Ijarah Accounting: A Comparison of Conventional IAS-17 and Islamic FAS-8

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Abstract

Financial reporting is very important aspect of any business as it determines financial rights and liabilities of the parties involved. With the advent of Islamic finance the issue of financial reporting as per Islamic law was raised, which was then addressed by the Accounting and Auditing Organization of Islamic Financial Institutions [AAOIFI]. There exist differences as well as similarities under both regimes of accounting [conventional and Islamic]. As in many countries, relevant changes in laws for application of Islamic accounting are yet to be made, hence Islamic Financial Institutions [IFIs] in those countries are bound to follow conventional accounting standards. This study is intended to highlight the financial issues emerging due to application of conventional accounting standard in Ijarah accounting by IFIs. Comparison of two accounting standards IAS-17 and FAS-8 as well as their implications is discussed. We found in the process that although an informed effort is being made by experts in Islamic finance to match, revenue as well as cost to customers, with conventional financial industry, however contract of leasing and Ijarah carries more financial, legal and accounting differences than similarities, hence application of conventional lease accounting is not appropriate for an IFI.

Key Words: IAS 17, FAS 8, IFRS, IFAC, AAOIFI, Lease accounting, Ijarah accounting

I-Introduction

Modern Islamic finance is an emerging area in the financial economics literature. Started with the establishment of Islamic development bank in 1973-74, it has shown a speedy growth and momentum in the first decade of 21st century. Global volume of assets under Islamic financial system, have reached to US$ 2,000/- billion by the end of December 2014 (MIFC-2015). Islamic finance has shown resilience in the era of global
melt down, and recorded average annual growth of 21% from 2007 to 2011 [IFSL-2012]. Islamic banking was emerged as a reaction to Haram (prohibited by Islamic law) practices in financial sector including Riba (interest & usury), Gharar (excessive risk) Myser & Qimar (game of chance) and financing for Haram (prohibited) businesses. In Pakistan Islamic finance has shown marvelous overall average annual growth of above 28% during 2010-14. By the end of September 2014, 22 (5+17) banks operate in Pakistan with a branch network of 1,423, carrying assets of PKR 1,102 (USD 11) billion covering 10% of market share (SBP-2014).

With the development and expansion of Islamic finance industry, guidance was required which was provided partially by Accounting and Auditing Organization of Islamic Financial Institutions (AAOIFI), Islamic Fiqh Academy (IFA) and Shari’a Boards of central and commercial banks. Although Islamic finance is the talk of the day, however like any emerging sector, it is facing certain resolvable issues, for example, system development, standardization, trained human resources, financial reporting and extended capital market operations, which require attention of researchers. It is also important to note that the approaches followed by conventional banks do not necessarily fit the needs of Islamic finance (Alexakis&Tsikouras, 2009).

Financial reporting is the language of business through which business speaks to internal as well as external stakeholders including management, workers, shareholders, regulators and investors (Belkaoui, 2004). It depicts financial health and compliance with regulations by an organization and Islamic financial institutions have no exception. Existing financial reporting framework has been developed under capitalism which promotes wealth maximization, liberalism, utilitarianism and individualism without any moral filter (Ibrahim, 2000). These values promoted by capitalism are clearly different from the socioeconomic system guided by Abrahamic religions including Judaism, Christianity and Islam. Accounting is not an economic reality as claimed generally, but a social construct (Hines, 1988; Roslander, 1992 as quoted by Ibrahim, 2000) duly influenced by human behavior. Islamic finance has its own objectives (e.g. wealth circulation, dignity of labor, morally filtered consumption, socially responsible investments among others) that are distinct from conventional finance. It is expected that financial reporting of Islamic financial institutions would disclose information required to assess the level of objectives achieved in addition to the financial results relating to profitability and solvency. Use of conventional accounting for Islamic organization

2. [Examples of prohibited businesses include liquor, pork, pornography, promotion of adultery etc]
may result in deviation from the core objectives (Ibrahim, 2000). Therefore, financial statements should also report Islamic accounting standards including e.g. justice, Shariah compliance, zakah requirements (Harahap, 2003) in addition to profitability and financial position.

