ACCOUNTING POSTULATES AND PRINCIPLES FROM AN ISLAMIC PERSPECTIVE

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Abstract

This paper reviews and scrutinizes accounting postulates and principles from an Islamic Perspective. It concludes that accounting postulates are generally acceptable and can be used as the basis of accounting in Islamic banks and Islamic financial institutions. Accounting principles are also largely acceptable. However, some of these do not comply with fairness accounting; they are subject to considerable debate and criticism, even from a conventional point of view. Accounting for Islamic institutions should be based on justice and fairness, to ensure all parties’ rights and dues. All principles which help achieve the objective of justice are acceptable and desirable. Compromises, however, are inevitable in some cases, even though they should be within the general framework of Islam and should maintain welfare. In other words, realization of major objectives might justify some compromise on principles of less priority. Although Islamic banking has abandoned interest, that does not necessarily mean different accounting. However, some accounting principles and concepts are more desirable than others.

Introduction

This research examines the compatibility of accounting postulates and principles with Islamic Law and principles. It provides a general review of accounting postulates and principles, and considers in the light of Islamic Law whether they are acceptable to furnish a basis for accounting in Islamic financial institutions. More general aspects of accounting from an Islamic perspective are also discussed.

* The author would like to thank the two referees for their valuable comments and remarks. Needless to say the author solely remains responsible for any shortcomings.
Naturally, accounting postulates and principles are indispensable for Islamic financial institutions, thus making it imperative to assess their compatibility with Islamic law and principles. Also accounting postulates and principles merit special consideration in the face of an Islamic opinion which believes that they do not conform to Islamic principles and teachings.

As a matter of fact, theory evolves over time whereby errors in the prescription of existing theories are examined and the theories modified - and accounting is not an exception. Accounting theory has progressed through a long evolutionary process, being affected by logic, policy-making, government regulations and developments in finance, which itself evolved from economics. Norms and societal beliefs also play an important role in the evolution of theories.

Accounting principles emerge from and express the values and essential characteristics of a society. They are rooted in the value system of the society in which they operate, and are hence socially determined. Value judgments are applied to the interpretation and justification of economic and social events. The subjective nature of these values implies that there is ample opportunity for controversy as to how events should be measured and for whom such measurements are intended. Accordingly, accounting developments reflect a response to changing social needs.

Contemporary concepts of accounting evolved with the growth of accounting theory in the Western world, in relation to developments in economic life and the changing needs of different groups for accounting information. This is clearly explained by Catlett, who indicates that accounting was created and developed to accomplish various desired objectives and, therefore, it is not based on fundamental laws or absolute precepts. Since accounting has evolved over many years through trial and error, it should be continually improved to give a better final product to satisfy the requirements of end-users who utilize financial statements.

Even more critically, there is no unanimity among accounting authors in defining postulates. Some authors refer to assumptions, while others use the term “concepts” or “conventions”. Paton himself uses many terms, including postulates, assumptions, and concepts. However, we shall stick to the definition that postulates are basic assumptions or fundamental propositions concerning the economic, political and sociological environment in which accounting operates. They serve as a foundation for the logical derivation of further propositions, and they must be generally accepted by accountants. A short review and definitions of some key accounting postulates and principles, and their acceptability from Islamic Law point of view, now follows.
Accounting Postulates and Principles from an Islamic Perspective

1. Accounting Postulates

1.1 Accounting Entity

An accounting entity is "Any economic unit which has been selected as the subject to be accounted for (that is, as the accounting entity) is to be viewed, in the accounting process, as a real entity, existing in its own right, separate and distinct from other entities which have dealings with it."\(^8\)

This postulate enables the accountant to differentiate between the person or persons who own the enterprise and the enterprise itself. It also enables the accountant to segment the enterprise into smaller accounting entities for measuring performance or control. It states that financial accounting information relates to the activities of a business entity only, and not to the activities of its owners, given that the enterprise is something separate and distinct from those who provide its capital. The business entity or unit owns the resources of the company and is liable to the claims of the providers of capital and to those of the creditors. Accordingly the accounting equation is:

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\text{Assets} = \text{Liabilities} + \text{Stockholders' Equity}.\]

1.2 Accounting Entity From the Islamic Point of View

As we have already seen, under the entity theory, transactions are recorded from the viewpoint of the firm rather than those of its owners, and income and expenditure are defined from the viewpoint of the enterprise. As a result, entity theory enables us to consider:

1. the firm as a separate and distinct entity from the owners and other firms;
2. the firm as a real thing responsible for itself;
3. that the firm owns the resources;
4. that the accountant is to report the transactions of the firm rather than those of its owners.

