THE EMERGING ISSUES ON THE OBJECTIVES AND CHARACTERISTICS OF ISLAMIC ACCOUNTING FOR ISLAMIC BUSINESS ORGANIZATIONS

Shahul Hameed Mohd. Ibrahim
Department of Accounting
Kulliyah of Economics and Management Sciences
International Islamic University Malaysia
Malaysia

and

Rizal Yaya
Department of Accounting
Faculty of Economics
Muhammadiyah University of Yogyakarta
Indonesia

Islam has a different worldview which affects the socio-economic activities of its adherents. As accounting is a social institution which should reflect the nuances of its society and help achieve its socio-economic objectives, a different type of accounting is required as compared to the conventional accounting of capitalistic society. Research on Islamic accounting is still at an exploratory stage; its pioneers trying to develop a theoretical framework for Islamic accounting using various methodologies. As with the development of conventional accounting, the search is on the objectives and characteristics of Islamic accounting as a foundation on which to lay its principles, conventions, rules and standards. This article explores the emerging issues in this development and searches for patterns in the debate on Islamic accounting theory. We evaluate these different methodologies and approaches suggested in the literature used to develop Islamic accounting theory. We find the hybrid approach promising as compared to the "ibaha" approach.

Introduction

Islam recognizes the desirability of engagement in business activity. It does not denounce business or other worldly activities as such. Business activities can become part of *ibadah* (worship and obedience to Allah) if they are performed in accordance with the commands of Allah and the Islamic code of conduct (Ahmad, 1988). In Islam, man is the vicegerent of Allah on earth, and Allah has made the universe subservient to him (Al-Qur'an 2:30; 14:32-33; 22:65; 31:20; 35:39 and 45:12-13). As vicegerent, it is man's duty to work hard to build this world and to use its natural resources in the best possible manner in accordance with Divine rules (Al-Qur'an 2:5; 6:153).

However, current business practices are separated from religion, which to some extent has resulted in a contradiction with Islamic morality. Furthermore, current business practices are also equipped with an accounting system, which is more likely established to achieve capitalistic socio-economic objectives (Sombart, 1919). This situation leads to the need for establishing an accounting system that could attain the Islamic socio-economic objective of *falah* (the success in the world and the hereafter). The importance of such efforts becomes even greater with the development of Islamic financial institutions in many parts of the world, which operate on the basis of Islamic teachings *(Shariah)*. However, since this concern is still in its infancy, the debates on this issue are still very vague.

This article tries to explore the emerging issues of the objectives and characteristics of what is perceived as Islamic accounting and tries to find patterns in the debate which will probably be needed in the future to formulate Islamic accounting theory. Section one of this article elaborates on the characteristics of Islamic business activities, followed by section two on the inappropriateness of conventional accounting for Islamic business organizations. In section three, some emerging approaches in developing Islamic accounting system will be evaluated. Finally, sections four and five will discuss the objectives and characteristics of Islamic accounting respectively.

Characteristics of Islamic Business Activities

Islam is premised on ethical and moral conduct. This can be inferred from the *Hadith* narrated by Abu Hurairah, saying that the Prophet Muhammad (pbuh) has been sent only for the purpose of perfecting good morals. Naqvi (1981) views that the Islamic ethical and moral code of conduct permeates human life whether individual or collective in a way that Islam considers ethics as an offshoot of the Muslim belief system itself.

Siddiqi (1979) notes that *'adala (*justice*)* and *Ihsan (*benevolence*)* (Al-Qur'an 2:177; 5:8; 4:36) could be considered as the summary of the entire morals in the economic enterprise derived from the *Qur'an*. These values, in his opinion, are the basic values, which offer guidance in almost every action in human life. Therefore, Islamic business should also be characterized with these manners. These twin concepts of justice and benevolence need some elaboration and will be discussed further.

'Adala (Justice)

Allah has commanded the maintenance of justice under all circumstances and in all aspects of life (Al-Qur'an 6:152; 5:9). Meanwhile, the Prophet (pbuh) has also reiterated the maintenance of justice and has sternly warned against indulgence in injustice. The *Qur'an* commands Muslims to be just and truthful while bearing witness and while deciding a disputed matter, which is not only among them but also when dealing with their enemies. Muslims are, therefore, enjoined to cooperate with each other in the establishment of justice and righteousness. In other words, they are not allowed to exploit others and also may not let others exploit them (Ahmad, 1995).

In order to maintain justice in the conduct of business, the *Qur'an* has provided believers with certain guidelines that serve as safeguards. Ahmad (1995) proposes some principles for safeguarding the rights such as; (1) writing of a contract; (2) witnesses; and (3) the principle of individual responsibility. In Islam, a contract should be put in black and white. This is specially recommended in the case of both large and small scale credit transactions (Al-Qur'an 2:282). In the business realm, writing down the terms of transactions is an effective safeguard against any false claims made by either party[1]. To enhance the safeguarding function, the *Qur'an* also recommends that credit transactions should be witnessed by two men or twice that number if they are women (Al-Qur'an 2:282). The presence of reliable witnesses, in the realm of business is much needed as an added safeguard against any sort of foul play.

