THE NEED FOR IMPLEMENTATION OF ISLAMIC SOCIO ACCOUNTING

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Abstract: Conventional Accounting is argued to be unsuitable for an Islamic Society because it embraces fundamental values and principles which are in conflict with its value. Adopting or even modifying conventional Accounting concept is insufficient to develop an accounting system which provides information that will lead to behavior consistent with Islamic norms and towards Islamic objective. Besides, Conventional accounting has increasingly come under attack in its home ground because of it adopting a narrow marginalist, utilitarian economic principle and the assumption of a pristine liberal economics democracy as the basis of society. This paper aimed to emphasized how important is the implementation of Islamic Socio accounting in Islamic Economics and Islamic Financial institution, by showing critics on conventional accounting, its philosophy under value and inability of Conventional Accounting to be applied in Islamic Economics, particularly at their incapability for the purpose of Zakat and interest-free banking.

JEL Classification: 
Keywords: Conventional Accounting, Islamic Socio accounting, Zakat , Islamic Banking
1. Introduction

Conventional Accounting is argued to be unsuitable for an Islamic Society because it embraces fundamental values and principles which are in conflict with its value. Adopting or even modifying conventional Accounting concept is insufficient to develop an accounting system which provides information that will lead to behavior consistent with Islamic norms and towards Islamic objective.

In addition, the establishment of Islamic organization in many Muslim countries with their stated Islamic objective reinforces the need for Islamic Accounting. One important thing, Conventional Accounting which aim to present the best financial report for the potential investor or stake holder, often focus on the material or capital (more capitalist/money oriented) without consciously or unconsciously take into account the damage which may caused by the activity of the company in achieving their goal (good return, good financial report etc.). Therefore it is a need to broaden the horizon of the Accounting people (The Accountant, the user, the accounting scholar, etc) not to focus only on money or capital matters but also consider the non capital matters in the Accounting system. This is not only for the sake of society in the general but also for the company itself to be aware for unpredictable case in the future. So Islamic Socio Accounting could be one of the solutions for accounting system.

In this paper, it is described several critics and philosophy under value of conventional accounting. Inability of Conventional Accounting to be applied in Islamic Economics focusing particularly at their incapability for the purpose of Zakat and interest-free banking elaborated. In the last part, to come up with several reasons why it is a need to an implementation of Islamic Socioeconomic Accounting, as a conclusion

2. Objective

The objectives of this paper are: (i). to describe or to draw several critics on conventional accounting, The philosophy under value of conventional accounting, and the reasons why Conventional Accounting can not be applied in Islamic Economics focusing particularly at their incapability for the purpose of Zakat and interest-free banking and (ii). To come up with conclusion why the implementation of Islamic socioeconomic Accounting is needed

3. Critics and Limitation On Conventional Accounting

3.1. Critique on conventional accounting

Conventional accounting has increasingly come under attack in its home ground because of it adopting a narrow marginalist, utilitarian economic principle and the assumption of a pristine liberal economics democracy as the basis of society (Lehman 1992, Gray 1996, in Hameed, 1997).
As defined by AAOIFI (1996, 1997) the objectives of conventional accounting are to be provision of useful information to permit informed decision. Hence accounting is said to provide information which makes the market efficient by enabling market participants make effective economic decisions leading to the efficient allocation of resources, which in turn leads to economic growth and social welfare (AAOIFI 1996). The tenuous link between useful information and social welfare has been trenchantly criticized by Laughlin and Puxty (1983), thus social welfare can not be appealed to by suggesting that if user needs (i.e. information to maximize wealth in terms of share price) are satisfied, greater welfare will result, because of the operation of the Lipsey-Lancaster theorem.

Conventional accounting has also been responsible for the destruction of the environment and the promotion of consumer culture of financial greed which has led to the inequitable state of world affairs where 20% of the world population consumes 80% of its resources. (Tinker 1985, in Hameed, 1997). Accounting has been said to be at least partly responsible for both the world’s bad news (widespread poverty, environment degradation, inequality distribution of income and wealth) and the good news (high standard of living in the west and newly industrialized countries, longer life span, globalization and developments in computer and communications technology)

3.2. The philosophical values underlying conventional accounting
Conventional accounting is a product of Capitalist economic system which based on philosophies rationalism, materialism and secularism (Maliah and Willet, 2001). Conventional accounting in its current structures, follows what are known as General Accepted of Accounting Principle or fundamental accounting. This includes, Historical Cost, Conservatism, Accrual and Matching, Substance Over Form, Going Concern, Monetary Measurement, Materiality And Consistency. These principles were defined and elaborated from the beginning of this century. However, the origin of these principles reflect the historical development of Western Civilization, which has a big difference with Shariah (Islamic Law)

Why conventional accounting can not be applied in Islamic Economics? Before coming up with the statement why application of conventional accounting is not appropriate for Islamic economics, we need to see fundamental difference between Western economics and Islamic economics, afterwards we can expressed why conventional accounting can not be applied in Islamic financial institution.