Accounting discipline has a deep rooted relationship with modern banking. We see due care and concentration of the experts in this area of study. At present efforts are in the way to have a global set of accounting standards to make the accounting results relevant and comparable across the globe. Being a special type of finance based upon Islamic law [obligatory to follow by Muslims], Islamic finance needs accounting guidelines to execute day to day transactions and determine financial rights and liabilities of the parties involved. With the emergence of Islamic finance, a separate set of accounting standards was required, primarily, justified on the following grounds/arguments (AAOIFI-2008).

- **Accounting standards must confirm with Islamic code of life [e.g. prohibition of interest, present value through discounted cash flows etc], a requirement absent in conventional set of accounting standards.**
- **New forms of business contracts emerged based upon principles of Islamic finance [Murabaha, Musharaka, Diminishing Musharaka, Ijarah, Takaful and PLS deposits etc], which are not taken into account while setting conventional accounting standards.**
- **Ensuring Shari’a compliance in business dealings [Halal business, interest free operations etc]; which is a unique requirement of Islamic financial institutions only.**
- **Determination of zaka based upon results of financial reporting is another requirement from Islamic financial institutions which is not addressed in the conventional accounting standards.**

Keeping in view the industry needs, Accounting & Auditing Organization of Islamic Financial Institutions [AAOIFI] was established in 1991, which has significantly contributed towards the development of Islamic accounting standards for IFIs. By the end of Nov 2007, 40 Shari’a standards and by June 2008, 23 accounting standards, 5 auditing standards, 6 governance standards and 2 codes of ethics were issued by AAOIFI for the guidance of Islamic Financial Institutions (IFIs).

IFIs and conventional banks perform their functions in the same institutional settings. In many countries including Muslim-majority countries common business, corporate and
taxation laws are in practice. In fact, in several countries including Muslim-majority countries, the required changes in financial laws have yet to be inserted; hence IFIs have to follow the national business, corporate and tax laws; resulting in preparation of financial reports according to the conventional accounting standards. (e.g. Hossain & Khatun, 2014, documented that compliance status of Islamic banking industry in Bangladesh, with AAOIFI standards, is only 64%; while Sakib, 2015, documented even lesser compliance of 54%; and may be even less or no compliance in many other countries). A primary reason of lesser application of AAOIFI accounting standard could be lack of awareness among the Islamic finance market participants, as concluded by Abdulah, (2007) in Saudi Arabian market. Ameer, et. al; (2012) concluded in Malaysian institutional settings that 40% of Islamic banks were compliant with BNM guidelines of disclosure and identified reasons of non-compliance as lack of expertise, outdated information system structure, and shortage of support and highly trained staff. Smolo and Hassan (2011) discusses the necessity of using diminishing musharaka in Islamic finance.

There is a need to highlight the financial reporting issues of IFIs prepared under conventional accounting standards. As we have two sets of accounting standards international financial reporting standards [IFRS, IAS] and Financial accounting standards [FAS] issued by International Federation of Accountants [IFAC] and AAOIFI respectively, hence the difference in financial reporting is expected, resulting in difference in revenue recognition as well as assets measurement. The difference in revenue recognition and assets measurement can lead to a difference in financial rights and liabilities of the parties involved in Islamic finance/business.

This study is intended to contribute in the literature by comparing financial reporting process and its implications under Ijarah accounting standard FAS-8 and Leasing accounting standard IAS-17. It is an exploratory study based upon the in-depth analysis of two regimes of accounting [i.e. conventional and Islamic]. We want to uncover the impact of conventional accounting in determination of rights and liabilities of parties engaged in Islamic finance/business. Also we want to present the difference in results prepared under both regime of accounting and their implications for Islamic finance industry.

The remaining sections proceed as under. In section II features of Ijarah [FAS-8] and lease [IAS-17] accounting standards are presented followed by discussion tracing similarities and differences in section III. Section IV concludes the discussion.
II-Leasing Vs Ijarah

A. Difference in Lease and Ijarah

Leasing and Ijarah are the synonymous [in practice] concepts used for a business where earnings are made by renting assets. Under this type of business an investor after purchasing the asset, hand over the right of use to another person for an agreed amount of rentals payable in lump sum or in installments for a pre-determined period. However there are some clear differences in both types of businesses (primarily legal differences) discussed as under.

1. Under Ijarah rent is charged when the asset is made available to the lessee for use while under conventional leasing interest is charged once the contract is signed and cash made available to the customer, irrespective of whether asset is actually available for use or not. Any rent received prior to delivery of the asset is not forming income of an IFI and treated as liability which is not the case under interest based banking.

