

**ACCOUNTING DISCLOSURE OF THE FINANCIAL STATEMENTS IN ISLAMIC  
FINANCIAL INSTITUTIONS FROM AN ISLAMIC PERSPECTIVE**

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<b>Abstract</b>	<p><i>In recent years, there has been a significant focus on accounting disclosure, driven mainly by the reliance of external stakeholders, particularly those involved with financial institutions, on the information shown in financial statements to guide their decision-making processes. Since these parties lack the authority to access information from financial institutions directly, the omission of relevant information within the financial statements renders them deceptive compilations that provide uninformative data, thus impacting the decision-making process of individuals seeking such information. This study aims to provide a comprehensive definition of accounting disclosure in Islamic financial institutions, as outlined by the accounting standard for Islamic financial institutions released by AAOIFI, with a specific focus on the Islamic perspective. This can be achieved by examining the notion of disclosure, its significance, and various forms inside these establishments from a legal perspective and exploring disclosure mechanisms. This study employed a descriptive methodology by analyzing data obtained from prior studies and historical records. The findings revealed a decline in customer confidence in Islamic financial institutions.</i></p> <p><b>Keywords:</b> <i>Accounting, Disclosure, Financial, Statements, IFI.</i></p>
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**INTRODUCTION**

Accounting disclosure plays a crucial role in fostering effective communication between financial institutions and diverse stakeholders. It enables the dissemination of information regarding the activities of the financial institution to external parties, thereby facilitating the evaluation of the institution's performance and aiding in investment decision-making processes. Accounting disclosure is of utmost significance in the objective presentation of accounting information, free of any ambiguity, color, or prejudice that can potentially affect the decision-making process pertaining to the accounting entity (Muhyiddin Omar, 2013).

The significance of disclosure is apparent in its role of disseminating information that represents the ultimate result of accounting disclosure processes, typically manifested in financial statements, an indispensable component in the decision-making process, in its diverse manifestations. It is a crucial factor that aids in enhancing the performance of an institution to get a competitive edge.

In the context of Islamic jurisprudence, a thorough examination of the sacred texts, namely the Quran and the verified sayings of the Prophet Muhammad, reveals a clear emphasis on the significance of divulging facts with utmost transparency, honesty, and

impartiality, as Allah Almighty said in Quran: “*O you who believe, fear Allah and be with the truthful*” (al-Quran. al-Tawbah: 119). According to the teachings of the Prophet Muhammad (peace and blessings be upon him), he stated that “*honesty is a virtue that leads to righteousness, which in turn leads to attaining Paradise. A person who upholds honesty and diligently seeks the truth will eventually be recognized by Allah as a close companion. Conversely, lying is deemed as immoral and leads to sinful behavior, ultimately leading to the punishment of Hell. A person who habitually lies and actively engages in falsehoods will eventually be identified by Allah as a deceitful individual*”. (Hadis. al-Bukhari. 6094.; Muslim. 2607).

## **PROBLEM STATEMENT**

Accounting disclosure in financial statements holds significant importance for financial institutions when making investment decisions. It serves as a communication tool through which financial institutions objectively obtain accounting information without bias or manipulation. This transparency aids decision makers in determining whether to invest in the accounting unit or not.

The proliferation of authoritarian governments that undermine the principles of Islamic Sharia and its inclusive educational frameworks, such as the socialist system, is a noteworthy concern. This system has been characterized by its inclination towards controlling individuals' means of subsistence and depriving them of their fundamental rights to freedom and justice in economic endeavors. Additionally, it has failed to prioritize productive labor and has allowed for the practice of usury. In contrast to the Islamic economy, which was characterized by its reliance on enduring principles and frameworks that facilitated its ability to withstand and surmount crises, it emerged as the sole refuge and ultimate solution among these challenging circumstances.

The significance of accounting information from an Islamic standpoint, which diverges from conventional systems, has given rise to the concept of disclosure as one of the crucial concepts that necessitates careful consideration and optimal implementation, in compliance with the regulations and principles set forth by Islamic Sharia, it is noteworthy to mention that the disclosure of information holds significant importance. Of particular relevance is the fact that an Islamic accounting standard has been assigned to this matter, which holds the top position among the standards established by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). Therefore, it is imperative to comprehend and implement disclosure practices in Islamic financial institutions in line with the principles of Islamic Sharia, rather than relying solely on conventional interpretations of disclosure.