These points are now considered from the viewpoint of Islamic principles and rules, in order to see whether or not the accounting entity theory contradicts them. The principles and rules which govern financial contracts in Islam, as summarized by Ibn al A'rai, are:\(^10\)

1- Prohibition of interest and legitimacy of trade. Although trade is allowed, there are restrictions on the conditions and practices of trade.
2- Prohibition of 'unjustified' enrichment (Akl Anwāl al-Nā's Bi al-Ba'til); "do not eat up your property among yourselves for vanities" (Qur'an, IV:29).
3- Prohibition of 'dubious circumstances' and uncertainty in trade contracts (Bai' al-Gharar), that is, a sale which involves fraud or unfair exchange.
4- Giving consideration to intentions and aims (al-Maqāśid) and to welfare (al-Maṣālih). Consideration of aims indicates that the intentions of dealers must conform with Islamic teachings. Therefore, it is not permitted to commit an illegitimate act through a trick. For example, a person may approach a trader to
buy from him a commodity for 110 units on a deferred basis on condition that the trader should rebuy it from him at 100 units immediately and in cash. Although this transaction consists of two permitted transactions, it is not legitimate as the intention of the buyer is to obtain a loan of 100 units which he will repay in the future with an increment of 10 units. In effect, the transaction is a loan with interest.

The accounting entity theory does not conflict with any of these four rules; indeed it is compatible with Islamic principles for the following reasons:

1- The entity postulate makes matters easier for the clients of the enterprise; instead of dealing with many owners the clients are dealing with only one nominal person. It is also easier for the accountant to prepare the financial statements of this nominal person. This helps to maintain the rights of all parties who are dealing with the entity.

2- The entity postulate enables the establishment of huge joint-stock companies, in which a large number of people are shareholders. This can lead to the distribution of wealth among a large number of people, while the possibility of concentration of wealth in few hands is reduced.

3- The entity postulate makes it easier for the court to deal with a nominal person in case of disputes.

4- The postulate is accepted, because in Islam everything is permitted and lawful except that which is explicitly prohibited in the Holy Qur’an or in the Sunnah.

5- Muslim jurisprudence (Fiqh) is familiar with the idea of entity or nominal personality as it is the case for endowment (Waqf), treasury (Baitul Mal) and government. This shows that the concept of an institution as a distinct entity is acceptable in Islamic thought.

1.3 The Going Concern Postulate

The going concern, or continuity, postulate holds that the business entity will continue its operations long enough to realise its projects, commitments, and on-going activities. As most economic units are organized for operation over an indefinite period of time, it is frequently argued that the entity should logically be viewed as remaining in operation indefinitely under normal circumstances. The postulate assumes either that the entity is not expected to be liquidated in the foreseeable future or that it will continue for an indefinite period of time. Such a hypothesis of stability reflects the expectations of all parties interested in the entity. Thus, the financial statements provide a tentative view of the financial situation of the firm and are only part of a series of continuous reports.

Newman and Mellman define the continuity concept as follows: “unless and until the entity has entered into a state of liquidation, it is to be viewed as having an indefinite life.”

From the valuation point of view, the going concern postulate is considered very important: many assets derive their value from their employment in the firm, and
should the firm cease to operate, the value which could be obtained for these assets on a closing-down sale would probably be much less than their book-value. That is the reason why the valuation of assets used in a business is based on the assumption that the business is continuing, and not on the verge of cessation.

This postulate however, has come under attack from many accountants. Sterling describes it as an unreasonable and absurd assumption. He argues that the high rate of business failures makes it difficult to build an evidential case for a projection of continuity. Fremgen also attacks the going concern assumption, arguing that it “is not a scientific fact or even a completely rational assumption.”

1.4 The Going-Concern Postulate from an Islamic Perspective

The continuity postulate assumes that the entity is a going-concern or is remaining in operation in the absence of evidence to the contrary. This assumption does not seem to contradict any of the Islamic principles. In Islamic jurisprudence there is a principle similar to this postulate, that is, the principle of “retaining” or “accompaniment” (Istiṣḥāb). This principle means retaining any event or verdict experienced in the past, until evidence is found that this event or verdict has changed. Hence if a person is known to exist, his existence is not denied till an evidence to the contrary.

