An investigation into the extent IFIs display the characteristics of useful decision making within their financial statements’

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Declaration

I hereby declare this research report to be of my own work and unaided by anyone else. It is submitted as part of the completion of the degree of Master of Commerce at the University of the Witwatersrand, Johannesburg, involving coursework and a research report. I have not submitted this report anywhere else for the purpose of being awarded a degree or for examination by another University.

Shabeer Cassim

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Dedication

Dedicated to my late mum Farida Carrim who passed away on 13 July 2020 from Covid-19.

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بِسْمِ ٱللَّهِ ٱلرَّحْمَٰنِ ٱلرَّحِيمِ

(In the name of Allah, the Most Gracious, the Most Merciful)

Everything I have ever achieved is only through the grace and mercy of Allah. I would like to express my sincere gratitude and thanks to Allah, my creator, for granting me the ability and success in completing this study.

Secondly, my parents, especially my dear late mum, who succumbed to Covid-19 in early July 2020 and, unfortunately, did not see me complete this study. Words, a thank-you and an acknowledgment is insufficient for everything you did for me. All the support, love, and constant encouragement you gave me throughout my life. My dad, Jazakallah (May Allah reward you) for everything that you do for me. My brother, Muhammad, thank-you for your support: I know I can count on you for anything.

I would like to thank my supervisor, colleague and friend, Wayne Van Zijl, for all your support, help and dedication in assisting me to complete this study. I would also like to thank my co-supervisor, Irfaan Omarjee, for your guidance, assistance and support throughout the process.

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Abstract

Locally and abroad, Islamic finance has shown phenomenal growth in recent years. The Global Islamic Finance Report discloses that the global Islamic finance industry stood at US$ 2.293 trillion at the end of December 2016. Islamic finance is not only limited to middle eastern countries but has shown growth in western countries as well, for example the United Kingdom, Luxembourg, Germany and Switzerland. This has led to growth in the number of Islamic Finance Institutions (IFIs). With the growth and reach of Islamic finance, understanding the differences between the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) accounting framework and other commonly used accounting frameworks is crucial. At present there is limited research which explores these differences. This research begins to address this gap in the literature by investigating to what extent IFI's financial statements reflect the qualitative characteristics of useful information and investigates if there is a significant difference in the application of the qualitative characteristics, as presented in published financial statements, under AAOIFI and International Financial Reporting Standards (IFRS).

Shariah (Islamic law) has important cultural differences from most western cultures and countries. Most notable is the prohibition of the concept of 'interest'. Other prohibitions include trading in pork, intoxicants and games of chance. This may have significant effects on how financial instruments are dealt with compared to IFRS.

The Accounting and Auditing Organisation for Islamic Financial Institutions was established to maintain and promote Shariah standards for IFIs. Some IFIs apply accounting standards issued by AAOIFI, however, the current practice is that many IFIs apply IFRS.

The purpose of financial reporting is to provide useful financial information which will aid users in decision making. IFIs rely on strong public confidence as stakeholders expect the institute to act in compliance with Shariah principles and, as a result reporting transparently on financial transactions is essential. The purpose of this research is to assess the qualitative characteristics of useful financial information in the financial statements produced by IFIs and to assess if there is a significant difference in the application of the qualitative characteristics between IFIs which use AAOIFI accounting standards and those which use IFRS.

This research employed a quantitative approach and used a 21-item index against which the qualitative characteristics of IFI's financial statements were scored. This research analysed the financial statements of 83 IFIs, 30 of which produced financial statements using accounting standards issued by the AAOIFI and 53 IFIs which use IFRS**.**

The main finding of this study is that financial statements issued by IFI’s adequately display the characteristics of useful financial information. The results further indicate there is no significant difference in the score of IFIs which apply IFRS and IFIs which apply AAOIFI in respect of their application of the qualitative characteristics.

Keywords: Islamic finance, Islamic financial institution, AAOIFI, decision-useful, financial reporting quality.

Contents

Table i: Definition of terms

Term	Definition
AAB	The AAOIFI Accounting Board
AAOIFI	Accounting and Auditing Organisation for Islamic Financial Institutions
Allah	God
AOSSG	Asian Ocean Standard Setters Group
Gharar	Uncertainty
GRAP	Generally Recognised Accounting Practices
Halaal	Arabic word that means permissible or lawful
Haraam	Arabic word that means unlawful
Hisaab	A term used in the Quraan, the literal meaning is to account
IASB	International Accounting Standards Board
IFI	Islamic Financial Institute
IFRS	International Financial Reporting Standards
IFT	Islamic Financial Transaction
Ijara	Leasing
Mudarabah	Profit sharing and loss bearing agreement. One party provides capital and the other party provides work or effort
Murabahah	Cost-plus arrangement
Musharaka	Joint venture
Quran	The Islamic sacred book, the word of Allah (SWT) as revealed to the Prophet Muhammed (SAW)
Riba	Usury or interest. Increment in borrowing or lending money
SAW	These letters stand for the Arabic words “Sallalaahu Alaihi Wasallam”, meaning “May the blessings of Allah (SWT) be upon him (Prophet Muhammad (SAW)) and peace”. These words are used to show respect to Prophet Muhammed (SAW) when mentioning his name.
Shariah	Sacred laws of Islam
Wadiah	Safekeeping
Zakaah	Charity, one of five basic tenants of Islam

"Islamic financial products have been around much longer than the IASB. It's quite a daunting task, but it's more than just an intellectual challenge. It is important for the global markets that we bring ourselves together." (ACCA and KPMG 2010)

The late Professor Robert Garnett

Chapter 1: Introduction

1.1 Background

Modern day Islamic finance has its roots in Egypt in 1963 with the establishment of the first Islamic Bank by Ahmad-al-Najjar (Askari, Iqbal et al. 2011, Vinnicombe 2012, Kholvadia 2017). Islamic banking has seen phenomenal growth since its inception (Gait and Worthington 2008, Ismail and Sori 2017, Kholvadia 2017). Consequently, there has been significant growth in Islamic Financial Institutions (IFIs) in recent years (Dhai 2015, Mohammed, Fahmi et al. 2015, Ismail and Sori 2017). The Global Islamic Finance Report states that the global Islamic financial services industry was US$ 2.293 trillion as at the end of December 2016 (GIFR 2017). The Quran (the Holy Book of Islam) explicitly prohibits earning *riba* (interest). IFIs were established in order to adhere to the Shariah (Islamic Law) (Mohammed, Fahmi et al. 2015). Islamic finance exhibit features which are different from conventional finance. As a result, products offered by Islamic banks differ from those offered by conventional banks (Mohammed, Fahmi et al. 2015). A consequence of this is also the accounting treatment of the Islamic banking products.

Some IFIs are applying what is collectively referred to as Islamic accounting standards to prepare their financial statements. Foremost amongst Islamic accounting standards are those promulgated by Bahrain based Accounting and Auditing Organisation for IFIs (AAOIFI) to comply with Islamic Law (AOSSG 2011). However, the current practice is that many IFIs apply International Financial Reporting Standards (IFRS) (Mohammed, Fahmi et al. 2015). There are genuine challenges in applying IFRS by IFIs. IFRS has been considered to be inappropriate for IFIs reporting Islamic Financial Transactions (IFTs) (Dhai 2015). It has been inferred that IFRS does not adequately address the unique institutional features of these entities (Mohammed, Fahmi et al. 2015). The underlying principles of IFRS are different from those of IFIs and Islam. The IASB’s Conceptual Framework is underpinned by a neoliberal, capitalist ideology (Ravenscroft and Williams 2009, Zhang and Andrew 2014). Islam strictly prohibits charging interest. The rationale behind this favours the greater good of society. Charging interest to a person who is forced to borrow money to meet his essential consumption requirements is seen as an exploitative practice (Hossain 2009). A fundamental principle underlying IFRS is the concept of time value of money and credit risk, products of the interest system. This is in stark contrast to the prohibition of interest under the Shariah. This renders the IFRS standards incompatible with satisfying the needs of IFIs.

The purpose of financial reporting is to provide financial information which will be of use to users when making financial decisions (Beest, Braam et al. 2009). The qualitative characteristics included in the Conceptual Framework of IFRS include fundamental characteristics, namely, relevance and faithful representation and enhancing characteristics, namely, comparability, understandability, timeliness and verifiability (IASB 2018). The AAOIFI Conceptual Framework identifies the following as the qualitative characteristics of accounting information: primary qualitative characteristics, relevance and faithful presentation and, enhancing characteristics, decision usefulness, transparency, timeliness, understandability, reliability, comparability and prudence (AAB 2020).

The importance of high quality financial reporting is defined by its role in providing information which will enable, among other stakeholders, capital providers to make informed economic decisions and allocate resources accordingly (Beest, Braam et al. 2009). The need for global convergence of financial reporting standards has been debated by both academics and practitioners alike (ACCA and KPMG 2010). There are differences between AAOIFI standards and IFRS but they are underpinned by Frameworks which are conceptually very similar.

In recent years, there has been noticeable public scrutiny of financial statements as a result of corporate failures, such as China Medical Technologies (Miller 2017). Corporate failures are not only indicative of business failures but also often include audit failures as well as auditors are criticized for not detecting issues earlier and providing sufficient warning to investors (Gavious 2007, Yasseen, Mohamed et al. 2019). These scandals and corporate failures have raised public interest in the financials issued by entities, as well created a heightened awareness of fraud and the auditors’ responsibility to detect it (Gavious 2007, Yasseen, Mohamed et al. 2019). Public trust has been lost as a result of these failures, along with users perceived ability to use financial statements to make appropriate financial and economic decisions (DiPiazza Jr and Eccles 2002).

Regardless of whether accounting standards are based on principles or rules, by its nature, the preparation of financial statements will always include a significant level of judgement (DiPiazza Jr and Eccles 2002). Accounting for financial statements can result in natural errors, or, in certain cases, strategic manipulation to achieve a particular picture or goal (Nyor 2013).

This study assessed the qualitative characteristic of financial statements produced by IFI’s and determines whether there is a significant difference in the score of IFIs applying IFRS and IFIs applying AAOIFI in respect of their application of the qualitative characteristics.

The remainder of this chapter discusses the purpose of the study (Section 1.2), the research questions at the core of this study is put forward in section 1.3. Section 1.4 discusses the significance of this study in more detail before concluding the chapter with the limitations of this study.

1.2 Purpose of the study

The purpose of the study is to assess whether the information in the financial statements produced by IFIs reflect the qualitative characteristics of useful financial information. The study was inspired by a study by Beest, Braam et al. (2009) which assessed the qualitative characteristics of public entities listed in the U.S, U.K and Dutch stock markets.

1.3 Research questions

1. To what extent do IFIs' financial statements reflect the qualitative characteristics of useful financial information?
2. Is there a significant difference in the score[1] of IFIs applying IFRS and AAOIFI in respect of their application of the qualitative characteristics?

For each of the factors in this study, the following hypothesis will be tested:

H_0 – There is no statistically significant difference between the scores for those IFIs applying IFRS and those applying AAOIFI.

H_1 – There is a statistically significant difference between the scores for those IFIs applying IFRS and those applying AAOIFI.

1.4 Significance of the study

1.4.1 Practical contributions of the study

Commenting on the gap between the Islamic world and much of the rest of the world on IFRS, past IASB member and IFRIC chairperson, the late Professor Robert Garnett stated that:

> "*Islamic financial products have been around much longer than the IASB. It's quite a daunting task but it's more than just an intellectual challenge. It is important for the global markets that we bring ourselves together"* (ACCA and KPMG 2010).

[1] This score is based on a 21-item index developed by Beest et al. (2009). Refer to section 3.4

Islamic finance is no longer restricted to Islamic countries but rather has steadily been proving to be a competitive form of financing spread across the world. Islamic Financial Transactions (IFTs) reported under IFRS will be essential to all IFIs to maximize their global potential.

Comparability of financial statements of IFI's are affected if there are two sets of accounting standards (Mohammed, Fahmi et al. 2015). Complying with two sets of accounting standards also places an unnecessary financial burden on the respective IFI. This study sheds light on how well financial statements produced using the AAOIFI standards comply with the IASB's qualitative characteristics of useful financial information. As these qualitative characteristics are used to help guide standard setters set standards, this will help standard setters understand how divergent (or not) this aspect of financial reporting is.

This study is of significant value as capital markets have become global and there has been exponential growth in international business (Nyor 2013). Therefore, the quality of financial reporting is a topical and important topic of research (Nyor 2013).

There is minimal research focused on the quality of information presented in financial statements (Padia and Yasseen 2011). Regarding this field, recent research has focused on corporate social responsibility and integrated reporting, not on the qualitative characteristics of financial information. This research contributes to this existing body of knowledge.

1.5 Assumptions and limitations

1.5.1 Assumptions

This study assumes that reliance can be placed on the financial statements used in this research. All the financial statements used are audited and it is assumed this assumption is appropriate. The audit report includes an opinion on whether the financial statements present fairly in all material respects (Asare and Wright 2012). The research method followed is a quantitative research method. The assumptions underpinning quantitative research are used in this study, including, reality is objective and can be studied objectively (University 2020)

1.5.2 Limitations

As a result of the methodology, the study required the researcher to apply judgement when scoring each criterion in the measurement tool. An element of subjectivity was present, however, this was mitigated through the researcher's sufficient understanding of financial reporting ability to apply professional judgement when assessing the qualitative characteristics. Subjectivity is present, especially when, for example, differentiating between a score of 2 of a score of 3. Subjectivity concerns were reduced to an acceptable level due to the controls discussed in section 3.9

Due to the population, the study required the researcher to utilize purposive sampling. The primary limitation of purposive sampling is that it is prone to research bias. This study is based on an index created by Beest, Braam et al. (2009) and the nature of the index tool limits the opportunity for research bias to materially impact the findings of this study.

There are inherent limitations to this research as this research is quantitative in nature. This research was a descriptive quantitative study so no casual relationships between variables were established. Rather, the correlation between variables was determined (Leedy and Ormrod 2015).

This research was exploratory in nature. As a result, there is an inherent limitation as this research was carried out to study an issue which has not been considered before (Pratap 2018).

This research was evaluated using the qualitative characteristics included in the frameworks issued by the IASB and AAOIFI only. All other available reporting frameworks were excluded.

1.5.3 Delimitations

The scope of this research is limited to attributes of decision usefulness of IFI's, the research will not test the application of standards applicable to IFIs and IFTs. The research is limited to institutions reporting IFTs and is of most value to this sector only. The financial statements used in this study are the 2017 annual reports which are available to the public and to only those which are available in English.

1.6 Structure of the remaining report

The remainder of the report is structured as follows. Chapter 2 discusses the existing body of literature related to the topic with a strong emphasis on the qualitative characteristics of financial reporting and how these will be measured. Chapter 3 discusses the research methodology adopted for this study. Chapter 3 further sets out the procedures for the data collection. Chapter 4 analyses, discusses and presents the results of the data. Chapter 5 provides concluding remarks and future recommendations for research.

Chapter 2: Literature review

2.1 Introduction

In order to understand what an IFI is and why IFIs were established, we need to understand what Islamic finance is and what its objective is. This chapter begins with a discussion of the literature review strategy. This chapter introduces the concept of Islamic finance before expanding on Islamic accounting. Thereafter, the chapter briefly discusses IFIs, their purpose, history, objective and social responsibilities.

This chapter then discusses a brief history of two dominant standard setting bodies, the IASB and AAOIFI respectively. Section 2.5.1 discusses the concept of high-quality financial reporting. This is further explored in section 2.5.2. The next subsection discusses the users of financial statements. Section 2.6 discusses the conceptual frameworks in more detail. This is followed by a discussion on agency theory in section 2.7 and accountability in section 2.8 before concluding the chapter with a discussion on the measurement criteria for decision-useful financial information.

2.2 Literature review strategy

The objective of a literature review is to provide a theoretical understanding of a topic under review. A literature review is necessary to demonstrate the knowledge which the researcher possesses about the relative field (Randolph 2009). A literature review provides the researcher with an opportunity to identify existing evidence, identify which areas have not been researched in relation to a particular topic, discover important characteristics relevant to the topic, so as to gain an understanding of the problem question, to understand the structure of the topic and to identify new ideas which will give rise to future research (Hart 2018). A structured literature review provides an overview of existing literature pertaining to a clearly formulated research question which decisively examines the relevant research (Engelbrecht, Yasseen et al. 2018). This is appropriate as this research is an assessment of the quality of financial statements of IFIs and is formulated into two clearly defined research questions. The literature review which follows provides an understanding of the existing literature which relates to the two research questions this study will address. The objective of this literature review is to comprehend clearly the characteristics of decision useful information in order to execute this research effectively. The sources of information include conceptual frameworks, journal articles and online references.

