
Component of Islamic Accounting

Mahdi Haghghat*

Islamic Azad University, Omidiyeh Branch, Omidiyeh, Iran

*Corresponding Author E-mail: mhaghghat@yahoo.com

Received: 11 December 2011, Revised: 20 January 2012, Accepted: 29 February 2012

ABSTRACT

In Islamic countries, regarding to the role of teachings of Islam in people's personal and social life and the role of religious law as the general pattern of ideal Islamic society, in accounting also must be considered teachings and commands of religious law. In this study, the component of Islamic accounting has been reviewed. Review of different description of Islamic accounting and comparing them with common accounting showed that there are differences among them: in the purpose of preparation of information, kind of realized information and the way they are measured and reported, information users, economic infrastructure, kind of accountability and application of religious law. Islamic accounting is after realization of some purposes including the following: profitability for decision making, Islamic accountability, zakat payment, usury prohibition, speculation prohibition, etc. It seems that Islamic accounting can improve the accounting and financial reporting in Islamic countries to a great extend, through considering the religious, cultural and social features and institutionalizing the common accounting in Islamic societies.

Key words: Islamic accounting, Usury, Zakat, Speculation.

Introduction

In Islamic countries, the role of Islamic teachings is strong in personal and social life and in compiling laws and regulation quran and sunnah are considered. Religious law as a general pattern of an ideal Islamic society considers muslimhood aspects through proving faith and the belief of the Muslim person. Islamic ideology is funded on three basic principles: monotheism, God's successor and justice. Monotheism as the foundation of existence. The concept of God's successor refer to quran (Baqarah/30), which specifies the role and status of human being and his responsibilities regarding himself and the Islamic

nation. Justice is related to the concept of God's successor which has been emphasized strongly in quran (A'raf/29 and Ma'idah/8). Because of Islam's commitment regarding the necessity of implementing justice, wealth must not concentrate in the hands of a few people (Chapra, 1992; Sulaiman, 2003). On the other hand, according to the prophet Muhammad's hadith: "Indeed, I have been chosen to complete moral virtues." Islam is basically a collection of moral guidance for the personal and social life of Muslims. Some of the notable of Islam believe that the economic activities are funded on two moral pillars of "justice" and "beneficence". These values are

basic values that have guidance for all angles of human life. Therefore, Islamic business must be funded on these values (Yaya and Hameed, 2006). Justice: quran necessitates observance of justice in all matters of human life under any condition. prophet Muhammad also emphasized on justice and reacted severely to injustice. Quran instructs Muslims that in testifying and deciding about controversial matters among Muslims and even with enemies do not get out of justice course. Therefore, Muslims must try collectively for establishing justice (Yaya and Hameed, 2006). Beneficence: beneficence means good behavior toward, or helping others without any expectation or commitment for others. Some of the religious people consider beneficence to be even superior to justice. If justice protects society from exploitation and suffering, beneficence makes life sweeter and more pleasant. In the realm of business, methods like leniency, motive of serving others, attention to God and his satisfaction will strengthen beneficence. Leniency is one of beneficence's pillars and God's attributes that Muslims have been encouraged to keep this attribute alive in them. Leniency can be expressed as respect to others, forgetfulness and solving problems of other people. The mean of motive of serving others is that business organizations must consider other's needs and interests. So, Muslims in business activities must be after providing services which are the real need of society. In addition to that, business activities must be in accordance with Quran's moral values (Yaya and Hameed, 2006). Therefore, the Islamic ideology provides a frame that can help the "Islamic accounting" was described and expanded.

Concept of Islamic accounting

At the beginning, it is necessary that the concept of Islamic accounting is considered. Muslim thinkers in accounting have provided several descriptions that among which Among which a few is referred: Zaid (1997) has described Islamic accounting as: "The organized process of registering lawful transactions in ledgers and measuring the financial results according to these transactions in order to use them in decision making" (Velayutham, 2004). It seems that the major difference between this description with the description of American accounting association (AAA, 1966) from the common accounting, is only the word "lawful". Al-Khadash (2001), in addition to lawfulness, has also included the matter of zakat in the description of Islamic accounting: "Accounting is the process of recognition, measuring and reporting of lawful financial activities, which are for decision making, zakat calculation and the calculation of real profit of Islamic investment according to regulations." Shahata (1982) reasons that since accounting system is a financial subsystem, its goals must compatible with Islamic financial system. Therefore, he describes accounting system from Islamic viewpoint as: "Accounting system is a general frame and comprising a group of connected parts, according to a collection of accounting regulations on the base of requirements of Islamic law. This system acts on a chain of methods that help in consideration and evaluation of performance (Velayutham, 2004). According to the descriptions given, the following comprehensive description of "Islamic accounting" can be given: "Islamic accounting is the process of recognizing, measuring, recording,

