.37% of the pooled variance. Together these three groups explain 61.41% of the variance.

The Scree plot below depicts that the Eigenvalue slopes steeply downwards from the factor one to factor two and ends at factor three before moving slowly towards the horizon line.

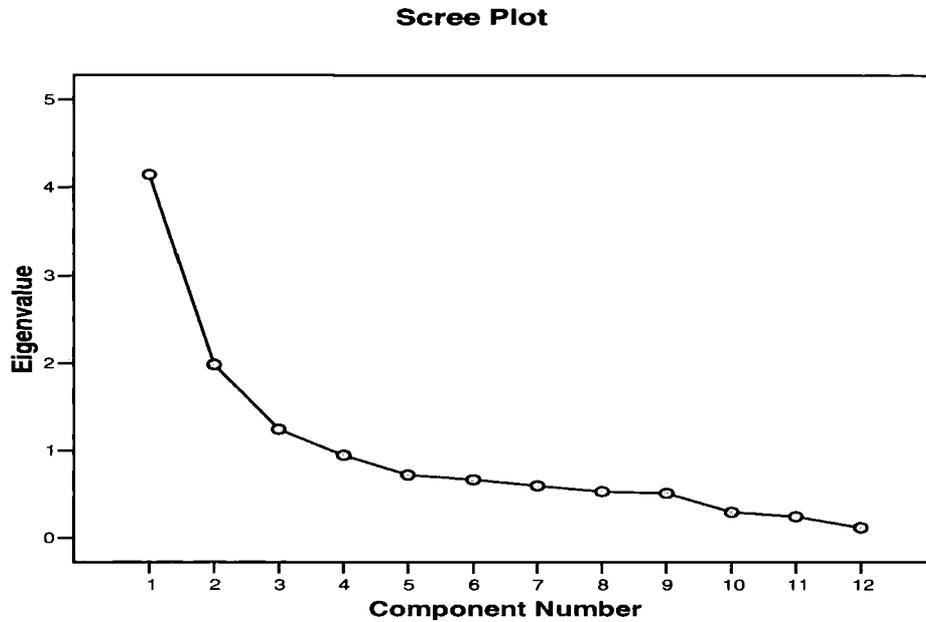


Figure 10.2: Scree plot for IBs' annual report items

An inspection of the Scree plot in figure 10.2 reveals a clear break after the third factor. The rotated solution (presented in table 10-10) reveals the presence of three factors with a number of strong loadings. The interpretation of the three factors is based on the loading of twelve variables of these items. A factor loading is a correlation coefficient showing how much weight is assigned to that factor. Table 10-10 below presents the rotated component matrix (a) for IBs' annual report items.

The results in table 10-10 indicate that all 12 items of the IBs' annual report exhibit large factor loading (above 0.3). The three factor solution explains a total of 61.41% of the variance, with factor 1 contributing 23.68%, factor 2 contributing 22.27% and factor 3 contributing 15.47% (see table 10-9). Table 10-10 also depicts the communality of each variable. Communalities measures correlations among the 12 variables to be factor analysed. As can be seen all variables have a good communality and the least communality variable was 0.416. The result of the factor analysis shows that IBs' annual report can be divided into three groups, the first group includes (in descending order based on the varimax rotated matrix):

- Income statement
- Balance sheet
- Statement of cash flow
- Statement of changes in owners' equity (statement of retained earnings)
- Note of the financial statements

The second group of variables includes 4 items as follows:

- Statement of changes in restricted investments
- Statement of sources and uses of funds in the *Zakah* and the charity fund
- Summary of annual activities
- Report about internal control

The third group of variance includes three items as follows:

- Board of directors' report
- Auditor's report
- *Shari'ah* supervisory board's report

Table 10-10: Rotated Component Matrix (a) for IBs' annual report items

IBs annual report items	Component			Communalities
	1	2	3	
Board of directors' report			.705	.552
Auditor's report			.704	.597
Balance sheet	.753			.704
Income statement	.859			.801
Statement of changes in owners' equity (statement of retained earnings)	.684			.493
Statement of cash flow	.737			.621
Note of the financial statements	.525			.416
<i>Shari'ah</i> supervisory board's report			.672	.579
Summary of annual activities		.730		.713
Report about internal control		.729		.535
Statement of changes in restricted investments		.791		.714
Statement of sources and uses of funds in the <i>Zakah</i> and the charity fund		.783		.645

Extraction Method: Principal Component Analysis. Rotation Method: Varimax with Kaiser Normalization. A Rotation converged in 5 iterations.

This result of the factor analysis assures the importance of the first group, which has 5 items of the IBs' annual report (as listed above) compared to the second and third groups since it has the higher eigenvalue and variance (eigenvalue = 2.84, variance = 23.68%). The second group has a lower eigenvalue and variance (eigenvalue = 2.67, variance = 22.27%) whereas the third group has the lowest eigenvalue and variance (eigenvalue = 1.86, variance = 15.47%). In order to support this outcome, the results of all respondents together and individually compared with previous studies are discussed in the following section.

10.3.3.2 Comparing the result among the three samples regarding the importance of the annual report of IBs in Saudi Arabia

In this section, tables 10-11 and 10-12 present the ranking of the importance of each section of the annual report in IBs in Saudi Arabia according to the respondents' opinion, as a whole and individually.

Table 10-11: The ranking of the importance of each section of the annual report according to all respondents' point of view

Section of the report	Mean	Std. Deviation	Analysis N	Rank
Board of directors' report	4.47	.765	180	8
Auditor's report	4.86	.446	180	3
Balance sheet	4.94	.262	180	1
Income statement	4.93	.280	180	2
Statement of changes in owners' equity (statement of retained earnings)	4.79	.484	180	6
Statement of cash flow	4.83	.429	180	4
Note of the financial statements	4.82	.450	180	5
Shari'ah supervisory board's report	4.62	.678	180	7
Summary of annual activities	4.17	.731	180	11
Report about internal control	4.23	.910	180	9
Statement of changes in restricted investments	4.20	.808	180	10
Statement of sources and uses of funds in the Zakah and the charity fund	4.04	.930	180	12

As can be seen from table 10-11 above, it is very clear that all respondents believe that all 12 items of the IBs' annual reports are very important as the least scored item has the

mean value of 4.04. However, when it comes to rank the importance of each section of the IBs' annual reports, the respondents are in the opinion that 'Balance sheet' is the most important item with the highest mean value of 4.94. In second place, respondents have chosen 'Income statements' with a mean of 4.93. 'Auditor's report' comes third with a mean of 4.86 and 'Statement of cash flow' comes fourth with a mean of 4.83. The fifth section was 'Note of the financial statements' with a mean of 4.82 and the sixth was 'Statement of changes in owners' equity (statement of retained earnings)' with a mean of 4.79.

This result is consistent with the result of the factor analysis above; as five of the six sections of IBs' annual reports mentioned have been classified in the first group except 'the auditor's report' which was classified with the third group. Beside 'the auditor's report' in the third group classified by factor analysis test, there are two sections which are '*Shari'ah* supervisory board's report' and 'Board of directors' report' which were ranked seventh and eighth with a mean of 4.62 and 4.47 respectively.

Surprisingly, the remaining four sections which have been classified by factor analysis test as the second group were in the bottom of the ranking based on the mean. These sections respectively are, 'Report about internal control' ranked ninth with a mean of 4.23, 'Statement of changes in restricted investments' ranked tenth with a mean of 4.20, 'Summary of annual activities' ranked eleventh with a mean of 4.17 and the last section was 'Statement of sources and uses of funds in the *Zakah* and the charity fund' which was ranked twelfth with a mean of 4.04. Finally, it is worth mentioning that all five reports suggested by the researcher were perceived as important sections by the respondents which can be suggested and added to the IBs' financial statements. Table 10-12 below presents the rank of each section of the IBs' annual report from the opinion of the respondents individually.

Table 10-12: Compare the ranking of each section of the annual report of Islamic banks in Saudi Arabia among respondents

Section of the report	The Ranking		
	Academics	External Auditors	IBs employees
Board of Directors' report	8	7	8
Auditor's report	3	4	4
Balance sheet	1	1	2
Income statement	2	1	1
Statement of changes in owners' equity (statement of retained earnings)	6	6	4
Statement of cash flow	4	5	3
Note of the financial statements	5	1	6
<i>Shari'ah</i> supervisory board's report	7	7	7
Summary of annual activities	12	11	10
Report about internal control	9	10	9
Statement of changes in restricted investments	11	9	11
Statement of sources and uses of funds in the <i>Zakah</i> and the charity fund	10	12	12

In table 10-12, the ranking of the importance of each section of the IBs' annual report varies among respondents. The most interesting result is that external auditors have ranked three of the sections to be the first important sections and these sections are 'Balance sheet', 'Income statement' and 'Note of the financial statements'. On the other hand, academics ranked 'Balance sheet' as first and 'Income statement' as second and vice versa for IB employees. Despite the slight differences between the samples in ranking the importance of each section of IBs' annual reports, they are all agreed about the importance of the 'Balance sheet' and 'Income statement'. It should be mentioned that this result is consistent with the factor analysis test and all respondents ranking. The finding that the income statement and the balance sheet were regarded as the most important by academics, external auditors and IB employees is similar to the finding of Al-Razeen and Karbhari (2004) and Ba-Owaidan (1994), whose surveys were based in Saudi Arabia. It is also consistent with the findings of Abu-Nassar and Rutherford (1996) who surveyed multiple groups of users of Jordanian annual corporate reports. It is also consistent with Idris (1996) who survey the preparers of the IBs and Islamic windows in Malaysia. Al-Mehmadi (2004) found that inventors ranked balance sheets and income statements as second and third in importance, however, in first place was the

Shari'ah report. Unlike Al-Mehmadi, in this study academics and professionals agreed to rank the *Shari'ah* supervisory boards report as seventh in importance among the 12 IBs' annual reports whereas Idris (1996) ranked it fifth. Regarding the cash flow statements, IB employees ranked it as the third important section after the balance sheets and income statements which are consistent with Al-Mehmadi's result. Whereas, the results for all groups show that cash flow ranked fourth after the auditors' report which ranked third.

If we look at all respondents' ranking, we found that 'Statement of changes in restricted investments' and 'Statement of sources and uses of funds in the *Zakah* and the charity fund' were that last two sections of IBs' annual report in importance. This result is similar to Idris (1996) who found that statements of 'change in restricted (special) investments' was ranked last and second last (number 13 and 12) by respondents of the two groups of respondents, Islamic banks and Islamic windows respectively, Whereas the statements of *Zakah* and charity funds was ranked 11 by both respondents.

To sum up, the empirical results in this section provides further evidence for the importance of all IBs' annual reports, especially the balance sheets and income statements like other previous studies mentioned above. It should be noted that despite the importance of the IBs' annual report from the respondents' point of view, some of those items are not included in the IBs' financial statements. As Al-Mehmadi (2004) stated, most IBs do not disclose the *Shari'ah* board's report in their annual reports. This is because most of the IBs do not follow the AAOIFI accounting standards which allow IBs to reveal any statements, reports and other data which assist in providing information required by users as mentioned in paragraph 2 (IFAS) No. 1. The results in this study supports the idea of adopting AAOIF accounting standards in preparing IBs' financial statements in Saudi Arabia.

10.3.4 Factors Affecting the Quality and Adequacy of the Accounting Information Disclosed by Islamic Banks

The aim of this section is to explore the importance of the accounting standard used to prepare the Islamic banks' financial statements. In order to do this, the respondents were asked about their views regarding the importance of eight factors which might affect the quality and adequacy of the accounting information disclosed by IBs. These eight factors are:

- 1-The external auditors is a national firm;
- 2-The external auditors is a national firm affiliated with an international firm;
- 3-Capability of Islamic bank's management;
- 4-Bank size and its products and services;
- 5-Accounting standards adopted in preparing the financial statements;
- 6-The level of education and professional qualification that employees hold;
- 7-An effective system of internal control in the bank;
- 8-Ownership structure (e.g. percentage of government, private and foreign ownership);

In order to examine the respondents' view, factor analysis tests is used as well as comparing all respondents' opinion together and individually.

10.3.4.1 Factor analysis: Classifying the factors that affect the quality and adequacy of the accounting information disclosed by Islamic banks

This section discusses the results of the factor analysis that was run on eight items that were considered as the main factors that affect the quality and adequacy of accounting information disclosed by Islamic banks as mentioned above.

To test the factorability of the data, the Kaiser-Meyer-Olkin (KMO) test was used to measure the sample adequacy while Bartlett's test is a test of sphericity. Table 10-13 presents the results of the statistical tests, which support the use of factor analysis.

Table 10-13: KMO and Bartlett's Test Results for 8 items combined (factors that affect the quality and adequacy of accounting information disclosed by Islamic banks)

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		.580
Bartlett's Test of Sphericity	Approx. Chi-Square	145.514
	Df	28
	Sig.	.000

From table 10-13, the KMO measure for factors affects the quality and adequacy of the accounting information disclosed by Islamic banks showed a value of 0.580 (rounded). This indicates that the sample adequacy according to the Kaiser (1974) scale is above 0.50 which is acceptable, and hence is deemed appropriate for use in further factor analysis. The Bartlett's Test of Sphericity also reached statistical significance (0.000), supporting the factorability of the correlation matrix.

Based on results achieved in table 10-13, factor analysis proceeds to conduct principal component analysis (PCA) and varimax rotation with Kaiser Normalisation. Table 10-14 below presents the total variance explained for the factors affecting the quality and adequacy of accounting information disclosed by IBs.

Table 10-14: Total variance explained (factors that affect the quality and adequacy of accounting information disclosed by Islamic banks)

Component	Initial Eigenvalues			Rotation Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	1.968	24.604	24.604	1.747	21.836	21.836
2	1.424	17.801	42.405	1.519	18.989	40.825
3	1.206	15.081	57.486	1.333	16.661	57.486
4	.885	11.056	68.542			
5	.775	9.688	78.231			
6	.697	8.718	86.949			
7	.532	6.646	93.595			
8	.512	6.405	100.000			

Extraction Method: Principal Component Analysis.

In the table 10-14 there are three factors greater than 1 (1.068 – 1.424 and 1.206). This initial analysis therefore resulted in a three factor solution. That is, these 8 items can be simply reduced to three factors. Each factor explains a particular amount of variance in the items. In this case, factor 1 explains 24.60%, factor 2 explains 17.80% and factor 3 explains 15.08% of the pooled variance. Together these three factors explain a total of 57.49% of the variance. Vaus (2002), mentioned that the more variance that is explained by the factors, the better factor solution and the more comfortable the study in reducing the initial 8 items to three factors.