2. During repair and overhauling phase, IFI cannot charge the rentals while conventional banks continuously receive the installments consisting of interest as well as principal irrespective of usage of the asset by lessee.

3. Under Ijarah, sale of asset (if any) and lease of asset take place through two separate contracts. Contract of Ijarah is signed by the time of asset handed over for use and contract of sale is signed by the time ownership is transferred, while under conventional leasing a single contract includes sale and lease.

4. Under Ijarah, risk of asset is mitigated through Takaful only (permitted mode of risk sharing) while under conventional lease risk is minimized through insurance (prohibited mode of risk sharing)

5. Under Ijarah, all rights and liabilities of ownership lie with the IFI being owner of the asset while usage related rights and liabilities transferred to customer being user. Under conventional leasing all such rights and liabilities are placed on the user without distinguishing.

6. Under Ijarah, lease rentals are ceased, once the asset has become unusable due to any reason (e.g. theft, destruction etc.) without negligence of customer which is not the case under conventional leasing.
7. Penalty for default in prompt payment is levied in both cases however usage of penalty is different. Under conventional leasing it is the late payment charges and covers time value of money lost by leasing company, hence, it is compensation for leasing company while under Ijarah it is not the income of lessor rather it goes to charity being coordinated by Shari’a supervisory board of the IFI.

IAS-17 [conventional accounting] and FAS-8 [Islamic Accounting] address the accounting issues of leasing and Ijarah. Both standards are effective from January 1, 1999. Scope of both standards eliminate the lease agreements for extraction and use of natural resources, and licensing agreements including motion pictures, video recordings, plays, manuscripts, patents and copy rights. Traditionally leasing/Ijarah business is divided into two categories of operating and finance lease. In the following paragraphs we have presented similarities and differences in IAS-17 and FAS-8.

B. Finance Lease/ Ijarah Muntahia Bitamleek

According to Ijarah FAS-8 if legal title of the leased asset transfers to the lessee as a result of Ijarah agreement, it is called Ijarah Muntahia Bitamleek, while according to Leases IAS-17, “A finance lease is a lease that transfers substantially all the risks and rewards incident to ownership of an asset. Title may or may not eventually be transferred”. In order to determine whether a lease is a finance lease only ownership transfer is not the sole criteria, rather one has to look into economic substance of underlying transaction. Following tests could be very effective in determining the status of a lease [as per IAS-17].

- The lease transfers ownership of the asset to the lessee by the end of the lease term;
- The lessee has the option to purchase the asset at a price which is expected to be lower than the fair value.
- The lease term is for the major part of the economic life of the asset
- Present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset;
- The leased assets are of a specialized nature such that only the lessee can use them
- Gains or losses from the fluctuation in the fair value of the residual fall to the lessee;
- The lessee has the ability to continue the lease for a secondary period at a rent which is substantially lower than market rent.
Under FAS-8 only ownership transfer is the deciding factor between operating Ijarah [operating lease] and Ijarah Muntahia Bittamaleek [finance lease], while under IAS-17 in addition to ownership there are certain other indications which can change the status of lease from operating lease.

At the time of leasing an asset to a customer by a financial institution, under Ijarah standard [FAS-8], historical value of asset, acquired by financial institution, remains in the balance sheet, arising neither profit nor loss, however under leasing standard [IAS-17], asset is reported as receivable by assigning value of net investment [which is the difference of Minimum Lease Payments (MLP) plus any residual value and Present value of MLP plus any residual value using implicit interest rate]. Practically it is fair value of asset, hence generally there is no difference in the value under both standards as under normal course of business financial institution acquires the asset on request of a customer, consequently historical cost and fair value is the same. However in case the asset was purchased earlier by a financial institution than date of lease agreement, difference might arise in fair value and historical cost, hence, using the word fair value is more appropriate than historical cost. Another difference is, under IAS-17 asset is reported as receivables [as if it is sold], while under FAS-8 it still remains Investment in Ijarah Assets.

Expenses incurred to negotiate a lease contract can either be expensed out immediately or if material can be spread over Ijarah [Lease] term. In addition, if there is any reduction in value of asset that is debited to income summary account [IAS-17, FAS-8].

Ijarah Revenue/Lease Rentals are the periodic payments [or lump sum payment] made by lessee under a lease agreement in return for right to use the leased asset. Under FAS-8, the amount received as Ijarah revenue should be recognized over Ijarah term proportionately, however under IAS-17 it should be allocated between return of principal and finance income.