classifying, summarizing and reporting of lawful financial activities (except amoral activities and against the social principles such as: usury, speculation, gambling, etc.) which are useful for calculation of zakat and khoms, calculation of real profit of Islamic investment operation (such as: modarabah, co-ownership, etc.) and the possibility of decision making for users.”

Differences between common accounting and Islamic accounting

As it was mentioned in the description of Islamic accounting, despite the distinction between common accounting and Islamic accounting, both of them have the role of preparation of accounting information. Differences between them, is to be investigated in three ways:

1. Information preparation goals: the goals of common accounting is to provide effective and efficient information in market for informed decision making of those whose final goal is the improved allotment of limited available resources, for an effective use of them (FASB, 1978). It is evident that this goal for users is achieved through suitable decision regarding purchase, sale and keeping investments. On other hand, Islamic accounting hopes to make the users able to remain persistent to their Islamic organizations and institutes (such as: entities, government, etc.) through implementing principles of Islam law in their business and able to evaluate the method of goal attaining of organizations and institutes. In summary, it can be said that Islamic institutes are different from their common peers in point of view of necessity of loyalty to basics and regulations of Islam law and also endeavor for achieving economic-social

goals are recommended by Islam (Hameed, 2009).

2. Kind of recognized information and their way of measurement, recording and reporting: the kind of information that Islamic accounting recognizes and measures is different. Common accounting is concentrated on recognizing events and economic transactions, while Islamic accounting must be concentrated on recognizing events and economic, social and religious transactions. Due to prohibition of revenue and expense based of usury, calculation and recognition of profit in Islamic accounting is very much important than the common accounting. Anyway, Islamic accounting must also be clean and pure in its reporting. In this way, both financial and non-financial criteria related to events and economic, social, environmental and religious transactions must be measured and reported. In common accounting mainly the criterion of historical cost is used for measuring and evaluating assets and liabilities. Indeed the profession itself is well aware of limitations and problems of unit of measurement assumption based on fixed monetary unit and its validity has been tested in inflation accounting in the past. While even with recommendations from studies of the profession itself (like Trueblood committee), the idea of using current values has been ignored due to complication and its presumption not being objective. From the point of view of Islamic accounting, at least for calculation zakat (as the most important goal of Islamic accounting) using current value is mandatory (Clarke et al, 1996) and needs quick preparation of balance sheet based on current values (Baydoun and Willett, 2000; Hameed, 2009).

3. Information users: the third kind of differences is related to the users of information. Although accounting profession has identified different beneficiaries as users of accounting information, but in fact, the real user is stockholders and creditors. It's clear that in statement number one of financial accounting standard board (SFAS no.1), a big multitude of beneficiaries have been ignored through the use of the word "and others". But Islamic accounting provides services for all realms of identified beneficiaries in the firm, not just a group that is able to provide its needs completely. But society as a whole unit can make the corporations accountable in their transactions and can make sure that they observe the basics of religious law and for earning money will not damage others morally, and distributes and allots the capital among the society members, especially beneficiaries related to the firm in a suitable way (Hameed, 2009).

In addition to differences mentioned between common accounting and Islamic accounting regarding information preparation, the other differences are mentioned as the following:

4. Difference in economy infrastructure: researchers believe that Islamic economy infrastructure is thoroughly different from the infrastructure of western economy (Taheri, 1999; Rahman, 1999; Baydoun and Willett, 2000). This difference can be expressed in three ways of "difference in base of ownership" and "difference in philosophical ideology" and "difference in the types of market control" (Velayutham, 2004). a) difference in base of ownership: western economic system is used on personal sovereignty