The Scree plot below depicts that the value slopes steeply downwards from the first factor to the third factor before moving slowly towards the horizon line.

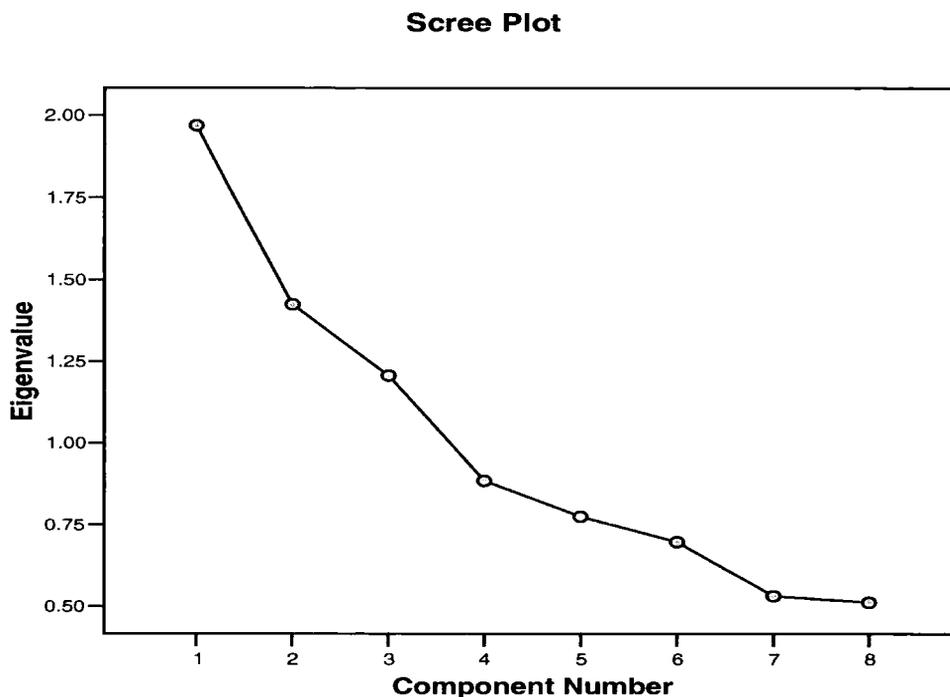


Figure 10.3: Scree Plot for the factors that affect the quality and adequacy of the accounting information disclosed by Islamic banks

An inspection of the Scree plot (figure 10.3) reveals a clear break after the third factor. The rotated solution (presented in table 10-15) revealed the presence of three factors

with a number of strong loadings. The interpretation of the three factors is based on the loading of eight variables of these items. A factor loading is a correlation coefficient showing how much weight is assigned to that factor. Table 10-15 below presents the rotated component matrix (a) for the factors that affect the quality and adequacy of the accounting information disclosed by IBs.

Table 10-15: Rotated Component Matrix (a) for the factors that affect the quality and adequacy of the accounting information disclosed by Islamic banks

Factors	Component			Communalities
	1	2	3	
The external auditors is a national firm		.780		.617
The external auditors is a national firm affiliated with an international firm			.767	.646
Capability of Islamic banks' management	.579			.467
Bank size and its products and services			.648	.701
Accounting standards adopted in preparing the financial statements		.619		.565
The level of education and professional qualifications that employees hold	.732			.560
An effective system of internal control in the bank	.640			.458
Ownership structure (e.g. percentage of government, private and foreign ownership)		.629		.586

Extraction Method: Principal Component Analysis. Rotation Method: Varimax with Kaiser Normalization. a Rotation converged in 7 iterations.

The results in table 10-15 indicate that all 6 items of the factors that affect the quality and adequacy of the accounting information disclosed by IBs, exhibit large factor loading (above 0.3). The three factor solution explained a total of 57.49% of the variance, with factor 1 contributing 21.84%, factor 2 contributing 18.99% and factor 3 contributing 16.66% (see table 10-14). Table 10-15 also depicts the communality of each variable. Communalities measures correlations among the 8 variables are to be factor analysed. As can be seen all variables have a good communality and the least

communality variable has the 0.458 value. The result of the factor analysis shows that the factors that affect the quality and adequacy of the accounting information disclosed by IBs can be divided into three groups. The first group includes 3 items (in descending order based on the varimax rotated matrix):

- 1- The level of education and professional qualification that employees hold;
- 2- An effective system of internal control in the bank;
- 3- Capability of Islamic bank's management.

The second group of variables includes 3 items as follows:

- 1- The external auditors is a national firm;
- 2- Ownership structure (e.g. percentage of government, private and foreign ownership);
- 3- Accounting standards adopted in preparing the financial statements.

The third group of variance includes two items as follows:

- 1- The external auditor is a national firm affiliated with an international firm;
- 2- Bank size and its products and services.

This result of the factor analysis provides evidence for the importance of the first group which has 3 items of the factors that affect the quality and adequacy of the accounting information disclosed by IBs (as listed above) compared to the second and third groups, it has the higher eigenvalue and variance (eigenvalue = 1.75, variance = 21.84%). The second group has a lower eigenvalue and variance (eigenvalue = 1.52, variance = 18.99%) whereas the third group has the lowest eigenvalue and variance (eigenvalue = 1.33, variance = 16.66%). In order to support this outcome, the results of all respondents together and individually are compared and discussed in the next section.

10.3.4.2 Comparing the result among the three samples regarding the factors might affect the quality and adequacy of the accounting information disclosed by IBs in Saudi Arabia

In this section, tables 10-16 and 10-17 present the ranking of the importance of the factors that might affect the quality and adequacy of the accounting information

disclosed by IBs in Saudi Arabia according to the respondents' opinion, all together and individually.

Table 10-16: The ranking of the importance of the following factors that might affect the quality and adequacy of the accounting information disclosed by Islamic banks according to all respondents' point of view

Factor	Mean	Std. Deviation	Analysis N	Rank
The external auditors is a national firm	3.82	1.264	182	6
The external auditors is a national firm affiliated with an international firm	3.33	1.262	182	8
Capability of Islamic bank's management	4.75	.495	182	2
Bank size and its products and services	4.22	.770	182	5
Accounting standards adopted in preparing the financial statements	4.63	.588	182	3
The level of education and professional qualification that employees hold	4.47	.678	182	4
An effective system of internal control in the bank	4.81	.435	182	1
Ownership structure (e.g. percentage of government, private and foreign ownership)	3.69	1.054	182	7

As can be seen in table 10-16, most factors are perceived by respondents as important factors affecting the quality and adequacy of accounting information disclosed by IBs. However, respondents believe that the existence of 'an affective system of internal control in the bank' is the most important factor with a mean of 4.81. The following factor was the 'capability of Islamic bank's management' with a mean of 4.75. The accounting standards adopted in preparing the financial statements comes in third place with a mean of 4.63. In the fourth, fifth and sixth places were the 'level of education and professional qualification that employees hold', 'Bank size and its products and services' and 'The external auditors is a national firm' respectively. Finally, the last factors ranked were 'Ownership structure' and 'The external auditors is a national firm affiliated with an international firm' with a mean of 3.69 and 3.33 respectively.

Table 10-17: Comparing the ranking of the importance of the following factors that might affect the quality and adequacy of the accounting information disclosed by Islamic banks among respondents

Factor	The Rank		
	Academics	External Auditors	IBs employees
The external auditors is a national firm	6	6	6
The external auditor is a national firm affiliated with an international firm	8	8	8
Capability of Islamic bank's management	2	2	2
Bank size and its products and services	5	5	5
Accounting standards adopted in preparing the financial statements	3	3	3
The level of education and professional qualification that employees hold	3	4	4
An effective system of internal control in the bank	1	1	1
Ownership structure (e.g. percentage of government, private and foreign ownership)	7	7	7

It should be noted from table 10-17 that all respondents together and individually were identical in perceiving the factors which, might affect the quality and adequacy of accounting information disclosed by IBs. This result shows how important the internal control in the bank as well as the role of IBs' managements are in enhancing the quality and adequacy of the accounting information. This result is also consistent with the factor analysis test in this section, which put the previous two factors together in the first group with 'level of education and professional qualification that employees hold'. On the other hand, the 'accounting standards adopted in preparing the financial statements' was ranked as the third important factor and in the second group after the factor analysis test. It should be also be noted that the last group of the factor analysis included 'the external auditors is a national firm affiliated with an international firm' which respondents were not sure about the importance of, as its mean indicates that their response was "Neutral".

In sum, the aim of this sub-section is to explore the importance of the accounting standards adopted in preparing the IBs' financial statements. It was perceived as one of the most important factors that affect the quality and adequacy of accounting information disclosed by IBs. This result again supports the arguments that choosing the

type of accounting standards to be adopted in preparing the IBs' financial statements is very important.

In conclusion, the results obtained in this section demonstrate the importance of Islamic banks' financial statements. Thus, the results gained in the first and second sections in this chapter are perceived as the introduction to the following section, which is considered the corner stone of this study. In the following sections, adopting AAOIFI accounting standards in Islamic banks in Saudi Arabia will be discussed and the hypothesis of this study will be examined.

10.4 ADOPTING AAOIFI ACCOUNTING STANDARDS IN ISLAMIC BANKS IN SAUDI ARABIA

The need to develop accounting standards that adequately and appropriately reflect the nature of Islamic financial transactions was considered by some experts as an important step to enhance the reliability, consistency, clarity and credibility of financial reporting by Islamic financial institutions which would also enhance investor confidence in Islamic finance. Thus, intensive efforts were made by the Islamic Development Bank (IDB) to establish a formal entity to address Islamic accounting issues. This led to the establishment of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) which was registered on March 27, 1991, in the Kingdom of Bahrain, as a non-profit making independent international organization. The objective of the organization is to prepare and develop accounting, auditing, governance and ethical standards relating to the activities of Islamic financial institutions, taking into consideration international standards and practices and the need to comply with *Shari'ah* rules.

Central banks and monetary agencies in some Muslim countries such as the Kingdom of Bahrain, Jordan and Sudan require Islamic banks within their financial system to comply with AAOIFI accounting standards. On the other hand, AAOIFI regulations are not adopted by any Saudi banks even those banks that claim to be Islamic banks, such as Al-

Rajhi Bank, Al-jazira Bank and Bank Albilad. However, as Saudi Banks, they have to follow the SAMA requirements which do not consider AAOIFI accounting standards as one of the accounting standards that should be adopted in Saudi Arabia.

The implementation of the accounting standards as a new phenomenon would be expected to receive considerable attention from professionals such as academics in the accounting field, external auditors and preparers of financial statements in Islamic banks, e.g. managers and employees. This section aims to examine the awareness of these three groups regarding AAOIFI accounting standards, and also aims to find the extent by which these groups prefer AAOIFI standards to be adopted by the Islamic banks in the Kingdom of Saudi Arabia. In addition, hypothesis stating that the objectives might be achieved if AAOIFI accounting standards adopted in IBs in Saudi Arabia is examined as well as the potential problems of using different accounting standards. Lastly, harmonisation of Islamic banks' financial statements is discussed and examined to explore whether or not harmonizing IBs' financial statements will lead to comparable accounting information.

10.4.1 Awareness of AAOIFI Accounting Standards

Awareness of AAOIFI accounting in Saudi Arabia among respondents in the position of stake holders are considered as one of the main objectives of this study. To the knowledge of the researcher, this study is the first one which tries to explore the awareness of AAOIFI accounting standards in Saudi Arabia and the second research in Muslim countries after Idris (1996) who examined the respondents awareness of the Financial Accounting Organisation for Islamic Banks and Financial Institutions (FAOIBFI)². In this study, respondents were asked to choose one of three options they have been given in order to explore the level of awareness of AAOIFI accounting standards among respondents. The three options that respondents had been given to choose from as listed in question No13 of the questionnaire were:

1-I am aware of it;

² Financial Accounting Organisation for Islamic Banks and Financial Institutions (FAOIBFI) was the former name of the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI).

2-I heard about it;

3-I have never heard about it.

The answers of the three groups are depicted in table 10-18 followed by table 10-19 which will illustrate the total response towards this issue.

Table 10-18: comparative statistics between the sample groups on their awareness of AAOIFI accounting standards.

SAMPLE	AWARENESS OF AAOIFI ACCOUNTING STANDARDS					
	I AM AWARE OF IT		I HAVE HEARD ABOUT IT		I HAVE NEVER HEARD ABOUT IT	
	FREQUENCY	PERCENTAGE	FREQUENCY	PERCENTAGE	FREQUENCY	PERCENTAGE
Academics	26	50%	14	26.9%	12	23.1%
External auditors	18	36.7%	25	51%	6	12.2%
Islamic Banks employees	38	48.7%	30	38.5%	10	12.8%

In last three chapters, descriptive analyses were presented for each group of respondents separately. However, in table 10-18 the results of the three samples responses have been integrated to facilitate comparison among them. It is clear that academics with 50% are the most aware group about the AAOIFI standards, which is followed by Islamic banks' employees with 48.7%, while external auditors were least aware among the three groups with 36.7%. On the other hand, for the response of 'never heard about it', external auditors were less ignorant about the existence of AAOIFI accounting standards with 12.2%, followed by Islamic banks' employees with 12.8%, whereas 23% of the academics have never heard about the AAOIFI accounting standards. Table 10-19 depicts the respondents' awareness of AAOIFI accounting standards.

Table 10-19: Respondents' awareness of AAOIFI accounting standards

AWARENESS OF AAOIFI ACCOUNTING STANDARDS	FREQUENCY	VALID PERCENT
I am aware of it	82	45.8
I heard about it	69	38.5
I have never heard about it	28	15.6
Total	179	100.0

As we can see from table 10-19, only 45.81% of the respondents were aware of the AAOIFI accounting standards. Although, this percentage looks quite high, this result is rather disappointing if we know that the respondents were believed to be the most knowledgeable groups who are supposed to know everything in this field. The researcher was expecting a higher percentage; however this result gives an indication that 15.46% are completely ignorant of the existence of AAOIFI accounting standards, whereas 38.55% had only heard about it. In comparison with Idris (1996) who found that most respondents at 67.6 % were not aware of the organisation, while only 30.6% were aware of it. Both studies discovered lack of awareness of AAOIFI accounting standards.

