

**UNIVERSITY OF HULL**

**ACCOUNTING IN INDONESIA - A STUDY  
OF THE IDEOLOGICAL INFLUENCES ON WESTERN AND  
ISLAMIC ACCOUNTING THOUGHT AND PRACTICES**

being a Thesis submitted for the degree of Doctor of Philosophy  
in the University of Hull

by:

**Bambang Agus Pramuka**

BSc. in Accounting, Gadjah Mada University, Indonesia, 1984  
Sarjana in Accounting, Gadjah Mada University, Indonesia, 1986  
M.A. in Accounting, University of South Australia, Australia, 1993

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## ABSTRACT

This study tries to document and review the ideological-environmental factors surrounding the conventional accounting concepts in the Western, with reference to the US, UK and the IASC's conceptual framework, and to examine the influence of such factors on accounting concepts. It is found that the conventional accounting concepts find their justification from the Western ideological-environmental system, including ideological, political, economic, legal, social, and cultural systems. Therefore, it is argued that the conventional accounting system would not be suitable for a different ideological-environmental system, such as an Islamic or Indonesian system.

The study then examines ideological-environmental systems and concepts according to Islamic teaching (the *Shari'ah*) and according to the Indonesian ideology of *Pancasila*. Examining the conventional accounting concepts from the Islamic point of view, it is found that it is difficult to justify the adoption of the conventional accounting concepts. The study then suggests accounting concepts which better reflect Islamic values.

The study also reveals that the environmental system and concepts according to *Pancasila* ideology are closer to the Islamic system and concepts, rather than to the Western ideological system and concepts. Therefore, it is suggested that Indonesia should reconsider the adoption of the Western (i.e. IASC) accounting system as the ideological logic underlying it is not appropriate in the Indonesian context. For this reason, and the increased demand for 'Islamic' accounting due to the blossoming of Islamic banks, financial institutions and insurance (*takafol*) as a result of the re-assertion of Islam in the political, economic and social spheres in Muslim societies, it is suggested that the development of accounting standards and knowledge in Indonesia be directed to the adoption of an 'Islamic' accounting system.

A small survey has been conducted to find out the perceptions of Muslim 'accounting lecturers', as they are so far the main actors in the Indonesian accounting standards development, regarding the above issues. It was revealed that most of them believed that the accounting system is strongly influenced by its surrounding ideological-environmental systems. Most of them also believed that an Islamic ideological system and concepts would be significantly different from the Western ideological system and concepts, so that 'Islamic' accounting would also be different from the Western conventional accounting system and concepts. However, contrary to the belief that the Indonesian ideological systems and concepts are different from the Western, most of them still believed that the IASC's accounting concepts are acceptable.

Recommendations are proposed to the authorities responsible for accounting education and accounting standards setters in order to increase the awareness among academicians, policy makers, and the society as a whole regarding the importance of having an accounting system which reflects the national ideology and philosophy.

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## Abbreviations

AAA	= American Accountant Association (USA)
AAOIFI	= Accounting and Auditing Organization of Islamic Financial Institution
AARF	= American Accounting Research Foundation
AIA	= American Institute of Accountants (USA)
AICPA	= American Institute of Certified Public Accountants (USA)
APB	= Accounting Principles Board (USA)
ARS	= Accounting Research Study (USA)
ARB	= Accounting Research Bulletin (USA)
ASB	= Accounting Standard Board (UK)
ASC	= Accounting Standard Committee (UK)
ASOBAT	= A Statement of Basic Accounting Theory (USA)
ASSC	= Accounting Standard Steering Committee (UK)
BAPEPAM	= <i>Badan Pelaksana Pasar Modal</i> (Capital Market Executive Board)
BKPM	= <i>Badan Koordinasi Penanaman Modal</i> (Coordinative Agency for Investments)
BMI	= <i>Bank Muamalah Indonesia</i> (Indonesian Muamalah Bank)
BMT	= <i>Baitul Mal wat-Tamwil</i> (an Islamic Financial Institution)
BPK	= <i>Badan Pemeriksa Keuangan</i> (The Supreme Audit Board)
BPRS	= <i>Bank Perkreditan Rakyat Syariah</i> (Shariah Public Credit Bank)
BPS	= <i>Biro Pusat Statistik</i> (The Indonesian Central Bureau of Statistics)
BP-7	= <i>Badan Pembinaan, Pendidikan dan Pelaksanaan P-4</i> (a special body responsible to 'construct, educate and implement' the P-4)
CSIS	= Central of Strategies for Indonesian Studies
CV	= <i>Commanditair Vennotschaap</i> (Partnership)
DGHE	= Directorate General of Higher Education
DPA	= <i>Dewan Pertimbangan Agung</i> (The Supreme Advisory Council)
DPR	= <i>Dewan Perwakilan Rakyat</i> (The House of People's Representatives)

FAOIBFI	=	Financial Accounting Organisation for Islamic Banks and Financial Institutions.
FASB	=	Financial Accounting Standards Board (USA)
GBHN	=	<i>Garis-garis Besar Haluan Negara</i> (State Guidelines)
IAI	=	<i>Ikatan Akuntan Indonesia</i> (Indonesian Institute of Accountants)
IASC	=	The International Accounting Standards Committee
ICAEW	=	Institute of Chartered Accountants of England and Wales
ICAS	=	Institute of Chartered Accountants of Scotland
ICMI	=	<i>Ikatan Cendekiawan Muslim Indonesia</i> (Association of Indonesian Muslims Intellectuals)
IDB	=	Islamic Development Bank
ILO	=	International Labour Organisation
INPRES	=	<i>Instruksi Presiden</i> (the Instruction of the President)
KEPMEN	=	<i>Keputusan Menteri</i> (the Decision of the Minister)
KEPPRES	=	<i>Keputusan Presiden</i> (the Decree of the President)
KUHD	=	<i>Kitab Undang-undang Hukum Dagang</i> (Commercial Code)
LPP	=	<i>Lembaga Penunjang Pasar Modal</i> (Capital Market Supporting Agency)
MA	=	<i>Mahkamah Agung</i> (The Supreme Court)
MPRS	=	<i>Majelis Permusyawaratan Rakyat Sementara</i> (Provisional People's Consultative Assembly)
MPR	=	<i>Majelis Permusyawaratan Rakyat</i> (The People's Consultative Assembly)
PAI	=	<i>Prinsip Akuntansi Indonesia</i> (Indonesian Accounting Principles)
PERMEN	=	<i>Peraturan Menteri</i> (the Minister's Regulation)
PERPU	=	<i>Peraturan Pemerintah Pengganti Undang-Undang</i> (Government's Regulation in Lieu of Law)
PMA	=	<i>Penanaman Modal Asing</i> (Foreign investment)
PMDN	=	<i>Penanaman Modal Dalam Negeri</i> (Domestic investment)
PP	=	<i>Peraturan Pemerintah</i> (Government's Regulation)

PPN	= <i>Pajak Pertambahan Nilai</i> (Value Added Tax)
PPnBM	= <i>Pajak Penjualan Barang Mewah</i> (Sales Tax on Luxury Goods)
PT	= <i>Perseroan Terbatas</i> (Limited liability company)
P-4	= <i>Pedoman Penghayatan &amp; Pengamalan Pancasila</i> (Guidance for comprehending and implementing Pancasila ideology)
SAK	= <i>Standard Akuntansi Keuangan</i> (Indonesian Financial Accounting Standards)
SFAC	= Statement of Financial Accounting Concepts (USA)
SFAC	= Statement of Financial Accounting Concepts
STAN	= <i>Sekolah Tinggi Akuntansi Negara</i> , a special Higher Education Institution set up by the Indonesian Ministry of Finance to educate accountants for governmental offices (Governmental Accountants)
TAP MPR	= <i>Ketetapan Majelis Permusyawaratan Rakyat</i> (the Decision of the People's Consultative Assembly)
UU	= <i>Undang-undang</i> (Law, Act, Bill)
UUPT	= <i>Undang Perseroan Terbatas</i> (Limited Liability Company Act)
UNA	= <i>Ujian Negara Akuntan</i> (National Examination for Accountant)
VOC	= <i>Verenigde Ost-Indische Companij</i> (Dutch East India Company)

# CHAPTER 1

## INTRODUCTION

### 1.0. General Background

Definitions of accounting seem to be changing and developing (if not improving) from time to time. The first official definition is, probably, the one that has been proposed by American Institute of Accountants (1941) in the Accounting Terminology Bulletin No.2 as follows:

“Accounting is the art of recording, classifying, and summarising in a significant manner and in terms of money, transactions and events which are, in part at least, of financial character, and interpreting the results thereof” (AAA 1953, p.9).

This definition focuses on what a group of people called accountants usually do. Most (1982, p.1), states that this is a definition of 'accountancy' rather than 'accounting'. Kam (1992, p.33), on the other hand, argues that the definition does not explain properly what accounting is. There are, he states, also some professionals other than accountants who perform the same functions, such as financial analysts, operation researchers, and so on. However, he did not propose any proper definition.

The second definition was also proposed by the AAA, in what they called *A Statement of Basic Accounting Theory* (ASOBAT), which defined accounting as “the process of identifying, measuring, and communicating economic information to permit informed judgements and decisions by users of the information” (AAA,

1966, p.1). Kam (1992, p. 34), again, criticises this definition as being too broad and general. Accountants are not the only providers of economic information, he argued. This definition is also quite similar to those proposed by the Netherlands Institute of Registered Accountants which defined accounting as “the systematic recording, processing and supplying of information for the management and operation of an entity and for the reports that have to be submitted thereon” (Most 1982, p.2).

The last definition which is used today is probably the one which has been proposed by AICPA in its APB Statement No. 4 (October, 1970) as follows:

“Accounting is a service activity. Its function is to provide quantitative information, primarily financial in nature, about economic entities that is intended to be useful in making economic decisions, in making reasoned choices among alternative courses of action. Accounting includes several branches, for example, financial accounting, managerial accounting and government accounting”.

This definition, however, has also been criticised due to the use of some 'vogue words', such as 'quantitative information' and 'economic decision', and also the phrase 'primarily financial in nature' which has led to an attempt to distinguish between 'financial statements' and 'financial reporting' (Kam 1992, p. 34; Most 1982, p.2). These critics, however, never proposed any proper definition of accounting. Kam only stated that all definitions describe “what accountants do, but the boundaries are fuzzy” (Kam 1992, p.34). No more attempts, since then,

have been made by any accounting associations or individuals to define accounting, even though some conceptual frameworks have been constructed.

Most (1982, p.3), furthermore, states that 'the role of today's accountants has not been clearly spelled out, and their position in society is ambiguous'.

However, Most classifies the role of accountants into three categories, which are:

- 1) the keeper of the firm's records and preparer of financial statements. This is a 'traditional view' which sees accountants as servants of the capitalistic enterprises.
- 2) a person of trust, a professional to whom society can give a variety of tasks knowing they will be performed in the public interest, such as auditing, tax advice, and so forth.
- 3) a technician, that is, one skilled in the techniques of business management and knowledgeable about the organisation and operations of particular industries.

With such roles, the *Accountants' Handbook* (Saliers, 1986) classifies accounting into the following fields: (1) Financial reporting; (2) Tax determination and planning; (3) Independent audits; (4) Data processing and information systems; (5) Cost and management accounting; (6) Internal auditing; (7) Budgeting; (8) Fiduciary accounting; (9) National income accounting; and (10) Management consulting. Most (1982, p.4) adds another field, that is *government accounting*, including *government auditing*.

In general, however, accounting for business organisation usually distinguishes between 'financial accounting' and 'management accounting'. Financial accounting deals with providing financial information about an enterprise



for external users; while management accounting deals with providing information for internal users (management of the enterprise).

### 1.1. Accounting and its environments.

It is believed that accounting systems are influenced by their environments. The environments of accounting are political, legal, economic, social, cultural and other systems. These systems are usually derived from specific philosophical concepts of ideology. Because there are a lot of ideological concepts in the world, different ideologies will inspire different political, legal, economic, social and cultural systems. In turn, there will be more than one accounting system, due to these different environmental factors.

So far, accounting has been developed mainly in Western countries, which have their own specific ideology(ies), so that their environments--political, legal, economic, social and cultural systems--are also specific. Due to some influences, such as colonialism (Engleman, 1962; Heatly, 1979), Western multinational companies (Seidler, 1969), the influence of local professional associations which are usually founded originally by Western counterpart organisations, and aid and loan agencies (Heatly, 1979), etc., Western accounting systems have been transmitted to and adopted by non-Western countries for various reasons. Some of them have ignored the importance of environmental influence on accounting. It is argued that due to the difference in environmental factors between the West and

the developing countries, such a transfer of technology may not work (Perera, 1989, p. 50).

The influence of environmental factors on accounting has been recognised for a long time. Statement of Financial Accounting Concept (SFAC) No.1 of the AICPA, for example, discussed a number of environmental postulates which aspires to deriving the function of accounting, the assumptions regarding the behaviour of the users of accounting information, the accounting entity, the measurement process and the objectives of accounting (Hendriksen 1982, pp. 62-63). Some researchers in accounting, such as Previts (1971), Radebaugh (1975), and Choi and Muller (1984), believe that environmental factors have an influence on accounting. However, they have different opinions in explaining the factors or elements which have direct or indirect effects upon accounting development, both theoretically and practically.

Most studies of the influence of environmental factors on accounting have focused mainly on the cultural factor. The studies conducted by Mueller (1967), Nobes (1983), Hofstede (1987) and Schreuder (1987) considered that culture is an important environmental factor influencing the accounting system of a country. Violet (1983), furthermore, came to the conclusion that in fact accounting is determined by culture. Hofstede (1985), moreover, found that the reason for the lack of consensus across different countries as to what represents proper accounting methods is that their purpose is cultural, not technical (in Riahi-

Belkaoui & Picur, 1991). Some empirical and conceptual studies have also examined the impact of national culture on accounting (Soelsters, 1988; Chevalier, 1977; Acheson, 1972; Alhashim, 1973; Beazley, 1968; McComb, 1979; Belkaoui, 1983).

It is believed that the conventional Western accounting system has been developed based on the ideological-environmental factors of the Western society. It is also believed that the ideological, philosophical concepts and systems in the Western society have been developed based on the concepts of 'materialism' and 'liberalism'. In political terms, the Western system is believed to be 'democratic and liberalistic' in nature. In economic terms, the Western system is always referred as 'capitalistic'. In legal terms, the Western, Anglo-American countries mostly adopt the 'Common Law' system, though some of them combine it with the 'Romano-Germanic' system. In social terms, Western society is believed to be 'individualistic' in nature. The cultural, ethical and moral systems in Western society are also believed to be 'unique', different from other civilisation. Therefore, as far as accounting is concerned, it is argued that the Western conventional accounting system reflects its ideological-environmental systems, so that its applicability to other different ideological-environmental society(ies) such as an Islamic society is arguable.

## 1.2. Problem of the Muslim & Islamic Countries

The end of the colonisation era has been proved by the birth of many independent countries in Asia and Africa continents. Many (if not most) of these new born countries are Muslim countries (countries in which their population are mostly or predominantly Muslims), and some of them, such as Sudan and Iran, have proclaimed themselves as Islamic countries which apply Islamic *Shari'ah* as the ideology inspiring their political, economy, legal, and social and cultural systems. (Refer to Appendix 1)

For Muslims (meaning individuals who have embraced Islam as their way of life), Islam is not merely a 'religion'. It is an '*ad-deen*', which means a 'total way of life'. As an '*ad-deen*', Islam is not only concerned with 'spiritual matters', but is also concerned with all aspects of human life. Islam is not only concerned with faith, worship or morality; but it is also concerned with political, economic, legal, social and other human life matters. Islam is both a religion and an ideology at the same time. Moreover, as the 'primary mission' of the sending of the Prophet Mohammed (pbuh) was to 'perfect human morality' (*al-Hadith*), the moral aspect underlies the whole societal system in Islam.

The Islamic ideological-environmental systems are believed to be different from the Western systems. The social, political, economy, legal, cultural and moral concepts laid down in the *Shari'ah* (Islamic Law) are believed to be divine and unique. For example, the concept of *Ummah* in Islam is believed to be different

from the Western concept of 'society'; it functions as the balance between two extremes of individualism and collectivism, which are the core of the Western social system. The concept of *Shura* in the political system is believed to be different from the concept of 'democracy' in the Western liberal system, and from the 'totalitarian' system of the communist countries. The concept of 'equity' in economics is believed to be different from the concept of 'development and maximisation of utility' of the capitalist system.

The uniqueness of an Islamic community, compared to other cultures or civilisation, is recognised by scholars. Huntington (1993a, 1993b), for example, predicted that after the collapse of the communist system in the Soviet Union, Islam is a new 'paradigm' which may become a 'potential enemy' for the West. Islamic civilisation has its own culture derived from its religious beliefs. Its ideology is manifested in its political, legal, economic, social systems. Therefore, Muslim countries have their own ideological-environmental factors.

In the economic and business world, this has been proven by the blossoming of so many Islamic banking and insurance corporations world-wide, not only in Islamic and Muslim countries but also in Western countries such as the USA and UK. The Islamic values which it has been attempted to apply within the business sectors are the concepts of 'equity and morality'. These concepts mean the universally accepted principles of justice and fairness which, though not

necessarily incorporated in written laws and regulations, do often play an effective role as a source of law (Ali, 1992, p. 30).

One of the main problems currently faced by the Islamic business sectors is the lack of an 'Islamic' accounting system, which should be derived from and oriented to the Islamic environment. Even though *double-entry accounting* has been practised by Muslims since the tenth century (Scorgie, 1994; Hamid et al, 1996), long before the era of Pacioli, it has not been well developed in Muslim countries today. Historically, while Western countries were developing rapidly, most (if not all) Muslim lands remained stagnant--in all aspects of life--under the shadow of imperialism. Only recently, in the twentieth century, are they becoming independent-national states. As new and young countries, they have been left behind by the West in almost all aspects, including accounting.

Some research and studies have also been conducted; however, most of them are conceptual in nature, and concentrate on 'Islamic Banking', which is only one aspect of Islamic Business (e.g.: Tomkins & Karim (1987); Karim (1990a); Hamid, Craig & Clarke (1993)) Others concentrate on the finance and auditing aspect of Islamic banks, and are also conceptual in nature (e.g.: Briston & El-Ashker (1986); Tomkins & Karim (1987); Karim & Ali (1989); Karim (1990b); Siddiqi (1991); and Ali (1992)).

An effort has been made by the Financial Accounting Organisation for Islamic Banks and Financial Institutions (FAOIBFI, which later became AAOIFI,

the Accounting and Auditing Organization of Islamic Financial Institutions)--a private standard-setting body--to regulate externally the financial reporting by Islamic banks. It has published two statements on the objectives and concepts of financial reporting to act as a framework in setting accounting standards for Islamic banks. In doing so, FAOIBFI were faced with two alternative approaches (AAOIFI, 1996, para. 23): (1) to deduce directly from the *Shari'ah*, and (2) to adopt the Western contemporary framework by first filtering through the *Shari'ah*, and then adopting those principles which are suitable and rejecting or modifying those which are not suitable. For various reasons, FAOIBFI has chosen the latter, with some additions specific to Islamic banks.

There are at least two weaknesses of choosing the second alternative. The first is the difference in ideological background between the West and Islam. The difference, as has been discussed in the previous paragraphs, led to differences in the political, economic, legal, socio-cultural, and moral systems. Secondly, in the West itself, the conceptual framework of accounting has been criticised for 'leaving the real world' (Chambers, 1996). As a result, as mentioned by Karim (1995), "the more the FAOIBFI sets accounting standards that incorporate doctrinal (*Shari'ah*) ruling, the less it would tend to find its own theoretical framework (which has been adopted from the West) useful".

From the above background, it is argued that a conceptual or theoretical framework for Islamic accounting should be deduced directly from the Islamic

source--the Shari'ah, instead of adopting from an *alien* system. Therefore, it is interesting to know what accounting would be like if it were based on Islamic environmental factors. A study of the process of developing the Western accounting system will also be useful in order to construct or formulate an Islamic one.

### 1.3. The Problems of Indonesia.

Indonesia is a relatively new and young 'nation state'; it was proclaimed on the 17th of August, 1945. The 1945 Constitution of the Republic of Indonesia has laid down general social, political, economic, legal and cultural principles for Indonesia, based on *Pancasila* as the state ideology, philosophy, way of life and moral system. The *Pancasila*, which literally means 'five principles', is believed to be 'dug out' from the Indonesians' own values, as the crystallisation of values already in being for a long time. Therefore, the political, economic, legal, social, and cultural concepts, as well as moral systems are claimed to be different from those of other society, especially Western society. In the belief that accounting systems are influenced by, and reflections of, their ideological-environmental systems, it is argued that the Indonesian accounting system should be different from that of the West. Therefore, the validity of the adoption of Western accounting systems, i.e. the Dutch system until the 1970s, the American (US) system from the 1970s to 1994, and the IASC's system from 1994 onwards, is questionable (e.g. Pramuka, 1989).



There is also an increased demand for Islamic accounting concepts due to the blossoming of Islamic banks and financial institutions and Islamic insurance companies (*Takafol*) since the 1990s. This is due to the re-assertion of Islam in the political, economic and social spheres among Indonesian Muslims in particular, and in Muslim society world-wide in general. As far as economics is concerned, the total prohibition of interest (*riba*) by the *Shari'ah* has resulted in the use of equity-funding/leasing and instalment sale techniques of financing by the above institutions. In addition, the formal re-institution of *Zakah* (a welfare wealth tax) as a major source of social welfare and public funding, and the general wish of Muslims to abide by the *Shari'ah* in their business dealings, necessitates the search for an 'Islamic' accounting alternative which will meet the needs of this society.

It is also argued, therefore, that because Muslims predominate in the Indonesian population, an Islamic system would be more suitable or closer to the *Pancasila* based system, than the Western system. However, it is probably important to know the perception of 'accounting lecturers' regarding these matters, as they play an important role in the development of accounting (knowledge and standards) in Indonesia, in order to direct the future policies.

#### 1.4. The Objectives the Study

The current Western accounting practice, which is adopted by most Muslim and developing countries, is most suitable for the environment where it has been

developed. Since the environmental factors in Western countries are different from, if not conflicting with Islamic environmental factors, the adoption of Western accounting by an Islamic society is questionable. An accounting system/practice most suitable for an Islamic environment should be developed by considering its own environmental factors. Based on this issue, the objectives of this project are formulated as follows:

1. To identify, examine, document and determine the ideological-environmental influence on the development of the existing 'Western' accounting.
2. To identify, examine, and document the Islamic ideological-environment factors, which are most likely to influence the development of Islamic accounting.
3. Based on the findings of the second objective, to construct/formulate Islamic accounting concepts.
4. To study and evaluate the ideological-environmental factors of accounting and the accounting system currently applied in Indonesia, and compare it with the results of the above objectives.
5. To ascertain the perception of Indonesian accounting lecturers, who are the dominant 'actors' in the development of accounting in Indonesia, regarding the Western and Islamic accounting concepts.
6. To draw conclusions from the study and to make recommendations accordingly.

