



The Conceptual Framework of Islamic Accounting

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Abstract: The present study has been conducted to serve the objectives pursued by the conceptual framework of Islamic accounting based on Quran, which is in line with Sharia emphasizing ordinances and laws originating from Quran such as justice, kindness, ethics, contracts and Zakat. Furthermore, it challenges the economy developed by cruelty, hoarding, usury, and destruction of social and moral principles. Finally, it should be noted that traditional accounting plays a helpful and reasonable role for corporate accountants and auditors.

Keywords: Accounting, Islam, Quran

INTRODUCTION

The expansion and diversification of financial institutions around the world and the vast range of information users, objectives of accounting and its direct effect on politics, the intricacy of trading, skills, innovation, social status and the gap between management and ownership as well as the recent crises in different countries and huge financial scandals such as Etrod, WorldCom, Tico and Riparo altogether give Islamic accounting an effective role as a helpful instrument in order to resolve the problematic situation. Accounting is defined as a process of diagnosis, measurement, and reporting of financial information, which enables AAA (American Accounting Association) users to make wise decisions and judgments. Such mechanism and definition from the Quranic perspective encounters some deep-rooted problems. Through the Muslim Holy book Quran and Prophet Mohammad, however, God has put forth to humans the proper orientations brought by religious teachings so as to resolve those problems. Therefore, the need for Islamic accounting is critically felt. Anther ET al¹ have defined Islamic accounting as a branch of accounting, objectives and functions of which are aimed at achieving moral and practical goals in accordance with Sharia.

The significance of accounting is stated by Quran as below:

“ .10 ye who believe! When ye deal with each other, in transactions involving future obligations in a fixed period of time, reduce them to writing Let a scribe

write down faithfully as between the parties" (002:282). The emphasis is on the method of ensuring debts and deals.

" .2If ye are on a journey, and cannot find a scribe, a pledge with possession (may serve the purpose)." (002:283).

..." .3and get two witnesses, out of your own men, whenever ye make a commercial contract;" (002:282).

The emphasis of the last two verses is on mortgage and providing witnesses in a fair deal.

Hence, the present paper attempts to review the conflicts of Islamic accounting and traditional accounting as well as to explore the fundamental principles and differences with a focus on standards of Islamic accounting, analyses of traditional accounting assumptions from an Islamic viewpoint, shortcomings of financial communication approach in traditional accounting and major solutions to disputes, and finally, draw conclusions.

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Conflict of Islamic accounting and traditional accounting

1. In terms of nature, the intellectual, cultural and moral impact left by traditional accounting on humans spreads a spirit of rebellion and totalitarianism among materialists, destroying the main social roots. This faith has nothing to do with standards of capitalism. Hence, human relations in traditional accounting involve solely economic ties firmly based on profitability. In Islamic accounting, however, social relationships, human beliefs and recognition of the true value of humanity in the legal context of Sharia ensure a healthy society and keep economic-political leverage away from the hand of wealthy people.^{2, 3}

2. In terms of origin, traditional accounting comes from economic rationality, while Islamic accounting fundamentally comes from God, unity, commitment to respecting the rights of others and avoiding misuse of other people's property, Just as God states in Quran, "O ye who believe! Fulfill (all) obligations." (005:001) or somewhere else "O ye who believe! Eat not up your property among yourselves in vanities," (004:029).

3. In terms of definition, traditional accounting is a process, objective of which is to ensure optimum dedication of scarce resources restricted to profitable activities through available information in the market and incompatible with Sharia Law. Islamic accounting, however, is a process, objective of which is to ensure transparent, adequate and accurate financial information in activities of an institution and their compatibility with Sharia law as well as social and economic regulations.⁴

4. In terms of normative and positive accounting theory, a few economists and accountants have made efforts to theorize accounting concepts. The positive theory deals with description of facts, behaviors and performances, such as the relationship between unemployment and inflation. The normative theory,

