

## Islamic Finance and Accounting Standards in the UK: A Political Perspective

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### Abstract

*This research aims at exploring the needs of accounting standards in the United Kingdom A Political Perspective as to whether they require a set of standars either under IFRS or other specific standards. Systematic Literature Review is adopted in this research to summarize previous studies with the subject of standart islamic accounting. The research method utilized Systematic Literature Review (SLR), enabling the collection, evaluation, and synthesis of diverse literature related to Islamic Finance and Accounting in the United Kingdom, The SLR steps are identified and carried out throughout the study to arrive athe the analysis. The research findings reveal that there is a huge need of applying a specific accounting standard in the United Kingdom a Political Perspective. As the demand for Sharia-compliant financial products and services grows, there is a need for a robust accounting and regulatory framework to govern this industry. the process of setting standards for Islamic finance and accounting in the United Kingdom is not merely a technical exercise; it is deeply influenced by political factors and power dynamics. The results indicate that this study highlights some key issues that may pose important recommendation to the accounting standard setter such as in this case United Kingdom Accounting Standards.*

**Keywords:** Accounting Standards, Political Perspective, United Kingdom, Systematic Literature Review

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### 1. INTRODUCTION

Islamic finance is an emerging sector in the United Kingdom's financial landscape. As the demand for Sharia-compliant financial products and services grows, there is a need for a robust accounting and regulatory framework to govern this industry. However, the process of setting standards for Islamic finance and accounting in the United Kingdom is not merely a technical exercise; it is deeply influenced by political factors and power dynamics. This paper explores the political dimensions of Islamic finance and accounting standard-setting in the United Kingdom.

The growth of Islamic finance in the United Kingdom over the past few decades has brought with it a need for accounting and reporting standards that align with Sharia principles. Islamic finance transactions and products differ fundamentally from their conventional counterparts in terms of their underlying contracts, equity-based financing modes, and avoidance of interest. As such, they require

distinct guidelines to ensure proper accounting treatment and reporting.

The United Kingdom welcomed the trend of Islamic banking and finance from the beginning of the emergence of this system, namely the late 1970s and early 1980s, with the introduction of murabahah transactions. In 1976, after the First International Conference on Islamic Economics, held by King Abdul Aziz University, Jeddah in Makkah Al Mukarramah, Saudi Arabia, the United Kingdom (UK) Leicester Islamic Foundation established the Islamic Economics Unit as the first research center on the subject of Islamic economics. This research center was followed by the International Center for Research in Islamic Economics at King Abdul Aziz University in 1977.

The English Islamic Foundation then published major works by pioneers of Islamic economics, banking and finance such as Nejatullah Siddiqi, Umer Chapra, and others (2014). Then in 1981, the International Association for Islamic Economics was

established in Leicester, UK, which was responsible as an organization for the international conference on Islamic economics. The 4th International Conference on Islam was held in Loughborough, England in 2000, the 8th and 9th Conferences were held in Qatar in 2011 and the last one in Turkey in 2013. In 1982, the UK allowed Dar Al-Mal Al-Islami (DMI), based in Geneva, to open an office in London and mobilize investment funds for the Luxembourg investment company and the Luxembourg takaful company. DMI was under the supervision of the Commonwealth of the Bahamas with headquarters in Geneva (Switzerland) aiming to conduct business in accordance with Islamic laws, principles and traditions as well as offering various Islamic financial services. Furthermore, in 1983 the United Kingdom Takaful company was established as a subsidiary of DMI to meet the needs of Muslims in the United Kingdom by offering Sharia-compliant investment opportunities provided by Takaful United Kingdom in Luxembourg. The establishment of Takaful was intended for those who believed that conventional financial products, especially insurance, were contaminated by interest or *riba*. Still in 1983, the Bank of England (BOE) granted permission to Al-Baraka Bank to operate in the UK. This bank was founded in 1982 by the Al-Baraka Investment Company based in Jeddah, Saudi Arabia. This bank was the only bank at that time that exclusively offered Islamic banking services in the United Kingdom under the 1987 Banking Act. Al Baraka Bank was the main initiative in housing finance because it had started providing long-term financing for Sharia-compliant home ownership for its customers since 1988 and onwards (Rodney Wilson, 1999).

