

Conventional Accounting vs. Islamic Accounting: A Comparative Study

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ABSTRACT

This paper is to explore the contradictions between conventional accounting and Islamic accounting. The conflicts between the two accounting systems need to be disclosed since they are widely different. But people, in most cases, treat them synonymous i.e. some of them, irrespective of religion, think that the term 'Islamic Accounting' is nothing else but just by adding the word "Islamic" with the term 'Accounting'; so that it looks more religious. In fact, there are huge differences between the two accounting systems which can be seen in their objectives, activities, accountabilities, disclosure practices and so on. Basically, people are segregated into two groups, viz. some of them want to get benefit from the accounting as the traditional accounting provides. But some of them, on the contrary, expect some additional advantages - especially by the Muslim, in line to their religion - along with the regular benefits offered by the conventional accounting. Conventional accounting, however, is enough for the first group; but the demand of the second group can be addressed only by the Islamic accounting. This paper is to help people knowing the differences between two accounting systems so as they realize the impacts of existing contradictions between two systems of accounting and can cope themselves with the system which one serves them best.

Key Words: Islamic Accounting, Shariah Accounting, Accounting, Conventional Accounting

1. INTRODUCTION

It is widely accepted that the primary objective of accounting is to provide information to its interested users in making necessary economic decisions [1]. It is also recognised that, human welfare - to a great extent - is ignored here. If so, then what's about the term 'accountability' - a religious obligation, related to the term accounting? The rule of accountability is purely divine. So, an appropriate accounting framework based on Shariah principles should be in place to serve the objectives of accounting and accountability as well. The motivation for development of Islamic accounting comes forward with the emergence of Islamic economic and Islamic resurgence for the last few decades. The consciousness for the need of Islamic accounting is due to the basic building blocks of traditional accounting itself, since the International Financial Reporting Standards (IFRS) are based on interest-based elements. As an alternative accounting system, Islamic accounting

has gained more recognition, especially by the Muslims. However, Islamic accounting as a whole is very much capable to serve all of its stakeholders. Its divine principles serve not only the interest of any particular entity or group, but also the society as well [2].

2. OBJECTIVES OF THE STUDY

The main objective of this study is to broaden one's knowledge-base by discussing and sharing the existing contradictions between conventional accounting and Islamic accounting. More specifically the objectives of this study are as follows-

- To explore the contradictions between conventional accounting and Islamic accounting.
- To examine the impacts of existing differences between two systems of accounting so that one can cope oneself with the system which serves him/her best.

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3. LITERATURE REVIEW

The article 'Contribution of Islamic Accounting System to the Commercial Organizations' determines the importance of the Islamic Accounting in the current economic world and the paper analyzes the values of the Islamic principles in the accounting process that prevent the unexpected activity such as fraud, dishonesty etc. to appear in reality. The paper evaluates the Islamic accounting system as a successful and proven accounting system for all the organizations. Furthermore, this paper attempts to make clear distinction between values underlying the Islamic accounting and that of the conventional accounting system [3]. The article 'Islamic Accounting; History, Development and Prospects' discusses the history of Islamic accounting from its emersion to its subsequent development and expected growth in the future. In doing so, the paper analyzes the historic influence of Islamic accounting over its conventional counterpart which dominates the industry today. Moreover, it provides an analysis of the similarities and differences between Islamic and conventional accounting from both a theoretical and practical perspective [4]. The article 'Conventional accounting vs Islamic accounting: the debate revisited' evaluates the arguments that the assumptions underlying conventional accounting are incompatible with Islamic values, hence the need for new accounting. The paper adopts an analytic approach based on a combination of archival and bibliographic data sources. It is shown that this belief of incompatibility can be traced to misconceptions about the assumptions underlying "conventional accounting". It is then argued that the neglect of Islamic accounting in Islamic countries could be attributed to Islamic accounting not meeting the needs of users rather than acculturation or economic dependency [5]. The article titled 'Islamic accounting' showed that there are different goals for Islamic accounting such as Usefulness for decision-making, accountability, Islamic responsiveness and accountability through Zakat. In this regard, accounting features are focused on measurement and disclosure. In the field of measurement, dominant opinion is that, for the purposes especially determining