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however, includes descriptive theories based on value judgments and moral principles. Hence, there is a difference between the two theories in a capitalist system, while they cannot be distinguished in Islamic accounting and there is no difference between the two theories.⁵

5. In terms of responsiveness, the answers to economic fundamental questions in the Islamic accounting system fall under Sharia law and certain instructions. For instance, a portion of goods and services are prohibited by Islam, such as trading alcoholic drinks and committing usury. Therefore, such goods should not be produced, referring to the general responsiveness and transparency. In traditional accounting, however, subjective responsiveness takes place regardless of Sharia law and order.⁴

6. In terms of procedural consistency, traditional accounting is carried out based on the Generally Accepted Accounting Principles (GAAP), while the focus of Islamic accounting is on divine commandments presented by Quran, Hadith and Islamic doctrine.⁶

7. In terms of production method, Islamic accounting adopts, in the instructional framework of sacred Sharia, production methods that are not detrimental to society and also employs production resources in a waste-less way and safe to future generation. Such method, however, has nothing to do with capitalist economy; i.e. maximum production for personal satisfaction and maximizing the current wealth.⁷

8. In terms of service and goods distribution, there are certain regulations proposed in the Islamic society regarding service distribution, or generally income distribution. According to such regulations, the national income is shared by entire segments of a society, whether or not capable of earning money. In traditional accounting or capitalist system, however, there are no specific regulations to enforce circulation of wealth in a society, and the capital is packed for the benefit of certain groups.⁸

9. In terms of profit, traditional accounting involves materialism, profit maximization and welfare regardless of legitimacy of contracts (halal vs. haram), while Islamic accounting takes in to accounting the precise profits, and legitimacy of contracts based on Sharia restrictions.⁹

Fundamental principles and differences

The current principles and procedures in accounting are closely related to Islamic Sharia and Islamic instructions, i.e. transactions in Islam are founded upon adherence to commitments and respecting other people's rights as well as avoidance from misusing other people's property. In this regard, God Almighty states in Quran 005:001 "O ye who believe! Fulfill (all) obligations." The purpose of Sharia is to maintain a balance between needs of human body and soul through establishment of standards such as justice, perseverance, spirituality, honesty, and ethics. Accordingly, it is essential to offer proper guidelines for economic

prosperity. The Islamic Sharia views economic power in a way that it benefits the entire aspects of human life and all segments of society and ultimately providing their needs. Sometimes, God associates property and wealth to Him and appoints substitutes for protection, accumulation and donating to the needy. As God states in Quran 057:007 "Believe in Allah and His messenger, and spend (in charity) out of the (substance) whereof He has made you heirs." Moreover, one of the objectives of Islamic economy, as argued by Shafi² is that wealth should not be amassed in the hands of one or several individuals, but it should be allowed to circulate in the society, so that the distinction between rich and poor fades as much as possible away.

There are certain institutions to carry out such mission, one of which is Zakat. Islam is a religion that covers the entire physical and spiritual needs as well as the proper rules and instructions. By establishment of Islamic government, therefore, observation of religious practices such as performing prayers, fasting, haj (pilgrimage) and paying zakat became necessary. As a treasury resource, the last one supplies Bayt Al-mal, settles the problems for disadvantaged segments of society and promotes piousness. In fact, zakat constructs one of the major pillar of Islam, which has been emphasized in Quran as a financial solution in Islamic governments, so that zakat is considered as an integrated part of financial and economic system in Islam, rather than an absolute strategy, to the extent that paying zakat has been regarded by Quran as equal to performing prayers. For instance, it is stated in 073:020 "and establish regular Prayer and give regular Charity;" and in 009:103 "Of their goods, take alms, that so thou mightiest purify and sanctify them;"²

Unfortunately, zakat is not so much propagated in other societies, while it receives tremendous attention from Islam as illustrated below:

1. In most of the Quranic verses about performing prayers, Zakat has been mentioned through various interpretations, since there is an unbreakable bond between the two practices. Just as God states in 009:005 "but if they repent, and establish regular prayers and practice regular charity, then open the way for them",

