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# “Conventional” accounting vs “Islamic” accounting: the debate revisited

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## Abstract

**Purpose** – The purpose of this paper is to evaluate the arguments that the assumptions underlying conventional accounting are incompatible with Islamic values, hence the need for new accounting objectives and assumptions.

**Design/methodology/approach** – The paper adopts an analytic approach based on a combination of archival and bibliographic data sources.

**Findings** – It is shown that this belief of incompatibility can be traced to misconceptions about the assumptions underlying “conventional accounting”. It is then argued that the neglect of Islamic accounting in Islamic countries could be attributed to Islamic accounting not meeting the needs of users rather than acculturation or economic dependency.

**Research limitations/implications** – The study relies solely on the literature and highlights important issues in the area but does not provide any empirical evidence. The implications are significant for the future development of Islamic accounting and the economies of Islamic countries. The objective of accounting is to provide useful information for economic decision-making and the adoption of wrong assumptions would limit the usefulness of accounting information.

**Originality/value** – Few scholars have questioned the assumptions underlying Islamic accounting, and this debate is important for the continued development of Islamic accounting. The paper also attempts to contribute to the debate on the poor adoption of Islamic accounting.

**Keywords** Religion, Culture, Islamic accounting, Western accounting

**Paper type** Conceptual paper

## Introduction

The development of Islamic financial institutions and a growing belief that the assumptions underpinning Western financial accounting systems are not compatible with Islamic beliefs and values have contributed to the development of Islamic accounting research and Islamic corporate reports (Baydoun and Willett, 1997, 2000; Mirza and Baydoun, 2000; Lewis, 2001; Haniffa and Hudaib, 2007). Islamic accounting researchers have labeled currently used financial statements around the world as Western financial accounting statements (Baydoun and Willett, 2000), and called for the development of Islamic accounting standards (Rahman, 1999). Toward this end, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) was formed in 1991 (Pomeranz, 1997).

Testing of the usefulness of information, provided by models of Islamic corporate financial reports (Baydoun and Willett (2000), through both survey (Sulaiman, 1998) and experimental research (Sulaiman, 2001), indicates that there is no difference in the perception of usefulness by Muslim and non-Muslim subjects. From the above studies,



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it appears that, as far as the usefulness of financial reports is concerned, Muslims and non-Muslims did think alike, and this challenges the need for a separate set of Islamic corporate financial reports:

This result may be interpreted as challenging the notion (either explicitly or implicitly stated in the literature), that culture in general and Islam in particular, may have a significant influence on accounting practice (Sulaiman and Willett, 2001).

The above findings have contributed to a number of studies focused on understanding the dominance of Western accounting in many Islamic countries (Sulaiman and Willett, 2001; Altarawneh and Lucas, 2012). Sulaiman and Willett (2001), in an analytical study, attribute the dominance of Western accounting in Islamic countries to acculturation, due to the influence of colonial governance and later due to the influence of multinationals. Altarawneh and Lucas' (2012) structured interviews in Jordan indicate that the dominance of Western accounting could be attributed to "Jordan's integration into the international capitalist economic system, which has been enforced by Western countries and their agencies" (the World Bank, International Monetary Fund, World Trade Organization and United States Agency for International Development; Altarawneh and Lucas, 2012). The above findings (Altarawneh and Lucas, 2012), however, do not explain the lack of difference in the perception of usefulness by Muslim and non-Muslim subjects. Furthermore, the above explanations also do not explain the success of Islamic banking, which would have faced similar problems of acculturation and integration into the international capitalist economic systems.

Sulaiman's (1998, 2001) findings have also contributed to a more critical appraisal of the application and contribution of Islamic accounting (Kamla, 2009; Napier, 2009; Khan, 2010). Kamla (2009) argues that minimal critical theorising and the narrow instrumental and mechanical emphasis of the majority of Islamic accounting research are indications that Islamic accounting research is diverting from its primarily proclaimed social and moral roles. Napier (2009) observes that "Islamic accounting" currently is a convenient label to group together quite disparate accounting practices and ideas across time and space.