Ihsan **(Benevolence)**

Ihsan (benevolence) means good behavior or an act which benefits other persons without any obligation (Beekun, 1997). Siddiqi (1979) views *Ihsan* as being even more important in social life than justice. If justice is the corner stone of society, *Ihsan* is its beauty and perfection. If justice saves society from undesirable things and bitterness, *Ihsan* makes life sweet and pleasant (Siddiqi, 1979). In the realm of business, Ahmad (1995) outlines certain manners that would support the practice of *Ihsan*. They are (1) leniency; (2) service motives; and (3) consciousness of Allah and of His prescribed priorities.

According to Ahmad (1995), leniency is the foundation of *Ihsan*. It is a highly praised quality and encompasses every aspect of life. It is an attribute of Allah Himself and Muslims are encouraged to incorporate it in themselves. Leniency can be expressed in terms of politeness, forgiveness, removing of other people's hardship and providing help. Meanwhile, service motives means that Islamic business organizations should consider others' needs and interests, provide help and spend on others, recommend and support a good cause to others. Therefore, through his involvement in business activity, a Muslim should intend to provide a needed service to his community and humanity at large.

Although the *Qur'an* has already declared business as lawful, yet a person's engagements should not become a hindrance to remembering Allah and complying with His commands (Al-Qur'an 24:37). A Muslim is required to be mindful of Allah either when he has success or failure in his business. God consciousness must be the driving force in determining his course of action. He must, for instance interrupt his activity at the time of prayers.

Business activity must also be compatible with the morality of and the higher values prescribed by the Qur'an. The believers are exhorted to seek the felicity of the hereafter by making proper use of the bounties provided by Allah in the present world (Al-Qur'an 28:76-77). They are also asked to recognize and observe the priorities determined by the *Qur'an*, for instance; (1) to prefer the great and everlasting rewards of the Hereafter to the finite benefits of the present world (2) to prefer that which is morally pure to that which is impure and (3) to prefer what is lawful to that which is not (Ahmad, 1995).

The Inappropriateness of Conventional Accounting for Islamic Business Organizations

The characteristics of Islamic business activities as we have discussed above can be considered as an ideal practice for an organization controlled by Muslims. Such an organization then can be called an Islamic business organization. In order to maintain its characteristics, an Islamic organization is also recommended to be equipped with accounting tools with such characteristics (Hameed, 2001). However, conventional accounting has been criticized on its inability to support the Islamic objectives; in other words, it is not appropriate for the Islamic business organization.

The issue of the inappropriateness of conventional accounting for the Islamic business organization (IBO) can be categorized into three groups; (i) contradictory to Islamic teachings, (ii) irrelevance to Islamic accounting objectives, and (iii) insufficiency in focusing on Islamic socio-economic objectives. The following section will elaborate on them.

The Contradictions of Conventional Accounting to Islamic Teachings

Many studies have indicated that conventional accounting has resulted in a situation, which contradicts the Islamic socio-economic economic objectives. For example, Gray (1994) asserts that conventional accounting has directed organizational growth at the cost of environmental degradation. He argues that this could happen because conventional accounting as the scorekeeper in evaluating the performance of an organization, does not take such a view into account. Briloff (1990) argues that it has led to the concentration of wealth by a few individuals at the expense of society. Further, Arnold and Cooper (1999) find that it has led to the loss of jobs through downsizing and transfer of wealth through privatization. Therefore, we can conclude that conventional accounting often results in organizational practices, which are contradictory to Islamic principles.

In particular, Hameed (2000a) points out that these contradictions are caused by the use of decision usefulness objectives in conventional accounting. Although he admits that the term ‘decision usefulness’ seems rational, harmless and acceptable from an Islamic perspective, but, when one examines this concept in depth, a number of problems arise. Firstly, conventional accounting’s focus on informational efficiency in the capital market from the perspective of the shareholders. This can imply that the resulting equilibrium may not be efficient from the perspective of other members of society such as employees, government and the community at large. Secondly, conventional accounting operates under an assumed pristine liberal economic society (Gray et. al., 1996). In this type of society, the increasing gap between the rich and the poor is not questioned and there is no room for environmental and ethical values other than utilitarian self-interest. Thirdly, the decision usefulness paradigm on which conventional accounting is based, was born in the countries with developed capital markets. Meanwhile, many Muslim countries have not established or developed stock exchanges[2] and the economy is non-monetized. Therefore, in such a situation, the decision usefulness of accounting oriented toward the market does not make any social or economic sense.