The sections which follow are structured as follows:

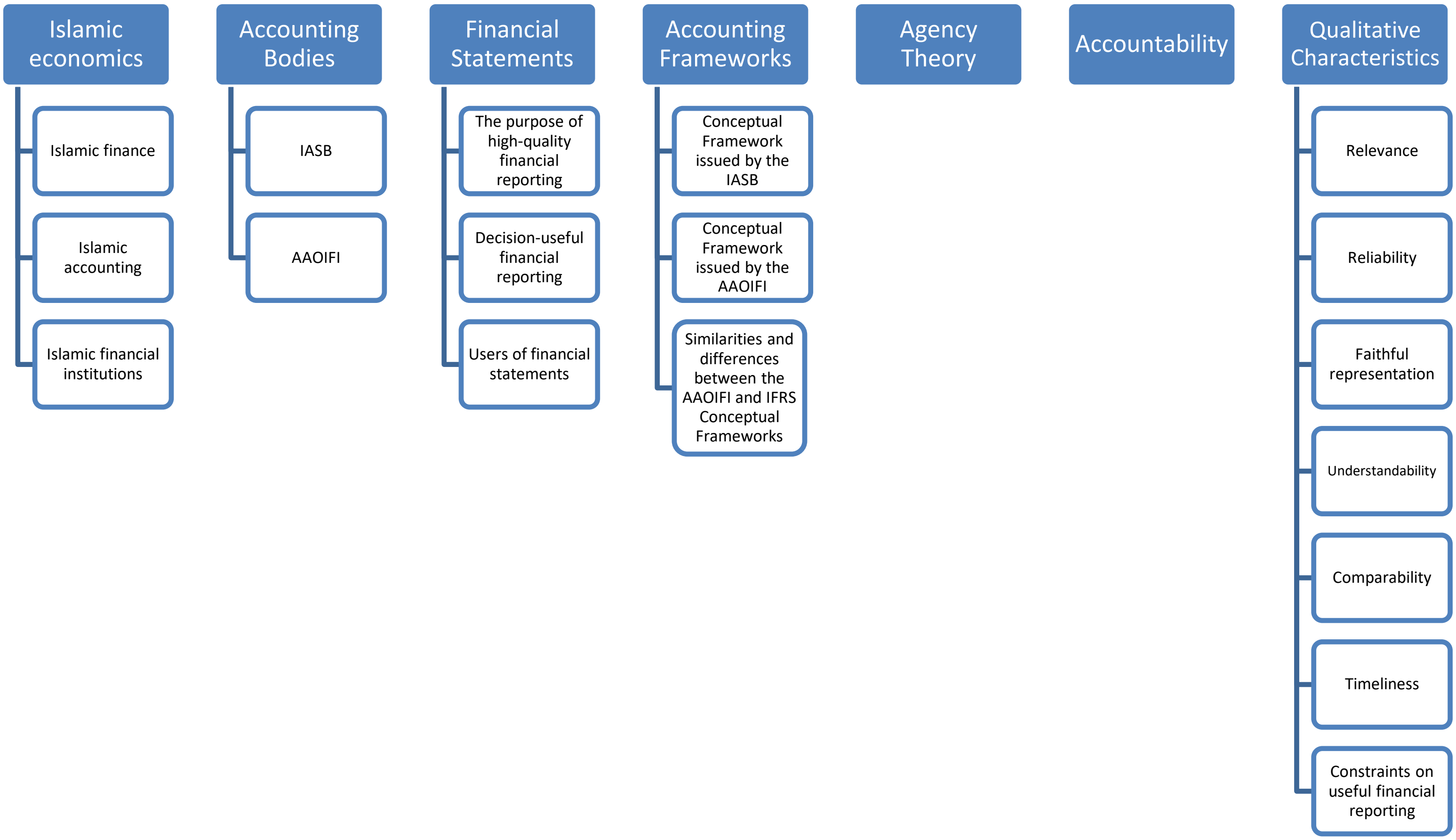

Figure 1: Structure of literature review

2.3 Islamic economics

2.3.1 Islamic finance

Islamic finance has arisen as a result of conventional banking not conforming to the beliefs and precepts of Islam (Rahaman 2011). A key aspect of conventional banking is the charging or payment of interest. Shariah prohibits *riba*, or usury, commonly defined as interest paid on all loans of money (Gait and Worthington 2008, Rahaman 2011, Mohammed, Fahmi et al. 2015). Key to the evolution of Islamic finance is the belief held by Muslims that absolute ownership belongs to Allah and man, as the servant of Allah, must act in a truthful manner when administering wealth (Rahaman 2011, Kholvadia 2017). Islamic finance and conventional finance differ in many respects but both systems of finance share a goal in achieving the same economic benefits to society (Rahaman 2011).

In other non-banking businesses, conventional products or services may contain elements of Gharar (uncertainty), such as insurance products. In the case of insurance, the protection offered by the insurer in exchange for a premium is always uncertain about its amount as well as its timing. This element of Gharar or uncertainty is prohibited by Shariah (Gait and Worthington 2008, Rahaman 2011).

Conventional practices can also involve selling or buying goods and services which are not lawful from a Shariah perspective. These might be the provision of alcohol or non-Halaal foods such as pork. In essence, conventional business practices can be non-compliant from a contractual structure perspective, if they are based on interest and uncertainty, or from a transactional perspective when they are involved in producing, selling or distributing goods and services which are not lawful according to Shariah (Rahaman 2011, Kholvadia 2017). The wisdom behind these restrictions is to deter sinful actions such as greed while maintaining equality and creating balanced opportunities for all (Kholvadia 2017). Simply put, to ensure allocative justice is meted out (Farook 2008).

In its simplest sense, Islamic finance can be defined as financial business which is conducted in accordance with Shariah (Rahaman 2011). The foundations of Islamic finance, derived from Shariah, embody the Islamic principles of balance, fairness and equal opportunities (Kholvadia 2017). Islamic Banks promote principles of ethical and moral behavior while considering social impacts. Islamic banks administer and use public funds and should serve public interest (Ariff 1988).

Islamic finance is essentially driven by principals and contracts which are structured in a manner not only compliant with Islamic teachings, but also capable of offering products and services comparable to and compatible with those of conventional finance (Rahaman 2011). Islamic finance enjoys certain features not found in conventional banking. Salient features include the system being free from interest, the need for underlying assets, the avoidance of uncertainty and gambling and the sharing of profits and losses (Rahaman 2011, Kholvadia 2017). The core concept of Islamic banking is to participate in the profits from investing activities, rather than merely to earn a return based on time (Kholvadia 2017). Profit-sharing and loss-bearing models spread risk between the banker and the investor. Research has been conducted which concludes that Islamic banks are better capitalized and have stronger asset quality (Beck, Demirgüç-Kunt et al. 2010). Islamic bank share prices also performed better during the sub-prime crisis (Kholvadia 2017). Some of the products of Islamic banking offered to achieve this objective include

Mudarabah (profit-sharing and loss-bearing), Wadiah (safekeeping), Musharaka (joint venture), Murabahah (cost-plus) and Ijara (leasing) (Gait and Worthington 2008, Rahaman 2011, Kholvadia 2017, Wikipedia 2020).

2.3.2 Islamic accounting

What is Islamic accounting? In its simplest form, Islamic accounting can be defined as true and correct information which provides the economic standing and results of operations of an entity, complies with Shariah, and is free from misstatement (Dhai 2015). One of the five basic tenets of Islam is the requirement for every Muslim, provided he has the means, to pay Zakaah. Zakaah loosely translated is charity (Dhai 2015). A term used in the Quran is Hisaab, the literal meaning is to account. In the context of the Quran, this means man's accountability to Allah (God) for his deeds and actions. Similarly, managers are accountable to stakeholders for their actions regarding the entity (Dhai 2015). In Islam, the concept of disclosure encompasses the entity disclosing all information necessary to advise stakeholders of their operations, regardless of whether this would be in the best interest of the entity or not (Dhai 2015). We are accountable to Allah, and we achieve this by making information freely available. Disclosure is necessary to highlight compliance with Shariah but also assists stakeholders in managing risk (Lewis 2001).

2.3.3 Islamic financial institutions

A financial institution is an entity which engages in the business of financial and monetary transactions such as, but not limited to, loans, currency exchanges and investments. Financial institutions take on many shapes and sizes and encompass a broad range of operations such as banks, brokerage firms and insurance companies (Hayes 2019).

There has been significant growth of IFIs, not only in Muslim countries, but in western countries as well (Mohammed, Fahmi et al. 2015). As previously mentioned, Islamic finance exhibits features which are different from conventional finance. As a result, products offered by Islamic banks differ from those offered by conventional banks (Mohammed, Fahmi et al. 2015). A consequence of this is also the accounting treatment of the Islamic banking products. IFIs were established as banking agents to comply with Shariah (Farook 2008, Mohammed, Fahmi et al. 2015). In terms of Shariah, man is accountable to Allah for all his actions and deeds. This principle extends to IFIs and the transactions in IFIs are meant to be accountable to Allah and so become an act of worship in order to seek reward in this world and the hereafter (Mohammed, Fahmi et al. 2015). As a consequence, strong public confidence is essential for the survival of an IFI as the public expect the IFI to be compliant with Shariah and this can only be achieved through transparency and accountability (Mohammed, Fahmi et al. 2015).

There is a constant debate about whether IFIs have any social responsibility beyond their role as a financial institution (Farook 2008). It has been suggested IFIs essentially have two social responsibilities which are correlated, i.e. the obligations to fulfil any religious duties in providing financial offerings in conformance with Shariah and being an exemplary financial institution in the global market (Farook 2008).

The core teachings of the Islamic faith originate from the Quran. The three major foundational principles for Islamic Social Responsibility are the vice regency of mankind on earth – where man is seen as the slaves who are in obedience to Allah, divine accountability for all actions committed by man and the positive obligation to enjoin good and forbid evil (Farook 2008). It is inferred an IFIs policies and processes should be in line with the above three principles in order to fulfil the first part of their social responsibility.

Through their transactions, IFIs have the ability to influence allocative justice, more so than the capabilities of an individual Muslim (Farook 2008). Secondly, IFIs are highly visible entities, the actions taken by IFIs have a significant impact in influencing other institutions (Farook 2008). It is for these two reasons, that IFIs have a special duty of social responsibility. This social responsibility is the responsibility of every individual Muslim but one which individual Muslims do not have the means to act upon (Farook 2008).

2.4 Accounting bodies

2.4.1 International Accounting Standards Board

The International Accounting Standards Board (IASB) was founded in 2001 and is responsible for the development of IFRS (IASB 2018). IFRS provides a standardized way of describing an entity's financial performance. IFRS has the objective of producing a single set of high quality, understandable and globally accepted accounting standards (IASB 2018). By enhancing comparability and quality of financial information, IFRS standards intend to enhance transparency (IASB 2018).

2.4.2 Accounting and Auditing Organisation for Islamic Financial Institutions

In 1991, AAOIFI was established by Islamic banks and other interested parties in the State of Bahrain as an international, not-for-profit organization with its primary responsibility being the development and issuance of standards for the global Islamic finance industry (AAOIFI 2018).

Western banks either apply a local accounting framework or IFRS to the preparation of their financial statements. These accounting standards are based on conventional financial principals, which are different from Islamic financial standards (Dhai 2015). The Asian-Oceanian Standard-Setters Group (AOSSG) was formed by countries which were affected by IFTs; to discuss and share experiences on the adoption of IFRS and to contribute to the development of a high-quality set of global accounting standards (AOSSG 2018). Foremost among Islamic accounting standards are those promulgated by Bahrain-based AAIFIO to comply with Islamic Law (AOSSG 2011).

In an attempt to develop financial products which meet the requirements of Islamic finance, IFIs have developed financial instruments which are Shariah compliant. Accounting for these Shariah compliant financial instruments is not always catered for in conventional accounting standards (Dhai 2015). Prior literature suggests there are two schools of thought regarding accounting for IFTs. The first school of thought are of the opinion that given conventional accounting standards are principle based: these principles should be applied to the specific IFT and accounted for accordingly. The second school of thought are of the opinion which given the differences between Islamic finance and conventional finance, conventional accounting standards are inadequate for IFTs and a separate set of Islamic standards should be applied (Dhai 2015).

2.5 Financial statements

2.5.1 The purpose of high-quality financial reporting

This research is focused on the quality of financial statements issued by IFIs with an emphasis on the application of the qualitative characteristics. This section explores various definitions of high-quality financial reporting and the effect of this.

The objective or purpose of general purpose financial statements is to provide users of financial statements with useful information (IASB 2018, AAB 2020). Users of financial statements are existing and potential investors, lenders and other creditors. The information presented in the financial statements must be useful in assisting these various user groups in making economic decisions (Barth 2007, IASB 2018). This can be referred to as “decision-useful” information.

The importance of decision-useful information is exhibited by its role in enabling stakeholders to allocate resources and make investments decisions appropriately and efficiently (Beest, Braam et al. 2009, IASB 2018). Quality of financial reporting extends beyond pure financial information and includes other non-financial disclosures as well. This additional non-financial information assists users to make more informed decisions (Beest, Braam et al. 2009).

The quality of financial reporting is measured by the application of the qualitative characteristics with respect to the information disclosed in the entity's financial statements and the adherence to the objectives of the Conceptual Framework (Gajevszky 2015, IASB 2018). Academic literature on the topic provides alternate definitions for the concept of financial reporting quality (Gajevszky 2015). Financial reporting quality can be defined as the degree of truthful and accurate information presented in relation to the entity's main performance and financial position (Tang, Chen et al. 2008). Biddle, Hilary et al. (2009) define financial reporting quality as the precision and accurateness with which financial statements provide information on an entity's operations, such as cash flows. Jonas and Blanchet (2000) define financial reporting quality as financial information which is complete and transparent and presents information which is not misleading.

Financial reporting quality is an attitude and not a set of rules or principles. This attitude entails the entity communicating with stakeholders to gain an understanding of their needs and what they consider useful (Miller 2002). An entity will not achieve high-quality financial reporting by adhering to reporting frameworks such as IFRS and AAOIFI only, an entity needs to voluntarily expand on the information already disclosed in their financial statements where relevant (Miller 2002). Organisations are duty bound to conduct their business in a manner which meets the needs of stakeholders without compromising the needs of future generations (Marx and Mohammadali-Haji 2014). The needs of stakeholders and users of the financial statements vary and have evolved due to increased consciousness regarding environmental, social and governance (ESG) issues (Holt, Yasseen et al. 2015). Multiple negative consequences have arisen as a result of this lack of high-quality financial reporting, including uncertainty experienced by stakeholders manifesting itself into higher risk and, consequently, a higher rate of return and cost of capital and security prices (Miller 2002). A higher discount rate (cost of capital and required rate of return) results in lower share prices or higher interest rates on borrowings.

2.5.2 Decision-useful financial reporting

The concept of decision usefulness was introduced in the previous sub-section. The previous version of the Conceptual Framework listed the main objective of financial reporting as providing useful information to stakeholders (Zhang and Andrew 2014). The IASB's Conceptual Framework project identified decision usefulness as the objective of financial reporting (Gassen and Schwedler 2010). However, research within this area is yet to yield a definitive narrative for decision-usefulness (Gassen and Schwedler 2010). Decision usefulness can be described as the approach to preparing financial information, in which the emphasis is on the decision-making ability of investors (Scott 1997, Dandago and Hassan 2013). Investors and providers of capital are considered the primary stakeholders in assessing the level of decision usefulness of information (Dandago and Hassan 2013, Zhang and Andrew 2014). The needs of stakeholders are key in determining the usefulness of financial reporting. Consequently, a discussion on the different users of financial statements is necessary and appears in the next sub-section to gain a clearer understanding of the usefulness of information in the decision making process of different users.

2.5.3 Users of financial statements

An understanding of the different user groups of financial statements is necessary because different elements of financial reporting are important to the assessment of decision usefulness of different users. The users of financial statements are existing and potential investors, lenders and other creditors (IASB 2018). Other parties, such as regulators and members of the public other than investors, lenders and other creditors, may also find financial reports useful but, those reports are not primarily directed to these user groups (IASB 2018). Users of financial statements rely on financial statements to make decisions relating to providing resources to the entity, including decisions about; when to buy, hold or sell equity instruments of an entity; the provision or settlement of loans and other forms of credit and to hold management accountable for actions which affect the entity's economic performance and position (IASB 2018).