This paper seeks to contribute toward this debate, in view of the continuing maturity of this area of research. The findings of Sulaiman (1998, 2001) highlight the need to evaluate the argument that the assumptions underlying conventional accounting are incompatible with Islamic values. It is pointed out that this belief of incompatibility can be traced to misconceptions about the assumptions underlying "conventional accounting", and a confusion between assumptions and objectives of accounting. Finally, the paper compares the success of Islamic banking versus the limited adoption of Islamic accounting, and attempts to define the possible role of Islamic accounting. The paper adopts an analytic approach based on a combination of archival and bibliographic data sources to support its findings.

However, before this study can be undertaken, it is necessary to consider the issue of definitions. Napier's (2009) historical review of Islamic accounting highlights the fact that the term is broadly used and therefore any use of the term requires clear boundaries to be identified. Napier (2009) following from Said (2003) warns against slipping too easily between the terms "Middle Eastern", "Arab" and "Islamic". He similarly observes that Islamic accounting currently refers to different ideas and practices. He found that Islamic accounting literature fell into two main categories with subcategories within

each one. The first category refers to Islamic accounting from a spatial or temporal sense and the second from a religious sense. Studies in the first area have focused on “accounting in parts of the world where Islam is the majority religion during periods when Islam has been dominant” (Napier, 2009, p. 124), and this is the main focus of Napier’s study.

The second category of studies seek to develop a theory of accounting based on business concepts stated or implied in the authoritative sources of Islamic doctrine, the Qur’an (believed by Muslims to be the word of God revealed to the Prophet Muhammad; Ali and Leaman, 2008, p.108) and the Sunnah (the acts and sayings of the Prophet, as transmitted through traditions known as hadith; Ali and Leaman, 2008, pp. 45). Studies in this category can be roughly divided into two main areas, the first focuses on the accounting needs of Islamic banking and the second on accounting requirements due to Islamic concepts of accountability and *zakat*. This study is mainly focused on the second category as that by Kamla (2009).

The paper is therefore organised into three sections. The first section outlines the argument in the literature, highlighting the need for different financial reporting system. The second section evaluates the above arguments, and the third section highlights the possible reasons for the neglect of Islamic accounting in Islamic countries.

### **The arguments in favour of Islamic corporate reports**

The case for Islamic corporate reports in the literature is based mainly on the differences in philosophical differences leading to arguments for different economic systems and institutions. It is argued that conventional economics and accounting is based on the philosophical viewpoint of economic rationalism encompassing the principles of individualism, self-interest, survival of the fittest and profit maximisation (Baydoun and Willett, 2000). The latter is particularly relevant to positive accounting theory (PAT; Watts and Zimmerman, 1986). The Islamic philosophical viewpoint is based on the unity of God encompassing the principles of community interest, equity and reasonable profit (Baydoun and Willett, 2000).

Baydoun and Willett (2000) argue that the philosophy of economic rationalism emphasises the paramount importance of individual satisfaction with profit maximisation as the gauge of successful performance. In contrast, it is argued that Islamic attitudes toward business matters stem from a religious belief in the Unity of God leading to a focus on community interests in the decisions and actions of firms. While recognising the legitimacy of the profit motive, Islam discourages a sole focus on profit, and the making of excessive profit is tantamount to exploitation, which violates the principle of equity between people. The scope of intervention is broad and can include state interference in many areas of economic activity (Saqr, 1980, p. 56).

Following from the above, it is argued that the salient features underlying the Islamic economy are quite different from those underlying the Western economic system (Rahman, 1999; Baydoun and Willett, 2000). For example, it is pointed out that Western economic systems following from the principles of individual sovereignty emphasise private property rights, while an Islamic economy is based on the principle of multi-faceted ownership. It is argued that whereas in a Capitalist society, public ownership is only recognised when required by social necessity, Islamic law recognises individual ownership, state ownership and public ownership (Normani and Rahnema, 1995). In Islam, God is the creator and owner of wealth and people are the vice-regent of

God and hold property in trust for which they are accountable to God (Presley and Sessions, 1994). Justice and equality in Islam means that people should be granted equal opportunities but does not imply that they should be equal in poverty or riches (Chapra, 1985). However, it is incumbent on the Islamic state to guarantee a subsistence level to its citizens that is a minimum level of food, clothing, shelter, medical care and education. This is frequently achieved by the requirement of Muslims to pay religious tax (*zakat*).

