Chap1-Introduction to Accounting in Islam

Introduction –

The history of accounting in Islam dates back to the emergence of Islamic civilization, and it has evolved over time, benefiting from the development of other sciences within Islamic civilization, as well as other civilizations in general. Islam has a distinct worldview that influences the social and economic activities of its followers. Since accounting is a social institution that must reflect the nuances of its society and contribute to achieving its social and economic goals, a different type of accounting is required compared to traditional accounting practices in capitalist societies.

1- Islamic Accounting concept :

Accounting is a social science that is influenced by its surrounding environment, and its objectives, concepts, and standards are consistent with and reflective of that environment. **The Islamic** environment encompasses several aspects, including legal, economic, social, and political dimensions, as well as the level of development of accounting theory and practice.

Muslim scholars and jurists considered the term "**accounting**" synonymous with "**record-keeping** of financial transactions," meaning the recording of income and expenditures, such as in the accounts of the state treasury.

The person responsible for maintaining these records (**the accountant**) must adhere to established procedures. Several references to **the concept** of **accounting** from an Islamic perspective can be found in the Holy Quran, the Sunnah (Prophet's traditions), and the writings of many Muslim scholars who have addressed this topic.

Accounting in the linguistic sense: The word "accounting" is derived from the verb "to calculate" or "**to reckon**," and its various forms include "accounting" and "calculation." It means to review and record someone's actions in order to assess them and determine their consequences; it also means **counting** and **enumeration**. Thus, "to account for something" means to record, categorize, and count it.

1.1-The meaning of the word "accountability" in the Holy Quran: If we refer to the primary source, which is the Holy Quran. we find that the word "accountability" (as a noun) does not appear in it. However, the verbs used in this context are derived from the verb "to calculate" (حاسب), assess, or hold accountable) are used, referring to accountability and recompense in this life and the hereafter, based on the record of one's deeds.

The word "account" (or "calculation") is also used as a synonym for "accounting," meaning counting and recording. In the Quran, the phrase "accountant of funds" refers to the person responsible for overseeing and managing financial resources. Below, we will present some of these meanings of the concept of accountability as found in the Quran.

Meaning	**verse**
The Calculator	: "And We will set up the scales of justice for the Day of Resurrection, so no soul will be wronged at all. And if there is [anything] equal to the weight of a mustard seed, We will bring it, and sufficient are We as accountants." Verse 47, Surah Al-Anbiya
Self-Accounting	: "But if you do not—and you will never be able to—then fear the Fire, whose fuel is men and stones, prepared for the disbelievers." Verse 24, Surah Al-Baqarah
Independence of Accountability	: "Read your record; it is sufficient." "Yourself, this Day, is a reckoner against you." Verse 14, Surah Al-Isra
Counting and Enumeration	"That you may seek bounty from your Lord and know the number of years and the account." Verse 12, Surah Al-Isra
Preserving and Storing Money	He said, "Appoint me over the storehouses of the land. Indeed, I am a knowing guardian." Verse 55Surah Yusuf

1.2- The Concept of Accountability in the Prophetic Sunnah:

The concept of accountability in the Prophetic Sunnah is not different from the concept found in the Holy Quran, as mentioned above. It refers to the act of counting and recording for the purpose of discussion, accountability, and recompense.

1.3- The Concept of Accountability in Muslim Writings:

The views of modern Muslim scholars on the concept of accounting have varied and differed. Accounting in Islam can be considered **as Islamic knowledge** derived from Islamic jurisprudence(sharia), encompassing various accounting aspects, such as accounting theory and its general academic framework, as well as the **accounting of Zakat** (charitable giving), which includes material, spiritual, and humanitarian dimensions rooted in our noble Islamic religion.

This approach serves as an alternative **to tax accounting**, which focuses solely on material and financial aspects.

1.4-Islamic accounting :

Islamic accounting is defined as "a set of terminology, concepts, principles, and rules derived from Islamic legal texts, which constitute the Islamic accounting system for processing Islamic transactions."

It is also defined as "a set of accounting concepts, principles, and methods aimed at adapting the conventional accounting system to suit the financial transactions of institutions operating in accordance with the principles of Islamic law.".

What can be concluded from the previous definitions is that accounting from an Islamic perspective is a set of concepts, assumptions, and principles consistent with the sources of Islamic law (the Holy Quran, the Sunnah of the Prophet, consensus, and scholarly interpretation). These principles govern and define the standards, methods, rules, and procedures for measuring the impact of legitimate economic events on a specific accounting entity, and for communicating the results of this measurement in the form of useful information for its users.