Next, in 1995, Loughborough University became the first Western university to recognize and adopt the system of Islamic banking and finance at the Master's level. The university collaborated with the English Islamic Foundation to sponsor joint research to improve teaching and supervision for students choosing elective courses in their master's degrees. In the same year, they held an International Conference in cooperation with the IDB on Islamic Economics and Finance, attended by central bank governors from Muslim countries such as Malaysia and the UAE. After that, in 1997, the Kuwait Joint Bank made a major contribution to the availability of Islamic financial products in the United Kingdom by forming a Sharia specialist division called the Sharia

Investment Banking Unit. The Kuwait Joint Bank then merged with Al-Ahli Bank, known as Al-Ahli United Bank. The home purchase product was branded Manzil, meaning 'residence'. Initially, Manzil was offered only using the *murabahah* contract product, but in 1999 the bank introduced an *ijarah*-based home ownership financing version, which proved to be much more popular (Ahmed Belouafi dan Abdel Kader Chachi, 2014).

Islamic banking first emerged from Egypt in the city of Mith Ghamr in 1963 without using the label of Islam or Sharia due to concerns that the ruling regime at the time would see it as a fundamentalist movement. Currently, in its development since 1963, Islamic banking from various countries has emerged and continues to grow. Countries that use the Islamic economic system in their banking operations include Malaysia, Indonesia, Saudi Arabia, Singapore, Egypt, Sudan, the Netherlands, Pakistan, the United Kingdom, Germany and many more in European, Asian and African American countries.

Starting in the 2000s, European countries began to open up to the Sharia economy and adopt the concept of the Islamic economy. The rapid development of Islamic banks began to be felt after in 2004, The Islamic Bank of Britain (IBB) was officially established and became the first Islamic bank in Europe, followed by brilliant achievements. 50 thousand customers that year were clear evidence of a positive public response to the Islamic economy. Although newly formed, Islamic banking could compete with other conventional banks in offering quality products to the public. Islamic banking in the United Kingdom serves as an investment place for wealthy Muslims from the Gulf countries with Sharia principles, so Islamic banking in the United Kingdom is known as investor banking and also offers many investment products whose use of funds complies with Islamic law.

Although not originating from a Muslim-majority country, the United Kingdom is the most advanced country in implementing the Islamic economy. Since the beginning, the United Kingdom's economy has been based on social welfare combined with a free market, which is why the United Kingdom feels compatible with the Islamic economic system. According to To'in's research findings (2015), both capitalist and socialist economic systems have so far been unable to realize welfare and justice, either for individuals as part of the state (socialist economic

system) or for society in general or the working class (capitalist economic system). Therefore, inevitably, there needs to be a breakthrough by developing the concept of an Islamic economic system as a middle ground, combining elements from the two previous economic systems, namely capitalism and socialism. This unification effort is made to take the positive and dynamic aspects from both systems. This has also triggered the interest of other Western countries in the concept of the Islamic economy, which has shown extraordinary resilience, such as France, Italy and Germany, which have ultimately adopted this system as well.

Islamic finance is based on the principles of Sharia law, which prohibits interest (riba), excessive uncertainty (gharar), and investments in forbidden industries like gambling or alcohol. Financial transactions must be backed by tangible assets, and risk-sharing is emphasized over risk-transfer. In the United Kingdom, the development of Islamic finance has been driven by the government's efforts to position London as a global hub for Islamic finance. Islamic finance made its entrance into the United Kingdom in the 1980s, enabled by regulatory changes that allowed for the establishment of Islamic financial institutions. However, it was not until the early 2000s that efforts to develop Islamic accounting standards gained significant traction. The United Kingdom's financial sector regulator at the time, the Financial Services Authority (FSA), recognized the need for standardization in this emerging market. In 2004, the FSA issued guidance on the application of existing accounting standards to Islamic finance transactions, highlighting areas where further clarification was needed.

This paper examines the development of Islamic accounting standards in the United Kingdom from a political lens. It explores the role of various stakeholders, regulatory bodies, and political factors that have shaped the evolution of these standards within the British financial landscape.

