THE DEVELOPMENT OF THE CONCEPTUAL FRAMEWORK FOR ACCOUNTING FOR ISLAMIC BANKING

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1.0 INTRODUCTION

The Islamic business institutions have to be operated based on Shariah percepts (Beekun, 1997). Thus the emergence of Islamic banks and financial institution and the great challenge they face to successfully serve the society in which they operate have led them, together with specialist in Islamic Shariah and accounting to seek the most appropriate means to present adequate, reliable and relevant information to users of financial statement of such organizations. Many efforts have been put to establish and develop a conceptual framework for accounting it has been very slowly, conceptual framework of AAOIFI has the same problems.

2.0 THE IMPORTANCE OF CONCEPTUAL FRAMEWORK

Conceptual framework is fundamental, in the sense that other concepts flow from it and repeated references to it. It will be necessary in establishing, interpreting and applying accounting and reporting standard. Conceptual framework is intended to act as a constitution for the standards-setting process or provide a basis for the creation of accounting standards to guide in resolving accounting disputes that arise during the standard-setting process by narrowing the question to whether or not specific standards conform to the conceptual framework.

Based on Godfrey, accounting practice is overly permissive because accounting standards allow some alternatives accounting practices to be applied to similar circumstances (Godfrey, 2000). So that, there is a need for someone to make a judgment about the type of accounting standard, which is desirable and appropriate (Solomon, 1983). Conceptual framework should not be more than just providing broad and general objectives for financial reporting which no one could take serious objection (Peasnell, 1982).

As in the case of Islamic banks, Karim (1990) opines that the Islamic banks have taken the initiative to self-regulate their financial reporting for the concern that regulatory bodies may meddle and mandate accounting policies for the Islamic banking operations. However, a uniform conceptual framework may be difficult to achieve (Stauton, 1984) as different societies have different worldviews and values.
3.0 THE APPROACHES TO DEVELOP CONCEPTUAL FRAMEWORK

There are two approaches to develop conceptual framework. The first approach is based on the principles of Islam and its teachings and then considers these establishments in relation to contemporary accounting thought. It is deducing the objectives of financial reporting, the postulates of accounting and definitions of accounting principles from Shari’ah principles (Gambling & Karim, 1991). This approach is called constructive approach. This approach is to minimize the influence of secular contemporary accounting thought on the objectives to be developed (Karim, 1995). It is necessarily detached from certain features of reality and one cannot know a priori how influential this factor will turn out to be (Rashid, 1987). It is the move from theory to practice and turns out to be quite difficult when one has only these approach at hand (Shahul & Yaya, 2003).

The second approach is pragmatic approach. The construction of this theory begins with observations and measurement and moves toward generalized conclusions (Belkaoui, 2000). According to Karim (1995), it adopts the objectives of Western financial accounting currently available that are appropriate for Islamic business organization and excludes any objectives violating Shari’ah percepts.

4.0 PROBLEM IN CONVENTIONAL CONCEPTUAL FRAMEWORK

Zaid & Tibbits (1999), argue that some weaknesses in accounting are caused by inappropriateness of accounting definitions. For example, the term of principle may be defined as rule, law, belief or theory (Oxford, 2000). Whereas in GAAP, it is defined as conventions, rules or procedures. Therefore some accounting principles may be misinterpreted or interchangeable in the categorization of CF of accounting (assumptions, qualitative characteristic and constrains or fundamentals).

According to Islamic perspective, referring Kitabul Taarief (Al Jarjani Ali bin Mohammed Al Sharief), at least there are three classifications of terminology hierarchy:
1. *Asl* (foundation, eg. the compliance of Shari’ah Islamiah)
2. *Mabda* (principle, eg. halal mu’amalah, truth and fairness in the
stewardship reporting, zakat focused reporting

3. Kaidah (rule)

These three classifications can not be interchangeable each other because each classification has its fixed position, whereas, Lane & Tery (1990) show the problem inconsistencies with some existing standards regarding the CF establishment.

5.0 THE CONCEPTUAL FRAMEWORK OF AAOIFI AND THE ANALYSIS

5.1 The Objective of AAOIFI’s CF (Decision Usefulness)

The accounting objective, as it is common perceived, is inseparable from accounting concepts, because accounting concepts and all their derivatives are developed from accounting objective. AAOIFI could not avoid the influence of capitalist or liberal thought which Western accounting has developed (Adnan and Graffikin, 1997). The objectives more emphasize on how to provide information for investors and customers in making economic decision and do not cover how it may enable to serve other users such as employees, society and etc. Shahul (2000) argues that Islamic financial institutions should provide and consider some information needed by an Islamic society.