Definition of Islamic Accounting

Islamic accounting can be defined as the accounting process which **provides appropriate information** (not necessarily limited to financial data) **to stakeholders** of an entity which will enable them to ensure that the entity is continuously **operating within the bounds of the Islamic Shariah** and **delivering on its socio-economic objectives**.

Islamic accounting has also been defined as “the process of **identifying, measuring and communicating economic and other relevant information**, inspired by the **Islamic worldview and ethics**, and **complied with the Shari’ah** (Islamic law) – **in order to permit informed judgments and decisions** by potential and expected users of information– to **enhance social welfare and seek the blessings of Allah**”.

Islamic accounting is also a **tool which enables Muslims to evaluate their own accountabilities to God** (in respect of inter-human/environmental transactions

Objectives of Financial Accounting and Reporting for IFIs: To provide information about:

I. Islamic bank’s **compliance with the *Shari’ah* and its objectives**

II. **Islamic bank’s economic resources and related obligations** to enable assessment of capital adequacy, risk and liquidity.

III. **To assist the concerned party in the determination of *Zakat*** on the Islamic bank's funds.

IV. T**o assist in estimating cash flows**, their **timing and risk** associated with **their realization**.

V. T**o assist in evaluating the Islamic bank's discharge of its fiduciary responsibility** to safeguard fund and to invest them at reasonable rates of return.

VI. Islamic bank's **discharge of its social responsibilities**.

VII. To **enable assessment of the extent of achieving socio-economic objectives.**

The Need for Islamic Accounting Standards

The need for accounting records as means for trust building is emphasized in the Quran : "...Never get bored with recording it, however small or large, up to its maturity date, for this is seen by Allah as closer to justice, more supportive to testimony, and more resolving to doubt, except when it is spot trade carried out amongst yourselves, then you are not to blame for not recoding it" (Baqara: 282).

Conventional accounting standards (IASs and IFRSs) are grossly inadequate to cater for the needs of IFIs since they are **secular** in nature, **encourage *riba, gharar*** **and *maysir***, do **not cater for a religious rite** like Zakkah accounting, they are skewed towards profit maximization, among others. Hence, **AAOIFI was established on 1 Safar, 1410AH** (26 February, 1990) **in Algiers**, and then, registered on 11 Ramadan 1411 (27 March, 1991) in the State of Bahrain **with the responsibility to issue five different types of standards, AcS, AuS, ES, GS and SS**. It also offers two **certification programs, namely CIPA and CSAA**.

Application of GAAPs in Islamic Accounting

- **Going Concern Concept: This applies based on** presumption of continuity, or *istishab* in Islamic jurisprudence.
- **Accruals/Matching Concept:** This applies in the same way as conventional.
- **The Concept of Prudence/Conservatism:** This applies but **guard against extremism**.
- **The Concept of 'Substance over Form:** This **does not apply**, but rather the opposite.

- **Money measurement Concept**: This **applies with extension** to include relevant narratives.
- **Dual Aspect Concept**: This applies in the same way as conventional.
- **Consistency Concept:** This applies in the same way as conventional.
- **Historical Cost Concept:** This applies except in accounting for *Zakkah* where **cash equivalent value is recommended by AAOIFI**.
- **Materiality Concept: This applies but in different perspective**. "... and if there be no more than the weight of mustard seed, we will bring it to account ..." (Surah Al-Anbiya, verse 47).
- **Periodicity Concept:** This applies in the same way as conventional.
- **Realization and Accrual Concepts**: Applies where the payer has the obligation to pay, the receiver has the right to receive and the amount is known with certainty.

2-The objectives of accounting in Islam

The objectives of accounting in Islam are to provide a moral and ethical framework for financial reporting that promotes accountability to God and society, facilitates the calculation and distribution of zakat, ensures fairness and transparency in transactions, and contributes to overall social welfare by offering comprehensive information on economic and socio-religious activities. This unique approach, rooted in the Quran and Sunnah, aims to foster justice and ensure that financial decisions are aligned with Islamic values and Sharia principles.

3- The development of accounting science in Islam

The development of Islamic accounting represents a fascinating intersection of religious ethics, historical practices, and contemporary financial needs. Far from being a modern invention, its roots trace back to the 7th century with the Prophet Muhammad, predating conventional accounting by centuries, with principles derived from the Quran and Hadith emphasizing justice, truth, and accountability. Key developments include establishing accounting for Zakat (charity), state revenues, and businesses, with early practices detailed in manuscripts from the 14th century. Islamic accounting also introduced unique principles like **prohibiting interest** (**riba**) and **uncertainty (gharar**), promoting ethical conduct, and highlighting social responsibility alongside financial reporting, which is evidenced by historical financial institutions and professional roles.