### 1.5. The Scope of the Study

This study will attempt to explore theoretically the area of *financial accounting*, with an emphasis on the conceptual framework of accounting. The study is conceptual, descriptive and exploratory in nature. It will attempt to construct an accounting system (theory) based on Islamic environmental factors, describe existing conditions in Indonesia from the Islamic point of view, and explore their processes, strengths and weaknesses, and how the environment affects or influences practice. Finally, it will attempt to suggest ways of improving accounting for Islamic business institutions in general, and especially in Indonesia.

In doing so, it first examines the Western environmental/societal (ideological, political, economic, legal, social and cultural) systems surrounding accounting, and their influences on Western accounting concepts. After that, it explores the Islamic concepts and systems, in order to formulate an 'Islamic conceptual framework of accounting'. Lastly, it examines the situation in Indonesia, and the possibility of implementing 'Islamic accounting concepts' there.

### 1.6. Organisation of the Report.

The thesis is divided into five parts, and ten chapters, as follows:

The first part contains the introduction chapter (Chapter 1), which outlines the purpose of the project, and an explanation of the methodology of the research (Chapter 2).

The second part discusses in general the environmental factors surrounding accounting, i.e.: the concepts of ideology, political systems, economic system, legal systems, social and culture systems, in the Western countries, especially in the US and UK (Chapter 3). Then, Chapter 4 discusses the accounting 'conceptual framework' in the US, UK and the International Accounting Standard Committee (IASB)'s conceptual framework.

The third part presents an examination of the Islamic paradigm, in order to identify the Islamic ideological-environmental factors. Chapter 5 introduces Islam and its 'religious' concepts, including: the concept of God, Faith, worship, the spiritual system and the moral system. Chapter 6 explains Islamic concepts related to the political, legal, economic, and social and cultural systems. Based on these factors, a model for Islamic accounting concepts is proposed and discussed in Chapter 7.

The fourth part presents the evaluation of the situation in Indonesia. This includes Indonesian political, economic, legal, social and cultural concepts, and the conditions of Islamic business activities there (Chapter 8). Then, Chapter 9 presents the survey findings and conclusions from the findings.

The last part (Chapter 10) relates all elements of the study, draws overall conclusions and proposes some suggestions for implementation and further research.

## **CHAPTER 2**

### **RESEARCH METHODOLOGY**

#### 2.1. Research Method

To accomplish the purpose of the study mentioned in the previous chapter, library research and survey have been implemented.

##### 2.1.1. Library Research

Intensive library research was conducted to gain knowledge regarding the concepts of accounting and the philosophy underlying them. In the first stage of the library research, the emphasis was put on studying the western concepts of: ideology, politics, economy, legal, social and cultural systems, and their influence on accounting in respect of the conceptual framework. The next stage was in-depth study of the Islamic principles and concepts related to the same aspects (ideology, politics, economy, legal, social and cultural systems). Based on these concepts, by referring to the Western model, an Islamic accounting conceptual framework was proposed. The third up to seventh chapters present the results of this library research.

##### 2.1.2. Survey

The survey was conducted to gain information regarding the perceptions of accounting lecturers in Indonesia toward: accounting and its environment, the

IASC conceptual framework currently adopted in Indonesia, and the conceptual framework based on an Islamic concepts. This has been seen as an important issue by the researcher because:

- The majority (more than 85%) of the Indonesian population are Muslims (BPS, 1995). With this majority, therefore, the main Indonesian ideology should ideally be Islam, or at least contain Islamic values and principles.
- Historically, due to some constraints, Indonesia has adopted Western accounting (Dutch, American, and now the IASC accounting standards).
- Accounting lecturers play an important role in deciding the accounting model to be applied in Indonesia due to the fact that most (if not all) of them should be registered, they are allowed to set up or work as partners of accounting firms, and they are significantly represented in the membership of the *Indonesian Institute of Accountants (IAI, Ikatan Akuntan Indonesia)*. In fact, most of the members of the *Accounting Standard Setting Board* of the IAI are lecturers, as the Board is a part-time committee and lecturers tend to have more spare-time to be involved in it.

## 2.2. Data Collection Strategy

Questionnaires were used to collect data from respondents across the nation. The findings from structured questionnaires were supplemented by interviews where possible. A quantitative methodology for questionnaire analysis was employed to give strength to the study.

### 2.3. Questionnaire Design

The development of the survey instrument was carried out in phases:

#### *Phase 1:*

A thorough review of the literature was undertaken to determine the appropriate concepts to be included, and the design of the research framework which served to guide the desired information and specify the relationships to be investigated.

#### *Phase 2:*

Initial construction of the questionnaire. The conceptual framework of financial accounting, and the philosophy behind the concepts, formed the major sources for survey questions. The questions were grouped into sections:

Section A: The respondents' profile

Section B: Respondents' perceptions toward the relationship between ideology and accounting.

Section C: Respondents' opinions toward the conceptual framework

Section D: Respondents' perceptions toward Islamic accounting

#### *Phase 3:*

Discussions were held with the supervisor, to check on the clarity of the questions, and the appropriateness of the proposed scale. (Refer to Appendix 2 for the Questionnaires).

*Phase 4:*

Survey. On arrival in Indonesia, the researcher spent about two months (April-May 1996) in distributing and collecting the questionnaires. Due to practical constraints, interviews were held only with those respondents residing close to the researcher's base.

#### 2.4. Sample Selection

The target population of this study is accounting lecturers of all State (Government Owned) Universities conducting accounting courses. At the time of the survey, there were 16 State Universities with accounting departments. They are:

1. University Syah Kuala, Banda Aceh (Aceh Province)
2. University Sumatra Utara, Medan (North Sumatra Province)
3. University Andalas, Padang (West Sumatra Province)
4. University Sriwijaya, Palembang (South Sumatra Province)
5. University Indonesia, Jakarta (Capital Territory)
6. University Padjadjaran, Bandung (West Java Province)
7. University Diponegoro, Semarang (Central Java Province)
8. University Jenderal Soedirman, Purwokerto (Central Java Province)
9. University Sebelas Maret, Surakarta (Central Java Province)
10. University Gadjah Mada, Yogyakarta (Yogyakarta Province)
11. University Airlangga, Surabaya (East Java Province)
12. University Brawijaya, Malang (East Java Province)
13. University Lambung Mangkurat, Banjarmasin (South Kalimantan Province)
14. University Hassanuddin, Ujung Pandang (South Sulawesi Province)
15. University Udayana, Denpasar (Bali Province)
16. STAN (Sekolah Tinggi Akuntansi Negara), special Higher Education Institution set up by the Ministry of Finance to educate accountants for governmental offices (Governmental Accountants)

The sample was chosen as follows:



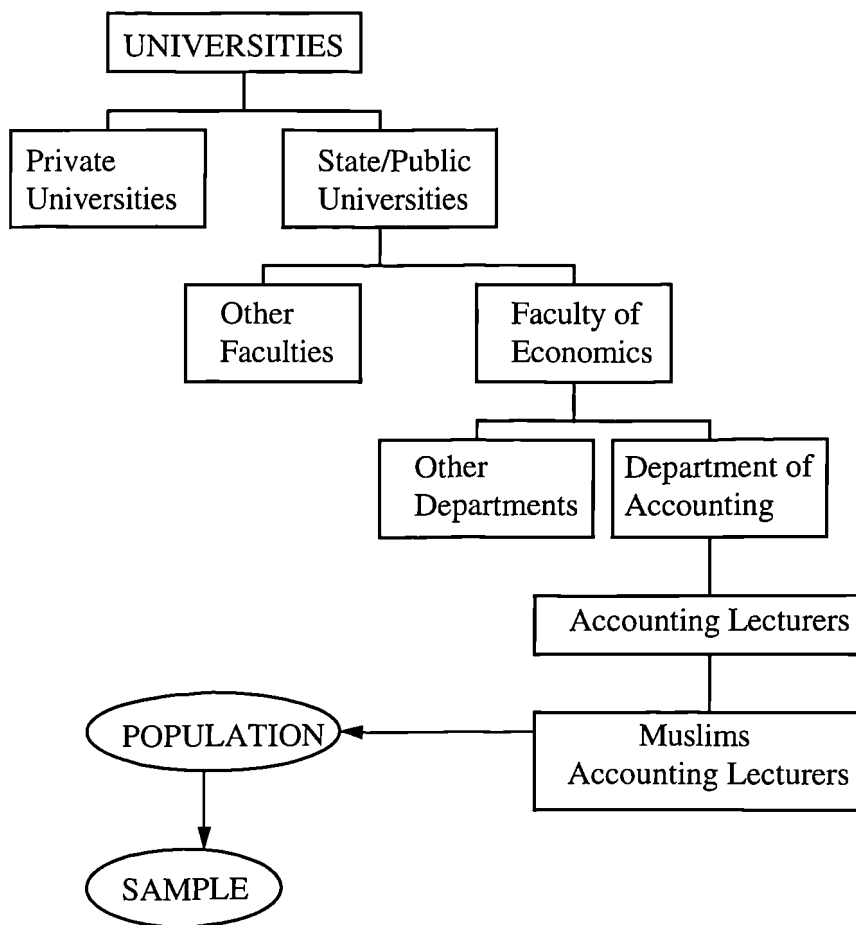


Figure 2.1. Procedure of Choosing the Sample

For the following reasons, the last two institutions listed were excluded from the survey. The University of Udayana is situated in Denpasar, Bali, where the dominant religion is Hinduism; the researcher had no information about Muslim accounting lecturers who could be contacted there. The STAN was also excluded because this institution was set up to prepare accountants for Governmental bodies (governmental accountants), so that the main interest of this institution is in 'governmental accounting' rather than financial accounting.

In addition to these State Universities, in fact, there are some private universities which have accounting departments/programmes. However, they have been excluded from the survey due to the fact that some (probably most) of the lecturers of the State Universities also work for the private universities as 'part-time' lecturers. Therefore, to avoid duplication of responses, the lecturers of the private universities have been excluded from the survey.

In addition, accounting lecturers in Indonesia are also allowed to set up and/or work as partners of accounting firms. This matter, therefore, has been included in the questionnaire.

Data on the total number of accounting lecturers for each university under investigation were not available. On average, however, there are about 30-50 accounting lecturers for each university. Assuming that the proportion of Muslims in the Indonesian population (87%) is represented in the survey population, there would be 365-610 Muslims accounting lecturers ( $87\% \times (14 \times 30-50)$ ). Five questionnaires were sent to the Head of the Accounting Department of each investigated university, and they were asked to distribute them to their staff (accounting lecturers). This means that the sample taken was 70 staff, or 11%-19%, approximately, of the target population.

## 2.5. Method of Analysis.

Non-Parametric statistical analysis was used to analyse the data collected from the survey. As all the data were categorical in nature, statistical tests appropriate to categorical data were applied. They are:

### 2.5.1. Frequency & Crosstabulation.

The *frequency* procedure has been used to know the distribution of respondents for each choice of answers on each variable. Sometimes, respondents have been re-distributed according to their personal characteristics (age, sex, degree, partnership). Alternatively, *crosstabulation* has been used, especially when the data are nominal.

### 2.5.2. Chi-Square.

(1) Chi-Square for one sample test.

Chi-square for one sample test has been used to know whether any one choice of answer is favoured significantly more than the other, the null hypothesis (H<sub>0</sub>) in this case being that there is NO significant difference in respondents' choice of answers on a certain variable. The H<sub>0</sub> would be rejected if the difference was significant, provided that the significance value resulting from the SPSS is small, i.e. less than 0.05. The rejection of the H<sub>0</sub> means that there is significant difference in respondents' choice of

answer, i.e. one answer has been favoured significantly more than the others.

#### (2) Chi-Square for multi-sample test.

This test has been used to find out whether there is a significant difference in the range of option choices of answers recorded by two or more groups of respondent, the null hypothesis (H<sub>0</sub>) in this case being that the choices and the grouping are not related, i.e. the respondents' answer is not influenced by (or related with) their grouped characteristics. Similarly to the chi-square for one sample test, the H<sub>0</sub> would be rejected if the difference was significant, provided that the significance value resulting from the SPSS is small, i.e. less than 0.05. The rejection of the H<sub>0</sub> means that there is an association between respondents' choice of answers and their grouped characteristics (age, sex, degree, partnership). Chi-square tests are applicable when data are nominal and grouped into categories or boxes (Cohen & Holliday, 1982, p. 133).

#### 2.5.3. Measuring the Association.

The Chi-Square test, besides being helpful to test the independence of variables, also gives information about the association of the tested variables. If the H<sub>0</sub> is rejected, it means that the variables are associated. However, the chi-square provides little information about the strength and nature of association. because:

- the value of the chi-square statistic depends on sample size as well as the amount of departure from independence for the two variables; it is impossible to compare chi-square values from several studies with different sample sizes. This is one reason why the chi-square statistic is not very useful as a measure of association.
- chi-square is based only on expected and observed frequencies; therefore, it is possible for many different types of tables to have the same value for the chi-square statistics. Different types of relationships between two variables can result in the same chi-square value. Knowing the chi-square tells us nothing about the nature of the association (Norusis, 1991, pp. 311-312).

Therefore, further test is needed in order to know the strength and nature (direction) of the association. Different tests should be used for different types of data, i.e. Nominal or Ordinal variables.

(1) Measures of Association for Nominal variables.

SPSS provides four measures to know the association of two Nominal variables (Norusis, 1991, pp. 313-320):

- (a) Phi coefficient
- (b) Contingency coefficient (C)
- (c) Cramer's V
- (d) Lambda

The first three measures are measures based on chi-square, while the last one is a measure of proportional reduction in error (called PRE measures).

The *Phi coefficient* is appropriate when each of the variables takes only

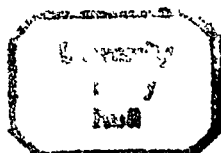
two truly dichotomous values, e.g. male/female, pass/fail, right/wrong, etc. (Cohen & Holliday, 1982, p. 182).

The *Contingency coefficient*, on the other hand, is an extremely useful measure of association because of its wide applicability, and its freedom from assumptions and requirements. However, there are some limitations in connection with the use of C as follows:

- (i) while the contingency coefficient equals zero when there is no association between two variables, it can never get as high as 1, even for a table showing what seems to be a perfect relationship.
- (ii) two contingency coefficients are not comparable unless they are derived from contingency tables of the same sizes;
- (iii) the data must be amenable to the computation of chi-square before C can be used; and
- (iv) C is not a directly comparable measure of correlation such as *Pearson's r*, *Spearman's rho* or *Kendall's tau*;  
(Cohen & Holliday, 1982, p. 187; Norusis, 1991, p. 313).

*Cramer's V*, furthermore, is identical in value to the *Phi coefficient* when the number of rows or columns is 2, and its value can attain 1 for tables of any dimension.

*Lambda*, on the other hand, is an *asymmetric measure of association* which shows how much error is reduced when Y categories are guessed from knowledge of X, but not the other way round. However, it has the undesirable property that it may take on the value of zero in cases where other measures of association will not be zero and where one would not



refer to the X and Y variables as being un-correlated or statistically independent (Cohen & Holliday, 1982, p. 286-287).

SPSS provides all of these measures under the Non-Parametric Statistic; and for comparison purposes, all of these measures have been presented.

(2) Measures of Association for Ordinal variables.

SPSS provides five measures to know the association of two Ordinal variables:

- (a) Goodman & Kruskal's *gamma*
- (b) Kendall's *Tau-b*
- (c) *Tau-c*
- (d) Somer's D
- (e) Spearman's R

The first four measures of ordinal variables are identical: they predict the association of Y and X variables. The first three (*gamma*, *tau-b*, and *tau-c*) are all symmetric measures; it does not matter which one of the variables is considered dependent. The difference is that *gamma* ignores any ties on the variables. *Somer's d*, on the other hand, is an asymmetric measure; it considers the ties on the Y (dependent) variable, but not on the X (independent) variable.

If the concern is merely with a weak monotonic relationship, *gamma* is the best choice. If the concern is with a strictly monotonic asymmetric

relationship, *Somer's d* is the best choice. If the concern is with a category rank linear relationship, *tau-b* is the best choice (Kohout, 1974, p. 231).

*Spearman's R* (Spearman's Rank Order Correlation, or *Spearman's rho*) is mathematically equivalent to the correlation coefficient computed on ranks instead of scores. The Spearman's Test should generally be preferred to the Kendall's Test only if it is considered important to emphasise large differences between the two rankings. *Spearman's Rho* is frequently used as a measure of association when there are few ties in either variable. Like Goodman and Kruskal's *gamma* and *Kendall's tau*, it varies between -1 and +1, with values close to zero indicating little or no association. A major advantage of the Spearman Test is that it is closely related to the Friedman Test.

All these association measures were used to predict the association between respondent's perception as expressed in their answers with their groups of characteristics (age, sex, degree, partnership). The respective association would give information whether respondents' characteristics do influence their responses; if they do, how strong is the influence and what is the nature of the association.

The findings might be useful to support the conclusion made, and the recommendations proposed, if any.



## CHAPTER 3

### WESTERN ACCOUNTING ENVIRONMENT

#### 3.0. Introduction

Accounting is a phenomenon in society; therefore, it is influenced by all aspects of social life. However, as Hendriksen (1982) argued, not all aspects of the social life are relevant to accounting; some are totally irrelevant, others are only indirectly relevant, while many economic, social and political aspects are directly relevant. The relevance of these environmental aspects is also subject to time and place.

Usually, systems in society are developed (constructed) based on a certain ideology. Different ideologies, therefore, will inspire different systems (political, legal, economic, socio-cultural, etc.); and in turn, will affect the accounting system. This chapter discusses briefly the impacts of ideology, political, legal, economic and socio-cultural systems on accounting in western countries, mainly in English speaking countries such as the United States and the United Kingdom.

#### 3.1. Ideology

According to *Encyclopaedia Americana* (1986, p.744), ideology is “a system of practical belief developed by and characteristic of a group whose members have common political, economic, religious, or cultural bonds.” Ideology

is also “a system of ideas that aspires both to explain the world and to change it” (*Encyclopaedia Britannica*, 1990, p. 768). In other words, ideology will inspire the concepts of political, economic, legal, social and culture, and other systems within society.

Ideology may also be defined loosely or strictly. In the loose sense, ideology may mean any kind of action-oriented theory or any attempt to approach politics in the light of a system of ideas, while in the strict sense, ideology is a "science of ideas", with has five characteristics as follows:

1. it contains an explanatory theory of a more or less comprehensive kind about human experience and the external world;
2. it sets out a programme, in generalised and abstract terms, of social and political organisation;
3. it conceives the realisation of this programme as entailing a struggle;
4. it seeks not merely to persuade but to recruit loyal adherents, demanding what is sometimes called commitment;
5. it addresses a wide public but may tend to confer some special role of leadership on intellectuals. (*Encyclopaedia Britannica*, 1990, p. 768).

*Collier's Encyclopaedia* (1984, Vol. 12, p. 493), on the other hand, defines ideology as the science dealing with the beliefs, notions, and theories growing out of fundamental assumptions held by a group; also, the sum of such beliefs, notions, and theories. Acceptance of ideology and being conditioned by it are requirements for membership in groups. Sometimes such indoctrination is conscious; often it is informal. Sometimes the member makes a conscious effort to acquire the right ideas; more often he accepts them unconsciously. Further, since a person may belong to more than one group, it is possible for him to hold conflicting ideologies.

Thus, one may hold to a religious belief in the brotherhood of man and, at the same time, hold that an elite must manage affairs with a minimum of attention to the desires of minority groups. Implicit in the idea of ideology is the theory that what one believes will vary with time and place and that opinions must be interpreted in terms of group allegiance. This leads to a philosophy based on cultural conditioning.

Some religions can also be classified as ideology, because they have some similar characteristics; they are 'total systems' which are concerned at the same time with the questions of truth and conduct, and the need for commitment (*Encyclopaedia Britannica*, 1990). Therefore, as ideology, both religious ideologies and men-constructed ideologies inspire people in managing their societal life. Some of them may be relevant for one aspect of life, while others may be relevant for more than one, even a complex, of life.

It is also true that some religions are based on revelation, constructed in terms of a divine order, emphasise faith and worship, and are seldom centred on this world alone. Some of them are difficult to apply to practical political and economic programmes, due to their appeal to inwardness, aiming at the redemption or purification of the human spirit (*Encyclopaedia Britannica*, 1990). In the West, Christianity used to be the dominant ideology, especially in the era of the Holy Roman Empire and during the era of feudalistic society.

The concept of ideology arose in Europe as a result of the conflict of various systems of thought. As a result, it is frequently used as a label for a rival system of belief, which is viewed as erroneous and corrupt. Thus, Marx argued that much religious and political thinking was ideological and served to protect capitalism, and vice versa.

Ideologies are created through a process of thinking--philosophical thinking. They may be the creation of a single thinker, or the result of a long accretion of opinions. Cultural aspects are believed to be prominent in influencing the process of developing 'secular' ideologies. Secular ideologies are usually relatively materialistic, while religious ideologies are relatively spiritualistic in their principles. Moreover, religious ideologies lay more emphasis on revelation or dogmatic statements.

Ideologies may also be relatively conservative or revolutionary toward the existing state of things. They may also be open or closed toward change in their own structure and conclusions. In their appeal, they may be restricted or wide. Towards other ideologies, they may be relatively passive or aggressive (*Encyclopaedia Americana*, 1986).

Ideologies can also be distinguished according to their systematisation, emphasis or natures. In terms of systematisation, they are classified according to precision and completeness. Some, such as the so-called American ideologies,

emphasise politics and economics, while some others, such as religious ideologies, place more emphasis on morality and little on economics.

Baradat (1994), however, states that ‘ideology’ was a term originally used in an objective way to explain the origin of ideas. Later, however, ideologies came to be understood as subjective political rationalisations. Today, he stated further, ideologies are understood to be political statements that call upon the masses to act in some way in order to improve the political life.

In practice, ideologies will provide a basis for the conception of political, economic, social and other systems. In political aspects, there are communism, liberalism, democracy, etc. In economic aspects, there are capitalism, Marxism, socialism, etc., and in social aspects, there are conservatism, fatalism, etc.