The researcher believes that this result is because AAOIFI accounting standards are not adopted by SAMA. In addition, there is a neglect of teaching AAOIFI to accountant students at Saudi Universities and there are some weaknesses in training IBs' accountants. On the other hand, AAOIFI must increase awareness of its existence and role among Islamic banks. It should be noted that the researcher asked the respondent about their opinion regarding the importance of three obstacles, which might delay the adoption of AAOIFI accounting standards in IBs in Saudi Arabia; those obstacles are:

- 1-The novelty of AAOIFI Standards and its lack of experience;
- 2-AAOIFI Standards are not compulsory;
- 3-AAOIFI Standards are not internationally acceptable.

The result shows that respondents believe that all obstacles are important. The most important obstacle was that 'AAOIFI standards are not compulsory' with a mean of

4.57. The second obstacle was the 'novelty of AAOIFI standards and its lack of experience' with a mean of 4.14 and the last obstacle was that 'AAOIFI standards are not internationally acceptable', which scored mean value of 4.06.

Karim (2001) mentioned that several factors have contributed to the low implementation of AAOIFI's standards in the countries in which Islamic banks operate. These include, among others, the lack of appreciation by the relevant agencies that are responsible for enforcing accounting standards of the benefits that can be gained by implementing AAOIFI's standards, namely (a) rendering the financial statements of Islamic banks comparable and transparent; and (b) providing relevant and reliable information to users of financial statements of Islamic banks. This would require AAOIFI to exert more efforts to have its standards recognized by an increasing number of countries (Karim 2001).

To sum up, awareness of AAOIFI accounting standards must be better than what has been found. In order to increase the awareness among academics and professionals, special efforts need to introduce AAOIFI standards in Saudi Arabia. The researcher suggests introducing AAOIFI accounting standards in the curricula of the accounting departments in Saudi universities. Moreover, IBs in Saudi Arabia should take responsibility to increase awareness of AAOIFI accounting standards, through seminars and courses and they should concentrate in training their accountants

10.4.2 The Preferred Accounting Standards to Prepare the Financial Statements for Islamic Banks in Saudi Arabia

The main purpose of Islamic banks' financial statements is to provide information about financial position, performance and changes in the financial position that are useful to the main users of the IBs' financial statements in making decisions. The adoption of AAOIFI's accounting standards provides comparable financial statements (Mustafa 2003). It also provides useful information, which helps users to make good decisions. Mustafa (2003) argue that AAOIFI accounting standards are a major step towards

accounting harmonization and the comparability of financial statements issued by Islamic banks. Comparable financial statements allow users to identify similarity and differences in banks' performance in relation to their own performance over time or in relation to other banks' performance (Mustafa 2003).

In Saudi Arabia, SAMA requires all banks to prepare their financial statements according to SAMA's accounting standards and the International Accounting Standards IAS. On the other hand, Saudi Islamic banks which are based in the Kingdom of Bahrain prepare their financial statements using AAOIFI accounting standards. As stated in the 2005 Annual Report of Al-Rajhi Bank, the basis of preparation of the annual report is as the following:

“The consolidated financial statements are prepared in accordance with the Accounting Standards for Financial Institutions promulgated by the Saudi Arabian Monetary Agency (SAMA) and with International Financial Reporting Standards and the interpretations issued by the International Accounting Standards Board (“IASB”). The Corporation also prepares its consolidated financial statements to comply with the Banking Control Law and the Regulations of Companies in the Kingdom of Saudi Arabia” (Al-Rajhi Bank 2005:20).

On the other hand, Shamil Bank stated the following regarding the preparation of consolidated financial statements:

“The consolidated financial statements of the Group are prepared in accordance with and comply with Financial Accounting Standards (“FAS”) issued by the Accounting and Auditing Organisation for Islamic Financial Institutions” (Shamil Bank 2005:30).

We can observe the differences between both Islamic Saudi banks in the preparation of their financial statements. Therefore, in this study the respondents' perceptions regarding whether or not they prefer AAOIFI accounting standards to be implemented in

IBs in Saudi Arabia are attempted to be measured. Table 10-20 depicts the result of the respondents' preference.

Table 10-20 Preference of AAOIFI accounting standards

PREFERENCE OF AAOIFI ACCOUNTING STANDARDS	FREQUENCY	VALID PERCENT
Strongly Dislike	3	1.6
Dislike	4	2.2
Neutral	19	10.4
Prefer	39	21.4
Strongly Prefer	117	64.3
Total	182	100.0

As can be seen from table 10-20, it is very obvious and clear that the majority of respondents prefer AAOIFI accounting standards to be implemented in Islamic banks in Saudi Arabia with 85.7%. This high percentage can be divided into two subdivisions which are 64.3% of them strongly prefer and 21.4%, who said they prefer to apply it. On the other hand, only 1.6% strongly dislikes AAOIFI accounting standards to be adopted in Saudi Arabia. This result gives a clear indication that the majority of academics and professionals in Saudi Arabia follow the trend of the Islamisation banking sector in Saudi Arabia and want the Islamic banks' financial statements to be prepared according to AAOIFI accounting standards. Table 10-21 presents a comparative statistics between the answers of the three groups regarding their preference of AAOIFI accounting standards.

Table 10-21: comparative statistics between the sample groups on their preferences of AAOIFI accounting standards.

SAMPLE	PREFERENCE OF AAOIFI ACCOUNTING STANDARDS TO BE IMPLEMENTED IN ISLAMIC BANKS IN SAUDI ARABIA										MEAN
	STRONGLY DISLIKE		DISLIKE		NEUTRAL		PREFER		STRONGLY PREFER		
	NO	%	NO	%	NO	%	NO	%	NO	%	
Academics	2	3.8	—	—	2	3.8	5	9.6	43	82.7	4.67
External auditors	1	2.0	2	3.9	6	11.8	13	25.5	29	56.9	4.31
Islamic Banks' employees	—	—	2	2.5	11	13.9	21	26.6	45	57.0	4.38

Table 10-21 provides a clear idea that all three samples demonstrated similar degree of preference of adopting AAOIFI accounting standards in Islamic banks in Saudi Arabia. In addition, academics shows more enthusiasm in their desire as the majority of them prefer AAOIFI accounting standards with the mean value of 4.67, followed by IBs employees with the mean value of 4.38 and last but not least, the external auditors with the mean value of 4.31.

10.4.2.1 Potential problems of using different accounting standards

In this section, the researcher attempts to explore the relation between using different accounting standards to prepare the financial statements and the potential problems, which might be caused by this difference. For instance, while Islamic bank 'A' is adopting international accounting standards IAS for preparing its financial statements and another Islamic bank 'B' may use another set of accounting standards like AAOIFI. What are the perceptions of the respondents regarding the following problems, which might be caused for such differences? The potential problems listed are:

- 1- Difficulty in comparing financial statements;
- 2- Variations in the users' interpretation of the financial information;
- 3- Difficulty in making decisions;
- 4- Decreased user's trust in accounting information;
- 5- Loss of trust in the audit reports;
- 6- Expand the range of the work done by the external auditors;
- 7- Difficulties for accountants to deal with different accounting standards;
- 8- Cost of training accountants to be familiar with different accounting standards.

In order to examine the respondents view, factor analysis used as well as comparing all respondents' opinions together and individually.

10.4.2.1.1 Factor analysis: classifying the potential problems of using different accounting standards

This section examines the results of the factor analysis that was run on eight items that are assumed to be the main potential problems of using different accounting standards.

To test the factorability of the data, the Kaiser-Meyer-Olkin (KMO) test will be used to measure the sample adequacy while Bartlett's test is a test of sphericity. Table 10.18 presents the results of the statistical tests, which support the use of factor analysis.

Table 10-22: KMO and Bartlett's Test for the Potential problems of using different accounting standards

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		.825
Bartlett's Test of Sphericity	Approx. Chi-Square	693.159
	df	28
	Sig.	.000

From table 10-22, the KMO measure the potential problems of using different accounting standards showed a value of 0.825 (rounded). This indicates a “meritorious” sample adequacy according to the Kaiser (1974) scale, and hence is deemed appropriate for use in further factor analysis. The Bartlett's Test of Sphericity also reached statistical significance (0.000), supporting the factorability of the correlation matrix.

Based on results achieved in table 10-22, factor analysis proceeds to conduct principal component analysis (PCA) and varimax rotation with Kaiser Normalisation. Table 10-23 below presents the total variance explained for the potential problems of using different accounting standards.

Table 10-23: Total Variance Explained for the Potential problems of using different accounting standards

Component	Initial Eigenvalues			Rotation Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	4.111	51.382	51.382	3.060	38.252	38.252
2	1.330	16.630	68.012	2.381	29.761	68.012
3	.800	9.998	78.011			
4	.520	6.506	84.517			
5	.417	5.212	89.728			
6	.347	4.338	94.066			
7	.259	3.237	97.303			
8	.216	2.697	100.000			

Extraction Method: Principal Component Analysis.

In table 10-23, there are two factors with an eigenvalue greater than 1 (4.111 and 1.330). This initial analysis therefore resulted in a two-factor solution. That is, these 8 items can be simply reduced to two groups. Each group explains a particular amount of variance in the items. In this case, group 1 explains 51.38% and group 2 explains 16.63% of the pooled variance. Together these two groups explain 68.01% of the variance.

The Scree plot below depicts that the value slopes steeply downwards from the factor one to factor two before moving slowly towards the horizon line.

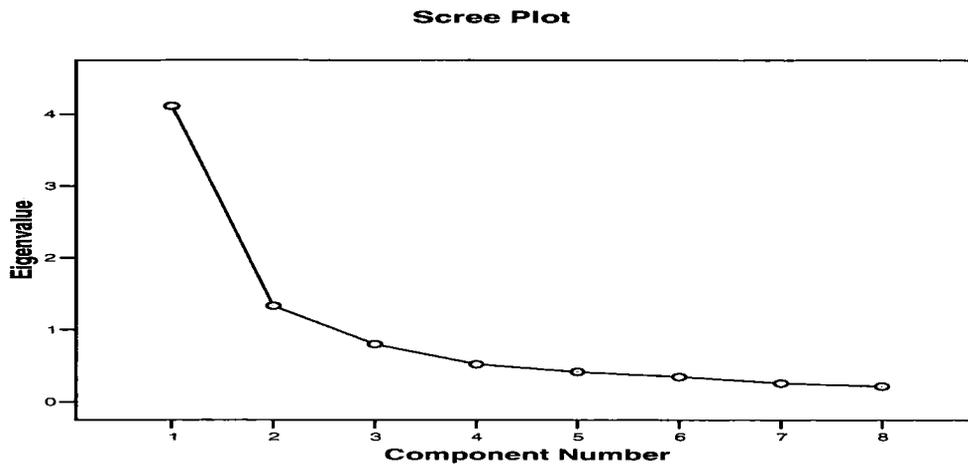


Figure 10.4: Scree plot for the potential problems of using different accounting standards

An inspection of the Scree plot (figure 10.4) reveals a clear break after the second factor. The rotated solution (presented in table 10-24) revealed the presence of two factors with a number of strong loadings. The interpretation of the two factors is based on the loading of eight variables of these items. A factor loading is a correlation coefficient showing how much weight is assigned to that factor. Table 10-24 below presents the rotated component matrix (a) for the potential problems of using different accounting standards.

The results in table 10-24 indicate that all 8 items of the potential problems of using different accounting standards exhibit large factor loading (above 0.3). The two factor solution explained a total of 68.01% of the variance, with factor 1 contributing 38.25% and factor 2 contributing 29.76% (see table 10-23). Table 10-24 also depicts the communality of each variable, which shows that all variables have a good communality

and the less community variable was 0.560. The result of the factor analysis shows that potential problems of using different accounting standards can be divided into two groups, the first group includes 4 items (in descending order based on the varimax rotated matrix):

- 1- Difficulty in comparing financial statements;
- 2- Difficulty in making decisions;
- 3- Variations in the users' interpretation of the financial information;
- 4- Decreased user's trust in accounting information.

The second group of variables includes 4 items as the following:

- 1- Cost of training accountants to be familiar with different accounting standards;
- 2- Expand the range of the work done by the external auditors;
- 3- Difficulties for accountants to deal with different accounting standards;
- 4- Loss of trust in the audit reports.

It should be noted that the item known as 'Loss of trust in the audit reports' has been represented in both groups. However, because the highest load of this variable is 0.554; therefore, 'Loss of trust in the audit reports' should be included in the second group.

Table 10-24: Rotated Component Matrix (a) for the potential problems of using different accounting standards

	Component		Communalities
	1	2	
Difficulty in comparing financial statements	.870		.764
Variations in the users' interpretation of the financial information	.794		.689
Difficulty in making decisions	.861		.757
Decreased user's trust in accounting information	.737		.706
Loss of trust in the audit reports	.503	.554	.560
Expand the range of the work done by the external auditors		.807	.664
Difficulties for accountants to deal with different accounting standards		.704	.610
Cost of training accountants to be familiar with different accounting standards		.827	.690

Extraction Method: Principal Component Analysis. Rotation Method: Varimax with Kaiser Normalization. A Rotation converged in 3 iterations.

This result of the factor analysis assures the importance of the first group which has 4 items of the potential problems of using different accounting standards (as listed above) since this first group has the higher eigenvalue and variance (eigenvalue = 3.06, variance = 38.25%) compared to the second group which has a lower eigenvalue and variance (eigenvalue = 2.38, variance = 29.76%). In order to support this outcome, the results of all respondents together and individually are compared and discussed in the following section.

10.4.2.1.2 Comparing the results among the three samples regarding the potential problems of using different accounting standards

In this section, tables 10-25 and 10-26 present the ranking of the potential problems of using different accounting standards according to the respondents' opinion, all together and individually.

Table 10-25: The ranking of the potential problems of using different accounting standards according to all respondent's view.

POTENTIAL PROBLEMS OF USING DIFFERENT ACCOUNTING STANDARDS	MEAN	STD. DEVIATION	ANALYSIS N	RANK
Difficulty in comparing financial statements	4.38	.908	178	1
Variations in the users' interpretation of the financial information	4.29	.891	178	2
Difficulty in making decisions	3.85	1.011	178	5
Decreased user's trust in accounting information	3.51	1.151	178	7
Loss of trust in the audit reports	3.11	1.297	178	8
Expand the range of the work done by the external auditors	3.75	1.077	178	6
Difficulties for accountants to deal with different accounting standards	4.02	.971	178	3
Cost of training accountants to be familiar with different accounting standards	3.88	.918	178	4

As can be seen from table 10-25 above, generally speaking, all the above problems were perceived as important issues caused by using different accounting standards. However,

respondents believe that using different accounting standards cause great difficulties in comparing financial statements between IBs, and this problem was perceived as the most important issue with a mean of 4.38. Variations in the users' interpretation of the financial information were perceived as the second problem of using different accounting standards with mean of 4.29. In third place, respondents believe that accountants might face some difficulties in dealing with different accounting standards; this problem has a mean of 4.02. The cost of training for accountants to be familiar with different accounting standards was perceived as the fourth problem with a mean of 3.88. In addition, the users of the IBs' financial statements to make a decision might find difficulties when using different accounting standards; this problem comes in the fifth place with a mean of 3.85. Using different accounting standards will cause difficulties to external auditors, as they need to expand their work; this problem was perceived by respondents as the sixth place with a mean of 3.75. The last two problems believed to be caused by using different accounting standards are 'Decreasing user's trust in accounting information' and 'Loss of trust in the audit reports' with means of 3.51 and 3.11 respectively.