Under FAS-8 there could be four ways of transferring title to lessee as under 1) Through gift; (2) Through Sale for a token amount; (3) Through sales prior completion of Ijarah term; (4) Gradual sale. While under IAS-17 asset is sold along with finance lease agreement.

Under Ijarah FAS-8, the depreciation is charged by financial institution, whereas under Lease IAS-17 no depreciation shall be charged by lessor in case of finance lease, rather it is depreciated by lessee. As per FAS-8, in all the four cases of transfer of ownership (finance lease), the depreciation is charged by lessor except case # 4, where lessor’s
charge for depreciation decreases while lessee’s charge for depreciation increases gradually. Under gift scheme the residual value is zero, whereas under sales the residual value is agreed sales amount.

In case of impairment of asset, prior to transfer to lessee in all four cases, the difference of lease payments received and fair market rental value is returned to lessee by lessor under FAS-8. While no such arrangements exist under IAS-17.

As per FAS-8, if asset is not taken over by lessee any of the two situations emerge. Lessee is not obliged to purchase the asset, then asset is revalued and lower of net book value Vs cash equivalent value is reported in the balance sheet, consequently any loss arises is reported in income summary account. However, if lessee is obliged to purchase the asset and fails in meeting his obligation; and cash equivalent value is less than net book value, consequent loss is to be recovered from lessee.

C. Operating Lease/Ijarah

A type of lease which is not finance lease or an Ijarah Muntaha Bittamleek. It is a short term lease whereby ownership risks and rewards rest with lessor and lessee is awarded a right to use the asset for agreed lease rentals. There is no difference in treatment of operating leases between Ijarah standard [FAS-8] and leasing standard [IAS-17]

III. Discussion

As for operating lease is concerned, there is no meaningful difference under both standards. Interestingly, the application of operating lease by conventional as well as Islamic financial industry is very rare, given the nature of business. However, under finance lease, which is the prime tool of financing by banks and leasing companies, differences exist under both regimes of accounting. Following points would clear the differences and similarities between conventional and Islamic accounting standards on leasing/Ijarah:-

1. Under Ijarah FAS-8 asset is recorded at historical cost at the time of inception of lease while fair value is recommended by IAS-17. Hence IAS-17 provides solid foundation for depiction of economic reality which is absent under Ijarah standard. Under normal course of business where an IFI purchases an asset for its customer, historical book value and fair value are the same. However, there exist other circumstances where fair value is different from book value [e.g.an asset purchased in the past; and/or substantial change in the market price occurred due to demand, supply or technological change]. Hence it is concluded that IAS-17 is more helpful in depiction of economic reality than FAS-8.
2. Under IAS-17 a physical asset is converted into receivables as if it is sold, which is not the case with FAS-8. Under FAS-8 investment account is maintained and depreciated as per normal policy of lessor. Legal position is more supportive to FAS-8 than IAS-17. In fact it is the nature of contract which changes the whole scenario. Under leasing, lessor is not responsible for making good the asset or a portion of asset which is not fit for use, while under Ijarah, lessor is responsible for maintaining asset in working condition.

3. As for decision to treat a lease as operating or finance, IAS-17 prefers the economic substance over legal form. However, once again it is the nature of the contract that binds lessor under Ijarah to follow the legal form instead of economic substance principal. Furthermore even after declaring a lease as Ijarah Muntahia Bittamleek [Finance lease] nothing changes in financial reporting framework under Ijarah FAS-8.

4. As for earning is concerned the amount received as lease rentals is treated as revenue and depreciation is treated as an expense of the period under FAS-8; while lease rentals are allocated between principal and interest earnings under IAS-17. In case of FAS-8 earnings are appropriated over lease term equally, while under IAS-17 higher earnings are recognized in earlier years and lesser in later years.

5. However if an asset is impaired under FAS-8 adjustment to earnings is made to refund the difference of fair market rentals and Ijarah installments received, resulting in higher loss charging in the year of adjustment, consequently undue bad picture to be reported as a cost of prosperity depicted earlier. This is not the case under IAS-17 as substantial risks and rewards are already transferred to the lessee.

To put the concept in practice, let us look at following example. Mr. Khan entered into a lease agreement with a local bank on following terms and conditions.