In terms of orientation, ideologies may be distinguished into two opposite directions, left and right. The right direction is commonly referred to as the *individualistic* orientation, while the left direction is the *collectivistic* orientation. The manifestation of orientation in economic policy can be drawn as follows (Figure 3.1.):

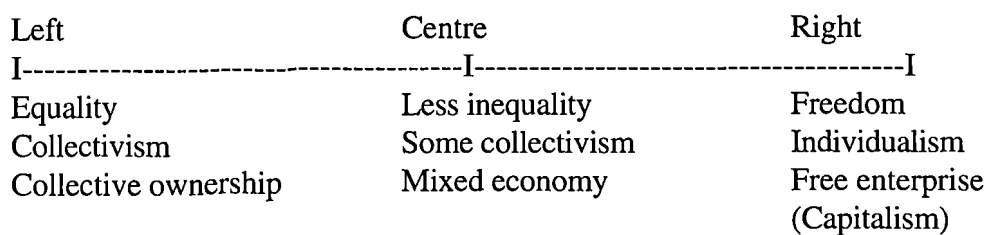


Figure 3.1. Ideological orientation & economic policy

In political systems, by combining the left-right dimensions with a vertical axis in which the top refers to *tough-authoritarian* systems, and the bottom refers to *tender-democratic* systems, ideologies can be drawn as follows (Figure 3.2):

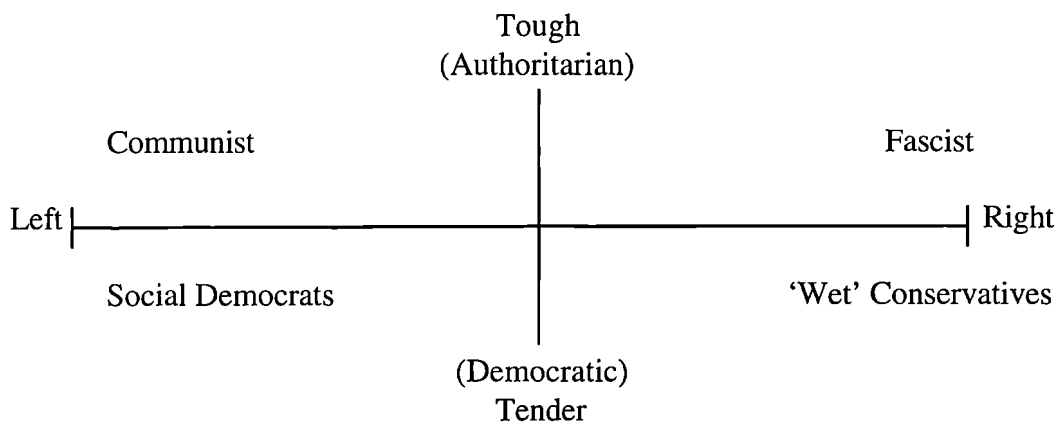


Figure 3.2. Ideologies and political systems

The Western ideologies are believed to be generally materialistic and individualistic; but this does not mean that spiritualistic and collectivistic (socialistic) tendencies are unknown in the West. In fact, both individualistic and collectivistic ideologies have been developed in the West. However, the individualistic one seems to be dominant. Political, economic and societal life in the West, especially in the UK and US, are believed to be influenced by the materialistic and individualistic ideologies (individualism, liberalism), with some socialistic tendencies which vary in time and place. Collectivistic ideologies, on the other hand, are prominent in the political, economic and social life of the Eastern Europe (ex Soviet Union) and east Asia (China).

To sum up, it is believed that ideologies are the result of a philosophical process, as the fundamental principles in human thinking and ideas. Ideologies are also believed to have led to political and social developments in the management and operation of countries all over the world, resulting in various different characteristics in their political, social and economic performance. The differences among ideological systems of countries may cause differences in accounting development, in theory and practice.

### 3.2. Political systems

The term 'politics' has an ambiguous meaning. In the practical sense, however, it usually refers to 'governmental systems' concerned with any extensive use of power, rule or authority within society. The relevant aspects considered as the areas of politics are: struggle for power, determination of the government rules, government involvement, micropolitics, resource allocation, and the study of, or efforts directed towards, achieving a better or ideal political system (polity) (Leeds 1981, pp.4-5).

Political ideas are usually based on an ideology. Ideologies are used by leaders to justify their own rules. Ideologies also provide moral justification for a specific form of government. Political ideas, in turn, will influence the political attitudes of the people, that can be arranged in a *linear spectrum*, *circular*

*spectrum* or *continuum spectrum*. These spectrums are based on the degree of support toward the status quo or a change.

*Linear spectrum.* On the linear spectrum, the *degree of support* toward the status quo or a change in either a forward or backward direction can be defined as follows: Reactionary-Conservative-Liberal-Radical-Revolutionary. Reactionary is the lowest degree of support toward change, while revolutionary is the highest.

On the linear spectrum, *political doctrines* are arranged along a straight horizontal line. On the left-end is *extreme liberty* (a situation of no government) and on the right-end is *extreme authority* (a situation with maximum government or totalitarianism). Most political doctrines may then be arranged along the line as follows: *liberty, anarchism, syndicalism, guild socialism, conservatism, pluralist democracy, democratic socialism, state communism, Fascism* (Leeds 1981, pp. 110-111).

*Circular spectrum.* De Witt C. Poole, on the other hand, believed that political attitudes should be conceived in terms of a circle rather than a line. Fascism was considered to be the extreme of conservatism, and communism the extreme of socialism. The extreme attitudes of both the right and left, having in common a belief in totalitarian systems, would meet at the bottom of the circle (Refer to figure 3.3 below).



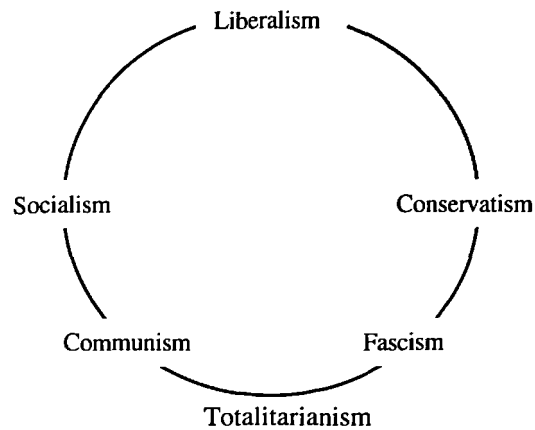


Figure 3.3. A circular spectrum of attitudes to politics

Source: Leeds, 1981, p. 112

*Continuum spectrum.* According to this spectrum, the opposite of democracy (rule by many) is authoritarianism (rule by one or a few) rather than totalitarianism. All states can be classified on a linear scale according to the degree to which they conform to the democratic or authoritarian extremes. Since the theory of either democracy or authoritarianism can be associated with the linear spectrum of liberalism-totalitarianism, these two linear models can be placed at right angles to each other as shown in Figure 3.4. “Each state can be placed in one of the four areas depending on the degree to which they conform to the features portrayed” (Leeds 1981, p.112).

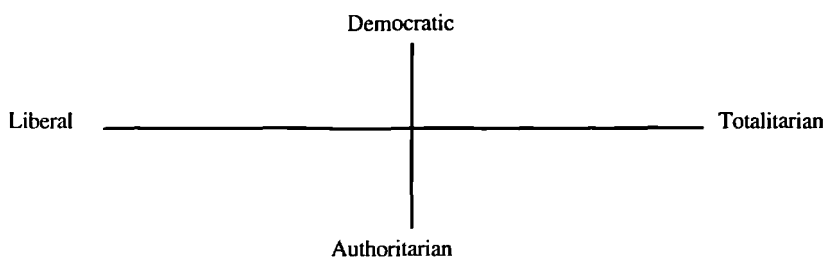


Figure 3.4. Political attitudes represented as a continuum

Source: Leeds, 1981, p. 113

The Western political systems are believed to be based on: *nationalism*, *democracy*, and *liberalism*. Nationalism is the ideology of the nation-state. *Nation* is a term referring to a people who have strong bonds of kinship with each other; while *state* is a political term implying people or peoples under a certain government, within a certain territory, which has sovereignty over its affairs (Baradat, 1994). The nation-state, therefore, refers to a nation of people who enjoy the existence of a state that sees to their interests. Nationalism asserts the right of a nation of people to be served by a state that complements their interests. It maintains that the national interests are paramount over individual interests and above the interests of other national groups. Nationalism can unify people, but it can also divide people and lead to conquest and imperialism, as history have proven.

Democracy literally means ‘people sovereignty’. In its pure-philosophical meaning, it means that people make the law themselves. Procedurally, however, there are different ways for people to make the law. In a *pure* or *direct* form of democracy, the relationship between the people and the policy-making process is direct. It can be illustrated as follows:



Figure 3.5. Pure (direct) form of democracy

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Source: Baradat, 1994, p. 108

A *republican* form of democracy uses representatives of the people to make law so that the legislative process become indirect. The representatives are usually appointed through an election. It can be illustrated as follows:

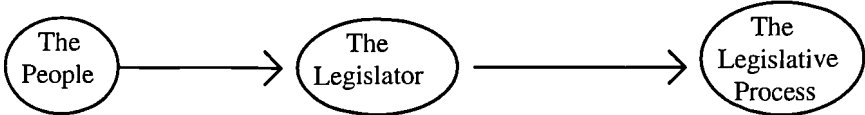


Figure 3.6. Republican form of democracy

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Source: Baradat, 1994, p. 109

In a *pluralist* form of democracy, interest groups advocate before the legislators in order to influence the legislation, thereby removing the people one step further from the legislative process. It can be illustrated as follows:

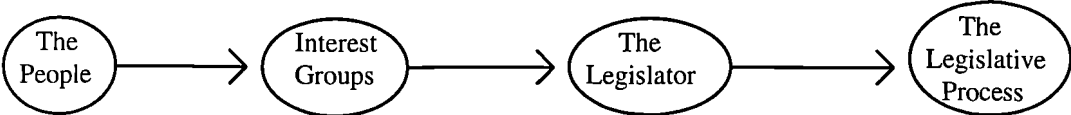


Figure 3.7. Pluralist form of democracy

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Source: Baradat, 1994, p. 111

The United Kingdom (British) system uses a *unitary form* that concentrates governmental power in the central government. The parliamentary-cabinet system adopted provides that the people elect (the members of ) Parliament, and then the Parliament chooses the executive, the prime minister. The executive, the legislative and the judicial are independent and separate powers, but together they form the Parliament. It can be illustrated as follows:

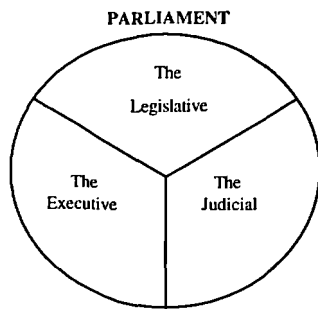


Figure 3.8. Unitary form of democracy

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Source: Baradat, 1994, p. 119

The US system of government uses a *federal form* to divide powers between the national (federal) and state government. The presidential-congressional system adopted has the executive and legislators elected separately for fixed terms. Furthermore, the separation of power system in the US differs from that of the UK, in that each power body can influence the other two bodies at certain levels to make *checks and balances*. It can be illustrated as follows:

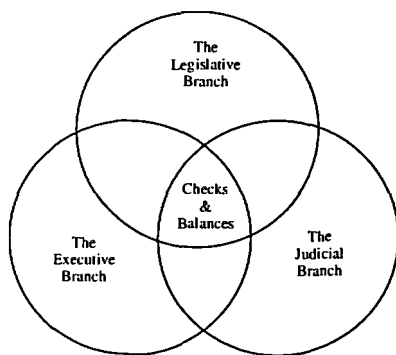


Figure 3.9. Federal form of democracy

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Source: Baradat, 1994, p. 117

In any democratic system, moreover, elections are used to decide issues as well as to choose officers (representatives). The single-member district encourages a single or two-party system, while a multi-member district fosters a multi-party system. The two-party system gives voters alternatives, and it usually produces a majority for the winner. The multi-party system features many alternatives, but it

often fails to produce a majority and it may be incompatible with the presidential-congressional system.

Representative government, however, poses questions about who should be represented, and about what criteria the representatives should use when casting a vote: the will or the interest of constituents. Moreover, democracy has been criticised as being overly idealistic, leading to mediocrity and inefficiency when coping with modern problems.

The political system adopted by a country will directly affect its economic and social system. Political decisions which have been taken by the government will be formulated through the process of legal systems, and their implementation will guide economic and social activities, and in turn, will direct the accounting system.

Instability in political conditions will cause instability in economic conditions, in terms of inflation, unstable exchange rates, high interest rate, etc. Such conditions will affect the accounting system with the requirement of accounting standards for foreign exchange transaction and translation, interest expenses, capitalisation, etc.

The stability of the political system and the stability of the power of government are necessary to the development of the accounting profession, including education, accounting theory, accounting standards and practices. Some

Western countries such as the UK, US, Norway and Sweden, which have a mature political culture, have advanced accounting systems (Leeds 1981, p.195).

### 3.3. Legal systems

The word 'legal' commonly means 'related to law', that is “a set of rules or norms, written or unwritten, about right and wrong behaviour, duties and rights” (Friedman 1975, p.1). However, the definition of 'legal systems' is still unclear because the boundaries of such a system is difficult to define. Like other systems, the legal system also has inputs, which it processes in order to produce an output; and the product of the legal system is law. Law is the product of social demands.

There are a lot of families of law as the products of corresponding legal systems. The classification of law into families of law depends on the criteria used; different criteria will result in different classifications. Esmain (1905), for example, divided families of law into: Romanistic, Germanic, Anglo-Saxon, Slavic and Islamic (in Podgorecki 1985, p.1), while Zweigert and Kotz (1977), more comprehensively classified the families of law into: Romanistic, Germanic, Nordic, Common Law Family, Socialist, Far Eastern System, Islamic System and Hindu Law. Such classification are based on historical background, the predominant model of thought, particularly distinctive institutions, types of legal sources and ideology. David and Brierley (1978), simply based on ideology and legal technique, divided law families into: Romanistic-German, Common Law, Socialistic, Islamic,

Hindu and Jewish, Far East and Black African. However, the most popular and dominant systems adopted in Western countries are the Romano-Germanic and Common Law families.

The Romano-Germanic family of laws originated in Europe. It was formed by the scholarly efforts of the European universities which, from the twelfth century and on the basis of the compilation of the Emperor Justinian (AD 483-565), evolved and developed a juridical science common to all and adapted to the condition of the modern world. Most European-continental countries, and their former colonies, are believed to adopt this type of law, with some variants according to local culture.

The Common Law family, on the other hand, was formed primarily by judges who had to resolve specific disputes. It seeks to provide the solution to a trial rather than to formulate a general rule of conduct for the future. Therefore, it is much less abstract than the characteristic legal rule of the Romano-Germanic family. Matters relating to the administration of justice, procedures, evidence and execution of judgements have, for Common Law lawyers, an importance equal, or even superior, to substantive legal rules because, historically, their immediate preoccupation has been to re-establish peace rather than articulate a moral basis for the social order. The origins of the Common Law are linked to royal power. This family of law has been adopted by most English-speaking and Commonwealth countries.

Scotland, Israel, South Africa and the Quebec province of Canada, however, are believed to adopt both Romano-Germanic and Common Law families. From the socialist point of view, both Romano-Germanic and Common Law are claimed as 'capitalist'/'bourgeois' laws, because individualism, liberalism, and personal rights are prominent.

In general, the functions of legal systems include: (1) the settlement of disputes; conflicts arise in every society, and the legal function is to offer machinery and a place where people can go to resolve their conflicts and settle their disputes; (2) a tool of social control; essentially the enforcement of rules of right conduct; (3) admonishing, rehabilitating the branches of the law; (4) creating the norms themselves as the raw material of social control (Friedman 1975, pp.17-18).

There are many legal factors influencing accounting, which vary from one country to another. The main areas of legal systems which directly influence accounting are: taxation law, companies acts, and various rules and regulations in economic and business. Such influence is so great because accounting is also a response to social demand, that is, demand for financial information regarding a certain economic and social organisation in the society. Accounting, like law, is not impartial, timeless, classless or value-free, in terms of its institutions and technical aspects. Accounting's functions, like law's, include the settling of disputes, and providing tools of social control, as has been proven in many court



cases when business disputes arise. The body of rules of accounting has been accepted by the courts and given the dignity of the law, and the accountant, once his rules have found their way into the body of the law, becomes obliged to follow them in his work (Simon 1976, p.1).

### 3.4. Economic system

An economic system is a set of principles and techniques by which the ownership and allocation of economic resources are decided and organised by society (Encyclopaedia Britannica, p. 357). It consists of "a set of mechanisms and institutions for decision-making and the implementation of decision concerning production, income, and consumption within a given geographic area" (Gregory & Stuart, 1980, p.12). The central problem in economics is how to allocate available resources in order to produce goods and service for national prosperity. The term economic system, therefore, refers to the manner in which the answers to basic economic questions are determined in a particular society. These familiar questions, simply stated, include:

1. What products shall be produced, and how much of each?;
2. What techniques of production shall be used?;
3. Who shall do what work?;
4. How shall the total output be distributed?
5. How shall the rates of saving and investment be determined?;

The manner in which the answers to these basic question are supplied, and the pattern of ownership of productive capital and land, altogether determine the

nature of the economic system of a society. The *traditional* approach focuses on the ownership of the means of production and style of economic control, and defines economic systems as feudalism, capitalism, socialism, fascism, etc. The *modern* approach identifies characteristics such as property ownership, processing and utilisation of information, decision making process, behaviour rules and so on (Gregory & Stuart, 1980, p.11).

There are two main types of *modern economic system*, the *private* or *free-enterprise economy (capitalist)* and the *centrally controlled and planned economy (socialist)*. These two contradictory systems reflect the ideologies underlying them. Individualism and liberalism seem to be the basis of the capitalist system, whereas collectivism and Marxism seem to be the basis of the central-planning system. Neither of these is, however, to be found in practice in its pure form. In reality, all economic systems combine in varying degrees elements of each of these systems (*Encyclopaedia Britannica*, 1990, p. 357).

The basis of the private-enterprise (capitalist) system is the belief that when each member is allowed to pursue his rational self-interest the maximum common good will be generated. In effect, the greatest common good is simply a sum of its constituent parts, and anything that interferes with the pursuit of individual rational self-interest will reduce that sum. The mechanism that assures that the pursuit of myriad private goals will produce public good is the market, which impersonally sets prices for both the factors of production (land, labour, and capital) and the

products of industry. With the factors of production in private hands, the proportions in which these factors are combined to produce different goods and services are determined through the price mechanism. If something is supplied in quantities greater than are required, the price will fall or production will be reduced, or both results will occur. If there is unsatisfied demand for any product, the price will rise and, with profits in prospect, production will be stimulated (*Encyclopaedia Britannica*, 1990, p. 357). Most of the developed Western economies are described as being of this type.

The central-planning approach, on the contrary, is based on the observation that the private-enterprise system accepts patterns of unequal wealth and income distribution and that, moreover, because of technological and other developments, some producers attain a size and importance that destroy the competitive conditions required for the operation of the market mechanism. The answer, for proponents of central planning, is public ownership of the means of production and the central determination and control of what is produced. In this way, inequalities of wealth and income are to be reduced or eliminated and economic activities organised according to agreed upon social and political objectives (*Encyclopaedia Britannica*, 1990, p. 357). This system has been adopted by the Communist/Socialist countries.

Elements of capitalism can be traced quite far back into history. However, it is in the period since the beginning of the industrial revolution in England that the

capitalistic system has assumed the greatest significance. The increasing profit possibilities resulting from the rapid growth of technology in the latter quarter of the eighteenth century and the spread of the philosophy of *individualism* contributed to the growing sentiment in favour of *laissez-faire* governmental policies. Under the philosophy of individualism, each individual has the right: to obtain and use their private property, to choose their own way to expend their own economic activity, and to use their property in their own way. The capitalist movement has been supported by economic theories proposed by individualist economists such as Adam Smith (1723-1790), and by ethical theories justifying materialism, such as the utilitarianism theory of Jeremy Bentham (1748-1832). In this atmosphere, production grew rapidly in the nineteenth century and the capitalistic system seemed to function very much along the lines suggested by the *laissez-faire-competitive* model which classical economists had described.

In the latter quarter of the nineteenth century, the trend toward large-scale production and concentration in a number of industries became quite pronounced. In time, this situation stimulated the passage of regulatory legislation to prevent undesirable business practices. From this point on, there have been increasing departures from a *laissez-faire* policy by the United States government and by the governments of other advanced capitalistic countries. There has also been a continuing trend away from the 'small-scale, many-producers-of-each-product' pattern which is characteristic of conditions of pure competition.

As a result of their departures from conditions of *laissez-faire* and pure competition, the economies of mature capitalistic systems have become known as mixed-capitalistic systems to distinguish them from the purer form of capitalism described by the *laissez-faire*-competitive model. The evolution from capitalism to mixed capitalism should not be regarded as necessarily unfortunate or undesirable. Indeed, this evolution reflects one of the greatest strengths of capitalism which has been its ability to adjust to changing conditions and circumstances without losing its vigour and vitality and while maintaining its emphasis upon the institution of private property and the profit incentive. Today there is a rather wide range of variation among the mixed-capitalistic countries in regard to the role of government in the economy and the nature of the competitive structure of industry.

Even though capitalism has been changing, developing, and varying from time to time, and from place to place, the foundations of the system remained unchanged. These are: (1) the laws of private property, (2) the basic class structure, and (3) the processes of commodity production and allocation through the market. In the earlier stages of capitalist development, individual capitalists had played a central role in the accumulation process. The process from their standpoint had depended on organisational skills, cunning, business acumen, ruthlessness, and no small amount of luck. From the standpoint of society, however, the fortune of any particular capitalist was irrelevant--accumulation was an inexorable, ceaseless, spiralling process that had momentum and patterns of development that were quite independent of the actions of any particular capitalist.

The late nineteenth century saw the accumulation process rationalised, regularised, and institutionalised in the form of the large corporation. 'Taylorism' and scientific management replaced the older, more individualistic mode of capital accumulation. A new managerial class became increasingly important. Ownership of the means of production remained the principal source of economic, social, and political power in capitalism. The new managerial class was primarily composed, at least in its highest echelons, of important and powerful owners of capital. The managerial class was clearly and decisively subordinated to the entire capitalist class.

Among the consequences of this institutional transformation were two changes of particular importance. The first was the internationalisation of capital, which led to *imperialism*. The late nineteenth and early twentieth centuries witnessed the imperialistic carving up of most of the world's economically underdeveloped areas. The inhabitants of these areas were harshly and cruelly exploited for the profits of large corporations in the advanced capitalist countries.

The second was a change in the structure of the capitalist class. Although the social, political, and economic dominance of the capitalist class remained unchanged, the institutionalisation of the accumulation process permitted the majority of capitalists to perpetuate their status merely through passive absentee ownership. The majority of capitalists became a pure rentier class, while a minority engaged in managerial functions (in both the economy and the polity) and acted as

a kind of executive committee to protect the interests of the entire capitalist class. This committee performed its function by 'managing the managers' of the new corporate structure; meanwhile, the remaining capitalists simply enjoyed lavish incomes derived from ownership alone.

Indeed, the very basic concept of financial accounting, the separate entity concept, has been born from the above situation. The very fundamental objective of financial reporting and accounting --'stewardship'--is originally derived from the economic atmosphere as explained above. Even though later it was developed through many theories of accounting, the original objective--stewardship--remained unchanged. The Western accounting system is, therefore, developed to serve the economic system of capitalists.