The AAOIFI Conceptual Framework differs slightly from the IFRS Conceptual Framework in this respect. Information needs of users of financial statements increase and vary with different types of users. The revised Conceptual Framework specifies users of financial statements can be split into primary users, such as existing and potential investors in the entity and secondary users, comprising debtors, employees of the entity, regulators and other government agencies. (AAB 2020). Government agencies have the ability and authority to obtain the information that suit their needs directly and so are not explicitly included as users. However, other external users do not possess such powers and their access to information is limited. These users rely on the information presented in the IFI's general purpose financial statements (AAB 2010). As a result, the current AAOIFI Conceptual Framework mandates that the common information needs of primary and secondary users be the focus of financial statements. Common information needs of these users can be summarized as information which:

a) Will assist in establishing the IFI's compliance with Shariah principles;
b) Will assist the user in evaluating the risks inherent in or associated with the IFI;
c) Will assist in assessing the IFIs management and consumption of economic resources and carrying out its fiduciary and social responsibilities;
d) Will assist employees of IFIs in evaluating their relationship and future with the entity, including the entity's ability to safeguard and develop their managerial skills and capabilities (AAB 2010).

Annual reports are regularly used by stakeholders as a basis for making investment and other economic decisions (Mirshekary and Saudagaran 2005). The trend of developing countries demonstrates that users depend more heavily on information obtained from published annual reports than on advice from stockbrokers, acquaintances or on tips and rumours (Mirshekary and Saudagaran 2005) This affirms the notion that financial statements are important in the decision-making process of users. Mirshekary and Saudagaran (2005) came to the conclusion that, while users differed in their rating of the importance of different sections of the annual report, the overall results indicate that the most important information to users of financial statements is the income statement, the auditor's report and the balance-sheet – in that order (Mirshekary and Saudagaran 2005).

2.6 Accounting frameworks

2.6.1 The Conceptual Framework issued by the IASB

This subsection discusses the Conceptual Framework issued by the IASB. An analysis and understanding of the Conceptual Framework is necessary as the measurement tool used in this study was based on the qualitative characteristics of the framework.

The IASB issued an updated Conceptual Framework in 2018. The purpose of the conceptual framework is to assist the IASB in developing new accounting standards which are based on consistent concepts. By doing so, this will result in information which is more useful to investors, lenders and creditors (IASB 2018). The conceptual framework also aims to assist preparers of financial statements to develop consistent accounting policies for transactions or other events when no standard applies, or a standard allows an accounting policy choice (IASB 2018). The

Conceptual Framework also aims to assist users and preparers to understand and interpret the Standards (IASB 2018).

The Conceptual Framework issued by the IASB includes qualitative characteristics. Qualitative characteristics are those characteristics which produce useful financial information and aid in meeting the objectives of financial reporting (Barth 2013). Qualitative characteristics are classified as fundamental qualitative characteristics and enhancing qualitative characteristics (IASB 2018). The fundamental characteristics are relevance and faithful representation. These are the guiding principles of the Conceptual Framework and, without these, information is not useful. The enhancing qualitative characteristics are comparability, verifiability, timeliness and understandability. Enhancing characteristics can make information more useful, but cannot change non-useful information into useful information (IASB 2018).

Comparability is one of the enhancing qualitative characteristics. Comparability between different entities financial statements is important because capital is a scarce resource. If stakeholders are able to compare different entity's financial statements effectively with each other, stakeholders will be in a position to allocate their resources effectively. In order to prepare financial statements which can be compared with other financial statements, high-quality financial reporting is essential (Barth 2013).

The updated conceptual framework issued in 2018 includes slightly modified qualitative characteristics. Materiality has been added. Material information is any information, which if omitted, will influence the decisions of users of financial statements (IASB 2018). There is no definitive threshold for materiality; it will vary among companies and situations (IASB 2018).

Limitations to the Conceptual Framework will be identified through highlighting strengths and weaknesses of the Conceptual Framework. This will be achieved through an analysis of the advantages and disadvantages of the IFRS.

A strong advantage of IFRS is implicit success which has been made possible through developing a comprehensive set of high-quality standards, which has been adopted by some 100 countries (Ball 2006). IFRS have also managed to obtain convergence in standards with important non-adopters, most notably, the United States of America (Ball 2006). A disadvantage of IFRS is that there will, ultimately, be differences in implementation of IFRS among different countries. The notion that uniform accounting standards only will produce uniform financial reporting is a naïve thought (Ball 2006).

Entities applying IFRS have higher quality financial statements than those which do not (Barth, Landsman et al. 2008). Barth, Landsman et al. (2008) determined entities applying IAS generally have less earnings management, include more timely loss recognition and more value relevance of accounting amounts compared to their counterparts not applying IAS. The IASB has a goal to develop a global set of high-quality financial reporting standards. This goal will become a reality through the issuance of principles-based standards. The purpose of this is to reduce the number of alternate treatments for the same economic transaction and to require accounting measurements which better reflect an entity's economic reality (Barth, Landsman et al. 2008). Financial reporting quality will increase if standard setters take appropriate measures which will limit management's opportunistic mindset in determining the correct accounting treatment (Barth, Landsman et al. 2008).

A disadvantage of the conceptual framework is the lack of guidance regarding the trade-off between relevance and reliability (Whittington 2008, Christensen 2010). Whittington (2008) supports the stewardship perspective of accounting. This view favours reliability in the preparation of financial statements. The Conceptual Framework issued in 2018 removed stewardship as the main objective of financial reporting, the key objective now being to provide useful information to stakeholders (IASB 2018). The Conceptual Framework is now more aligned with a neoliberal view. The neoliberal perspective favours relevance over reliability (Zhang and Andrew 2014).

Stewardship is encompassed within that objective as users assess management's stewardship of the entity's economic resources to enable users to make their relevant decisions (IASB 2018). The purpose behind qualitative characteristics is to make financial reporting more useful to current and potential investors, lenders and creditors (IASB 2018). Qualitative characteristics will follow aspects of both viewpoints. The concepts of stewardship and decision useful information are parallel; they do not conflict and their only differentiating factor is their focus (Lennard 2007). However, stewardship is a very important element of financial reporting and it must be integrated into the reporting process (Lennard 2007). Useful financial information takes into account current and future stakeholders, in this way, placing equal importance on both parties. This is in line with the accountability perspective (Whittington 2008). Although decision usefulness replaced the concept of stewardship as the primary objective of financial reporting, decision usefulness will have different connotations for a neoliberal as opposed to a steward (Zhang and Andrew 2014). Therefore, the qualitative characteristics display aspects of both viewpoints.

This research assessed the qualitative characteristics following an accountability perspective. The rationale behind this is because stewardship is part of the “living law” of the accountancy profession, which emphasizes that accountability is a natural and vital element of the accounting profession (Murphy, O’Connell et al. 2013). Stewardship is focused on the relationship between the accountor and accountee (Murphy, O’Connell et al. 2013). It follows that accounting as a profession does not make logical sense unless accountability or stewardship is a primary objective (Murphy, O’Connell et al. 2013). Stewardship is vitally important because society has lost trust in the accounting profession. A means to restoring this lost public trust is a greater emphasis on stewardship/accountability (Murphy, O’Connell et al. 2013).

2.6.2 The Conceptual Framework issued by AAOIFI

It is well known that the primary reason for the establishment of the AAOIFI was specifically to address financial reporting issues of IFIs (Sori and Mohamad 2019). The Conceptual Framework underpins accounting information and assists setters to create standards which result in useful accounting information being included in financial statements. This, in turn, enhances confidence in IFIs (AAB 2010). As mentioned previously, IFIs rely on strong public confidence as stakeholders expect the institute to be Shariah compliant and to be reporting transparently on financial transactions becomes essential (Mohammed, Fahmi et al. 2015). Accountability is important in society and is valued by the public (Sands 2004). The absence of the Conceptual Framework may result in ‘ad-hoc’ solutions to new problems, instead of solutions based on cohesive accounting theory (Sori and Mohamad 2019).

The first iteration of the Conceptual Framework for Financial Reporting by Islamic Financial Institutions was adopted on 22 July 2010 (AAB 2010). It came into effect on 1 January 2011. It replaced “Statement of Financial Accounting No. 1: Objectives of Financial Accounting for Banks and Financial Institutions” and “Statement of Financial Accounting No. 2: Concepts of Financial Accounting for Banks and Financial Institutions” (AAB 2010). The rationale behind the Conceptual Framework is a framework which provides the basis for the financial accounting standards of the AAOIFI (AAB 2010). Three primary factors underpin the development of the Conceptual Framework and separate financial accounting standards for IFIs:

1) The need to establish a common framework for accounting and financial reporting to demonstrate to the ordinary users of general purpose financial reports that the IFIs they are associated with, comply with the principles and rules of the Shariah.

2) The relationship between IFIs and stakeholders is different from the relationship between conventional entities and its stakeholders. This is primarily because of the limitations of an IFI, such as the prohibited use of interest and the prohibition of entering into speculative transactions.
3) The information needs of stakeholders of an IFI are unique and specific and differ from conventional entities. Consequently, the financial statements of IFIs must reflect this different nature (AAB 2010).

The AAOIFI emphasised a key principle of the Conceptual Framework which is strengthening confidence in IFIs (Sori and Mohamad 2019). An overriding principle, explicitly stated, is a presumption that nothing in the Conceptual Framework will lead to non-compliance with the Islamic Shariah (AAB 2010). The other benefits of the Conceptual Framework as outlined by the AAOIFI are that the Conceptual Framework; (i) encourages harmonization of their financial accounting standards with Islamic principles by providing a basis for selecting the most appropriate accounting treatment; (ii) acts as a guide for the development of new financial accounting standards and any transaction not within the ambit of current standards; (iii) assists users in interpreting financial information; (iv) provides guidance to preparers of financial statements when dealing with subjective judgements and (v) provides information on the approach adopted by the AAOIFI in developing financial accounting standards (AAB 2010).

Since the issuance of the first iteration, the Accounting Board (AAB) of the AAOIFI observed changes and developments in market practices in various jurisdictions. In its efforts and contributions to the Islamic finance industry, and continued improvement to existing financial reporting practices, the AAB has issued the exposure draft of the revised “AAOIFI Conceptual Framework for Financial Reporting by IFIs” (AAB 2020). The revised framework is drafted with the intention to cater for the needs of accounting and financial reporting practices of the Islamic finance industry while upholding the principles of Shariah (AAB 2020). it should be noted, the revised Conceptual Framework is not yet implemented and is currently an exposure draft.The revised AAOIFI Conceptual Framework splits the objectives of financial reporting into two categories, namely, (i) objectives of financial accounting and reporting and (ii) objectives of general-purpose financial statements (AAB 2020). The AAOIFI objective of financial accounting and reporting can be summarized as;

(i) To determine the rights and obligations of all relevant parties, in accordance with the Sharia principles. This encompasses fairness, clarity and compliance with ethical values, as well as, relevant laws and regulations;

(ii) To improve the managerial and productive capabilities of the institution and promote the achievement of established goals and policies whilst complying with Shariah principles and rules.

(iii) To provide decision-useful information to users of financial statements.

The objectives of general-purpose financial statements include providing the following types of information:

(i) The IFI's nature of operations and transaction with the intention of providing sufficient information to enable the user to determine the level of compliance with Shariah principles

(ii) The economic resources and claims against the entity or on specific economic resources which, in turn, will aid the user to evaluate the business risks of the institution.

(iii) Information to assist in determination of zakah[2]

(iv) The manner in which prohibited earnings were dealt with by management

(v) Information about the entity's discharge of its fiduciary duties and social responsibilities

2.6.3 Similarities and differences between the AAOIFI and IFRS Conceptual Frameworks

Unlike the IFRS Conceptual Framework, the AAOIFI Conceptual Framework puts a special emphasis on Shariah compliance of IFIs business (Sori and Mohamad 2019). As mentioned previously, the AAOIFI was established with the aim of satisfying the financial reporting needs of IFIs which offers products and services that comply with the principles of Shariah. Consequently, the objectives of financial reporting are geared towards fulfilling the Shariah principles. An important principle to note is that the focus of Islamic finance is to deliver fair and just products and services (Sori and Mohamad 2019). The Conceptual Framework reiterates that compliance with Shariah is not limited to the conduct of activities undertaken by the respective IFI but extends to ensuring compliance with Shariah in all aspects of financial reporting

[2] Charity, one of five basic tenets of Islam. A Muslim is required to donate 2.5% of their net wealth annually to a Muslim in need.

The revised AAOIFI Conceptual Framework splits the objectives of financial reporting into two categories, namely, (i) objectives of financial accounting and reporting; and (ii) objectives of general-purpose financial statements (AAB 2020). Unlike the IFRS Conceptual Framework which broadly outlines the objective of general purpose financial reporting only. Although both bodies discuss similar issues, their concentration is significantly different. The IASB emphasizes providing useful financial information to capital providers and lenders, existing or new, to make appropriate economic decisions (IASB 2018). The IASB's Conceptual Framework emphasizes that financial reporting should provide information for capital providers to assess the amount, timing and uncertainty of future net cash inflows to the entity and their assessment of management's stewardship of the entity's economic resources (IASB 2018). This can be achieved by analyzing information about the economic resources of the entity, claims against the entity and changes in those resources and claims and how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's economic resources (IASB 2018).

Consistent with the Conceptual Framework issued by the IASB, the AAOIFI Conceptual Framework recognizes that financial statements are not complete and comprehensive for every user and users should seek information from other sources where necessary (AAB 2010, IASB 2018, Sori and Mohamad 2019).

The AAOIFI was established with the aim of satisfying financial reporting requirements of IFIs (AAOIFI 2018, Sori and Mohamad 2019). IFIs are not based on a capitalist ideology which underpins the IFRS (Ibrahim and Hameed 2007). While the IFRS framework is centred around a decision-useful framework, the AAOIFI framework is based on an accountability, together with, sharia compliance framework which seeks to "*determine the rights and obligations of all interested parties, including those rights and obligations resulting from incomplete transactions and other events, in accordance with the principles of the Islamic Sharia and its concepts of fairness, charity and compliance with ethical values*" (AAB 2010). Whilst the AAOIFI Conceptual Framework does not ignore the objective of financial reporting to provide the user with decision useful information, this is present to enable the user to make informed, legitimate decisions in their dealing with IFIs as opposed to buy, sell or hold decisions to increase their wealth (Ibrahim and Hameed 2007).

A more practical reason for the use of AAOIFI standards versus IFRS standards is that the functions and contracts of an IFI are different from those of a conventional bank (Ibrahim and Hameed 2007). The foundation of modern banking is the advancement of loans and earning interest. As mentioned previously, interest is strictly forbidden according to Shariah. Consequently, IFIs cannot pay or receive interest and utilize different contracts which comply with Shariah, to earn profits (Ibrahim and Hameed 2007). An example of an Islamic banking product is a *Mudaraba* contract. According to the *Mudaraba* contract, the bank, in its capacity as the party which invests on behalf of the client, receives a percentage of profits only in the case of profits. In the event of losses, the bank receives no reward for its effort and the provider of funds is allocated the full loss (Ibrahim and Hameed 2007, Rahaman 2011). Investment accounts may be divided into unrestricted or restricted. In the case of *unrestricted Mudaraba*, the investment holder authorizes the bank to invest his funds in any way the bank deems fit, without any restrictions about where or how. In the case of *restricted Mudaraba*, the investment holder imposes restrictions of where, how and for what purpose his funds are to be invested (Ibrahim and Hameed 2007). Some of the accounting implications include:

(a) Unrestricted Mudaraba accounts are not liabilities but are a special class of equity.
(b) Restricted Mudaraba accounts are not assets or liabilities of the bank but are reported off balance-sheet.
(c) Because Shariah requirements, Islamic leasing contracts cannot be accounted for as a finance lease. The leased assets are recognized in the records of the bank and are not capitalized in the records of the customer. Consequently, the leased asset is depreciated in the records of the bank. This may contravene IFRS 16.
(d) Islamic insurance companies cannot follow IFRS 4 as premium contributions by policyholders belong to policyholders, not the insurance company. Subsequently, it is not included in the balance sheet of the insurance company but a separate fund accounting of the policy holders is undertaken.
(e) Certain Islamic contracts and requirements, such as leasing with gradual sale and zakah, require inventory to be valued at cash equivalent values (fair values), not the lower of cost and net realizable value as is the case with IAS 2.