The Islamic principle that has had the greatest impact on Islamic economics is the prohibition on the payment of interest (*riba*), sale of risky assets (*gharar*) and gambling or speculation (*maysir*) (Institute of Islamic Banking and Insurance, [www.islamic-banking.com/prohibition\\_of\\_gharar\\_masir\\_riba.aspx](http://www.islamic-banking.com/prohibition_of_gharar_masir_riba.aspx) (accessed 15 March 2012); Khan, 2010; Kuran, 1995). The Institute website further observes that “gharar” and “maysir” are frequently inter-related as in a normal insurance contract. Both the payment of *zakat* and the prohibition of *riba* follow from the main aim of Islamic economics: that wealth should be accumulated through effort and value-added activities. Islam is also focused on encouraging people to participate in economic activity. It is also felt that this would prevent wealth becoming concentrated in the hands of a few, and narrow the distinction between the rich and the poor as far as is natural and practicable (Shafi, 1979). The payment of *zakat* is required of those with a certain level of accumulated wealth with the social role of helping the needy. According to Haqiqi and Pomeranz (1987), this would purify people from the sin of greed. Islamic accounting researchers have distinguished *zakat* from normal taxation in that it is a levy on accumulated wealth, or the net stock of assets rather than a levy on selected wealth increments, or income (Rahman, 1999).

Further, it is asserted that *riba*, or fixed interest “reinforces the tendency for wealth to accumulate in the hands of a few, and thereby diminishes man’s concern for his fellow men”, guarantees gain without risk of loss, and hampers investment and employment (International Monetary Fund, 1982, pp. 110-111, cited in Rahman, 1999). This view has contributed to the development of Islamic financial institutions based on profit and loss sharing arrangements. Some of the different profit and loss sharing arrangements developed by Islamic financial institutions include *mudarabah* (trust financing), *murabaha* (cost-plus trade financing), *musharaka* (participation financing) and *Ijara* (Islamic leasing) (Haqiqi and Pomeranz, 1987).

The third item of major importance is the prohibition of *gharar* (speculation), which is claimed as an integral part of conventional insurance contracts. Vogel and Hayes (1998) identify *gharar* to occur:

- when parties to a transaction lack knowledge about the object of transaction;
- when the object does not exist at present; or
- when the object evades the parties’ control.

These views have contributed to the development of Islamic insurance contracts based on the principle of *takaful* (mutual guarantee or solidarity) (Warde, 2000). Finally, Islam does not allow the participation of Muslims in activities considered to be immoral or antisocial such as gambling, alcohol consumption and pornography.

### Islamic corporate reports

The proposals for Islamic corporate reports range from the ambitions (a different conceptual framework and accounting standards) (Karim, 1995; Rahman, 1999) to

supplements to the current financial reporting system (Baydoun and Willett, 2000) and specific standards for Islamic banks (Al Khadash, 2001).

The ambitious proposals have frequently started from the critical theorist critique (Laughlin and Puxty, 1981; Tinker *et al.*, 1982; Chua, 1986) of positive accounting research and have argued that we need to redefine accounting itself (Ibrahim and Yaya, 2005). Others have argued that accounting is not a new phenomenon in Islamic society (Zaid, 1997). Zaid (1997, p. 106) offers the following definition of accounting from an Islamic perspective: "A systematic process to record the legitimate transactions in the records and measure the financial results based on these transactions in order to be used in decision-making". The main characteristic of this definition, in comparison to the conventional ones, is that transactions should be legitimate to coincide with Shari'ah Islam'iah requirements (Al Khadash, 2001).

Al Khadash (2001) goes further to argue that any objective from an Islamic perspective should include the calculation of *zakat*. Following from the above he offers an alternative definition as follows:

[...] as the process of identifying, measuring and communicating the legitimacy of financial activities to be useful in making decisions, calculating *zakat* as well as calculating the right profit of Islamic investment operations based on its rules (Al Khadash, 2001, p. 26).

The above definition in addition to legitimacy of transaction emphasises the calculation of *zakat* and right profit.

