

Substance or form in Islamic banking: a case study

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Abstract

Islamic banks differ from conventional banks in that their transactions do not rely on receiving and paying interest. This raises the issue of how to account for the transactions of Islamic banks, and in particular whether International Financial Reporting Standards (IFRS) are adequate for reporting Islamic banking transactions. If the economic substance of these transactions corresponds to the substance of conventional transactions, then IFRS should be adequate, but if there is a distinctive “Islamic substance”, then special accounting practices may be necessary, such as the standards of the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI). To investigate this issue, we undertook a case study within one of the leading Islamic banks, to ascertain how Islamic banking transactions operated in practice, and how the bank’s staff understood the form and substance of the transactions. We found that, despite an espoused belief that the transactions under examination were substantively different from equivalents within conventional banking practice within the bank was not consistent with such a belief. The evidence presented in the study provides a new perspective on the debate over whether Islamic banking is genuinely innovative or is merely an example of financial engineering.

Key words: Accounting standards, substance or form, Islamic banking, financial engineering, mudaraba, murabaha, ijara