Hameed (2000b) views that the characteristics of conventional accounting would be utilized for the enrichment of shareholders and creditors even at the expense of damaging social and environmental consequences. In particular, Adnan and Gaffikin (1997) point out that some accounting concepts are contradictory to Islamic principles. The concept of historical cost and conservatism for instance, according to them, can be misleading and cannot guarantee the quality of justice and honesty within the information it carries. Therefore, they argue that such concepts have no room in the accounting for Islamic institutions (Adnan and Gaffikin, 1997). Meanwhile, the conservatism concept could also go against the *Qur'an* and *Sunnah* as it would distort accounting data. They argue that the conservatively reported data are not only subject to improper interpretation but also contradict the objective to disclose all relevant information related to the particular company (Adnan and Gaffikin, 1997).

Abdelgader's (1994) assertion on the stability of the purchasing power of the monetary unit concept reveals that this concept inherently contradicts Islamic principles, as in an inflationary environment, money as a unit of measure is unable to serve as a just and honest unit of account. It makes money an inequitable standard of deferred payments and an untrustworthy store of value and would encourage some people to be unfair to others even though unknowingly.

Meanwhile, the realization concept particularly for the Islamic bank would create a problem, as it does not realize fairness for withdrawing depositors. This concept suggests that the earning process for the revenues of the bank should be known and should be collectible with a reasonable degree, if not already collected. This means that if some of the depositors withdraw before the full liquidation of the project in which their funds have actually participated, they may lose a part of the profit that might be realized in the future (Abdelgader, 1994).

The inappropriateness of conventional accounting is also viewed in terms of attitude before Allah. The going concern concept for instance, according to Adnan and Gaffikin (1997) would mean that there is something else other than Allah that will live continuously. In fact, in Islam one of the characteristics of Allah is that only He lives indefinitely forever (Al-Qur'an 3:2; 2:255; 20:111; 25:58; 40:65; 53:27) and a Muslim is prohibited to have such an attitude.

The Irrelevance of Conventional Accounting to Islamic Accounting Objectives

Adnan and Gaffikin (1997) assert that some of the accounting concepts in conventional accounting are irrelevant to Islamic accounting. The matching concept for instance, is considered irrelevant because it leads to the preference for the revenue-expense approach rather than the asset liability approach. In fact, if the objective of accounting in Islam is to uphold the accountability through *Zakat* as Adnan and Gaffikin (1997) propose, the asset-liability approach needs to be applied.

Besides the matching concept, the objectivity concept is also considered as irrelevant. Adnan and Gaffikin (1997) argue that putting objectivity in the context of qualitative characteristics indicates that it is related more to the secondary objectives of accounting information, which is to facilitate accounting users in making legitimate economic decisions for their own interests. Therefore, since the primary objective of Islamic accounting is for *Zakat* accountability (as they propose), the objectivity concept is basically not relevant to the main concern of a primary objective in *Zakat.*

The Insufficiency of Conventional Accounting in Achieving Islamic Socio-economic Objectives

Hameed (2000a) asserts that the main accounting reports of conventional accounting (e.g. the income statement, balance sheet, cash flow statement and other subsequent or extraordinary events information) are considered important in Islamic accounting and could continue to be applied. This is because the investors and other financial providers are also members of society and they must get their due rights. In this case, the calculation of profits is absolutely essential in order for various parties to get their just and fair share.

However, that information is insufficient for Islamic society which should uphold accountability to Allah (as the primary accountee) and to men (as the secondary accountee) (Hameed, 2000a). Therefore, the uniqueness of Islamic accounting would be to provide other types of information in an integrated manner in the accounting report or statement.

Khan (1994) observes that the point of reference is the overall objective of the *Shariah* and not users' rights or needs as claimed by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) (1996). Therefore, he proposes additional requirements so that Islamic socio-economic objective can be obtained, such as providing true figures of *Zakat* payable, the extent to which justice and benevolence are considered in the organization, treatment of the employees, the impact of the business on its environment and adherence to the Islamic code of ethics.

Approaches in Developing Islamic Accounting

Basically, there are two approaches that can be used in developing Islamic accounting; (1) based on Islamic teachings and (2) based on contemporary accounting which is in line with Islamic teachings. These two approaches have been noted by the AAOIFI (1996) when they initially started to develop accounting for Islamic banks. Each approach contains inherent weaknesses in terms of either its applicability or reliability to meet Islamic socio-economic objectives. Therefore, Hameed (2000a) proposes a hybrid of the first and the second approach, which later will be considered as the third approach.

Deduction from Islamic Teachings Approach

This approach starts by establishing objectives based on the principles of Islam and its teachings, and considers these objectives in relation to contemporary accounting thought (AAOIFI, 1996). This approach deduces the *Shariah* precepts into what ought to be the objectives of financial accounting. If necessary, these could be supplemented by Western objectives of financial accounting that do not breach *Shariah* precepts and are deemed to be appropriate for Islamic business organizations.

The proponents of this approach believe that this would help to minimize the influence of secular contemporary accounting thought on the objectives to be developed (Karim, 1995). However, Rashid (1987) argues that this approach is necessarily detached from certain features of reality and one cannot know *a priori* how influential these factors will turn out to be. As a result, the move from theory to practice turns out to be quite difficult when one has only this approach at hand.