3.2.1. Islamic economics versus western economics
Islamic economics is based on Shariah the Islamic law which govern secular as well as religious activity. The basic objective of Shariah is to ensure general human well-being and socio-economic justice. It teaches that all wealth belongs to Allah and that humans are merely trustees of this wealth, entrusted with it to realize the above-mentioned objectives (Quran 57:7). The Islamic economic system is based on the
teaching that "no-one should claim for himself what is basically the creation of Allah, or the product of another man's efforts and skills (Haqiqi&Pomeranz, 1987). The system therefore grounded heavily towards social justice. This is the basic difference between Islamic and Western economics.

In Western materialistic economics, the individual has unconditional and absolute rights over wealth and is allowed to use it as he or she pleases (Shafi, 1979). The individual's main aim is to maximize this wealth and the bottom line in a western profit-making enterprise is maximization of profit and minimization of loss. In Islamic economics, on the other hand, individuals do not have absolute right over their wealth. Although they have been granted ownership over wealth, this is just trustee only, and they must use it only according to the instruction give by Allah. They must not wastefully consume their wealth, and they must give to others their due. For others also have right to a person wealth. The Holy Quran states: "In their wealth there is a known right for those who ask for it and those who have need for it". Thus, wealth maximization is not the main objective of economic in Islam. Crane (1981) nicely summed up the distinction: "Western economics generally can not conceive of any measure that extends beyond the material world, whereas Muslim generally can not conceive of any measure that does not."

3.2.2. Conventional accounting inability to apply for Zakat
One of the main aims of Islamic economics is that wealth, instead of becoming concentrated in the hands of a few, should be allowed to circulate in society as widely as possible, so that the distinction between the rich and the poor is narrowed down as far as is natural and practicable (Shafi, 1979). Certain institution are put in place to achieve this aim, for example the imposition of Zakat, a kind of mandatory religious levy on the rich to give to the poor and needy, and the prohibition of riba or fixed interest.

The rules for Zakat are inconsistent with the generally accepted accounting practice (GAPP) of Anglo-American accounting. Problem arise from the valuation of inventories, the valuation of accounts receivable and the concept of conservatism valuation of inventories. According to GAPP, inventories should be valued at the lower of cost market value. Market value can be either replacement cost or net realizable value, although it is usually the latter. In practice, this rules almost always result in "cost" being the balance sheet valuation (Clarke, 1996). For Zakat purposes, only the selling price is relevant. This means that Muslim firms can not follow GAAP valuation for inventories if they want to Comply with the rule of Zakat.

The valuation of accounts receivable zakat is payable on net receivables only, i.e. on account receivables less expected bad debt minus account payable. Thus it is payable on those receivables expected to be realized. But, unlike Anglo-American practice, there is no overall estimated provision for bad debts. Account are assessed one-by-one determine whether and to what extent they are expected to
be collected. There is no such thing as “doubtful debts”- the debt is either good or bad. (Clarke et al., 1996). Concept of conservatism. Anglo American accounting follows the concept of conservatism or prudence. This concept refers to the “need to exercise care when dealing with uncertainties”. It states that extra care should be taken to ensure that assets and revenues are not overstated and liabilities and expenses are not understated. This means that given two valuations for an asset, the Anglo-American accountant would choose the lower. However, this is inconsistent with the concept of Zakat. Understating asset value would mean less zakat liability. While as stated above, paying zakat is one of the most important religious duties of Muslim, and Islam encourages Muslim to be generous with their wealth. Therefore they must be careful not to underestimate their assets or overstate their liabilities. Thus the concept of conservatism is not applicable for assessing Zakat.

3.2.3. Inappropriate Conventional accounting to apply for Islamic Banking

The principles guiding Islamic Banks are significantly different from those for conventional bank. Islamic bank are organized and operate under upon principles of Islamic law (the Shariah) which requires risk sharing and prohibit the payment or receipt of interest (riba). In contrast, conventional banks are guided mainly by the profit maximization principles. (Zoubi, Taisier A.)