However, although the continuity postulate does not contradict Islamic principles, the significant ideas which underlie this postulate and their consequences are questionable from the Islamic point of view. These include the recording of assets at the lower of cost or market value which is known as the conservatism principle. One of the most questionable consequences of the continuity postulate from the Islamic point of view is the so-called conservatism principle. It holds that when choosing among two or more acceptable accounting techniques, some preference is shown for the option that has the least favourable impact on the stockholders’ equity.

Newman and Mellman argued that conservatism may be expressed as a necessary condition for the fair presentation of accounting data. They argue that this concept comes into play because events or activities which must be reflected in the accounting process are characterised by uncertainty. The conservatism concept is used to avoid risk in terms of accounting results and is equivalent to taking a cautious or prudent approach to valuation.

Hindmarch justifies this concept on grounds that uncertainty prevails in the economic environment. He argues that, “if it is possible to measure with accuracy then conservatism has little impact, but there are many situations where accuracy cannot be achieved and in such situations this concept should prevent optimism.”

Many authors criticise the principle of conservatism. Sterling points out that “the Finney and Miller texts, which mirror the mainstream of accounting thought, referred to conservatism as a ‘principle of accounting’ through four editions. In the fifth edition, however, they complain about the ‘fetish of conservatism’. Finney and Miller argue that, in the early days of the development of accounting, public accountants’ records were required mainly for the preparation of reports for bankers
and guarantors of short-term credit, who were primarily interested in the margin of security. When the interest of bankers and other short-term creditors changed, accountants, who were influenced by their attitudes, changed their emphasis. Thus conservatism was a more highly esteemed virtue in the past than it is today. As stated by Belkaoui: “The present view of conservatism as an accounting principle is bound to disappear.” Sterling argues that “conservatism yields, not only zero information, but also, misinformation”, because historical costs, when they are used, are themselves conservative. Hence, he concluded, historical costs are justified if and only if conservatism is justified. Thus historical costs also yield misinformation.

As a result of the conservatism principle, profits may be shifted from one year to another. Furthermore, valuation of inventories under this principle minimises the base for Zakah, which should be paid annually. For these reasons the conservatism principle is not compatible with Islamic principles and rules.

1.5 Accounting Period Postulate

The life of an entity is currently regarded as consisting of a chain of periodical segments. The final statements which report on the activities for a year and the condition of the entity as at the close of that year, are based on what is referred to by many writers as the ‘accounting period convention’. Belkaoui claims that, although the continuity postulate assumes that the entity will exist for an indefinite period of time, users require a variety of information about the financial situation and performance of an enterprise to make short-term decisions. In response to this constraint, the accounting period assumption holds that financial reports showing changes in the wealth of an enterprise should be published periodically.

Paton considers this postulate as one of the important conventions of accounting. For the purpose of comparisons between revenues and applicable costs related to a fiscal year, the accounting period postulate enables accountants to analyse and rearrange original accounting data to reflect immediate administrative decisions and provides administratively useful data for future use.

By requiring an enterprise to provide periodic, short-term financial reports, the period convention thus implies the accrual basis of accounting. “This entails the assignment of revenue to the period in which it was earned (rather than when received).” Sales of assets will be considered as revenue during the year in which sales took place regardless of when payment is received.

However, the accounting period postulate, besides helping in investment decisions, assists in the prediction of bankruptcies and risk and, hence, is useful in making loans.

1.6 The Accounting Period Postulate from an Islamic Perspective

The accounting period postulate does not contradict any Islamic principle, and is desirable rather than questionable, for it helps in paying Zakah. This concept was known to Muslims before it has been suggested recently as an accounting concept.
Depicting the financial situation of an enterprise periodically helps the enterprise to know how much it should pay as Zakah. However, accrual accounting entails the assignment of revenue to the fiscal year in which it was earned rather than received. This could cause firms to pay Zakah for revenues not yet received, and according to the al-Madhhab al-Maliki, (Maliki school of thought), loans are exempted from Zakah.\(^3\) However, this constraint is not a sufficient justification to reject the accrual basis of accounting, for revenues which are not yet received can be deducted from the wealth which is subject to Zakah. Furthermore, it is not universally agreed among religious scholars, that loans are exempted from Zakah.