Khairul Nizam, the director of technical development at AAOIFI, commented *"it is clear that gaps and differences exist and will continue to exist between the two set of standards. These gaps and differences are a natural result of the differing structural objectives of the IASB and AAOIFI. AAOIFI's mandate is to develop standards where IFRS's do not cater for the specificities of Islamic Banking or leads to Shariah compliance issues. As long as there are economic, legal and social differences between Islamic and conventional banking and finance practices, there will also be differences in the standards issued*." (Ibrahim and Hameed 2007)

2.7 Agency theory

Agency theory describes the relationship between a principal and an agent, in which the agent acts on behalf of the principal and is expected to act in the best interest of the principal (Jensen and Meckling 1979, Gibson 2000). Agency is one of the oldest forms of business relationships to exist (Ross 1973). This theory assists in indicating the usefulness of financial statements as they inform owners of the entity how effectively management have executed their roles and responsibilities (Dharwadkar, George et al. 2000). Accountability for IFIs is two-fold, firstly, being accountable to Allah for all actions as described in the previous sections, and, secondly, as the agent, accountable to the principal. The agent, being the IFI will use the resources provided to them by the principal, to invest and earn a return for the principal.

If management (the agent) and capital providers (the principal) are different, there is an increased risk that management will make decisions which further their interests as opposed to the interests of the owners (Watts and Zimmerman 1983). This is described as the agency problem (Watts and Zimmerman 1983). The agent may not always act in the best interest of the principal by not disclosing all information or by wasting resources (Eisenhardt 1989). Information asymmetry exists when the agent has more information than the principal does (Blume and Easley 1984). Information asymmetry is described as a situation in which one party has more information, or access to more useful information (Blume and Easley 1984, Healy and Palepu 2001). Within an efficient market space, management will more often than not have more information than capital providers have. This results in capital providers making inappropriate investment decisions (Healy and Palepu 2001).

The relationship between shareholders and managers of a public entity is an example of a pure agency relationship as there is separation between ownership and control (Jensen and Meckling 1976). Financial reporting is a mechanism designed to ensure that discrepancies in information between managers and shareholders is kept to a minimum (Watts and Zimmerman 1983).

When less information is disclosed, it is less likely there will be sufficient scrutiny by the agent and this increases the risk of inappropriate use of resources. In order to reduce the impact of information asymmetry, firms must make adequate disclosures in their annual reports (Gray, Meek et al. 1995, Botosan 2006). When adequate disclosures are made, it is more likely the IFI will demonstrate adequate accountability. The next section will discuss the mechanics of accountability and how this can be applied.

2.8 Accountability

Interests of a group are supported by valid organisations (Greco, Sciulli et al. 2015). In order to remain valid and legitimate, the organisation must be held accountable for its actions (Black 2008). It has been inferred that something is in the interest of the public if it has to comply with certain criteria or regulations (Sikka, Willmott et al. 1989). The degree of public interest will be measured by ascertaining to what extent the person meet those criteria or regulations (Sikka, Willmott et al. 1989). As stated previously, IFIs are accountable to stakeholders and, ultimately, to Allah (Dhai 2015, Mohammed, Fahmi et al. 2015). It is appropriate and in the public interest to measure accountability as IFIs are required to comply with an accounting framework to boost public confidence (Mohammed, Fahmi et al. 2015).

There is a need for accountability but often accountability is difficult to define and measure (Patton 1992). Audited financial reports will help to improve the accountability of an organization (Pendlebury, Jones et al. 1994). By providing decision-useful information, IFIs can demonstrate adequate and appropriate use of resources and that appropriate stewardship has been exercised. In order to provide decision-useful information, an entity must appropriately apply and fulfill the qualitative characteristics (IASB 2018, AAB 2020). The next section will discuss what the measurement criteria are for these qualitative characteristics in terms of IFRS standards and AAOIFI standards.

2.9 Qualitative characteristics of useful financial information

In April 2001, the IASB adopted its "Framework for the Preparation and Presentation of Financial Statements (IASB 2018). In March 2018, an updated "Conceptual Framework for Financial Reporting" (The Framework) was issued. The Framework states:

"The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions relating to providing resources to the entity. Those decisions involve decisions about buying, selling or holding equity and debt instruments; providing or settling loans and other forms of credit; or exercising rights to vote on, or otherwise influence, management's actions that affect the use of the entity's economic resources." (IASB 2018)

The qualitative characteristics of financial statements are those which make financial information useful. The fundamental characteristics are relevance and faithful representation. Enhancing characteristics are comparability, verifiability, timeliness and understandability (IASB 2018).

The objective of financial reporting as per the current and revised AAOIFI Conceptual Framework for Financial Reporting by IFIs is to provide useful information to users to enable them to make decisions in their dealings with IFIs (AAB 2010, AAB 2020). The qualitative characteristics of financial information are those qualities which result in useful financial information and the basic principles which should be used to evaluate such financial information. The AAOIFI Conceptual Framework identifies the following as the qualitative characteristics of accounting information; primary qualitative characteristics, relevance and faithful presentation; and, supplementary characteristics, decision usefulness, transparency, timeliness, understandability, reliability, comparability and prudence (AAB 2020). The next section of the research discusses the qualitative characteristics and the measurement criteria for these qualitative characteristics.

2.9.1 Relevance

"Relevant financial information is capable of making a difference in the decisions made by users" (IASB 2018) The ability to use historical information to predict future earnings or cash flows is known as the predictive value of information (Beest, Braam et al. 2009). There exists a trade-off from implementing historical cost versus implementing fair value accounting and this trade-off leads to a difficulty in implementing both relevant and reliable information (Johnson 2005, Whittington 2008). If information is to be useful to the users of financial statements, the information needs to be both relevant and reliable (Johnson 2005).

The focus of a set of financial statements is financial information (Jonas and Blanchet 2000). Earnings are restricted as there is less focus on non-financial information and it excludes 'future' financial information. (Jonas and Blanchet 2000). To ensure a reasonable standard and to improve the quality of this research, annual reports will be used. This improves the quality as annual reports are broader and are the primary source of financial and non-financial information (Beest, Braam et al. 2009, Padia and Yasseen 2011).

Predictive value discusses information surrounding an entity's ability to generate future cash flows. The starting point to determine the level of relevance is to ascertain whether or not the annual reports contain statements regarding future events (Beest, Braam et al. 2009). These statements are considered to be relevant as management of an entity are deemed to have more information available to them than the users of the financial statements. This is referred to as information asymmetry (Blume and Easley 1984). The predictive nature of future events is provided for the use of non-financial information (Jonas and Blanchet 2000, Beest, Braam et al. 2009). The second measure of relevance is determined through the disclosure of any opportunities or risks facing the entity (Jonas and Blanchet 2000, Beest, Braam et al. 2009). By disclosing these events, the information highlights to the users the predictive value of future events through non-financial information (Jonas and Blanchet 2000, Beest, Braam et al. 2009). The third measure of relevance is the use of fair value accounting instead of cost accounting (Beest, Braam et al. 2009). As mentioned previously, fair value accounting adds to the predictive value of information and is relevant to the users of financial statements (Whittington 2008). Information is relevant and useful if it provides the user feedback on past transactions (Jonas and Blanchet 2000). This feedback should assist the user in developing an expectation about how those transactions will affect the company (Jonas and Blanchet 2000).

The measurements are as follows:

1. R1: To what extent does the entity provide forward-looking information in order to provide reasonable expectations and predictions of the company?
2. R2: To what extent does the presence of non-financial information in terms of business opportunities and risks complement the financial information?
3. R3: To what extent does the company use fair value instead of historical cost?
4. R4: To what extent do the reported results provide feedback to users of the annual report about how various market events and significant transactions affected the company?

2.9.2 Reliability

For information to be useful, it must be reliable. Users prefer information which has a high degree of reliability because the users can act upon such information with confidence (AAB 2020). Reliability means the method chosen to measure or disclose a particular transaction or event produces information which reflects the substance of the transaction over its legal form (AAB 2020). Reliable information will contain the following characteristics and these are discussed below: faithful representation, and consequently, neutrality and substance over form.

2.9.2.1 Faithful representation

Financial information represents the economic phenomena in words and numbers, to be useful, it must not only represent the economic phenomena, but it must faithfully represent the economic substance of the transaction (IASB 2018). Faithful representation is measured using three characteristics, these being neutrality, completeness and being free from error (Beest, Braam et al. 2009).

A significant characteristic of faithful representation is to include information free from bias. To produce a set of financial statements that is completely free from error has been suggested to be impossible (Beest, Braam et al. 2009). To ensure free-from bias information, it is necessary to include a good argument for the use of a specific accounting estimate as well as a rational explanation for the use of this estimate (Beest, Braam et al. 2009). This improves the quality of a set of financial statements through a reduction in bias and, ultimately, leads to improved faithful representation of the economic phenomena (Beest, Braam et al. 2009).

The second measure of faithful representation is the measurement of the accounting policies or principles by ensuring an entity has adopted said accounting principles through appropriate rationale (Beest, Braam et al. 2009). The reasoning behind this measurement is to assess whether a knowledgeable third party selected the same accounting policies given similar facts and circumstances (Jonas and Blanchet 2000, Maines and Wahlen 2006).

The third measure of faithful representation is the determination if the entity received an unqualified audit opinion or not (Beest, Braam et al. 2009). Companies that do not obtain unqualified audit opinions often file for bankruptcy or go into liquidation (Gaeremynck and Willekens 2003). The audit report provides reasonable assurance the financial information faithfully represents the economic phenomena and gives the user confidence that the information has been faithfully represented and is reliable (Maines and Wahlen 2006, Beest, Braam et al. 2009).

The next measure of faithful representation attempts to ascertain the level of corporate governance disclosure (Beest, Braam et al. 2009). It has been suggested that poor corporate governance and poor internal controls results in poorer overall quality of financial statements (Dechow, Sloan et al. 1996, McMullen 1996). Improving corporate governance disclosures improves the faithful representation of the information (Holland 1999, Sloan 2001).

The final measure of faithful representation is an assessment of the neutrality defined as financial information without a bias (IASB 2018). Neutrality is about objectivity and balance, presenting financial information such that it is not manipulated favourably or unfavorably (Beest, Braam et al. 2009, IASB 2018). The intention is the preparer should focus on a balanced view as opposed to focusing on positive events and omitting negative events (Beest, Braam et al. 2009).

The measurements are as follows:

1. FR1: To what extent are valid arguments provided to support the decision for certain assumptions and estimates in the annual report?
2. FR2: To what extent does the company base its choice of certain accounting principles on valid arguments?
3. FR3: Which type of auditor's report is included in the annual report?
4. FR4: To what extent does the company provide information on corporate governance?
5. FR5: To what extent does the company, in the discussion of the annual results, highlight the positive events as well as the negative events?

2.9.3 Understandability

Understandability is that characteristic which enables users to understand its meaning (AAB 2020). Information should be easy to classified, characterized and presented clearly and concisely if it is to be understandable (Beest, Braam et al. 2009). Accounting information included in annual reports is often difficult to understand (Jones and Shoemaker 1994). It is imperative that entities prepare their annual reports in a fashion as easy to understand as possible (Jones and Shoemaker 1994). A measure for understandable financial information is how well such information is organized (Jonas and Blanchet 2000). To improve understandability, information should be easy to locate (Jonas and Blanchet 2000). Note disclosures that provide additional information and expand on the financial information provided in the statement of financial position and statement of profit and loss and other comprehensive income add to the understandability of the financial information. A second measure of understandability is how well the notes to the financial statements are organized (Beretta and Bozzolan 2004, Iu and Clowes 2004).

There are various users of financial statements and stakeholder's needs are different. This is especially true with respect to an increased emphasis on environmental, social and governance issues (Cook and Sutton 1995, Holt, Yasseen et al. 2015). To address this need, companies include more information and the level of complexity of information presented has increased; such reports are becoming increasingly difficult to read (Rezaee and Porter 1993, Frownfelter-Lohrke and Fulkerson 2001, Dilla and Janvrin 2010). Financial statements with complex data and reading create a challenge in understanding the information presented (Saad, Yahya et al. 2011). Increased usage of narratives is being used to allow for simplified reports and easier understanding (Rentz 1992, David 2001). There is a noticeable increase in the use of visual content in corporate reporting (Beattie and Jones 1997, Beattie, Dhanani et al. 2008, Ditlevsen 2012). Entities are using more visual content to disclose important corporate information (Havemo

2018). Users tend to find the financial section of annual reports too technical (David 2001). Graphs and tables are used to display numerical information (Chan 2001). There is strong support for the view that graphs are a better medium than tables in cases where the amount of information is not substantial (Beattie and Jones 1994). In recent years, the advent of information and graphic technologies has resulted in graphs becoming more popular and are commonly adopted as inexpensive decision aids (Chan 2001).

Graphs are a visual display of quantitative data (Guddal 2016). Graphs are a mechanism for visually communicating statistical data and relationships using the presentation of symbols, words and numbers (Isa 2006). Different types of graphs exist. Bar, column, pie and line charts; each better suited than the next for certain types of data (Guddal 2016). Graphs are superior to alternatives such as tables when highlighting trends and relations between different values (Vessey and Galletta 1991).

When used appropriately, graphs improve understandability; the visual element focuses and attracts the user's attention, highlights patterns and trends, assists memory recall and breaks down language barriers (Courtis 1997, Douglis 2000). The usage of graphs assists users in identifying financial trends. The reason for this is the graphical presentation of numerical data assists users to observe the trend and draw attention to important data (Coles 1997). Graphs assist the user to pay attention to one issue at a time and due to the large quantity of information included in the financial statements, users tend to place reliance on information presented visually and graphically to make decisions (Courtis 1997, Guddal 2016) . To improve the understandability of information, qualitative characteristics provided for an explanation to support any other information should be included as well (Beest, Braam et al. 2009). The presence of tables and graphs improves the understandability by clarifying relationships and summarizing information (Jonas and Blanchet 2000). As a result, the third measure of understandability is the extent of graphs and tables in the financial statements.

The language used in the financial statements must be simple and easy to understand to aid in the understandability (Courtis 1995). The next measure of understandability is the use of technical language and jargon. If the financial statements contain terminology that is difficult to understand, or industry jargon, to improve understandability, a glossary of terms must be included (Beest, Braam et al. 2009). The final measure of understandability is the length of the glossary.

The measurements are the following:

1. U1: To what extent is the annual report presented in a well organized manner?
2. U2: To what extent are the notes to the financial statements presented in a clear manner?
3. U3: To what extent does the presence of graphs and tables clarify the presented information?
4. U4: To what extent is the use of language and technical jargon in the annual report easy to follow?
5. U5: What is the size of the glossary?

2.9.4 Comparability

Users make decisions by choosing where to direct their resources. It follows then that information is more useful if it can be compared with other entities within the same sector (IASB 2018). Comparability is that qualitative characteristic which enables the user to identify similarities and differences in financial information between different entities as well as differences in performance of the same entity over a period of time (IASB 2018, AAB 2020). Comparability allows users to benchmark the performance of an entity against itself and against the industry. The usefulness, is therefore enhanced by such comparisons (AAB 2010).

Because of the lack of consistency among different countries in respect of the implementation of various principles and methods it has been argued that comparability is difficult to implement (Barlev and Haddad 2007).

Accounting policies and accounting estimates may change because of a more appropriate accounting measure or because of changes in legislation and rules (Beest, Braam et al. 2009). A change in accounting policy or accounting estimate affects the comparability of financial information and an appropriate measure is to assess the explanation of the implications of a change in accounting policy or the revision in an accounting estimate (Beest, Braam et al. 2009). If a change in accounting policy or a revision in accounting estimate arises, an entity can choose to disclose the effects of the change or revision on prior period results to assist the user to identify the effects these changes have on the financial information (Beest, Braam et al. 2009). Consistency refers to using the same accounting principles for the same items with the intention of producing financial information which can be compared with previous periods, or with different entities within the same sector (IASB 2018). Comparability with other companies within the same sector should be assessed by reviewing the general structure of the annual report, the consistency of accounting policies and the general explanations offered in the annual report (Jonas and Blanchet 2000). An assessment of the various financial ratios computed and presented in the annual report will also assist the user in making meaningful, decision-useful comparisons between companies (Beest, Braam et al. 2009).