### 3.5. Social Systems

The word 'social' means any human activities within society. In its specific meaning, the word social means relationship among people within society in order to protect their mutual interests. As applied to human beings, the word social refers to "any behaviour or attitude that is influenced by past or present experience of the behaviour of other people (direct or indirect)" (A Dictionary of the Social Science, p. 273).

In order to fulfil their mutual needs, people organise themselves in systems, which differ from one society to another. Such systems have been developing

from a primitive-simple system to a modern-complex system. Each system has its own characteristics and differs from others, even though some elements may be similar. The characteristics that distinguish one society from another are called 'culture' in its widest context.

People have developed, from a long time ago till today, some social theories in order to create an ideal society. In the ancient Greek era, there was Plato's *rationalism*<sup>1</sup>. And then Aristotle combined rationalism with *empiricism*, which then gave birth to *feudalism*<sup>2</sup>. As a reaction to feudalism, *individualism*<sup>3</sup> then rose up. Supported by economic theorists (such as Adam Smith) and ethical theorists (such as Jeremy Bentham), individualism influenced the birth of *capitalism*. Furthermore, by including the role of government, *liberalism* was born. Nowadays, the ideology of liberalism is the foundation of the society, economy, and polity of most capitalist countries. Even though there have been some changes, adjusted and justified by law and government policy, the original idea of liberalism is individualism.

As an antithesis to individualism is *collectivism*<sup>4</sup>. Collectivist theory claims that human interest can only be achieved together in a society not ruled by a monarchy (kingdom) system. This theory was developed by Karl Marx, based on materialistic dialectics, to become *socialism*. The socialist theory was adopted by Lenin, and applied through a revolution, and then became known as *communism*.



People as social humankind create and naturally create organisations that guide and control their behaviour in many ways. Such organisations free and limit people's activities, create measures to be followed and maintained by them. This continuously changing and complex system is called society. It is a network of social relations. A society which is not based on the Islamic faith will use the changing characteristics of society as elements determining social life style and laws. This means that social evolution is the back-bone of the evolution of law, not only in its side effects, but even in its foundations and principles. This means that the society is the creator of laws (MacIver & Page, 1950, pp. 6-7).

The characteristic of Western society is believed to be individualism. This characteristic has been reflected (manifested) in their ideology, political, economic and cultural systems. The ideology of liberalism, which favours individual freedom, is a reflection of the individualistic society. In its polity manifestation, it is reflected in a liberal-democratic system. In economy, it is manifested in a capitalist system (capitalism). And in culture, it is reflected by individualistic values.

### 3.6. Cultural Systems

Kluckhohn (1951, p. 86) quotes, as a consensus of anthropological definitions, that:

“Culture consists in patterned ways of thinking, feeling and reacting, acquired and transmitted mainly by symbols, constituting the distinctive achievements of human groups, including their

embodiments in artefacts; the essential core of culture consists of traditional (i.e. historically derived and selected) ideas and especially their attached values.”

Stated in simpler words, culture is to a human collectivity what personality is to an individual. Personality has been defined by Guilford (1959) as “the interactive aggregate of personal characteristics that influence the individual’s response to the environment.” Culture, therefore, could be defined as the interactive aggregate of common characteristics that influence a human group’s response to its environment. Culture determines the identity of a human group in the same way as personality determines the identity of an individual. Cultural traits sometimes can be measured by personality tests.

Hofstede (1984, p.21), on the other hand, defines culture as “the collective programming of the mind which distinguishes the members of one human group from another. It includes systems of values; and values are among the building blocks of culture.” Culture is learned, not inherited. It derives from one’s social environment, not from one’s genes. Culture should be distinguished from human nature on one side, and from an individual’s personality on the other, although exactly where the borders lie between human nature and culture, and between culture and personality, is a matter of discussion among social scientists (refer to Figure 3.10. below) (Hofstede, 1987, p. 5).

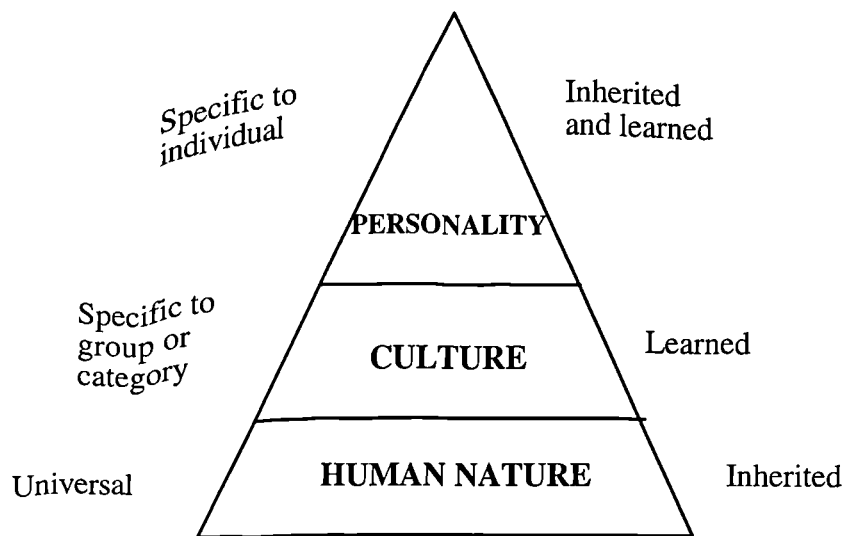


Fig.3.10. Three levels of uniqueness in human mental programming.

Hofstede (1987, 1991), further, argued that there are four characteristics of culture, namely: symbols, heroes, rituals, and values.

- *symbols*, these are words, gestures, pictures or objects that carry a particular meaning which is only recognised by those who share the culture.
- *heroes*, these are persons, alive or dead, real or imaginary, who possess characteristics which are highly prized in a culture, and who thus serve as models for behaviour.
- *rituals*, these are collective activities, technically superfluous in reaching desired ends, but which, within a culture, are considered as socially essential; they are therefore carried out for their own sake.
- *values*, are broad tendencies to prefer certain states of affairs over others. Values are feelings with a direction: they have a plus and a minus side. They deal with: evil vs. good; dirty vs. clean; ugly vs. beautiful; unnatural vs. natural; abnormal vs. normal; paradoxical vs. logical; irrational vs. rational. Of all characteristics, values are the most difficult to change.

There are five dimensions of societal value identified by Hofstede (1991): Power Distance, Individualism-Collectivism, Masculinity-Femininity, Uncertainty Avoidance, and Short-Long Term Orientation. These dimensions are described as follows:

#### *a. Large versus Small Power Distance*

Power distance is defined as “the extent to which the less powerful members of institutions and organisations within a country expect and accept that power is distributed unequally” (Hofstede 1991, p. 28). People in Large Power Distance societies accept a hierarchical order in which everybody has a place needs no further justification. People in Small Power Distance societies strive for power equalisation and demand justification for power inequalities. The fundamental issue addressed by this dimension is how society handles inequalities among people when they occur.

Table 3.3. in the Appendix to this Chapter shows the key differences between small and large power distance societies. Referring to this table, it is believed that the Western societies tend to have a ‘small’ power distance.

#### *b. Individualism versus Collectivism*

Individualism is concerned with a preference for a loosely knit social framework in society whereas collectivism is concerned with a preference for a tightly knit social framework. The fundamental issue addressed by this dimension is the degree of interdependence a society maintains among individuals.

Table 3.4. in the Appendix to this Chapter shows the key differences between collectivist and individualist societies. Referring to this table, it is believed that the Western societies tend to be individualist.

*c. Masculinity versus Femininity*

Masculinity stands for a preference in society for achievement, heroism, assertiveness, and material success. Femininity, on the other hand, stands for a preference for relationships, modesty, caring for the weak, and the quality of life. The fundamental issue addressed by this dimension is the way in which society allocates social roles to the sexes.

Table 3.5. in the Appendix to this chapter shows the key differences between masculine and feminine societies. Referring to this table, it is believed that the Western societies tend to be masculine.

*d. Strong versus Weak Uncertainty Avoidance*

Uncertainty avoidance is defined as “the extent to which the members of a culture feel threatened by uncertain or unknown situations.” This feeling is, among other things, expressed through nervous stress and in a need for predictability: a need for written and unwritten rules (Hofstede 1991, p. 113). Strong Uncertainty Avoidance societies maintain rigid codes of belief and behaviour and are intolerant towards deviant persons and ideas. Weak Uncertainty Avoidance societies maintain a more relaxed atmosphere in which practice counts more than principles and deviance is more easily tolerated. The fundamental issue addressed by this dimension is how society reacts to the fact that time only runs one way and that the future is unknown.

Table 3.6. in the Appendix to this chapter shows the key differences between strong and weak uncertainty avoidance societies. Referring to this table, it is believed that the Western societies tend to be weak in uncertainty avoidance.

*e. Short- vs. Long-term Orientation*

This fifth dimension was added in Hofstede's 1991 publication. The orientation is the view of societies toward traditions, social and status obligations, social pressure, investment and its expected result, and concern toward others and truth. Table 3.7. in the Appendix to this chapter shows the key differences between short-term and long-term oriented societies. Referring to this table, it is believed that the Western societies tend to be long-term oriented.

Gray (1988), furthermore, used Hofstede's (1987) model to explain the effect of societal values on accounting practices. Based on accounting literature and practice, the following accounting (subculture) values could be derived (Gray, 1988, p. 8):

*Professionalism versus Statutory Control* - a preference for the exercise of individual professional judgement and the maintenance of professional self-regulation as opposed to compliance with prescriptive legal requirements and statutory control.

*Uniformity versus Flexibility* - a preference for the enforcement of uniform accounting practices between companies and for the consistent use of such practices over time as opposed to flexibility in accordance with the perceived circumstances of individual companies.

*Conservatism versus Optimism* - a preference for a cautious approach to measurement so as to cope with the uncertainty of future events as opposed to a more optimistic, *laissez-faire*, risk-taking approach.

*Secrecy versus Transparency* - a preference for confidentiality and the restriction of disclosure of information about the business only to those who are closely involved with its management and financing as opposed to a more transparent, open and publicly accountable approach.

Furthermore, after analysing the relationship between Hofstede's societal values and these accounting values, Gray (1988) postulated a number of hypotheses. The hypotheses suggest that of the four Hofstede dimensions, *Uncertainty Avoidance* and *Individualism* are the most influential dimensions in relation to the accounting sub-culture dimensions. (Refer to Table 3.1. below).

Table 3.1. Direct Association Between Societal and Accounting Values

Values of accounting sub-culture	Relationship with societal values	
	Positive	Negative
Professionalism	Individualism	Uncertainty avoidance
Uniformity	Uncertainty avoidance	Individualism
Conservatism	Uncertainty avoidance	Individualism
Secrecy	Uncertainty avoidance	Individualism

Source: Perera, 1989, p. 47

Accordingly,

- where there is a *high level of individualism* in a society, it will have a positive effect on the degree of professionalism and negative effects on the degrees of uniformity, conservatism, and secrecy preferred in the accounting sub-culture.
- where there is a *strong uncertainty avoidance* in a society, it will have a negative effect on the degree of professionalism and positive effects on the degrees of uniformity, conservatism, and secrecy preferred in its accounting sub-culture.

The former represents the situation in Anglo-American countries, while the latter conditions apply in Continental European countries, particularly France and West Germany.<sup>5</sup>

Gray then extended this analysis by suggesting that the values of the accounting subculture find their expression in the accounting practices of ‘*authority and enforcement*’ and ‘*measurement and disclosure*’. In particular Gray contended that the accounting sub-culture values most relevant to *authority and enforcement* appear to be the dimensions of *professionalism* and *uniformity*; whereas the accounting sub-culture values most relevant to *measurement and disclosure* appear to be the dimensions of *conservatism* and *secrecy* (refer to Figure 3.11. below) (Fechner and Kilgore, 1994, p. 268-9).<sup>6</sup>

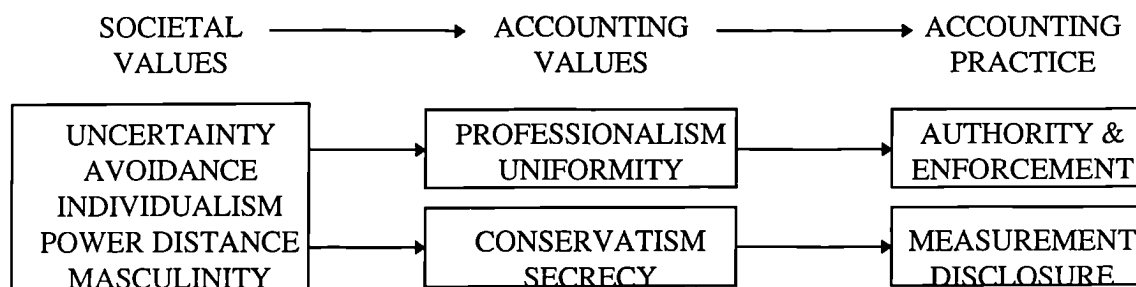


Figure 3.11. The relationship between societal values, accounting values and accounting practice--Gray’s theoretical framework.



### 3.7. Summary

From the above explanation, it is clear that the concepts of polity, economy, legal, social and culture are derived from a certain ideology. The ideology itself may have been based on a revelation (i.e. religion), or it may have been created through a process of thinking (i.e. philosophical thinking). Therefore, the ideology of a certain society may evolve due to an evolution in the philosophical thinking of that society.

The ideology currently dominating the Western society is one which is individualistic in nature, which is based on materialistic and hedonistic philosophy, and sometimes called liberalism. Liberalism is the creed of those who believe in individual liberty.

In the concept of politics (polity), materialistic and individualistic ideology have been manifested in the form of liberalism and democracy. However, since "no government allows absolute liberty" (John Locke), liberalism is the belief that it is desirable to maximise the amount of liberty in the state. Traditionally, a liberal believes that the primary function of the state is to protect the rights of the citizens. These rights are often ascribed to nature (natural rights), and frequently affirmed in proclamations, petitions, bills of rights, declarations of the rights of man, and so forth. Particularly at the beginning of liberal movements, liberals are reformers, enemies of entrenched institutions, traditions, and customs. Liberal programmes, therefore, seek to place constraints on governmental power. Sometimes this may

be achieved in the structure of the government itself, through a parliamentary system of government or a constitutional monarchy, or through the separation of governmental powers into functionally differentiated agencies such as executive, legislative, and judiciary, the classical example being the United States government. These constraints may also include barring the government so far as possible from the marketplace, as in the policies known as *laissez-faire* economics. Finally, these constraints may be introduced in the form of more specific limitations on governmental power, such as guarantees of *habeas corpus*, bail, rights of speech and assembly, and so on. Democracy, then, is the procedural system of how people in a liberal system make law; it could be in direct, republic or pluralist forms.

In the economic system, there are two opposing systems known: the capitalistic and socialistic systems of economy. The capitalistic system of economy (capitalism), also called FREE MARKET ECONOMY or FREE ENTERPRISE ECONOMY, has been dominant in Western world since the break-up of feudalism, in which most of the means of production are privately owned and production is guided and income distributed largely through the operation of markets. The Socialistic system of economy, also called CONTROLLED or PLANNED economy, on the contrary, is where the means of production are owned by the government and production and income distribution are guided and controlled by the government. Capitalism is derived from individualistic-liberalist ideology, while socialism is derived from collectivistic-Marxist ideology. Both, however, are

philosophically materialistic in nature. The pure forms of these two extremes, however, remain purely conceptual. The practice varies from place to place, and develops from time to time. The Western, English speaking countries are believed to apply capitalism, in its various forms.

In the legal system, there are several families of law known: Romano-Germanic, common law, socialistic, Islamic, Hindu and Jewish, Far East, and Black African. Most Western-English speaking countries adopt the Common Law family of law; while most Western-European Continental countries, on the other hand, adopt the Romano-Germanic family of law. The classification of legal systems into families of law is based on the ideology underlying the legal system, and the legal techniques applied. Both the Common Law and Romano-Germanic families of law are claimed by socialists to be “capitalis/bougeois” laws, because individualist, liberalist-personal rights are prominent in them.

Social systems are also believed to be derived from ideology. Individualistic ideology creates an individualistic society, and collectivistic ideology creates a collectivistic society. In an individualistic society, the ties between individuals are loose; everyone is expected to look after himself or herself and his or her immediate family. In a collectivistic society, people from birth onwards are integrated into strong, cohesive groups, which throughout people’s lifetime continue to protect them in exchange for unquestioning loyalty (Hofstede, 1991, p. 51). The Western societies are believed to be individualistic.

Ideology is also believed to be manifested in cultural systems (culture). Four characteristics of culture, as identified by Hofstede (1991) are: symbols, rituals, heroes, and values. Among these, values is the one which is most difficult to change. Hofstede, further, identifies five dimensions of values, namely: Power Distance, Individualism-Collectivism, Masculinity-Femininity, Uncertainty Avoidance, and Short-Long Term Orientation (Hofstede, 1991). Western/English Speaking (Anglo-American) societies are believed to tend to be characterised by: small power distance, individualism, masculinity, weak uncertainty avoidance, and long-term orientation.

The accounting system, as a phenomenon in the society, is believed to be strongly influenced by all of the above systems, individually or collectively, and directly or indirectly. The concepts and principles of accounting, therefore, are believed to reflect the essence of these systems. However, the differences in accounting systems between English Speaking (Anglo-American) countries on the one hand, and the Continental Europe (especially Germany and French) on the other hand, are believed to be 'cultural', as their ideological, political, economic and social concepts are quite similar (refer to *Note 5* and *Note 6* of this Chapter).

The next chapter will show the Western accounting concepts and their relation to the respected systems of politics, economy, legal, social and culture.

## **CHAPTER 4**

### **WESTERN ACCOUNTING CONCEPTS**

#### 4.0. Introduction

The previous chapter has discussed concepts of ideology and societal-environmental systems in the Western countries, which are believed to influence the accounting system in the respective countries. The influence of these concepts on accounting practices, however, is believed to be indirect; their direct influence is on the conceptual level which underlies the standards governing the practices. The conceptual matters are usually known as the 'conceptual framework' of accounting.

This chapter discusses the conceptual framework of accounting in Western countries, particularly in the US and UK, and the IASC. Before coming to the discussion, it is important also to know the importance of a formal 'conceptual framework' in guiding the standard setting process.

#### 4.1. The Importance of a Conceptual Framework

A conceptual framework has been defined as follows:

"In general terms, a conceptual framework is a statement of generally accepted theoretical principles which form the frame of reference for a particular field of enquiry. In terms of financial reporting, these theoretical principles provide the basis for both the development of new reporting practices and the evaluation of existing ones" (Davies et al., 1994, p. 29; 1997, p.39).

The FASB (1976, p.2) described it as ‘a coherent system of interrelated objectives and fundamentals that can lead to consistent standards and that prescribes the nature, function and limits of financial accounting and financial statements’. In particular, a conceptual framework of accounting will form the theoretical basis for determining which events should be accounted for, how they should be measured and how they should be communicated to the user. Therefore, although it is theoretical in nature, a conceptual framework for financial reporting has a highly practical end in view. A conceptual framework of accounting, therefore, can be seen as a theory of accounting against which practical problems can be tested objectively (Davies et al, 1994, p. 35; 1997, p. 35). The importance of a framework is that ‘one cannot make a rational choice of accounting procedures without some framework of principle’ (Macve, 1981, p. 9).

The need for a conceptual framework actually has been recognised since a long time ago (Sanders et al., 1938; Paton and Littleton, 1940; Vatter, 1947; Moonitz, 1961; FASB, 1976; Macve, 1981; Stamp, 1982; Peasnell, 1982; Anthony, 1983; Agrawal, 1987; Archer, 1993; Davies et al., 1994, 1997; Power, 1993). Davies et al (1994, 1997), argued that the lack of a conceptual framework in accounting has led to a ‘fire-fighting’ approach in setting accounting standards, in which the accounting standards have been developed to resolve practical accounting and reporting problems without referring to an accepted theoretical frame. Furthermore, it also has resulted in redundancies, in which the same

theoretical issues are revisited on numerous occasions by different standard setting bodies, resulting in different standards which are inconsistent with each other. In the case of the US, the lack of use of a conceptual framework has led to standards being too detailed. It has also led to a politicisation by interested parties which are economically affected by the standards.

Therefore, a generally accepted conceptual framework is needed in order to change the role of the standard setter from that of 'fire-fighting' to that of 'architect', by being able to design external financial reports on the basis of the needs of the user. This will lead to consistent and compatible standards, and avoiding highly detailed accounting rules by emphasising general principles. Moreover, this will result in sound and objective theoretically-based standards, avoiding political interference (Davies et al, 1997, p. 40).

The main purpose of the conceptual framework is to assist and guide the standard body responsible for establishing and developing standards. In the absence of specific promulgated standards, the conceptual framework is expected to provide a frame of reference for resolving accounting questions (IASB, 1988, para. 1; FASB, 1978, p. 7). The conceptual framework is also expected to assist the preparers of financial statements to determine bounds for judgement in preparing financial statements and dealing with topics that have yet to be subject of the standard (ASB, 1991, 1995; IASB, 1988). It is also expected to assist auditors in preparing opinions (IASB, 1988), and to increase the users' understanding and

confidence in financial statements (FASB, 1978; IASC, 1988). The comparability of financial statements is also believed to be enhanced, as the conceptual framework will assist standards setting bodies in promoting harmonisation of regulations, accounting standards and procedures relating to the presentation of financial statements by providing a basis for reducing the number of alternative accounting treatments permitted (ASB, 1991, 1995; FASB, 1978).

The attempts to develop a conceptual framework for financial accounting in the US and UK have been presented by Davies et al (1994, 1997). They can be summarised as follows:

#### 4.1.1. The US initiative

##### (1) Accounting Research Studies.

The US is probably the country where the conceptual framework of accounting was first developed. The first attempt was made by the AICPA, when this association appointed Maurice Moonitz and Robert Sprouse to study the basic postulates underlying accounting principles generally. Their products were published in 1961 and 1962 in Accounting Research Study (ARS) No.1--*The Basic Postulates of Accounting*-- and ARS No. 3--*A Tentative Set of Broad Accounting Principles for Business Enterprises*, respectively. However, these studies were rejected by the Accounting Principles Board (APB) because they were viewed as being too radically different from the practice at that time. Instead, the APB



accepted Paul Grady's ARS No. 7--*Inventory of Generally Accepted Accounting Principles for Business Enterprises*--which was published in 1965, and which catalogued the various accounting methods which had been approved by the ARBs, APB Opinions or some other precedent. (Indonesia adopted this ARS No. 7 during the period of 1972-1984).

(2) APB Statement No. 4.

The next attempt was made by APB in order to provide a basis for guiding the future development of accounting. The results were published in 1970 in APB Statement No. 4--*Basic Concepts and Accounting Principles Underlying Financial Statements of Business Enterprises*. The Statements contained a description of: (1) the environment of financial accounting, (2) the objectives of financial statements, (3) the basic features and basic elements of financial statements, and (4) a summary of existing generally accepted accounting principles. Therefore, it was a descriptive statement, not a prescriptive one. (This Statement was adopted in Indonesia during the period of 1984-1994).