### 1.7 The Unit-of-Measure Postulate

The unit-of-measure postulate holds that accounting is a process of measurement and communication of the activities of the firm that are measurable in monetary terms. This assumption implies that the purchasing power of the monetary unit is stable over time.\(^3\) To express accounting information in terms of money alone may exclude factors such as quality of the product. Another disadvantage of this assumption is that it ignores changes in the purchasing power.\(^3\) “Even actual cost,” as expressed by Paton, “is only a tentative figure. Accounting deals largely with judgements and estimates, not with certainties. Values are always more or less conjectural and unstable. But an exhibit of cost is in itself a significant statistical record; it gives a fairly reasonable starting point, at least.”\(^3\) He argues that it is important for the accountant to assume that cost indicates actual value for purposes of initial statement, for cost is the only definite fact available when an asset is purchased. It is therefore reasonable to charge the appropriate asset account with the amount of this cost.\(^3\)

It is believed\(^3\) that using monetary terms to measure financial position at a given moment in time is the most objective and least biased method.

Despite changes in the purchasing power of money, accounting has been unwilling to introduce into the accounts modifications of values in order to reflect changes in the value of the monetary standard. Therefore, “values in accounting are expressed in terms of money as a fixed and constant standard.”\(^3\)

Paton and Littleton\(^4\) do not agree that accounting qualitative measurements should be designed to interpret and influence business conduct. To do so, in their opinion, overstates the purpose and subject matter of accounting. They argue that the term “measured consideration” is more appropriate than the word “value” to indicate the type of information which makes up the subject matter of accounting. If the value which expresses the mutual valuation of the buyer and seller as of the moment of exchange, changes, the recorded price-aggregate is still the best means available for representing varied transactions in homogeneous terms.

However, the unit-of-measure postulate assumes that the purchasing power of the monetary unit is stable over time. If it changes, this change is insignificant. This assumption is not always correct, especially in the current world-wide inflationary environment.\(^4\)
Recently, however, accounting information resulting from the application of the historical cost concept has been questioned by various financial-statement user groups. It is argued that the use of historical cost information frequently results in income not being recognized during the period in which it occurs, and also results in overstating income in periods of inflation. Changes in prices create two accounting problems: (i) valuation; the value of individual assets changes in relation to all other assets in the economy, irrespective of any change in the general level of price; (ii) measurement unit; the value of the measurement unit changes because prices in general change.

Two different viewpoints as to how to present financial information to account for the effect of changing prices and values of an enterprise, to overcome the disadvantages of historical cost information. One school of thought advocates statements prepared on the basis of current value to address the valuation problem. The other proposes “price-level-adjusted financial statements”, that is, adjustment of historical cost information to account for the effect of the overall change in prices. This viewpoint addresses the measurement unit problem.

1.8 The Unit-of-Measure Postulate From an Islamic Perspective

Money as a unit-of-measure is accepted from the viewpoint of Islam, as generally accepted currency having the attributes of gold and silver and serving as a store of value. Thus the same rules concerning usury in gold and silver apply: Money must not be sold against itself unless like for like, equal for equal and hand-to-hand. However, if the denominations of money differ, it is allowed to exchange them against themselves hand-to-hand, provided the sale and transfer of the two quantities of the different currencies take place on the spot.

Money as a unit of measure can be accepted in Islam under a stable monetary system, where stability in the value of money is maintained, because of the unequivocal stress of Islam upon honesty and justice in all measures of value:

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\text{Give measure and weight with (full) justice (6:152).}
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\text{Give just measure and weight, nor withhold from the people the things that are their due (7:85). (Translation).}
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However, in an inflationary environment the role of money as a unit of measure becomes questionable from the Islamic viewpoint, as it fails to serve as a just and honest unit of account. It makes money an unfair standard of deferred payments and an untrustworthy store of value, whereas some people become unjust towards others, albeit unknowingly. This contradicts Islamic principles, such as “do not eat up your property among yourselves for vanities” (Qur’an 4:29). Inflation does injustice to the Riba-free lender by eroding the real value of (Qard hassan), a loan extended without either interest or profit-sharing. It has been suggested that the effect of inflation can be minimized by indexation, or monetary correction, of all monetary assets and incomes, but indexation has not yet been accepted by any school of Islamic
Accounting Postulates and Principles from an Islamic Perspective

jurisprudence.\textsuperscript{47} Others suggest the use of replacement or present value to value assets.\textsuperscript{48} However, this is not so easy.

It seems, however, that the alternative which conforms to Islamic principles is to maintain stability in prices and value of money. Indexation, replacement price or current value are merely temporary palliatives, not a permanent solution to the problem of inflation.