Table 10-26: Comparing the ranking of the potential problems of using different accounting standards according among the respondents

POTENTIAL PROBLEMS OF USING DIFFERENT ACCOUNTING STANDARDS	THE RANK		
	ACADEMICS	EXTERNAL AUDITORS	IBS EMPLOYEES
Difficulty in comparing financial statements	1	1	1
Variations in the users' interpretation of the financial information	2	2	2
Difficulty in making decisions	4	5	6
Decreased user's trust in accounting information	6	7	7
Loss of trust in the audit reports	8	8	8
Expand the range of the work done by the external auditors	7	6	4
Difficulties for accountants to deal with different accounting standards	3	3	3
Cost of training accountants to be familiar with different accounting standards	5	4	5

It is very clear from table 10-26 above that all three samples are consistent in choosing the first three important problems that could be as a result of using different accounting standards. These three problems are 'Difficulty in comparing financial statements', 'Variations in the users' interpretation of the financial information' and 'Difficulties for accountants to deal with different accounting standards'. On the other hand, all three samples agreed with each other that 'Loss of trust in the audit reports' was perceived as a less important problem among all eight problems.

To sum up, this result shows that there is a consensus among respondents and the result of the factor analysis test that using different accounting standards will cause difficulties in comparing the IBs' financial statements. This result leads to discussion and exploration of the respondents' perceptions regarding the need for harmonising IBs' accounting standards which is presented later in this chapter. In addition, this result also shows that if IBs use the same accounting standards this will make it very easy for users to interpret the financial information and become useful, also it becomes easier for accountants to deal with one set of accounting standards in order to avoid confusion. It is worth mentioning that training accountants in IBs in order to deal with accounting issues in Islamic banking will be discussed later in this chapter as the respondents see the cost of training the accountant as one of the problems caused by using different accounting standards.

10.4.2.2 Objectives that might be achieved if AAOIFI accounting standards are adopted in Islamic banks in Saudi Arabia

In this section the researcher attempts to discover the most positive aspects that might occur when AAOIFI accounting standards are implemented in IBs in Saudi Arabia. In order to achieve this objective, the researcher asked the respondents about their opinion regarding six objectives that the researcher believes might be achieved if AAOIFI accounting standards are adopted in IBs in Saudi Arabia. These six objectives are:

- 1- Harmonizing financial statements between Islamic banks;
- 2- Promoting adequate disclosure of comparable financial information;

- 3- Providing definitive criteria for the guidance of accountants in the process of the preparation of Islamic banks' financial statements;
- 4- Providing reasonable consistency in Islamic banks' financial reporting over time;
- 5- Increase users' trust in Islamic banks' financial information;
- 6- Providing definitive criteria for the guidance of external auditors through the process of auditing Islamic banks' financial statements.

In order to examine the respondents' views, factor analysis tests will be used as well as comparing all respondents' opinions as a whole and individually.

10.4.2.2.1 Factor analysis: Classifying the objectives that might be achieved if AAOIFI accounting standards are adopted in Islamic banks in Saudi Arabia

This section discusses the results of the factor analysis that was run on six items that are assumed as probable objectives that might be achieved if AAOIFI accounting standards are adopted in IBs in Saudi Arabia. Table 10-27 presents the results of the Kaiser-Meyer-Olkin (KMO) test, which support the use of factor analysis.

Table 10-27: KMO and Bartlett's Test for the Objectives that might be achieved if AAOIFI accounting standards are adopted in Islamic banks in Saudi Arabia

Kaiser-Meyer-Olkin Measure of Sampling Adequacy		.840
Bartlett's Test of Sphericity	Approx. Chi-Square	561.029
	df	15
	Sig.	.000

From table 10-27, the KMO measures the potential problems of using different accounting standards showed a value of 0.840 (rounded). This indicates a "meritorious" sample adequacy according to the Kaiser (1974) scale, and hence is deemed appropriate for use in further factor analysis. The Bartlett's Test of Sphericity also reached statistical significance (0.000), supporting the factorability of the correlation matrix.

Based on results achieved in table 10-27, factor analysis proceeds to conduct principal component analysis (PCA) and varimax rotation with Kaiser Normalisation. Table 10-28

presents the total variance explained for the objectives that might be achieved if AAOIFI accounting standards are adopted in IBs in Saudi Arabia.

Table 10-28: Total Variance Explained for the Objectives might be achieved if AAOIFI accounting standards are adopted in Islamic banks in Saudi Arabia

Component	Initial Eigenvalues			Extraction Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	3.786	63.099	63.099	3.786	63.099	63.099
2	.698	11.640	74.739			
3	.506	8.433	83.171			
4	.423	7.053	90.224			
5	.388	6.460	96.683			
6	.199	3.317	100.000			

Extraction Method: Principal Component Analysis.

In table 10-28, there is only one factor with an eigenvalue greater than 1 (3.786). This initial analysis therefore resulted in a one-factor solution. Thus, the solution cannot be rotated. This result shows that all objectives are important and can not be divided into groups. Therefore, the following objectives are achievable when AAOIFI accounting standards are adopted in IBs in Saudi Arabia:

- 1- Harmonizing financial statements between Islamic banks;
- 2- Promoting adequate disclosure of comparable financial information;
- 3- Providing definitive criteria for the guidance of accountants in the process of the preparation of Islamic banks' financial statements;
- 4- Providing reasonable consistency in Islamic banks' financial reporting over time;
- 5- Increase users' trust in Islamic banks' financial information;
- 6- Providing definitive criteria for the guidance of external auditors through the process of auditing Islamic banks' financial statements.

In the next section, the results among the respondents regarding these objectives are compared and discussed.

10.4.2.2.2 Comparing the results among the three samples the Objectives that might be achieved if AAOIFI accounting standards are adopted in Islamic banks in Saudi Arabia

In this section, tables 10-29 and 10-30 present the ranking of the objectives that might be achieved if AAOIFI accounting standards are adopted in Islamic banks in Saudi Arabia according to the respondents' opinion, all together and individually.

Table 10-29: The ranking of the objectives that might be achieved if AAOIFI accounting standards are adopted in Islamic Banks in Saudi Arabia according to all respondents' view.

OBJECTIVES	MEAN	STD. DEVIATION	ANALYSIS N	RANK
Harmonizing financial statements between Islamic banks	4.68	.646	183	1
Promoting adequate disclosure of comparable financial information	4.66	.579	183	2
Providing definitive criteria for the guidance of accountants in the process of the preparation of Islamic banks' financial statements	4.58	.605	183	3
Providing reasonable consistency in Islamic banks' financial reporting over time	4.43	.714	183	5
Increase users' trust in Islamic banks' financial information	4.34	.830	183	6
Providing definitive criteria for the guidance of external auditors through the process of auditing Islamic banks' financial statements	4.57	.658	183	4

In table 10-29, which brings together views of all the participant categories, it is very obvious that all respondents strongly agree with all objectives that would be achieved when AAOIFI accounting standards are adopted in IBs in Saudi Arabia. In table 10-29 as can be seen, the less objective has a mean of 4.34. This result is consistent with the factor analysis test, which puts all objectives in one group as an indication to the importance of all objectives. When it comes to the ranking of the importance of these objectives, respondents believe that harmonizing financial statements between Islamic banks is the most important objective that will be achieved when AAOIFI accounting standards are implemented with a highest mean of 4.68. The second important objective perceived was 'adequate disclosure of comparable financial information' with a mean of

4.66. 'Providing definitive criteria for the guidance of accountants in the process of the preparation of Islamic banks' financial statements' was perceived by the respondents as the third important objective with a mean of 4.58, whereas 'Providing definitive criteria for the guidance of external auditors through the process of auditing Islamic banks' financial statements' comes in fourth place with a mean of 4.57. The last two objectives which are believed to be achieved if AAOIFI standards are applied in IBs in Saudi Arabia were 'Providing reasonable consistency in Islamic banks' financial reporting over time' and 'Increase users' trust in Islamic banks' financial information' with means of 4.43 and 4.34 respectively.

Table 10-30: Comparing the ranking of the objectives that might be achieved if AAOIFI accounting standards are adopted in Islamic Banks in Saudi Arabia, among respondents

OBJECTIVES	THE RANK		
	ACADEMICS	EXTERNAL AUDITORS	IBS EMPLOYEES
Harmonizing financial statements between Islamic banks	2	3	1
Promoting adequate disclosure of comparable financial information	1	3	2
Providing definitive criteria for the guidance of accountants in the process of the preparation of Islamic banks' financial statements	3	2	3
Providing reasonable consistency in Islamic banks' financial reporting over time	5	5	5
Increase users' trust in Islamic banks' financial information	5	6	6
Providing definitive criteria for the guidance of external auditors through the process of auditing Islamic banks' financial statements	4	1	4

As can be seen from table 10-30, there are some differences between the samples in ranking the objectives. For instance, academics ranked 'Promoting adequate disclosure of comparable financial information' as the most important objective followed by 'Harmonizing financial statements between Islamic banks' in the second place and vice versa for the IB employees. However, for the rest of the objectives it seems that academics and IB employees agreed with each other in ranking them. On the other hand,

external auditors have a different view in ranking the objectives; they have chosen 'Providing definitive criteria for the guidance of external auditors through the process of auditing Islamic banks' financial statements' as the most important objective which might be achieved if AAOIFI accounting standards are adopted in IBs in Saudi Arabia. This result is natural because it touches the personal needs of the external auditors. Again the same reason made external auditors choose 'Providing definitive criteria for the guidance of accountants in the process of the preparation of Islamic banks' financial statements' as the second objective. Then they gave 'Harmonizing financial statements between Islamic banks' and 'Promoting adequate disclosure of comparable financial information' the third place equally, and they agree with academics and IB employees on the rest of the objectives.

In summing, the result of this sections shows that all respondents believe that adopting AAOIFI accounting standards in IBs in Saudi Arabia will lead to the achievement of the six objectives mentioned above. Moreover, this result supports the result achieved in section 10.4.2 above which presents a clear indication that the majority of respondents prefer AAOIFI accounting standards to be implemented in Islamic banks in Saudi Arabia with 85.7%. It is worth mentioning as well that harmonization of Islamic banks' accounting standards was perceived as the most important objective that will be achieved when AAOIFI accounting standards are implemented in IBs in Saudi Arabia, therefore, the next section will be dedicated to discussing and exploring how respondents perceive this matter.

10.4.2.3 Harmonization of Islamic banks' accounting standards

Most countries either look directly to IASs as their national standards or develop national standards based primarily on IASs. This has rendered the financial statements of Islamic banks non-comparable (Karim 2001).

Accounting harmonization could be defined as "the process of bringing international accounting standards into some sort of agreement so that the financial statements from

different countries are prepared according to a common set of principles of measurement and disclosure'' (Haskins, Ferris et al. 1996). Karim (2001) suggested that Islamic banks should implement AAOIFI's standards, as this would render the financial statements of these banks comparable because AAOIFI's standards are specifically developed to cater for the unique characteristics of the *Shari'ah* contracts that govern the Islamic banks' financial instruments.

In the previous sections, the respondents perceived the 'harmonization of financial statements between banks' and 'Promoting adequate disclosure of comparable financial information' as the two most important objectives, which will be achieved when AAOIFI accounting standards are implemented in IBs in Saudi Arabia. In order to make sure that respondents really like to see AAOIFI standards to be adopted in IBs in Saudi Arabia, this section tends to explore whether or not respondents support the idea of harmonizing accounting standards used for Islamic banks' financial statements or not. Table 10-31 demonstrates the result of question No: 9 of the questionnaire.

Table 10-31: Supporting the idea of harmonizing accounting standards used for Islamic banks' financial statements

DO YOU SUPPORT THE IDEA OF HARMONIZING ACCOUNTING STANDARDS USED FOR ISLAMIC BANKS' FINANCIAL STATEMENTS	FREQUENCY	VALID PERCENT
Yes	171	95.5
No	5	2.8
I Don't Know	3	1.7
Total	179	100.0

From table 10-31, it is very clear that the vast majority of the respondents, namely 95.5% of them, support harmonizing accounting standards used for Islamic banks' financial statements. Although, the establishment of the AAOIFI in the Kingdom of Bahrain and its effort to establish accounting and auditing standards for Islamic institutions in order to harmonize accounting standards used to prepare the Islamic banks' financial statements, there is a delay in harmonizing accounting standards for Islamic banks (Al-Martani 2005). This is exactly the situation in Saudi Arabia as SAMA

requires the banks to follow the international accounting standards for preparing the financial statements without distinguishing between Islamic or conventional banks.

In summing, the results show that harmonisation of IBs financial statements become a serious need to enhance one of the most important qualitative characteristics of the financial statements which is 'comparability'. The trend of Islamising conventional banks in Saudi Arabia must be accompanied by creating new legislations and regulations from the Saudi Arabian Monetary Agency (SAMA). Moreover, AAOIFI accounting standards should be adopted to prepare the IBs' financial statements in Saudi Arabia in order to achieve the harmonisation of accounting standards and enhance the comparability between IBs' financial statements.

10.5 THE NEED FOR TRAINING ISLAMIC BANKS' ACCOUNTANTS

Most of the employees of the Islamic banks, including the managers and financial experts come from traditional sources lacking necessary expertise in Islamic banking. An institution is only what its employees make it. Therefore, it is extremely important to have the people with the right kind of skills and commitment (Iqbal, Ahmed et al. 1998).

Training is a continuous and ongoing process and it cannot stop at a point in time. It is fair to say that the Islamic banks still suffer from insufficient cadres especially at the administrative level and in the developmental area, which refers to the need to make a greater effort to cover this deficit (Al-Martani 2005) through training programmes.