(3) The Wheat and Trueblood Committees.

In 1971 the AICPA formed two study groups as a response to continued criticism from both within the profession and from the Security Exchange Commission (SEC) about its inability to establish sound accounting principles. These groups were: the *Study Group on Establishment of Accounting Principles* and the *Study Group on Objectives of Financial Statements*, which were chaired

by Francis Wheat and Robert Trueblood respectively. The Wheat Committee published its report in 1972, resulting in the establishment of the Financial Accounting Standards Board (FASB) in 1973 as the successor of the APB, a private sector body independent from the AICPA. The other committee, the Trueblood Committee, also succeeded in its job. In its *Trueblood Report* published in 1973, it developed twelve objectives of financial statements and discussed seven qualitative characteristics of financial statements. These results then were passed to the new body, the FASB, and became the main sources for the FASB's first and second concepts statements.

(4) The FASB Conceptual Framework.

The FASB has issued six concepts statements (SFAC--Statement of Financial Accounting Concepts) up to now. They are (FASB, 1978, 1980a, 1980b, 1980c, 1984, 1985):

SFAC No.1--Objectives of Financial Reporting by Business Enterprises;

SFAC No.2--Qualitative Characteristics of Accounting Information;

SFAC No.3--Elements of Financial Statements of Business Enterprises,

which was then replaced by the SFAC No. 6;

SFAC No.4--Objectives of Financial Reporting by Non-Profit Organization;

SFAC No.5--Recognition and Measurement in Financial Statements;

SFAC No.6--Elements of Financial Statements;

#### 4.1.2. The International Accounting Standards Committee

The International Accounting Standards Committee (IASC) came into existence in 1973 as a result of an agreement by various accountancy bodies around the world. As at the beginning of 1997, the IASC had members in 88 countries, and its business is conducted by a Board comprising representatives of up to 13 countries and up to four other organisations having an interest in financial reporting. The objectives of the IASC as set out in its constitution are:

- (a) to formulate and publish in the public interest accounting standards to be observed in the presentation of financial statements and to promote their world-wide acceptance and observance; and
- (b) to work generally for the improvement and harmonisation of regulations, accounting standards and procedures relating to the presentation of financial statements.

In 1988 the IASC published *Framework for the Preparation and Presentation of Financial Statements*. The framework, and the Standards set based on it, have been adopted by some member-countries, including Indonesia (since 1994).

#### 4.1.3. The UK Initiative

The attempts to develop a conceptual framework for financial accounting in UK have been more 'complicated' and varied than those in the US. The main factor is probably because there are several professional organisations in the UK.

##### *(1) SSAP 2: Disclosure of accounting policies*

SSAP 2, which was issued in 1971, does not really set out to form part of a conceptual framework, but its content covers some of the same ground. It is aimed at assisting the user in understanding and interpreting the financial statement by promoting improvement in the quality of information disclosed. It develops the standard accounting practice for the disclosure of accounting policies in three stages. First, it describes the four fundamental accounting concepts, namely: the *going concern* concept, the *accruals* (or *matching*) concept, the *consistency* concept, and the *prudence* concept. These four fundamental accounting concepts, together with a fifth concept--the 'non aggregation' concept introduced by the *Companies Act*--have broadly been adopted by the *Companies Act 1985* as the accounting principles which should be used in the determination of all items shown in a company's financial statements, although the terms in which they are described are not identical.

The second stage is 'accounting bases', which are 'the methods developed for applying fundamental concepts to financial transactions and items, for the purpose of financial accounts, and in particular: (i) for determining the accounting

periods in which revenue and costs should be recognised in the profit and loss account; and (ii) for determining the amount at which material items should be stated in the balance sheet'. Accounting bases, therefore, are accounting treatments which have evolved in response to the necessity of having to apply the fundamental concepts to areas of practice. However, due to the variety and complexity of types of business and business transactions, there may exist more than one legitimate accounting basis for dealing with a particular item; for example, there are several acceptable accounting bases for the depreciation of fixed assets, each of which is suited to particular types of assets and business circumstances.

Finally, there are 'accounting policies', which are 'the specific accounting bases selected and consistently followed by a business enterprise as being, in the opinion of management, appropriate to its circumstances and best suited to present fairly its results and financial position.' The accounting policies selected for dealing with items which are judged material in determining financial position and profit or loss for the year should be disclosed by way of a note to the financial statements.

## (2) The Corporate Report

The first real attempt by an accounting profession in the UK to develop a conceptual framework was a discussion paper issued in 1975 by the then-styled *Accounting Standard Steering Committee* (later the ASC) and entitled *The Corporate Report*. The discussion paper dealt with 'the fundamental aims of

published financial reports and the means by which these aims can be achieved' (para. 0.7). The paper used the term 'corporate report' to mean 'the comprehensive package of information of all kinds which most completely describes an organisation's economic activity' (para. 0.8). The 'comprehensive package' should include more than the 'basic financial statements' (i.e. the balance sheet, profit and loss account, and funds statement), and should incorporate additional narrative and descriptive statements (App. 2). The paper centred around three main elements: 'the types of organisation which should be expected to publish regular financial information; the main users of such information and their needs; and the form of report which will best meet those needs' (para. 1.1). The committee argued that every economic entity of significant size has an implicit responsibility to report publicly. It then concluded that general purpose reports designed for general purpose use are the primary means by which this public accountability is fulfilled. Users were defined 'as those having a reasonable right to information concerning the reporting entity' (para. 1.8), a right which arises from the entity's public accountability. The paper identified seven user groups as having a reasonable right to information (i.e. the equity investor group, the loan creditor group, the employee group, the analyst-adviser group, the business contact group, the government, and the public (para. 1.9)), and discussed the basis of the rights of each group and their information needs.

The committee concluded that current reporting practices did not fully satisfy the needs of users. It then suggested that the following additional

statements should be published in the corporate report: a statement of value added, an employment report, a statement of money exchanges with government, a statement of transactions in foreign currency, a statement of future prospects, and a statement of corporate objectives. In addition, the committee recommended further study into methods of social accounting as well as the disgregation of certain financial information (paras. 6.56-6.57).

Finally, the committee discussed the concepts and measurements employed in the 'basic financial statements'. In considering the purpose of profit measurement, it concluded that income statements 'should be concerned with the measurement of performance although they may also be used in the measurement of capital maintenance and income distributability' (para. 7.1). Regarding the measurement basis, the committee stated that 'historical cost accounting fails, in times of rapidly changing prices and values, to ensure that sufficient provision is made for capital maintenance. When reported figures are not related to current values there may be over- or under-statement of performance as measured by profits and return on assets' (para. 7.15).

### (3) The Sandilands Report

The Sandilands report was a report by the Sandilands committee, a government Inflation Accounting Committee, made to the House of Commons by the Secretary of State for Trade and Industry. The committee's principal term of reference was 'to consider whether, and if so how, company accounts should allow

for changes (including relative changes) in costs and prices' (p. iv). *The Sandilands Report* followed a similar approach to that of *The Corporate Report*, to the extent that it focused on the information needs of users. The report stated that 'the requirements of users of accounts should be the fundamental consideration in deciding the information to be disclosed in company accounts' (para. 144).

The report proposed that the development of accounting for inflation should be an evolutionary process towards a system of current cost accounting, the essential features of which are: (a) money is the unit of measurement (as opposed to the 'current purchasing power' basis of expressing financial information in terms of a unit of measurement of constant value when prices change); (b) assets and liabilities should be shown in the balance sheet at their 'value to the business'; and (c) operating profit (to be known as 'current cost profit') is calculated after charging the 'value to the business' of the assets consumed during the period, thereby excluding holding gains and showing them separately (Chapter 12). The concept of 'value to the business' was first promulgated here as a panacea to accounting measurement difficulties (Davies et al., 1997, p. 69).

In formulating its system of current cost accounting, the committee examined three other alternative accounting systems which had been developed in an attempt to overcome the deficiencies of historical cost accounting, namely: (i) the 'current purchasing power' (CPP) method, (ii) 'value accounting' methods (i.e. replacement cost accounting based on current entry values, present value



accounting, and Continuously Contemporary Accounting or CoCoA), and (iii) Cash flow accounting.

#### (4) The Macve Report

Macve concentrated his effort on evaluating selected conceptual framework projects and studies, focusing in particular on *The Corporate Report* and the FASB's conceptual framework project. The discussions centred around the problems that arise in determining profit and net assets, and the difficulties involved in establishing what constitutes useful accounting information. Macve further highlighted the fact that the variety of user needs and conflicts of interest between different parties were likely to cause disagreement as to what information financial statements should provide (Chapter 6). On this issue, Macve came to the conclusion that 'agreement on the form and content of financial statements is as much a "political" process, a search for compromise between different parties, as it is a search for the methods which are "technically" best' (p. 52). Macve concluded his study by putting forward several suggestions for further research.

#### (5) The Stamp Report

In 1980, Professor Edward Stamp produced a research study primarily for the Canadian Institute of Chartered Accountants which was 'intended to provide a Canadian solution to the problem of improving the quality of corporate financial reporting standards.' Stamp adopted a similar approach to that of other studies (such as *The Corporate Report* and Trueblood) by looking at users, their needs,

their rights to information and the qualitative characteristics of the information. Stamp identified a more detailed list of users (15 in all) than did, for example, *The Corporate Report* or *Sandilands Report*. However, to a large extent his list merely broke down broad categories of users into smaller groups; for example, *The Corporate Report* identified the 'business contact group' as a single user group (which includes suppliers, customers, competitors and business rivals), whilst Stamp listed 'customers, suppliers, industry groups, and other companies' as individual groups (p. 44).

Stamp then developed a set of 20 qualitative criteria which could be used as yardsticks whereby standard-setters, as well as the preparers and users of published financial statements, can decide whether or not the financial statements are meeting the objectives of financial reporting and the needs of users. The criteria, which were ranked by the ASC members, are: relevance, clarity, substance over form, timeliness, comparability, materiality, freedom from bias, objectivity, rationality, full disclosure, consistency, isomorphism, verifiability, cost/benefit effectiveness, non-arbitrariness, data availability, flexibility, uniformity, precision, and conservatism. Stamp also devoted a considerable amount of effort towards discussing certain fundamental conceptual issues; these included the problems of allocation, income measurement, capital maintenance, as well as the issue of the proprietary versus the entity theory and the question of which attribute accounting should measure. Stamp concluded his study by recommending that further research be carried out in various areas of user needs and decision-making processes,

including (as did the Corporate Report) the investigation of and experimentation with multi-column reporting.

(6) The ICAS discussion document: 'Making Corporate Reports Valuable'

The Research Committee of the ICAS started off by explaining what motivated it to reconsider the nature of corporate reporting, which included the following basic conclusions:

- all financial reports ought to reflect economic reality;
- the information which investors need is the same in kind, but not in volume, as the information which management need to run their entities;
- some of the information that management has but does not normally communicate comes out into the open when management wants something-such as additional capital or to be able to defend a hostile take-over bid;
- present-day financial reports are deficient in that they are based on legal form rather than economic substance, on cost rather than value, on the past rather than the future, and on 'profit' rather than 'wealth';
- there is no consistent conceptual basis underlying the production of either the profit and loss account or the balance sheet, and some of the concepts used appear to defy normal understanding of financial affairs;
- corporate reports are not made public sufficiently speedily; and
- the audit report is insufficiently informative and is often incomprehensible to non-auditors; (in Davies et al, 1997, pp. 81-82).

The committee then considered who are the users of financial reports and what are their informational needs. It is believed that corporate reporting should aim to communicate directly to only four of the groups identified in *The Corporate Report*; they are: (i) the equity investor group, (ii) the loan creditor group, (iii) the employee group, and (iv) the business contact group (which includes ordinary creditors). The committee then listed five fundamental information needs of these

groups which external corporate reports should be able to contribute to meeting;

these are:

- knowledge of the corporate objectives of the entity, and information which would enable users to evaluate the entity's performance against these objectives;
- a comparison of the total wealth of the entity now as against what it was at the time of the last corporate report, together with an explanation of the reasons for change;
- the ability to judge where the entity is going in the future and whether it has the necessary financial and other resources to do so;
- adequate information about the economic environment within which the entity has been and will be operating; and
- knowledge of the ownership and control of the entity and the experience and background of its directors and officials (in Davies et al, 1997, p. 82).

In addition, in order to enable users to judge the reliability of management's planning based on past period performance, it was suggested that the users should also be given information on: (i) the entity's actual performance for the accounting period just past as compared with its previously published plan for that period; (ii) management's explanation of any significant variances between the two; and (iii) management's financial plan for the current and future accounting periods, together with explanations of the major assumptions used in preparing it. Clearly, these additional proposals were designed to provide information on how the management of an entity had discharged its stewardship responsibility to owners and, as the committee suggested, this assessment should be based on earnings information and entity performance.

The committee then discussed various bases for applying values to assets, focusing on historical cost, current replacement cost, current net realisable values,

and economic value. Having discussed what it saw as the deficiencies of historical cost and economic value, the committee noted that current replacement cost and net realisable value both met its criteria of economic reality and 'additivity' (i.e. the total number in a statement should not mean something different in kind from its constituent numbers). However, the committee expressed a preference for net realisable value as the basis for applying values to assets, 'principally because it is value-based whereas replacement cost is cost-based', and it felt that 'value rather than cost is important in assessing financial wealth' (in Davies et al, 1997, p. 83).

The committee then proposed an entirely new information package, using net realisable values as the basis of valuation. The four basic statements proposed to replace the existing financial statements were: (i) Assets and Liabilities Statements, (ii) Operations Statements, (iii) Statements of Changes in Financial Wealth, and (iv) Distributions Statement. The committee also suggested the inclusion of the following additional information in the reporting package:

- a Cash Flow Statement showing the inflow and outflow of cash broken down into its main components, dealing with the current period and going three years forward;
- segmental information split by product, by manufacturing location, geographical and by currency;
- information on related parties;
- information on accounting areas subject to uncertainty, for example management's view on the margin of error in accounting estimates;
- a statement on relative innovation which would illustrate the stance that the company is adopting in relation to innovation.
- information on effectiveness and lead-time of research and development;
- information on the economic environment within which the entity operates, including an analysis of facts such as market share, market strength, market size, the activities of competitors, etc.;
- comparative operational statistics 'culled from similar statements by its competitors or other entities in similar markets';

- information on staff resources; and
- information on ownership, management and their responsibilities;  
(in Davies et al, 1997, pp. 85-86)

(7) The Solomons Report (1989)

This was a study conducted by Professor David Solomons sponsored by the ICAEW. He followed what has become an almost traditional approach to a study of this nature; however, this is perhaps because in fact he acted as consultant to the FASB on its conceptual framework project and was principal author of SFAC No.2. He started by examining the purposes of financial reporting, the users of general purpose reports, their needs and how their needs were at present being met. The report then discussed the elements and sub-elements of financial statements and, in so doing, reached a conclusion on the asset and liability vs. the revenue and expense approach to financial accounting, thereby setting the scene for the rest of his study. This concluded that although ‘there is no prospect of proving that one of these views is right and the other wrong, it is possible to find reasons for preferring one view to the other, and these Guidelines will be uncompromisingly based on the asset and liability view’. Solomons’ principal argument against the revenue and expense view of income determination was that it ‘opens the door to all kinds of income smoothing’; he went on to say that ‘the revenue and expense view threatens the integrity of the balance sheet and its value as a useful financial statements. Its value is maximised if it can be seen as a statement of financial position; but it can only be that if all the items in it are truly assets, liabilities, and equity, and not other bits left over from the profit and loss

account, and if all such items that are capable of being recognised are included in it' (in Davies et al, 1997, p. 87).

Having established the fact that he would be following an asset and liability approach, Solomons then set about defining the elements of financial statements on much the same basis as was done in SFAC No. 6. Assets were defined as 'resources or rights incontestable controlled by an entity at the accounting date that are expected to yield it future economic benefits', whilst liabilities were defined as 'obligations of an entity at the accounting date to make future transfers of assets or services (sometimes uncertain as to timing and amount) to other entities'. All the other elements are then derived from these basic definitions; for example, owners' equity comprises net assets and income is the change in net assets.

The report then ran quickly through the qualitative characteristics of accounting information, giving what might be viewed as a summarised version of SFAC No. 2. Then he focused his attention on the issue of recognition and measurement and the choice of an accounting model for use in preparing general purpose financial statements. Solomons then examined the present historical cost accounting model which is generally accepted in the UK, listing its deficiencies and pointing out that it is not a true historical cost model (as a result, for example, of asset revaluation and the translation of monetary asset and liabilities designated in foreign currencies at closing rates). Then he attempted to prove that the model

which is better than any other, rests on two concepts: value to the business (as espoused by *The Corporate Report* and Sandilands Committee) and the maintenance of real financial capital.

(8) *The Future Shape of Financial Reports*

*The Future Shape of Financial Reports* was a discussion paper jointly published by the ICAS Research Committee and the ICAEW Research Board in 1991. The authors of the paper started by identifying two purposes of financial reporting: (i) to provide information to shareholders, lenders and others to appraise past performance in order to form expectations about an organisation's future performance and hence to inform their decisions concerning their relationships with the organisation; and (ii) to enable the enforcement of contracts, the terms of which include reference to accounting information. The paper identified the first of these as their primary concern (para. 1-2).

Next, the paper identified what it considered to be five main defects of existing reporting practice:

- the predominant use of historical costs;
- excessive emphasis on earnings per share;
- insufficient emphasis on cash and liquidity;
- too much focus on the past rather than the future; and
- too much emphasis on legal form rather than economic substance.  
(paras. 3-1 to 3-5)

The paper went on to suggest that an improved reporting package would comprise the following elements:

- a statement of objectives and related strategic plan;
- a statement of assets and liabilities;



- an income statement;
- a cash flow statement; and
- information on future prospects.

Regarding the measurement basis, the authors of the paper clearly had some difficulty, because previous papers had proposed different valuation approaches: MCRV had favoured exit-values, while Solomons had favoured current cost. The paper then advocated an 'eclectic' approach, choosing different approaches for different assets according to their particular characteristics, perhaps on the basis that *any* basis of current valuation is better than historical cost, but neglecting to recognise that the different methods have quite different purposes.

#### (9) The ASB's Statement of Principles

The ASB prefers to use the phrase 'Statement of Principles' rather than 'conceptual framework'. The draft of the statement was first issued in July 1991 (Chapters 1, 2, and 3), then in December 1991 (Chapter 6), July 1992 (Chapter 4), March 1993 (Chapter 5), and July 1994 (Chapter 7). The revised version was issued in November 1995 (whole Chapters, in Statement of Principles for Financial Reporting), but then effectively withdrawn in July 1996 following overwhelming criticism from commentators, with a statement that 'the Board has concluded that it would not be appropriate to proceed directly to the development of a final document'. A revised exposure draft was promised for 1997, but has not so far materialised.

In its Foreword to Accounting Standards, the ASB stated that 'FRSs are based on the Statement of Principles for Financial Reporting currently in issue, which addresses the concepts underlying the information presented in financial statements. The objective of this Statement of Principles is to provide a framework for the consistent and logical formulation of individual accounting standards. The framework also provides a basis on which others can exercise judgement in resolving accounting issues' (ASB, 1993, para. 4).

The Draft Statement of Principles is comprised of seven chapters, as follows:

Chapter 1. The objective of financial statements

Chapter 2. The qualitative characteristics of financial information

Chapter 3. The elements of financial statements

Chapter 4. Recognition in financial statements

Chapter 5. Measurement in financial statements

Chapter 6. Presentation of financial information

Chapter 7. The reporting entity.

#### 4.2. The Conceptual Framework of Financial Accounting

The matters covered in a conceptual framework of accounting include: (1) objective of financial statements; (2) qualitative characteristics which determine the usefulness of information in financial statements; (3) definitions, recognition and measurements criteria of the elements of financial statements; and (4) concepts of capital and capital maintenance (IASB; FASB; ASB). Table 4.2. at the end of this

chapter summarises the components of accounting conceptual frameworks according to the Financial Accounting Standards Board (FASB, United States), the International Accounting Standard Committee (IASC), and Accounting Standard Board (ASB, United Kingdom).

#### 4.2.1. Objectives of financial statements

The term 'financial statements' has been designated differently by different bodies or writers, in respect of identifying the objectives. The ASSC (1975, p.15) used the term 'corporate reports' in this respect, and the FASB (1978, para. 34) used the term 'financial reporting'. The ICAS (1988, para. 3.11) used the term 'external corporate reports', and the AARF (1990, para.43) used the term 'general purpose financial reports'. The CICA (1988, para. 15) used the term 'financial statements', as did the IASC (1988). Solomons (1989, p.9) used the term 'general purpose external financial reporting'. The ASB (1991) used the term 'financial statements'. The FASB (1978), the IASC (1988) and the ASB (1991, 1995), however, seem to agree regarding the difference between 'financial statements' and 'financial reporting'--that the financial statements are only part of financial reporting. FASB (1978, para. 7) states that '[f]inancial reporting includes not only financial statements but also other means of communicating information....', while IASC and ASB acknowledge that '[f]inancial statements form part of the process of financial reporting' (IASC, 1988, para. 7; ASB, 1991, *Scope*, part 8). For simplicity, this study adopts the term used by the IASC, which is also used by the

Trueblood Report, the CICA, and the ASB, that is, 'financial statements' to refer to the 'general purpose financial statements' (IASB, 1988, para. 6).

The 'economic decision' made by the 'users of financial statements' (decision usefulness approach) seems to have dominated most conceptual frameworks of financial accounting. It has most likely been influenced by the APB's definition of accounting, stated before, that

"Accounting is a service activity. Its function is to provide quantitative information, primarily financial in nature, about economic entities that is intended to be useful in making economic decisions, in making reasoned choices among alternative courses of action" (AICPA, 1970, p. 17).

The APB then considered that because financial information was used by a variety of groups and for diverse purposes, 'the needs and expectations of users determine the type of information required' (AICPA, 1970, p. 18). This view has subsequently been followed by other bodies, such as the FASB, IASB, and ASB.

The Trueblood Report (AICPA, 1973, p.13), for example, stated that 'the basic objective of financial statements is to provide information useful for making economic decisions'. The FASB, in its Statement of Financial Accounting Concepts (SFAC) No.1--*Objective of Financial Reporting by Business Enterprises*-- (FASB, 1978) identified some objectives of *financial reporting* which can be summarised as follows:

Financial reporting should provide information:

- that is useful to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions (para. 34);

- to help present and potential investors and creditors and other users in assessing the amounts, timing, and uncertainty of prospective cash receipts from dividends or interest and the proceeds from the sale, redemption, or maturity of securities or loans (para. 37);
- about the economic resources of an enterprise, the claims to those resources (obligations of the enterprise to transfer resources to other entities and owner's equity), and the effects of transactions, events, and circumstances that change resources and claims to those resources (para. 40);
- about an enterprise's financial performance during a period (para 42);
- about how an enterprise obtains and spends cash, about its borrowing and repayment of borrowing, about its capital transactions, including cash dividends and other distributions of enterprise resources to owners, and about other factors that may affect an enterprise's liquidity or solvency (para. 49);
- about how management of an enterprise has discharged its stewardship responsibility to owners (stockholders) for the use of enterprise resources entrusted to it (para. 50);
- that is useful to managers and directors in making decisions in the interests of owners (para. 52).