Khan (1994) opines that the information needs of an Islamic society are different from those of a capitalist society because of their different worldviews. Baydoun and Willet (2000) assert that unlike conventional accounting, in Islam the focus is on God and the community rather than the individual demands, a social accountability perspective rather than personal accountability found in the West. Adnan & Gaffikin (1997) strongly suggest that the fulfillment the accountability to God-which is paying Zakat-should be the primary objective of accounting information for Islamic Institutions.

In Islam, the objective of accounting information is clear that is to seek Allah’s pleasure and not look for material only. Therefore, maximizing profit or wealth is not the sole purpose of living. The focus in Islam is the maslahah ummah as a whole, not on individual. Hence, decision usefulness objective, which concentrate on individual shareholders and creditors, are not acceptable in Islam. Based on those arguments, we conclude that the statements of objectives of AAOIFI are not very
much in line with Islamic values since the center of focus in still on decision usefulness for primary users of shareholders and investors. It is obvious that the goals of the establishment of Islamic bank are how to achieve Falaah (success) in the world and in the here after (Karim, 1995).

5.2 The AAOIFI’s Basic Assumptions / Concepts

5.2.1 Accounting Entity/Unit

In the SFA No. 2 (para 65-68), it states Islamic bank is considered an accounting unit separate from its owners or others who have provided the bank with the fund. Ahmad (1990) supports this assumption based on the examination of the concept upon the principles and rules which govern financial contracts in Islam, as advised by Ibn al’A’rabi, which includes prohibition of interest and legitimacy of trade, prohibition of “unjustified” enrichment, prohibition of “dubious circumstances” and uncertainty in trade, and giving consideration to intention and aims (al-Maqasid) and to welfare (Maslih). Gambling and Karim (1991) argue that some jurists see no objection to the extension of this status quo to trading concerns, if the arrangements conform to the requirements of the Shariah in other respect.

Khan (1994) argues that entity concept suffer from some incongruities proprietary concept is nearer to the Islamic framework since it is not clear who is the ultimate owner of the business. He proposes that proprietary concept is nearer to the Islamic framework since zakat has to be calculated on the property of individuals, which makes proprietary theory is more reasonable in Islamic framework. To conclude, as most of the scholars (Adnan and Graffikin 1997; Ahmad 1994) later by Gambling and Karim (1991) who agree to this concept, it is sufficiently convincing that this concept is acceptable and applicable from an Islamic point of view. However, in our opinion, we support the argument presented by Khan (1994) that the proprietary theory is more Islamic than entity theory.

5.2.2 Going Concern Concept

This concept defines the business will continue to exist in the foreseeable future. It suggests that by valuing the assets at the historical cost in the balance sheet, the benefits of the assets will accrue for foreseeable future. Adnan and Graffikin
(1997) attack this concept because it carries element of ‘shyrik’ as it assumes something other than Allah is equal to His characteristic. Abdel-Magid (1981) also attacks this concept on the ground that “the Islamic model of Mudaraba does not recognize this concept”. He relates his opinion to asset valuation in which basis of asset valuation and income determination for the Mudaraba contract is on liquidation and exit value. Ahmed (1994) argues that this assumption does not seem to contradict to any of the Islamic principles. It’s based on Islamic principle that is the principle of “retaining” or “accompaniment”( Istishab). This principle entails retaining any event or verdict experienced in the past, until evidence is found which says that the event or verdict has changed. Hence, if a person is known to exist, his existence is not denied until evidence to the contrary is produced.

In our opinion, going concern concept does not violate Islamic principles as mentioned by Ahmed (1994). However, the implication underlie this concept i.e. conservatism concept which closely linked to other concepts especially on the valuation of the asset such as historical cost concept (Mirza and Baydoun, 2000), objectivity matching and realization has resulted to many arguments.

5.2.3 Accounting period concept

Ahmed (1994), Adnan and Graffikin (1997) and Gambling and Karim (1991) testify that accounting period postulate does not contradict to any Islamic principle and is desirable rather than questionable, for it helps in paying Zakat. This concept is known to Muslims before it emerged more recently as an accounting concept. Adnan and Graffikin (1997) quotes a hadith to support his view. It is reported that the Prophet Muhammad (pbuh) has said; “No Zakat on wealth until a year passes”. Based on this, every Muslim is automatically ordered to calculate his or her wealth once a year, in order to determine the amount of Zakat he or she has to pay. In our opinion, we agree to the arguments presented that based on “haul” for calculating the Zakat due to support this postulate.