Chapra (2000) states that the general purpose of the *Sharia* is to promote the welfare of the people and therefore this should be an objective of accounting. Following from the above, he argues that the decision usefulness objective of financial reporting that is focused on wealth maximisation would be irrelevant to Islamic accounting. Instead he promotes accountability as the more logical objective for Islamic accounting. Shahata (1982) argued that as the accounting system is a sub-system of the financial system, its objectives must be compatible with the Islamic financial system. Shahata (1982, p. 47, cited in Al Khadash, 2001) offers the following definition for an accounting system within an Islamic perspective: "a general framework that includes a group of parts or components connected together, according to a set of accounting rules based on the *Shari'ah Islami'iah* requirements". This system works according to a chain of procedures to help in the investigation and the discussion to evaluate the execution.

### *Objectives*

Following from the Islamic economics literature, most Islamic accounting studies endorse accountability as the favoured objective of financial reports (Gambling and Karim, 1991; Baydoun and Willett, 1994; Adnan and Gaffikin, 1997). It is further asserted that this objective will be better if it is directed toward the fulfillment of the *zakat* obligation. They argue that by making the requirements for calculating and paying *zakat* as the primary objective, one tends to avoid the unwanted practice of cheating or "window dressing" in any form, because nothing can be hidden from Allah (Adnan and Gaffikin, 1997, p. 121). Triyuwono (2000) further suggests that organisations should be *zakat*-oriented instead of profit-oriented, as they are now. Haniffa and Hudaib (2002) identify three main objectives for an Islamic perspective of accounting:

- *Al-Adl and al-ihsan* – To assist in achieving socio-economic justice.
- *Ibadah* – To assist in fulfilling obligations to *Allah*, society and individuals concerned.
- *Al-Falah* – To assist in achieving the rewards in this world and the hereafter.

AAOIFI (1996) in its Statement of Financial Accounting, however, adopted a decision usefulness focus. While there seems to be an agreement among researchers that *zakat* should be part of the objective of accounting, there are differences in opinion. For example, Baydoun and Willett (2000) feel that financial statements should continue to focus on investors and creditors.

#### *Accounting concepts*

The focus on *zakat* requires Islamic accounting researchers to re-examine conventional accounting concepts and principles. First it is pointed out that the valuation of assets for the payment of *zakat* should be the selling price prevailing at the time *zakat* falls due. Following the above principle, Hamid *et al.* (1993) and Clarke *et al.* (1996) argue that *zakat* valuation is parallel to the concept of continuously contemporary accounting rather than historic cost accounting. Gambling and Karim (1991) also support a shift from a revenue-expense approach to an asset-liability approach as income determination.

Some issues have also been raised about the going concern convention and the concept of conservatism. The going concern principle which assumes that the business has an indefinite life is not appropriate for the *mudarabah* banking situation, where the contract (which makes the entrepreneur and the bank partners) may be rescinded at any time (Rahman, 1999). Zaid (1997), in contrast, argues that the continuity of investment activity is considered as a mode of life acknowledged by *Shari’ah Islam’iah*. On the concept of conservatism, it is pointed out that the spirit of *zakat* is to encourage Muslims to be generous with their wealth, and therefore, Muslims must be careful not to understate their assets or overstate their liabilities (Rahman, 1999).

Baydoun and Willett (2000, p. 80) argue that economic rationalism and its consequent principles:

[...] lead to disclosure practices that might best be described as being based upon the criteria of “personal accountability” and “the limited disclosure of financial information” necessary to achieve such accountability.

On the other hand, the focus in Islam on the Unity of God demands a form of *social accountability* and full disclosure of accounting information, not based on the outcome of political process but on what ought to be disclosed to serve the objective of social accountability (Baydoun and Willett, 2000, p. 81).

#### *Islamic corporate reports*

AAOIFI (1996) in addition to the normal conventional financial reports of income statement, cash flow statement, statement of changes in equity and the balance sheet (historical cost), also require a statement of sources and application of *zakat* and *qard* funds and a statement of changes in restricted investment. Baydoun and Willett (2000), in addition to the above statements, included a balance sheet based on current values and a value-added statement.