## **2. RESEARCH METHOD**

This research uses the Systematic Literature Review (SLR) approach with data sources coming from indexed journal literature that has an ISSN (International Standard Serial Number) in electronic form that has been published on the internet with an E-ISSN code. Data collection is done through internet surfing from Google Scholar. The research data

population is journals focusing on Islamic financial standards in the UK from a political perspective. There are several indexed journals from various journal publishers.

A Systematic Literature Review (SLR) is defined as the process of identifying, assessing, and interpreting all available research evidence to provide an answer for a particular research question (Kitchenham and Charters, 2007). This literature review has been conducted as a systematic literature review based on the original guidelines proposed by Kitchenham and Charters (2007).

The Systematic Literature Review (SLR) is conducted in three stages: planning, conducting, and reporting the literature review. In the first step, the requirements for the systematic review are identified. Then, the systematic review on the issue of Islamic financial accounting standards in the United Kingdom, from a political perspective, is identified and reviewed. A review protocol is designed to guide the implementation of the review and reduce the possibility of researcher bias. In the second step, this defines the research question, search strategy, study selection process with inclusion and exclusion criteria, quality assessment, and finally the data extraction and synthesis process. The third step is reporting by writing the research results based on the literature that has gone through the first and second step processes, then discussing them in the research results and concluding.

## **3. RESULTS AND DISCUSSION**

### **3.1. Standardization of Financial Reporting**

The literature suggests several advantages for standardizing financial reporting practices such as establishing better capital market discipline (Jeanjean, T. and Stolowy, 2008), improving quality of financial accounting (Landsman, & Lang, 2008) and enhancing forecast accuracy of financial information (Horton, J., Serafeim, G. and Serafeim, 2013). On the contrary, there are also studies that highlight the disadvantages associated with standardizing accounting practices such as increasing risk (Papadamou, S. and Tzivinikos, 2013) opening space for accounting manipulation (Ball, 2006), and bearing high cost (De George, E. T.; Ferguson C. B.; Spear, 2013). Studies that argue for IFRS are those related to countries enforcing strong governing, such as the study on Kenya see (Bova, F. and Pereira, 2012). The study documents the usefulness of adopting IFRS and

suggests that Kenyan firms are to be given economic incentives in order to obtain higher level of compliance.

Meanwhile others argue that standardizing international financial reporting is not needed, as it benefits only certain users (Nobes, C. and Parker, 2012), and it also neglects the country's social, cultural, and institutional setting, as well as the role of influence by the politic and economic institutions (D. Cooper, 2007). In other words, accounting is no longer considered as a neutral device that merely captures and reports the facts of economic activity (Hopwood, A. G. and Miller, 1994) . From these literatures, it is expected that the standardization process of financial reporting in Indonesia will be influenced by the active role of those steering the direction of the economy, especially those who believe that the neoliberal economic model is the way forward for the country.

Standardization of financial reporting refers to the establishment of uniform principles, standards, and practices for companies to follow when preparing and presenting their financial statements. It aims to enhance the transparency, consistency, and comparability of financial information across different organizations and industries. Here are some key points about the standardization of financial reporting:

- a. Generally Accepted Accounting Principles (GAAP): In many countries, including the United States, financial reporting standards are governed by Generally Accepted Accounting Principles (GAAP). GAAP is a set of rules and guidelines established by authoritative bodies, such as the Financial Accounting Standards Board (FASB) in the US, to ensure consistency and fairness in financial reporting.
- b. International Financial Reporting Standards (IFRS): Developed by the International Accounting Standards Board (IASB), IFRS is a set of globally recognized accounting standards widely adopted by many countries and jurisdictions. IFRS aims to provide a common language for financial reporting, facilitating cross-border investment and enhancing global capital market efficiency.
- c. Objectives of Standardization:
  - 1) Comparability: Standardized reporting ensures that financial statements from different companies can be easily compared, allowing investors, analysts, and other stakeholders to make informed decisions.