The FASB prefers to use the term, 'financial reporting' rather than 'financial statements', because, in its view, the former is broader than the latter as 'the financial reporting includes not only financial statements' (para. 7). The statement, moreover, focuses on the information needs of *investors* and *creditors*; and the primary focus of financial reporting is information about an enterprise's *performance* provided by measures of *earnings* and its components (para. 43). FASB still recognises the fact that financial reporting should provide information about how the management of an enterprise has discharged its stewardship responsibility (para. 50). However, it goes on to say that 'earnings information is commonly the focus for assessing management's stewardship or accountability. Management, owners and others emphasise enterprise performance or profitability

in describing how management has discharged its stewardship accountability' (para. 51). From this point, it seems that the FASB would adopt the 'income statement' approach, in which the next steps would be defining and specifying the recognition criteria and measurement of earnings and its components. However, as it will be seen later, it is not so.

The International Accounting Standards Committee (IASB, 1988), in whose work it is indebted to the FASB concepts, stated in its *'Framework for the Preparation and Presentation of Financial Statements'* that the objective of financial statements is 'to provide information about the [1] financial position, [2] performance and [3] changes in financial position of an enterprise that is useful to a wide range of users in making economic decisions' (IASB, para 12). It states further, but not in the definition of the objectives of financial statements, that '[f]inancial statements also show the result of the stewardship of management, or the accountability of management for the resources entrusted to it' (IASB, para 14). Unlike the FASB, however, the IASB focuses its conceptual framework on the objective of 'financial statements', not the 'financial reporting'.

The Accounting Standards Board (ASB) of UK, on the other hand, in its original 'Statement of Principles for Financial Reporting' (1991) stated that the objective of financial statements is 'to provide information about the [1] financial position, [2] performance, and [3] financial adaptability of an enterprise which is useful to wide a range of users in making economic decisions (para 1.1). This

objective is quite similar to the IASC's objective except that the ASB prefer to use of the term 'financial adaptability' rather than 'changes in financial position'. And exactly like the IASC, the ASB then stated that ' [f]inancial statements also show the result of the stewardship of management, that is, the accountability of management for the resources entrusted to it' (para. 1.3).

From the perspectives of the above three accounting standards boards --the FASB, the IASC and the ASB--there are some similarities regarding the objective of financial statements. The FASB, however, seems to be rather too detailed in wording; the IASC and ASB, however, have summarised what the FASB has done. In short, the financial statements are expected primarily to provide information about the (1) financial position, (2) performance, and (3) changes in financial position of an enterprise. Another similarity among them is that such information is expected to be useful to wide a range of users in (1) making economic decisions, and for (2) assessing the stewardship or accountability of management regarding the resources entrusted to it. From this point of view, the 'accountability' function of financial statements is viewed as secondary.

#### 4.2.2. Users and Their Information Needs.

As has been stated before, the APB's view that 'the needs and expectations of users determine the type of information required' (1970, p. 18) has directed the accounting standards bodies towards the 'decision-usefulness' approach. The next questions to answer are 'who are the users?', 'what economic decisions they want

to make?', and then 'what kind of information they need?'. It is believed that different users make different economic decisions, so that the information they need may be different. Can financial statements satisfy the probably conflicting needs?

The FASB identifies some potential users. They are: owners, lenders, suppliers, potential investors and creditors, employees, management, directors, customers, financial analysts and advisors, brokers, underwriters, stock exchanges, lawyers, economists, taxing authorities, financial press and reporting agencies, labour unions, trade associations, business researchers, teachers and students, and the public. A distinction is then drawn between those with direct interests--such as owners, management, creditors, and employees, and those with indirect interests--such as financial analysts and advisers, regulatory authorities, and trade unions (FASB, 1978, para. 24). However, having identified this wide range of users, the FASB focuses on the information needs of '*investors and creditors*', as it is stated in the first of primary objectives identified in the statements: 'financial reporting should provide information that is useful to present and potential *investors and creditors* and other users in making rational investment [e.g. to buy, hold or sell their shares], credit [e.g. to provide, extent, or sell their credits], and similar decisions' (FASB, 1978, para. 34). The major groups of *investors* are equity security holders and debt security holders, while the major groups of *creditors* are suppliers of goods and services who extend credit, customers and employees with claims, lending institutions, individual lenders, and debt security holders (para. 34).



The FASB stated further that:

“Potential users of financial information most directly concerned with a particular business enterprise are generally interested in its ability to generate favourable cash flows, because their decisions relate to amounts, timing, and uncertainties of expected cash flows.

To *investors, lenders, suppliers, and employees*, a business enterprise is a source of cash in the form of dividends or interest and perhaps appreciated market prices, repayment of borrowing, payment for goods or services, or salaries and wages. They invest cash, goods, or services in an enterprise and expect to obtain sufficient cash in return to make the investment worthwhile. They are directly concerned with the ability of the enterprise to generate favourable cash flows and may also be concerned with how the market’s perception of that ability affects the relative prices of its securities.

To *customers*, a business enterprise is a source of goods or services, but only by obtaining sufficient cash to pay for the resources it uses and to meet its other obligations can the enterprise provide those goods or services.

To *managers*, the cash flows of a business enterprise are a significant part of their management responsibilities, including their accountability to directors and owners. Many, if not most, of their decisions have cash flow consequences for the enterprise.

Thus, *investors, creditors, employees, customers, and managers* significantly share a common interest in an enterprise’s ability to generate favourable cash flows. Other potential users of financial information share the same interest, derived from investors, creditors, employees, customers, or managers whom they advise or represent or derived from an interest in how those groups (and especially stockholders) are faring”.(FASB, 1978, para. 24).

Based on the above explanation, the FASB (1978) concluded that “financial reporting should provide information to help investors, creditors, and others assess the *amounts, timing, and uncertainty of prospective net cash inflows* to the related enterprises” [emphasis added] (para. 37). However, this conclusion did not result

in companies being required to present cash flow, management forecast or current value information, as it is supposed should be. As an excuse, it states that

“the objective focuses on the purpose for which information provided should be useful ... rather than the kinds of information that may be useful for that purpose. The objective neither requires nor prohibits “cash flow information”, “current value information”, “management forecast information”, or any other specific information. Conclusions about “current value information” and “management forecast information” are beyond the scope of this Statement. Paragraphs 42-44 [of SFAC No. 1] note that information about cash receipts and disbursements is not usually considered to be the most useful information for the purposes described in this objective” (FASB, 1978, footnote 6).

The IASC and ASB, on the other hand, identify seven groups of users of financial statements and their information needs; they are: (1) investors, (2) employees, (3) lenders, (4) suppliers and other trade creditors, (5) customers, (6) governments and their agencies, and (7) public (IASB, 1988, para. 9; ASB, 1995, paras. 1.5 and 1.7). The focus of the financial statements, however, is for ‘*investors*’. This is because the investors are ‘providers of risk capital to the enterprise’ (IASB, 1988, para 10; ASB, 1995, para 1.5). Therefore, they are interested in information that can help them to assess the performance of management to which they have entrusted their risk capital, the risk inherent in and return provided by their investments, and the ability of the enterprise to pay dividends, so that they may be able to determine whether they should buy, hold or sell their investments (ASB, 1995, para. 1.5). It is believed that such information (about financial position, performance and financial adaptability/changes in financial position) is common and useful for other users, so that financial

statements that meet the needs of providers of risk capital to the enterprise (investors/ owners) will also meet most of the needs of other users (IASB, 1988, para 10; ASB, 1995, para. 1.6).

Having established this generalisation, the ASB then goes on to assert that ‘the economic decisions that are taken by users of financial statements require an evaluation of the enterprise’s *ability to generate cash* and the *timing* and *certainty of its generation*’ [emphasis added], and that the ‘evaluation of the ability to generate cash is assisted by focusing on the enterprise’s financial position, performance and cash flows and using these in predicting expected cash flows and assessing financial adaptability’ (para. 1.11). Financial adaptability is described as consisting of “the ability of an enterprise to take effective action to alter the amount and timing of its cash flows so that it can respond to unexpected events and opportunities. All the primary financial statements provide information that is useful in evaluating the financial adaptability of the enterprise” (para. 1.13).

The slight difference of focus regarding users, between the IASB and ASB on one hand (on investors), and the FASB on the other hand (on investors and creditors), does not seem to affect the type of information they identify as needed by users. It does, however, affect the Boards’ views regarding the ‘measurement bases’, as will be presented further.

#### 4.2.3. Components of financial statements

The FASB (1984), in its concept statement (SFAC) No. 5--*Recognition and Measurement in Financial Statements of Business Enterprises*--indicates that financial statements are the principal means of communicating useful financial information. A full set of such statements are: (1) Financial position at end of the period, (2) Earnings for the period, (3) Comprehensive income for the period, (4) Cash flows during the period, and (5) Investments by and distributions to owners during the period. Information about financial position is given by the 'balance sheets', and information about earnings and comprehensive income are given in the 'income statement'.

The IASC identifies four components of financial statements, [1] balance sheet, as the statement of financial position, [2] income statement, as the statements of performance, [3] separate statement for information about 'changes in financial position', and [4] notes and supplementary schedules (IASB, 1988, paras. 19, 21). However, the IASC did not specify the statement for changes in financial position. In its later Standards, it seems that the IASC mean 'Cash Flow Statements' as the statement of changes in financial position.

The difference between IASC and FASB is probably the order of importance, in which the FASB put the importance more on the 'income statements' rather than the 'balance sheet'. As has been stated before, the FASB still recognises the fact that financial reporting should provide information about

how the management of an enterprise has discharged its stewardship responsibility (FASB, 1978, para. 50). However, it goes on to say that ‘earnings information is commonly the focus for assessing management’s stewardship or accountability. Management, owners, and others emphasis enterprise performance or profitability in describing how management has discharged its stewardship accountability’ (para. 51). In other words, the FASB is asserting that the measurement of earnings in the income statement (income statement/profit & loss approach) should take precedence over the measurement of assets and liabilities in the balance sheet (balance sheet approach).

The ASB, on the other hand, uses a rather different approach. It specifies the primary financial statements component as: [1] the profit and loss account, [2] the statement of total recognised gains and losses, [3] the balance sheet, and [4] the cash flow statement (para. 6.11). Other components, which are not considered as primary, are: notes to financial statements (para. 6.13) and supplementary information (para. 6.17). The profit and loss account and the statement of total recognised gains and losses are considered as providing information regarding ‘the performance’ of the enterprise, the balance sheet provides information regarding ‘the financial position’, and they altogether, ( but especially the cash flow statement), provide information about ‘financial adaptability’ of the enterprise (paras. 6.46-6.49).

#### 4.2.4. Qualitative Characteristics

The characteristics of quality information, even though they may seem to be common sense, have been identified, specified and classified rather differently by IASC, FASB and ASB. The principal characteristics of quality information, however, are quite similar among them, especially the IASC and the ASB.

The FASB (1980), in its second Concepts Statement (SFAC No. 2--*Qualitative Characteristics of Accounting Information*), viewed the characteristics that make accounting information useful to the users of that information as 'a hierarchy of accounting qualities', which then form the basis for selecting and evaluating information for inclusion in financial reports. The hierarchy is represented in Figure 4.1. below.

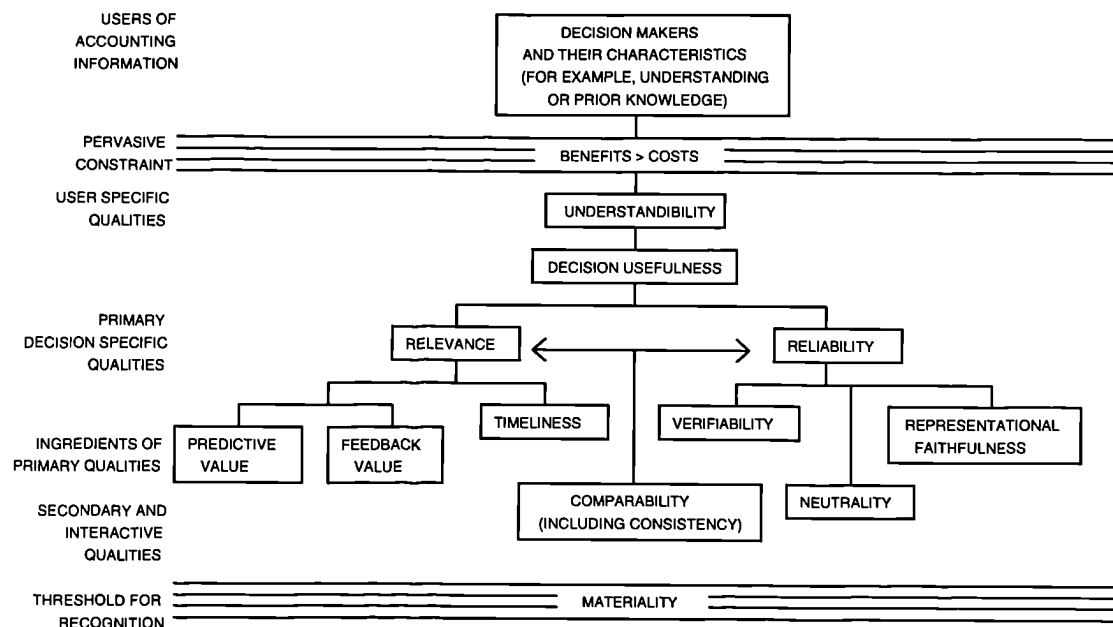


Figure 4.1. Hierarchy of Accounting Qualities (SFAC No. 2)

The IASC (1988), furthermore, identified four principal qualitative characteristics of useful information; namely: *understandability*, *relevance* (including *materiality*), *reliability* (including factors influencing it, those are: *faithful representation*, *substance over form*, *neutrality*, *prudence*, and *completeness*), and *comparability* (para. 24). It also identified some constraints on relevant and reliable information, namely: *timeliness*, *balance between benefit and cost*, and *balance between qualitative characteristics* (paras. 43-45).

The ASB (1991), on the other hand, distinguished between primary characteristics that relate to content, which are *relevance* and *reliability*; and those that relate to presentation, which are *comparability* and *understandability*. These are quite similar to factors identified by the IASC. It also identified *materiality* as a criterion for relevant and reliable information. (Refer to Figure 4.2. on the next page)

The structure of these qualitative characteristics may be different among them (FASB, IASC and ASB); however, the meanings are similar. They are as follows:

*Materiality.* Materiality is said by the FASB, IASC and ASB to be a 'threshold' criterion which means 'one that needs to be considered first', because if information is immaterial, the other characteristics do not matter. Information is material if its omission or misstatement could influence the economic decisions of

users taken on the basis of the financial statements. Material information, then, could be relevant or not, depending on the decision that the users will make.

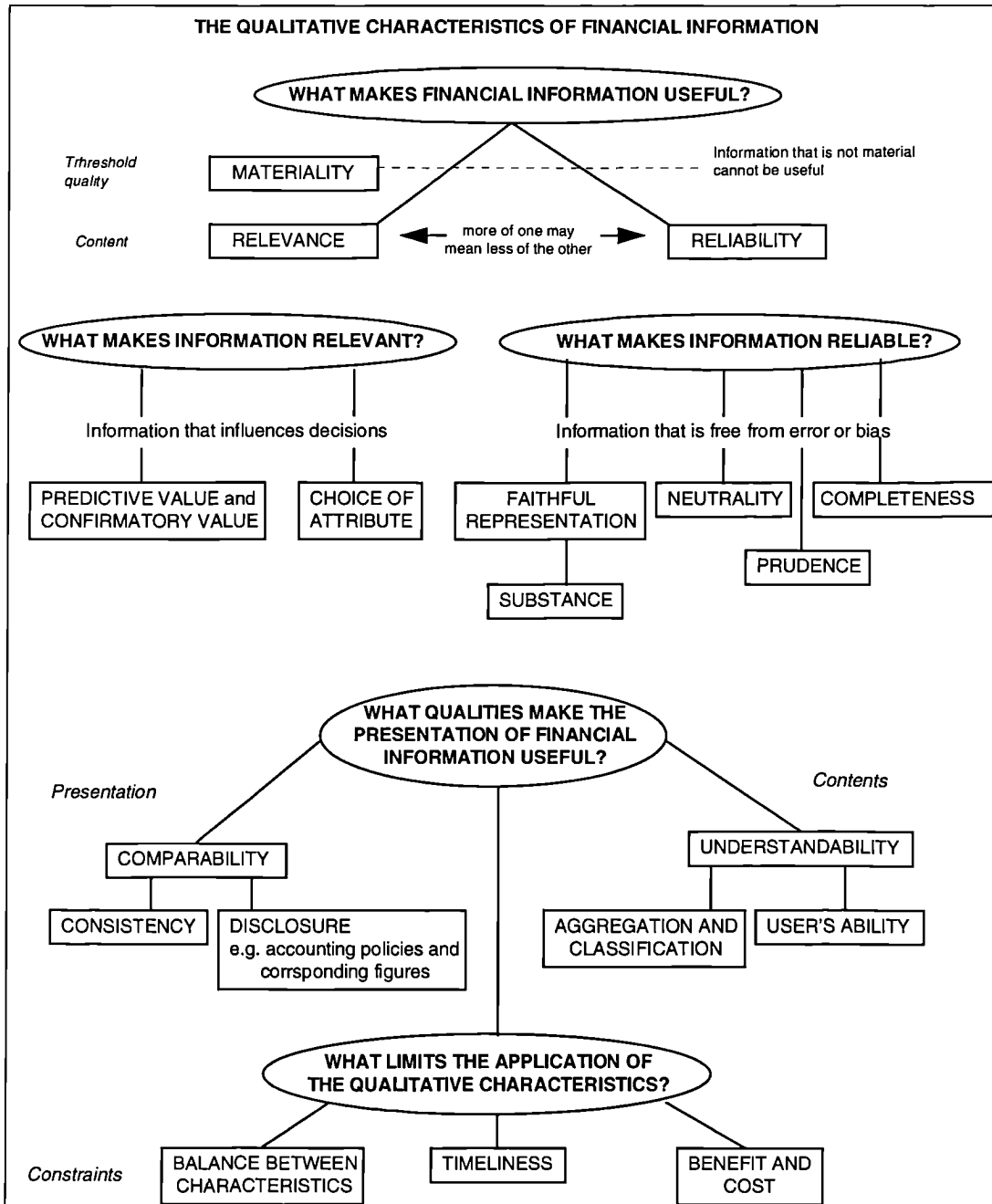


Figure 4.2. The ASB's Qualitative Characteristics of Financial Information



*Relevance.* To be useful, information must be relevant to the decision-making needs of users. Information has the quality of relevance when it influences the economic decisions of users by helping them evaluate past, present or future events or confirming, or correcting, their past evaluations (*confirmatory value* and *predictive value*), and it is *timely* (as included in the FASB, 1980, para. 56).

*Reliability.* To be useful, information must also be reliable. To be reliable, information must:

- (1) represent faithfully the transaction and other events it either purports to represent or could reasonable be expected to represent (*faithful representation*). Information faithfully represents the transaction and other events that it purports to represent if they are accounted for and represented in accordance with their substance and economic reality and not merely their legal form (*substance*).
- (2) be *neutral*, that is, free from bias. To be neutral, the FASB includes *verifiability* as another characteristic (1980, paras. 81-89).
- (3) be *complete* within the bounds of materiality and cost.
- (4) be prepared with *prudence*; that is, not deliberately overstated income or assets, or understated expenses or liabilities, when there is uncertainties involved. The FASB refers this as 'conservatism' (1980, paras. 91-97).

*Comparability.* Users of information must be able to compare the financial statements of an enterprise through time in order to identify trends in its financial position and performance (*consistency*). Users must also be able to compare the financial statements of different enterprises in order to evaluate their relative financial position, performance and changes in financial position (adaptability) (*uniformity*).

*Understandability.* Information provided in financial statements must be readily understandable by users. For this purpose, users are assumed to have a reasonable knowledge of business and economic activities and accounting and a

willingness to study the information with reasonable diligence. However, information about complex matters that should be included in the financial statements because of its relevance to the economic decision-making needs of users should not be excluded merely on the grounds that it may be too difficult for certain users to understand.

To sum up, there are similarities among these three frameworks. First, they all recognised *understandability*, *relevance*, *reliability*, and *comparability* as the main (primary) qualitative characteristics of useful information. Secondly, they all recognised *materiality* as the threshold. Lastly, they all realised the ‘*benefit-cost*’ constraint. The ASB, further, classifies *relevance* and *reliability* as the primary qualities of the content, and *understandability* and *comparability* as the primary qualities of the presentation. The greatest difference among them relates to *timeliness*, which the FASB placed as one of the factors influencing relevance, while the IASC and ASB view it as a constraint. It is right that relevant information will be useful only if it is obtained in time (FASB). However, it is realised that timely information will be most likely be difficult to obtain due to some technical difficulties in preparing financial statements (IASC and ASB).

#### 4.2.5. Elements of financial statements

The SFAC No. 6--*Elements of Financial Statements*--of FASB (1985) specifies and defined ten elements of the financial statements: (1) assets, (2) liabilities, (3) equity, (4) investment by owners, (5) distribution to owners, (6)

comprehensive income, (7) revenues, (8) expenses, (9) gains, and (10) losses. The IASC (1988), on the other hand, only identifies five main element of financial statements, which form the statements of financial position and performance. Those that form the statement of financial position are: (1) assets, (2) liabilities, and (3) equity; and those that form the statement of performance are: (1) income (includes *gains*) and (2) expenses (includes *losses*) (paras. 49-70). The ASB (1991), moreover, identifies and defines seven elements of financial statements; those are: (1) assets, (2) liabilities, (3) ownership interest, (4) gains, (5) losses, (6) contributions from owners, and (7) distributions to owners (paras. 3.1-3.49). Moreover, the definitions of each of them, even those with the same names, are sometimes quite different.

#### *(1) Assets*

Assets have been defined as being:

‘probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events’ (FASB, 1985, para. 26).

‘a resource controlled by the enterprise as a result of past events and from which future economic benefits are expected to flow to the enterprise’ (IASB, 1988, para. 49(a)).

‘rights or other access to future economic benefits controlled by an entity as a result of past transactions or events’ (ASB, 1991 & 1995, para. 3.5).