Zakat, we should use the current values. In disclosure aspect, the emphasis is on following the Sharia and providing the required information, especially in the field of social responsibilities [6]. The article titled 'Accounting Measurements: Islamic Perspective versus Financial Accounting Perspective' identified the accounting measurement as stated in Islamic thought, and contemporary financial accounting thought. To achieve this objective, required data were collected through documents as a major tool of data collection. The results of the analysis of the Islamic accounting theoretical framework has shown that most of the items of financial statements that are subject to Zakat system are assessed at the current market value, and the remaining asset values are evaluated at the current values at the time of liquidation in case of musharakah, mudarabah or murabaha, or other types of Islamic sales [7]. The article 'The Need of Accounting Standards for Islamic Financial Institutions' discussed the Islamic accounting standards through a review of the literature. Overall, the evidence reviewed suggests that the need of the Islamic accounting standards to fill the gap in the Organization of Islamic Conference (OIC) countries. This paper concludes with various recommendations for future research, the most important of which is the need for future studies to be done to implement the Islamic accounting standards [8]. The article titled 'The Conceptual Framework of Islamic Accounting' conducted a study to serve the objectives pursued by the conceptual framework of Islamic accounting based on Quran, which is in line with Sharia emphasizing ordinances and laws originating from Quran such as justice, kindness, ethics, contracts and Zakat. Furthermore, it challenges the economy developed by cruelty, hoarding, usury, and destruction of social and moral principles. Finally, it should be noted that traditional accounting plays a helpful and reasonable role for corporate accountants and auditors [9]. The article titled 'Accounting in Islamic Perspective: A Timely Opportunity, A Timely Challenge' presented a review of the literary achievements made in the field and the areas of current focus. Although the field carries a huge growth potential, the author argues that there are

several challenges and problems that the proponents of Accounting in Islamic Perspective (AIP) will face as the field develops further. This paper outlines these problems and challenges and makes suggestions to surmount the potential pitfalls. It is argued herein that, in order to develop AIP as a formal discipline and integrate it within real-life business practices, the research efforts need to be more organized through an international consortium of researchers [10]. The article 'Theoretical Bases of Islamic Accounting and Challenges Ahead' shows economic, social and political environment differences of Islamic countries has made some of the Islamic researchers, those who believe that fundamental assumptions of prevalent financial accounting system is not compatible with Islamic values and beliefs, to seek Islamic conceptual framework and accounting standards with an optimistic attitude. Regardless of whether it is possible to value accounting science or not, profound investigating of the matter will blazon this standpoint unrealistic [11].

4. METHODOLOGY OF THE STUDY

This study is descriptive in nature and no quantitative tool has been used to analyze the data. The study is basically based on secondary data and information related to traditional and Islamic accounting which has been gathered from various books, journals, newspapers, research papers and also from a good number of websites.

5. CONVENTIONAL ACCOUNTING

Accounting is an information system that identifies, records, and communicates the economic events of an organization to its interested users [12]. And this communication is generally in the form of financial statements and in monetary terms under the control of a proper management. Traditional Accounting process aims to help economic decision making whose ultimate purpose is to efficiently allocate scarce resources in some profitable ways. Therefore, the accounting systems which identifies, measures and records the financial aspects of an entity and communicates the

information - without any compliance to Islamic Shariah - to the interested users is termed as 'Conventional Accounting.'

6. ISLAMIC ACCOUNTING

The type of accounting which sets its goals and performs all of its operations to achieve those (goals) ethically and objectively within the limits and boundary of Islamic Shariah is known as Islamic accounting. In other words, the accounting system which identifies, measures, records and analyzes the financial aspects of an entity on the basis of Islamic Shariah is termed as 'Islamic Accounting'. In fact Islamic accounting is such an 'accounting process' which provides necessary financial and non-financial information to the stakeholders of an entity, which will ensure that the entity is continuously operating within the bounds of the Islamic Shariah [13]. Islamic accounting is a great tool, which enables the Muslims to evaluate their own accountabilities to Allah (SWT), the Almighty.

