THE PECULIARITIES OF THE ISLAMIC ACCOUNTING SYSTEM IN THE CURRENT ECONOMIC CONTEXT

Florentina Moisescu[1]
Dragomir Georgiana[2]

Abstract:
This paper treats the particularities of the islamic accounting system in the context of a much more different culture compared to the culture from any other country. Islamic accounting represents the process of identification, measurement and reporting of financial activities which is necessary for decision making, calculation of zakat and calculation of real benefits of islamic investments operations as per compliance with islamic laws. As a lifestyle, islamic religion has given a special attention to business activities. Thus, in economic activities, divine forgiveness must be the ultimate goal and accounting as an instrument which offers information in economic environment, must serve this purpose. Currently, islamic accounting becomes more and more important, since it is a field which gains a lot of attention in the whole world as a result of the spread of Islam in the new territories. The objective of this study is to evidence the particular characteristics of the islamic accounting system, along with its history and evolution. More than that it presents the need of islamic accounting system in islamic society and its benefits.

Keywords: Accounting, Islam. Quran, Sharia Law, Zakat

1. Introduction

Islam is the second largest religion in the world after christianity, with 1.9 million followers called muslims, which represent approximate 4.9% from the total world's population. The holy book of Islam is the Quran, which pictures word by word of God's words and lists lessons and normative examples of prophet Mohamed.

Sharia law is a religious law which is being part from the islamic tradition and derives from the religious precepts of islam, particularly from the Quran. Islamic Sharia law is governing mulsims' rituals and aspects of everyday life, including financial and banking sectors.

Zakat is one of the five pillars of islam alongside prayer, fasting, mercy and pilgrimage to Mecca. As per Sharia law, it should be payed by all muslims.

Accounting is a particular instrument of a national culture, because is influenced by the economic, social legal and even political and religious developments in each country. Accounting is the science and the art of recording, classifying, analysing data, presenting and interpreting information about business activities incurred by the firm during a certain period of time, so that its overall activity results and its financial position can be ascertained.

The aim of an accounting system is not to impose a purely technical system, but a socio-technical activity or system which reflects the characteristics of a particular society. In islamic society the type of accounting used alongside conventional accounting is the islamic accounting. Thus, islamic accounting can be defined as an accounting framework which plans to furnish clients with data empowering them for a better management of their organizations and establishments, as indicated by the Sharia law or islamic law.

This paper represents a summary of islamic accounting history and analyses similarities and differences between islamic and conventional accounting.

2. The coordinates of the islamic accounting system

The accounting organized in the form we use today has its origins from Italy and Luca Pacioli, the so called father of modern economics or father of accounting. His book, 'Summa de Arithmetica, Geometria, Proportioni et Proprotionalita', published in 1494 CE is considered the first test on accounting (Ramachandran and Kakani, 2005). Although, it's

[1] University "Dunarea de Jos" din Galati, Romania, florentina.moisescu@ugal.ro
[2] University "Dunarea de Jos" din Galati, Romania, dragomir.georgiana90@yahoo.com

being said that Luca Pacioli is not accredited to be the inventor of accounting system, however he is considered to be the first person who codified and published about the accounting system. This is because merchants have been using an accounting methodology and used in trade and commerce around the middle ages (Ramachandran and Kakani, 2005).

Accounting in the islamic world can be traced back even farther than these above mentioned claims (Ramachandran and Kakani, 2005). The population which lived in the Middle East during the time of Prohet Mohamed, was a population of which the entire economic system was reliant on trade and commerce. Even the Prophet himself worked as a merchant (Chapra and Whaples,2008).

The arrival of Islam through the revelation of the Quran provided instructions on every aspect of life, including economic transaction (Chapra and Whaples,2008). The base of the islamic economic system comes from Quran, which offers examples of how to conduct business in a permissible manner. Therefore, the emergence of islamic accounting system was essential and in the same time inevitable.

The Quran provided guidance on how to conduct accounting activities and seeing as the divine revelation began around 610 CE, this would mean that Islamic accounting was present some 800 years Pacioli's book (Zaid, 2004). This fact is not surprising as the writing of accounting history was dominated by english writers who focus and discus private sector accounting in english speaking countries of the 19th and 20th century (Parker, 1993). Therefore the scope of accounting history, is much wider from a geographic point of view, because does not limit only to the english speaking countries, and also from a time point of view as accounting was present prior to the modern era.