Contemporary Accounting Based Approach

This approach adopts the objectives of Western financial accounting currently available that are appropriate for Islamic business organizations and excludes any objectives violating *Shariah* precepts. This approach focuses on the moral dimensions that are absent in conventional accounting thought as a result of its development on the basis of the separation between spiritual and temporal affairs (Karim, 1995)

The proponents of this approach argue that it deals with the actual functioning institutions and is practicable in nature (Rashid, 1987). Abdelgader (1994) asserts that this approach is in line with the Islamic judicial principle of *Ibaha* which suggests that everything is permitted and lawful except that which is explicitly prohibited in the Holy *Qur'an* or in the *Sunnah*. Other proponents of this approach argue that most of the accounting issues in Islamic banks have fallen within the scope of existing accounting standards, so there is no need for their extensive overhaul except for those which conventional accounting has not covered i.e *musharakah* transactions (Ahmad and Hamad, 1992).

This approach has been objected to earlier by Gambling and Karim (1991) in that the conceptual framework of accounting currently applied in the West is justified in a dichotomy between business morality and private morality. Thus, it cannot be implemented in other societies that have revealed doctrines and morals that govern all the social, economic and political aspects of life. Anwar (1987) calls such a model a partial approach to Islamization. He labels this kind of inductive approach as deceptive because they mostly contain unIslamic assumptions while the norms and hypotheses of the original models are retained even though partial adjustment has been made by allocating some Islamic components to it.

Hybrid Approach

This approach is a combination of the two earlier approaches. It tries to bridge the weaknesses of the deductive approach and the inductive approach. Therefore, it is expected that the resulting Islamic accounting would be applicable and could achieve the Islamic socio-economic objectives. Hameed (2000a) proposes this approach by starting with; (1) identifying the ethical and accounting principles of the *Shariah* in relation to business activities and comparing it with what is currently being practiced; (2) identifying the main objectives and subsidiary objectives based on the Islamic ethical principles; (3) considering the development of socially related reporting that cannot be ignored by modern accounting; (4) identifying the theoretical foundation of Islamic accounting; and finally (5) identifying the users of Islamic accounting information and what information they need. Then, based on those identifications and considerations, try to develop the characteristics of Islamic accounting, which would incorporate Islamic business ethical principles and the achievement of the objectives of Islamic accounting.

This approach implies that the resulting Islamic accounting should be based not only on the understanding of *Shariah* principles related to business activities but also of the problems of society that it could probably contribute to solve. As Al-Faruqi (1982) points out regarding the methodology of Islamization, an Islamic methodology must maintain its relevance to the *ummah's* (society) reality by addressing itself to the problems that have already been identified and analyzed from the standpoint of Islam.

The Objectives of Islamic Accounting

Different approaches in developing accounting have resulted in different objectives of Islamic accounting. The AAOIFI, for instance, with its inductive approach has proposed objectives, which are similar to the current objectives of accounting practice based on the decision usefulness approach. Meanwhile, others (i.e. Hameed, 2000a; Adnan and Gaffikin, 1997), who develop it with different approaches, have also come up with other different objectives as well. This section will discuss the possible objectives of Islamic accounting, which so far have already been brought up in the issue of the objectives of Islamic accounting. They are; (1) decision usefulness, (2) stewardship, and (3) accountability.

Decision Usefulness

This objective is proposed by the AAOIFI for the Islamic banks. The AAOIFI (1996) in its Statement of Financial Accounting (SFA) No.1, recognized that the objectives of financial accounting determine the type and nature of information which should be included in financial reports in order to assist users of these reports in making decisions (SFA para 25). Therefore, financial reports should provide the information which is useful for users, such as; (a). Information about the Islamic bank's compliance with the Islamic *Shariah* (SFA para 37); (b) Information about the economic resources and obligations and the effect of transactions, other events and circumstances and related obligations (SFA para 38); (c) Information to assist the concerned party in the determination of *Zakat* on the fund (SFA para 39); (d) Information to assist in estimating cash flows that might be realized from dealing with the Islamic bank, the timing of those flows and the risk associated with their realization (SFA para 40); (e) Information to assist in evaluating the Islamic bank's discharge of its fiduciary responsibility to safeguard funds and to invest them (SFA para 41); and (f) Information about the Islamic bank's discharge of its social responsibility (SFA para 42).

The AAOIFI's objectives for Islamic accounting are most likely the same as those currently being practised in conventional accounting. For example, in the Statement of Financial Accounting Concepts (SFAC) no.1 issued by the Financial Accounting Standard Board (FASB) in the United States, it is stated that the financial report should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit and similar decisions (SFAC para 34). While in the SFA no.1 para 25, it also mentions that the role of financial reporting in the economy is to provide information that is useful in making business and economic decisions.

In our opinion, both the AAOIFI and the FASB accept the traditional view that relevant information for users is information about the company's financial position and performance. In fact, financial performance has to do with how successful a firm is in achieving its overall goal which, it is assumed, is to make a profit (Kam 1990). Therefore, financial performance is directly linked to profitability. Presumably, the greater the amount of profit, the greater the achievement of the firm (Kam, 1990).