The issue addressed in this study is to the definition of accounting disclosure in the financial statements of Islamic financial institutions, specifically from an Islamic standpoint.

## **METHODOLOGY**

This study utilized the descriptive inductive technique due to its suitability in examining such context. Initially, we discussed the notion of disclosure, its significance, and its varieties within Islamic financial organizations in relation to Sharia. Furthermore, we explored the disclosure system employed by these organizations. The study encompassed an examination of the characteristics of the disclosed data in a comprehensive manner. The subject of the research was thoroughly explored by conducting a review to prominent references, sources, studies, and historical data pertaining to the research topic. Additionally, online searches were conducted on websites that specialize in similar subjects, such as the official website of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). The relevant laws pertaining to the research topic of Islamic financial institutions were thoroughly examined and analyzed. Notably, significant sources of information included the publications of the Central Bank of Libya, the World Bank Report of 2020, and the International Accounting Standards Committee (IASB). The IASB

has issued numerous international accounting standards specifically addressing disclosure matters.

### **THE CONCEPT OF DISCLOSURE**

Linguistically, *Ifsah* "disclosure" refers to clarification. *Afsaha* (disclose) is a verb and *Ifsah* "disclosure" is a noun. In such circumstances, it is commonly advised to disclose one's opinion, that is, to openly express it, and to make known the act of disclosure itself. *Ifsah* "disclosure" is defined idiomatically as providing information and data to users in a morally correct and appropriate manner in order to assist them in making decisions. This definition encompasses both internal and external users in the same time (Nadia Shraideh & Ammar Al-Samarrai, 2019).

According to al-Mayhi (2022) accounting disclosure serves as a fundamental cornerstone upon which all stakeholders and entities associated with the facility rely. Among these stakeholders, investors play a crucial role, as they rely on disclosure to get pertinent information that substantiates their investment choices.

Accounting disclosure is one of the communication instruments, as the outputs of the accounting system would be useless without communication. Accounting has shifted its primary focus from serving to safeguard the financial interests of its stakeholders through meticulous record-keeping to serving instead as an information system whose primary goal is to supply stakeholders with accurate data upon which to base strategic and operational decisions (Zyoud & Issa, 2011).

The definition of the term "disclosure" has been subject to varying interpretations among researchers and accounting organisations. Some have characterised it as the provision of relevant financial information that aids decision-makers possessing adequate knowledge in their decision-making processes (Abdul Haq & Baali, 2019).

The concept of disclosure was initially developed by Moonitz, a prominent researcher who is recognized for being among the earliest scholars to explore this area. He defined it as "financial reports should encompass all essential and pertinent data to provide financial statement users with accurate and unbiased information, as well as a comprehensive understanding of the entity's condition" (Zyoud & Issa, 2011).

Hendrickson provided a definition of financial disclosure as the communication of significant information to investors, creditors, and other stakeholders in a manner that facilitates the assessment of a company's future profitability and its capacity to meet its financial obligations. The quantity of information to be disclosed is not contingent upon the reader's level of expertise, but rather on the prescribed criteria for disclosure, specifically encompassing sufficient and customary disclosure (Fadl Salem, 2008).

Therefore, it can be asserted that accounting disclosure entails the provision of a comprehensive and transparent account of an organization's financial position, business performance, and all necessary explanatory details to both internal and external stakeholders, without any form of misrepresentation, deceit, or omission of information that the institution may perceive as insignificant but is considered significant by other interested parties.

Islamic banks demonstrate comprehensive ethical disclosure not only through the external presentation of financial statements and contracts, but also through the fundamental nature of their operations. This is a direct result of their adherence to the principles and provisions of Islamic Sharia, which is prominently reflected in the development of Islamic accounting standards. Consequently, Islamic banks are committed to applying these standards when preparing their financial statements. The implementation of privacy measures by an Islamic bank can provide it with a competitive edge, instilling confidence among its stakeholders and leading to a gradual expansion of its market share, so bolstering its position vis-à-vis its competitors (Nadia Shraideh & Ammar Al-Samarrai, 2019).