With the development of Islam, the islamic economic system was developed as well, along with all activities therein. The expansion in trade within and beyond the muslim world promoted the development of a mechanism which would ensure the acceptable accountability of cash, goods received and distributed (Iqbal and Mirakhor, 2011). This became very important in the year 624 CE when the zakat was introduced and it was necessary the existence of accounting for calculation and payment of zakat. Also, it was very important for those individuals conducting business, specifically entrepreneurs to develop a writing and bookkeeping system for accounting operations, to ensure that their acts were compliant with Sharia law.

The formal introduction of accounting books, concepts and procedures occurred during the time of the second Caliph, Umar bin al-Kattab, who ruled between 634-644 CE (Parker,1993).

Since the development of accounting in the Islamic state was associated with zakat, its formal establishment was initiated for government purpose. Namely, it was implemented for the recording of Public Treasury revenues and expenses (R. Haniffa et al, 2004).

The accounting system developed and practiced in the Islamic state can be divided into 7 types (R. Haniffa et al, 2004):

- Stable Accounting;
- Construction Accounting;
- Rice Farm Accounting (Agricultural Accounting);
- Warehouse Accounting;
- Mint Accounting (Currency Accounting);
- Sheep Grazing Accounting;
- Treasury Accounting.

The mandatory recording procedures helped the development and implementation of accounting system in the Islamic state. Some examples of recording procedures developed and applied by government authorities, as well as individual entrepreneurs, include (Ambashe and Alrawi, 2013):

- Transactions had to be recorded immediately, as soon as they occurred.
- Transactions had to be classified according to their nature.
- Receipts were recorded on the right hand side of the page (sources of these receipts also needed to be disclosed) while payments were recorded on the left hand side (with explanations).
- No spaces were to be left between transactions.
- Corrections, overwriting or deleting recorded transactions was prohibited.
- Monthly and yearly report had to be prepared.
- Yearly reports were reviewed and compared to prior year reports (auditing).

As it can be seen, the above procedures were implemented for diminishing the risk of fraud and manipulation and for enforcing some sort of accounting control.

Preparing of annual and monthly financial statements was mandatory, while budgeting was utilized as an internal control procedure for analysing and interpreting these financial statements. Therefore, we can notice that even audit was practiced and became mandatory to ensure the rightful implementation for a complete accounting system. Even though the accounting was practiced by the Islamic state from the early stages, the term accounting and accountant was not known at that moment of time. It is unknown when these terms were introduced, but it is possible that their occurrence coincides with the influence of colonization and introduction of western culture to the Islamic state in the 19th century.

After the fall of Islamic state in the 19th century, islamic economics saw a decline, where the conventional accounting system dominated overall in the world economics. Colonization of muslim in the 19th century represented adjustment to the western influence from a cultural point of view, to every aspect of the social life, even to the accounting practices. Even those majority muslim populated countries which were not colonized, like: Saudi Arabia, Afghanistan and Iran, had a significant western influence. The Ottoman Empire was influenced by german accounting principles and even the Wahhabi[1] influenced Saudi Arabia borrowed its accounting practices from the west (Naser and Nuseibeh,2003).

After the second world war, in the post-colonial period, muslims around the world were left with the dilemma if they should stay with the western accounting practices already embedded in their society or to adopt back islamic accounting practices.

Thus, islamic economics started to develop in the modern era in parallel with conventional economics, especially during the time of the islamisation, like Pakistan and Iran and in the Middle East after the price of petrol rose significantly in the early '70s. The increased need to set up islamic financial institutions and banks it led to the need for an accounting system which should be appropriate for those institutions and should understands the objectives of Sharia law. The first reference of islamic accounting in a literature writing in english language was in 1981, when Abdel-Magid proposed a tentative theory about islamic banks accounting practices (Napies, 2009).

Hence, islamic accounting in the modern context can be defined as accounting process which provides the necessary information to stakeholders enabling them to ensure that their entity is continuously operating under Islamic or Sharia Law, while fulfilling its socio-economic objective (Abel-Karim, 1999).