2. Shariati argues that Abuser, a companion of the Prophet Mohammad, believed that government should, with or without permission, pay the surplus money of wealthy people to the needy through zakat.¹⁰

3. Zakat is a worship act directly related to Muslim refinement and purification, promoting piousness as asserted by the following Quranic verse: "But (even so), if they repent, establish regular prayers, and practice regular charity, they are your brethren in Faith," (009:011)

4. Zakat influences individual behavior in several ways such as staying away from avarice and greed, blessing on the property, protection of property from pests, accepted prayers etc.¹¹

5. Zakat also leaves social effects such as dispelling disaster from the nation, eradication of poverty, and public adherence to religious practice.¹²

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Another important aspect of accounting is ethics. It can be assumed that collective ethics is influenced by individual ethics. In the accounting profession, however, collective ethics is much more influential; because accounting is the language of trading and just as human language can represent impure faith of a human, accounting can similarly represent unhealthy economic activities in a healthy way, compromising the economic health, public interests and trust in a society. Therefore, it is essential for accountants and auditors to adhere to professional ethics.

As narrated in a hadith by Bokhara, the Prophet Mohammed (PBUH) stated "I have been motivated to complete the ethics". Furthermore in 068:004, he states "And thou (standest) on an exalted standard of character." The violation of ethics by accountants, the interests of shareholders are undermined. On the other hand, it seems highly essential to observe ethics in today's fast-growing scientific and technological communities, since tremendous scandals in the accounting history committed by corporations like Etrod, WorldCom and Ticko were a consequence of violating ethical standards in accounting.¹³

In order to assess the accounting procedure, other standards can be pointed out, such as honesty, justice and kindness, which have been mentioned in Quran. The initial measures taken by Islam for protection of human solidarity in a society and emphasis on keeping society away from division and vengeance are to observe justice as well as to maintain honesty and faith in performing tasks according to Sharia and Islamic instructions. In this regard, God states in 016:090 "Allah commands justice, the doing of good, and liberality to kith and kin",

In another verse (006:152), He clearly states "whenever ye speak, speak justly", Accordingly, God has regarded justice as the link between the entire religious teachings and the Prophet's mission on invitational guidance and correction. Such justice can be seen in various economic areas (including contracts and agreements). Moreover, God states in Quran 002:282 regarding the necessity of determining that obligations of the two parties in a contract: "O ye who believe! When ye deal with each other, in transactions involving future obligations in a fixed period of time, reduce them to writing Let a scribe write down faithfully as between the parties: let not the scribe refuse to write," or somewhere else He declares in 004:135 "O ye who believe! Stand out firmly for justice, as witnesses to Allah, even as against yourselves, or your parents, or your kin, and whether it be (against) rich or poor",

As it was mentioned earlier regarding contracts, which is essential to be described in Islam, the concept of Islamic agreement highly signifies so as to ensure security and interests of an Islamic society, giving power to Muslims to make free decisions. A few of these contracts are obviously mentioned in Quran, such as divorce, marriage, war, trade etc., while others concern the relationship between God and humans, as He states in "O ye who believe! Fulfill (all) obligations."

From such statements, several conclusions can be drawn as below:

1. The subject of a business contract should not be in contrast with the established Islamic Sharia and rules. In this regard, it has been narrated from Prophet Mohammad (PBUH) that every provision contrasting the Book of God is rejected and cancelled, because such attempt threatens the Islamic identity and value, paving the way for capitalists and enemies to penetrate into markets.¹⁴

2. The items stipulated in a contract should be fully consensual between the two parties, because consent on the contract is the natural and fundamental requirement and Quran states in 004:029 "But let there be amongst you Traffic and trade by mutual good-will"

3. The basic provisions as well as objectives and obligations of the two parties should be clarified, so as not to make any grounds for suspending interpretation or playing with words.^{15, 16}

Beekun¹⁶ defines benevolence (Ihsan) as a good behavior. Siddique¹⁷ (2009) considers benevolence more important than justice, because wherever justice is the building-block of society, benevolence is its culmination of beauty and perfection. Furthermore, when justice leads to economization of undesirable behaviors, benevolence can make life more pleasant.