Henderson and Peirson (1988) assert that the decision usefulness can be extended to include the needs of those parties who seek to exercise an overview or monitoring role over the social performance of the corporation. However, most of the literature on decision usefulness relates only to the needs of shareholders and creditors (Kam, 1990). Therefore, useful information is mainly associated with, (1) the ability to predict when the investor will receive dividends and the amount involved (or how much they would receive if they were to sell their shares) and (2) the ability to know if the company is able to pay a creditor's loan (or how much they will receive if they were to sell or redeem their bonds).

Since naturally the investors and creditors hope that their cash receipts will exceed their cash outlays, the company then is directed towards increasing its ability to generate favorable cash flows (Kam 1990). In this case, decision usefulness is a suitable objective to support an organization to achieve such goals.

Stewardship

Stewardship accounting has been practised since ancient times and was particularly important at the time to establish the credibility of their tenant to the often-absent landlord (Mathews and Pereira, 1996). Chen (1975) notes that the concept of stewardship arose from the religious teachings, mainly Christian, that man is a steward of God for the resources given to him. Man as God's steward owes a responsibility to use the property effectively not only for himself but also as a social responsibility for others around him. This concept developed in the feudal version of stewardship where resources, especially lands were given to the serfs to manage on the landlord's behalf. Here, the serf was responsible for taking care of the land for the landlord whereas the landlord had to take care of the social responsibility for others around him.

Since the middle of the nineteenth century, the concept of stewardship in accounting has referred to the separation of ownership and capital, which resulted from the development of the joint stock company structure. At this time, the classical form of stewardship, developed in a different way that the managers who were servants of the capital providers recognized only the stewardship to their masters and ignored, their social responsibility (Chen, 1975). Meanwhile, the financial statement became a way of demonstrating that the resources entrusted to management have been used in a proper manner. In terms of external reporting, the emphasis of stewardship is on showing that investments have been made in productive assets in an attempt to meet the organization's objectives. This requires a balance sheet and profit and loss accounts, so that owners can trace aggregate financial movements during a certain period (Mathews and Pereira, 1996). The current stewardship concept is quite close to the decision usefulness concept, but the information for stewardship is basically less than that under decision usefulness. This is because in stewardship (1) potential investors and creditors are not included as users; (2) it is not intended for the prediction model of users and (3) it mainly looks at the past to see what has been accomplished (Mathews and Pereira, 1996).

The AAOIFI (1996) also recognizes stewardship as one of its objectives. It points out that the objective of financial accounting is to contribute to the safeguarding of the assets, and to the enhancement of the managerial and productive capabilities of the Islamic bank while encouraging compliance with its established goals and policies (SFA para 33 – 34). Mirza and Baydoun (2000) support this objective and suggest that the stewardship function must be the focus of attention of accountants of Islamic institutions in reporting to external parties.

Meanwhile, the SFAC no. 1 also suggests that financial reporting should provide information about how the management of an enterprise has discharged its stewardship to shareholders for the use of the enterprise resources entrusted. The stewardship is maintained not only in the custody and safekeeping of resources but also for their efficient and profitable use and for protecting them to the greatest extent possible from an unfavorable economic impact such as inflation, deflation and technological and social changes (SFAC para 50). Since the AAOIFI uses the contemporary accounting based approach, their stewardship function in our opinion seems most likely to be the same as the one applied in conventional accounting.

Accountability

Accountability is said to be a broader concept than stewardship. Gray et. al. (1996) define accountability as the duty to provide an account or reckoning of those actions for which one is held responsible. This definition takes accountability as a form of principal agent relationship. In this form, an Accountee (principal) enters into a contractual relationship with an agent an Accountor (agent). The Accountee gives the power over resources along with instructions about actions and rewards to the Accountor. On the other hand, the Accountor is supposed to take certain actions and refrain from others in managing the resources given to him to meet certain objectives and to account to his principal by giving information about his actions to him.

Hameed (2000a) extends this form of accountability into two parts; (1) the responsibility to undertake (or to refrain from) certain actions and (2) to provide an account of these actions. The Accountability objective has been proposed by many scholars as the primary objective of Islamic accounting. For example, Adnan and Gaffikin (1997) proposed accountability through *Zakat* as the primary objective and Hameed (2000a) suggests Islamic accountability as the primary objective. The following section will discuss each of the above suggestions.

Accountability through *Zakat*

Based on the deductive approach that they use, Adnan and Gaffikin (1997) assert that the primary objective of Islamic accounting information is the provision of information to satisfy an accountability obligation to the real owner (Allah). Therefore, the overall accountability will be better operationalized, if it is directed towards the fulfillment of the *Zakat* obligation. They argue that by making *Zakat* the primary objective, one tends to avoid the unwanted practice of cheating or window-dressing in any form, as he or she believes that Allah always watches him or her. Consequently, accounting information will indirectly fulfill its users' needs as well as its societal responsibility (Adnan and Gaffikin, 1997).