The measurement convention, which limits the recognition of activities to those which can be expressed in monetary terms only,\textsuperscript{49} though practical in registering financial transactions, does not cover all aspects. However, the Financial Accounting Organization for Islamic Banks and Financial Institutions (FAOIBFI) assumes, for accounting purposes for Islamic Banking, that the purchasing power of money is stable.\textsuperscript{50}

2. The Accounting Principles from an Islamic Perspective

Definition and discussion of some accounting principles and how they are fit into Islamic framework to furnish an accounting system and procedures for Islamic financial institutions, will be considered here. The plan to study accounting principles from an Islamic perspective is to review these principles from the viewpoint of the major Islamic principles which govern financial dealings and contracts, as mentioned in the Qur’an. These are:

1. Realisation of fairness and justice.
2. Preservation of the rights and dues of all parties’.
3. Paying Zakah (that necessitates having accurate and just financial statements which represent accurately and truly the financial position of the entity).

The first two Islamic principles are emphasized by the Holy Qur’an. It is instructed that measure and weight should be given with justice and without withholding from people what is theirs (Qur’an, 6:152, 7:29, 11:85, 17:35, 55:9, 57:25). Muslims also are asked, when dealing in financial transactions involving further obligation (debt), to write down faithfully and precisely this obligation (Qur’an, 2:282). Therefore, accounting which helps to keep and record the rights and dues of all parties’ is required in Islam. It represents an integrated part of the just system which Islam requires. Therefore accounting principles in a Muslim Community should be formulated so as to provide fair and just information (i.e. fairness accounting).

On the other hand Zakah is one of the five pillars of Islam. Qur’an requires Muslims with a specified minimum wealth (Nişâb) to pay Zakah (12:41, 78; 24: 56; 33: 33; 58: 13). The rate of Zakah varies according to the type of wealth. Zakah revenue is earmarked to be spend on certain items detailed in the Qur’an (9:60).

2.1 The Objectivity Principle

The usefulness of financial information depends heavily on the reliability of the measurement procedure used. Because ensuring maximum reliability is difficult,
accountants have employed the objectivity principle to justify the choice of a measurement procedure. Financial reporting is considered useful if it provides useful information to present to potential investors, creditors and other users, on which to base rational investment, credit and similar decisions. The principle of objectivity has been subject to different interpretations\textsuperscript{51} as below:

1. An objective measurement is a verifiable measurement in the sense that it is based on evidence.

2. An objective measurement is an impersonal measure and free from the personal bias of the measurers.

The development of new ways and means for realizing objectivity is particularly needed in the present situation of inflation. Although historical cost, for example, realizes objectivity for recording values of different items at their acquisition, it does not maintain the same if used as the basis for valuation. Therefore, it is essential to differentiate between measurement objectivity and valuation objectivity.

The objectivity principle, from an Islamic point of view, is a desired principle for fairness accounting, especially when recording different transactions, i.e. assets, goods and services at the price prevailing during the date of acquisition (historical cost). However, objectivity turns out to be anything but objective when valuation is taken according to historical cost in an inflationary environment. Therefore, the objectivity realised by using cost price at acquisition date is not necessarily achieved when valuation is made at a later date. As a result, it is believed that objectivity can be accepted for recording transactions at the prices of the date of acquisition in Islamic financial institutions. However, in certain circumstances it yields non-objective information. Therefore, other methods of valuation, e.g., current value, should be adopted. Difficulties embodied with alternatives should not prevent the acceptance of the need for change. Indeed, it is believed that difficulties involved with other methods can be solved through practice.

\textbf{2.2 The Matching Principle}

The matching principle (or convention) holds that expenses should be recognized in the same period as associated revenue. Hence, the matching principle links revenue with their relevant expenses. This means identifying the gains resulting from transactions and setting them off against those expenses which are related to those transactions\textsuperscript{52}.

One of the consequences of the conventional matching principle is that it relegates the balance sheet to a secondary position.

Three matching principles are employed by accountants: associating cause and effect, systematic and rational allocations, and immediate recognition. Applying these principles involves a great deal of judgment. The accountant should determine whether a cost pertains to future revenues and hence should be deferred; whether a cost is related to past revenues and therefore should be written against prior income; or whether a cost, although not yet paid, is related to current revenues and therefore
Accounting Postulates and Principles from an Islamic Perspective

should be accrued. In making these decisions, official pronouncements by authoritative bodies, conservatism and expendiency play an important role. Some rules are very specific, others are vague, such as recording a loss if it is probable that a liability has been incurred.