Another noteworthy point is the prohibition of usury or riba .¹² it has been explicitly stated in Islam that Riba or usury (i.e. charging an ensured risk-free high rate of interest) hinders investment and employment, because the tendency turns toward accumulation of wealth by a specific group of people.

The term riba refers to increase, addition, expansion or growth. Sharia defines riba as a surcharge paid by the borrower to the lender. In the following verses, Quran has obviously prohibited riba:

"Those who devour usury will not stand except as stand one whom the Evil one by his touch Hath driven to madness. That is because they say: "Trade is like usury," but Allah hath permitted trade and forbidden usury." (002:275)

Somewhere else in Quran, God states "O ye who believe! Devour not usury, doubled and multiplied; but fear Allah; that ye may (really) prosper." (003:130)

Standards of Islamic accounting

1. Justice 2. Benevolence 3. Trusteeship 4.Trust in God 5. Infaq (spending) 6. Patience 7 Avoidance from usury 8. And squandering.

Analysis of the fundamental concepts (assumptions) of traditional accounting from Islamic perspective

There are general assumptions and principles providing the basis for financial statements and the status of accounting principles. Such assumptions are generally not illustrated, since they are presumably recognized as true (Luis, 2006). By observing the accounting assumptions, efforts are made to analyze the principles of traditional accounting from Islamic perspective, a few of which are mentioned as below:

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1. The assumption of continuing activity: This assumption implies that an economic unit will continue its activity for an unknown time in the future, unless otherwise is proved. Furthermore, this assumption is the basis for classification of assets and debts into current and long-term types. The process of measuring cost instead of current value for assets is also influenced by this assumption. From Islamic perspective, only God shall exist unlimitedly. On the other hand, the calculation of zakat is conducted based on the current value of assets, which is challenging to this assumption.¹⁶

2. The assumption of measuring unit: This assumption implies that entire financial events, transactions and operations should be measured, reported and assessed based on money. In practice, however, the actual value of money is lowered due to inflation over time. The increased prices and weakened purchasing power has turned this opportunity into the most controversial assumption in accounting. As argued by Napir (2007), there are advantages to an interest-free economy that cannot be represented in the context of money value, such as environmental damage caused by companies.¹⁸

3. The assumption of financial period: The actual results obtained from an economic unit are determined basically at the end of the operation or as soon as the settlement is completed. From the Islamic viewpoint, however, zakat is levied when a property is kept for one year and accounting basis should be applied to periods for which the amount of zakat is calculated.¹⁹

4. The assumption of commitment: The basis of this assumption is that incomes and outcomes in accounting should be identified and registered in accounts as soon as they take place. In contrast, there is a cash basis where incomes and outcomes are identifiable and register able as soon as they are received or paid. Zakat is calculated on a cash basis, and the assumption of commitment for calculation of zakat is opposed to Islamic accounting.^{20, 21}

5. The disclosure principle: Islam views disclosure in two major requirements: 1. Full disclosure 2. Social accountability.²²

The concept of accountability is associated with full disclosure aimed at safeguarding the interests of stakeholders in the framework of Islamic content. One of the ways of providing full disclosure is its accordance with Islam as well as social and public reporting. Based on such concept, the entire information about an organization should be fairly and completely disclosed in financial statements. Traditional accounting emphasizes information needs, while Islamic accounting rather emphasizes moral accountability. Furthermore, Mirza & Bidon (2000) have recommended regarding disclosure that financial statements be transparent and free from manipulation.¹²

Khan (1994), however, suggested that certain transactions are permitted within the capitalist framework, but prohibited in Islam, such as gaining interest and other usury-related deals which should be disclosed in financial statements of Islamic corporations.