principles and private ownership rights, while Islamic economy is based on the principles of multi ownership. In capitalistic society, general ownership is only recognized when there is the social necessity, while Islam law recognizes the private ownership, governmental ownership and public ownership following this fact that everything belongs to God and properties in people's hands are trusts that they are accountable regarding them (Taheri, 1999; Velayutham, 2004). b) difference in philosophical ideology: common accounting is based on philosophical ideology of economic rationality which includes individualism, personal profit, and survival of the best and maximizing profit; while the philosophical ideology of Islam is based on the oneness of God and includes the basics of social profits, equality and logical profit (Taheri, 1999; Baydoun and Willett, 2000). Baydoun and Willett (2000) discussed that economic rationality philosophy emphasizes on the highest personal satisfaction with maximizing the profit (as the criterion of performance success). But it is reasoned that Islamic viewpoint to the subject of business is resulted from belief in oneness of God, which causes the firms to be concentrated on social profits in decision making and action, be after lawful profit (not too much profit which is gained through exploitation) and equality between human beings also is considered (Velayutham, 2004). c) difference in the types of market control: Taheri (1999) emphasizes that in western economy, markets are "self-adjusted"; but in Islamic economy people are free in dealing, and trading merchandises and services, and the government interferes only when one party has committed an injustice against

the other party. Injustice includes corruption and hoarding (keeping merchandises in stockroom for jobbery) (Velayutham, 2004).

5. Difference in the kind of accountability: Baydoun and Willett (2000) believe that economic rationality and principles resulted from that will lead to the revealing of activities which maybe the best description based on the "personal accountability" criterion and for having such an accountability, revealing financial information to a limited level is necessary. But in Islam concentration is on a kind of "social accountability" and complete revealing of accounting information; as a result, for reaching the goal of social accountability, what is needed must be revealed (Velayutham, 2004).

6. Using the orders of religious law: despite common accounting, in Islamic accounting a lot of attention has been paid to zakat payment, prohibition of usury and prohibition of speculation which will be discussed in this study.

Goals of Islamic accounting

Different goals have been mentioned for Islamic accounting. In this study, five of the most important goals are discussed:

1. Profitability for decision making: this goal has been proposed by accounting and auditing organization of Islamic financial institutions (AAOIFI). In statement number one of this organization it is said that goals of financial accounting determine kind and identity of information that has to be presented in financial reports for the purpose of helping the users in decision making. This information includes the following items: a) information regarding observance of the Islamic law by banks. b) information regarding economic resources and obligations and

effects of events. c) necessary information for determination of zakat. d) information regarding cash flows. e) necessary information for Assessment of banks consignment responsibilities for protection of resources, investments, etc. f) information regarding fulfillment of social responsibilities by banks. Although in this list the essence of Islam can be seen, but the theoretical framework of the mentioned organization is more in line with the common accounting. For example in the theoretical framework of financial accounting standards board (FASB) it has been expressed that financial statements must present helpful information for current and potential investors and creditors and other users for investment, crediting and other similar decisions. Organization of accounting and auditing of Islamic financial institution (AAOIFI) has shown this tendency in paragraph 25 of its statement number one. According to this paragraph, the role of financial reporting in economy is to provide useful information for economic decision makings (Yaya and Hameed, 2006).

2. Islamic accountability: this subject is reliant to the concept of succession. According to this quranic concept, human being is God's successor that God's trust has been given to him; as it has been expressed in quran: "We did indeed offer the trust to the heavens and the earth and the mountains; but they refused to undertake it, being afraid thereof: but man undertook it; he was indeed unjust and foolish. " (Ahzab/72, Holly Quran) Responsibility of this trust so heavy that skies, the earth and mountains could not tolerate to accept it. Therefore, human being must be aware of the hardship of accepting this

responsibility. Human being is not only accountable regarding the spiritual matter, but he is also accountable regarding social, business and contractual matters, because God has commanded human to return whatever has been trusted to him. Hamid (2000) proposed that this kind of accountability can be considered as the main goal of accounting and called it "Islamic accountability". He said this concept is so rooted in Islamic society that it can be utilized the biggest motive for practical development of Islamic accounting. For performance of Islamic accounting, both Islamic organizations (as the agent) and capital owners (as the employer) have responsibility. Primary accountability is originated from the concept of succession, because human being is the trustee of God's resources. The way this succession is done, has been specified in quran and sunnah as the main sources of religious law. Also, secondary accountability is established between capital owner (investor) and the director through contract. A firm for providing primary and secondary accountability has to identify measure and report economic-social activities related to Islamic, social, economic and environmental matters. In addition to this, according Islamic accountability, other secondary goals such as: observation of religious law, evaluation and distribution of zakat, fair distribution of wealth among beneficiaries and creation of an atmosphere of cooperation and assistance can be explained that help in providing information and encourage firms to take part in resolving the problems of the Islamic nation (Yaya and Hameed, 2006).