### **THE IMPORTANCE OF DISCLOSURE**

There exists a divergence of perspectives regarding the significance of information disclosure and its boundaries. This disparity arises from the vested interests of the entities associated with the economic entity. Within this context, the provision of suitable and reliable accounting information facilitates the effective allocation of economic resources. Accounting disclosure in financial statements plays a pivotal role in ensuring efficient resource allocation within society and mitigating knowledge asymmetry between companies and shareholders. This significance can be attributed to three fundamental principles (Zyoud & Issa (2011):

1. The factors that are of direct importance to many parties are disclosed.
2. Financial statements are widely regarded as the most dependable and trustworthy means of obtaining information.
3. The expense associated with acquiring information from financial statements is quite minimal, given that the expenditure involved in generating customized reports for various consumers significantly surpasses the cost of compiling financial statements.

Some argue that disclosure is significant due to the representation of accounting system outputs in reports and financial statements, which are prepared based on specific dates to reflect the true state of the organization. Moreover, disclosure is considered a crucial source of information, if not the sole, then for numerous users, the disclosure of pertinent information regarding the organization's operations serves as a crucial means to acquire significant insights. It also serves the purpose of objectively describing and evaluating the facility, thereby meeting the expectations of individuals with a vested interest in it. Consequently, it can be asserted that the act of disclosure yields several advantages for users of financial statements (Azmar, 2015).

1. The disclosure of information plays a crucial role in the financial markets by influencing the financial prices of stocks. This is because disclosure reduces uncertainty related to investment and enhances the willingness of savers to allocate their funds to investors. Furthermore, when information is readily accessible to all market participants without any bias.
2. The regular dissemination of information serves to mitigate the presence of information asymmetry, which can be exploited by individuals or groups inside an organization to obtain significant advantages.
3. The primary function of accounting information is to facilitate the efficient allocation of economic resources by enabling users to make informed decisions based on the information given.
4. Accounting disclosure aids management in showcasing the organization's role in delivering services to all individuals and its commitment to social responsibility within the broader society.
5. Accounting disclosure provides clear and valuable information regarding money market dealers and their transactions which is crucial for establishing a well-organized and effective market. This aspect is considered a fundamental requirement for ensuring market discipline.

When it comes to the significance of disclosure in Islamic banking, it is highlighted by Nadia Al-Sharida and Ammar Al-Samarrai (2019) which as follow.

1. The disclosure of the concentration percentage in Islamic financial products, the bank's capacity to assess risks, and the revelation of the integrity level of internal control systems and their compliance extent.
2. The capacity to effectively handle liquidity and the level of commitment of the Islamic bank towards fulfilling the requirements of the community.
3. The degree to which rules and processes are optimal in the realm of financing and investment operations.

4. The appropriateness of sources and funds and their uses, and the disclosure of the principles followed by the Islamic bank in the distribution of profits.
5. The facilitation of Sharia compliance monitoring through the utilization of financial statements and reports.

The significance of accounting disclosure, both in a general context and specifically within Islamic banks, stems from the value and importance of the information it provides. Additionally, the role of this information in facilitating rational decision-making by users. In the case of Islamic banks, the importance of accounting disclosure is heightened due to the unique nature of the products offered by these banks, as well as their distinctiveness and divergence from the services provided by conventional banks, given that all Islamic contracts and products are founded upon the principle of participation in profit and loss, it becomes imperative to ensure complete, comprehensive, and ethically sound disclosure. Moreover, it is essential to recognize that the recipients of this disclosed information may include individuals who are non-Muslims.

Therefore, it is crucial to establish and foster trust with these individuals by providing them with high-quality information that serves as a reflection of the activities and objectives of the Islamic bank, which are in accordance with the provisions and principles of Islamic Sharia. It is worth mentioning that there has been a notable surge in the number of individuals utilizing Islamic banking services, particularly following the globalization of the banking sector. This has therefore heightened the interest of industry stakeholders. By establishing a mutually agreed-upon standard language for the creation and presentation of financial statements, and present this information in a way characterized by transparency, reliability and integrity which are the Islamic accounting principles, specifically the criteria of presentation and public disclosure (Nadia Shraideh & Ammar Al-Samarrai, 2019).

#### **TYPES OF DISCLOSURE**

There exist numerous forms of disclosure, and perspectives on them exhibit variations among different studies. However, as a whole, these forms can be categorized into the following six significant types, as outlined below:

- First: Full Disclosure: The level of disclosure being referred to is characterized by the dissemination of all relevant information to the recipients of financial reports (Khashrama, 2003).
- Second: Appropriate Disclosure: Disclosure that considers data consumers' interests, the entity's needs, and the context in which the data is used and the nature of an entity's activity is crucial in determining the significance of disclosing financial information. It is not merely about the act of disclosure itself, but rather the value and usefulness of the information for investors and creditors. This value should align with the entity's operations and internal circumstances (Al-Zammar, 2015).
- Third: Adequate disclosure: It is the minimum amount of information that should be disclosed along with their accompanying notes and supplementary information, are published to encompass all pertinent information pertaining to the organization. This is crucial in order to prevent any potential misrepresentation of facts that may mislead stakeholders. Adequate disclosure stands as one of the foremost principles in the preparation of financial statements.
- Fourth: Preventive Disclosure: This form of disclosure embraces the notion of comprehensive disclosure as implemented in the modern accounting framework, with a focus on shareholders, lenders, and creditors - external investors in general - serving as the primary determinant for the content and mechanisms employed in this disclosure (Al-Zammar, 2015).
- Fifth: Educational disclosure: This disclosure presupposes a rational investor possessing extensive expertise and acumen, capable of conducting thorough analysis, conducting comparative assessments, and making professional forecasts.

Furthermore, this disclosure is commonly distinguished by a growing inclination towards augmenting the scope of information provided and diversifying its domains. It emphasizes not only financial data but also encompasses both quantitative and descriptive non-financial information, this includes data pertaining to the production capacity of the accounting unit, the sufficiency and qualifications of its staff, as well as the enhancement of their efficiency and productivity (Al Aloul, 2008).

- Sixth: Fair Disclosure: Fair disclosure pertains to the equitable consideration of the financial requirements of all stakeholders. This entails the production of financial statements and reports in a manner that avoids favoring one group's interests over others. It necessitates a balanced approach that takes into account the interests of all relevant parties (Bradhia & Belazzouz, 2015).

The researcher asserts that it is imperative for Islamic banks to strictly adhere to the implementation of various forms of prior disclosure in all their activities and transactions. This adherence is crucial in order to effectively attain both economic and social objectives, in order to maintain impartiality and address the interests of all key stakeholders. It is imperative to demonstrate commitment and include the values and ethical standards drawn from Islamic Sharia while formulating financial statements and reports.

### **DISCLOSURE TOOLS**

There are numerous instruments that can be employed for the purpose of disclosing financial statements, with particular emphasis placed on the following tools:

#### **First: Financial lists**

The ultimate phase of the accounting system is dedicated to the generation of reports and financial lists, which necessitates handling a substantial volume of data and information, in order to accurately convey the financial status and performance of an institution within regular reporting periods, it was imperative to generate simplified and concise reports that effectively encapsulated the relevant information and extensive data (quarterly, semi-annually, or annually). The presentation of these lists to stakeholders and users for the purpose of making informed decisions, and the identification of the two primary attributes that are most essential to users' needs from these lists (Ashour, 2008):

- The financial position of the company can be assessed by analyzing the statement of financial status.
- The company outcomes can be determined by analyzing the income statement.

The basic financial statements are considered the backbone of disclosure, and their preparation takes into account generally accepted accounting principles. Therefore, Financial Accounting Standard No. (1) issued by the Accounting and Auditing Organization for Islamic Financial Institutions AAOIFI specified a complete set to be published by banks, perhaps the most important of which are the financial position statement, the income statement, and the statement of income cash flows, list of changes in owners' equity or statement of retained earnings, list of changes in restricted investments, list of sources and uses of zakat fund funds (if the bank assumes responsibility for collecting zakat in whole or in part), list of sources and uses of loan funds, notes about the financial statements, any lists or other reports that fulfill the needs of the users of the financial statements (Standards for Islamic Financial Institutions, 2015: 155).

#### **Second: Notes**

It is considered an integral and complementary part of the financial statements. It includes financial statements that are not included in them and are at the bottom of the financial

statements, such as referring to the method used to evaluate the inventory, the depreciation method used, or the events that occur after the budget (Al Zammar, 2015).