Iqbal et al (1998) mentioned that the future of Islamic banking and finance crucially depends on teaching, training and research in the desired specialisation. There is also a need to arrange short courses for *Shari'ah* scholars in economics and finance and similar courses for economists in *Shari'ah*. The efforts in this area need to be enhanced to several times that of current levels (Iqbal, Ahmed et al. 1998).

This study has discovered that there is a lack of awareness of AAOIFI accounting standards among various stake holders in the industry in Saudi Arabia. The researcher tends to ask the respondents about their opinion whether or not Islamic banks in Saudi Arabia are very concerned about their accountants, and they usually organise training courses regarding "Accounting Issues in Islamic Banking". The respondents' perceptions were illustrated for each sample in the pervious three chapters. For instance, most of the academics (62.2%) were not sure and it seems that the vision is not clear for them in regard to the training of accountants of Islamic banks. Similarly, external auditors were divided into three groups; the first group of 29% believe that IBs were doing their duties in training their accountants. And the second group represented by 35.3% of them do not believe so and the last group with the same percentage of 35.3% expressed that they do not know. IBs employees equally split into two groups regarding the trainings provided to the accountants working in the Islamic banks in Saudi Arabia: 42.5% of the respondents believed that Islamic banks in Saudi Arabia provided training courses to their accountants regarding accounting issues in Islamic banking, whereas, the other half of the same percentage do not believe that Islamic banks make such provisions.

Training Islamic banks' accountants is a very important issue. However, as the results indicate, the perceptions of the sample did not give a clear vision whether or not Islamic banks are concerned about training their accountants regarding "Accounting Issues in Islamic Banking". The lack of awareness of AAOIFI accounting standards indicates that there are some weaknesses in training and promoting AAOIFI accounting standards in Saudi Arabia. Finally, the researcher believes that training IBs' accountants in order to be ready to deal with accounting issues in Islamic Banking needs to be studied and investigated in depth.

10.6 TESTING THE HYPOTHESIS

This section will test the hypotheses that associate the awareness and preference of AAOIFI standards with respondents' education, professional qualifications and

experience variables. The first section explores the relations of the respondents' education, professional qualifications and experience variables with the awareness of AAOIFI accounting standards. The second subsection discovers the relations of the same variables with the preference of AAOIFI accounting standards.

Testing the hypotheses of independent research variables that appear to have an effect on a dependent variable is very important in order to be able to state with confidence that the effect was really due to the variable, and not just to chance. Thus, the objective of this section is to explore the presence of any significant relationship between several pairs of variables within the research hypotheses. Possible relationships between variables were investigated using the Pearson chi-square and cross-tabulation statistical functions of the SPSS package.

The null hypothesis states that the independent variable has no effect on the dependent variable. The null hypothesis is expressed as H_0 . This hypothesis is assumed to be true unless proven otherwise. The alternative to the null hypothesis is the hypothesis that the independent variable does have an effect on the dependent variable. This hypothesis, known as the alternative is expressed as H_1 .

10.6.1 Awareness of AAOIFI Accounting Standards

In this sub section, three hypotheses are tested to explore the relations between the respondents' education, professional qualifications and experience variables with their awareness of AAOIFI accounting standards. These null hypotheses are:

Hypothesis No. 1 education

H₀: There is no significant relationship between the education of the respondents and their awareness of AAOIFI accounting standards.

H₁: There is a significant relationship between the education of the respondents and their awareness of AAOIFI accounting standards.

Hypothesis No. 2 professional qualifications

H0: There is no significant relationship between the professional qualifications of the respondents and their awareness of AAOIFI accounting standards.

H1: There is a significant relationship between the professional qualifications of the respondents and their awareness of AAOIFI accounting standards.

Hypothesis No. 3 experience

H0: There is no significant relationship between the experience of the respondents and their awareness of AAOIFI accounting standards.

H1: There is a significant relationship between the experience of the respondents and their awareness of AAOIFI accounting standards.

The results of each hypothesis are presented in two tables, cross-tabulation and chi-square respectively in the following section in relation to demographic variables.

10.6.1.1 Respondents' Education

This hypothesis was intended to determine whether there is a relationship between the respondents' education and their awareness of AAOIFI accounting standards. In the next two tables 10-32 and 10-33 below will examine the following hypothesis:

The hypothesis No.1,

H0: There is no significant relationship between the education of the respondents and their awareness of AAOIFI accounting standards.

H1: There is a significant relationship between the education of the respondents and their awareness of AAOIFI accounting standards.

Table 10-23: Education and the Awareness of AAOIFI Accounting Standards Cross-tabulation (1st hypothesis)

		Awareness of AAOIFI Accounting Standards			Total
		I am aware of it	I heard about it	I have never heard about it	
Education	Below bachelor level	1	2	0	3
	Bachelor	34	42	17	93
	Master	17	13	1	31
	PhD	29	12	10	51
Total		81	69	28	178

Table 10-33: Chi-Square test to explore the relations between education of respondents and their awareness of AAOIFI accounting standards (1st hypothesis)

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	12.916(a)	6	.044

The Chi-Square test shown in table 10-33 confirms a statistically significant relationship between the education of the respondents' variable and the awareness of AAOIFI standards variable. The level of observed significance (p value) was .044. Hence, the null hypothesis can be rejected as the level is below the standard .05 level of significance. The table 10.28 shows that only one respondent who had education below bachelor level was aware of AAOIFI accounting standards, compared to two respondents who only heard about it, which means a ratio of 1 to 2 exactly. Regarding respondents who hold a bachelor level, we can observe that the largest number of 42 respondents had heard about AAOIFI compared to 34 who were aware of it. However, when we come up to a higher level of education, the situation begins to change gradually. Respondents who hold a master degree are much more aware of AAOIFI with 17 participants compared to only one respondent who had never heard about it. The same thing applied to the respondents who hold a PhD degree as 29 of them were aware of AAOIFI compared to only 10 of them who had complete ignorance of its existence.

This result shows that the higher degree respondents had more awareness of AAOIFI accounting standards and vice versa. Therefore, the null hypothesis will be rejected and the alternative hypothesis H1 is accepted.

10.6.1.2 Respondents' Professional qualification

This hypothesis was intended to determine whether there is a relationship between the respondents' professional qualifications and their awareness of AAOIFI accounting standards. The next two tables 10-34 and 10-35 below examine the following hypothesis:

The hypothesis No.2,

H0: There is no significant relationship between the professional qualifications of the respondents and their awareness of AAOIFI accounting standards.

H1: There is a significant relationship between the professional qualifications of the respondents and their awareness of AAOIFI accounting standards.

Table10-34: Professional qualifications and Awareness of AAOIFI Accounting Standards Cross tabulation (2nd hypothesis)

		Awareness of AAOIFI Accounting Standards			Total
		I am aware of it	I heard about it	I have never heard about it	
qualifications	CPA (USA)	10	8	0	18
	SOCPA (KSA)	22	11	2	35
	Other	3	3	2	8
	CPA+SOCPA	3	0	0	3
	CPA+SOCPA+Other	0	2	0	2
	Total	38	24	4	66

Table 10-35: Chi-Square test to explore the relations between professional qualifications of respondents and their awareness of AAOIFI accounting standards (2nd hypothesis)

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	12.846(a)	8	.117

After testing for the significance of the professional qualifications variable with the awareness of AAOIFI, it was found that there was no significant relationship between the professional qualifications of the respondents and their awareness of AAOIFI accounting standards. Since the level of significance (p value) for this variable was no less than .117 (see Table 10-35), and this level is above the standard .05 level of statistical significance. Thus, the null hypothesis is accepted indicating that there is no statistical significance between the professional qualifications of the respondents and their awareness of the AAOIFI standards.

10.6.1.3 Respondents' Experience

This hypothesis was intended to determine whether there is a relationship between the respondents' experience and their awareness of AAOIFI accounting standards. In the next two tables 10-36 and 10-37 below we will examine the following hypothesis:

The hypothesis No.3,

H0: there is no significant relationship between the experience of the respondents and their awareness of AAOIFI accounting standards.

H1: there is a significant relationship between the experience of the respondents and their awareness of AAOIFI accounting standards.

Table 10-36: Experience and Awareness of AAOIFI Accounting Standards Cross-tabulation (3rd hypothesis)

		Awareness of AAOIFI Accounting Standards			Total
		I am aware of it	I heard about it	I have never heard about it	
Experience	Less than 5 years	1	11	6	18
	5- 10 years	13	9	8	30
	10- 15 years	19	13	6	38
	15- 20 years	18	7	4	29
	More than 20 years	31	29	4	64
Total		82	69	28	179

Table 10-37: Chi-Square test to explore the relations between experience of respondents and their awareness of AAOIFI accounting standards (3rd hypothesis)

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	23.382(a)	8	.003

The Chi-Square test shown in Table 10-37 confirms a statistically significant relationship between the experience of the respondents' variable and the awareness of AAOIFI standards variable. The level of observed significance (p value) was .003. Hence, the null hypothesis can be rejected. The table 10-36 shows that 31 respondents who had experience for more than 20 years were aware of AAOIFI accounting standards, compared to only one respondent who had less than 5 years experience was

aware of it. This result shows that the more experience respondents had the more they are aware of AAOIFI accounting standards and vice versa.

10.6.2 Preference of AAOIFI Accounting Standards

In this sub section, three hypotheses are tested to explore the relations between the respondents' education, professional qualifications and experience variables with their preference of AAOIFI accounting standards. These hypotheses are:

Hypothesis No. 4 education

H0: There is no significant relationship between the education of the respondents and their preference of AAOIFI accounting standards.

H1: There is a significant relationship between the education of the respondents and their preference of AAOIFI accounting standards.

Hypothesis No. 5 professional qualifications

H0: There is no significant relationship between the professional qualifications of the respondents and their preference of applying AAOIFI accounting standards.

H1: There is a significant relationship between the professional qualifications of the respondents and their preference of applying AAOIFI accounting standards.

Hypothesis No. 6 experience

H0: There is no significant relationship between the experience of the respondents and their preference of applying AAOIFI accounting standards.

H1: There is a significant relationship between the experience of the respondents and their preference of applying AAOIFI accounting standards.

The results of each hypothesis are presented in two tables, cross-tabulation and chi-square respectively. From those tables, decisions can be made whether to accept or reject the hypothesis.

10.6.2.1 Respondents' Education

This hypothesis was intended to determine whether there is a relationship between the respondents' level of education and their preference of AAOIFI accounting standards. In the next two tables 10-38 and 10-39 below will examine the following hypothesis:

The hypothesis No.4,

H0: There is no significant relationship between the education of the respondents and their preference of AAOIFI accounting standards.

H1: There is a significant relationship between the education of the respondents and their preference of AAOIFI accounting standards.

Table 10-38: Education and Preference of AAOIFI Accounting Standards Cross-tabulation (4th hypothesis)

		Preference of AAOIFI Accounting Standards					Total
		Strongly Dislike	Dislike	Neutral	Prefer	Strongly Prefer	
Education	Below bachelor level	0	0	0	0	3	3
	Bachelor	1	4	10	29	51	95
	Master	0	0	4	5	23	32
	PhD	2	0	5	5	39	51
Total		3	4	19	39	116	181

Table 10-39: Chi-Square test to explore the relations between education of respondents and their preference of AAOIFI accounting standards (4th hypothesis)

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	18.166(a)	12	.111

After testing for the significance of the education variable with the preference of AAOIFI, it was found that there was no significant relationship between the levels of education of the respondents with their preference of AAOIFI accounting standards. Since the level of significance (p value) for this variable was no less than .111 (see Table 10-39), and this level is above the standard .05 level of statistical significance. Thus, the null hypothesis is accepted indicating that there is no statistically positive relationship between the education of the respondents and their preference for AAOIFI standards.

10.6.2.2 Professional qualification of the respondents

This hypothesis was intended to determine whether there is a relationship between the respondents' professional qualifications and their preference of AAOIFI accounting standards. In the next two tables 10-40 and 10-41 below will examine the following hypothesis:

The hypothesis No.5,

H0: There is no significant relationship between the professional qualifications of the respondents and their preference of applying AAOIFI accounting standards.

H1: There is a significant relationship between the professional qualifications of the respondents and their preference of applying AAOIFI accounting standards.

Table 10-40: Professional qualification and the preference of AAOIFI Accounting Standards Cross-tabulation (5th hypothesis)

		Preference of AAOIFI Accounting Standards				Total
		Dislike	Neutral	Prefer	Strongly Prefer	
Professional qualifications	CPA (USA)	0	4	7	7	18
	SOCPA (KSA)	2	4	7	24	37
	Other	0	0	2	6	8
	CPA+SOCPA	0	1	1	1	3
	CPA+SOCPA+Other	0	1	0	1	2
	Total	2	10	17	39	68

Table 10-41: Chi-Square test to explore the relations between professional qualifications of respondents and their preference of AAOIFI accounting standards (5th hypothesis)

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	11.036(a)	12	.526

The Chi-Square test shown in Table 10-41 confirms that there was no significant relationship between the professional qualifications of the respondents' variable and the preference of AAOIFI standards variable. The level of observed significance (p value) was .526. Hence, the null hypothesis can be accepted. As we can see the professional qualifications of the respondents have no statistically significant impact on their awareness and preference of AAOIFI accounting standards. It should be stated that in

rejecting this relationship caution should be taken, as the null-hypothesis is accepted at the margin.

10.6.2.3 Experience of the respondents

This hypothesis was intended to determine whether there is a relationship between the respondents' experience and their preference of AAOIFI accounting standards. In the next two tables 10-42 and 10-43 below will examine the following hypothesis:

The hypothesis No.6,

H0: There is no significant relationship between the experience of the respondents and their preference of applying AAOIFI accounting standards.

H1: There is a significant relationship between the experience of the respondents and their preference of applying AAOIFI accounting standards.

Table 10-42: Experience and Preference of AAOIFI Accounting Standards Cross-tabulation (6th hypothesis)

		Preference of AAOIFI Accounting Standards					Total
		Strongly Dislike	Dislike	Neutral	Prefer	Strongly Prefer	
Experience	Less than 5 years	0	0	2	8	8	18
	5- 10 years	0	4	5	4	16	29
	10- 15 years	0	0	6	15	19	40
	15- 20 years	1	0	3	3	22	29
	More than 20 years	2	0	3	9	52	66
Total		3	4	19	39	117	182

Table 10-43: Chi-Square test to explore the relations between experience of respondents and their preference of AAOIFI accounting standards (6th hypothesis)

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	47.745(a)	16	.000

The Chi-Square test shown in Table 10-43 confirms a statistically significant relationship between the experience of the respondents' variable and the preference of AAOIFI standards variable. The level of observed significance (p value) was .000. Hence, the null hypothesis can be rejected. The table shows that a largest number of 52 respondents who had experience for more than 20 years strongly prefer AAOIFI

accounting standards, whereas only two respondents strongly dislike it. On the other hand, whenever respondents experience decreases as those who had experience between 5-10 years, the gap between preference and non-preference of AAOIFI accounting standards became less. This result shows that the more experience respondents had the more they prefer AAOIFI accounting standards to be implemented in Islamic banks in Saudi Arabia.