- 2) Transparency: Standardization promotes transparency by requiring companies to disclose relevant information in a consistent and understandable manner.
  - 3) Reliability: Adherence to established standards enhances the reliability and credibility of financial information, as it is subject to consistent principles and auditing procedures.
  - 4) Global Integration: With the increasing globalization of markets, standardized reporting facilitates cross-border investment and business activities by providing a common language for financial reporting.
- d. Key Financial Statements: Standardization typically covers the preparation and presentation of key financial statements, including the balance sheet, income statement, cash flow statement, and related notes and disclosures.
  - e. Regulatory Oversight: Accounting standard-setting bodies, such as the FASB and IASB, along with regulatory agencies like the Securities and Exchange Commission (SEC) in the US, play a crucial role in developing, implementing, and enforcing financial reporting standards.
  - f. Challenges and Ongoing Efforts: While significant progress has been made in standardizing financial reporting, challenges remain, such as accommodating industry-specific practices, addressing emerging issues, and achieving global convergence of standards. Continuous efforts are made to improve and harmonize financial reporting standards to meet the evolving needs of stakeholders.

The standardization of financial reporting aims to enhance transparency, comparability, and reliability in financial reporting, ultimately promoting informed decision-making and facilitating efficient capital allocation in global markets.

### **3.1.1. Political Sense**

Politics comes from the word "polis" (Greek) meaning city. The people inhabiting the polis are called polites or citizens, politikos (citizenship), politike techne (political skill), ars politica (knowledge of statecraft), politike episteme (political science) (Aristoteles, 2013).

Aristotle (384-322 BC) was an early thinker who introduced the word politics in his famous observation that "humans are by nature political animals."

Aristotle also said that political science does not create humans but utilizes humans. This means that in every life, humans will be involved in politics. Keller (1993) explained that when Aristotle wrote Politics, the situation was the declining quality of the ancient city-states. For this reason, the politics conceived by Aristotle aimed to find a constitution for the Greek city-states that was appropriate to their different historical, social and moral conditions. In its development, there have been many different definitions of politics. Laswell explains politics as who gets what, when, how (Lasswell, 1950). Ramlan Surbakti (1993) explains that "getting what" means getting values. "When" means the measure of influence used to determine who will get the most values. "How" means by what means someone gets values.

The definition of politics that has explained the meaning of power and policy was written by Morgenthau (1961), who defined politics as the struggle for power, as well as David Easton (1971), who defined politics as the study of the making of public policy, or all activities that influence policy and how policies are implemented.

From the above definitions, politics is the activity of citizens (Aristoteles, 2013) to obtain values (Lasswell, 1950) through the struggle for power (Morgenthau, 1961) in the form of policies (Easton, 1971). Miriam Budiardjo (1991) explains that politics constitutes various activities within a political system (or state) that involve the process of determining the goals of that system and carrying out those goals in the form of public policies.

Ramlan Surbakti (1993) classifies at least 5 perspectives on politics: 1) Projection of citizens to realize the common good, 2) Activities of administering the state and government, 3) Activities to seek and maintain power, 4) Activities regarding policy implementation, and 5) politics as conflict in order to seek and/or maintain sources considered important.

Classifications one to four are the realm of pure politics in terms of power, the struggle for power, and state policies. Meanwhile, the fifth classification can be interpreted as politics that is still general in nature. Political scientists have long conceptualized power as the "distribution of power control." However, politics, including in the Muslim world, does not merely discuss the established coercive authority of compliance. Politics also concerns bargaining among

many competing forces or groups, even often occurring with coercion (coups).

In the context of a comprehensive definition of political science, it was written by Soltau (1961). He wrote:

*Political sciences is the study of state, it's aims and purposes... the institutions by which these are going to be realized, its relations with is individual members, and other states.*

It can be interpreted that political science is the study of the state, its goals, and the institutions that will carry out those goals, which relates between the state and its citizens, and (the state) with other states.

Politics in the realm of Islamic scholarship is called as-siyasah. Ibn Qayyim al-Jauziyah wrote:

*Siyasah or politics in Islam is all human activity to create peace and distance from disputes and corruption. Although the methods and rules of these political activities, the Prophet Muhammad SAW or the revelation of Allah SWT did not explain explicitly. This means that activities in siyasah Islamiyah are very open to opportunities for the community to exercise ijtihad.*

The operational definition of politics in its development has also become idiomatic with other social science disciplines that have given rise to various definitions of politics.