In our opinion, *Zakat* payment and the consciousness of Allah's watching over one's acts are two different things. A person who pays *Zakat* will not necessarily adhere to the other commandments of Allah. This is because the consciousness of Allah's watching us is more related with one's worldview and reflected in the consciousness that all he does is because of Allah as well. In this case, Islam recognizes that there is a possibility of doing a good act, not because of Allah. This can be inferred from the hadith narrated by Bukhari and Muslim that a good deed will only be accepted if the intention is because of Allah (Nawawi, 1997). Since there is a possibility of one paying one's *Zakat* not because of Allah, we cannot simply assume that making *Zakat* the primary objective will result in less creative accounting.

Triyuwono (2000) also suggests that Muslim organizations should be *Zakat* oriented instead of profit oriented as they are now. This means that the net profit is no longer used as a basis of performance measurement as it is replaced by *Zakat*. Therefore, an enterprise is directed to the achievement of higher *Zakat* payment. To achieve a *Zakat* oriented enterprise, it needs to maintain a *Zakat* oriented accounting system. Triyuwono (2000) believes that the use of *Zakat* oriented accounting would result in a more Islamic organization as it implies certain features. Firstly, the transformation from profit maximization to *Zakat* optimization. Therefore, profit is only regarded as an intermediary goal while *Zakat* is the primary goal. Secondly, since *Zakat* has been taken as the ultimate goal, any activities policy of the enterprise must comply with the Islamic *Shariah*. Thirdly, it would inherently incorporate a balance between individual character and social character whereas the *Zakat* concept encourages Muslims to make profits (under *Shariah* guidance) some of which would then be distributed as *Zakat* representing one's concern for social welfare. Fourthly, the enterprise would be encouraged to participate in releasing humans from the oppression of economic, social and intellectual factors and releasing the environment from human exploitation. Fifthly, it provides a bridge between the world and the Hereafter as *Zakat* raises human consciousness that any worldly activities are related with their destiny in the Hereafter.

In our opinion, putting *Zakat* as the ultimate objective would mean entail narrowing the Islamic view on economic issues. Although, there is no doubt that *Zakat* is one of the main pillars in Islam and should be upheld, it is simplistic to say that *Zakat* would solve the remaining economic problems. In fact, Islamic socio-economic objectives involve a wide range of concerns. In our view, *Zakat* is one of the main instruments to achieve such objectives alongside other instruments such as a riba free system etc.

Pertaining to this issue, Chapra (1992) reminds us that an Islamic system in business should be able to achieve the *maqasid al-Shariah* (objective of the *Shariah*) which includes everything that is needed to realize *falah* (success in the world and the Hereafter) and *hayat tayyibah* (good life) within the constraints of the *Shariah.* Even if *Zakat* accompanied by behavioral norms and the prohibition of interest could be established, they still cannot carry the burden and responsibility of realizing the *maqasid.* As Chapra (1992) commented, it is just like looking at the skull, chest, and legs of a skeleton and saying that this is the human being.

However, the proponents of this objective i.e Triyuwono (2000) argue that a *Zakat* oriented enterprise will strive for the higher *Zakat* payment. Borrowing Chapra's (1992) terminology of ingredient and recipe, we believe that making *Zakat* the main objective of Islamic accounting is the same as treating an ingredient as a recipe. In terms of the socio-economic objective, it is justice that should be increased, and the higher portion of *Zakat* will not necessarily ensure better justice. Just like a cook, too many ingredients could result in awful tasting food, so an overestimated *Zakat* could also end up in injustice by sacrificing the rights of the *Zakat* payer or the employees who work for that particular enterprise.

Islamic Accountability

By using the hybrid approach, Hameed (2000a) starts his argument on Islamic accountability with Faruqi's (1982) description of the concept of *Khilafah* (vicegerency). This concept explains the vicegerent status of man in the world, in which Allah – God Almighty – has given *amanah* or trust of the earth to man (Al-Qur'an 35:39) while other creatures including angels, animals and non-living matter have no ability to fulfill it. As stated in the Holy *Qur'an*, Allah indeed has offered the trust to the Heavens and Earth and the Mountains, but they refused to undertake it being afraid thereof but man undertook it (Al-Qur'an 33:72).

Al-Faruqi (1982), notes that the trust constitutes such a heavy responsibility that even the Heavens, the Earth and the Mountains did not feel prepared to bear it. Man as the one who accepted the trust, therefore should be aware of fulfilling it, since this will be accounted for. Man is not only accountable for the spiritual aspects but also for social, business and contractual dealings as Allah also commands man to give back things that have been entrusted, to whom they are due (Al-Qur'an 4:58). This command then is detailed in another verse of the *Qur'an* that man should fulfill (every contract) because for (every) contract will be questioned (on the day of the judgment) (Al-Qur'an 17:34)

Hameed (2000a) suggests that this kind of accountability can be used as the main objective of Islamic accounting which he then names Islamic accountability. From a practical point of view, this suggestion is supported by Khir (1992) who asserts that this concept is so ingrained in the Muslim community that it will give the greatest motivation for the practical development of Islamic accounting.