10.7 CONCLUSION

This chapter has provided a comprehensive analysis of the results of the survey which was conducted to explore the respondents' perceptions on adopting AAOIFI accounting standards in Islamic banks in Saudi Arabia. The following summarises the major findings from the analysis which have been conducted throughout this chapter:

The majority of respondents believe that Islamic windows in the conventional banks in Saudi Arabia are the first step towards Islamizing it. This result is consistent with the general trend towards Islamisation of conventional banks as we are witnessing a tremendous shift in recent years in the Kingdom of Saudi Arabia.

Factor analysis on the importance of the source of information indicates the IBs' performance reveals that 'Islamic banks' financial reports' and 'Islamic banks interim financial statements' are considered as the main and most important sources of information. This finding regarding the annual reports as the first source of information is consistent with the findings of much of the literature mentioned in chapter 5.

Respondents have assured the importance of all IBs' annual reports, especially the balance sheets and income statements like other previous studies mentioned in this research. According to the factor analysis test, the most important items of the IBs' annual report were: 'Income statement', 'Balance sheet', 'Statement of cash flow', 'Statement of changes in owners' equity (statement of retained earnings)' and 'Note of the financial statements'.

The perceived importance of IBs' annual report items reveals that all five reports which have been suggested by the researcher, which are: 'Board of directors' report', 'Auditor's report', '*Shari'ah* supervisory board's report', 'Summary of annual activities' and 'Report about internal control' perceived as important sections by the respondents which can be suggested and be added to the IBs' financial statements.

This study discovered that there is a lack of awareness of AAOIFI accounting standards as only 45.81% of the respondents were aware of the AAOIFI accounting standards. This result is rather disappointing as the respondents were believed to be the most knowledgeable groups who are supposed to know everything in this field. The researcher was expecting a higher percentage; however this result gives an indication that 15.46% are completely ignorant of the existence of AAOIFI accounting standards, whereas 38.55% had only heard about it. The researcher believes that this result was because AAOIFI accounting standards are not adopted by SAMA. In addition, there is a neglect of presenting AAOIFI to accounting students at Saudi Universities and there are some weaknesses in training IBs' accountants.

The vast majority of respondents prefer AAOIFI accounting standards to be implemented in Islamic banks in Saudi Arabia with 85.7%. This result gives a clear indication that the majority of academics and professionals in Saudi Arabia follow the trend of the Islamisation banking sector in Saudi Arabia and want the Islamic banks' financial statements to be prepared according to AAOIFI accounting standards.

This study reveals that the vast majority of respondents, 95.5%, support the idea of harmonizing Islamic banks' financial statements. Also they believe that adopting AAOIFI accounting standards in Islamic banks in Saudi Arabia will enhance the comparability of IBs' financial statements. These findings encouraged the researcher to suggest that AAOIFI accounting standards have to be adopted by SAMA.

Testing the hypotheses of this study shows how important education and experience are in relation to respondents' awareness and reference of AAOIFI accounting standards

Overall, the result of analysis presented in this chapter, in many ways, suggest that academics, external auditors and IBs' employees show a positive perception and attitude towards the need for adopting AAOIFI accounting standards in Islamic banks in Saudi Arabia. In particular, various results indicate that respondents are willing to support the idea of harmonizing IBs' financial statements which will lead to achieve and enhance the comparability of accounting information between Islamic banks in Saudi Arabia. However, awareness of AAOIFI accounting standards seems to be an important issue in Saudi Arabia. Therefore, the level of awareness of AAOIFI accounting standards must be raised by introducing it in the curricula of accounting departments in Saudi University, Islamic banks to establish training courses and seminars about AAOIFI standards and finally, the role of SAMA in presenting and adopting it.

CHAPTER 11

EPILOGUE

11.1 INTRODUCTION

This thesis aimed to study and explore the perceptions of academics and professionals in Saudi Arabia regarding the need to adopt AAOIFI accounting standards in Islamic banks in Saudi Arabia. This was fulfilled through a questionnaire to explore the opinion of the three knowledgeable groups whom prepare financial reports regarding AAOIFI accounting standards. The awareness and preference of the respondents regarding AAOIFI accounting standards were examined and the correlations of respondents' education, professional qualifications and experience variables with their awareness and preference of AAOIFI accounting standards were estimated. Also the respondents' views regarding the trend of Islamizing conventional banks in Saudi Arabia were evaluated and the importance of IBs' financial reports were examined and compared with previous literature in this field.

This chapter provides a summary of the major answers and conclusions of the research questions examined in the thesis in section 11.2. Some recommendations are presented in section 11.3. Section 11.4 discusses the limitations of the study. Section 11.5 provides suggestions for further research. Conclusions and final remarks are in section 11.6.

11.2 SUMMARY OF THE RESEARCH

This section summarises and presents the most important findings and contributions of this study. The research questions which have been presented in the introductory chapter will be answered in the following sub-sections:

11.2.1 The Importance and Usefulness of Islamic Banks' Annul Report to its Users

The result of the factor analysis presented in Chapter 10 shows that IBs' source of information can be divided into two main categories, the first group includes:

- 1- Islamic banks' financial reports;
- 2- Islamic banks' interim financial statements.

The second group includes:

- 1- Newspapers and specialist magazines;
- 2- Direct information from the Islamic bank;
- 3- Market's rumours;
- 4- Government's Publications.

This result shows the importance of the annual reports as a source of information, which gives an indication as to the performance of the Islamic banks and helps the decision makers to make the right decisions from the respondents' point of view. Also this result shows how important it is to look at the accounting standards and regulations through which these annual reports have been prepared.

In terms of the importance and usefulness of IBs' annual report, the result of the factor analysis shows that IBs' annual report can be divided into three groups, the first group includes (in descending order based on the varimax rotated matrix):

- Income statement

- Balance sheet
- Statement of cash flow
- Statement of changes in owners' equity (statement of retained earnings)
- Note of the financial statements

The second group of variables includes 4 items as follows:

- Statement of changes in restricted investments
- Statement of sources and uses of funds in the *Zakah* and the charity fund
- Summary of annual activities
- Report about internal control

The third group of variance includes three items as follows:

- Board of directors' report
- Auditor's report
- *Shari'ah* supervisory board's report

If we look at the importance of the IBs' annual reports as ranked in table 10.10 in Chapter 10, it is very clear that all respondents believe that all 12 items of the IBs' annual reports are very important as the least scored item has the mean value of 4.04. However, when it comes to rank the importance of each section of the IBs' annual reports, the respondents are in the opinion that 'Balance sheet' is the most important item with the highest mean value of 4.94. In second place, respondents chose 'Income statements' with a mean of 4.93. 'Auditor's report' comes third with a mean of 4.86 and 'Statement of cash flow' comes fourth with a mean of 4.83. The fifth section was 'Note of the financial statements' with a mean of 4.82 and the sixth was 'Statement of changes in owners' equity (statement of retained earnings)' with a mean of 4.79.

The participants in this study, thus, assured the importance of all IBs' annual reports, especially the balance sheets and income statements like other previous studies

mentioned in this research. According to the factor analysis test, the most important items of the IBs' annual report were: 'Income statement', 'Balance sheet', 'Statement of cash flow', 'Statement of changes in owners' equity (statement of retained earnings)' and 'Note of the financial statements'.

The findings in this section answers research question No: 1, and, hence, proved the usefulness and importance of the Islamic banks annual reports.

11.2.2 The Awareness of AAOIFI Accounting Standards among Respondents

This study discovered that there is a lack of awareness of AAOIFI accounting standards in Saudi Arabia as highlighted by the participants in this study. Only 45.81% of the respondents were aware of the AAOIFI accounting standards. This result is rather disappointing as the respondents were believed to be the most knowledgeable groups, who are supposed to know everything in this field. This study was done in the expectation that a higher percentage would express their knowledge of Islamic accounting standards. However this result gives an indication that 15.46% are completely ignorant of the existence of AAOIFI accounting standards, whereas 38.55% had only heard about it. This result should be attributed to the fact that AAOIFI accounting standards have not been adopted by SAMA. In addition, there is a neglect of presenting AAOIFI standards to accounting students at Saudi universities and there are some weaknesses in training of IBs' accountants to be fully aware of the requirements and current developments.

In order to support the above result, a number of hypotheses were tested to explore the correlation between the respondents' education, professional qualifications and experience variables with their awareness of AAOIFI accounting standards. The results of hypotheses testing as revealed in chapter 10, shows the following:

- (i) Hypothesis No: 1 confirms a statistically significant relationship between the education of the respondents' variable and the awareness of AAOIFI standards variable. This result shows that the higher degree respondents had more awareness of AAOIFI accounting standards and vice versa.
- (ii) Hypothesis No: 2 confirm that there was no significant relationship between the professional qualifications of the respondents and their awareness of AAOIFI accounting standards. Thus, the null hypothesis is accepted indicating that there is no statistical significance between the professional qualifications of the respondents and their awareness of the AAOIFI standards.
- (iii) Hypothesis No: 3 confirm a statistically significant relationship between the experience of the respondents' variable and the awareness of AAOIFI standards variable. This result shows that the more experience respondents had the more they are aware of AAOIFI accounting standards and vice versa.

11.2.3 Preference of AAOIFI Accounting Standards to be adopted in Islamic Banks in Saudi Arabia

The results of this study show that the vast majority of respondents (85.7%) prefer AAOIFI accounting standards to be implemented in Islamic banks in Saudi Arabia. This result gives a clear indication that the majority of academics and professionals in Saudi Arabia follow the trend in the Islamisation of banking sector in Saudi Arabia and want the Islamic banks' financial statements to be prepared according to AAOIFI accounting standards.

The results of a number of hypotheses testing provided the necessary evidence to reach this conclusion, which aimed at exploring the relations between the respondents' education, professional qualifications and experience variables with their preference of AAOIFI accounting standards. The results of testing those hypotheses as presented in chapter 10, shows the following:

(i) Hypothesis No: 4 confirm that there was no significant relationship between the levels of education of the respondents with their preference of AAOIFI accounting standards. Thus, the null hypothesis is accepted indicating that there is no statistically positive relationship between the education of the respondents and their preference for AAOIFI standards.

(ii) Hypothesis No: 5 confirm that there was no significant relationship between the professional qualifications of the respondents' variable and the preference of AAOIFI standards variable. As it can be seen the professional qualifications of the respondents have no statistically significant impact on their awareness and preference of AAOIFI accounting standards. It should be stated that in rejecting this relationship caution should be taken, as the null-hypothesis is accepted at the margin.

(iii) Hypothesis No: 6 confirms that a statistically significant relationship between the experience of the respondents' variable and the preference of AAOIFI standards variable. This result shows that the more experience respondents had the more they prefer AAOIFI accounting standards to be implemented in Islamic banks in Saudi Arabia.

11.2.4 The Need of Harmonizing Islamic banks' Accounting Standards in Saudi Arabia

This study reveals that the vast majority of respondents, about 96% of them, support the idea of harmonizing Islamic banks' financial statements. Also they believe that adopting AAOIFI accounting standards in Islamic banks in Saudi Arabia will enhance the comparability of IBs' financial statements. These findings encouraged the researcher to suggest that AAOIFI accounting standards have to be adopted for Islamic banks by SAMA.

11.2.5 Islamizing Conventional Banks in Saudi Arabia

The majority of respondents (59.24%) believe that Islamic windows in the conventional banks in Saudi Arabia are the first step towards Islamizing them. This result is consistent with the general trend towards Islamisation of conventional banks, as we are witnessing a tremendous shift in recent years in the conversion of conventional banks into Islamic banks in the Kingdom of Saudi Arabia.

Islamic banking is spreading very quickly in Saudi Arabia and the majority of respondents believe that more Islamic banking will be the major banking activity in Saudi Arabia either through the establishment of new banks such as “Bank Al-Enma” or through Islamisation of conventional banks such as the National Commercial Bank (Al-Ahli) and SAMBA. Therefore, SAMA has to expedite its efforts to regulate Islamic banking in Saudi Arabia, like some other Muslim countries.

11.3 RECOMMENDATIONS

The major results of this study are presented above, which provides a base for developing some recommendations to improve accounting standards for Islamic banks in Saudi Arabia:

- Major efforts are required from the AAOIFI through promoting its accounting standards to further enhance the credibility and comparability of accounting information of Islamic banks;
- Since the trend of Islamisation of conventional banks are very obvious in Saudi Arabia and supported with the results of this research, SAMA should expedite the enactment of laws and special legislation Islamic banks to cope with this trend;

- Since the majority of respondents prefer AAOIFI accounting standards to be adopted in Islamic banks in Saudi Arabia, SAMA should start resolving the difficulties, which prevent the application of AAOIFI accounting standards in Islamic banks in Saudi Arabia.
- Since the result of this research provide evidence that harmonizing accounting standards will enhance the comparability between Islamic banks' financial statements, Islamic banks in Saudi Arabia should attempt to convince SAMA on the importance of adopting AAOIFI accounting standards;
- Conventional banks which have Islamic windows in Saudi Arabia should use AAOIFI accounting standards as a guidance (AAOIFI standards No:18) to disclose some important information;
- Since the result of this study revealed that there are weakness in the awareness of AAOIFI accounting standards, the researchers advice is that Islamic banks in Saudi Arabia need to increase the knowledge of their accountant and auditors regarding AAOIFI accounting standards and the accounting issues in Islamic banking by training them and organising a special course in this matter. In addition, AAOIFI accounting standards should be introduced in the curricula of the accounting departments in Saudi universities. Moreover, Institute of Banking should work together with SOCPA to provide courses for the preparation for The Certified Islamic Professional Accountant (CIPA) for auditors and accountants;
- Ignorance of the existence AAOIFI accounting standards shows the need of more conferences and seminars in this area. In addition, Islamic banks in Saudi Arabia should financially support the research in the accounting issues of Islamic banking and attract experienced and specialists in this field to work for them;
- Finally, since this study provides evidence that the higher the education and experience of the respondent the more they are aware of AAOIFI accounting standards, the researchers advice to SAMA is to consult experts and the most knowledgeable figures in the Islamic banking and accounting fields regarding the

need of implementing AAOIFI accounting standards in Islamic banks in Saudi Arabia.