Even though the wordings seem to be different, however, there are three key words or phrases which are similar in the above three definitions. They are: (1) future economic benefits, (2) controlled, and (3) as a result of past

events/transactions. The word 'resource' in the IASC's definition refers to the FASB's statements that the kinds of items that qualify as assets under this definition are also commonly called 'economic resources', i.e. the scarce means that are useful for carrying out economic activities, such as consumption, production and exchange (FASB, 1985, para. 27). The FASB states further that the common characteristics possessed by all assets is 'service potential' or 'future economic benefit' which eventually results in net cash inflows to the enterprise (para. 28).

The phrase 'rights or other access' in ASB's definition seems to emphasise that the ability to enjoy benefits does not necessarily imply an ownership interest; and the phrase is also broad enough to imply that the benefits may be uncertain, so the word 'probable' (as in the FASB's definition) is not needed.

## *(2) Liabilities*

Liabilities have been defined as being:

'probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events' (FASB, 1985, para. 35).

'a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits' (IASB, 1988, para. 49(b)).

'obligations of an entity to transfer economic benefits as a result of past transactions or events' (ASB, 1991 & 1995, para. 3.21).

There are also three characteristics of liabilities which are similar among the above definitions: (1) present obligation, (2) to transfer (outflow) of economic benefit (in the future), and (3) as a result of past transactions. By definition, liabilities are the reverse of assets; therefore, they are sometimes also called 'negative' assets.

### *(3) Equity, or Ownership Interest (ASB)*

Equity, or Ownership Interest (ASB), has been defined as being:

'the residual interest in the assets of an entity that remains after deducting its liabilities' (FASB, 1985, para. 49).

'the residual interest in the assets of the enterprise after deducting all its liabilities' (IASB, 1988, para. 49(c)).

'the residual amount found by deducting all of the entity's liabilities from all of the entity's assets' (ASB, 1991 & 1995, para. 3.39).

The wordings of the above definitions are similar, and the logic is identical and follows from the accounting equation that assets minus liabilities equals equity ( $A - L = E$ ). Equity is, in fact, the sum of the equity investment made by the entity's owners, and the entity's earnings retained from its profit-making activities.

### *(4) Investment by Owners/Contribution from owners*

Investment by owners (FASB), or contribution from owners (ASB), are defined as being:

‘increases in equity of a particular business enterprise resulting from transfers to it from other entities of something valuable to obtain or increase ownership interests (or equity) in it’ (FASB, 1985, para. 66).

‘increases in ownership resulting from investments made by owners in their capacity as owners’ (ASB, 1991 & 1995, para. 3.49).

The ASB’s definition is a straightforward, and is needed in order to exclude capital injections from being included within the definition of *gains*. Although investment (contribution) by owners is most commonly made in the form of assets, it can also be represented by services, or the settlement or conversion of liabilities of the enterprise. The IASC does not offer any definition regarding this matter.

#### *(5) Distribution to owners*

Distribution to owners has been defined as being:

‘decreases in equity of a particular business enterprise resulting from transferring assets, rendering services, or incurring liabilities by the enterprise to owners’ (FASB, 1985, para. 67).

‘decreases in equity resulting from transfers made to owners in their capacity as owners’ (ASB, 1991 & 1995, para. 3.49).

The FASB’s definition incorporates all forms of capital distributions which result in a decrease in net assets. The ASB’s definition is, again, straightforward, to prevent dividends and capital repayments being categorised as *losses*.

*(6) Comprehensive Income and its components (only in FASB)*

Comprehensive income is defined as:

‘the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. It includes all changes in equity during a period except those resulting from investments by owners and distributions to owners’ (FASB, 1985, para. 70).

This definition is not consistent with SFAC No. 1 that ‘the primary focus of financial reporting is information about an enterprise’s performance provided by measures of earnings and its components’, which means an adoption of ‘*income statement approach*’. However, defining ‘comprehensive income’ as ‘change in equity’, i.e. ‘change in net assets (assets minus liabilities)’ is an adoption of a ‘*balance sheet approach*’, in which the definition refers back to the definition of assets and liabilities.

Moreover, the SFAC No. 6 (in a footnote) stated that the term ‘comprehensive income’ is what the SFAC No. 1 (footnote 1) called ‘earnings’. SFAC No. 5, however, had described ‘earnings’ for a period as *excluding* certain cumulative accounting adjustments and other non-owners changes in equity that are included in ‘comprehensive income’ for a period. It seems that the FASB is not consistent in using the terms.

FASB (1985), furthermore, identifies four components of comprehensive income, namely: *revenues*, *expenses*, *gains*, and *losses*. They have been defined as follows:

*Revenues* are 'inflows or other enhancements of assets of an entity, or settlements of its liabilities (or combination of both) from delivering or producing goods, rendering services, or other activities that constitute the entity's ongoing major central operation' (para. 78).

*Expenses* are 'outflows or other using up of assets, or incurrences of liabilities (or combination of both) from delivering or producing goods, rendering services, or carrying out other activities that constitute the entity's ongoing major or central operation' (para. 80).

*Gains* are 'increases in equity (net assets) from peripheral or accidental transactions of an entity and from all other transactions and other events and circumstances affecting the entity except those that result from revenues or investment by owners' (para 82).

*Losses* are 'decreases in equity (net assets) from peripheral or accidental transactions of an entity and from all other transactions and other events and circumstances affecting the entity except those that result from expenses or distribution to owners' (para 83).

From the above definitions, 'comprehensive income' [CI] then equals 'revenues' [R] minus 'expenses' [E] plus 'gains' [G] minus 'losses' [L]; or,  $CI = (R - E) + (G - L)$ . However, although the statement states that revenues, expenses, gains and losses can be combined in various ways to obtain various measures of enterprises performance (para. 77), it fails to define 'net income' (Davies et al, 1994, p. 54).

From the above definitions, also, it can be known that *increases* in equity may be from: (1) revenues (operational/ordinary activities), (2) gains (non-operational/extra-ordinary activities), and (3) investment by owners; while



*decreases* in equity may be from: (1) expenses (operational/ordinary activities), (2) losses (non-operational/ extra-ordinary activities), and (3) distribution to owners. The changes in equity according to the FASB can be represented diagrammatically as follows.

Increases the equity	Sources	Decreases the equity
Revenues ←	Operational (Ordinary)	→ Expenses
Gains ←	Non-operational (Extra-ordinary)	→ Losses
Investment ←	Owners	→ Distribution

Figure 4.3. Sources of changes in ownership interest a/t the FASB.

The IASC, on the other hand, did not provide a definition of ‘comprehensive income’; instead, it defined ‘income’ and ‘expenses’ which form the ‘net income’, which is probably equivalent to the FASB’s comprehensive income. Income and Expenses are defined by the IASC as follows:

*Income* are ‘increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contribution from equity participants’ (para. 70(a)).

*Expenses* are ‘decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants’ (para. 70(b)).

The definition of income encompasses both 'revenue' and 'gains'. *Revenue* arises in the course of the ordinary activities of an enterprise and is referred to by a variety of different names including sales, fees, interest, dividends, royalties and rent (IASC, 1988, para. 74). *Gains*, on the other hand, represent other items that meet the definition of income and may, or may not, arise in the course of the ordinary activities of an enterprise (para. 75). The definition of income includes *realised* gains (e.g. those arising from the disposal of non-current assets) as well as *unrealised* gains (e.g. those arising on the revaluation of marketable securities and those resulting from increases in the carrying amount of long term assets) (para. 76).

The definition of expenses, on the other hand, encompasses *losses* as well as those expenses that arise in the course of the ordinary activities of the enterprise such as cost of sales, wages and depreciation (para. 78). While *losses* represent other items that meet the definition of expenses and may, or may not, arise in the course of the ordinary activities of the enterprise (para. 79). Losses include, for example, those resulting from disasters such as fire and flood, as well as those arising on the disposal of non-current assets. The definition of expenses, further, also includes *unrealised losses*, such as those arising from the effect of increase in the rate of exchange for foreign currency in respect of borrowings of an enterprise in that currency (para. 80). The changes in ownership interest according to the IASC can be represented as follows.

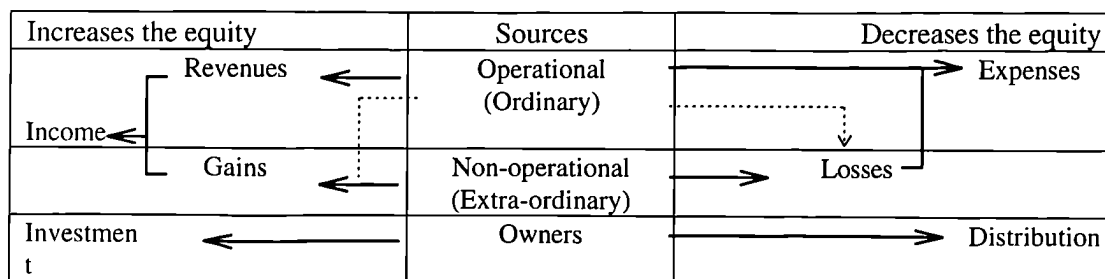


Figure 4.4. Sources of changes in ownership interest a/t the IASC.

The ASB, like the IASC, also does not provide the definition of ‘comprehensive income’; instead it provides the definition of ‘gains’ and ‘losses’ which comprise the comprehensive income. However, the definition of gains and losses according to the ASB’s ‘inconsistent’ with the IASC’s definition. ASB (1991, 1995) defines them as follows:

*Gains* are ‘increases in ownership interest, other than those relating to contributions from owners’ (para. 3.47).

*Losses* are ‘decreases in ownership interest, other than those relating to distributions to owners’ (para. 3.47).

The definition of ‘gains’ includes both the gains arising in the ordinary courses of business (sometimes referred to as ‘revenue’) as well as other kinds of gains (para. 3.48); similarly, ‘losses’ includes the ‘expenses’ arising in the ordinary courses of business (‘expenses’) as well as other kinds of losses (para. 3.48). These definitions seem to be ‘inconsistent’ with the definitions offered by the FASB and the IASC. What the ASB defines as ‘gains’ are what the IASC defines as ‘income’; and what the ASB defines

as 'losses' are what the IASC defines as 'expenses'. The changes in ownership interest according to the ASB then can be depicted as follows.

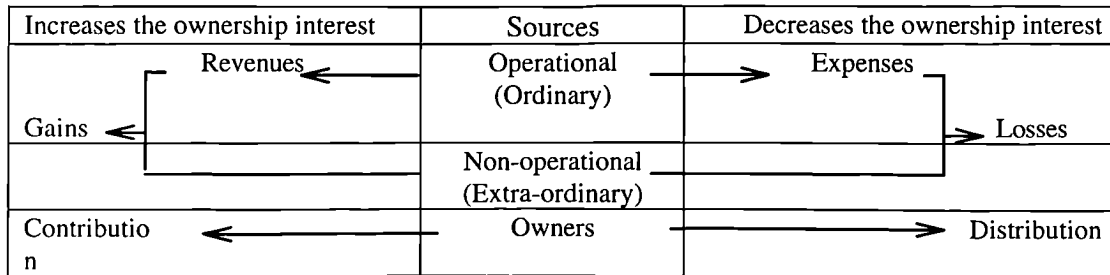


Figure 4.5. Sources of changes in ownership interest a/t the ASB.

Figure 4.6. below summarises the elements of financial statement as identified and defined by the FASB, IASC and ASB.

FASB (US)	IASC	ASB (UK)	
1. Assets	1. Assets	1. Assets	
2. Liabilities	2. Liabilities	2. Liabilities	
3. Equity	3. Equity	3. Ownership interest	
4. Investment by owners		6. Contribution from owners	
5. Distribution to owners		7. Distribution to owners	
6. Comprehensive Income			
7. Revenues	4. Income	4. Gains	'Comprehensive Income'
8. Expenses	5. Expenses	5. Losses	
9. Gains			
10. Losses			

Figure 4.6.

Elements of Financial Statements: Comparison between FASB, IASC and ASB

#### 4.2.6. Recognition and measurement criteria, and capital maintenance concepts.

The FASB (1984), in its statement (SFAC) No. 5--*Recognition and Measurement in Financial Statements of Business Enterprises*, defines recognition

as 'the process of formally recording or incorporating an item into the financial statements of an entity as an asset, liability, revenue, expense, or the like' (para. 58). It then discusses four 'fundamental recognition criteria' which any item should meet in order to be recognised in the financial statements on an entity. These criteria, which are subject to a 'cost-benefit constraint' and a 'materiality threshold', and are no more than an encapsulation of certain criteria contained in SFAC No. 2--*Qualitative Characteristics of Accounting Information*, are:

- *Definitions*--the item meets the definition of an element of financial statements;
- *Measurability*--the item has a relevant attribute measurable with sufficient reliability;
- *Relevance*--the information about the item is capable of making a difference in user decisions;
- *Reliability*--the information is representationally faithful, verifiable and neutral; (para. 63).

Regarding the 'measurement', SFAC No. 5 tends to *describe current practice* rather than propose improvement or indicate preferences. For example, in dealing with 'measurement attributes' it states that 'items currently reported in financial statements are measured by different attributes, depending on the nature of the item and the relevance and reliability of the attribute measured' (FASB, 1984, para 66). Furthermore, instead of prescribing particular measurement attributes, or discussing the circumstances under which particular attributes should apply, the statement discusses five different attributes which 'are used in present practices' (namely: historical cost, current cost, current market value, net realisable value, and present value of future cash flows) and concludes that 'the use of different attributes will continue' (FASB, 1984, paras. 66-70). At the end, the

statement also fails to prescribe a particular ‘concept of capital maintenance’ that should be adopted by an entity, although the FASB bases its discussions on the concept of ‘financial capital maintenance’ (FASB, 1984, para 45-48).

In its statement (SFAC) No. 5, the FASB (1984) distinguishes between ‘*comprehensive income*’ (one element of financial statements), *earnings* (SFAC No. 1) and *net income*. It is stated that the concept of ‘earnings’ is similar to ‘net income’ in present practice, and that a ‘statement of earnings’ will be much like a present ‘income statement’, although ‘earnings’ does not include the cumulative effect of certain accounting adjustments of earlier periods that are recognised in the current period (FASB, 1984, paras. 33-34). However, the statement goes on to say that the FASB ‘expects the concept of earnings to be subject to the process of gradual change or evolution that has characterised the development of net income’ (FASB, 1984, para. 35) without indicating what it considers to be the desirable direction for the gradual change to follow. Furthermore, the FASB seems to be stating that concepts will evolve as accounting standards are developed, instead of the other way around (Davies et al, 1994, p. 55).

The IASC, being much indebted to the FASB’s work, does not depart significantly from the FASB. It defines recognition as ‘the process of incorporating in the balance sheet or income statement an item that meets the definition of an element and satisfies the criteria for recognition’ (para. 82). The criteria, after meeting the *definition*, are:

- it is probable that any future economic benefit associated with the item will flow to or from the enterprise; and
- the item has a cost or value that can be measured with reliability; (IASB, 1988, para. 83).

Materiality, however, should be considered in assessing whether an item meets the above criteria and therefore qualifies for recognition in the financial statements (para. 84).

Regarding the 'measurement', it does not make any progress compared with the FASB. Like its 'predecessor' (the FASB) it does not prescribe nor indicate any preferences regarding the 'measurement bases', instead of stating that 'a number of different measurement bases (namely: historical cost, current cost, realisable/settlement value, and present value) are employed to different degrees and in varying combination in financial statements' (IASB, 1988, para. 100). Indeed, it mentions that 'the measurement basis most commonly adopted by enterprises in preparing their financial statements is historical cost', which is usually combined with other measurement bases (para. 101); however, once again, it does not prescribe nor indicate any preferences. Consequently, the framework also does not prescribe any 'concept of capital and capital maintenance', even though it discusses two of them, i.e. financial and physical capital maintenance concepts.

The ASB (1995), on the other hand, does not define the meaning of 'recognition'; it only states that recognition 'involves depiction of the item in words and by a monetary amount and the inclusion of that amount in the statement

totals' (para. 4.1). Besides meeting the definitions, any item should be recognised in financial statements if they also meet the criteria. The statement categorises the recognition criteria into: initial recognition, subsequent remeasurement, and derecognition.

An element should be [initially] recognised if:

- (a) there is sufficient evidence that the change in assets or liabilities inherent in the elements has occurred (including, where appropriate, evidence that a future inflow or outflow of benefit will occur); and
- (b) it can be measured at a monetary amount with sufficient reliability; (ASB, 1995, para. 4.6).

A change in the amount at which an asset or liability is recorded should be recognised if:

- (a) there is sufficient evidence that the amount of an asset or liability has changed; and
- (b) the new amount of the asset or liability can be measured with sufficient reliability; (ASB, 1995, para. 4.7).

Furthermore, “an asset or liability should cease to be recognised if there is no longer sufficient evidence that the entity has access to future economic benefits or an obligation to transfer economic benefits (including, where appropriate, evidence that a future inflow or outflow of benefit will occur)” (ASB, 1995, para. 4.8). At any stage in the recognition process, where a change in total assets is not offset by an equal change in total liabilities or a transaction with owners, a gain or loss will arise (para. 4.9).

In the ‘measurement’ aspect, the ASB makes a big deal by introducing the concept of ‘value to the business’. The value to the business rule values the assets at replacement (rather than historical) cost if the recoverable amount is higher, i.e.



if the asset is one that the entity would replace. If replacement is not justified, the asset is valued at recoverable amount (para. 5.35). It is diagrammed as follows:

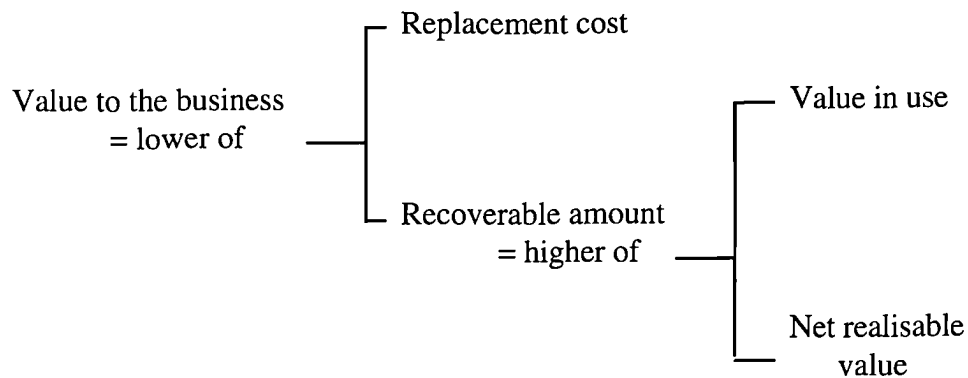


Figure 4.7. Value to the business

In the case of liabilities, the use of the value to the business rule is an unnecessary complication because the various values will converge to a single current value and thus market values may be used (ASB, 1995, para. 5.36).

Unlike the FASB and IASC, the ASB does indicate a preference for the use of 'real terms capital maintenance system' and the application of 'current values' (ASB, 1995, paras. 5.37, 5.38).

#### 4.3. Comments and Criticism on Conventional Accounting.

It is believed that a conceptual framework is needed in order to assist and guide standard setters in evaluating, developing and proposing accounting standards. In the absence of a specific promulgated standards, the conceptual

framework is expected to provide a frame of reference for resolving accounting questions. The conceptual framework is also expected to assist the preparers of financial statements to determine bounds for judgement in preparing financial statements and dealing with topics that have yet to subject of the standard. It is also expected to assist auditors in preparing opinions and to increase the users' understanding and confidence in financial reporting. Finally, the comparability of financial statements is also believed to be enhanced, as the conceptual framework will assist standards setting bodies in promoting harmonisation of regulations, accounting standards and procedures relating to the presentation of financial statements by providing a basis for reducing the number of alternative accounting treatments permitted.

The logical relationship of the contents of the conceptual framework of accounting described above can be diagrammed as follows.

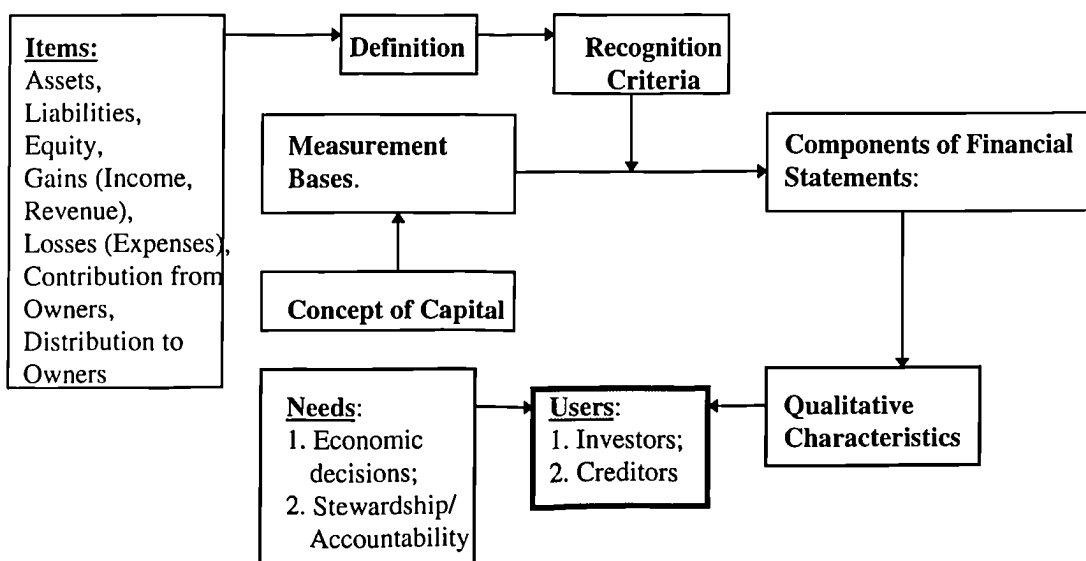


Figure 4.8. Diagram of the Conceptual Framework.

The 'accounting conceptual framework questions' then can be traced back from the 'users' to 'qualitative characteristics', 'components of financial statements', 'recognition criteria', 'measurement criteria', 'concept of capital', and the 'items and their definitions'. The questions are as follows:

- (1) Who is (are) the user(s) of financial statements?
- (2) What is (are) their need(s)?
- (3) What is (are) the qualitative characteristic(s) of information which fulfil(s) their needs?
- (4) In what form should the information be presented?
- (5) What is (are) the 'basic assumption(s)' underlying the preparation of that statements?
- (6) What items should be reported?
- (7) How should the items be reported and measured?
- (8) What is the logic (concept) underlying the measurement bases (basis) used?

From the study on the US, IASC, and UK conventional accounting concepts, it can be concluded that the conventional accounting has been developed to satisfy the needs of 'investors and creditors' only, even though the conceptual frameworks listed some other potential users. These two primary users are the dominant owners of capital in the society (capitalists). Within the capitalistic economic system, they are the 'elite groups' which control the economy and political life. Their existence is also legally well supported, as they are the dominant groups influencing the law making process.