One of the most desirable and acceptable principles for fairness accounting from an Islamic perspective is the matching principle. The matching principle as it allocates expenses to their related revenues, provides fairness and justice simultaneously to shareholders and depositors in Islamic banks. Indeed it is of paramount importance in the allocation of profits in case of Islamic investment accounts where a large pool of investible funds with different maturities is formed.

2.3 The Consistency Principle

It is held that similar economic events should be recorded and reported in a consistent manner from period to period. The principle implies that the same accounting procedures will be applied to similar items over time. Application of the consistency principle makes financial statements more comparable and more useful, especially within the same firm.

Comparing the accounts of different companies is more difficult and the accounting methods of individual firms are not always the same. There is no uniformity of accounting methods which would provide the consistency of treatment of information necessary for the comparison of the accounts of different companies. Therefore, the needs of investors for greater comparability of information between companies is undermined by accounting conventions which accept internal consistency, but allow different methods of measurement and treatment which cannot yield comparable results. Therefore, it is recommended that accounting standards committees are charged with the task of finding a way to secure agreement on appropriate accounting methods which ensure a higher degree of comparability of accounting information.53

The consistency principle is desirable from the Islamic point of view, as it helps to provide more useful information and more accurate and fair financial statement. Failure to maintain consistency might lead to unrealistic profit with obvious implications for Zakah and distribution of profit to investment depositors in Islamic Banking.

2.4 The Uniformity and Comparability Principle

This refers54 to the use of the same procedures by different firms. The desired objective is to achieve comparability of financial statements by reducing the diversity created by the use of different accounting procedures by different firms. The principal arguments for uniformity are that it would:

1- Reduce the diverse use of accounting procedures and the inadequacies of accounting practices.
2- Allow comparisons of the accounts of different firms.
3- Lead to governmental regulation of accounting practices.

Showing similar and comparable financial statements help users to take right decisions, which is indeed desirable from an Islamic viewpoint.

2.5 The Materiality Principle

Materiality serves as an implicit guide for the accountant in terms of what should be disclosed in the financial reports, enabling the accountant to decide what is not important or what does not matter on the basis of record-keeping cost, accuracy of financial statements, and relevance to the user. An item should be considered as material if there is reason to believe that knowledge of it would influence the decisions of an investor or a user. Materiality is primarily related to relevance. If an item is not material, then it is not relevant. Materiality really matters because financial reporting is only concerned with significant information.

The materiality principle, however, lacks an operational definition. Most definitions of materiality stress the accountant’s role in interpreting what is and what is not material. That may introduce an element of subjectivity, as accountants vary in their considerations of what is, or is not, material. However, it is indicated that the ratio of an income item to current income is a popular guide for materiality judgment. It has been suggested that accounting standards committees may furnish quantitative guidelines on materiality to achieve uniformity of practice.

The importance of the materiality principle relates to the simple fact that accounting and audit depend to a large extent on sampling. Since it is impractical and sometimes impossible to show all and every detail of the firm’s transactions, the accountant is given the right to decide what is relevant and what is not. We believe that this principle does not violate Islamic financial principles, provided safeguards against its misuse are adopted.

2.6 The Cost Principle

This principle holds that the acquisition cost, or historical cost is the appropriate valuation basis for recognition of the acquisition of all goods and services, expenses costs and equities. It implies that an item is valued at the exchange price at the date of acquisition and is recorded in the financial statements at that value or an amortized position of that value. The historical cost may be justified in terms of its objectivity and the going concern postulate.

However, because of changes in price levels and purchasing power, the actual cost basis has been subject to much criticism. It is argued that although money can be an adequate common denominator among diverse activities, it is a less than satisfactory common denominator between different periods of time. Historical cost valuation may produce unrealistic figures if changes in the values of assets over time are ignored. Due to the perceived deficiencies of historical cost accounting, many alternatives have been suggested to replace historical cost.
Recently many books on Inflation Accounting have been published; inflation accounting as defined by Tweedie and Whittington, is "eclectic, including all forms of accounting which seek to reflect the consequences of price changes, whether by means of general prices indices or by reporting the market price of specific commodities". In recent history, accounting for changing prices, (i.e. a form of current cost accounting) has been adopted in the USA as has been the case in the rest of the English-speaking world.59 As the objective of financial statements is to report economic events and the economic status of an enterprise as realistically as possible and to provide useful information for managers to help them in decision-making, it has been argued that under inflation financial statements should be adjusted or current cost accounting used to fulfill that role. It is argued60 that adjusted financial statements are essential for efficient management and it is in the interest of shareholders that they should be provided with that adjusted information.