The islamic accounting principles are (Sultana, 2015):

- Islamic accounting must be interest free system as it is prohibited according to the Sharia law.
- This system must be transparent in recording transactions and there must be an efficient accounting system.

[1] Wahhabi – is a form of faith derived from islam; pursues literal interpretation of Quran

- Islamic accounting system should avoid income from gambling or any other unlawful business.
- Business transaction should be material and both the rights and obligations should be ensured
- Fairness and justice for all the related parties should be ensured under islamic accounting.

Principle objectives of islamic accounting are:

- Protection of funds intact and declaration of shareholding by all parties involved. Without registration of transactions we cannot determine which transactions are on the credit side and which are on the debit side.
- Establishing justice and preventing doubt.
- Helps to judge between stakeholders.
- Helps to establish financial results (profit and loss) on a specific period of time.
- Accounts the amount of zakat for a period of time and its distribution.
- Determine the structure of the shareholding in the islamic companies as per islamic laws.

3. Sharia law features and islamic accounting nature

Trade plays an important role in islam. Sharia law explains the way in which trade and business needs to take place from a legal perspective, and if they are acceptable by law (halal) or prohibited by law (haram).

The principles of trade governance and business governance in islam are defined by Sharia law, which defines even muslims' life. The sources of Sharia law are divided into 2 categories, the first one being the Quran and Sunnah (tradition) and second one, scholars' interpretations of islam.

The status of women in society defers in the whole world. Amongst various important characteristics associated with the inequality between men and women we can list the culture, tradition, social practice and religion. Contrary to the view of outsiders who misconceive islam as subjugating women, Quran regards both genders as equal in terms of moral responsibility, rewards and punishments. All too often, incorrect interpretations or selective reading of the Quran lead to impression that Islam subjugated women (Engineer, 2008; Hartman, 1914; Zayzafoon, 2005). Islam does not give man dominant status over women; rather, this religion treats both men and women equally. Engineer (2008) contends that Islam gives equal rights to man as well as women to contract, to enterprise, to earn and equal pay. This view point is consistent with Hartman's (1914) view that any property acquired by the woman through her own efforts our through inheritance belongs to her independently. This means that a husband can only intervene in managing his wife's wealth only with her permission.

The Quran explicitly states the equality between men and women in front of God. Furthermore in Quran are mentioned the following aspects:

- Forbids female infanticide;
- Instructs muslims to offer education to its children, daughters as well as boys;
- Insists that women have the right to refuse a potential husband;
- Offers women the right to divorce from their husbands in specific cases;
- Offers rights to women which are divorces by their husbands;
- Offers women the right to own or to inherit a propriety;
- While polygyny is allowed, is not encouraged and is less practiced the imagines in the west. The most is frequent in the Arabic Gulf, especially in Saudi Arabia.

The veil worn by muslim women is seen most of the time by the west as a symbol of subordination position in society, but in fact the significance and the use of vail varies a lot in muslim societies. Quran encourage men and women to have a decent wear, but the actual interpretation and implementation of this rule varies a lot from one country to another. In modern society, stricter rules regarding women's clothing are mostly applied to evidence religious orientation of a specific state, like Saudi Arabia or Iran. On the other side in Turkey, women are not allowed to wear the veil in public offices or universities, because turkish government wants to maintain a secular identity.

Throughout the history, women played a very important role in important fields, such as: in policies/strategies making, in politics, in academic environment and in business. With all these, the active participation of women in business and finance is a contemporary phenomenon, which has its roots from western influence with regards to the lifestyle and how the business is organized. In the traditional way, islamic banks and finance have been dominated by men, but starting with past two decades we could see a growth in the numbers of women in these industries. A prominent role in the islamic banking and finance have been taken by women in Malaysia, because apart from the fact that they occupy majority of leadership positions in islamic banks, they play an important role as well in the overall development of islamic financing.

In Middle East area, even if women are thriving in islamic financing industry, just few of them are holding a leadership role. Preconceived ideas of women status in society still affects banking industry, however in the past years we can observe a gradually change in the society mentality in general.

According to islam, a person answers in front of God for all its actions and this philosophy constitute the basis of accounting principles in islam.