The measurements are the following:

1. C1: To what extent do the notes to changes in accounting policies explain the implications of the change?
2. C2: To what extent do the notes to revisions in accounting estimates and judgements explain the implications of the revision?
3. C3: To what extent did the company adjust previous accounting period's figures, for the effect of the implementation of a change in accounting policy or revisions in accounting estimates?
4. C4: To what extent is the information in the annual report comparable to information provided by other organizations?
5. C5: To what extent does the company present financial index numbers and ratios in the annual report?

2.9.5 Timeliness

Timeliness refers to having information available for users in time to be able of making relevant decisions before it loses its capacity to influence decisions (IASB 2018, AAB 2020). Generally, if information is late, it will lose its relevance (IASB 2018). Timeliness considers two factors: firstly, the frequency of financial statements issued by the entity, with the implication the longer the period for which financial statements are prepared, the less useful the information contained therein (AAB 2020). Secondly, the time between the end of the period and the date the financial statements are issued (AAB 2020). Obaidat (2007) concludes that, from an investor's perspective, timeliness is the most important qualitative characteristc. A lag between the end of a period and the date the financial statements are issued is acceptable according to Dimi, Padia et al. (2014), although, the earlier the financial information is released, the more useful the information will be (Dimi, Padia et al. 2014).The measurement for timeliness is a natural logarithm of the number of days from the end of the period to the date the audit report is signed.

2.9.6 Constraints on useful financial reporting

Reporting financial information imposes costs. It is important that the entity finds the balance between these costs and the benefit of such financial reporting (IASB 2018). An assessment must be carried out whether the benefits of reporting particular information are likely to justify the costs incurred to provide and use that information (IASB 2018).

2.10 Summary

Islamic finance is one of the fastest growing segments of the international financial system (Folio 2017, Ismail and Sori 2017). IFIs today are not only operating and competing against conventional banks in Muslim countries, but also in Western countries where conventional banks have ventured into the market (Mohammed, Fahmi et al. 2015). The study performed by Mohammed, Fahmi et al. (2015) concludes that although there is feasibility in IFRS reporting IFIs, there is greater emphasis on the spirit of Islam based on Islamic contracts. This chapter demonstrates there is a need for effective accountability to be demonstrated by IFIs. By providing decision useful financial information this can be achieved.

There are challenges in applying IFRS for IFIs as a result of the nature of IFIs. The AAOIFI was established in 1991 with the primary responsibility being the development and issuance of standards for the global Islamic finance industry (AAOIFI 2018). Although differences between the Conceptual Framework issued by the IASB and the Conceptual Framework issued by the AAB exist, the frameworks are underpinned by similar qualitative characteristics of decision useful information, namely, relevance, reliability, faithful representation, understandability, comparability and timeliness. Below is a table comparing the differences between the IFRS Conceptual Framework and the AAOIFI Conceptual Framework.

Table 1: Differences between the IFRS Conceptual Framework and the AAOIFI Conceptual Framework

	IFRS	**AAOIFI**
Users of financial statements	Existing and potential investors, lenders and other creditors.	Primary – existing and potential investors. Secondary – debtors, employees, regulators and other government agencies.
Information needs of users	Rely on financial statements to make decisions relating to providing resources to the entity.	Information which: a) Establishes compliance with Sharia

		b) Will assist the user in evaluating risks c) Will assist in assessing management and consumption of economic resources. d) Will assist employees in evaluating their relationship with the IFI.
Emphasis on specific matters	None	Specific emphasis on compliance with Shariah principles.
Objectives of financial reporting		Geared towards fulfilling the Shariah principles. Split into (i) objectives of financial accounting and reporting; and (ii) objectives of general-purpose financial statements.
Ideology underpinning the framework	Capitalist ideology	Accountability together with Shariah compliance
Applicability	Broad and general, applicable to most industries	Islamic Financial Institutions.

Chapter 3: Research methodology

The study made use of a descriptive, quantitative research methodology. Quantitative, as the name suggests, implies using numerical data so that statistical processes can be applied (Gunnel 2016). Quantitative research uses measureable data to formulate facts and uncover patterns (DeFranzo 2011). Descriptive research involves identifying the characteristics of an existing theory: that means, the researcher examined phenomena as it is (Leedy and Ormrod 2015). The study used descriptive statistics to describe the data collected (Leedy and Ormrod 2015). The central points of tendency were estimated by calculating the mean, median and mode (Leedy and Ormrod 2015). These statistical measures were calculated for IFIs using AAOIFI standards and those using IFRS standards. The mean score demonstrates to what extent do IFI's financial statements display useful information. Standard deviation represents the dispersion and variability in the scores obtained (Leedy and Ormrod 2015). The data were graphically depicted to look for outliers and assess reasonableness.

3.1 Overview of method

Beest, Braam et al. (2009) conducted a study which assessed 231 public companies listed at US, UK and Dutch stock exchanges in an attempt to assess the quality of financial reporting in terms of the underlying fundamental and enhancing qualitative characteristics. The study conducted by Beest, Braam et al. (2009) produced a 21-item index against which the qualitative characteristics of financial statements were scored. This study used the same 21-item index developed by Beest, Braam et al. (2009) to assess the extent to which IFI's financial statements are representing the characteristics of useful decision making information. The annual reports of IFIs were thoroughly reviewed and scored against the index. Refer to Annexure A for the entire index.

3.2 Research population and sample

Table 1 below lists the countries with the highest percentage of the world's Shariah compliant assets. Malaysia, Turkey, Pakistan and Indonesia exert compliance with a local GAAP and will not be included in this study. Local GAAP has been ignored as this is not relevant for this study which compares IFRS and AAOIFI only. The population consists of IFIs in the countries listed in Table 1 and which prepare financial statements in compliance with either IFRS or AAOIFI. Challenges for a study of IFIs is that IFIs are primarily concentrated in the Middle East and Asia, therefore, there is a risk annual reports will not be available in English. To counter these risks, the researcher selected samples using a purposive sampling technique. Using a purposive sampling technique entails choosing samples on a non-probability basis. The sampling only considered publicly available financial statements in English, resulting in a sample of 83 IFIs. The sample of 83 companies was selected from the countries in Table 1, limited to 21 IFIs per country. Of the 83 IFIs, 53 applied IFRS and 30 applied AAOIFI. Please refer to Appendix B for the complete list of the sample.

Table 2: List of countries with the highest percentage of the world's Shariah compliant assets

Country	**Percentage of the world's Shariah compliant assets**	**Accounting framework applied**
Saudi Arabia	31.7%	IFRS and AAOIFI
Malaysia	16.7%	Local GAAP
UAE	14.6%	IFRS
Kuwait	10.6%	IFRS and AAOIFI
Qatar	7.7%	IFRS and AAOIFI
Turkey	5.8%	Local GAAP
Indonesia	3.8%	Local GAAP
Bahrain	1.7%	IFRS and AAOIFI
Pakistan	1.2%	Local GAAP
UK	<1%	IFRS
Jordan	<1%	IFRS and AAOIFI
Bosnia	<1%	IFRS
Bahamas	<1%	IFRS
South Africa	<1%	IFRS
Oman	<1%	IFRS and AAOIFI
Kazakhstan	<1%	IFRS
Sudan	<1%	AAOIFI

Source: Hirst (2015)

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3.3 Sources collection of data

The source documents used in the research were obtained from the publicly available annual reports as published on the respective IFIs' websites.

3.4 Data capturing

An electronic version of the annual report for each IFI for the year ending 2017 was obtained from the respective IFI's website. In order to keep track of the data which were collected, an Excel spreadsheet was maintained. The sample was split between IFIs which apply AAOIFI standards and those which apply IFRS. The information recorded for each IFI selected included the name, the country the IFI is headquartered in, the year-end of the entity and the name of the IFI's independent auditor. A comprehensive evaluation of the annual report was carried out and detailed rules were followed to ensure a consistent and objective evaluation. In order to improve the comprehensiveness of the measurement tool, this study considered the full annual report including the director's report, the chairman's report, financial highlights, corporate governance report, risk management report, the auditor's report, the financial statements and notes to the financial statements.

This study used the 21-item index developed by Beest, Braam et al. (2009). The 21-item index developed by Beest et al. (2009) was developed with reference to the IASB's conceptual framework and used to assess the extent to which IFRS financial statements are displaying the characteristics of useful information. The 21-item index is appropriate for this study as this study assessed IFI's financial statements prepared using IFRS and AAOIFI standards. The use of the same 21-item index to assess IFI's financial statements prepared using AAOIFI standards is appropriate as the AAOIFI conceptual framework is underpinned by the same fundamental qualitative characteristics as the IASB's conceptual framework and similar enhancing qualitative characteristics. Refer to Section 2.9 in this regard.

Using the index in Annexure A, each aspect of the qualitative characteristics as listed in the data collection tool, the researcher reviewed the company's financial statements and scored each item. The scoring used a 5-point Likert scale where each item was awarded a score out of 5, with 1 being the lowest fulfilment of the criteria and 5 being the highest fulfilment of the criteria, except for timeliness in which case the inverse is true. The 21-item index is provided in Appendix A and provides an insight into the items used to operationalize the qualitative characteristics. Appendix A also includes the measurement scales used to assess the value of each item. For example, U4 assesses the level of technical jargon – if there is no explanation of technical jargon when used, a score of 1 was recorded. If there is minimal explanation with much jargon, a score of 2 was recorded. If there is jargon present, but explained in a text or glossary, a score of 3 was recorded. If there is minimal jargon or jargon that is well explained, a score of 4 was recorded. If there is no jargon or very comprehensive explanation, a score of 5 is recorded.

C1 assesses the explanation of the implications of a change in accounting policy – if changes are not explained, a score of 1 is recorded. If there is a very comprehensive explanation or there is no change in accounting policy, a score of 5 is recorded. Please refer to Appendix A for a full explanation of the measurement scales used to assess the value of each item. Please refer to appendix C for illustrative examples of the Likert scale. Each item was provided with equal weighting. The purpose of this is to ensure subjective judgements are kept as low as possible. To ensure consistency during the scoring process, the same rating measurement for each criterion was applied to each annual financial statement. The full set of financial statements, including the annual report was considered and read through to score the respective items. A mean score (out of 5) for each item was calculated by adding the scores of each IFI and dividing by the number of IFIs.

A mean score (out of 5) for each qualitative characteristics was calculated by adding the scores of each item and dividing by the number of items. By following this approach, each measurement criterion for each qualitative characteristic has an equal weighting and consequently subjective judgements will be kept to a minimum. Scoring was tracked using a Microsoft Excel spreadsheet.

3.5 Data analysis

The data were analysed using a descriptive analysis technique. The descriptive analysis indicates to what extent IFIs' financial statements reflect the qualitative characteristics of useful financial information. The data analysis produced the mean, standard deviation, minimum, maximum and mode of the scores of each IFI. The mean is the sum of scores divided by the number of scores (Leedy and Ormrod 2015). The mean score demonstrates to what extent the IFIs' financial statements represent useful information. Standard deviation is the variability in the scores obtained (Leedy and Ormrod 2015). The mode is the most common score obtained (Leedy and Ormrod 2015). The standard deviation, minimum and maximum mode compares how the IFIs fair in relation to each other.

3.7 Hypothesis testing

A Shapiro-Wilk test was undertaken to determine if the data are parametric or non-parametric. As the data were non-parametric and the data satisfy the assumptions for the Mann Whitney U test below, a Mann-Whitney U test was performed in order to assess if there is a significant difference between the quality of financial statements of IFIs between those prepared using AAOIFI standards and those prepared using IFRS standards.

Assumptions for the Mann Whitney U test include the following:

- The dependent variable should be measured on an ordinal scale or a continuous scale.
- The independent variable should be two independent, categorical groups.
- Observations should be independent, that is, there should be no relationship between the two groups or within each group.
- Observations are not normally distributed. However, they should follow the same shape (i.e. both are bell-shaped or skewed left) (Glen 2015).

Each measure or criterion to test the qualitative characteristics of the financial statements will be compared between those prepared using AAOIFI standards and those prepared using IFRS standards. Hypothesis testing for each criterion will be fairly similar. The test can be done separately for each, or all factors combined. The result will be the same, therefore, the combined approach will be adopted.

For each of the factors in this study, the following hypothesis will be tested:

H_0 – There is no statistically significant difference between the scores for those IFIs applying IFRS and those applying AAOIFI.

H_1 – There is a statistically significant difference between the scores for those IFIs applying IFRS and those applying AAOIFI.

The probability that the null hypothesis will be rejected increases the lower the p-value. The level of statistical significance will be 5%. If the p-value is less than the confidence level of 0.05, then the null hypothesis will be rejected and it can be concluded that there is a significant difference in the quality of financial reporting of IFIs between AAOIFI standards and IFRS standards.

3.8 Validity

3.8.1 Internal Validity

Internal validity refers to the manner in which the design and data used in a study will allow accurate conclusions to be drawn regarding cause and effect relationships within the data (Leedy and Ormrod 2015). The study is a replication of a study performed by Beest, Braam et al. (2009) which improves the reliability of the study. The method is valid as it has been used by other researchers for similar types of studies (Padia and Yasseen 2011, Holt, Yasseen et al. 2015, Phala 2016, Surty, Yasseen et al. 2018). The method replicated in this study was tested for internal validity in the original study mentioned above. There are limited studies which attempt to operationalise the qualitative characteristics. Studies performed by Tasios and Bekiaris (2012) and Mbobo and Ekpo (2016) operationalise the qualitative characteristics using questionaires patterned on the model developed by Beest, Braam et al. (2009).

3.8.2 External Validity

External validity is the extent to which the results of research can be generalised to make predictions about the entire population (Shuttleworth 2009). External validity was achieved as the sample size selected was appropriate and selected from countries with the highest percentage of the world's shariah compliant assets.

3.8.3 Content Validity

The third measure of validity is content validity (Heale and Twycross 2015). Content validity measures whether the data collection instrument covers all the content needed in order to meet the objectives of the study The study by Beest, Braam et al. (2009) determined the data collection tool as appropriate. This study is a replication of the study performed by (Beest, Braam et al. 2009) and has similarly determined the data collection tool to be appropriate. By utilizing an appropriate score card, subjectivity is reduced.

3.9 Reliability

The study was completed using audited financial statements. As these financial statements were issued by independent audit firms in terms of International Standards on Auditing (ISAs), there is reasonable assurance that the information presented is free from material error. The information can be relied upon.

The data were first tested for reliability using the Cronbach Alpha measure. For the purposes of this test, the AAIOFI and IFRS samples were combined. A Cronbach Alpha measure of greater than 0.7 will need to be obtained in order for the data to be considered acceptable. Cronbach's alpha is a measure of internal consistency, or "reliability" (Glen 2014). Cronbach's alpha is commonly used for multiple Likert questions in a survey and to test if the scale used is reliable (Glen 2014). An alpha value of 0.841 was calculated. This indicates that the results collected are "Good". In addition, the total items statistics table (Table 1) indicates that if any of the rating criteria were removed, the value calculated for alpha would not change to a different level of acceptance. It will remain in the range of 0.9 > a >= 0.8; this indicates the internal consistency is good and the data are acceptable.

Table 3: Total Item Statistics

Item-Total Statistics					
	Scale Mean if Item Deleted	Scale Variance if Item Deleted	Corrected Item-Total Correlation	Squared Multiple Correlation	Cronbach's Alpha if Item Deleted
R1	65.58	88.491	.572	.687	.827
R2	64.61	80.606	.764	.815	.813
R3	65.94	103.252	-.092	.275	.847
R4	65.18	84.516	.760	.805	.816
FR1	64.78	97.099	.295	.455	.839
FR2	64.70	95.847	.472	.554	.834
FR3	63.20	100.555	.208	.240	.841
FR4	64.48	79.131	.666	.700	.821
FR5	64.73	97.173	.316	.548	.838

U1	64.31	89.267	.641	.646	.824
U2	64.27	93.734	.636	.679	.829
U3	65.53	82.813	.578	.608	.827
U4	64.49	96.814	.310	.796	.839
U5	65.05	96.315	.232	.809	.843
C1	63.34	103.153	-.073	.751	.849
C2	65.12	100.595	.272	.243	.841
C3	63.51	105.033	-.173	.733	.857
C4	65.39	93.093	.441	.474	.833
C5	64.57	92.907	.601	.629	.829
C6	65.51	87.351	.612	.582	.824

In order to keep the subjective nature of the scoring to a minimum, the following controls were introduced. The researcher scored five annual financial statements, rested for a bit, and re-scored those same five annual reports. No differences were noted. This reduced objectivity concerns and ensured the data is consistent. Furthermore, a sample of the annual financial statements was analysed by a separate researcher. No significant differences were noted. All the annual financial statements scored in this study were scored by the same researcher. This reduced subjectivity and reduced the risk of having a material impact on the findings to an acceptable manner.