3. Zakat payment: the word zakat means "something which becomes decorated".

Zakat is a tax that its payment is mandatory for any Muslim whose wealth passes a specified average (the least amount). In fact, this is wealth tax (Sulaiman, 2003). In many quarnic verses, immediately after the pray command, zakat has become mandatory for Muslims; therefore, zakat is one of Islam pillars (Yaya and Hameed, 2006). Zakat is one of necessary and inseparable parts of Islamic lifestyle (Sulaiman, 2003). If zakat is considered as the primary goal, each person evades deceit and showing off, because he always sees God as observing his action [(Yaya and Hameed, 2006). Zakat covers moral, social and economic realm of Islam financial affairs. In the realm of ethics, zakat removes the greed and wealth amassing of the rich and in social realm, zakat is a unique criterion for removing poverty in society and encourages the rich to do their social responsibilities. In economic realm, zakat prevents the limitless and unbounded wealth in the hands of a few people and lets it to be distributed widely (Sulaiman, 2003). Therefore, for fulfilling this obligation, it is necessary that Muslims use the needful tools (including accounting) (Yaya and Hameed, 2006). Religious law states clearly that only individuals are obligated to pay zakat; but the considerable subject who is proposed by Islamic law experts is that how a firm should be included for zakat? In zakat conference which was held in Kuwait in 1985, this subject was discussed and it was agreed that if a firm is considered as a separate legal entity, zakat has to be specified according to the current net assets, as though the firm is willing to pay the zakat. Zakat is specified like, and then is shared between the owners so that each one of the owners can do their

own religious obligations. Anyway, Muslims law experts have concluded that the firm (whether as a legal entity or from its owners) is obligated to pay zakat under the four following conditions: a) law obligated the firm, as a legal entity, to pay zakat. b) article of association obligated the firm, as a legal entity, to pay zakat. c) stockholders general meeting passed a resolution that obligates the firm, as a legal entity, to pay zakat. d) owners permit the firm to pay their zakat as their representative (Sulaiman, 2003).

Measurement basics for zakat calculation: choice between the historical cost and current values is a kind of compromise between quality features of "relevance" and "reliability". In this choice, one of these two preferred through considering the current conditions, especially availability of current values of reliability. In addition to this, in decision making, the expense of getting the current values must be compared with its benefits (technical committee of Iran auditing organization, 2002). The dominant viewpoint of zakat calculation is the use of current value (sale price) at the time of zakat obligation creation. Therefore, Islamic trading organizations must use the current value instead of historical cost (Hamitha and Hudaib, 2001; Baydoun and Willet, 1997, 2000). Historical cost has no defense base in religious law; therefore, in calculation the current values must be used. Use of historical cost can cause the alteration of disclosure principle. Reality is the current value and must be disclosed. In inflation condition, utilizing historical cost causes separation with reality (Yaya and Hamid, 2004; Bozorg asl, 2005)

In fact, it must be reminded that the matters mentioned before, is Sunnite viewpoint about the zakat, while in Shiite religious jurisprudence, zakat is related to a few merchandises (camel, cow, sheep, wheat, barley, date, raisin, gold and silver) and generally does not include business profit. Therefore, zakat payment cannot be considered as the most important goal of Islamic accounting in Iran (Bozorg asl, 2005). But in Shiite religious jurisprudence, instead of zakat, "khoms" is taken from business profit; meaning that one fifth of annual extra income of each Muslim must be paid at a specified time, as khoms. Khoms like zakat is basically at the individual realm, but the agreement of zakat conference (Kuwait, 1985) maybe also can be generalized to khoms. Indeed, this matter needs comprehensive investigating.

4. Usury prohibition: the word usury literally means: increase, extra, expansion, growth. Religious law describes usury as "an extra cost which is paid by loanee to loaner. According to Chapra (1992) usury and interest are synonymous. Quran clearly prohibits usury in the following verse: "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. Those who after receiving direction from their lord, desist, shall be pardoned for the past; their case is for Allah (to judge); but those who repeat (the offence) are companions of the fire: they will abide therein (for ever)." (baqarah/275, Holly Quran) "Allah will deprive usury of all blessing, but will give increase for deeds of charity..." (baqarah/276, Holly Quran). Money is a medium of