11.4 LIMITATIONS OF THE STUDY

For every research, there are some limitations and this study is no exception. The following presents some limitations that the researcher considered in this study:

(i) There has been no previous study on this research, which makes this the first attempt to examine the awareness and preference of AAOIFI accounting standards in Saudi Arabia. Consequently, no information on the problem under investigation existed. Hence, an exploratory approach was used.

(ii) The scope of this study is limited to Saudi Arabia only due to time and resource constraints;

(iii) Bank Al-Bilad one of the main Islamic banks in Saudi Arabia was not included in the survey because it was in the process of being established during the fieldwork in 2004.

(iv) Since the questionnaire survey is the main method of measuring the perceptions of academics and professionals in this study, the usual limitations of this method apply to this research. In this study, there is a possibility of social desirability bias, especially for the IBs' employees where the researcher could not be allowed to meet them personally for privacy and security purposes. Therefore, IBs employees' responses might be influenced by their managers' views and attitudes. To minimize the social desirability bias to this group, the researcher made a clear statement within the covering letter of the questionnaire, to the respondents ensuring them of confidentiality and secrecy. In

addition, the researcher has offered an online questionnaire for those who needed more confidentiality.¹

(v) In addition to the quantitative analysis, using interviews with qualitative analysis could have provided further qualitative meaning to substantiate the findings from the quantitative methods;

(vi) Further quantitative analysis oriented statistical test could have improved the results such as testing the significance of the statistical differences between sample groups.

(vii) A content analysis on annual financial reports could have been conducted to develop an idea for the usefulness of the annual reports of the banks by locating the nature of the information presented in these reports.

11.5 SUGGESTIONS FOR FURTHER RESEARCH

Considering this research as the first of its kind that examines the importance and the need for implementing AAOIFI accounting standards in Islamic banks in Saudi Arabia, further research is needed to complete and fill the gap in this area of research. Thus, the researcher suggests the following further research:

- In depth study to explore the obstacles that prevent the adoption of AAOIFI accounting standards in Islamic banks in Saudi Arabia from the SAMA point of view;
- In depth analytical study on the AAOIFI accounting standards to explore the weakness and strengths of these standards and compare it with other international accounting standards;
- In depth study to evaluate the contributions of Islamic banks in Saudi Arabia in training their accountants regarding the accounting issues in Islamic banking;

¹ See online questionnaire at [<http://www.al-abdullatif.net/>].

- In depth study to explore the accounting implications of Islamising conventional banks in Saudi Arabia.

It should, however, be noted that Islamic banks and the government agencies should sponsor further and continuous research into various aspects of Islamic finance and banking including Islamic accounting and standards.

11.6 CONCLUSIONS AND FINAL REMARKS

This thesis aimed at studying and exploring the awareness and preference of AAOIFI accounting standards in Saudi Arabia, and it is considered to be the first of its kind, which attempted to evaluate the perceptions of academics and professionals regarding the application of AAOIFI accounting standards in IBs in Saudi Arabia. Therefore, this research is considered to be the foundation of further research regarding AAOIFI accounting standards in Saudi Arabia.

This research might be important to various groups of preparers and users of Islamic banks' annual reports, such as academics and researchers, accounting profession, banks' managements, professional accounting bodies such as SOCPA in Saudi Arabia and AAOIFI in the Kingdom of Bahrain, and lastly SAMA and other government agencies. In addition, as one of the first study in this area, it is believed that the findings of this research create substantial opportunities for further research.

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APPENDIX-1

COPIES OF THE
QUESTIONNAIRE IN ARABIC
AND ENGLISH

بسم الله الرحمن الرحيم

أخي الكريم

السلام عليكم ورحمة الله وبركاته

الاستبيان المرفق هو جزء من مشروع بحث أقوم بتنفيذه في الوقت الحالي وذلك لنيل درجة الدكتوراه من جامعة "درم" بالمملكة المتحدة، تحت إشراف البروفسور رودني ويلسون .

ويهدف البحث إلى دراسة أهمية القوائم المالية للبنوك الإسلامية وسبل تطويرها بالإضافة إلى تحديد أهمية المعايير المحاسبية الإسلامية ومدى الحاجة إليها والتعرف على المعوقات التي قد تحول دون تطبيقها بالمملكة.

وقد تم اختياركم ضمن المجموعة التي سوف تجيب على هذا الاستبيان إيماناً مني بأهمية رأيكم حول موضوع دراستي. وسأكون شاكراً لكم إذا تفضلتم بالإجابة على جميع الأسئلة المتضمنة في الاستبيان، وكتابة أي تعليقات واقتراحات تعتقد أنها ذات صلة بالموضوع على الصفحة الأخيرة من هذا الاستبيان.

وبسبب ضيق الوقت المتاح لإكمال هذا الجزء من البحث في المملكة، فإنني أرجو أن تتكرم بملء الاستبيان وإعادته لي شخصياً أو إلى الشخص الذي ساعد في توزيع هذا الاستبيان بأسرع وقت ممكن أو باستخدام مظلوف البريد المجاني المرفق. وأؤكد لك أن جميع المعلومات التي تقدمها لنا سيتم التعامل معها بسرية تامة وسيتم فقط استخدام ملخص البيانات في أي مطبوعة تتضمن نتائج البحث.

إذا كانت لديك أية استفسارات بخصوص الاستبيان أو موضوع البحث، الرجاء الاتصال بي على عنواني الموضح أدناه.

وأخيراً، أرجو أن تتقبل خالص شكري وتقديري لمساعدتكم وتعاونكم.

المخلص

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الجزء الأول

أهمية القوائم المالية السنوية للبنوك الإسلامية في المملكة العربية السعودية

1- ما مدى موافقتك أو عدم موافقتك حول الأهداف التالية للتقارير المالية السنوية للبنوك الإسلامية؟

الرقم	الأهداف	أوافق بشدة	أوافق	محايد	لا أوافق	لا أوافق بشدة
A	تعطي معلومات حول توافق البنك الإسلامي مع الشريعة الإسلامية					
B	تزود بمعلومات عن الموارد الاقتصادية للمصرف والالتزامات الناشئة عن هذه الموارد					
C	تعطي معلومات تساعد الجهة المختصة على تحديد الزكاة الواجبة في أموال المصرف					
D	تعطي معلومات تساعد على تقدير التدفقات النقدية المستقبلية					
E	تزود بمعلومات تساعد على تقييم أداء المصرف للامانة المنوطة به في حفظ الاموال وتنميتها بالمستوى الملائم					
F	تزود بمعلومات عن أداء المصرف لمسؤولياته تجاه المجتمع					
G	تساعد على إجراء المقارنة بين أداء البنك الإسلامي مع البنوك التقليدية والبنوك الإسلامية الأخرى أيضا					
H	أهداف أخرى (الرجاء ذكرها):					

2- ما مدى أهمية القوائم المالية للبنوك الإسلامية بالنسبة لكل من المستخدمين التاليين ؟

الرقم	مستخدمو القوائم المالية	مهم جداً	مهم	متوسط الأهمية	غير مهم	غير مهم على الإطلاق
A	المستثمرين / أصحاب الأسهم					
B	إدارة البنك					
C	الموظفين					
D	المراجعون القانونيون					
E	العملاء					
F	الحكومة					
G	أخرى (الرجاء التحديد):					

3- ما مدى موافقتك حول ما إذا كانت المعلومات المالية التي ينشرها البنك الإسلامي تحتوي على الخصائص التالية؟

الرقم	خصائص المعلومات المالية	أوافق بشدة	أوافق	محايد	لا أوافق	لا أوافق بشدة
A	الملائمة					
B	امانة المعلومات وإمكانية الثقة بها أو الاعتماد عليها					
C	قابلية المعلومات للمقارنة مع البنوك					
D	الثبات في تطبيق طرق وأساليب القياس والعرض والإفصاح					
E	قابلية المعلومات للفهم والاستيعاب					

4- ما هو رأيك حول أهمية كل عامل من العوامل التالية في تأثيرها على جودة وكفاية المعلومات المالية المفصح عنها من قبل البنك الإسلامي؟

الرقم	العامل	مهم جداً	مهم	متوسط الأهمية	غير مهم	غير مهم على الإطلاق
A	أن يقوم بعملية مراجعة الحسابات مكتب وطني					
B	أن يقوم بعملية مراجعة الحسابات مكتب دولي					
C	كفاءة إدارة البنك الإسلامي					
D	حجم البنك وتعدد نشاطاته وخدماته					
E	نوع المعايير المحاسبية المستخدمه في اعداد القوائم الماليه للبنك الإسلامي					
F	درجة التأهيل العلمي والمهني لموظف البنك					
G	توفر نظام فعال للرقابة الداخلية في البنك					
H	ملكية البنك (حصة الحكومه في البنك، حصة أعضاء مجلس الإدارة ، وجود شريك أجنبي)					
I	عوامل أخرى (الرجاء التحديد):					

5- ماهو برأيك أهمية كل مصدر من مصادر المعلومات التالية في توضيح أداء البنك الإسلامي لمهامه المنوطة به؟

الرقم	مصادر المعلومات	مهم جداً	مهم	متوسط الأهمية	غير مهم	غير مهم على الإطلاق
A	التقارير الماليه السنويه للبنوك الإسلاميه					
B	التقارير الماليه ربع السنويه للبنوك الإسلاميه					
C	الصحف اليوميه والمجلات المتخصصة					
D	معلومات مباشره من البنك الإسلامي					
E	الإشاعات في السوق					
F	نشرات حكوميه					
G	مصادر أخرى (الرجاء ذكرها):					

6- ماهو برأيك أهمية كل من التقارير و القوائم الماليه السنويه التاليه (إن وجدت) في قوائم البنك الإسلامي؟

الرقم	القسم	مهم جداً	مهم	متوسط الأهمية	غير مهم	غير مهم على الإطلاق
A	تقرير مجلس الإدارة					
B	تقرير المحاسب القانوني					
C	قائمة المركز المالي					
D	قائمة الدخل					
E	قائمة التغيرات في المركز المالي					
F	قائمة التدفقات النقدية					
G	الإيضاحات حول القوائم الماليه					
H	تقرير هيئة الرقابة الشرعية					
I	ملخص النشاط خلال العام					
J	تقرير عن نظام الرقابة الداخلي					
K	قائمة التغيرات في الإستثمارات المقيدة وما في حكمها					
L	قائمة مصادر وإستخدامات أموال صندوق الزكاة والصدقات					
M	تقارير تقترح إضافتها(الرجاء ذكرها):					

7- هل تملك فروع الخدمات المصرفية الإسلامية في المملكة العربية السعودية قوائم مالية منفصلة عن البنوك التقليدية التابعة لها؟

لا أدري

لا

نعم

8- الرجاء تحديد مدى موافقتك أو عدم موافقتك مع العبارات التالية:

الرقم	العبارة	أوافق بشدة	أوافق	محايد	لا أوافق	لا أوافق بشدة
A	يجب أن تقوم فروع الخدمات المصرفية الإسلامية بإعداد قوائم مالية إضافية خاصة بها وتنشر في إيضاحات القوائم المالية للبنك التقليدي التابعة له					
B	يجب أن تفصح فروع الخدمات المصرفية الإسلامية عما إذا كانت تخلط الأموال المتعلقة بالخدمات المالية الإسلامية مع الأموال المتعلقة بالخدمات المالية التقليدية أو فصلها عنها					
C	يجب أن تفصح فروع الخدمات المصرفية الإسلامية بالتفصيل عن مصادر واستخدامات الأموال التي تلقتها					

الجزء الثاني

أهمية وحاجة البنوك الإسلامية في المملكة العربية السعودية إلى تطبيق المعايير المحاسبية الإسلامية

9- هل تؤيد توحيد المعايير المحاسبية المستخدمة لإعداد القوائم المالية في البنوك الإسلامية؟

لا أدري

لا

نعم

10- ما مدى موافقتك أو عدم موافقتك حول المشاكل التالية التي قد تنتج بسبب استخدام معايير محاسبية مختلفة لإعداد القوائم المالية؟

الرقم	المشاكل المحتملة من جراء استخدام معايير محاسبية مختلفة	أوافق بشدة	أوافق	محايد	لا أوافق بشدة	لا أوافق بشدة
A	صعوبة المقارنة بين القوائم المالية السنوية للبنوك المختلفة					
B	إختلاف وتنوع تفسيرات المستخدمين لهذه القوائم المختلفة					
C	صعوبة إتخاذ القرارات					
D	فقدان أو إنخفاض ثقة المستخدم للقوائم المالية					
E	فقدان الثقة في تقرير المراجع الخارجي					
F	زيادة أعباء العمل على المراجع الخارجي					
G	الصعوبة التي يواجهها المحاسب من خلال التعامل مع معايير مختلفة					
H	تكلفة تدريب المحاسب ليصبح قادرا على التعامل مع معايير مختلفة					
I	صعوبات أخرى (الرجاء ذكرها):					

11- ما مدى موافقتك أو عدم موافقتك على الأهداف التالية التي قد تتحقق من خلال تطبيق المعايير المحاسبية الإسلامية؟

الرقم	الأهداف	أوافق بشدة	أوافق	محايد	لا أوافق	لا أوافق بشدة
A	توحيد القوائم المالية في جميع البنوك الإسلامية					
B	توفر معلومات مالية قابلة للمقارنة					
C	توفر قواعد محددة يسترشد بها في مراحل إعداد القوائم المالية للبنك					
D	توجد ثبات نسبي للقوائم المالية خلال فترات زمنية متتالية					
E	يعزز من ثقة مستخدمي القوائم المالية بها					
F	توفر قواعد ثابتة يسترشد بها المراجعون الخارجيون في عملية مراجعة البنوك الإسلامية					
G	أهداف أخرى (الرجاء ذكرها):					

12- ما مدى تفضيلك أو عدم تفضيلك لنوع المعايير الواجب إتباعها لإعداد القوائم المالية السنوية للبنوك الإسلامية؟

الرقم	الخيارات	مفضل جداً	مفضل	محايد	غير مفضل	لافضلة إطلاقاً
A	معايير المحاسبة الدولية فقط مع تعديلها لتناسب حاجات البنوك الإسلامية					
B	معايير المحاسبة الأمريكية فقط مع تعديلها لتناسب حاجات البنوك الإسلامية					
C	معايير المحاسبة البريطانية فقط مع تعديلها لتناسب حاجات البنوك الإسلامية					
D	معايير المحاسبة السعودية (SOCPA)					
E	معايير المحاسبة الإسلامية (AAOIFI)					
F	معايير أخرى (الرجاء التحديد):					