In general, Islamic banks have several distinguishing features. The first and most important feature of Islamic banks is the prohibition of the interest (riba), regardless of its form or source. The holy book of Islam (the Qur'an) prohibits both the receipt and payment of interest in all transactions. The rationale is that the credit system involving interest leads to an equitable distribution of income in society. Riba is a payment for taking risks, nor is it the reward for a constructive activity. However, without some kind of reward, Islamic banks could not operate. Although Islamic banks can not charge fixed interest in advance, they operate by participating in the profit resulting from the use of bank funds. The concept of interest, used by conventional banks, is replaced by profit and loss sharing. Also, a mark-up for delayed payments and trade financing commissions are allowed under the Islamic banking model. The second is risk sharing. Islamic banks should operate only on profit/loss sharing arrangements (PLS). The most popular two forms of PLS are Mudharaba and Musharaka. Islamic banks receive funds from the investing public on the basis of Mudharaba (profit sharing). The bank is allowed to use the funds in any activity that the management feels appropriate, so long as the activities are not forbidden by Islamic laws. Then, banks find borrowers (entrepreneurs) who will use the funds for Investments that are approved by the bank (Musharaka). The entrepreneurs share the profit/loss with the Islamic bank according to an agreed upon ratio. Islamic banks then pool all the profit/loss from different investments and share the profit with the depositors of the funds according to a predetermined formula. Islamic banks are partners with both depositors and entrepreneurs and share risk with both the depositors and entrepreneurs. Hence, Islamic banks can be viewed as financial intermediaries.
Conventional banks use both debt and equity to finance their investments. However, Islamic banks depend mainly upon equity financing and customers' deposit accounts i.e., current, saving, and investment (Karim and Ali, 1989). The current account is basically a safekeeping account. It is very similar to such accounts in conventional banks. No interest is paid to depositors of current accounts. Depositors have instant access to those accounts and are able to withdraw money any time they wish. Savings deposits are fixed term and cannot be cashed in before maturity date. The profit-sharing ratio of the investment accounts varies among Islamic institutions and may be a function of the bank's profit. The depositor's return is uncertain.

Islamic banks replace loans with investments, which are riskier than the secured interest-bearing loans issued by conventional banks. There are several different investment vehicles designed to somewhat reduce risk in Islamic banking. The two most popular methods are Musharaka and Mudharaba. Entrepreneurs wishing funds under these arrangements must show and document the feasibility of projects that would be undertaken with such funds.

The cost of capital in conventional banks represents the cost of debt and equity. The cost of capital in Islamic banks is replaced by with the profit and loss sharing. Depositors and equity holders of Islamic banks will share in profits and losses. Hence, the return on equity is move variable than for conventional banks. The default risk of not paying a return to depositors is eliminated under the Islamic banking model. However, the failure to reward depositors, just like the case of not paying interest to depositors of a conventional bank, could lead to withdrawal of deposits and the bankruptcy of the bank.

Riba or fixed interest, "reinforces the tendency for wealth to accumulate in the hands of a few and thereby diminishes man's concern for his fellow men" guarantees gain without risk or loss and hampers investment and employment. Haqiqi & Pomeranz (1987) describe some of the different profit and loss sharing arrangement which are used in Islamic Banks: Mudharabah (Trust Financing). The bank acts as a partner, providing cash to the borrower and sharing in the net profit and the net losses of the business. The loan is for undetermined period, although the contract may be rescinded by either party.

3.2.4. Murabaha (Cost-plus trade Financing).
The Bank as a partner, provides the finance for purchasing goods for a share of the profit once the goods are sold. The Bank may or may not share in any losses incurred. Repayment may be either in lump sum or in installment Musharakah (Participation financing). The Bank provides part of the equity and part of the working capital for the business and shares in profit and/or losses Ijarah (Rental Financing).
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Islam Society

Islamic Economic and Social Politics System

Islamic Accounting Theory

Islamic Accounting practice
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Source: Harahap, 2003. p.87

Third, it is clear that there is big difference between accounting for Zakat and general accounting practice in the West. Anglo-American accounting standards would not therefore be appropriate for Zakat purposes. Fourth, the establishment of Islamic Institution, such as the establishment of Islamic Banks, Insurance (takaful) companies, finance companies, relief organizations and even conventional companies headed by Muslims is the practical offshoot of Islamic economics. These organizations have been established in both Muslim and Non Muslim countries and in economic environments which has been Islamicized (Pakistan) or operating in parallel to their western counterpart (e.g. Malaysia). The realization that their different operating and normative environments require different types of information for their control and affectivity to achieve their specific Islamic objectives, has resulted in the calls for an Islamic accounting to meet their information of the Muslim societies in which they operate (Ali, 1977, Khan, 1994).
Especially for Islamic bank, banking success in general, depends on the extent of public trust placed in the financial strength of individual banks, particularly the trust of depositors and investors. Hence the developing unique accounting and auditing standard for the dissemination of such information about Islamic Bank becomes a necessity.

5. Conclusion
Conventional accounting has increasingly come under attack in its home ground because of it adopting a narrow marginalist, utilitarian economic principle and the assumption of a pristine liberal economics democracy as the basis of society. Conventional Accounting is argued to be unsuitable for an Islamic Society for several reasons. The establishment of Islamic organization in many Muslim countries with their stated Islamic objective needs a suitable accounting method. The Philosophy of Islamic economics which is based on Shariah (the Islamic law) which govern secular as well as religious activity in contrast with Western materialistic economics has become the fundamental reasons for asking the shariah compliance accounting system. Inability Conventional accounting to apply for Zakat accounting, the main difference between Islamic bank and conventional bank make Conventional accounting also inappropriate to apply for Islamic Banking. Therefore the Islamic accounting system is immediately needed and encourages to be applied.
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