Islamic accountability is defined by Hameed (2000a) as a being premised on both Islamic/Muslim organizations and owners with dual accountability. The first or prime accountability arises through the concept of *Khilafa* whereby a man is a trustee of Allah's resources. This primary accountability is transcendent, as it cannot be perceived through the senses. However, it is made visible through the revelation of the *Qur'an* and *Hadith*, which are the sources of Islamic teachings.

Meanwhile, the secondary accountability is established by a contract between an owner or investor and a manager. To discharge the secondary accountability, the company should identify, measure and report the socio-economic activities pertaining to Islamic, social, economic, environmental, and other issues to the owner. Further, based on Islamic accountability, subsidiary objectivities can be determined such as *shariah* compliance, assessment and distribution of *Zakat*, equitable distribution of wealth among stakeholders, the creation of a cooperative environment and solidarity and other type of reports that can contribute in providing information of and encouraging the enterprise to participate in solving contemporary the *Ummah's* (society) problems (Hameed, 2000a)

Characteristics of Islamic Accounting

After discussing the emerging issues on the objectives of Islamic accounting in the previous section, we will continue to delve deeper into the issues of the characteristics of Islamic accounting. Mainly, the debates on the characteristics of Islamic accounting are focused in two aspects (1) financial measurement and (2) disclosure presentation.

Therefore, the following section will discuss those two aspects of Islamic accounting characteristics.

Financial Measurement Aspects

Most of Islamic accounting literature takes *Zakat* as a cornerstone of determining measurement tools. There are, at least, three reasons for taking *Zakat* as the main focus of measurement issues. Firstly, *Zakat* is a concept in Islam that deals specifically with the measurement of assets. This can be inferred from some verses in the *Qur'an* and *Hadith* of the Prophet Muhammad (pbuh) regarding the timing and the way in which *Zakat* is calculated. Secondly, *Zakat* has been decreed in many verses directly after the ordinance of prayer and considered as one of the five pillars of Islam. This implies that Muslims are encouraged to establish instruments (including accounting instruments) in order to ensure this obligation can be fulfilled in accordance with the *Shariah* of Islam. Thirdly, the development of accounting in the early Muslim government are closely related with the practice of *Zakat*. During that time, the Islamic State had already provided accounting books and reports for the determination and accountability of *Zakat* (Zaid, 1997).

The majority of jurists appear to have concluded that the valuation of *Zakat* should be based on the selling prices prevailing at the time *Zakat* falls due (Al-Qardhawi, 1988). This implies that in accounting, Islamic business organizations should apply current cost rather than historical cost which is widely used at this time (Adnan and Gaffikin, 1997; Baydoun and Willet, 1997 and 2000; Clarke et. al., 1996; and Haniffa and Hudaib, 2001). Besides that, some accounting principles related to the measurement also need to be redefined. For instance, Haniffa and Hudaib (2001) argued that what is meant in Islamic accounting by the conservatism principle is not the selection of the accounting techniques that has the least favorable impact on owners but more towards the selection of accounting techniques with the most favorable impact on society i.e. better to overestimate funds for *Zakat* purposes.

The AAOIFI (1996) recognizes the current value concept of assets, liabilities and restricted investments in its statement of accounting concepts. However, due to the lack of adequate means, such a concept is not recommended. Instead- historical cost remains to be applied and the use of the current value financial statement is only regarded as supplementary information if the enterprise considers its importance for the potential investor and other users. Therefore, in practice, it is the historical cost which is applied by Islamic banks (Shihadeh, 1994).

Mirza and Baydoun (2000) view this issue differently from the above views in that Islamic accounting is likely to use both historical cost and market selling prices. Therefore, an Islamic accounting system would have a dual system of asset valuation. This argument is based on the premise that an Islamic enterprise needs to adhere both to the contract and discharge its obligation on *Zakat*. Since contract is based on past transaction and *Zakat* is based on current valuation, then the measurement needs to conform to each purpose.

Mirza and Baydoun's assertion (2000) on the application of historical cost in all (except for *Zakat* purposes) accounting calculations, is based on the arguments that historical cost is a highly reliable source of information about a firm's assets, private debts, the firms operation and cash management. In their opinion, historical cost also fits well into the concept of stewardship, which they believe is the objective of Islamic accounting. The historical cost method could highlight the fiduciary responsibility of the managers and their stewardship function. This method is most appropriate because contracts are written in historical cost numbers and this has survived over the centuries and if there were a more efficient valuation method it would have displaced the historical cost system long ago.

In our opinion, unlike the current valuation method, historical cost has no *Shariah* basis to be applied in an Islamic enterprise. The contract fulfillment principle in Islam cannot be used as the basis for applying historical cost for measurement purposes as contract itself is a kind of past activity but for future realization. Therefore, at the time of measurement, it is the current valuation which should be used. In this case, the use of historical cost could corrupt the principles of disclosing the truth (Al-Qur'an 2:42) and forbidding withholding it (Al-Qur'an 83:7). These principles encourage every enterprise to disclose the truth as it is, with neither understatement nor overstatement. Meanwhile, the historical cost reflects a type of conservatism that would lead to the understated valuation.