One of the questionable principles from the Islamic point of view is the cost principle. It conflicts with justice and fairness if valuation is based on it in an inflationary environment. Furthermore, financial information based on it will passively affect depositors who withdraw from investment in Islamic banks. In addition, unrealistic information as a result of inflation tends to reduce the Zakah base. However, ways of solving these problems need a separate research.

2.7 Realisation Principle

Revenue cannot be recorded except when it is evidenced by cash receipts or an exchange has actually occurred. Therefore, according to the dominant view, revenue is recognised only when realised.61 It has been argued that a clear distinction should be drawn between earned and realised revenue; earning should not be identified with realisation.62 Revenue is earned when the final product is delivered. On the other hand, it is fully realised when it is represented by cash receipts or when it is converted into cash or receivables. Revenue, therefore, will not be recognised with respect to a transaction that is incomplete at the close of an accounting period.63 It has been pointed out that the main reasons for deferring profit realisation until receipt of cash, are the risk of not collecting the amount due in full and the possibility of incurring additional expenses.64 Thus it sounds as if the justification of the realisation principle is certainty.

Although the realisation convention is the dominant current practice in accounting, it has been the subject of much criticism. Some writers65 have suggested that a valuation system should be established for inventories. It is argued that it is not fair to postpone the valuation of inventories until realisation takes place. Others66 argue that although it is accepted to value inventories of most businesses at cost of acquisition, except where the "lower of cost or market value" rule calls for departure from historical cost, there are some cases where inventory measurement at net realisable value is acceptable. In practice, net realisable value (i.e. current selling price less expected costs of realisation) is applied to some products such as cotton, raw sugar and crude oil.
Accounting Associations have considered the deficiencies of accounting reports using historical costs (if realisation does not take place the “lower cost or market value” rule will be adopted). The American Accounting Association argues for the reporting of both current and historical costs on the assumption that a periodic comparison between current costs and historical costs will be relevant to investors’ needs.67

The realisation principle is considered acceptable from the Islamic viewpoint as far as recording of transactions are concerned. It is prudent to recognize revenue only when it is realised. But this convention might harm transitional investors who withdraw from investment. Depositors in some Islamic banks have the right to withdraw their funds at any time. Thus if some of them withdraw before the full liquidation of the project in which their funds or part of them have actually participated, they may lose all or part of the profit that might be realised in the future.

Investment accounts, Mudarabah accounts in some Islamic banks are entitled to a part of the realised profits for the accounting period. Since these profits do include profits (positive or negative) of projects which are not yet liquidated, investors who withdraw at this stage may well not share in the profits of some of the projects in which their moneys have actually participated. Hence it may be argued that this conflicts with the requirement of justice and fairness.

To tackle this problem it is necessary to get a useful insight from the Islamic jurisprudence. In Islamic jurisprudence, a small degree of uncertainty (Gharar) in trade is accepted. Thus it is likely that a degree of “unfairness” which may affect the bank or its investors, may be considered acceptable, especially if it results in the elimination of interest.

Even if a holder of equity in a corporation, decides to withdraw by selling some or all of his shares, the price which he may obtain for each share is uncertain, although it reflects the financial situation of the company. The value of a share depends, to a large extent, upon dividends payable over the life of the company. Hence, valuation of the share depends on these dividends. However, it is difficult to know in advance the likely growth in dividends, and the market price in the shares at the predicted date of sale. Moreover, share prices in the stock exchange market are not always fair, and often fluctuate in response to speculative forces.

2.8 The Disclosure Principle68

There is a general consensus in accounting that there should be fair and adequate disclosure of accounting data. Fair accounting presentation necessitates the adequate disclosure of material information. Adequate disclosure requires that financial statements be designed and prepared to portray accurately the economic events that have affected the firm for the period and to contain sufficient information to make them useful and not misleading to users and average investors.

In general, it is expected that any matter of significance, such as major commitments, will be disclosed if knowledge of it would affect the decision of an
average investor. The term, “disclosure”, does not mean that any and all information is to be included in the accounting statements. It implies adequate disclosure of information which is of material interest to different users.