- Fair value of car is PKR 1 Million
- Lease term is five years
- Asset shall transfer to the lessee at the end of five years
- Lessor wants to earn 10% on his investment
- Lease rentals/MLP (Installments) are payable at the beginning of the year

Annual installment [lease rentals/MLP] becomes PKR 239,816/- and there is no difference in calculation under conventional as well as Islamic banking. Following
tables (1 to 4) show analysis of Lease rentals, comparative income statements and comparative balance sheets under both conventional and Islamic accounting standards.

As per table-I, lease rentals of amounting to PKR 239,816/- are divided in return of principal as well as return on investment. By application of time value of money software, we got higher return in earlier years as compared to later years. This is valid under conventional finance only as under Ijarah accounting standard lease rentals are equally recognized over the life of lease agreement as depicted in table-II.

Table-I. Analysis of Lease rentals under Conventional Accounting [IAS-17]

<table>
<thead>
<tr>
<th>End of Years</th>
<th>Payment Lease Rentals</th>
<th>Interest/Profit @ 10%</th>
<th>Amount of Principal returned</th>
<th>Balance of Original Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>239,816</td>
<td>-</td>
<td>239,816</td>
<td>760,184</td>
</tr>
<tr>
<td>1</td>
<td>239,816</td>
<td>76,018</td>
<td>163,797</td>
<td>596,387</td>
</tr>
<tr>
<td>2</td>
<td>239,816</td>
<td>59,639</td>
<td>180,177</td>
<td>416,209</td>
</tr>
<tr>
<td>3</td>
<td>239,816</td>
<td>41,621</td>
<td>198,195</td>
<td>218,014</td>
</tr>
<tr>
<td>4</td>
<td>239,816</td>
<td>21,801</td>
<td>218,014</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>1,199,079</td>
<td>199,079</td>
<td>1,000,000</td>
<td></td>
</tr>
</tbody>
</table>

Under FAS-8 Lease payments are treated as revenue and depreciation is deducted to reach the net earnings of the year. Also under conventional accounting net receivables [original investment less return of principal] is the asset to be shown in the balance sheet, while under Islamic accounting, it is the carrying value of asset, to be reported in the balance sheet.

Table-II. Analysis of Lease rentals under Islamic Accounting [FAS-8]

<table>
<thead>
<tr>
<th>End of Years</th>
<th>Payment Lease Rentals</th>
<th>Depreciation Expenses</th>
<th>Net Revenue</th>
<th>Net Asset</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>239,816</td>
<td>200,000</td>
<td>39,816</td>
<td>800,000</td>
</tr>
<tr>
<td>2</td>
<td>239,816</td>
<td>200,000</td>
<td>39,816</td>
<td>600,000</td>
</tr>
<tr>
<td>3</td>
<td>239,816</td>
<td>200,000</td>
<td>39,816</td>
<td>400,000</td>
</tr>
<tr>
<td>4</td>
<td>239,816</td>
<td>200,000</td>
<td>39,816</td>
<td>200,000</td>
</tr>
<tr>
<td>5</td>
<td>239,816</td>
<td>200,000</td>
<td>39,816</td>
<td>-</td>
</tr>
<tr>
<td>Total</td>
<td>1,199,079</td>
<td>1,000,000</td>
<td>199,079</td>
<td></td>
</tr>
</tbody>
</table>

According to table-III there is difference in recognition of income in all years ranging from 39,816/- to 1,805/-. Under IAS-17 higher income is recognized in earlier years
while under FAS-8 equal income is recognized throughout the Ijarah term. Under IAS-17 interest income is a source which decreases over time as the amount of receivables decreases; and there is no charge for repair and depreciation as the asset is transferred with substantial risks and rewards to lessee.

Table-III.Presentation of Comparative Profit & Loss

<table>
<thead>
<tr>
<th>Description</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>IAS 17 Interest Income</td>
<td>76,018</td>
<td>59,639</td>
<td>41,621</td>
<td>21,801</td>
<td>-</td>
<td>199,079</td>
</tr>
<tr>
<td>FAS 8 Net of LR &amp; Dep.</td>
<td>39,816</td>
<td>39,816</td>
<td>39,816</td>
<td>39,816</td>
<td>39,816</td>
<td>199,079</td>
</tr>
<tr>
<td>Difference</td>
<td>36,203</td>
<td>19,823</td>
<td>1,805</td>
<td>(18,014)</td>
<td>(39,816)</td>
<td>0</td>
</tr>
</tbody>
</table>