transaction and it is not a merchandise to be bought and sold. Therefore, when money demands extra cost, it is prohibited in Islamic economy. Ghazali (1990) believes that the moral motive of prohibition of usury is based on not misusing the needy through getting usury on loans that are given to them. This act (exploitation of the needy) is interpreted as a kind of oppression and injustice. In prohibition of usury, Islam supports an economic system that not necessities self returning capital. It is injustice that there be the possibility of certain guaranteed returning of the original capital and interest to the loaner, but the returning of original capital and interest to the loanee be unspecified and unstable. As a result, if loaner accepts his share of profit and loss, justice has been done (Sulaiman, 2003). Prohibition of usury has caused the development of Islamic financial institutions based on the contract of shared profit and loss. Some of the contracts of share in profit and loss have been spread in Islamic financial institutions including modarabah, murabahah, co-ownership and rent on condition of possession (Haqiqi and Pomeranz, 1987) (Velayutham, 2004).

5. Speculation prohibition: speculation means that investment in high risk assets, knowing this risk (with the hope of getting more profit) and accepting the fact that the risk possibility is more than medium level (Parsaeian, 2011). Another goal of Islamic accounting is prohibition of speculation which is claimed to be an inseparable part of current of insurance contracts. Vogel and Hayse (1998) have specified three kinds of speculation: a) when both dealing parties do not have knowledge about the goals of the transaction. b) when the item being dealt does not exist

in the dealing time. c) when the item being dealt is uncontrollable of both parties. The above items have helped in developing Islamic insurance contracts which are based on guaranteeing principle (shared guarantee) (Warde, 2000; Velayutham, 2004). Among other examples of speculation which do not agree with Islamic law are the following: a) price manipulation and directing prices toward unfair price. b) ignorance in transactions. c) deceit in transactions. d) collusion in transactions. e) spreading lies and giving wrong and misleading information. f) doing sham transactions and unfair market manipulation. g) transactions based on internal information, while it can cause the other party to be lost.

Conclusion

Regarding to role of Islamic teachings in personal and social life as general pattern of ideal Islamic society, in accounting also the teachings and commands of religious law must be considered. In this study, according to descriptions given of Islamic accounting, the following comprehensive description of "Islamic accounting" is given: "Islamic accounting is the process of recognizing, measuring, recording, classifying, summarizing and reporting of lawful financial activities (except amoral activities and against the social principles such as: usury, speculation, gambling, etc.) which are useful for calculation of zakat and khoms, calculation of real profit of Islamic investment operation (such as: modarabah, co-ownership, etc.) and the possibility of decision making for users." Regarding to Islamic accounting goals and reviewing the differences between Islamic accounting and common accounting, it seems that Islamic accounting can improve the accounting and financial reporting in Islamic countries to a great extent, through considering the

religious, cultural and social features and institutionalizing the common accounting in Islamic societies.

Acknowledgment

I greatly thank my dear wife, "Mrs. Marziyeh Kheirandish", who helped me in compiling and editing of this paper.

References

Bozorg asl, M. (2005). Ph.D. Islamic Accounting Challenges in Iran. Ketabnak website (<http://ketabnak.com/comment.php?dlid=17904>)

Hameed, S. (2009). Elementary Basics of Islamic Accounting. (Persian Translated by: Nonahal nahr A, Poyr zandi M Ph.D.). Journal of Hesabdar, 211: 70-76.

Holly Quran, Original Arabic Text. (English Translated by: Yusuf Ali A). Saba Islamic Media of Kualalumpur.

Parsaeian, A. (2011). Comprehensive Dictionary of Accounting. Termeh publication (First Edition). p: 710.

Sulaiman, M. (2003). The Influence of and Zakat on Islamic Accounting. (Persian Translated by: Jaber zadeh F, Mokhtari D). Journal of Hesabdar, 213:48-55.

Velayutham, S. (2004). Islamic Accounting and Common Accounting: Incompatible or Complementary. (Persian Translated by: Pour heidari O Ph.d). Analytical Journal of Hesabres, 26: 55-61.

Yaya, R., Hameed, S. (2006). Goals of Features of Islamic Accounting. (Persian Translated and summarized by: Bozorg asl M Ph.d). Analytical Journal of Hesabres, 31: 78-84.

How to cite this article: Mahdi Haghighat, Component of Islamic Accounting. *International Journal of Advanced Studies in Humanities and Social Science*, 2012, 1(1), 44-52. http://www.ijashssjournal.com/article_83349.html