7. CONFLICTS BETWEEN CONVENTIONAL ACCOUNTING & ISLAMIC ACCOUNTING

7.1 Origin of Accounting:

Conventional accounting comes from the economic rationality i.e. it is a human made system, while Islamic accounting fundamentally comes from Allah (SWT), the Almighty, which is designed to respect the rights of others and avoiding misuse of other people's property, Just as Allah (SWT), the Almighty, states in Quran, "O ye who believe! Fulfill (all) obligations." (Al Qur'an: Surah Al Mayeda, Ayat: 01) or somewhere else "O ye who believe! Eat not up your property among yourselves in vanities," (Al Qur'an: Surah An-Nisa, Ayat: 29). Hadith is the second source and Islamic doctrine, however, is also the indispensable part of Islamic accounting.

7.2 Objectives of Accounting:

Conventional accounting is a process, which objective is to ensure optimum utilization of scarce resources restricted to profitable activities through available information in the market which is incompatible with

Sharia Law. Islamic accounting, however, is a process, which objective is to ensure transparent, adequate and accurate financial information of an organization and the process is compatible with the Sharia law as well as social and economic regulations.

7.3 Nature of Accounting:

In conventional accounting, human relations are firmly tied with profitability. In Islamic accounting, however, social relationships, human beliefs and recognition of humanity in the legal context of Sharia ensure a healthy society and keep economic-political leverage away from the hand of wealthy people [14].

7.4 Procedural consistency:

Conventional accounting is carried out based on the 'Generally Accepted Accounting Principles' (GAAP), while the focus of Islamic accounting is on divine commandments presented by the Holy Quran, Hadith and Islamic doctrine.

7.5 Responsiveness:

Islamic accounting is responsive to face some fundamental economic issues by the help of its Shariah law, while conventional accounting has no much headache on those. For instance, a portion of goods and services are prohibited by Islam, such as trading alcoholic drinks and committing usury. According to Islamic accounting, such goods should not be produced or traded and Islamic accounting is very much transparent about it. In conventional accounting, however, this types of economic activities can take place regardless of Sharia law and order [15].

7.6 Production method:

Islamic accounting adopts production methods that are not detrimental to society and also employs production resources in a waste-less way and safe those for future production. Such method, however, has nothing to do with capitalist economy i.e. in conventional accounting where maximum production for maximization of personal satisfaction is a regular practice.

7.7 Distribution of goods and services:

In an Islamic environment, there are certain regulations regarding service or income distribution. According to such regulations, the national income is shared by the entire segments of a society, whether or not capable of earning money. In conventional accounting or capitalist system, however, there are no such specific regulation to impose circulation of wealth in a society, and the capital is stored for the benefit of a certain group

7.8 Earning profit:

Conventional accounting involves materialism, profit and wealth maximization regardless of legitimacy of contracts (without considering halal and haram), while Islamic accounting takes into account the optimum profits, and legitimacy of contracts based on Sharia principles [16].

7.9 Propagation of Zakat:

Transactions in Islam are founded upon adherence to commitments and respecting people's rights with avoiding misusing other's property. Allah (SWT), the Almighty, states "O ye who believe! Fulfill (all) obligations". (Al Qur'an: Surah Al Mayeda, Ayat: 01). The purpose of Sharia is to maintain a balance between needs of human being through establishment of various standards such as justice, honesty, perseverance, spirituality, and ethics. Accordingly, it is essential to offer proper guidelines for economic prosperity. The Islamic Sharia practices economic power in a way that ensures benefits the entire aspects of human life, and all segments of a society. Allah (SWT), the Almighty, states "Believe in Allah and His messenger, and spend (in charity) out of the (substance) whereof He has made you heirs." (Al Qur'an: Surah Al Hadid, Ayat: 07) Moreover, one of the objectives of Islamic economy is that wealth should not be amassed in the hands of one or several individuals, but it should be distributed in the society, so that the distinction between the rich and poor fades away. But unfortunately, zakat is not so much propagated in other societies as well as in conventional accounting system.