## The arguments revisited

### *Misconceptions about conventional accounting*

The claimed assumptions underlying conventional accounting theory such as individualism, self-interest, survival of the fittest and profit maximisation are simply assumptions underlying PAT, which is one of many accounting theories, [American Accounting Association \(1977\)](#) and [Velayutham and Rahman \(1992\)](#) provide a good summary of different accounting theories in accounting. [American Accounting Association \(1977\)](#) concluded that there exists in financial accounting literature not a theory, but a number of theories, and that it was not possible to develop a theory of accounting. The American Accounting Association (AAA) has since given up on its attempts to synthesise a theory of accounting, which began with [AAA \(1966\)](#). Furthermore, as highlighted by [Burchell \*et al.\* \(1980\)](#), pp. 9-10), the above theories attempt to provide a more secular basis for the accounting mission:

In such contexts, accounting is seen to have an essence, a core of functional claims and pretensions. It is, or so we are led to believe, essentially concerned with the provision of “relevant information for decision-making, with the achievement of a rational allocation of resources” and with the maintenance of “accountability” and “stewardship” [...]. Justifying the existence of the craft, they provide rationales for continued accounting action.

In reality, [Burchell \*et al.\* \(1980\)](#) argue that accounting is implicated in the creation of particular patterns of organisational visibility ([Becker and Neuheuser, 1975](#)), the articulation of forms of management structure and organisational segmentation ([Chandler and Deams, 1979](#)) and the reinforcement of particular patterns of power and influence ([Bariff and Galbraith, 1978](#)). All the above studies highlight the fact that the claimed assumptions underlying conventional accounting are narrow and the claimed function of accounting in Western society is also narrow. The development of conceptual frameworks, by the accounting profession, does not represent a theory of accounting but a synthesis of current theories to provide a foundation for setting standards for general-purpose financial reporting by reporting entities ([FASB, 2010](#)).

### *Efficient allocation of resources*

The conceptual frameworks identify the objective of financial reporting as a financial information providing function for various purposes, e.g. stewardship, decision-making and accountability. There has, however, been a bias toward decision-making in most recent conceptual frameworks ([FASB, 2010](#)). A major weakness of Islamic accounting research is the frequent absence of recognition that accounting seeks to provide information, rather than achieve certain economic objectives like social justice ([Haniffa and Hudaib, 2002](#)). Accounting could, however, provide information to assist in making those economic decisions.

Another feature that is absent in many Islamic financial reporting frameworks is the identification of primary users of accounting information and the type of decisions made by these users. The latest conceptual framework, issued by the Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) ([FASB, 2010](#)), identifies existing and potential investors, lenders and other creditors as the primary users, and resource allocation as the primary decision which accounting is supposed to assist in. Resource allocation is a critical economic function in both Islamic and non-Islamic societies, although the information required criteria used by Islamic investors and lenders could be different from that of non-Islamic investors and lenders

(Chowdhury, 1999). Both Islamic and non-Islamic investors would be interested in risk and return; in addition, Islamic investors would be concerned about the nature of business transactions, i.e. whether the transactions are *halal*. While the importance of wealth distribution through *zakat* is frequently mentioned in the Islamic accounting literature, wealth creation is scarcely mentioned in the accounting literature.

Most Islamic accounting studies focusing on economic objectives of social justice (Haniffa and Hudaib, 2002), the nature of transactions and *zakat* (Adnan and Gaffikin, 1997) appear to have neglected the fact that information for the allocation of scarce resources is paramount in both Islamic and non-Islamic societies.

#### *Normative theory versus positive theory*

It is not possible to compare the assumptions underlying a PAT with the assumptions underlying a normative accounting theory, which Islamic accounting is an example of as they have different functions. The purpose of normative accounting theories is to prescribe, while the purpose of positive accounting theories is to explain and predict (Watts and Zimmerman, 1986). Watts and Zimmerman (1986) in their book “*Positive Accounting Theory*” specifically state that the purpose of PAT is not to prescribe but to predict and explain. Following from the above function of PAT, the assumptions underlying the theory such as self-interest and individualistic behaviour are not to prescribe particular actions but rather to hypothesise the role of accounting in situations of individualistic self-interested behaviour. It is also important to note that PAT emerged following the lack of influence of fair value theories (Edwards and Bell, 1961; Chambers, 1966) on accounting standards at the time. Agency theory, an integral part of PAT, helped place in perspective the persistence of historic cost accounting:

Historical-cost-based net income has desirable properties for contracting purposes, including the fact that its rules are well-known, so that contracting parties have a good “feel” for how it responds to differing economic circumstances. Also historical-cost-based net income is reasonably reliable, relative to valuation-based alternatives, and it appears to be reasonably correlated with manager effort (Scott, 1997, p. 255).