Under FAS-8, income is fixed because Ijarah rentals are fixed which is being net-off for depreciation and repair-charge. As in this example straight line depreciation method is used and there is no charge for repair, hence every year there is a debit of PKR 200,000/- for depreciation expenses and credit of PKR 239,816/- resulting into net increase of PKR 39,816/- in earnings of IFI. Differences in income recognition as well as return of principal is clearly depicted in table-III, accordingly under IAS-17 slow recovery of principal is obtained, while fast recovery in the form of depreciation under FAS-8. It has implications for income generated in depositor’s pool. In case of IAS-17 distributable income is 76,000 for investment of 760,184 (table-1), which is 10% return on amount invested, and it is constant over the life of asset, while under FAS-8 it is 39,816 for investment of 800,000 (table-II), which is 5% in first and second year of contract, however it increase in % terms [5%, 7%, 10% and 20%]. It becomes 47% for four years [period of investment] or 11.75% annual average. Lesser profit is recognized under FAS-8 in initial years, hence lesser distribution to depositors of IFIs, however such a difference shall be averaged out in long term. Also speedy recovery of principal (through depreciation) reduces taxes and makes available more capital for other investments. Although total charge is same under present pricing mechanism, however allocation of lease installments [between principal and return] is different.

According to table-IV, there exists a difference in net assets under both standards. According to IAS-17, higher value of asset is shown in the balance sheet as receivable, while under FAS-8 equal depreciation is charged for whole period of Ijarah term.
According to IAS-17 lesser decrease in accounts receivables takes place in initial years as earlier installments carry higher amount of interest and lesser amount of principal \([76,018 + 163,797]\) and amount of principal increases over time as amount of interest decreases keeping in view the reduced amount of receivables.

### Table-IV. Presentation Comparative Balance Sheets

<table>
<thead>
<tr>
<th>Description</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>IAS 17</strong> Net Receivables</td>
<td>836,203</td>
<td>656,025</td>
<td>457,830</td>
<td>239,816</td>
<td>-</td>
</tr>
<tr>
<td><strong>FAS 8</strong> Net Asset under Ijarah</td>
<td>800,000</td>
<td>600,000</td>
<td>400,000</td>
<td>200,000</td>
<td>-</td>
</tr>
<tr>
<td><strong>Difference</strong></td>
<td>36,203</td>
<td>56,025</td>
<td>57,830</td>
<td>39,816</td>
<td>-</td>
</tr>
</tbody>
</table>

**IV. Conclusion**

Speedy emerging of Islamic finance has paved way for financial reporting. Keeping in view the needs of a different stream of banking [operating under Shari’a guidance], AAOIF was established to issue accounting standards for Islamic financial institutions. In this paper we have made a comparative study of lease accounting standards issued by conventional [IAS-17] and Islamic [FAS-8] accounting regimes.

We conclude that there exist many differences under both types of standards primarily due to difference in nature of transactions executed under relevant laws. Under conventional leasing it is a lending transaction linked with an asset, while under Islamic law it is a pure rental transaction. This difference in nature of transactions leads to differences in recording of asset [receivables], realization of revenue, depreciation and maintenance charge, risk bearing and finally disposal of asset under lease [Ijarah]. IAS 17 carries some superiorities over FAS-8 including recording of asset [receivable] by following fair value principle and substance over form by treating finance lease as if purchased by lessee. Also IAS 17 has provided multiple tests for identification of finance lease in addition to transfer of ownership. In contrast, FAS-8 is contended with legal form that ensures rights and liabilities of the parties. Further, FAS-8 suggests the smooth [equal] realization of lease rentals over the period of Ijarah term that ensures equal distribution of earnings among the depositors over Ijarah term, resulting in speedy recovery of principal which can be used to generate further income over the period of lease term. An important issue of [uncovered] major repairs under FAS-8 demands attention of experts which can reduce [disturb] the relevant year’s earnings.
In spite of matching the cost to customer under conventional and Islamic leasing, there exist legal, financial, and accounting differences under both types of contracts. In fact, differences are more than similarities due to the nature of contracts [Loan Vs Rental]. It is concluded that application of conventional lease accounting by IFIs misleads the users of financial reports as well as distorts financial rights and liabilities of customers of IFIs. It is recommended for regulators to ensure application of AAOIFI accounting standards for financial reporting of IFIs by making relevant changes in local laws.

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