13- مامدى إلمامك بالمعايير المحاسبية الصادرة عن هيئة المحاسبة والمراجعة للمؤسسات المالية الإسلامية (AAOIFI) ؟

على إطلاع جيد بها سمعت بها فقط لم أسمع بها مطلقاً

14- ماهو برأيك أهمية دور كل مجموعة من المجموعات التالية نحو تطبيق المعايير المحاسبية الإسلامية (AAOIFI) بالمملكة العربية السعودية؟

الرقم	المجموعة	مهم جداً	مهم	متوسط الأهمية	غير مهم	غير مهم على الإطلاق
A	مؤسسة النقد العربي السعودي (SAMA)					
B	الهيئة السعودية للمحاسبين القانونيين (SOCPA)					
C	وزارة التجارة					
D	إدارة البنك الإسلامي					
E	مكاتب المحاسبة القانونية					
F	الأكاديميون في حقل المحاسبة					
G	أخرى (الرجاء التحديد):					

15- ماهو برأيك تأثير العوامل التالية على تطبيق المعايير المحاسبية الإسلامية بالمملكة ؟

الرقم	العوامل	مؤثر جداً	مؤثر	متوسط التأثير	غير مؤثر	غير مؤثر على الإطلاق
A	حدائثة المعايير الإسلامية وإفتقارها للتجربة					
B	عدم إلزامية المعايير المحاسبية الإسلامية					
C	المعايير المحاسبية الإسلامية غير معروفة دولياً					
D	معوقات أخرى (الرجاء التحديد):					

الجزء الثالث

معلومات عامة

16- هل تعتقد بأن فروع الخدمات المصرفية الإسلامية في البنوك التقليدية في المملكة هي الخطوة الأولى نحو التحول الكامل إلى بنوك إسلامية؟

نعم لا لا أدري

17- هل تعتقد بأن البنوك الإسلامية في المملكة مهمة بالمحاسبين العاملين لديها، وتنظم على الدوام دورات تدريبية لتطوير قدراتهم للتعامل مع المشاكل الخاصة بالبنوك الإسلامية؟

نعم لا لا أدري

18- ماهي وظيفتك الحالية ؟

أخرى أذكرها	موظف في بنك اسلامي او في فرع خدمات مصرفية إسلامية				عمل خارج البنوك الإسلامية	
	محاسب	مدير مالي	عضو هيئة شرعية	مدير تنفيذي	محاسب قانوني	أكاديمي

19- ماهي أعلى شهادة تحصلت عليها؟

أقل من البكالوريوس	البكالوريوس	الماجستير	الدكتوراة

20- ماهي المؤهلات المهنية التي تحصلت عليها؟

CA	CPA	SOCPA	أخرى	CPA + SOCPA	CPA +SOCPA+ أخرى

21- كم عدد سنوات الخبرة لديك؟

أقل من 5 سنوات	من 5-10 سنوات	من 10-15 سنة	من 15-20 سنة	أكثر من 20 سنة

Dear Sir /

The attached questionnaire is part of a research project that I am carrying out in part fulfillment for the award of a Ph.D. degree at the University of Durham, UK under the supervision of Professor Rodney Wilson.

The objectives of the research are to study the importance of Islamic Banks' financial statements and how to improve them. In addition, an aim to examine the importance of the Islamic Accounting Standards (AAOIFI) and problems of applying these in Saudi Arabia.

You are among those who have been chosen carefully to answer my questionnaire. I would be extremely grateful if you answer all questions included and write any comments and suggestions you may think are relevant.

I assure you that all the information you provide will be dealt with in the strictest confidence and only the summarized data will be used in any publication of research findings.

If there are any queries concerning the questionnaire or the subject of the research, please do not hesitate to contact me at my address below.

Finally, please accept in advance my sincere thanks and admiration for your assistance and co-operation.

Yours faithfully

Sultan Al-Abdullatif

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Definition of the Terminology Used

Islamic windows: They are branches of conventional banks, which provide Islamic services.

List of abbreviations

AAOIFI: The Accounting and Auditing Organisation for Islamic Financial Institutions

SAMA: Saudi Arabian Monetary Agency

SOCPA: Saudi Organisation for Certified Public Accountants

CA: Chartered Accountants (UK)

CPA: Certified Public Accountants (USA)

Please indicate your opinion with the following questions by ticking the appropriate boxes.

Part 1:

The importance of the financial statements within the context of Islamic banks in Saudi Arabia

1 - Do you agree or disagree with the following objectives of the Islamic banks' financial statements reporting?

Objectives	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
To provide information about compliance with the Islamic <i>Shari'ah</i>	<input type="checkbox"/>				
To provide information about the Islamic bank's financial resources and related obligations	<input type="checkbox"/>				
To provide information about sources and uses of the Zakah fund	<input type="checkbox"/>				
To provide information about adequacy of Islamic banks' capital, the risk inherent in its investments and the degree of its liquidity.	<input type="checkbox"/>				
To provide information about ability to generate income and convert it into cash flows	<input type="checkbox"/>				
To provide information about Islamic banks' discharge of its social responsibilities	<input type="checkbox"/>				
It helps to compare the performance between Islamic banks and conventional banks.	<input type="checkbox"/>				
Others (please specify):					

2 – What is your view regarding the importance of Islamic bank's financial statements for each group of the following users?

The Group of Users	Very Important	Important	Neutral	Not Important	Not Important at all
Shareholders/investors	<input type="checkbox"/>				
Management	<input type="checkbox"/>				
Employees	<input type="checkbox"/>				
Auditors	<input type="checkbox"/>				
Customers	<input type="checkbox"/>				
Government	<input type="checkbox"/>				
Others (please specify):					

3 - Do you agree or disagree that the financial information disclosed by the Islamic banks has the following qualitative characteristics?

The Qualitative Characteristics	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
Relevance	<input type="checkbox"/>				
Reliability	<input type="checkbox"/>				
Comparability (between other banks and Islamic banks)	<input type="checkbox"/>				
Consistency	<input type="checkbox"/>				
Understandability	<input type="checkbox"/>				

4 - What is your opinion regarding the importance of the following factors that might affect the quality and adequacy of the accounting information disclosed by Islamic banks?

Factor	Very Important	Important	Neutral	Not Important	Not Important at all
The external auditor is a national firm	<input type="checkbox"/>				
The external auditors is national firm affiliated with international firm	<input type="checkbox"/>				
Capability of Islamic bank's management	<input type="checkbox"/>				
Bank size and its products and services	<input type="checkbox"/>				
Accounting standards adopted in preparing the financial statements	<input type="checkbox"/>				
The level of education and professional qualification that employees hold	<input type="checkbox"/>				
How effective is the internal control system in the bank	<input type="checkbox"/>				
Ownership structure (e.g. percentage of government ownership, percentage of private ownership and foreign participation)	<input type="checkbox"/>				
Others (please specify):	<input type="text"/>				

5 – What is your opinion regarding the importance of the following sources of information in indicating Islamic banks' performance?

The information sources	Very Important	Important	Neutral	Not Important	Not Important at all
Islamic bank's financial reports	<input type="checkbox"/>				
Islamic banks interim financial statements	<input type="checkbox"/>				
Newspapers and Specialist magazines	<input type="checkbox"/>				
Direct information from the Islamic bank	<input type="checkbox"/>				
Market's rumours	<input type="checkbox"/>				
Governments publications	<input type="checkbox"/>				
Others (please specify):	<input type="text"/>				

6 - What is your opinion regarding the importance of the following sections of the Islamic bank's annual report (if available)?

Section of the Report	Very Important	Important	Neutral	Not Important	Not Important at all
Board of Directors' report	<input type="checkbox"/>				
Auditor's report	<input type="checkbox"/>				
Balance sheet	<input type="checkbox"/>				
Income statement	<input type="checkbox"/>				
Statement of changes in owners' equity (statement of retained earnings)	<input type="checkbox"/>				
Statement of cash flow	<input type="checkbox"/>				
Note of the financial statements	<input type="checkbox"/>				
Shariah supervisory board's report	<input type="checkbox"/>				
Summary of annual activities	<input type="checkbox"/>				
Report about internal control	<input type="checkbox"/>				
Statement of changes in restricted investments	<input type="checkbox"/>				
Statement of sources and uses of funds in the Zakah and the charity fund	<input type="checkbox"/>				
Others (please specify):	<input type="text"/>				

7 - Do Islamic windows in Saudi Arabia have separate financial statements from their conventional banks?

<input type="checkbox"/> Yes	<input type="checkbox"/> No	<input type="checkbox"/> I don't know
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8 - Please indicate whether you agree or disagree with the following statements:

Statement	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
Islamic windows in Saudi Arabia must prepare supplementary statements to be published in the notes of the financial statements of the conventional banks.	<input type="checkbox"/>				
Islamic windows in Saudi Arabia must disclose whether or not they mingle funds relating to Islamic financial services with funds relating to conventional financial services.	<input type="checkbox"/>				
Islamic windows in Saudi Arabia must disclose, in detail, the sources and applications of funds mobilised and invested by their Islamic financial services.	<input type="checkbox"/>				

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Part 2:

The need and importance of the Islamic Accounting Standards for the Islamic banks in Saudi Arabia

9 - Do you support the idea of harmonizing the Accounting standards used for Islamic bank's financial statements?

<input type="checkbox"/> Yes	<input type="checkbox"/> No	<input type="checkbox"/> I don't know
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10 - Do you agree or disagree that the following problems might be caused by using different accounting standards?

Potential problems of Using Deferent Accounting Standards	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
Difficulty in comparing financial statements	<input type="checkbox"/>				
Variations in the users' interpretation of the financial information	<input type="checkbox"/>				
Difficulty in making decisions	<input type="checkbox"/>				
Decreased user's trust in accounting information	<input type="checkbox"/>				
Loss of trust in the audit reports	<input type="checkbox"/>				
Expand the range of the work done by the external auditors	<input type="checkbox"/>				
Difficulties for accountants to deal with different accounting standards	<input type="checkbox"/>				
Cost of training accountants to be familiar with different accounting standards	<input type="checkbox"/>				
Others (please specify): **	<input type="text"/>				

11 - Do you believe that applying Islamic accounting standards in Saudi Arabia might help in achieving the following objectives?

Objectives	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
Harmonizing financial statements between Islamic banks	<input type="checkbox"/>				
Promoting adequate disclosure of comparable financial information	<input type="checkbox"/>				
Providing definitive criteria for the guidance of accountants in the process of the preparation of Islamic bank's financial statements	<input type="checkbox"/>				
Providing reasonable consistency in Islamic bank's financial reporting over time	<input type="checkbox"/>				
Increase users' trust in Islamic bank's financial information	<input type="checkbox"/>				
Providing definitive criteria for the guidance of external auditors through the process of auditing Islamic bank's financial statements	<input type="checkbox"/>				
Others (please specify): **	<input type="text"/>				

12 – What is your preference for other alternatives that might be adopted for setting accounting standards for Islamic banks in Saudi Arabia?

The alternative	Strongly Prefer	Prefer	Neutral	Dislike	Strongly Dislike
International accounting standards only with modification to suit Islamic bank's needs	<input type="checkbox"/>				
American accounting standards only with modification to suit Islamic bank's needs	<input type="checkbox"/>				
British accounting standards only with modification to suit Islamic bank's needs	<input type="checkbox"/>				
SOCPA Accounting Standards	<input type="checkbox"/>				
AAOIFI Accounting Standards	<input type="checkbox"/>				
Others (please specify):	<input type="text"/>				

13 – Are you aware of the Islamic Accounting Standards which are issued by AAOIFI?

<input type="checkbox"/> I am aware of it	<input type="checkbox"/> I heard about it	<input type="checkbox"/> I have never heard about it
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14 - What is your opinion regarding the importance of each group in applying Islamic accounting standards (AAOIFI) in Saudi Arabia?

Groups	Very Important	Important	Neutral	Not Important	Not Important at all
SAMA	<input type="checkbox"/>				
SOCPA	<input type="checkbox"/>				
Ministry of Commerce	<input type="checkbox"/>				
Islamic bank's management	<input type="checkbox"/>				
Auditing firms	<input type="checkbox"/>				
Academics in the accounting field	<input type="checkbox"/>				
Other groups (please specify):	<input type="text"/>				

15 - What is your opinion regarding the impact of each of the following factors in applying Islamic accounting standards (AAOIFI) in Saudi Arabia?

Factor	Very Important	Important	Neutral	Not Important	Not Important at all
The newness of AAOIFI Standards and its lack of experience	<input type="checkbox"/>				
AAOIFI Standards are not compulsory	<input type="checkbox"/>				
AAOIFI Standards are not internationally acceptable	<input type="checkbox"/>				
Other factors (please specify):	<input type="text"/>				

Part 3:

General information

16 – Do you believe that Islamic windows in the conventional banks in Saudi Arabia are the first step towards Islamisation of all conventional banks?

<input type="checkbox"/> Yes	<input type="checkbox"/> No	<input type="checkbox"/> I don't know
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17 – Do you believe that Islamic banks are very concerned about their accountants, and they usually organise training courses regarding "Accounting Issues in Islamic Banking"?

<input type="checkbox"/> Yes	<input type="checkbox"/> No	<input type="checkbox"/> I don't know
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18 - Which one of the following describes your primary occupation?

Working outside Islamic banks		Employee at Islamic banks or Islamic windows				Other (please specify)
Academic	External Auditor	Executive manager	Shari'ah committee member	Financial manager	Accountant	Other <input type="checkbox"/> <input type="text"/>
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	

19 - What is the highest degree you hold?

Below bachelor level	Bachelor	Master	PhD
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

20 - What kind of Professional qualifications do you hold?

CA (UK)	CPA (USA)	SOCPA (KSA)	Other (s) please specify:
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="text"/>

21- How many years of experience do you have?

Less than 5 years	5- 10 years	10- 15 years	15- 20 years	More than 20 years
<input type="checkbox"/>				

Thank you very much for completing this questionnaire. Your comments and suggestions are highly appreciated:

Finally, I have pleasure to tell you that a summary of the findings of my research will be made available to those participants who ask for it.

The identity of respondents will be treated in strict confidence and not revealed in the theses or any other publications. So if you want your copy of my findings, please provide me with your details and address.

NAME	<input type="text"/>
ADDRESS	<input type="text"/>
TELEPHONE	<input type="text"/>
E-MAIL	<input type="text"/>
FAX	<input type="text"/>