Adequate disclosure, however, leaves several questions open to interpretation; what is meant by fair and adequate disclosure? Adequate connotes a minimum set of information to be disclosed; fair implies an ethical constraint dictating an equitable treatment of users; and complete and comprehensive presentation of information.

Adequate disclosure, from an Islamic perspective is also one of the desired principles for fair accounting. It provides the public with the needed information for sound financial decisions. Zakah base value and its distribution can also be attained as a result of this principle. It has been pointed out that disclosure is minimal in some Islamic banks69, as there is no strong pressure from the public nor from the shareholders. Although depositors generally feel that their money is safe, yet usefulness of information is realised in Islamic financial institutions if the accounting principles are maintained. One aspect of this usefulness is the possible provision of an accurate financial position. Accuracy, in a sense, involves an aspect of fairness. That may explain why it is felt that most accounting principles are acceptable from an Islamic perspective. Therefore, it can be concluded that accounting principles in a Muslim community should be formulated so as to provide fair and just information (i.e. fairness accounting). In recognition to this fact the Financial Accounting Organization for Islamic Banks and Financial Institutions suggests that the financial statements of Islamic Banks and Financial Institutions include information about sources and uses of Zakah and Qard Hassan funds.70

3. Conclusion

To sum up, accounting principles, are generally accepted for fairness accounting in Islamic banks. Although Islamic banks operate in a different way from conventional banks, that does not mean that they are totally different financial institutions which need entirely different accounting. Like their traditional counterparts, they also aim to generate profit which involve them in credit and debt transactions, which must be recorded in such a way as to produce useful, accurate and fair financial statements. Differences in aims and objectives among different groups of financial institutions focus on different accounting principles. As a result, priority can be given to certain accounting principles, policies and procedures. Hence, all principles and procedures which maintain fairness and justice are accepted in accounting for Islamic banks.
Notes and References


b) A. Abdullah, al-Shakhṣiyah al-‘Ibāriyah fil-Fiqh al-Islāmi (Nominal Entity in Islamic Jurisprudence) (Arabic), Al-Dār Al-Sudāniy lil Kutub, Khartoum, no year of publication. However the author accepts the concept of Entity but does not agree to its consequence, i.e., Limited Liability.


b) K.S. Most, Accounting Theory, Grid Publishing, Inc., Columbus, Ohio, 1982, pp. 4-16, 52.


b) W.A. Paton and A.C. Littleton, An Introduction to Corporate Accounting Standards, op cit., p. 7.


b) A. Belkaoui, op cit., 1985, p. 220.


c) A.A. Sayed, al-Hissu hil-‘Amal huyn al-Fiqh al-Islāmi wa al-Qanoon al-Wad‘i (Share According to Work in Islamic Jurisprudence & Traditional Law), Higher Council for Islamic Affairs, Cairo, No year of publication, pp. 49-56.

12-a) A. Belkaoui, op cit., 1985, p. 221.

b) E.S. Hendriksen, op cit., 1982, p. 64.


Accounting Postulates and Principles from an Islamic Perspective

20- A. Belkaoui, op cit., 1985, p. 239.
28- A. Belkaoui, op cit., 1985, p.223
37- Ibid., p. 488.
44- M.U. Chapra, Towards a Just Monetary System, the Islamic Foundation, Leicester, 1985, p. 37.
47- Ibid., pp. 39-40.
الفروض والمبادئ المحاسبية من منظور إسلامي

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خلاصة

يدرس البحث الفروض والمبادئ المحاسبية المتعلقة على في علم المحاسبة من وجهة نظر الإسلام، ليخلص إلى أن معظم الفروض وبعض المبادئ المحاسبية يمكن أن تكون أساساً مقبولةً للمحاسبة البنوك الإسلامية والمؤسسات المالية الإسلامية طالما أنها تنسق مع المحاسبة العادلة (Fairness Accounting) التي تتكفل الحقوق ولا تؤدي إلى التزام وأكل أموال الناس بالباطل. وعلى كل فإن بعض النزلات لابد منها لقبول بعض المبادئ المحاسبية "مثلاً مبدأ التحقق" بغرض تحقيق الأهداف الرئيسية التي تسعى إليها هذه المؤسسات. ومع أن البنوك الإسلامية قد هجرت الفائدة، لكن ليس معنى هذا بالضرورة أن المحاسبة فيها يجب أن تكون مختلفة مع أن هناك بعض المبادئ المحاسبية أكثر قبولًا من البعض الآخر في هذه المؤسسات المالية.