The self-interest assumptions of PAT highlight the regulatory role of accounting in society and provide a basis for the development of rules in accounting to prevent financial abuse and exploitation in society. Furthermore, as they are based on different objectives, they should be considered as complementary rather than incompatible. In short, to get to “what should be”, we have to identify “what is”.

It is also doubtful whether a positive Islamic accounting theory would be any different to PAT, as highlighted by the findings of Sulaiman (1998, 2001). Idris (1996) tested perceptions of preparers of financial statements in both Islamic banks and commercial banks that provide “Islamic windows” (separate departments offering transactions consistent with Islamic principles) regarding the items that should appear in the annual reports of Islamic banks. The respondents expressed the view that conventional statements like the balance sheet and income statements are the most important.

It is also important to note that the assumptions of accounting need not be the same as the objectives. For example, alcohol is *haram* in Islam and therefore banned in many Islamic countries. However, the assumption that nobody drinks alcohol will not help the authorities to eradicate the consumption of alcohol and prevent drunk driving.

Following from the above the assumption that individuals seek to maximise their wealth could actually help develop policies that enhance social justice.

*The assumption of profit maximisation*

Profit maximisation provides the incentive for innovation and growth in labour productivity. Productivity is of particular importance when the first Arab Human Development Report (UNDP, 2002) states that total factor productivity in Arab countries “declined at an annual average of 0.2 per cent during 1960-1990, while it rapidly accelerated in other parts of the world”. The same report cited that over the past 20 years, growth in per-capita income of Arab countries was the lowest in the world, except in sub-Saharan Africa. Islamic accounting researchers have argued for reasonable profit rather than profit maximisation, but have never defined what reasonable profit is. In many countries, when a maximum return on investment was specified for natural monopolies, it was found that the companies lacked incentive for innovation, and excess profits were consumed by management in the form of perks (Meyer and Morton, 1974; Mac Avoy, 1971). The solution is not moving away from the principle of profit maximisation but putting in place mechanisms for redistribution (zakat is an example) of profits and encouraging greater competition in the marketplace, which would ensure normal profits rather than abnormal profits.

*Objectives and information for the payment of zakat*

The question is whether this information should be provided by the accounting system of an individual or organisation, or should general-purpose financial reports be changed to fulfill this role. Baydoun and Willett (2000) explicitly propose changes to financial reports to provide information for the payment of *zakat*, while others have been vague. The payment of *zakat* it seems is more similar to taxation in the Western context. Current “conventional accounting” systems provide a basis for not only the preparation of general-purpose financial reports but also the preparation of management accounting reports, preparation of tax returns and establishing accountability for assets and transactions. The computation of tax, however, requires different measurement which would similarly apply to *zakat*. It therefore appears that the conventional accounting system should be able to provide the required data for the computation of *zakat* if Islamic accounting researchers developed a pro-forma sheet similar to tax returns, to assist Muslims in computing *zakat*, data which could be extracted from normal accounting records.

The additional requirement that general-purpose financial reports provide information for *zakat* computation could compromise the usefulness of financial reports for resource allocation. This does not, however, imply that current general-purpose financial reports are perfect and cannot be improved on. Accountability as the main objective of financial reporting has been discussed in the accounting literature extensively. Decision usefulness has, however, prevailed as the main objective of financial reporting in the conceptual frameworks of standard setters not only in the West (FASB, IASB) but also by AAOIFI. Probably, decision usefulness as the main objective of financial reporting is more easily operationalised in the temporal realm.

*Accountability and disclosure*

Baydoun and Willett (2000) have also argued that conventional disclosure practices based on the concept of “personal accountability” lead to limited disclosure, while the

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disclosure practices based on Islamic requirements would lead to full disclosure of financial information. They argue that the :

[...] focus in Islam on the Unity of God, the community and the environment demands a form of social accountability rather than the form of personal accountability found in Western societies (p. 81).