Chapter 4: Data analysis

4.1 Introduction

The purpose of this study is to assess to what extent IFI's financial statements reflect the qualitative characteristics of useful financial information and to assess if there is a significant difference in the score of IFIs applying IFRS and AAOIFI in respect of their application of the qualitative characteristics of useful financial information. This chapter will analyse, in detail the results obtained for each qualitative characteristic as per the Conceptual Framework issued by the IASB and the Conceptual Framework issued by AAOIFI. The results are reliable and valid due to the results being similar to the previous research on which this research relied upon.

4.2 Relevance

The first measure of relevance **R1**, measures the extent of forward looking information included in the financial statements. The mean scores for IFRS[3] application and AAOIFI[4] application are 2.64 and 2.37 respectively (see table 2). This score is between 2 and 3. A score of 2 indicates forward looking information is present, but there is no separate subsection for the forward looking information while a score of 3 indicates the inclusion of a general separate subsection with forward looking information. This indicates, on average IFIs include forward looking information, although not necessarily under a separate subsection. The median score for IFIs applying IFRS is 3 whilst those which apply AAOFI is 2. The mode for IFRS and AAOFI is 2 and 3 respectively. The lowest score awarded for IFRS and AAOIFI is 1 while the maximum for IFRS application is 5 and AAOFI application is 4 which indicates at least one IFRS compliant entity and one AAOIFI compliant entity have no forward looking information.

R2 measures the extent of non-financial information in relation to business opportunities and risks disclosed in the financial statements. The mean score for IFRS and AAOFI is 3.45 and 3.6 respectively. The median for IFRS and AAOFI is 4; while the mode for IFRS and AAOIFI is 5. This indicates that most IFIs achieved a score of 5. A score of 5 indicates non-financial information presents additional information which helps developing expectations. The minimum score awarded for IFRS and AAOFI is 1 and the highest score awarded is 5.

[3] Any reference to IFRS refers to IFI's which apply IFRS

[4] Any reference to AAOIFI refers to IFI's which apply AAOIFI

An information need of users of AAOIFI prepared financial statements is the provision of sufficient information to enable the user to determine the IFI's level of compliance with Shariah principles. This is consequently an objective of general purpose financial statements as per the AAOIFI Conceptual Framework. It follows then, that it is expected IFI financial statements prepared using AAOIFI standards will disclose more non-financial information about the IFI's business activities than IFI financial statements prepared using IFRS standards.

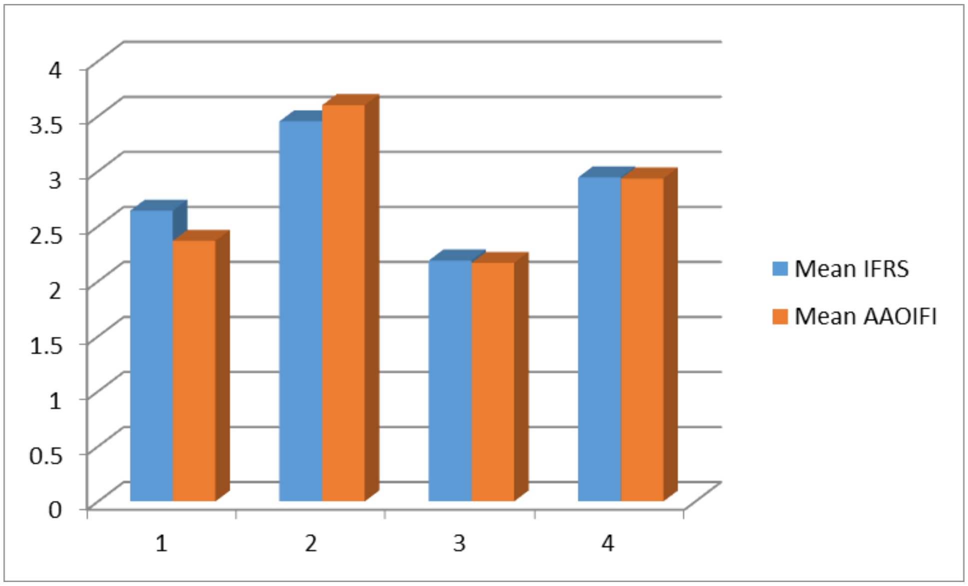
R3 measures the extent the entity uses fair value accounting instead of historical cost. The scores obtained for IFRS and AAOFI were very similar. The mean score for IFRS and AAOFI is 2.19 and 2.16 respectively. This indicates most IFIs apply more historical cost accounting than of fair value accounting. The median, mode and minimum score obtained for IFRS and AAOIFI is 2. The maximum score for IFRS and AAOIFI is 4. This indicates none of the IFIs sampled only apply fair value accounting.

The final criterion for relevance that was measured is **R4**. **R4** measures the extent to which an entity's annual report provides valuable feedback to users about how various market events and significant transactions affected the company. The results between IFRS and AAOFI are similar. The mean score for IFRS and AAOIFI is 2.94 and 2.93 respectively. The median and mode for IFRS and AAOIFI is 3. This indicates most entities include feedback of some sort. The minimum score awarded for IFRS and AAOIFI is 1 and the maximum score awarded for IFRS and AAOIFI is 5 , indicating two opposite ends of the spectrum, i.e. no feedback present and comprehensive feedback present.

Table 4: Results for relevance

Qualitative Characteristic	Mean		Standard Deviation		Median		Mode		Min		Max	
Relevance	**IFRS**	**AAOIFI**	**IFRS**	**AAOIFI**	**IFRS**	**AAOIFI**	**IFRS**	**AAOIFI**	**IFRS**	**AAOIFI**	**IFRS**	**AAOIFI**
R1	2.641509	2.366667	1.272404	0.999425	3	2	2	3	1	1	5	4
R2	3.45283	3.6	1.448687	1.476249	4	4	5	5	1	1	5	5
R3	2.188679	2.166667	0.441004	0.461133	2	2	2	2	2	2	4	4
R4	2.943396	2.933333	1.150503	1.284747	3	3	3	3	1	1	5	5

Graph 1: Comparison between IFRS and AAOIFI in terms of relevance



The results for relevance were positive with the exception of **R3.** This most likely stems from the choice allowed by IFRS and AAOIFI standards between the use of historical cost and fair value accounting; given cost implications, entities are likely to opt for the former.

The mean score calculated overall for entities applying IFRS is 2.8 (calculated from table 2) and the mean score calculated overall for entities applying AAOIFI is 2.77 (calculated from table 2). This indicates a relatively mediocre result for the relevance criterion. While IFIs appear to have a general understanding and awareness of these requirements, they have not as yet embraced these principles fully in their financial statements. A brief review of the preparers of the AAOIFI financial statements indicate many of the prepares have a background in IFRS. This suggests a possible reason for the insignificant difference in the mean scores between IFRS and AAOIFI. A visual comparison of mean scores obtained for measures **R1, R2, R3** and **R4** indicates a fairly similar value range between those IFIs that apply IFRS and those IFIs that apply AAOIFI (see graph 1). There is no significant difference in the score of IFIs applying IFRS and IFIs applying AAOIFI in respect of the relevance qualitative characteristic.

4.4 Faithful representation

The first measure of faithful representation **F1**, measures the extent of valid arguments provided to support the decision for certain assumptions and estimates in the financial statements. The mean scores obtained for IFRS[5] and AAOIFI[6] are 3.5 and 3.03 respectively. This indicates the average entity provides at least specific explanation of estimations. The median and mode for IFRS and AAOIFI is 4 and 3 respectively. The minimum score for an entity applying IFRS is 2, whereas the minimum score for an entity applying AAOIFI is 1, which indicates at least one entity only described estimates. The maximum score for IFRS and AAOIFI is 5, indicating at least one entity provided comprehensive argumentation.

F2 analysed the extent of which an entity bases its choice of certain accounting principles on valid arguments. The mean score for those IFIs applying IFRS and those applying AAOIFI are 3.49 and 3.3 respectively. This indicates, on average, most IFIs will explain the rationale behind a certain accounting policy choice. The median and mode of IFRS and AAOIFI is 3. The minimum and maximum scores for IFRS and AAOIFI are 2 and 5 respectively, indicating at least one IFI included a comprehensive explanation of its choice of accounting policy.

F3 measured the type of audit report included in the IFIs financial statements. The mean scores of IFRS entities is 4.9 while AAOIFI entities score is 4.93. The scores for **F3** are very positive and provide reasonable assurance that the vast majority of financial statements are free from material misstatement. This increases the perception of faithfully represented financial information. The median, mode and maximum of IFRS and AAOIFI is 5. This indicates most IFIs included an unqualified opinion on the financial statements and related notes. The minimum scores for IFRS and AAOIFI are 2 and 3 respectively. This indicates none of the sampled IFIs included an adverse opinion.

F4 measures the extent of information on corporate governance provided. The mean scores for IFRS and AAOIFI are 3.68 and 3.56 respectively. The median, mode and maximum for IFRS and AAOIFI are 5. This indicates a high degree of information on corporate governance with most IFIs sampled including a comprehensive description of corporate governance. The minimum for IFRS and AAOIFI is 1 indicating at least one IFI did not provide any information on corporate governance.

The final measure of faithful representation is **F5**. **F5** measures the extent of the discussion of positive and negative events affecting the entity. The mean score of IFRS is 3.41 and the mean score of AAOIFI is 3.33. The median and mode for IFRS and AAOIFI is 3. This indicates, on average, IFIs emphasize positive events but mention negative events or no negative events

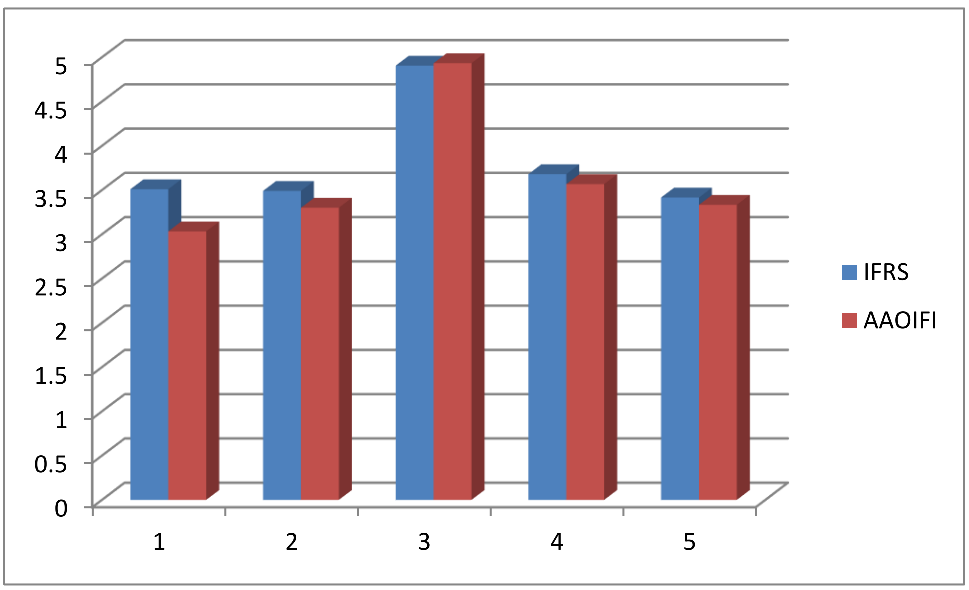
[5] Any reference to IFRS refers to IFI's which apply IFRS
[6] Any reference to AAOIFI refers to IFI's which apply AAOIFI

occurred. The minimum for IFRS and AAOIFI is 2 while the maximum score for those entities applying IFRS and those entities applying AAOIFI is 5, indicating, that apart from positive and negative event disclosure, the impact of positive and negative events is also explained.

Table 5: Results for faithful representation

Qualitative Characteristic	Mean		Standard Deviation		Median		Mode		Min		Max	
Faithful Representation	IFRS	AAOIFI	IFRS	AAOIFI	IFRS	AAOIFI	IFRS	AAOIFI	IFRS	AAOIFI	IFRS	AAOIFI
F1	3.509434	3.033333	0.723842	0.927857	4	3	4	3	2	1	5	5
F2	3.490566	3.3	0.668599	0.702213	3	3	3	3	2	2	5	5
F3	4.90566	4.933333	0.490845	0.365148	5	5	5	5	2	3	5	5
F4	3.679245	3.566667	1.69585	1.813424	5	5	5	5	1	1	5	5
F5	3.415094	3.333333	0.745085	0.844182	3	3	3	3	2	2	5	5

Graph 2: Comparison between IFRS and AAOIFI in terms of faithful representation



The overall mean score calculated for faithful representation for IFIs applying IFRS is 3.8 and the mean score for IFIs applying AAOIFI is 3.63. This is in line with the study performed by Haarburger, Yasseen et al. (2020), whereby South African entities mean score was 3.91 and the study performed by Beest, Braam et al. (2009), whereby IFRS applying entities obtained a mean score of 3.8. This indicates a relatively high application of the qualitative characteristic of faithful representation and the financial statements of IFIs appear to represent the economic phenomena of the entity concerned faithfully. A visual comparison of the mean scores for **F1, F2, F3, F4** and

F5 indicates a relatively similar or equal value between IFIs applying IFRS and those applying AAOIFI (see graph 2). This indicates no significant difference in the score of IFIs applying IFRS and IFIs applying AAOIFI in respect of the qualitative characteristic of faithful representation exists.

In terms of the faithful representation qualitative characteristic, overall, IFI financial statements prepared using IFRS standards fared better compared to IFI financial statements prepared using AAOIFI standards. Two key differences between the two frameworks are information which proves the level of compliance of the respective IFI with Shariah principles and information which will assist employees of the respective IFI in evaluating their relationship and future with the entity. The information disclosed in financial statements prepared using AAOIFI standards is likely geared towards satisfying these information needs, which is a possible reason for financial statements prepared using IFRS standards faring better in terms of the faithful representation qualitative characteristic.

4.5 Understandability

U1, the first measure in the understandability criterion measures how well the annual report is presented in an organized manner. The mean scores for IFRS[7] and AAOIFI[8] are 3.96 and 3.53 respectively. This indicates on average, IFIs financial statements are presented in a fairly good manner, including a complete table of contents, headings, a summary at the end of each subsection and overall, general good flow of information. The median for IFRS and AAOIFI is 4. The mode for IFRS is 5 and 4 for AAOIFI. This suggests a marginally better scoring for IFRS IFIs versus AAOIFI IFIs. The minimum for IFRS and AAOIFI is 2 and the maximum is 5, indicating at least one IFI within each subset is poorly presented in an organized manner.

U2 measures the extent the notes to the financial statements are presented in a clear manner. The median for IFRS and AAOIFI is 3.87 and 3.83 respectively. This score leans toward a rating of 4, which indicates the terms used in the notes, such as various assumptions are explained. The median and mode for IFRS and AAOIFI are 4. The minimum score for IFRS is 3 and the minimum score for AAOIFI is 2. The maximum for IFRS and AAOIFI is 5 which suggests a high level of clear presentation through explanation of all difficult concepts.

[7] Any reference to IFRS refers to IFI's which apply IFRS
[8] Any reference to AAOIFI refers to IFI's which apply AAOIFI

U3 measures the number of graphs used to clarify information. The mean score for IFRS and AAOIFI IFIs is 2.68 and 2.43 respectively. The scores obtained for this criterion are negative. On average, the IFIs scored include 3 or fewer graphs to present information. The median score for IFRS is 3 and for AAOFI is 1**.** The mode and minimum score for IFRS and AAOIFI is 1. This indicates most IFIs scored do not include any graphical representation of data. The maximum score for IFRS and AAOIFI is 5. Graphs improve understanding and the visual element assists users to interpret the information presented. Graphs highlight patterns, trends and break down language barriers (Courtis 1997).

U4 measures the extent of industry jargon used in the report and the easiness of understanding this jargon. This criterion fared better than U3, with a mean score of 3.57 for IFRS and 3.73 for AAOIFI. The median for IFRS is 3, whilst the median for AAOIFI is 4. The mode for IFRS and AAOIFI is 3. The minimum score for IFRS is 3 and AAOIFI is 2. The maximum for IFRS and AAOIFI is 5. The results suggest, on average, jargon is explained in a text or glossary and the explanations lean towards being well explained. The lowest score of 2 for an AAOIFI entity implies minimal explanation was given. The maximum score of 5 indicates extraordinary explanation for jargon.