With this starting point, i.e. investors and creditors as the primary users of information, the rest of the 'accounting questions' mentioned before are directed to satisfying the needs of these users. Therefore:

- The information prepared should fulfil the qualitative criteria (relevance, reliability, etc.) useful for the users (investors and creditors) to make their own economic decisions.
- The components of information should be presented in such a way so that satisfies the qualitative criteria mentioned. For this reasons, the information should be prepared based on certain 'basic assumptions' (accrual basis, going concern, etc.).
- The items reported in the financial statements should fulfil certain 'criteria for recognition', and should be measured according to certain 'measurement bases' based on certain 'concept of capital maintenance'. The conventional accounting favours the 'historical cost' measurement basis, based on a 'financial concept of capital maintenance'.

It is important to note that the definition of accounting proposed by AICPA in its APB Statement No. 4 (October, 1970) has been dominating and directing the development of accounting in the Western English-speaking (Anglo-American) countries. The definition has led to the 'decision usefulness' approach in guiding the standards setters. There are some criticisms of conventional accounting, with regards to the decision usefulness orientation, and as far as the 'conceptual framework' is concerned. Among them are:

#### *4.3.1. Users and their needs.*

All frameworks identify and recognise that there are many users of financial information. They also acknowledge that different users may have different needs. Taylor and Turley (1986), moreover, identified that different users would make different economic decisions, which are summarised in Table 4.1. below. It is

difficult, then, for such different needs to be satisfied by a single set of financial information which is prepared for ‘investors’ (and creditors) only.

Table 4.1. The decisions of users of accounting information

Management	Shareholders	Short-term suppliers of resources	Long-term suppliers of resources	Employees	Consumers	Government
1. Investment	1. Share purchase, holding or selling	1. Whether to supply resources	1. Whether to supply resources	1. Supply of labour	1. Purchase of goods or services	1. Taxation and subsidies
2. Acquisition & divestment		2. Choice of terms for supply	2. Choice of terms for supply	2. Employment contract, wages and conditions	2. After sales services	2. Regulation
3. Research and development		3. Fore-closure	4. Fore-closure			
4. Financing policy and financial structure						
5. Dividend policy						
6. Funds management						
7. Choice of technology			5. Purchase, holding or sale of securities			4. Supply of goods and services
8. Choice of inputs						
9. Bargaining on input costs and terms						5. Macro-economic policies
10. Pricing and output						
11. Stock holding						
12. Debtors and Creditors management						
13. Choice of suppliers of resources						

#### 4.3.2. Decision Usefulness vs. accountability and stewardship.

Among the three accounting bodies examined (FASB, IASC, and ASB), they broadly agreed, yet there were differences in detail, that:

- (1) financial statements are intended to serve *users*;
- (2) balance sheet, income statement ( or profit and loss account, and unrealised gains and losses statement), supplemented by funds statement (or a cash flow statement) are ‘fundamental financial statements’; and

(3)users are concerned with *economic* evaluation and decision making. (This implies that measurement should strive to reflect actual economic opportunities and steer us towards current valuation and the estimation of future prospects, rather than historical cost valuation and concentration on past transaction).

The users' economic decision orientation is frequently opposed to the traditional 'stewardship' orientation. The stewardship orientation of financial statement focus on how the stewards (directors) discharge the resources entrusted to them by owners/investors. Therefore, it is claimed that stewardship oriented financial statements provide information about the past, so that it is not relevant for decision making. This view has been argued by Page (1991, p. 31) who stated that: 'In my opinion the ASB should acknowledge that the decision-usefulness concept gives meagre guidance and should concentrate on setting standards which enhance the stewardship or control function of accounting'. Page continued (p.31):

"... it is the existence of financial reporting which limits the freedom of directors and companies to behave opportunistically. The knowledge that actions and their effects will be reported causes management to act differently than would otherwise be the case. Stewardship reporting is different in kind from mere provision of information for decisions."

Whittington (1991), on the other hand, argued that the stewardship concept is not inconsistent with economic decisions;

"The idea that stewardship is inconsistent with economic decisions was destroyed originally by the biblical parable of the talents [Matthew 25: 14-30] ... Those users who wish to assess the stewardship of management do so in order that they make economic decisions [e.g. whether to hold or sell their investment in the enterprise or whether to re-appoint or replace the management] ... It

would be a singularly ineffective form of stewardship which did not lead to a decision of this type ...” (p. 33).

Whittington (1996, p.7) argued further that:

“The traditional role of the financial statements is as a statement of stewardship by the directors. Although this is sometimes interpreted as requiring merely a factual account of how the directors have disturbed shareholders’ funds, as a check on their honesty, good stewardship is also a matter of good management, as the biblical parable of the talents reminds us.”

Conventional accounting with its reductionist decision usefulness approach has been soundly criticised by, among others, Laughlin & Puxty (1981), Chua (1986), Cooper & Sherer (1984), Tinker et al (1982), and Gray et al (1996) for constructing a social reality which results in an inequitable, exploitative world. Its implicitly stated goal of enhancing social welfare (AAA, 1975) by increasing economic growth and wealth which is accepted as ‘revealed truth’ by mainstream researchers and the accounting profession have been soundly criticised (e.g. Gray et al., 1996, and Laughlin & Puxty, 1981). As stated by Laughlin & Puxty (1981), “..Social welfare cannot be appealed to by suggesting that if user needs (i.e. information to maximise wealth in terms of share price) are satisfied, greater welfare will result, because of the operation of the Lipsey-Lancaster theorem”. The recognition that the world’s *bad news* (i.e. widespread poverty, environmental degradation, inequitable distribution of income and wealth, etc.) is related to the *good news* (i.e. high standard of living in the West and newly industrialised countries, longer life span, globalisation and developments in computer and communication technology, etc.) and conventional accounting based on the

decision usefulness, functionalist paradigm is partly responsible for creating this social reality and continues to motivate behaviour in the direction of self-destruction has resulted in the “need to replace the user needs approach with the more fundamental concept of accountability” (Gray et al., 1991, 1996).

This is, therefore, probably, why the ‘late’ UK (1995) and the IASC (1988) considered the ‘accountability, or stewardship’ as the second objective of financial statement in their respective conceptual framework.

Parker (1991) criticised the ‘accountability model’ as ‘resembling the principal-agent closely’. However, Gray et al. (1996) refutes this allegation by stating that the ‘whole raft of assumptions’, i.e. self interest and greed and utility maximising conflicting behaviour, is not necessary in the accountability model. The accountability model does not assume this reductionist philosophy but works for the betterment of both the accountant and the accountee. It holds promise not only as a framework for corporate social and environmental accounting but to reform conventional accounting as well.

Parker (1986) also argued that accountability has been equated with stewardship. However, accountability assumes that in addition to providing an account of the use of the resources entrusted, information on the effects of the use (e.g. environmental degradation) must be reported as well. Thus stewardship can be seen to be a ‘special, simple case of accountability’ (Gray et al. (1988).



Moreover, stewardship seems too simplistic a concept in the era of multinational corporations and other entities which significantly use community resources and assets. Thus, the Corporate Report 1975 by the ASSC defined the notion of 'public accountability'; where an organisation uses significant community resources, it should be accountable to the community for the use of those resources (whether priced or not). Stewardship looks like the poor relation of the decision-usefulness concept which emphasises shareholders and creditors to the 'detriment' of others.

Although accountability will not preclude decision-usefulness in the sense that information output during accountability discharge may be useful in making decision, e.g. whether the accountors have behaved responsibly and if not to replace or reform them, the notion of decision-usefulness today is altogether different. Decision-usefulness in a pristine liberal economic democracy means to provide information which will enable the capitalist provider of funds to get richer. Although this is supposed to take place within the rules of the game, the fact is that the rules of the game are more often than not captured by the capitalist's cohorts in the government and the profession which is supposed to safeguard the public interest.

Gray et al. (1996) proposed accountability as a theoretical framework for establishing corporate social reporting as legitimate effort. It is said that it will enhance the transparency of organisation and democracy in society. Accountability

has been defined as “the duty to provide an account (by no means necessarily a financial account) or reckoning of those actions for which one is held responsible” (Gray et al., 1996, p. 38).

However, the above definition emphasises the *discharge of accountability* rather than accountability itself. The second problem with this definition is that it is difficult to define what actions the accountor is responsible for to the accountee. From a western societal perspective, directors for example would not be responsible to the accountee for their private lives. The action for which the accountor is responsible arises due to entrusting of resources to him. Hence, use (or misuse) of resources (not by any means only financial) is the action the accountee is responsible for.

In addition to the contractual relationship between the parties, the essence of the accountability model derives from the role that society ascribes to the relationship, i.e. the social contract. In effect, this society (or in Islam, God and society) determines the responsibility and the right to information.

Gray et al. (1996) recognise that two different categories of rights and responsibilities exist, i.e. *legal* and *non-legal* (moral or natural rights and responsibilities), and that the law lays down the minimum level of rights and responsibilities. They note, however, that while law establishes responsibility for certain actions (e.g. equal opportunities) it does not provide an equal responsibility to account in all cases. Thus, the legal ‘*responsibility for action*’ and ‘*legal*

*responsibility to account*' are different things. The disparities in the two responsibilities, they argue, bring a 'moral responsibility to account' and despairing voluntary compliance, they call for mandatory regulations to cover Corporate Social Reporting. However, it is difficult to see the logic of insisting that a '*moral responsibility to account*' exists (only) when a '*legal responsibility for action*' exists. The social contract and the fact that the organisation (of significant size) use significant community resources (re: Corporate Report of the ASSC, 1975) should give rise to a '*moral responsibility for action*' even in the absence of legislation. Following the deep green view, "to be accountable is morally sound and spiritually uplifting thing to do. ... It is only ... the conditioning effect of large organisations that makes the idea of freely giving an account so bizarre." (Gray et al., 1996).

If the social contract/legitimacy view of business organisation is not emphasised, organisations following the cue from Friedman (1962) would insist they had no such responsibility to account. However, in the climate of neo-pluralist, self-interested and utility maximising capitalist society, there might be no other choice in the short term except through legislated "compliance with standard reports".

Another problem with the accountability model is the nature of moral/philosophical rights and how they are determined. Gray et al. (1996) distinguish absolute and relative philosophical responsibilities. However, in a society where

religious values do not permeate its fabric, even the absolute moral/religious values (e.g. attitude towards homosexuality and pre-marital sex) are becoming relative. It is true to some extent that philosophical rights can be achieved by debate, education and agreement. However, it is very difficult to reach consensus and agreement when large sections of society take what were once universally regarded as immoral or even perverted values as moral. This creates tension and disagreement more than consensus (the anti-abortion lobby in the USA is an example). Further, discussion and agreement might end up in the enthronement of teleological ethics to the detriment of deontological (not absolutist) ethics which will lead to a relativist moral philosophy which might encourage self-interest.

In an Islamic society, however, ethics are derived from the *Shari'ah* (Islamic law) and are not subject to change although teleological reasons (altruistic, not self-interested) may require the suspension of the ethics in certain situations (e.g. to save a life). In such a society, the moral/philosophical rights are easier to establish.

#### 4.3.3. Qualitative Characteristics.

(1) Understandability. Understandability is the key user-specific quality. Information cannot be useful if it is not understandable by those for whom it is intended. Understandability is partly within the control of the standard setter, but it also depends in part on the knowledge level of user. In fact, however, it is users who are supposed to 'understand' what the standard setters think to be 'useful

information'. 'Users are assumed to have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence.'

This quality seems to be difficult to achieve as accounting frequently uses terms, definition, techniques, postulates, etc.', which differ from (if not contradict) the general meanings, common sense, etc. For example, the definition of assets in accounting would be different from the definition of assets in finance, economics, law, etc. Moreover, the use of different measurement bases for different assets, depreciation and assets valuation methods and techniques, and the like, results in aggregate numbers which violate common sense and the mathematical rules for manipulating numbers.

(2) *Relevance*. To be relevant, information must have *predictive value* and *feedback value*, or both, and it must be *timely*. As the users' needs are assumed to vary in Western accounting, and the information is primarily intended for investors as the risk-capital providers, it is difficult to accept that such information would be relevant for other users. Moreover, for information to be timely, sometimes, reliability has to be sacrificed (IASB, 1988, para. 43).

The relevance of information, moreover, is said to be affected by its nature and *materiality*. Information is said to be material if its omission or misstatement could influence the economic decisions made by users who rely on the financial

statements. Materiality is, however, subjective because what is supposed to be material (in size) would be different among preparers and users.

(3) *Reliability*. To be reliable, information must be free from material errors and *faithfully represented*. The balance sheet, therefore, should represent faithfully the transaction and other events that result in assets, liabilities and equity of the firms at the reporting date which meet the recognition criteria. The recognition criteria in Western accounting, however, are subject to criticisms due to some 'ambiguous definitions' and 'alternative measurement bases' allowed.

Moreover, to be reliable, the information contained in the financial statements should be free from bias (neutrality) and *complete*. Financial statements are not neutral if, by the selection or presentation of information, they influence the making of a decision or judgement in order to achieve a predetermined result or outcome (IASB, 1988, para. 36). This 'rule' seems to be difficult to achieve in Western accounting due to some alternative methods/procedures/techniques available and allowable, the choice among which, involves personal preferences. The *completeness* criteria, furthermore, would also be difficult to achieve due to materiality and cost-benefit limitations (IASB, 1988, para. 38).

The reliability criteria would be more difficult to achieve in the Western accounting due to the 'prudence' (conservatism) concept. Even though it is in principle not allowed, the application of this concept will encourage the preparers of the financial statement to 'understate' assets and income, and to 'overstate'

liabilities and expenses, under the legitimisation of ‘uncertainties’. For example, the concept of ‘lower of cost or market’ (LCOM), and the ‘Provision of Doubtful Debts’, are applications of the prudence (conservatism) concept.

(4) *Comparability (and consistency)*. Comparability among companies and consistency from period to period in the information reported by a given company are secondary qualities that interact with relevance and reliability to contribute to the usefulness of information. Users are assumed to be interested in comparing the financial statements of an enterprise through time in order to identify trends in its financial position and performance (consistency). They are also assumed to be interested in comparing the financial statements of different enterprises in order to evaluate their relative financial position, performance and changes in financial position (comparability). These are based on the perceptions that the users’ concerns are ‘how to make decision regarding their loans and/or investments’; whether they should provide loan or not, whether they should buy, retain or sell their investment, and the like. However, once again, consistency and comparability criteria would seem to be difficult to achieve when alternative techniques and measurement bases are allowable.

(5) *True and fair view (Fair representation)*. It is argued that the application of the principal qualitative characteristics will enable the financial statements to provide a ‘true and fair view’, or present ‘fairly’, the financial position, performance and changes in financial position of an enterprise. However,

it will be a difficult (if not impossible) task due to some constraints and 'impossibilities', as described above. The phrase 'true and fair' itself indicates implicitly that there could be 'true but UNFAIR', and 'UNTRUE but fair', representations of financial information, which are 'unacceptable'. Moreover, the concept of 'true and fair' in the accounting point of view would be different from the taxation, finance, and economics points of view, due to the use of different definitions and measurement bases.

#### 4.3.4. Historical Cost.

There are also some critiques regarding the qualitative characteristics of financial statements, especially if they are contrasted with the 'measurement' concepts. As also mentioned in the framework, there are several measurement bases allowed in the Western accounting: historical cost, current cost (IASB; FASB: current/replacement cost and current market value), realisable (settlement) value (IASB; FASB: net realisable (settlement) value), and present value (IASB; FASB: present (or discounted) value of future cash flows). The *relevance* would have ruled the historical cost or proceeds, since no past or derivative of a past is demonstrably relevant as a present valuation, to a present choice or judgement. *Neutrality* (in *Reliability*) would have ruled out current (replacement/market) value and present (or discounted) value, since both entail presumptions about the future, the shape of which, if there are optional shapes, is yet to be decided. *Objectivity*



(FASB) would have ruled out all valuations other than historical cost, since all depend on personal (subjective) judgement and speculations.

However, the idea of ‘trade-off’ (balance) among qualitative characteristics is really an *absurd* idea. Whatever ‘combination’ of qualitative characteristics will actually eliminate those characteristics, for example, one-third of relevance is traded for one-quarter of neutrality, the result would be neither relevant nor neutral; and so forth.

There are some measurement bases to select; different measurement bases are employed to different degrees and varying combinations in financial statements. They are: historical cost, current cost, realisable (settlement) value, and present value (para. 100). The IASC does not recommend what ‘should be’ the true measurement basis. Due to this problem, there will be no uniformity nor consistency in practice, which means that the ‘comparability’ criterion of quality will never be achieved.

Even though the IASC does not mention any preference, it does mention that the ‘historical cost’ is the measurement basis most commonly adopted. In the West itself, however, historical cost accounting has been criticised for a long time, since its emergence about 50 years ago. The proponents of historical cost usually use *stewardship*, *historicity*, *measurement* and *decision making* arguments to defend the application of historical costing, though none of them are well-supported reasonably (Chambers, 1994, pp. 84-86).

The proponents of historical cost accounting argue that an original cost basis provides a continuing account of the stewardship of property originally entrusted by a principal. However, where the dated money's worth of property under management exceeds a reported (cost-based) amount, managers will have the undisclosed use and disposal in the subsequent period of greater wealth than the record shows. The differences may then be turned to the use of the stewards (or some of them) themselves, or to concealment from principals of losses, or of mismanagement or misappropriation. The cost doctrine thus leads to successively uninformed and improper judgements of stewardship.

Furthermore, they (the proponents of historical cost accounting) also argue that the accounts are, and are intended to be, historical. This is a groundless contention, as "History terminates ... in the present. The historian's task is to show how the present has come into existence ..." (Collingwood, 1946; quoted in Chambers, 1994, p. 84). The present, of course, is to be discovered by observation and inquiry, and it is not discoverable by applying conjectures, extrapolation, and guesswork to facts of the past. In Western accounting, however, discovery was simply abandoned for just such measures.

"In an earlier age, when ... business units [were] in general smaller ... it was possible to value assets ... and to measure the progress made from year to year by annual valuations. With ... corporate organisations becoming constantly larger, ... this has become increasingly impracticable" (AIA, 1932).

This is indeed an unacceptable statement; the larger and more complex the business unit, the more up-to-date information becomes necessary. The use of historical cost, the cost or market valuation rules, and other devices--all yielding no observable counterpart, but depending on judgements, opinions, and expediency--took the place of discovery. Balance Sheets, though still purporting to be dated statements of financial position, became nothing more than residuals arising from these exercises of the imagination (Chambers, 1994, p. 85).

Furthermore, the proponents of historical cost accounting also argue that historical cost is the only *objective measurement*. However, they forget the law of measure and measurement; and the constraints for aggregative measurement: careful observation, a specified property, a uniformity used scale, and identical conditions. Under these constraints, therefore:

- a dated sum of money may not legitimately be added to a cost price of a non-money object at the same date; for money represents dated spending power, whereas the cost price of a non-money good does not;
- a dated sum of money may not be added to a differently dated cost price (or a derivative of that price) if the scalar unit does not represent the same spending power at the two dates;
- a dated sum of money found by observation may not be added to a mere conjecture and speculation, for observation and conjecture are materially different processes yielding materially different magnitudes (Chambers, 1991, 1994, 1996b).

The conventional historical cost-based accounting has violated these rules, as the aggregative amounts in the balance sheet are derived by violating them.

In the decision making process, moreover, the most significant role of the past-historical information is the lesson: past errors of judgement should be

avoided, and past successes should be further exploited. The decision, however, should be based on the knowledge about the present (potentials) and future (opportunities), as the decision is always about future actions.

#### 4.4. Summary

Evaluating the conceptual framework of accounting of the US (FASB), IASC, and the UK (ASB), it can be summed-up that in general they are very similar, especially the US and the IASC conceptual frameworks. This is not surprising as the IASC conceptual framework owes much to the FASB conceptual framework. The UK conceptual framework, on the other hand, goes one step forward by identifying a preference for the 'measurement basis' and 'concept of capital'. It introduces and proposes a 'value to the business' for the measurement basis, and the concept of 'real capital'. However, as the Statement of Principles has been withdrawn, there is no 'formal' conceptual framework in UK now. The ASB has promised to issue a new-revised conceptual framework in the near future. Table 4.2. on the next page summarises and compares the conceptual frameworks of these three bodies.

Table 4.2. Summary of the US, IASC, and UK Conceptual Framework

Components	U.S.	IASB	U.K.
Objectives of	Financial Reporting: includes not only financial statements. The primary focus of financial reporting is information about an enterprise's performance provided by measures of earnings and its components (para. 43) It is also intended to provide information that is useful in making business and economic decisions.	The objectives of financial statements are to provide information about the financial position, performance and changes in financial position of an enterprise that is useful to a wide range of users in making economic decisions. (para 12) b. show the results of the stewardship of management, or the accountability of management for the resources entrusted to it. (para. 14)	The objective of financial statements is to provide information about the financial position, performance and financial adaptability of an enterprise that is useful to a wide range of users for assessing the stewardship of management and for making economic decisions. (para. 1.1)
Users	Direct interests: owners, management, creditors, and employees. Indirect interest: financial analysts and advisers, journalists, regulatory authorities, and trade union. focus: investors and creditors	investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies, and public. (para. 9) focus on investors (para. 10)	investors, employees, lenders, suppliers and other creditors, customers, government and their agencies and the public, (paras. 1.5 & 1.7) primary users (focus on): investors (para. 1.5)
Components of financial statements	1. balance sheet 2. income statements 3. statements of changes in financial position. 4. Notes to financial statements.  Emphasise: income statements (SFAC No. 1, para 51)	1. Balance sheets (financial position) 2. Income statement (performance) 3. separate statement for information about changes in financial position. 4. Notes and Supplementary Schedules.	a. Primary financial statements: (1) the profit and loss account; (2) the statement of total recognised gains and losses; (3) the balance sheet; and (4) the cash flow statement. b. Notes to financial statements. c. Supplementary information
Qualitative Characteristics	1. The decision-makers (e.g. understanding or prior knowledge) 2. The cost-benefit constraint 3. Understandability 4. Relevance and reliability 5. Comparability 6. Materiality 7. Conservatism	Principal qualitative characteristics: 1. Understandability 2. Relevance 3. Reliability 4. Comparability Constraints on Relevant & Reliable Inf.: 1. Timeliness 2. Balance between Benefit and Cost 3. Balance between Qualitative Characteristics True and Fair View/Fair Presentation	Primary characteristics that relate to content: Relevance and Reliability Primary characteristics that relate to presentation: Comparability and Understandability Threshold: Materiality

Table 4.2. Summary of the US, IASC, and UK Conceptual Framework (Cont.)

Components		U.S.	IAS	U.K.
Underlying Assumptions			<ol style="list-style-type: none"> <li>Accrual Basis</li> <li>Going Concern</li> </ol>	
Elements of Financial Statements	<ol style="list-style-type: none"> <li>Assets; 2. Liabilities; 3. Equity</li> <li>Investment by owners</li> <li>Distribution to owners</li> <li>Comprehensive income</li> <li>Revenues; 8. Expenses</li> <li>Gains ; 10. Losses</li> </ol>	<p>Fin. