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ISLAMIC BANKING AS AN ALTERNATIVE TO BANKS IN THE WESTERN COUNTRIES

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Abstract. *After the last banking crisis in the Western world, which provoked an economic recession in many countries, the attention to Islamic banking has increased. Islamic banking took a more important place in global banking, since the economic and financial crisis there was of smaller scope than in the banks of Western countries.*

The principles of Islamic banking are based on Shariah requirements, which emerged from the Koran. The most important fact is that Islamic banks cannot seek profit, which does not require any risk or efforts. They do not use any financial instruments, which are not covered by assets (derivatives). On the other hand, Islamic banks, while granting loans, assume all or a part of risk, if in the case of implementation of project some losses appear. They responsibly appreciate the possibility of granting the loans, the main goal of which is to finance projects and promote business development; they share the risk with the clients and value mutual cooperation.

The goal of the article is to investigate the peculiarities of Islamic banking. The article investigates the formation of Islamic banking's main characteristics and principles, its accounting peculiarities and the instruments that are applied.

Research methods include the analysis of collected information, comparison, critical assessment and induction.
Keywords: *Islamic banking, Shariah requirements, banking principles, banking products, corporate social responsibility.*

1. Introduction

Islamic banking appeared as an alternative to traditional banks.[1] It developed very fast and it became an important part of global banking. The stability of global banking depends, to a great extent, on the success of all the banks which participate in this system. The latest banking crisis, when many traditional banks, which were considered to be reliable, went bankrupt, provoked the crisis in other economic spheres, and negatively influenced the economics in many countries of the world.

[1] In this article, traditional banks refer to banks that exist in Western countries and that follow the laws and norms of ethics existing in Western countries.

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The crisis revealed the weaknesses of many traditional banks. An irresponsible granting of loans, an irrational application of financial derivatives and excessive profit seeking undermined the confidence of society. The Islamic banking industry suffered less not because of the collapse of the banks but because of the impact of the crisis in other countries, on the economy of Islamic countries and asset price decrease. Therefore, it drew attention to Islamic banking.

The other reason why the interest in Islamic banking is increasing is due to a growing number of immigrants to Europe and America from Islamic countries. They need such banking services that will not contradict their religious beliefs. Some traditional banks have so-called “Islamic windows” that function as separate departments and their activity is closely related to the requirements stated by Islamic banking.

This article compares the results of Islamic banks and their activities with their counterparts in the Western world. It is assumed that banking principles applied by traditional banks are known publicly. Therefore, the article does not present any additional investigation regarding traditional banking methods.

2. The Modern Features of Islamic Banking

The beginning of modern Islamic banking is considered to be the seventh decade of the last century. In 1963, in Egypt and Malaysia, the first prototypes of banks were established. The economist Ahmar al Naggar founded the Mit Gharm Savings Bank in Egypt as an experimental company functioning under the principles of Shariah.

The structure of bank management was taken over from German banks. The bank held clients’ deposits and granted loans, but interests were not paid. In the first year of their activity, the bank had 17 560 depositors. Later, after three years, the number of depositors increased to 251 152. The bank did not advertise its activity, because it was feared that such a banking practice, which functioned under Shariah requirements, would be evaluated as a stimulation of fundamentalism. Hence, it did not comply with the governmental policy of Egypt. This fear was confirmed, because after five years, the bank was closed, but the idea of Islamic banking was successful (Gilles 2002).

In the same year, in 1963, the Pilgrims Saving Corporation of Malaysia started its activity in the country, but it was not a bank, though it applied many principles of modern banking. The main goal of this corporation was to help save or lend money to Islamic believers for a trip to the holy city of Mecca. Up to that time, the banks took interest from people who wanted to borrow money for this purpose. The Pilgrims Saving Corporation of Malaysia increased the scope of its activities. If in the first year of functioning the bank had 1 281 depositors, after 22 years from its establishment, i.e., in 1985, the bank had 65 subsidiaries in the country, and the number of people who were saving money for their pilgrim journey to Mecca increased to 867 220. After several years, the corporation was renamed to Lerubaga Tabung Haji and is still functioning today (Çizakça 2011).

Later, more banks and institutions that apply Shariah requirements began to function. The data about the most important Shariah banking aspects are presented in Table No. 1.

TABLE No. 1. **The most important historical aspects and events of Islamic banking.**

The *Mit Gharm* Savings Bank was established in Egypt in 1963, which greatly influenced the further development of Islamic banking;
The *Pilgrim Saving Corporation of Malaysia* was established in 1963. Although officially this institution was not considered as a bank, many principles of modern Islamic banking were applied;
The *Islamic Development Bank* was established in Saudi Arabia in 1975. It was the first Islamic bank that functioned internationally. The bank established its subsidiaries in neighboring countries and its contribution to international trade and exchange was great;
The *Islamic Insurance Company of Sudan* was established in 1979 – it was the first Islamic insurance company;
The first investment fund that invested only in companies working under the principles of Shariah was established in 1986 in Indiana state (US);
Shell MDS in Malaysia established an Islamic bonds equivalent in 1990, which is considered to be the beginning of the Islamic Stock Exchange Market;
The *Accounting and Auditing Organization for Islamic Financial Institutions* (*AAOIFI*) was established in 1991. The goal of the organization was to establish general accounting and auditing standards for all Islamic companies;
The *Citi Islamic Investment Bank* (a subsidiary) in Bahrain was founded in 1996 by Citibank; it provided services to its customers according to Shariah requirements. It was the first commercial Western bank that entered the Islamic market with specific products and services;
The *Dow Jones Islamic Market Index* was introduced in 1999; this index is considered to be the first stock exchange market index and it tracked the return on Islamic investment funds;
The *Islamic Financial Services Board* was established in 2002; it was the first Islamic organization that regulated the activities of Islamic financial companies;
The *Islamic Bank of Britain* in 2004 became the first Islamic ban, that expanded beyond the borders of the Muslim world.

Source: Prepared by the authors on the basis of a 2015 study by Alharbi.

In 1998, the Dow Jones Index introduced the Dow Jones Islamic Market Index (DJIMI). It helped the Islamic financial sector to gain international acknowledgement and trustworthiness. The connection of the accumulated capital of Islamic countries with one of the leading financial institutions of capital market provided many opportunities for investors to invest in Islamic companies, which function under Shariah requirements.

As the industry of Islamic banking gained more power and expanded, some organizations, which aimed to unify and develop their activity, were founded.

In 1991, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) was founded with a goal to create and generate accounting and auditing standards for Islamic financial institutions. In 2002, the Islamic Financial Services Board (IFSB) was established. Its aim is to promote transparency in accepting new standards. IFSB coordinates its activities with the Bank for International Settlements (BIS).

Islamic banks, like traditional banks, accept deposits and, while granting loans and investing money, they generate profit. According to the requirements of Shariah, it is prohibited to pay and take interests. Islamic banks share the profit with customers or pay an agreed sum of money in advance in exchange for lent money.

According to the function and level of risk, three types of deposits can be named: current accounts (settlement accounts), savings accounts and investment accounts (Mackevičius, Čiapas 1998).

Current accounts do not guarantee any return for a depositor. The depositor entrusts money to the bank, the bank uses the money at its discretion as long as it does not contradict the Shariah requirements. The client has the right to withdraw money anytime.

Savings accounts give possibility to the client to get some profit for money lent to the bank. Differently from traditional banks, the Islamic bank generates profit which is not predetermined. The invested money can bring not only profit, but losses, too. However, if the project fails, the Islamic bank covers the losses for their depositors.

Investment accounts can generate the highest return to the clients; however, they are the most risky. If the client's money was invested in a project that failed and generated loss, the client may lose all the money in this account.

The Sariah council supervises the activities of Islamic banks. It not only supervises banking operations but it can announce regulations that cover products/services offered by the banks as well as applied practice (Wardheny, Arshad 2012). The regulations are just recommendations, but they have to be followed. The structure of the Shariah council is different in different countries, but it usually consists of three to six members. In big international banks, there may exist a central Shariah council and subordinate regional councils. The Shariah council is of great importance to the bank, too. Its existence strengthens confidence in banks and predicts in advance any legal misunderstandings or penalties due to the operations that do not comply with Shariah requirements.

3. The Principles of Islamic Banking

The Islamic banking is grounded on Shariah requirements and moral regulations. Consequently, Islamic banks apply the same measures as the traditional banks do, but only if they do not contradict Islamic traditions. Islamic banks participate in supporting economic equality and reducing social exclusion (Khurshid, Soliman 2014). The following principles must be followed:

1. Prohibition to take interest.[2]
2. Prohibition to speculate and gamble.
3. Ethical investment.
4. Corporate social responsibility (Lewis 2007).

[2] There might be exceptions.

Prohibition to take or pay interest is called *riba* in Arabic. In literature, this term (*riba*) is understood as income increase, growth, addition or usury. Some scientists treat it as a forbidden (prohibited) profit (Ayub 2006, p. 47). Prohibition to pay or take interest is based on arguments presented in Picture No. 1.

Profit for the sake of profit does not create any public benefit;

Stimulating the exploitation of less fortunate people;

It is not honest to earn profit without taking any risk;

Loss of profit from good projects which do not offer valuable collateral;

The negligence of banks is stimulated;

The development of small and medium-sized businesses is not stimulated.

PICTURE No. 1. **The arguments prohibiting paying/taking interest in Islamic banking.**

Source: Prepared by the authors on the basis of studies by Ahmad (2002), Amuda (2015), Ayub (2007), Hassan (2005), Hossain (2009), Shahar (2014).

According to the Koran, taking interest is prohibited because it allows the rich people to exploit and gain profit from the less fortunate. Seeking profit without taking any risk in Islamic banking is considered to be immoral. The roots lie in Shariah law, which states that making money out of money is not acceptable if it does not bring any welfare to the public. Following this principle and if compared to traditional banks, some peculiarities and differences emerge and these are depicted in Table No. 2.

TABLE No. 2. **The peculiarities and differences of Islamic bank activities as compared to traditional banks.**

Content	Islamic banking	Traditional banking
Loans	They grant loans on the basis of risk sharing	Loans are good granted if a collateral is pledged
From the point of view of the client	He/she is considered as a business partner	He/she is considered to be a potential profit source
The basis of granting a loan	The project itself	The creditworthiness and reliability of a borrower

Source: Prepared by the authors.

Islamic banking implies that the process of earning profit must be related with the bank risk. Therefore, while granting a loan to a customer, the Islamic bank can gain profit if the implemented project generates profit. In other words, in Islamic banking, the interest of a granted loan is changed by the risk-sharing concept. The financial result – either in the form of profit or loss – goes to the businessman and the bank in predetermined parts if the project was realized on the basis of the credit granted by the bank.

In Western countries, if a businessman wants to take a loan to finance his business, he has to take the risk. The bank grants a loan if a collateral is pledged and the bank earns interest. If the business goes bankrupt, the bank becomes the owner of the collateral. Having sold it, the bank covers the unpaid loan amount, gets interest, interest for latency, because the loan instalments were not paid on time.

The comparison of a business project crediting policy indicates that Islamic banks do not reject capital as an important production action; however, the return on capital is not based on prefixed interest but on sharing the gained profit and loss. Therefore, an Islamic bank evaluates the financed projects more carefully and takes a different point of view regarding the customer and project financing. An Islamic bank and a debtor become business partners. The first finances the project and the other implements it. Hence, in such circumstances, the priority of granting a loan is given not to a collateral but to the project itself. Such process stimulates a more rapid development of small and medium-sized businesses, because their initiators do not usually have the necessary start-up capital to implement projects.

The mentioned limit can be of several types. The most widely used categorization is between interest *al-fadl* (*riba al-fadl*) and interest *al-nasia* (*riba al-nasia*). Interest *al-fadl* (*riba al-fadl*) can emerge because of barter trade. The Koran states that if two parties exchange gold, silver, grains, such an exchange is legal if the wealth used in barter transaction is of the same weight and quality. Sometimes, if one good is exchanged for another, their quality might be different (e.g., grains that grew in different farms or under different climate conditions). If goods under exchange are different, interest *al-fadl* (*riba al-fadl*) may appear. Interest *al-fadl* (*riba al-fadl*) is prohibited; therefore, goods must be exchanged for money and settled in cash. Interest *al-nasia* (*riba al-nasia*) means interest for latency. It appears when the date of repaying the loan is over and a debtor would like to prolong it. The other case is when two legal entities exchange gold. One gets an ounce of gold from the other when the transaction is concluded and he/she promises to repay 1.5 ounce of gold after two years. *Riba al-nasia* is prohibited according to Shariah requirements as well.

According to Shariah law, it is not allowed to benefit without effort and when only a random factor brings the result (Bęllah, Maserd 2013). It means that two parties cannot make a deal, because when the term is over, one party will acquire profit and the other would incur losses, but nobody could predict the outcome at the time when transaction is being concluded. Therefore, no lotteries or bets can exist in countries that follow Islamic traditions, because such gambling makes some people rich, yet economic welfare is not created (El Gamal 2006). At the same time, banks and other financial institutions cannot sell insurance policies, which are very popular in Western countries, because it is considered gambling in order to win big amounts of money by taking advantage of chance (*maysir*). In this case, if the buyer is going to use insurance policy and will get an insurance premium, that individual will be the winner, as the buyer had paid a small amount of money but will get a bigger insurance premium according to the transaction, and the bank or insurance company will be the losing party. If the buyer did not make use of the insurance policy and would not get any premium, then that individual will be the losing party, as the buyer's loss will be equal to the insurance premium, and the bank or insurance company will be the ones winning.

Insurance companies do function in Islamic countries but they are working under a different principle. These are the so-called collective type of companies, where members regularly pay a certain amount of money (a fee) and, in exchange, they receive a compensation if something happens.

Islamic banks and other legal entities are obliged to not conclude an exchange or any trade transactions where the result is unpredictable. It is closely related with derivatives (financial instruments), such as options, forward contracts, swaps, future contracts. Uncertainty about the interest rate or a product that is related with derivatives, changes in price, forms uncertainty. Therefore, such a prohibition does not allow the countries to take on any ungrounded risk and assure, when the validity date of a transaction is over, that no arguments or disagreements will appear, because one or the other party had expected different results.

Ethical investment. Islamic banks invest only into such activities that do not contradict the requirements of Shariah. The Koran states that any action that is not prohibited is permissible. Those transactions that do not comply with Shariah requirements are called *haram*. *Haram* must be followed by everybody – investors and legal entities alike.

Kham and Bhatti (2008) indicated several *haram* spheres. They are as follows: gambling, cinema, pornography, music, tobacco, alcohol and pork. If it happens that only a part of business, which is expecting investments, is related with one or several forbidden activities, such an investment is not allowed. If a concern runs a small daughter company that, for example, produces tobacco, nobody has the right to buy any shares of the company. Islamic banks cannot invest in traditional banks and other financial institutions if they do not function in accordance with Shariah requirements.

Corporate social responsibility in Islamic countries is revealed through the religious *zakat* payment (tax fee). In some countries, the *zakat* payment (tax) is obligatory, while in others it is voluntary. An obligatory *zakat* payment (tax) is paid by companies and people in Liberia, Malaysia, Pakistan, Saudi Arabia, the Sudan and Yemen. In other countries like Egypt, Bahrain, Bangladesh, Indonesia, Iran, the Jordan, Kuwait, the Lebanon and the UAE (United Arab Emirates), this payment (tax) is voluntary. A 2.5% tax rate is imposed on cash and on other property, like agricultural goods, precious metals, minerals and cattle (Ayub 2006); the tax can vary from 2.5% to 20%.

This tax functions like a mechanism for redistributing wealth. It increases the purchasing power of people who aren't well-off, diminishes social exclusion and increases economic growth (Guermant at al. 2003).

It is considered that the *zakat* tax brings a double benefit, because companies get rid of greed and selfishness. Hence, this type of tax (payment) enhances economic development, as the part of a society that is not very well-off gets supported and their money goes in buying the most necessary products. It increases total demand and, at the same time, facilitates production and investments (Saad 2014).

In those countries where the *zakat* tax is obligatory, the collection of tax is administrated by governmental institutions, and elsewhere this voluntary tax goes to non-profit organizations.

3. Financial Instruments Used in Islamic Banks

Islamic banks provide a wide spectrum of services to their customers – from credit cards, consumer loans to financing international trade and real estate business. They apply a wide array of financial instruments. The following four are the most important:

- The Islamic business financing model according to which the bank finances the client's business alone. It is *mudaraba*;
- The Islamic business financing model according to which the partners, in the presence of the bank, use the capital together for establishing and developing the company. It is *musharaka*;
- An Islamic financial contract used when the bank buys some product for a customer and the customer is obliged to pay an agreed sum of money every month. It is *murabaha*;
- An Islamic lease contract is called *ijarah*.

Mudaraba is one of the most popular and historic ways of financing in Islamic banking. The essence of it lies in the fact that a bank and its client, who has business project, conclude a contract. The banks grant capital for business development; in turn, the client is responsible for the execution of the project. Though the bank has all the rights of ownership, it does not participate in project management. The bank provides capital, and the customer – work and knowledge. A *Mudaraba* contract is most suitable for projects if the time of implementation is not long (Visser 2013).

In a contract that was concluded between a bank and a customer, the duration of a project is indicated as well as the proportions of profit sharing. If the project failed and generated loss, the bank loses all invested capital. The customer risks of losing the job that he held onto while implementing the project, which effectively is the source of his living and reputation. In the case of big negligence, the bank can bring the case to the court and ask for a compensation of losses.

Another alternative of *mudaraba* is possible – the customer himself becomes the investor and grants capital to the bank and the bank meets the obligation to invest money.

A *Mudaraba* contract can be of one or two stages. If it is a one-stage contract, one investor and one project executor participate in it. If it is two-stage contract, three parties participate: a bank and two customers. The bank is like an intermediary between two clients. The bank forms a transaction where the first customer becomes the investor. At the same time, the bank concludes a contract with the other client, too. According to this transaction, a bank becomes the investor, and a client – an executor. Both transactions foresee the proportion of profit sharing. If the project fails, the first client will experience losses because he was the primary source of financing the project.

Musharaka is very similar to *mudaraba*. The main difference is that in the case of a *mudaraba* contract, the project is financed by the investor, i.e., by the bank. In the case of *musharaka*, the project is financed by both parties. This contract is chosen if, in the bank's opinion, the project is risky or when a bank wants to participate in project management. Therefore, both the bank and the client have the right to manage the project, to get a part of profit and, in the case of failure, have to share the losses. Usually, profits are shared proportionally to the part of invested capital. In other cases, profits can be shared in other proportions than the part of invested capital (Ahmad). However, if the project incurs losses, then this amount will be divided in accordance with the ratio of invested capital. Also, the bank has the right to claim a fixed fee for loan administration.

There are several types of a *musharaka* contract: permanent *musharaka* and diminishing *musharaka* (Szczepanowicz 2011). In the case of a permanent *musharaka*, both parties are regular shareholders of the project. They can lose shares if the project is not valid any more or when, on a mutual agreement, one party takes over the rights of other parties to participate in the project. In the case of a diminishing *musharaka*, the right – usually this concerns the bank – to participate in the project gradually diminishes. The other party commits itself to redeem all the shares gradually. Hence, the client becomes the single owner of the project. The bank's earnings consist of a part of annual profits and difference between the initial investment and money for shares sold.

Murabaha is used when a customer wants to buy some product but is short of money. Banks, according to the agreement with the customer, buy the product on behalf of themselves and later sell the mentioned product to the client for a bigger price (Addawe 2012). Such type of financing differs from services provided by traditional banks. If a client took a loan from the bank for purchasing a product, then the term of paying interests would depend on the term of the loan. However, a *murabaha* contract is different. The profit margin is fixed irrespective of the term when the loan is due for the purchased product. The customer can repay the bank at once when he/she receives the goods, or it can be a payment by instalments at a certain period of time. The bank is responsible for a product from the time when it was bought to the time when it was passed over to customer for rent.

Two *murabaha* contract types are used in practice: *bai salam* and *bai istisna*. *Bai salam* means a trust sale. Although, according to Sariah requirements, nobody can purchase a product that does not exist, *salam* is an exception under the condition that some additional rules are followed. The most important additional rules are as follows: the time for the delivery of goods must be fixed, the weight of goods must be defined in advance, the appearance and other important factors must be discussed. If the seller followed all the points stated in the agreement while delivering goods, then the buyer must buy the product. This financial instrument is used in agricultural activities. The bank buys a product on an agreed price from the third party, which is not produced yet. The seller, usually a farmer, receives money in advance, which can be used for the development of the farm, and the bank acquires the product that can be sold later at a higher price. Very often banks conclude a parallel *salam* contract according to which a given bank undertakes the responsibility of selling the product that is not yet produced. Hence, the bank minimizes the risk of being an intermediary.

The *Bai istisna* variant of contract is applied when a client wants to purchase a product that must be produced in accordance with the needs of the customer. The customer concludes a contract with the bank, stating what kind of product he wants to buy, and the bank, in its turn, concludes a contract with a third party, for example, for producing a car. The bank can pay the third party right away or pay in instalments. When the product (commodity) is produced, the bank takes it from the third party and transfers it to the client. The client pays for the product to the bank the sum of money that it had paid to the third party plus an agreed margin based on the transaction. There exist certain differences between *bai salam* and *bai istisna*. They are indicated in Table No. 3.

TABLE No. 3. **The comparison of products according to *bai salam* and *bai istisna*.**

Difference	***Bai salam***	***Bai istisna'***
A commodity/ product	It can be any product.	The product that is ordered and produced according to a specific order.
Payments	All the money must be paid right away.	Money can be paid right away or by multiple payments.
Withdrawal	Irrevocable	It can be cancelled if the production of the product (commodity) has not begun yet.
Delivery	The time of delivery is fixed beforehand.	The time of delivery is not necessarily fixed beforehand.

Source: Prepared by the authors on the basis of a 2017 study by Muhammad.

According to the table, *bai salam* is applied to finance any type of commodity (product), and *bai istisna* – for ordering a specific product for a client. According to a *bai salam* contract, money for a produced commodity (product) must be paid right away, and according to *bai istisna* – it can be paid right away or by instalments. A *Bai salam* contract cannot be withdrawn, but *bai istisna* can be withdrawn up to the time until the ordered commodity undergoes the process of production. And, as it has already been mentioned, according to *bai salam*, the contract of the delivery of goods is fixed in advance, while according to *bai istisna* it is not necessarily so.

Such commodities like gold, silver, corns, salt and dates, which were used as barter goods in the old times, cannot be bought and sold according to a *murabaha* contract.

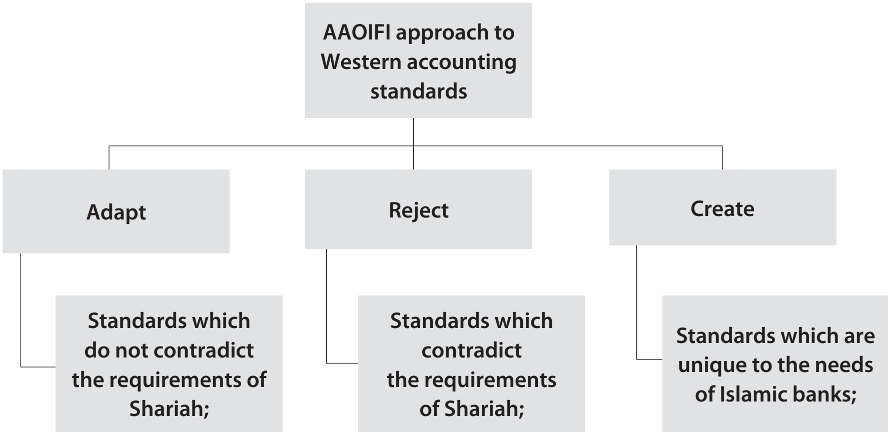
Ijarah is the term for Islamic leasing. The order and terms of leasing are almost the same as in Western countries:

- At the expiration date of a contract, the customer is either denied the right to leasing of goods (product, commodity) or the client becomes the owner of a commodity (depending on the initial contract). The difference with the international leasing lays in the fact that the lessor must own the assets for the full lease period, and the lessor can't charge any compound interest if the lessee defaults on payments or delays payments.
- According to an *Ijarah* contract, the bank is the owner of the product and if the commodity breaks or is stolen, the losses go to the bank. An exception is possible if the client intentionally damages product or if he/she uses it improperly (Mateeha 2006).

4. Regulation of Audit and Accounting in Islamic Banking

Specific principles of Islamic banking determined the origin of auditing and accounting standards for Islamic financial institutions. They consist of three standard groups: Shariah Standards, Accounting Standards and Auditing, Governance and Ethics Standards. The regulations of these standards comply with the requirements of Shariah. Shariah legal regulations are clarified in Shariah standards, Accounting Standarts cover accounting practice and audit, internal control, management and ethic requirements are covered in Auditing, Governance and Ethics Standards.

Standards are authorized by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), which was established in 1991. In 1993, the memorandum of the Statement of Financial Accounting No. 1: Objectives of Financial Accounting for Islamic Banks and Financial Institutions was produced, where the purpose of the standards is indicated under a condition that Islamic financial accounting should present a true and fair view of a financial status, activity results and state the facts of prohibition and permission. The AAOIFI does not ignore the IFRS. AAOIFI's attitude toward the TFAS is presented in a picture below.



PICTURE No. 2. **The AAOIFI's attitude toward the international standards of financial accountability.**
Source: Prepared by the authors on the basis of Shahul (2007) and Harmonising financial..., 2010.

The AAOIFI and IFRS differ on the basis of their geographical spectrums and purposes. The AAOIFI standards are applied to Islamic financial institutions, the banks firstly, and the IFRS are applied in companies, irrespective of a company's type of activity.

Despite of differences in the Accounting Standards for Islamic Financial Institutions and the IFRS, their regulations do not differ radically. The existing differences are related to the peculiarities of a bank's activities.

At present, 27 Accounting Standards regulating the activities of Islamic banks and financial institutions are valid. Few standards are very similar to the IFRS; others are specific to Islamic financial institutions. The list of standards is presented in Table No. 4.

TABLE No. 4. **Standards regulating activity and accounting of Islamic banks.**

The standard number	The name (title) of the standard
1	General Presentation and Disclosure in the Financial Statements of Islamic Banks and Financial Institutions
2	*Murabaha* and *Murabaha* to the Purchase Orderer
3	*Mudaraba* Financing
4	*Musharaka* Financing
7	*Salam* and Parallel *Salam*
8	*Ijarah* and *Ijarah Muntahia Bittamleek*
9	*Zakah*
10	*Istisna's* and Parallel *Istisna'a*
11	Provisions and Reserves

The standard number	The name (title) of the standard
12	General Presentation and Disclosure in the Financial Statements of Islamic Insurance Companies
13	Disclosure of Bases for Determining and Allocating Surplus or Deficit in Islamic Insurance Companies
14	Investment Funds
15	Provisions and Reserves in Islamic Insurance Companies
16	Foreign Currency Transactions and Foreign Operations
18	Islamic Financial Services offered by Conventional Financial Institutions
19	Contributions in Islamic Insurance Companies
20	Deferred Payment Sale
21	Disclosure of Transfer of Assets
22	Segment Reporting
23	Consolidation
24	Investment in Associates
25	Investment in Sukuk, shares and similar instruments
26	Investment in Real Estate
27	Investment Accounts

Source: Prepared by authors on the basis of financial accounting standards.

Though the AAOIFI standards are created specifically for Islamic financial companies, not all banks comply with the requirements. This application is regulated by laws in different countries. Some countries give the companies the freedom to choose which set of standards they will use, while others state exactly which set of standards the companies have to use for their financial statements. Below, in Table No. 5, a list of Islamic banks operating in different countries that either use the IFRS or AAOIFI standards is presented.

TABLE No. 5. **The application (adoption) of the AAOIFI standards in some countries.**

Country	Bank	Set of standards
Kuwait	*Kuwait Finance House*	IFRS
Bahrain	*Al Salam Bank- Bahrain*	*AAOIFI*
Qatar	*Qatar Islamic Bank*	*AAOIFI*
Saudi Arabia	*Samba Financial Group*	IFRS
UAE	*Dubai Islamic Bank P. J. S. C.*	TFAS
Sudan	*Faisal Islamic Bank*	*IFRS*

Source: Prepared by authors on the basis of the Adoption of AAOIFI Standards.

5. Conclusions

Islamic banks offer alternatives to their customers, providing the type of services used by traditional banks that do not contradict Shariah requirements. The policy of granting loans is different from traditional banks.

Islamic banks do not get fixed any income for granting the loans. When a bank grants a loan, it participates in the implementation of the project together with customer. If the project is successful, the Islamic bank gets a rather big revenue and in the case of failure, it shares losses with the client. Therefore, Islamic banks are interested not in the collateral, but how risky the project is.

Traditional banks grant credits if the customers pledge a collateral. They want to be sure that the loan will be repaid. Hence, all risk related with implementation of the project and the loan burden the customer. The bank gets interest in spite of how successful or not the project was. Therefore, the bank grants a loan without any essential concern about the project's implementation. If the initiator of the project does not have any collateral that could cover the loan in the case of failure, the bank does not finance the project. Such practice protects, to some extent, traditional banks from failure, but companies can go bankrupt because of the loans. However, all the banks are closely related with legal entities and any economic upheavals make impact on the financial stability of all banks.

Unlike traditional banks, the Islamic banks' activities are based not on profit maximizing but on cooperation with the customer. The essence of cooperation is mutual benefit and risk. Continual cooperation between a bank and client calls for mutual trust, the strategy of the bank's activity is more realistic, and it helps to ensure a lasting financial stability of a bank, which is the basis of economic stability and development.

Islamic banks have the tendency to finance riskier but more profitable projects. They do that by transferring a part of the risk to the depositors and, in that way, they minimize their own risk. Such a policy does not restrict the interests of the customers because they can choose the type of deposit, the risk and the possibility to get wanted return.

In the short period of time, the Islamic banks can experience poorer results than traditional banks. However, such a strategy of the Islamic banks ensures stable activity and profit, minimizes financial recession and the risk of bankruptcy.

Traditional banks apply more complex financial products, like derivatives, in their work process. Such instruments can help in generating bigger a return than usual financial tools but they are riskier. If the economic situation in the country is complicated, it may cause a big financial risk for the banks and the economy as the whole. In Islamic banks, all financial products are based on real assets. They are not using derivatives. In an economic boom, the application of smaller leverage provides poorer results than by applying derivatives, but in the rather complicated economic situations for banks, the Islamic banking system provides more financial stability.

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