#### **Third: Report of the External Auditor**

The auditor's report serves as a concise presentation of the auditor's findings resulting from the examination and audit procedures. The primary duty of the external auditor is to communicate to the stakeholders relying on the financial statements whether the statements have been presented in an unbiased, accurate, and equitable manner (Barimah, 2012).

#### **Fourth: Clarifications**

The clarifications accompanying the financial statements provide additional information that is not explicitly presented in the statements themselves. These clarifications serve the purpose of enhancing comprehension of the items included in the financial statements and the accounting principles employed in their preparation. They may include detailed explanations of accounting policies pertaining to fixed assets, as well as comprehensive descriptions of capital shares, long-term debts, contingent liabilities, and other aggregated items found within the financial statements (al-Muhasabah, 2021).

#### **Fifth: Additional lists and attached lists**

It contains additional lists that are attached to the original lists and provide details on some items included in the financial statements that are not absorbed by the marginal notes, such as fixed assets and methods of depreciation, the statement of financial position based on the change in the general level of prices, the list of debtors, and the provision for in doubt debts, commodity inventory list (Yasmina, 2018).

#### **Sixth: The information found through parentheses**

Brackets are employed within financial statements to elucidate certain figures presented therein that may pose challenges in comprehending their calculation methodologies or rationale for users lacking familiarity with accounting principles, such as the valuation of end-of-period inventory (Yasmina, 2018).

#### **Seventh: Capital Market Requirements**

Periodically during the year, the organization disseminates reports to the financial market encompassing comprehensive financial data that has the potential to impact both the institution itself and the recipients of these financial reports, both presently and in subsequent periods. These reports serve a valuable purpose in facilitating the process of forecasting and enabling stakeholders to make informed and logical economic choices (Al Zammar, 2015).

### **RESULTS AND RECOMMENDATIONS**

after an extensive review of numerous studies pertaining to the subject matter, conducted in various approaches, the study ultimately derived several findings and proposed recommendations aimed at enhancing the accounting disclosure process within the financial statements of Islamic financial institutions, from an Islamic standpoint. This section provides a comprehensive overview of these findings and recommendations:

#### **The Results of the Study**

1. The inclusion of accounting rules and processes adhering to Sharia principles in financial statement disclosures is vital, as it enhances the credibility and dependability of accounting information.
2. The majority of employees within the Islamic banking industry exhibit a strong inclination towards implementing accounting disclosure practices in accordance with Islamic Sharia principles. However, there exist certain hindrances that impede the

- realization of this objective, with the most significant being the sluggishness and lack of commitment displayed by senior management in certain banks within the sector, thereby obstructing the application of accounting disclosure in line with Islamic Sharia.
3. The incorporation of Shariah principles in accounting disclosure enhances the appropriateness and compatibility of financial statements issued by Islamic financial institutions with the standards of a robust accounting system. Moreover, it plays a pivotal role in reducing costs and fostering increased investments by bolstering investor confidence.
  4. The implementation of accounting disclosure from an Islamic standpoint enhances the reliability and trustworthiness of financial statements. It also provides safeguarding Islamic financial institutions against manipulation by individuals who exploit the diverse terminology associated with Islamic finance.
  5. The accounting disclosure of financial accounts from an Islamic perspective promotes transparency, accuracy, and comprehensiveness, so ensuring the integrity of the financial statements.
  6. The implementation of accounting disclosure from an Islamic standpoint promotes a commendable degree of transparency and disclosure of financial information.
  7. One of the primary deficiencies observed among employees in the Islamic banking sector in certain countries is the absence of sufficient experience and the necessity for educational courses and seminars to introduce accounting disclosure from an Islamic perspective. This lack of expertise hinders the effective implementation of accounting disclosure practices in accordance with Islamic principles. Additionally, the absence of active institutions, such as the central bank, stock market, and accountants' union, further exacerbates the challenge of promoting and supporting the application of accounting disclosure based on Islamic principles.
  8. The traditional accounting disclosure requirements are considered insufficient for Sharia-compliant transactions.
  9. The use of accounting disclosure practices from an Islamic perspective has the potential to enhance the international standing of Islamic financial organizations and mitigate instances of Sharia-related conflicts.
  10. The insufficient disclosure of certain accounting policies by certain banks has resulted in failures.
  11. The inadequate supervisory function of Sharia supervisory boards in ensuring compliance with Islamic principles in disclosure practices.
  12. Certain Islamic financial organizations may lack the necessary qualifications to adhere to disclosure requirements from an Islamic standpoint.