4-Principles of islamic accounting

Islamic accounting is fundamentally guided by a set of core principles derived directly from Sharia law. These principles distinguish it significantly from conventional accounting systems and form the bedrock of ethical financial conduct within Islamic finance

: • **Prohibition of *Riba* (Interest)**: A cornerstone of Islamic finance,riba is strictly forbidden, leading to financial instruments and transactions based on profit-sharing and equity participation rather than fixed interest.

• **Avoidance of *Gharar*** * (Excessive Uncertainty): Transactions must be clear, transparent, and free from excessive ambiguity or speculation, promoting stability and reducing risk for all parties.

• **Rejection of *Maysir*** * (Gambling): Activities akin to gambling are prohibited, emphasizing productive economic activity and genuine wealth creation.

• Promotion of Justice and Transparency: Islamic accounting mandates fairness in all dealings, ensuring that financial reporting accurately reflects the underlying economic realities and promotes equitable outcomes.

• **Risk and Profit Sharing**: Rather than transferring all risk to one party, Islamic finance encourages shared responsibility and profit/loss distribution.

These principles aren't mere guidelines; they are integral to the structure of Islamic financial products and services, such as *Sukuk* (Islamic bonds) and *Murabaha* contracts, which are designed to ensure ethical and moral adherence.

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Accounting assumptions and principles from a Sharia perspective

Assumptions represent a basis used in deriving accounting principles and preparing financial statements. A hypothesis can be defined as: "that which provides the primary basis for the process of deduction, or for a philosophical system, school of thought, or the like." They can be considered more comprehensive and general than accounting principles in terms of axioms and axioms for the purposes of preparing financial reports. They represent a hypothetical state that does not require proof, as they relate to assumptions derived from general objectives and related to the economic, social, legal, and political environment within which the economic entity operates**.**

The assumptions are generally accepted accounting axioms that can be used as the basis for accounting in Islamic banks. The accounting principles are also largely accepted. However, some of them do not comply with accounting principles of justice and equity. They are subject to considerable debate and criticism, even from a traditional perspective. The accounting of Islamic institutions must be based on justice and equity, ensuring the rights and entitlements of all parties. All principles that help achieve the goal of justice are acceptable.

Islamic accounting incorporates traditional postulates like Entity and Going Concern but prioritizes a strong ethical framework, emphasizing Justice, Accountability, and Transparency. It avoids unethical practices such as interest (riba), excessive uncertainty (gharar), and gambling (maysir), focusing instead on principles like risk/profit sharing, social responsibility, and the provision of accurate, fair, and timely financial information for the benefit of all stakeholders.

Key Islamic Accounting Principles and Postulates

- **Accountability and Trust (Amanah):**

  A central theme in Islamic accounting is accountability to God (Allah) and fulfilling trust in transactions, ensuring fairness and honesty in all dealings.

- **Justice (Adl):**

  Accounting must ensure that profit and loss are distributed fairly, and that financial information is presented justly and transparently, preventing exploitation.

- **Transparency and Disclosure:**

  Full and accurate disclosure of financial information is crucial to ensure transparency for all stakeholders.

- **Gharar and Maysir Prohibition:**

  Islamic accounting avoids excessive uncertainty (gharar) and gambling (maysir), ensuring clarity and fairness in financial transactions.

- **Risk and Profit Sharing:**

  Transactions are structured to share both risks and profits, rather than guaranteeing a fixed return, promoting fairness.

- **Social Responsibility:**
  Islamic accounting emphasizes social welfare through principles like Zakat (charity) and investments that benefit society and contribute to sustainable development.

Compatibility with Existing Postulates

- **Generally Accepted**:

Concepts like the accounting unit, going concern, and the monetary unit are generally considered compatible with Islamic principles.

-Monetary Unit Assumption:

The concept of recording transactions in currency units aligns with Islamic accounting principles

-Accrual Basis:

The accrual basis of accounting is preferred over cash-based methods to provide a more accurate and complete picture of financial performance and position.

-Historical Cost vs. Current Value:

While historical cost is used, current market value is often recommended for specific applications like zakat calculation to ensure fairness.

-Full Disclosure:
A strong emphasis on full disclosure is necessary to prevent hidden interest (riba) and to fulfill social and zakat obligations, making information fully and freely available.

- **Economic Entity Assumption:**

The separation of business from its owners is compatible with Islamic accounting.

-Going Concern Assumption:

The expectation of a business operating long-term is also accepted within Islamic finance.

-Time Period Assumption:
The need for timely financial information is consistent with Islamic principles, especially for purposes like Zakat calculation.

In essence, while traditional accounting postulates provide a foundational framework, Islamic accounting adds a crucial moral and ethical dimension, guiding financial practices toward justice, fairness, and divine accountability.

Home work -Comparing traditional accounting principles with accounting principles from an Islamic perspective