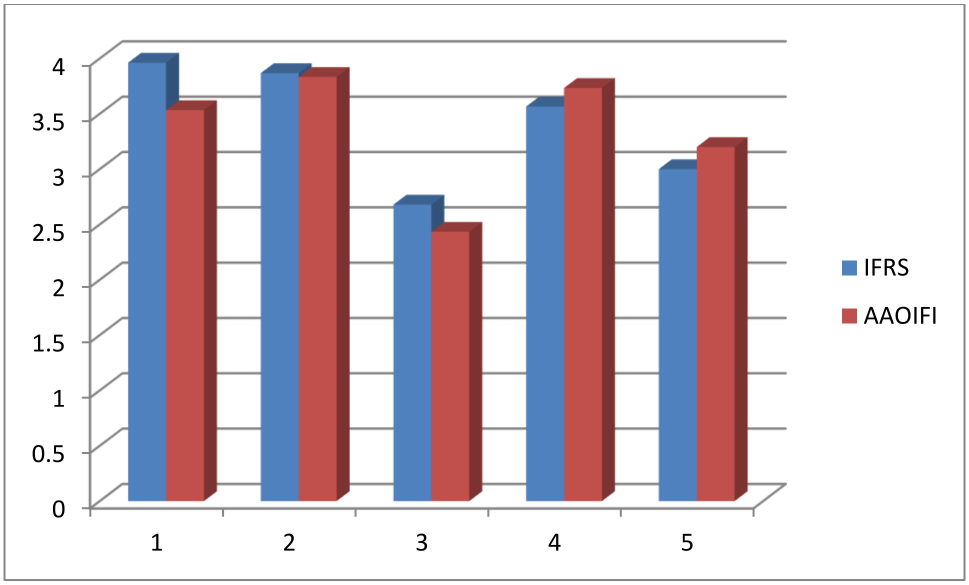
U5 measures the length of the glossary. The mean score for IFRS and AAOIFI is 3 and 3.2 respectively. The median score is 3, the mode is 2 and the maximum is 5. The minimum score for IFRS and AAOIFI is 2 and 1 respectively. These results indicate the length of the glossary is usually no more than one page refer o table 4).

The overall score obtained for understandability is 3.41. This score is in line with similar studies: Beest, Braam et al. (2009) obtained a score of 3.34 for understandability. In conclusion, the understandability of IFIs financial statements is satisfactory. Jargon is present, which makes the financial statements difficult to understand, however, this is mitigated through the use of graphs and glossaries.

Table 6: Results for understandability

Qualitative Characteristic	Mean		Standard Deviation		Median		Mode		Min		Max	
Understandability	IFRS	AAOIFI	IFRS	AAOIFI	IFRS	AAOIFI	IFRS	AAOIFI	IFRS	AAOIFI	IFRS	AAOIFI
U1	3.962264	3.533333	0.919077	1.136642	4	4	5	4	2	2	5	5
U2	3.867925	3.833333	0.708132	0.647719	4	4	4	4	3	2	5	5
U3	2.679245	2.433333	1.649867	1.612095	3	1	1	1	1	1	5	5
U4	3.566038	3.733333	0.747031	0.980265	3	4	3	3	3	2	5	5
U5	3	3.2	1.091928	1.15669	3	3	2	2	2	1	5	5

Graph 3: Comparison between IFRS and AAOIFI in terms of understandability.



The overall mean score obtained for understandability for IFIs that apply IFRS is 3.41 and the overall score obtained for IFIs that apply AAOIFI standards is 3.34. This score is in line with similar studies, (Beest, Braam et al. 2009) obtained a score of 3.48 for understandability. The slightly higher mean score for IFRS vs AAOIFI may be as a result of IFRS being the more dominant framework applied. IFRS has been applied for a longer time period improving on the understandability.The mean scores obtained for IFIs indicates the application of the qualitative characteristic of understandability in IFIs financial statements, is satisfactory. Jargon is present, which makes the financial statements difficult to understand, however, this is mitigated through the use of graphs and glossaries. A visual illustration and comparison of the understandability criterion, between IFIs that prepare financial statements using IFRS and those that use AAOIFI standards, indicate no significant difference exists in the score of IFIs applying IFRS and IFIs applying AAOIFI in respect of their application of the qualitative characteristic of understandability (see graph 3).

4.6 Comparability

The first criterion for comparability, **C1**, measures the extent to which the notes explain the implications of a change in accounting policy. The results are considered good, the mean scores for those entities applying IFRS[9] and those applying AAOIFI[10] is 4.7 and 4.93 respectively. The median, mode and maximum scores for IFRS entities and AAOIFI entities is 5. This indicates that most entities either have made no changes to accounting policies, or there are comprehensive explanations accompanying the change. The minimum score for IFRS entities is 2 and AAOIFI entities is 3.

C2 assessed the extent to which the notes explain the implications of a revision in accounting estimates and judgements. The results were satisfactory: the mean scores for entities using IFRS is 2.97 and the mean score for entities using AAOIFI is 3.06. The median and mode scores for IFRS and AAOIFI is 3. The minimum score for IFRS is 2 and the minimum for AAOIFI is 3. The maximum scores for IFRS is 4 and AAOIFI is 5. The results indicate that most entities either make no revision of estimates, or, in the event a revision is present, there are clear notes describing the estimate revision and the impact of these.

C3 reviewed the impact on prior period figures in the event of a change in accounting policy or a revision in accounting estimate. The results for this measure were good, with IFRS entities scoring an average of 4.45 and AAOIFI entities scoring an average of 4.9. The median, mode and maximum for entities applying IFRS and those applying AAOIFI is 5. The minimum score for IFRS and AAOIFI is 2. These results indicate most entities either had no change in accounting policies; or restated 2 years or more and included notes in this respect.

The measure of the extent of comparison periods presented is measured by **C4**. The mean score obtained for IFRS is 2.85 and AAOIFI is 2.53. The median and mode for IFRS and AAOIFI is 2. The minimum score for IFRS is 2 and AAOIFI is 1. The maximum score for IFRS and AAOIFI is 5, indicating a variance between entities. **C4** indicates most entities provide a 5-year comparison.

C5 assessed how comparable the financial report was. The scores obtained for this are satisfactory. The mean scores for IFRS and AAOIFI is 3.58 and 3.5, respectively. The median and mode for IFRS and AAOIFI is 4 and 3, respectively. The minimum scores obtained is 2 and the maximum is 5.

The final measure for comparability is **C6. C6** measures the number of financial ratios presented in the financial statements. The mean score for IFRS is 2.81 and the mean score for AAOIFI is 2.26. The median for IFRS and AAOIFI is 3 and 2 respectively. The mode is 3, the minimum is 1

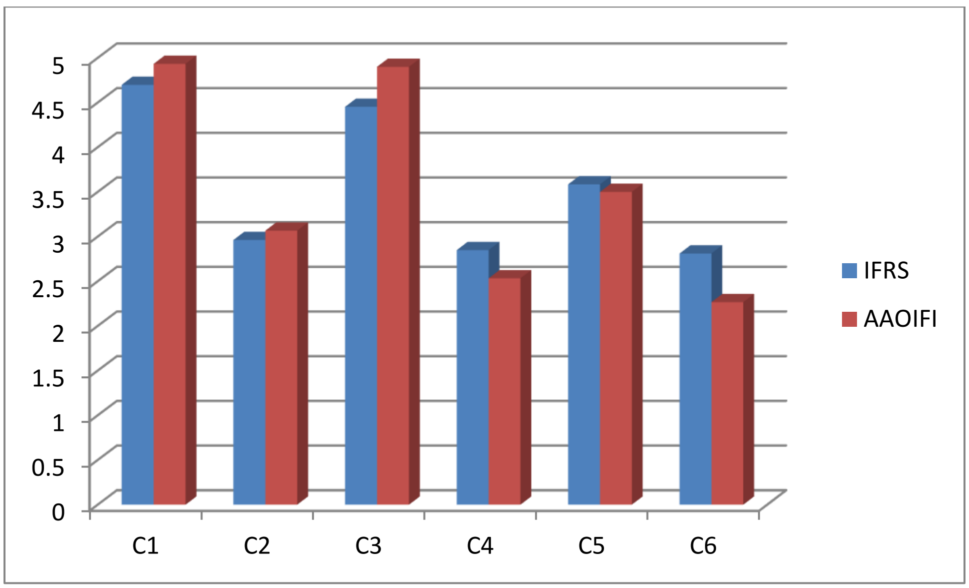
[9] Any reference to IFRS refers to IFI's which apply IFRS
[10] Any reference to AAOIFI refers to IFI's which apply AAOIFI

and the maximum score for IFRS is 5 and the maximum score for AAOIFI is 4. These results indicate, on average, IFIs disclose around 3 financial ratios. Considering the importance and necessity of final ratios, this indicates an underperformance in. The results for comparability are summarized in table 6.

<u>Table 7: Results for comparability.</u>

Qualitative Characteristic	Mean			Standard Deviation			Median			Mode			Min			Max	
Comparability	IFRS	AAOIFI		IFRS	AAOIFI		IFRS	AAOIFI		IFRS	AAOIFI		IFRS	AAOIFI		IFRS	AAOIFI
C1	4.698113	4.933333		0.695726	0.365148		5	5		5	5		2	3		5	5
C2	2.962264	3.066667		0.33754	0.365148		3	3		3	3		2	3		4	5
C3	4.45283	4.9		1.048186	0.547723		5	5		5	5		2	2		5	5
C4	2.849057	2.533333		1.045066	0.899553		2	2		2	2		2	1		5	5
C5	3.584906	3.5		0.745085	0.861034		4	3		4	3		2	2		5	5
C6	2.811321	2.266667		1.241225	1.080655		3	2		3	3		1	1		5	4

<u>Graph 4: Comparison between IFRS and AAOIFI in terms of comparability.</u>



The overall mean score for comparability for IFIs applying IFRS is 3.56 and the overall mean score for IFIs applying AAOIFI is 3.53. This indicates an adequate application of the qualitative characteristic of understandability, but there is room for improvement. In terms of IFI's financial statements comparability between entities, this is appropriate, but potential for improvement exists. A visual representation of the mean scores of comparability for IFIs applying IFRS versus IFIs applying AAOIFI, indicates no significant difference exists in the score of IFIs in respect of their application of comparability (See graph 4).

4.7 Timeliness

If information is not disclosed in a timely manner, the information will lose its relevance for the users of the financial statements (IASB 2018). Timeliness only has one measure for the fulfillment of the qualitative characteristic. This measure is, **T1**: how many days did it take for the auditor to sign the auditor's report after year-end? As mentioned under section 3.4, the higher the score awarded, the longer the time period until the audit report was signed and, consequently, the less relevant the information will be.

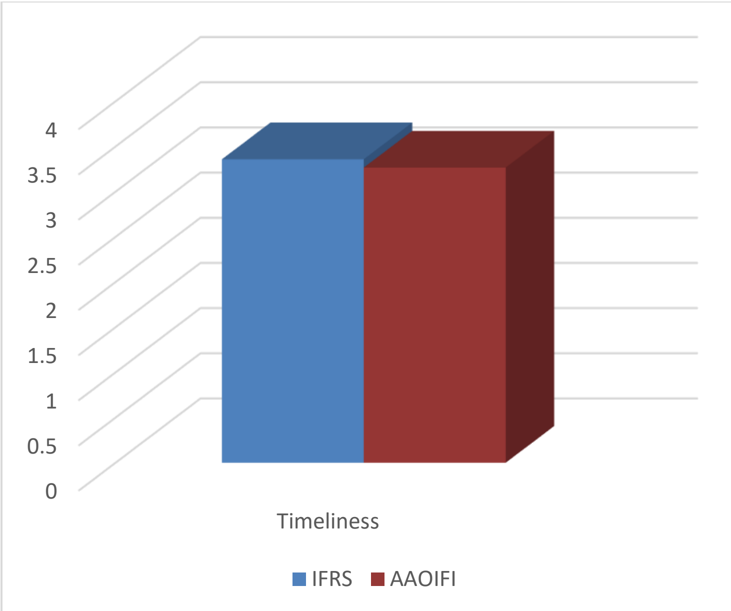
The mean score for IFIs applying IFRS is 3.36 and the mean score for IFIs applying AAOIFI standards is 3.27 (see table 6). This is a relatively positive score as this translates to, on average, the audit report is signed 60 days, or 2 months after year-end. As this is relatively timely, the information is relevant and has substance.

There is no significant difference between the timeliness of those entities using IFRS standards and those IFIs using the AAOIFI standards.

Table 8: Results for timeliness

	Mean			Standard Deviation			Median			Mode			Min			Max	
	IFRS	AAOIFI		IFRS	AAOIFI		IFRS	AAOIFI		IFRS	AAOIFI		IFRS	AAOIFI		IFRS	AAOIFI
Timeliness	3.35849	3.26667		0.76194	0.58329		3	3		3	3		2	2		5	4

Graph 6: Comparison between IFRS and AAOIFI in terms of timeliness.



4.8 Hypothesis testing

The hypothesis testing performed was based on the following null and alternate hypothesis:

H_0 – There is statistically no significant difference between the median relevance scores for those IFIs applying IFRS and those applying AAOIFI.

H_1 – There is a significant difference between the median relevance scores for those IFIs applying IFRS and those applying AAOIFI.

The test performed to test the hypothesis was dependent on the normality of the data. The data were nonparametric, so the appropriate test was the Mann Whitney U Test (Leedy and Ormrod 2015). The Mann Whitney U Test results in a p-value. The scale below indicates the level of confidence and acceptance or rejection of the null hypothesis.

For each factor:

If $p<0.05$ we reject the null hypothesis with 95% confidence

If $p>0.05$ we fail to reject the null hypothesis

The results for the hypothesis testing are summarized in the table below (Table 6).

Table 9: Results for Mann-Whitney U Test

Test Statistics					
	Relevance	Faithful representation	Understandability	Comparability	Timeliness
Mann-Whitney U	739.000	754.000	783.500	753.500	744.000
Wilcoxon W	1204.000	1219.000	1248.500	1218.500	1209.000
Z	-.538	-.428	-.117	-.408	-.535
Asymp. Sig. (2-tailed)	.591	.669	.907	.683	.593

The p-value for relevance is 0.591. The p-value is greater than 0.05 and we fail to reject the null hypothesis. The p value for faithful representation is 0.669. The p-value is greater than 0.05 and we fail to reject the null hypothesis. The p-value for understandability is 0.907 and we fail to reject the null hypothesis. The p-value for comparability is 0.683 and we fail to reject the null hypothesis. The p-value for timeliness is 0.593 and we fail to reject the null hypothesis.

In each test, the p-value is greater than 0.05. therefore, we fail to reject the null hypothesis and conclude that there is no evidence to support a significant difference exists in the score of IFIs applying IFRS and IFIs applying AAOIFI in respect of their application of the qualitative characteristics.

Chapter 5: Conclusion and recommendations for future research

5.1 Conclusion

Since its inception in 1963, Islamic finance has seen significant growth (Gait and Worthington 2008, Ismail and Sori 2017, Kholvadia 2017). This has led to growth in the number of IFIs (Dhai 2015, Mohammed, Fahmi et al. 2015). IFIs were established to adhere to the Sharia law and rely on strong public confidence as stakeholders expect the institutions to be compliant with the principals of Shariah (Mohammed, Fahmi et al. 2015). Therefore, reporting quality and transparency become essential (Mohammed, Fahmi et al. 2015).

The purpose of this study was to assess the qualitative characteristics of useful financial information in the financial statements produced by IFI's by assessing to what extent IFI's financial statements reflect the qualitative characteristics of useful financial information if there is a significant difference in the score of IFIs applying IFRS and AAOIFI in respect of their application of the qualitative characteristics.

Chapter 3 discusses the methodology applied to this study. This study was an exploratory descriptive quantitative research study (Leedy and Ormrod 2015). The measurement tool adopted to measure the qualitative characteristics of financial statements was a 21 point index scorecard, replicated from a study performed by Beest, Braam et al. (2009). This scorecard rated each characteristic of the financial statements with a score from 1 to 5, 1 being poor implementation of the particular qualitative characteristic and 5 indicating excellent implementation of the characteristic (Beest, Braam et al. 2009).