8. CONFLICTS REGARDING ACCOUNTING ASSUMPTIONS

There are several assumptions in accounting act as the basis of financial operations those are generally accepted as true. By studying those assumptions, efforts are made to examine the principles of conventional accounting from Islamic perspective; a few of them are as follows-

8.1 The assumption of continuing activity:

This assumption implies that an economic unit will continue its activity for an unknown and unlimited future time. Moreover, the assumption is also the basis for classification assets and liabilities into current and long-term types. The process of measuring cost instead of current value for assets is also influenced by this assumption. But a fact is that, the calculation of zakat is conducted based on the current value of assets which is challenging this assumption to a great extent [17].

8.2 The assumption of measuring unit:

This assumption implies that entire financial transactions and operations should be measured, assessed and reported based on money. In practice, however, the actual value of money is lowered due to inflation over time. The increased prices and weakened purchasing power has turned this opportunity into the most controversial assumption in accounting.

8.3 The assumption of financial period:

The final result of an economic unit should be determined at the end of the operation or as soon as the activity completed. From the Islamic viewpoint, however, zakat is levied when a property is kept for one year. So, for determination of zakat this assumption of conventional accounting is not valid.

8.4 The assumption of commitment:

According to this assumption revenues and expenses should be identified and recorded when they take place. In contrast, there is another approach known as 'cash basis' of accounting, which is not allowed by the Generally Accepted Accounting Principles (GAAP) or International Financial Reporting Standards (IFRS),

where income and expenses are recordable when they are received or paid. Zakat is calculated on a cash basis, and the assumption of commitment for calculation of zakat is contradictory to conventional accounting [18].

8.5 The disclosure principle:

According to Islamic views disclosure can be (a) Full disclosure and (b) Social accountability. The concept of accountability is associated with full disclosure aimed at safeguarding the interests of stakeholders in the framework of Islamic content. Based on such thinking, all the information of an entity should be disclosed in financial statements. Traditional accounting emphasizes information needs, while Islamic accounting emphasizes moral accountability.

8.6 Conservatism (restrictive convention):

In conventional accounting it has been argued that precautionary measure does not lead to hidden reserves. Reporting the assets and incomes of an entity lower than the reality, or reporting the expenses and debts higher than the actual violates neutrality and reliability of financial information. This concept is contradictory with the principles of Islamic accounting, which also hinders the calculation of Zakat. In fact, the current value of assets justifies the calculation of zakat.

9. FINDINGS & RECOMMENDATION

The study shows that there are huge conflicts between conventional and Islamic accounting and keeping all the conflicts in consideration the paper revealed that the Islamic accounting serves better and ensures comprehensive welfare to the users of accounting than the conventional accounting. So, as a part of muamalah connection, Islamic accounting can be the best way of practicing accounting, especially by the Muslims.

10. CONCLUSION

The conventional accounting, though it is progressively profitable for a group of people and practicing by the large number of users all over the world, still contains numerous of weakness because of its man-made features. So, it is necessary to encourage the business

entity to practice Islamic accounting as it brings benefit not only for the concern but also for the whole society. Islamic accounting can be the way of real ethical practice that can restrict the conventional accounting which only serves for the welfare of a few number of people.

NOTES

Qur'an: The fundamental religious text of Islam, which the Muslim believes to be a revelation from Allah (SWT), the Almighty.

Hadith: Hadith are various reports describing the words, actions, or habits of the prophet Muhammad (S).

Shariah: Islamic rules and regulation for the Muslim, supported by the Holy 'Quran' and 'Hadith'.

Halal: Complied with the Islamic Shariah. It simply means that something is lawful or permitted for the Muslim.

Haram: Activities which are sinful, unlawful and prohibited by the Shariah.

Zakat: Zakat is a form of alms-giving treated in Islam as a religious obligation or tax,

Muamalah: Commercial dealings and civil acts under Islamic law.

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