5.2.4 Unit Measurement Concept

SFA No.2 adopts this concept based on the argument that changes in the purchasing power of money should be ignored when setting financial rights and obligation (para. 79) produced by one school of thought. Adnan and Graffikin (1997)
argue that this matter is not dealt with sufficient argument. The consequences of this adopting are very important in Islam because it sacrifices the value of honesty and fairness. Ahmed (1991) writes that, in an inflationary environment, money as a unit of measure is questionable from Islamic point of viewpoint, for it implies, that money is unable to serve as just and honest unit of account. It makes money an inequitable standard of deferred payments and an untrustworthy store of value, and enables some people to be unfair to other, even though unknowingly. This contradicts to Islamic principle, such as “do not eat up your property among yourself for vanities” (Qur’an 4: 29).

There are many suggestions given to overcome this problem. Chapra (1985) has not yet accepted indexation or monetary corrections, while others suggest the use of replacement or present value-to-value assets. However this is not easy. Ahmed (1994) points out if all these suggestions were to be implemented, but it only serves as a temporary solution rather than a permanent solution to accounting problems in an inflationary or deflationary environment. Adnan and Graffikin (1997) argue that the application of gold or silver, for instance, as a measuring unit or currency as was used in the age of the Prophet Muhammad (pbuh), is perhaps relatively resistance to inflationary effects.

We agree to the application of gold or silver, as money back with gold price is more resistance to volatility and stable. In our opinion, gold-based currency such as Gold dinar can be applied, as it is less volatile compared to fiat-based currency. The difference arising on the gold price should be charging to the reserve account. Further studies must be carried out for its implementation (Hafiz, et all, 2002). In conclusion, we do not agree that the concept of unit measurement is Islamic. However since any better alternatives are currently not available, we have no choice but to accept it on the ground of darurah. Nevertheless, continuous research must be conducted to find better alternatives which fits more accurately in the Islamic perspectives.

6.0 WHAT THE MAIN SOURCES OF ISLAM SAY

The main source of Islam, Al Qur’an, in its surah (Al Baqoroh verse 208) tells that as a Moslem, we must apply the Islamic values and Islamic principles in our life
as a whole (kaaffah). It's meant that we must try to become kaaffah Moslem. Although in our opinion kaaffah is not only status being a Moslem but it is also a process to be a Moslem, we opine that everything we do in this life must be done in the ground of fully Islamic effort, not only partially effort. Furthermore, with regard to the effort in developing conceptual framework of Islamic Bank or Islamic Financial Institutions and the effort to Islamize accounting, we must adopt an effort which is fully Islamic, not only partially Islamic.

The other main source of Islam, Hadith of the Prophet SAW, which had been recalled by Ahmad, Abu Dawud and Tirmidzi, said that the sources of Islamic rules are 1). The primary sources are Al Qur'an and Al Hadith, 2). The secondary source, which is ijtihad, includes ijma' (conventions), qiyas (analogy), ‘urf (customary practice), maslahah (public interest), ihtisab (presumption of permissibility). It means that all rules in Islam must be derived from those three main sources of Islam. So, regarding to the conceptual framework of Islamic Bank and Islamic Financial Institutions, which will be the rules of the operation of Islamic Banks and Islamic Financial Institutions, it must be derived based on Al Qur'an, Al Hadith, and Ijtihad.

Based on the explanation of two main sources of Islam above, we can see that the approach that must be taken by AAOIFI in developing conceptual framework of Islamic Banks and Islamic Financial Institutions should be based on the constructive approach. It's just being caused that the constructive approach is derived from Al Qur'an, Al Hadist and Ijtihad. Hopefully, AAOIFI can apply the fully Islamic approach, not only partially Islamic approach. Nevertheless, we cannot deny that such approach is quit difficult to be applied (Shahul & Yaya, 2003), specifically in this condition where there has been a lot of Islamic Banks and Islamic Financial Institutions. So, it will be necessary for us to consider the permissibility of the use of pragmatic approach in the ground of dharurah. And the further question that must be answered is that whether we are in the dharurah condition with regard to the establishment of Islamic Banks and Islamic Financial Institutions or not.