### **3.1.2. Accounting in the United Kingdom**

The beginning of the accounting process in England was used to control debts and measure employee honesty (Day, 2000). However, the function of accounting was expanded along with the needs of managers for modern accounting records. So in 1844, the Joint Stock Companies Act was issued which stated that account books must show full and fair accounts (Day, 2000).

The formation of the Royal Charter to the Society in Edinburgh and the Institute of Accountants and Actuaries in Glasgow in 1853-1855 marked the beginnings of the accounting profession in England. Cooke and Wallace (1990) stated that internal and external environmental factors influenced the development of accounting in that country.

The research was conducted in 1990 and referred to efforts towards international harmonization of accounting principles and practices when England applied International Accounting Standards (IAS). The study showed that England (similar to other developed countries) was more likely to be influenced

by internal factors, namely the stage of economic development, societal goals, legal regulations, political system, economic system, level of education, financial pressures, and cultural variables. Meanwhile, Cooke and Wallace (1990) presented very general factors.

Tarca (2004) argued that England was among the five developed countries where it could be ascertained that companies in those countries voluntarily implemented international accounting standards. So this had the effect of government regulations on the adoption of international accounting standards in that country.

### **3.1.3. Political Drivers**

When viewed from the accounting development system, most of it is imbued with political values, such as the statement (Diaconu, 2007) that the United States is involved in the development of international accounting standards through the IASB. De facto, the countries developing international accounting standards actually have trade dependence with the United States. Consequently, these countries must prepare their accounting systems in accordance with the generally accepted accounting principles used in the United States (US GAAP).

The United States, as an economically strong and large country in the world, and its ability to control most of the capital market, is in a very strong position towards changes in the IASB. The impact is clear, IAS cannot be adopted without the approval of the FASB from the United States.

If we look at the environment or social factors as contributing factors to the development of accounting, then Cooke and Wallace (1990) argue that the factors that influence the disclosure of international accounting standards in a country are caused by internal and external environmental factors. They conducted research in the UK, the study found that UK (similar to other developed countries) was more likely to be influenced by internal factors, namely the stage of economic development, societal goals, legal regulations, political system, economic system, level of education, financial pressures, and culture. However, according to (Tarca, 2004), the UK is one of the countries that implements the accounting system voluntarily. After further investigation, it turns out that this is due to companies in the UK periodically adopting international accounting standards, this

phenomenon is due to the large amount of foreign income on the London stock exchange.

According to the research results of Mursalmina and Mukhlisin (2020), the influence of the application of Islam to several institutions in a country, in this case England, adopts Islamic Accounting based on the needs of an institution or company located in that country. In England, the development of the accounting system is dominated by political and economic factors compared to traditional or social factors. Mukhlisin & Antonio (2018) concluded in their research that the development of accounting standards in the United Kingdom evolved due to determinant factors in institutional regulation implementation, thus the initial development of Islamic finance in the United Kingdom did not show evidence of being driven by the Muslim population in the country. Supported by the research of Dashen & Bambang (2022), it concludes that the Islamic financial system adopted by England, which operates without interest or with a zero interest rate on capital in the United Kingdom, has the potential to enhance the real sector more effectively compared to the conventional financial system that imposes interest as a capital expense.

The growth of Islamic finance in the United Kingdom has been driven by both economic and political factors. From an economic standpoint, the United Kingdom sought to position itself as a leading hub for Islamic finance in the West, attracting investment and business from Muslim-majority countries.

Politically, the government's support for Islamic finance has been seen as part of broader efforts to foster social inclusion and accommodate the needs of the United Kingdom's Muslim community. This stance has been reinforced by subsequent administrations, reflecting a general consensus on the importance of facilitating Islamic finance within the British financial system.

### **3.2. Stakeholder Involvement**

The development of Islamic accounting standards in the United Kingdom has involved several key stakeholders, each with their own motivations and perspectives:

- a. Government and regulatory bodies: The United Kingdom government and financial regulators have played a crucial role in creating a conducive

environment for Islamic finance by adapting existing regulations and guidelines.