First the focus on [Baydoun and Willett's \(2000\)](#) observation of conventional accounting goes against all pronouncements of the profession that require full disclosure. Once again one has to distinguish normative requirements of full disclosure with specific disclosure requirements in accounting standards, a form of regulation that seeks to set standards for minimum disclosure.

There is also very little discussion in the Islamic accounting literature on the practice of social accountability in a community which is fundamental to Islamic accounting. While accountability is practised in different ways in different societies ([Velayutham, 1999](#)), the principles of accountability are similar as laid out by [Blatz \(1972, p. 110\)](#):

[...] when we say to some person, P, in the face of some moral failing, S, 'You are responsible for S', we are saying, 'you are accountable or answerable for S'.

A closer reading of the literature, however, indicates the general principle that "one cannot be held responsible for the moral failing of S, without the opportunity to account for S". Social accountability in this sense would also imply some form of social or collective responsibility and therefore collective decision-making. While collective decision-making and social accountability are practised in some non-hierarchical religious organisations such as the Religious Society of Friends (Quakers) ([Velayutham, 2014](#)), it is a rarity in business organisations.

### *Definition*

The question has to be raised on whether there is a need to change the definition of accounting from an Islamic perspective. As highlighted earlier, the main characteristic of a definition based on an Islamic perspective would include the criteria of legitimate transactions. I would argue that the criteria of legitimacy are implicit in current definition of accounting. Financial statements produced in many economies would not include illegal transactions, and it seems that activities deemed illegal in Islamic countries adopting Shari'ah Law would not be included in the financial statements, as they are illegal. In countries with a mixed legal system, providing for conventional banks and Islamic banks, interest would be legal for conventional but not Islamic banks.

The different profit and loss sharing arrangements developed by Islamic financial institutions that include *mudarabah* (trust financing), *murabaha* (cost-plus trade financing), *musharaka* (participation financing) and *Ijara* (Islamic leasing) would probably require a reassessment of conventional banking practices with respect to income measurement and asset valuations; however, this does not require a new financial reporting system, as standard setting authorities recognise the different needs of different industries and have sometimes developed specific standards for the industries. Islamic financial institutions would be one of these institutions. To this end, the Islamic banking industry has established the AAOIFI ([Pomeranz, 1997](#); [Maurer, 2010](#)).

Finally, one has to evaluate the role of accounting standards. Accounting standards represent a form of regulation. Regulation is the "intentional restriction of a subject's

choice of activity, by an entity, not directly party to, or involved in that activity” (Mitnick, 1980, p. 5). Mitnick further points out that at the base of most regulatory instruments is some formal rationalisation that the regulation is to proceed in the “public interest” frequently due to market failure in the provision of a particular product or service. In the case of accounting, accounting standards are developed when market forces alone are unable to drive the right amount of information production, principally due to conflicting interest caused by self-interest. (Scott, 1997). Following from the above, if self-interest is not considered as one of the assumptions of an Islamic accounting theory, then there would also be no necessity for accounting standards, or accounting standards would be for informational purposes rather than regulatory purposes.

### Discussion

In modern societies, the economic issues and problems that face Muslims are no different from than that faced by non-Muslims. We make the same economic decisions such as buying a house, where to invest our money and how much to save for the education of our children and our retirement. The criteria we use to evaluate the alternatives, however, could be different. The criteria could be that we would not invest in banks that pay interest or companies that deal in gambling and alcohol. The ethics we practice and type of lifestyle we desire would therefore determine the decisions we make and financial resources we require. For example, one might not lead a materialistic life and therefore not focus on the single-minded pursuit of profits and the accumulation of wealth (Sulaiman and Willett (2001), but the individual would still have to make decisions on the allocation of resources.

Institutions, such as banking and accounting, have developed to assist individuals in meeting their economic needs and making economic decisions. Islamic banks are no different from conventional banks in their function or objective. They both serve to act as a financial intermediary that is pooling funds from investors and lending to those who require funds for economic activities with the objective of making a profit for its shareholders in the process. The difference is that they serve the needs of individuals with a different criterion, i.e. those who consider interest to be *haram*, and therefore would not participate in an investment or lending contract that involved interest.