To answer the above question, we can consider some concepts of dharurah below. Firstly, Qordhowi (1976) stated that someone/something can be considered in the dharurah condition if it is under pressure (QS. An-Nahl: 106), it is under
weaknesses (QS. Ali Imron: 27), and it is for public benefit (*maslahah of ummah*). Secondly, we must also consider the dharurty requirements (Qhordowi, 2000), which tell that dharurty is really happened (QS. Al Faathir: 14), it can not be replaced by others (there is no other alternatives) and it's only occurred in the short term (temporary). Thirdly, the principles of fiqh (Qowa'id al Fiqiyah) say that all difficulty things can be made easier (*Al masyaqoh tajlibu taisir*, Muh. Zuhaili, 1993). Briefly, the principles state that every prohibited thing may allow being broke under the dharurty condition (QS. Al Maidah: 3) and every allowed thing under dharurty condition should appropriate with the need (QS. Al Baqoroh: 173). Lastly, every need can be categorized as dharurty things because if it cannot be provided, it will produce *masyaqoh/difficulty* (Qhordowi, 1976).

7.0 OUR STANDING

Based on the explanation of eight sections before, we can conclude that there is a mixture of Western and Islamic values in AAOIFI’s conceptual framework. The rationales for this statement would be because of the fact that AAOIFI has taken the pragmatic approach in establishing its CF. As clearly mentioned before, adopting and Islamizing conventional standards to be the base form of so-called Islamic CF, would suggest that Western values are inherited through the adoption of Western contemporary accounting thought.

With regard to the conceptual framework, which has been developed by AAOIFI, it has some loopholes and weaknesses and it also has a lot of possibilities to be criticized and to be objected, specifically for its objectives and some basic assumptions. Furthermore, the AAOIFI conceptual framework is far from reaching fully Islamic values status.

Islam has given the guidance for the *ummah* in developing the principles or the rules, which are Al Qur’an, As Sunnah and Ijtihad. All rules in Islam must be derived from that guidance. Islam also encourages all Moslems to apply Islamic values as a whole (*kaaffah*). And finally, regarding to the establishment of Islamic Financial Institutions (Islamic bankings) right now, we conclude that they have
established in the *dharury* condition, since they live in the conventional/capitalist economic system.

So, for the question of seventh week topic, we answer that basically we do not agree with the approach AAOIFI has taken in developing conceptual framework for Islamic banking, since Islam has already given the principles to derive the rules and it also encourages Moslems to apply Islamic values as a whole (*kaaffah*), whereas the approach that has been taken by AAOIFI is only partial approach to Islamize Accounting (Anwar, 1997). Besides that, the result of this approach, which is AAOIFI conceptual framework, is far from reaching fully Islamic values status and it also has some loopholes and weaknesses, specifically for its objectives and some basic assumptions.

Nevertheless, we can not deny the need of CF by Islamic banks, which have been established at this time. So, in the short term, it is permissible that pragmatic approach can be taken in developing Islamic banks’ CF. We can refer to the *dharury* condition which have been faced by Islamic banks. They have trapped in the established western economic system. But, since the dharury condition is not permanent (only short term/temporary), in this time we must start to develop our Islamic Conceptual Framework based on the principles of Islam (using constructive approach).

In our opinion, there are three types of our efforts to develop our Islamic Conceptual Framework under constructive approach, which are low efforts, moderate efforts, and hard efforts. The harder the effort, the faster the availability of conceptual framework for Islamic Banks and Islamic Financial Institutions under constructive approach will be.

1). Low effort
2). Moderate effort

3). Hard effort

Whatever type that we will choose to develop CF under constructive approach, someday we will able to meet the equilibrium point. In this equilibrium point, it is possible that the availability of CF under constructive approach will be as sufficient as the availability of CF under pragmatic approach. After that, the CF under constructive approach will be more comprehensive and more sufficient than those
under pragmatic approach. It is also possible that there will be the same perception about CF under constructive approach and pragmatic approach if the man behind the pragmatic approach keep consistent to reject all that violate with shari’ah and try to avoid the 'intellectual baggage' behaviors and also if the economic system gives the conducive environment for developing CF. But, when it will occur depend on the effort under pragmatic approach.

8.0 CONCLUSION

As for the conclusion, AAOIFI as Islamic accounting body should have its original conceptual framework, further and deep researches are needed in order to redefine and reconstruct the conceptual framework that derived from Shari’ah Islamiah. Nevertheless, we cannot deny the need of conceptual framework by Islamic Banks in this time, since there are a lot of Islamic Banks that have been established.

So, in the short term, we have no choice but to accept the pragmatic approach on the ground of dharurah. Since the pragmatic approach only consider in the ground of dharurah where it is only temporary/short term, in this time we must start to develop our Conceptual Framework based on Islamic principles and Islamic values. There are three types of our effort to develop our Conceptual Framework based on Islamic principles and Islamic values, which are low effort, moderate effort and hard effort. This effort will only be success if there are cooperation, especially cooperation between those who master in Islamic legacy and those who master in accounting.
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