Sharia law offers a common source from where instructions about what is considered to be business ethic practices in islamic accounting are emerging. A very important aspect of business ethic practices in islamic accounting is the scope behind all activities and intentions of the involved parties.

Islamic accounting relies on 3 general principles and values: Responsibility, Justice and Truth (Trokic,2015).

Baydoun and Willet differentiate the principals and philosophies of western accounting to the islamic accounting, based on the below:

Characteristics	Convetional accounting system	Islamic accounting system
Philosophical viewpoint	• Economic rationalism	• Unity of God
Principles	• Secular • Individualistic • Profit maximisation • Survival of the fittest • Process concentration	• Religious • Communal • Reasonable profit • Equity • Armony with the environment
Criteria	• Based upon modern commercial law- permissive rather than ethical • Limited disclosure (provision of information subject to public interest) • Personal accountability (focus on individual who control resources)	• Based upon ethical law originating in the Islamic law • Full disclosure (to satisfy any reasonable demand for information accordance with Islamic law) • Public accountability (focus on the community who particpate in exploiting resources)

4. Zakat accounting

In islamic accounting one of the most important requirements for all muslims is to pay a religious "tax", called 'zakat". Zakat is one of the five pillars of islam alongside prayer, fasting, mercy and pilgrimage to Mecca (Tayob, 1999). Zakat has three different connotations, namely from a linguistic, theological and legal standpoint. From a linguistic point of view, zakat means purification or cleansing from something filthy, but in the same time means also praise, growth and increase. From a theological point of view, zakat means spiritual purification as a result of its payment. From a legal point of view, zakat means transfer of ownership of wealth of a specific person to individuals under special conditions.

Zakat has a socio-economic objective, through which muslims are obliged to pay this "tax" which represents a surplus from their wealth, to the needy people. Zakat makes part of a social system of islamic and its social objective is to act as a mechanism for wealth distribution from wealthy to needy, which reduce the social gap between rich and poor.

Zakat represents a mandatory payment, however is not consider to be a charity, nor a tax, because the charity is consider to be volunteered and taxes can be determine by the government for payment of any other purpose.

Thus, zakat is distinguished by taxation through various elements, as follows (Rahman, 2010):

	Zakat	Taxation
Concepts	• Source of regulation is Sharia law • Levy sanctioned by God only on the muslims • Rated and distribution are specified	• Source of regulations is determined by the government of the time • Levy sanctioned by government on its citizens • Rate and distribution is subject to government fiscal policy and changeable
Legal Impact	• Both zakat avoidance and evasion are not in line with the true spirit of zakat • Compliance is voluntary and non-compliance is subjected mainly in the Hereafter	• Tax avoidance is allowed but tax evasion is an offence • Non-compliance is a punishable offence according to the tax law
Economic and Social Impacts	• Integral part of social security system and part of a broder islamic economic system and fiscal policy • No such transfer of burden	• Source of public finance and tools of state's fiscal policy • If not efficiently handled, tax burden may be shifted to the public, which in turn may adversely affects the economy
Ethical and Spiritual Impacts	• Spiritual implications and mode of worship • Religious duty and the payer pays zakat as an act of submission to God	• Focuses mainly legal and economic implications • A financial responsibility towards state

From a conceptual point of view, zakat is first of all muslims' religious debt, and then a national debt, where else in the case of taxation the concept is of a national debt. From a legal perspective, zakat is regulated by Sharia law, where else taxes are regulated by laws created by humans which can modify as per the state/government changes and/or economic changes. Zakat benefits are determined by the main source of the law in islam, which is Quran.

In muslim states, the state can impose taxes in addition to the zakat payment when is necessary. When governemt does not have enough funds to offer to its population the basic necessities, like health, defence, education etc. then the taxes are becoming mandatory.

Fundamental principles of Zakat

In zakat practice should be followed various fundamental principles, as follows:

- The wealth must be owned individually and legally. State of public wealth, donations and charitable proprieties are not part from zakat calculation;
- In determining of zakat value of payment, the wealth must be evaluated at the current market value, in order for the most relevant value to reflect;
- When zakat is evaluated, the calculation method must be detailed and accepted by both parties: the zakat collector and zakat payer. Zakat payer must be honest and to disclose all his/her financial situations.