Similarly, the objective of accounting cannot change, or else the information needs of the primary users such as investors and lenders would not be met, making the accounting function redundant. This does not, however, imply that the current financial reporting framework is perfect and historical cost is the correct approach to measurement. This also does not imply that *zakat* is not important, but rather that it needs to be computed separately. As pointed out earlier, the criteria that Muslims would use when making resource allocation decisions would be different from that of non-Muslims, i.e. they would not invest or lend to institutions involved in activities considered *haram*, and therefore, additional or new information would need to be disclosed, to assist their decision-making process. This information, as pointed out by Haniffa and Hudaib (2002), could include quantitative and qualitative information related to *zakat*, *halal* dealings, *riba*-free transactions and also those that affect the various stakeholders of a company.

We would therefore argue that the above reasons provide a more plausible explanation for the lack of difference in the perception of usefulness of information

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provided by models of Islamic corporate financial reports by Muslim and non-Muslim subjects (Sulaiman, 1998, 2001), and the extensive adoption of conventional accounting by Islamic banking in Muslim countries as opposed to Islamic accounting.

Furthermore, as highlighted by Burchell *et al.* (1980) and Watts and Zimmerman (1986), accounting also plays a role in many other facets of organisations and society, which are not stated in authoritative professional pronouncements, such as the conceptual framework. Similarly, accounting might also be implicated in other organisational and social facets of a Muslim society, as highlighted by Kamla (2009). For example, the economic literature identifies transaction cost as a principal cause of inefficiency in economies. Fukuyama (1995) points out that social capital reduces the transaction costs associated with formal coordination mechanisms like contracts, hierarchies, bureaucratic rules and the like. Fukuyama (1995) observes that it is possible to achieve coordinated action among a group of people possessing no social capital, but this would entail additional transaction costs of monitoring, negotiating, litigating and enforcing formal agreements. Fukuyama (1995) defines social capital as an instantiated informal norm that promotes cooperation between two or more individuals. It is further pointed out that the norms that constitute social capital can range from a norm of reciprocity between two friends, all the way up to complex elaborately articulated doctrines like Christianity and Confucianism. Similarly, we would like to argue that a useful avenue for Islamic accounting research would be to identify the role of Islamic norms in the development of social capital within Muslim countries and thereby reducing transaction costs and increasing efficiency in the economy.

### Conclusion

Islamic accounting researchers have claimed that the assumptions underpinning conventional accounting systems, based on Western philosophy, is incompatible with Islamic beliefs and values. Following from the above, it has been argued that Islamic corporate reports should be based on a revised set of objectives, concepts and statements. Empirical studies, however, indicate that Muslim users of financial statements do not perceive the additional information to be significantly useful. The above has contributed to a number of studies on the poor adoption of Islamic accounting in Muslim countries. This paper seeks to contribute to the above debate.

The discussion in this paper suggests that the arguments for different Islamic corporate reports can be traced, at least partly, to misconceptions about the assumptions underlying conventional accounting. It is emphasised that the conventional accounting objective of providing investors and creditors with useful information for resource allocation decisions is as important in Muslim societies as non-Muslim societies. It is pointed out that the main difference between conventional accounting and Islamic accounting would be in the disclosure of information, because the investment criteria of Muslims could be different from non-Muslims. Parallels are drawn to Islamic banking.

Nobel Prize winner Mohammad Abdus Salam in the forward to Hoodbhoy (1991) asserted:

There is only one universal science, its problems and modalities are international and there is no such thing as Islamic science just as there is no Hindu science, no Jewish science, and no Confucian science.

Said (2003, p. 305) in his seminal work *Orientalism* also expressed scepticism about the application of the label “Islamic” to different phenomena, such as warfare, art and city planning, asking whether there is a cohesive notion of, for example, Islamic warfare that is substantially distinctive from Western warfare. Similarly, it could be argued that there is no Western accounting and Islamic accounting but accounting. Accounting practices differ from region to region due to historic, legal, religious and cultural factors, just as different scientific innovations are more popular in different countries due to historical and cultural reasons.

In conclusion, the sub-discipline of Islamic accounting requires a firmer foundation than that currently identified in the literature: “is the term actually helpful in the sense that it describes, or potentially could describe, a sufficiently distinctive body of accounting ideas and practices?” (Napier, 2009, p. 122). The purpose of this paper is to stimulate further debate on the foundations of Islamic accounting leading to more rigorous arguments for Islamic accounting.

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