### **The Recommendations of the Study**

1. The imperative to mandate Islamic financial organizations to adhere to Islamic accounting principles for the purpose of enhancing the credibility of accounting information.
2. One crucial aspect in facilitating the implementation of disclosure practices in the Islamic banking industry is the removal of barriers that hinder employees' willingness to adhere to Islamic Sharia provisions. A significant impediment that needs to be addressed is the lack of commitment and sluggishness exhibited by senior management in effectively attaining this objective.
3. It is imperative to disseminate knowledge to those involved in Islamic financial institutions regarding the necessity of implementing accounting disclosure practices aligned with the Islamic perspective. This measure serves to safeguard institutions against manipulation and enhance the credibility and trustworthiness of their financial statements.
4. This statement emphasizes the importance of adhering to the Islamic perspective in the disclosure practices of Islamic financial institutions. It asserts that deviating from this perspective may result in variations in the extent and approach of financial information

- disclosure. Conversely, it suggests that adopting the Islamic perspective in disclosure practices will ensure a satisfactory level of financial information disclosure.
5. One potential approach to enhance the understanding and appreciation of financial disclosure from an Islamic standpoint is to implement more rigorous training programs and seminars. These educational initiatives would aim to emphasize the significance of accounting disclosure within the context of Islamic principles and values.
  6. The State provides assistance to its operational entities, including the Central Bank, accounting unions, and regulatory agencies, in order to facilitate the implementation of accounting disclosure practices within Islamic financial organizations, in accordance with Islamic principles.
  7. In order to attain worldwide recognition, it is imperative to prioritize the implementation of accounting disclosure practices from an Islamic standpoint within Islamic financial institutions. This measure aims to mitigate potential conflicts arising from Shariah-related matters.
  8. One potential approach to enhance accounting disclosure in Islamic financial institutions is to intensify regulatory pressure exerted by Sharia supervisory boards. This would entail enforcing stricter adherence to accounting practices aligned with the Islamic worldview.
  9. One way to enhance the operations of Islamic financial institutions is by ensuring that they have a team of well-qualified individuals who can effectively implement the Shariah provisions of transparency in their financial statements.

## **CONCLUSION**

This article examines the accounting disclosure practices in the financial statements of Islamic financial institutions, specifically from an Islamic perspective. The objective is to provide a comprehensive understanding of accounting disclosure in accordance with Islamic principles and to highlight its distinguishing features compared to conventional disclosure methods. The accounting disclosure from an Islamic perspective is deemed essential for enhancing confidence and reliability in accounting information.

Moreover, it facilitates transparency, precision, and comprehensiveness in financial accounts, hence upholding their integrity. This was done by talking in some detail about the concept of disclosure, its importance, types and tools. This study has yielded several key findings, with one of the most significant being the crucial role of accounting disclosure in Islamic financial institutions. It is imperative that these institutions adhere to the principles of Islamic Sharia in order to enhance the reliability of the accounting information they furnish. Furthermore, accounting disclosure plays a significant role in enhancing the correctness, comprehensiveness, and integrity of financial statements.

In this study, we have provided some recommendations aimed at clarifying the significance of accounting disclosure from an Islamic perspective. The most significant the purpose of these recommendations is to enhance the understanding and recognition of the significance of adhering to accounting disclosure practices in line with Islamic Sharia within the realm of Islamic financial institutions. Additionally, it is suggested that regulatory authorities should intensify their efforts to enforce compliance with these practices among Islamic financial institutions.

In conclusion, it is our aspiration that this paper serves as a foundational step towards the implementation and endorsement of accounting disclosure in Islamic financial institutions, aligning with the principles of Islamic Sharia and deviating from conventional disclosure practices. This approach aims to mitigate legal discrepancies among Islamic financial institutions and minimize variations in the extent and methodologies employed for financial information disclosure.

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