Zakat must be collected just for specifics types of wealth. These types of wealth are mentioned in the Quran and utilized by people even from the Prophet Mohammed times for storage and distribution of the wealth as follows: Agricultural products; Mineral and marine products; Gold, jewelleries and notes; Commerce products; Animal products.

In addition, there are other categories of wealth which are subject to zakat, but which are consider to be 'modern' wealth which were also extracted from Sharia law after interpretation of islamic scholars, having as reference the evolution and changes in society and economy and the way of obtaining a wealth. Few examples will be:

- Revenues from exploitation of goods;
- Revenues from employees' wages;
- Securities, as shares, bonds, sukuk[1] etc;
- Assets of banking financial institutions.

Zakat becomes mandatory when 2 of the underlying conditions are met, which are nisab and haul.

The term 'nisab' represents the minimum value of wealth when the zakat calculation and payment is applied. For determining the nisab there are available two measurements: gold and silver. The nisab value in gold is almost 87.48 grams or the gold equivalent in cash at the market value. The nisab value in silver is 612.36 grams or the silver equivalent in cash at the market value.

The term 'haul' means that the cumulated wealth must be in the possession of the beneficiary a whole year before to be subject to zakat payment.

The percentage of zakat payment is defined by the Sharia law and is different from one activity to another:

- Gold, paper currency and jewelleries – 2.5%;
- Agriculture products (non-irrigated land) – 10%;
- Agriculture products (non-irrigated land) – 5%;
- Total annual assets of the industrialists and businessmen – 2.5%;
- Mineral products – 20%;
- Farmers are paying as per the number of livestock owned each year.

5. Zakat accounting for companies

For companies/businesses Zakat must be paid once a year, and the applicable rate is 2.5%.

Zakat is applicable to all types of businesses, even if their purpose is profit generation. Fixed assets of companies, like buildings, furniture, vehicles etc, are not part of zakat calculation.

[1] Sukuk- is a Islamic financial certificare as per Sharia law, ehich is similar to a bond in western finance

Zakat is calculated based on one of the two methods:

- Direct method
- Indirect method

The calculation procedure of each method is different, same as the calculation basis, however the final result should remain the same as long the calculation formula is applied correctly.

Direct method:

Zakat base = All assets subject to Zakat payment – All current liabilities (Commercial liabilities)

Indirect method:

Zakat base = All sources of internal funds (Shareholders' equity, provisions and adjusted net profit of the current year) + external sources of funds not exceeding deductible assets (long-term liabilities and liabilities that are known to have financed deductible assets) – non-zakatable assets – zakatble assets, or adjusted net profit for the year, whichever is higher

Assets		**Liabilities and shareholders' equity**	
USD		USD	
Current assets	9,000	Current liabilities	6,000
		Long term liabilities	7,000
Long term assets (Buildings and equipments)	8,000	Shareholders' equity	4,000
Total	17,000	Total	17,000

Indirect method of Zakat base calculation:

Article	USD
Long term liabilities	7,000
Shareholders' equity	4,000
Minus: **Long term assets**	(8,000)
Total	3,000

Direct method of Zakat base calculation:

Article	USD
Current assets	9,000
Minus: Current liabilities	(6,000)
Total	3,000

Payable Zakat = 3,000 x 2.5% = 75 USD

6. Conclusions

To conclude, this paper provides a wider opinion of Islamic accounting system evolution, as well as its purpose in Islamic society. More than that presents a comparison between the Islamic and conventional accounting system, where one of the basic differences between the two is the way the information is supplied. In Islamic accounting all information is supplied from a clear perspective, where else in conventional accounting the information provided is selective. We can understand that the values in islam, like honesty, honour, truth are much more important and have a bigger value in Islamic accounting system, comparing to the conventional accounting system. If Islamic values are strictly followed, then it can drive a decline in the fraudulent practices and other suspect activities. Furthermore, will increase the social welfare of involved parties, because islam requests people to offer as much benefit as possible to the community. If Islamic accounting is followed in an appropriate manner will lead to an accounting process based on truth, justice, fairness, benefit, honesty and confidence.

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