6. Conservatism (restrictive covenant): It has been emphasized in accounting standards that precautionary measures should not lead to hidden reserves, reporting the assets and incomes of an institution lower than the reality while reporting outcomes and debts higher than reality, because such trend violates neutrality compromising the reliability of financial information. This concept is in contrast with the principles of Islamic accounting due to concealment of assets for calculation of Zakat. God requires Muslims to follow His path and avoid overindulgence. Hence, the current value justifies the assets for calculation of zakat.⁹

Shortcomings of financial communication approach in traditional accounting

1. Gauss (1997) argues that auditors in traditional accounting are not capable of providing information other than financial statements. In other words, he regards disclosure as a form of communication, since it is unidirectional in most cases, unable to build a two-way communication. Such reports, therefore, will be misleading, challenging the power of decision-makers.¹⁵

2. Another weak point of traditional accounting is the limited focus, i.e. endeavor to maximize the capitalist wealth disregarding the need of other stakeholders.

3. The emphasis in traditional accounting is on historical data, so that the value of assets over time never stays the same and constantly changes. Lehmann (1992) and Landholm (1999) have warned that accounting is losing the characteristic of relevancy, which might be caused by cost. According to these researchers, relevancy is questioned. The model of historical reporting in traditional accounting might be suitable for industrial economy, but it is unable to generate wealth in an economy based on current knowledge and information.¹⁶

4. The other disadvantage is that traditional accounting is constantly occupying itself with an avalanche of new accounting standards. Haley & Paelo (1993) consider such statement as unpleasant and believe it can stop accounting from going through a dynamic process.

In spite of the shortcomings mentioned particularly regarding the principle of cost, it is still applied as a conventional principle of accounting due to the following reasons:

1. The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and Islamic accounting should focus on a separate financial reporting based on social accountability.

2. Concerning the role of accounting standards, measures should be taken for Islamic institutions in a way that public interests are observed.³

3. Justifying and guiding the public opinion in order to shift their aimless funds in Islamic financial institutions with regard to the transparent role and activities of such institutions in growth and development of social interests.

CONCLUSION

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In the profession of accounting and auditing, Sharia and religious teachings as well as considering factors like ethics, honesty, and justice can together be employed as an effective tool to determine proper and improper relationships. Moreover, it can display the outline of an ideal society for Muslims. In fact, Islamic accounting can be explained and expanded if an Islamic worldview provides a framework. As a monotheistic lifestyle and worldview, Islam pays a great deal of attention to business activities. Through Quran, God has put forth a complete guide to human salvation both in this world and afterlife. Similarly, accounting should become consistent with such goals. On the other hand, the traditional accounting and financial system is currently suffering numerous crises, which can be seen in the recent examples in European countries. We know that world is, over time, evolving and developing, which should be in line with justice and moderation, so that traditional and socialist economic reasons would not change the world. This factor should operate within its boundaries, i.e. consistency with Sharia, because belief in Islamic accounting and Sharia, which emphasizes principles and regulations, widespread construction, and public participation in administering social affairs as well as intellectual growth and orchestrating development in every aspect of life, encouraging Muslims to pursue such objectives, can be a solution to tackle and curtail problems, conflicts and disputes. Traditional accounting and its desirable solutions for earning and reserving property and giving rights to the owners should make great efforts to realize a healthy and justice-oriented society, which shall be based on a series of fundamental principles and general rules summed up as below:¹⁵

1. The law of wealth circulation in public hands
2. The law of prohibiting usury
3. The law of prohibiting hoarding
4. The general law of public interests
5. The law of prohibiting squandering
6. The law of zakat

This is all because life and protection of rights and interests of others depend on the above rules. On the other hand, such situation has brought about a great concern for business activities. Therefore, it can be stated that accounting ought to be conducted through further research and studies by Muslim scholars, professors, students and experts in different countries, which shall be a huge step ahead for the entire human community.

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