Chapter 4 analysed the results of the data. The data were analysed using descriptive statistics. Each qualitative characteristic was analysed independently of one another and separately between those IFIs applying IFRS and those IFIs applying AAOIFI standards. The mean and mode scores for each qualitative characteristic was discussed in detail to address the first research question. The results indicate IFI's financial statements adequately demonstrate the qualitative characteristics of useful financial information. For each qualitative characteristic, a comparison of the scores between IFIs which apply IFRS and IFIs which apply AAOIFI is included in the analysis to address the second research question. Hypothesis testing was performed a Man Whitney U Test as the data were assessed to be non-parametric and did not follow a normal distribution. The results of the hypothesis testing suggest there is no significant difference in the score of IFIs applying IFRS and IFIs applying AAOIFI in respect of their application of the qualitative characteristics as the p-value in each test was greater than 0.05.

The results of this study indicate there is reasonable application of the qualitative characteristics amongst IFI's financial statements. On average, IFIs applying IFRS scored 3.4 out of 5 and IFIs applying AAOIFI scored 3.3 out of 5. This indicates IFI's are aware of the qualitative characteristics of useful information and do apply them, but, there is a room for improvement as the application is not currently excellent.

The results of this study further indicate there is no significant difference in the application of the qualitative characteristics between IFI's applying IFRS and IFI's applying AAOIFI.

AAOIFI standards were created as IFRS was deemed inappropriate to cater for the needs of IFIs (Mohammed, Fahmi et al. 2015, AAOIFI 2018). It is expected IFI's applying AAOIFI would have better application of the qualitative characteristics as opposed to IFIs which apply IFRS, as AAOIFI standards were designed solely for IFTs. An IFT may be accounted for differently, depending on whether IFRS standards are applied or AAOIFI standards are applied. The results from this study suggest, regardless of whether IFRS or AAOIFI is used, the decision-usefulness of the information will be the same, or at the very least, similar. With this in mind, the difference between IFRS and AAOIFI might not be material if the decision-usefulness of the information presented is the same. If the value-add is the same, regardless of standards adopted, is alignment between the standards necessary?

A brief review of the preparers of financial statements of IFIs using AAOIFI standards revealed many of the preparers have a background in applying IFRS standards. This is a possible reason for the similarities in the application of the qualitative characteristics between IFRS and AAOIFI, however, this statement is untested and is unconfirmed and is potentially an area for future research.

5.2 Future recommendations

The findings from this research add to the existing literature and create further opportunities to add to the body of literature that exists around this research topic. This study adds to the discussion around convergence to a global set of financial reporting standards. As mentioned in section 5.1, a possible reason for the similarities in the application of the qualitative characteristics between IFRS and AAOIFI is many of the preparers of financial statements using AAOIFI standards also have a background in IFRS. An area of future research is to test this theory and confirm if this is the case or not. Further areas of research which can be explored include investigating principal differences between IFRS standards and AAOIFI standards. IFIs are spread across many different counties, including western and middle eastern countries. An interesting area of future research may be to investigate if there are differences in financial reporting quality if IFIs among different countries. In the course of this research, it was noted not many IFIs prepare and issue integrated reports. An opportunity for future exists to explore reasons why there is a lack of integrated reports amongst IFIs and to explore the relationship between quality of financial reporting and those IFIs which do prepare and issue integrated reports.

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Appendix A

QUALITATIVE CHARACTERISTIC	***METHOD OF SCORING***	***RANKING***
RELEVANCE		
R1	To what extent does the entity provide forward looking information, in order to provide reasonable expectations and predictions of the company?	1= No forward-looking information 2= Forward looking information but no separate subsection 3= Separate subsection dealing with forward looking information 4= Extensive predictions 5= Extensive predictions useful for making expectations
R2	To what extent does the presence of non-financial information in terms of business opportunities and risks complement the financial information?	1 = No non-financial information 2 = Little non-financial information, not useful for forming expectations 3 = Useful non-financial information 4 = Useful non-financial information, helpful for developing expectations 5 = Non-financial information presents additional information which helps developing expectations

R3	To what extent does the company use fair value instead of historical cost?	1 = Only HC 2 = Most HC 3 = Balance FV/HC 4 = Most FV 5 = Only FV
R4	To what extent do the reported results provide feedback to users of the annual report about how various market events and significant transactions affected the company?	1 = No feedback 2 = Little feedback on the past 3 = Feedback is present 4 = Feedback helps understanding how events and transactions influenced the company 5 = Comprehensive feedback
RELIABILITY		
FAITHFUL REPRESENTATION		
FR1	To what extent are valid arguments provided to support the decision for certain assumptions and estimates in the annual report?	1 = Only described estimations 2 = General explanation 3 = Specific explanation of estimations 4 = Specific explanation, formulas explained etc. 5 = Comprehensive argumentation
FR2	To what extent does the company base its choice of certain accounting principles on valid arguments?	1 = Changes not explained 2 = Minimum explanation 3 = Explained why 4 = Explained why and consequences

		5 = No changes or comprehensive explanation
FR3	Which type of auditor's report is included in the annual report?	1 = Adverse opinion 2 = Disclaimer of opinion 3 = Qualified opinion 4 = Unqualified opinion: Financial figures 5 = Unqualified opinion: financial figures + internal control
FR4	To what extent does the company provide information on corporate governance?	1 = No description CG 2 = Information on CG limited, not in apart subsection 3 = Apart subsection 4 = Extra attention paid to information concerning CG 5 = Comprehensive description of CG
FR5	To what extent does the company, in the discussion of the annual results, highlight the positive events as well as the negative events?	1 = Negative events only mentioned in footnotes 2 = Emphasize on positive events 3 = Emphasize on positive events, but negative events are mentioned; no negative events occurred 4 = Balance positive/negative events

		5 = Impact of positive/negative events is also explained
UNDERSTANDABILITY		
U1	To what extent is the annual report presented in a well-organized manner?	Judgement based on: - complete table of contents - headings - order of components - summary/ conclusion at the end of each subsection
U2	To what extent are the notes to the financial statements presented in a clear manner?	1 = No explanation 2 = Very short description, difficult to understand 3 = Explanation that describes what happens 4 = Terms are explained (which assumptions etc.) 5 = Everything that might be difficult to understand is explained
U3	To what extent does the presence of graphs and tables clarify the presented information?	1 = no graphs 2 = 1-2 graphs 3 = 3-5 graphs 4 = 6-10 graphs 5 = > 10 graphs
U4	To what extent is the use of language and technical jargon in the annual report easy to follow?	1 = Much jargon (industry), not explained 2 = Much jargon, minimal explanation 3 = Jargon is explained in text/ glossary

		4 = Not much jargon, or well explained 5 = No jargon, or extraordinary explanation.
U5	What is the size of the glossary?	1 = No glossary 2 = Less than 1 page 3 = Approximately one page 4 = 1-2 pages 5 = > 2 pages
COMPARIBILITY		
C1	To what extent do the notes to changes in accounting policies explain the implications of the change?	1 = Changes not explained 2 = Minimum explanation 3 = Explained why 4 = Explained why + consequences 5 = No changes or comprehensive explanation
C2	To what extent do the notes to revisions in accounting estimates and judgements explain the implications of the revision?	1 = Revision without notes 2 = Revision with few notes 3 = No revision/ clear notes 4 = Clear notes + implications (past) 5 = Comprehensive notes
C3	To what extent did the company adjust previous accounting period's figures, for the effect of the implementation of a change in	1 = No adjustments 2 = Described adjustments 3 = Actual adjustments (one year) 4 = 2 years

	accounting policy or revisions in accounting estimates?	5 = > 2 years + notes
C4	To what extent does the company provide a comparison of the results of current accounting period with previous accounting periods?	1 = No comparison 2 = Only with previous year 3 = With 5 years 4 = 5 years + description of implications 5 = 10 years + description of implications
C5	To what extent is the information in the annual report comparable to information provided by other organizations?	Judgement based on: - accounting policies - structure - explanation of events
C6	To what extent does the company present financial index numbers and ratios in the annual report?	1 = No ratios 2 = 1-2 ratios 3 = 3-5 ratios 4 = 6-10 ratios 5 = > 10 ratios
TIMELINESS		
T1	How many days did it take for the auditor to sign the auditors' report after book year-end?	Natural logarithm of amount of days 1 = 1-1.99 2 = 2-2.99 3 = 3-3.99 4 = 4-4.99 5 = 5-5.99

Appendix B

	Company	Country	Framework
1	Arab Banking Corporation	Bahrain	IFRS
2	Boubyan Bank	Kuwait	IFRS
3	Sharjah Islamic Bank	UAE	IFRS
4	National Bank of Kuwait	Kuwait	IFRS
5	Dubai Islamic Bank	UAE	IFRS
6	Al Hilal Bank PJSC	UAE	IFRS
7	BLME Holdings PLC	UK	IFRS
8	Ahli Bank	Qatar	IFRS
9	ALAFCO	Kuwait	IFRS
10	Al Rayan Banl PLC	UK	IFRS
11	Arab Bank Group	Jordan	IFRS
12	Saudi British Bank	KSA	IFRS
13	Alijarah Holding	Qatar	IFRS
14	National Commercial Bank	KSA	IFRS
15	Al Rajhi Bank	KSA	IFRS
16	Gulf Investment House	Kuwait	IFRS
17	Alinma Bank	KSA	IFRS
18	ADIB	UAE	IFRS
19	Banque Saudi Fransi	KSA	IFRS
20	Alimtiaz Group	Kuwait	IFRS
21	Al Madar Finance and Investment Company	Kuwait	IFRS
22	Ahli United Bank	Bahrain	IFRS
23	Bank Albilad	KSA	IFRS
24	Bosna Bank International	Bosnia	IFRS
25	Noor Bank	UAE	IFRS
26	Dar Al Maal Al-Islami Trust	Bahamas	IFRS
27	Doha Insurance Group	Qatar	IFRS
28	Emirates NBD	UAE	IFRS

29	Albaraka Bank Limited	South Africa	IFRS
30	Gatehouse Financial Group Limited	UK	IFRS
31	Bank Muscat	Oman	IFRS
32	Sico Bank	Bahrain	IFRS
33	Kuwait International Bank	Kuwait	IFRS
34	Rasmala	UK	IFRS
35	Bupa Arabia For Cooperative Insurance Company	KSA	IFRS
36	Samba Financial Group	KSA	IFRS
37	Gulf Investment Bank	Bahrain	IFRS
38	Ajman Bank PJSC	UAE	IFRS
39	Arab National Bank	KSA	IFRS
40	Gulf One Investment Bank	Bahrain	IFRS
41	Al Hilal Bank JSC	Kazakhstan	IFRS
42	Islamic Holding Group	Qatar	IFRS
43	Mashreq Bank	UAE	IFRS
44	Al Madina for Finance and Investment Company	Kuwait	IFRS
45	Riyad Bank	KSA	IFRS
46	Sokouk Holding Company	Kuwait	IFRS
47	Salama	UAE	IFRS
48	Bank of Jordan	Jordan	IFRS
49	Ahli United Bank Kuwait	Kuwait	IFRS
50	Bank Aljazira	KSA	IFRS
51	HBZ Bank Limited	South Africa	IFRS
52	The Saudi Investment Bank	KSA	IFRS
53	Alawwal Bank	KSA	IFRS
54	Liquidity Management Centre	Bahrain	AAOIFI

55	Qatar International Islamic Bank	Qatar	AAOIFI
56	Al Baraka Islamic Bank	Bahrain	AAOIFI
57	Khaleeji Commercial Bank	Bahrain	AAOIFI
58	Al Salam Bank	Bahrain	AAOIFI
59	VC Bank	Bahrain	AAOIFI
60	Seera Investment Company	Bahrain	AAOIFI
61	Bahrain Islamic Bank	Bahrain	AAOIFI
62	United Capital Bank	Sudan	AAOIFI
63	First Energy Bank	Bahrain	AAOIFI
64	Bank ABC Islamic	Bahrain	AAOIFI
65	Citi Islamic Investmnet Bank	Bahrain	AAOIFI
66	Al Khaleej Takaful Insurance Company	Qatar	AAOIFI
67	Jordan Islamic Bank	Jordan	AAOIFI
68	Omdurman National Bank	Sudan	AAOIFI
69	Bank of Khartoum	Sudan	AAOIFI
70	Global Banking Corporation	Bahrain	AAOIFI
71	Ibdar Bank	Bahrain	AAOIFI
72	International Investment Bank	Bahrain	AAOIFI
73	Ithmar Bank	Bahrain	AAOIFI
74	Kuwait Finance House - Bahrain	Bahrain	AAOIFI
75	Qatar Islamic Bank	Qatar	AAOIFI
76	Safwa Islamic Bank	Jordan	AAOIFI
77	Bank Nizwa	Oman	AAOIFI
78	Masraf Al Rayan	Qatar	AAOIFI
79	Barwa Bank	Qatar	AAOIFI
80	Gulf Finance House	Bahrain	AAOIFI
81	Islamic International Arab Bank	Jordan	AAOIFI
82	Islamic Development Bank	KSA	AAOIFI
83	ISDF	Kuwait	AAOIFI

Appendix C

Below is an example of measure U4 that was awarded a score of 5 because of the exceptional explanations for the jargon used.

GLOSSARY OF TERMS

Term	Definition
Additional Tier 1 capital	Additional Tier 1 capital is a Basel III-defined concept and consists of high-quality capital. It essentially includes providing a permanent and unrestricted commitment of funds, is freely available to absorb losses at the point of non-viability, ranks behind the claims of depositors and other more senior creditors in the event of a wind-up, and provides for fully discretionary capital distributions.
Basel II	Refers to the "Rules and Regulations Concerning Capital Adequacy Standard" issued by Central Bank of Kuwait Circular number 2/BS/184/2005 dated 21 December 2005, as amended.
Basel III	Refers to the "Capital Adequacy Ratio Basel III for conventional banks" regulations issued by Central Bank of Kuwait Circular number 2/RB, RBA/A336/2015 dated 24 June 2015.
Capital Conservation Buffer	A Capital Conservation buffer of 2.5% (expressed as a percentage of risk-weighted assets) has been subsumed in the Minimum Common Equity Tier 1 Capital requirement level.
Countercyclical Buffer	A Countercyclical buffer requirement that varies from 0% to 2.5% which, when triggered as a requirement at the discretion of Central Bank of Kuwait, is required to be met from Common Equity Tier 1 capital.
Common Equity Tier 1 capital	Common Equity Tier 1 capital is the highest quality of capital available reflecting the permanent and unrestricted commitment of funds that are freely available to absorb losses. It essentially includes ordinary share capital, retained earnings and reserves less prescribed deductions.
Domestic Systemically Important Bank Buffer (D-SIB)	A Domestic Systemically Important Bank Buffer that varies from 0.5% to 2% required to be met in the form of Common Equity Tier 1 capital which will be determined at the level of each bank identified as systemically important by Central Bank of Kuwait on an annual basis.
External Credit Assessment Institution (ECAI)	An External Credit Assessment Institution (ECAI) as recognized by Central Bank of Kuwait from time to time for the purposes of the assigning risk-weights to obligors under the Standardized Approach.
Significant investments	Significant investments in capital of banking, financial and insurance entities are those where the Bank owns more than 10% of the issued common share capital of the issuing entity or where the entity is an affiliate of the Bank.
Tier 2 capital	Tier 2 capital consists of eligible capital instruments that provide an unrestricted commitment of funds for a defined period that is available to absorb losses at the point of non-viability, subordinated to claims of depositors in the event of wind-up. Limited recognition of general provisions held against future, presently unidentifiable losses are eligible for inclusion in Tier 2 capital.

2.18 Islamic financing to customers

Islamic financing to customers are financial assets with fixed or determinable payments that are not quoted in an active market.

a. Murabaha

Murabaha is an agreement relating to the sale of commodities at cost plus an agreed upon profit margin, whereby the seller informs the buyer of the price at which the deal will be completed and also the amount of profit to be recognized. Murabaha is a financial asset originated by the Group and is stated at amortised cost net of provision for impairment.

b. Wakala

Wakala is an agreement involving Al-Muwakkil (the Principal) who wishes to appoint Al-Wakil (the Agent) to be his agent with respect to the investment of Al-Muwakkil's fund, in accordance with regulations of the Islamic Sharia'a. Wakala is a financial asset originated by the Group and stated at amortised cost net of provision for impairment.