Disclosure and Presentation Aspects

Haniffa and Hudaib (2001) propose that the importance of disclosure and presentation is to fulfill the duties and obligations according to the Islamic *Shariah*. To achieve this purpose, an Islamic enterprise is expected to disclose at least: (1) any prohibited transactions they made; (2) *Zakat* obligation they have to pay and have already paid; and (3) social responsibility. Social responsibility would include charities, wages to employees, and environmental protection. This means that financial reporting in an Islamic society is likely to be more detailed than what is currently prevalent in Western societies.

Baydoun and Willet (2000) view that social accountability and full disclosures are the basis of Islamic corporate reports. They suggest the current value balance sheet be included as part of the reporting requirements of firms operating in an Islamic economy. Meanwhile, the income statement should be relegated to the notes because of its corruptive influence in directing people to become highly profit oriented. Instead of that, from an Islamic perspective, a Value Added Statement (VAS) should be applied. This is because the distributional characteristics of the VAS would support accountability in Islam (Baydoun and Willet, 1994).

The VAS, however, is basically a rearrangement of the income statement. Therefore, the existence of the VAS to provide a significant difference from an income statement is questionable. Just like the income statement, the VAS is also an ex-post report which would have no influential control on the enterprise's social aspect for the current year. But to some extent it can still be used by workers to influence the enterprise on policy following the issuance of the VAS in aspects such as bonus payment. Besides, community at large could also use it to enforce the enterprise to be more aware of their social responsibility whereas an income statement has no such specific tools.

From an Islamic perspective, growth should lead to social justice and a more equitable distribution of power and wealth. Meanwhile, the VAS could provide information on wealth distribution between the different sectors of society and is likely to facilitate focusing a firm's performance from the stakeholders' point of view (Mirza and Baydoun, 2000). Hence, it would promote a conscious policy of redistribution and resource transfers among various groups of society (Sulaiman 1997).

However, besides the distribution aspect of sources, Islam is also concerned about the acquisition of those sources. Islam requires that the sources acquired should meet the category of *halal* (permitted). To achieve this category, those sources should be permissible (*halal*) in nature and also permissible in the process of acquisition. The problem in the VAS is that, it does not provide a space for such consideration as it is only concerned with the distributional aspects of the sources. Therefore, in our opinion, it can be said that the VAS is insufficient in meeting the Islamic requirements for information.

Pertaining to this issue, Mirza and Baydoun (2000) suggested that the Islamic financial statements require an emphasis on transparency and avoidance of manipulation, which is manifested by the full disclosure principle of Islamic corporate reports. However, Khan (1994) is pessimistic about this principle especially on firms disclosing negative information about themselves i.e. unfair treatment of employees, environmental pollution, cheating income tax calculation, etc. Firms will think that they will be in the grip of the law if they disclose all these matters. Therefore, Khan (1994) suggests that it is only certain transactions, which are lawful in the capitalist framework but unlawful in the Islamic framework (e.g. interest income, interest paid, investment on mark-up without taking any risk and other *riba* type transactions) that should be adequately disclosed in the financial statements of Islamic business firms. To be adequate, disclosure of unlawful transactions should involve amounts, sources and circumstances which force the firm to engage in such transactions, and the method by which such incomes or assets will be disposed of (Khan, 1994).

However, in our opinion, letting the enterprise cover their negative information as Khan (1994) proposes will be the same as providing a comfortable environment for them to continue such practices. This can also be considered as compromising Islam with unjust business practices. We believe that in the end it definitely would depart from the Islamic socio-economic objectives.

Conclusion

As a way of life, Islam has a great concern for business activities. Through the revelation of the Qur'an and His Apostle, Allah has shown His guidance to mankind on how to be successful in this world and in the Hereafter while doing business. Since business is closely related to the economic problems which involve a wide and complex area, a single instrument e.g. *Zakat,* would not be sufficient to solve those problems. In fact, it needs all instruments that can be used to achieve success (*falah*)

Therefore, it would also be appropriate to direct an Islamic accounting system towards the achievement of the Islamic socio-economic objective of *falah*. Hence, in designing an Islamic accounting system, its objectives and characteristics should be able to direct the enterprise not only to provide a true picture of the enterprise but also to encourage them to be *Ihsan* (benevolent) and discourage them from being unjust. Based on the previous discussion, we have tried to show that some of the proposals for the objectives and characteristics of Islamic accounting have doubtful ability to achieve the Islamic socio-economic objectives.

Notes

[1] According to Littleton (1933), writing and arithmetic were tools of the antecedents for the development of accounting.

[2] Although a few Muslim countries have established stock markets, the majority of the Muslim population are employed in agricultural, pastoral, and small business activities.

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