- b. Islamic finance institutions: These institutions, both domestic and international, have advocated for robust accounting standards that align with Sharia principles, enabling them to operate effectively in the United Kingdom market.
- c. Professional accounting bodies: Organizations like the Association of Chartered Certified Accountants (ACCA) and the Institute of Chartered Accountants in England and Wales (ICAEW) have contributed their expertise in developing and implementing Islamic accounting standards.
- d. Sharia advisory boards: These boards, comprised of Islamic finance scholars and experts, provide guidance on the Sharia-compliance of financial products and accounting practices.
- e. Research Result Souveinia and Haryanto (2022) showing the variable board size has a significant negative influence on banking performance because the more the number of boards, the more diverse knowledge and abilities in important decision-making strategies to focus on improving firm performance.

### **3.2.1. Challenges and Ongoing Developments**

Despite the progress made, the development of Islamic accounting standards in the United Kingdom has faced several challenges:

- a. Lack of a single global standard: There is no universally accepted set of Islamic accounting standards, leading to variations in practices across jurisdictions.
- b. Divergent interpretations: Different Sharia advisory boards may have differing interpretations of Islamic finance principles, resulting in inconsistencies in accounting treatments.
- c. Adaptation of existing standards: Islamic finance institutions often need to adapt conventional accounting standards to their specific needs, which can be a complex and ongoing process.

To address these challenges, the United Kingdom has continued to work with international bodies, such as the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), to promote greater harmonization and standardization of Islamic accounting practices.

### **3.2.2. Political Factors in Standard-Setting:**

#### **a. Government Support and Initiatives:**

The UK government has played a pivotal role in promoting Islamic finance, recognizing its potential to attract investment and boost the country's financial services industry. Initiatives such as the issuance of sovereign Sukuk (Islamic bonds) and the establishment of advisory bodies like the Islamic Finance Task Force demonstrate the government's commitment to facilitating the growth of this sector.

#### **b. Regulatory Challenges:**

While the UK's financial regulatory framework is well-established, incorporating Islamic finance principles poses challenges. Existing accounting standards and regulations may not adequately address the unique aspects of Sharia-compliant financial instruments and transactions. Regulatory bodies, such as the Financial Conduct Authority (FCA) and the Bank of England, must navigate the complexities of adapting existing frameworks or developing new ones specifically for Islamic finance.

#### **c. Stakeholder Influence:**

The standard-setting process involves various stakeholders with diverse interests, including Islamic finance institutions, professional bodies, religious scholars, and industry associations. Each stakeholder group may exert influence through lobbying efforts, representation on advisory committees, or public consultations. The relative power and influence of these groups can shape the direction and content of Islamic finance and accounting standards.

#### **d. International Harmonization:**

The United Kingdom does not operate in isolation when it comes to Islamic finance and accounting standards. Efforts to align with international bodies, such as the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the Islamic Financial Services Board (IFSB), introduce additional political considerations. Balancing domestic priorities with international harmonization can be a delicate process, involving negotiations and compromise among various stakeholders.

#### **e. Public Perception and Acceptance:**

The successful implementation of Islamic finance and accounting standards in the UK also depends on public perception and acceptance.

Political factors, such as concerns over religious influence in financial matters or misconceptions about Islamic finance, can shape public opinion and potentially impact the regulatory environment.

#### 4. CONCLUSION AND RECOMMENDATION

The development of Islamic finance and accounting standards in the United Kingdom is not solely a technical matter but is deeply intertwined with political dynamics. Government support, regulatory challenges, stakeholder influence, international harmonization efforts, and public perception all contribute to the complex landscape of standard-setting in this emerging sector. Recognizing and navigating these political factors is crucial for establishing a robust and widely accepted framework for Islamic finance and accounting in the United Kingdom.

The development of Islamic accounting standards in the United Kingdom has been shaped by a complex interplay of economic, political, and religious factors. While progress has been made, ongoing challenges highlight the need for continued collaboration among stakeholders, both domestically and internationally, to ensure the effective integration of Islamic finance within the British financial system.

As the United Kingdom's Islamic finance industry continues to grow, the evolution of accounting standards will remain a critical area of focus, balancing the need for Sharia compliance with the principles of transparency, comparability, and robust financial reporting.

This study is far from perfect; This qualitative approach study is not without limitations, therefore we propose there be improvements in the future. This research can be enhanced by incorporating the latest data on the current Islamic financial accounting standards in effect in the UK, thus yielding a more accurate and up-to-date study in line with the current state of affairs in the UK.

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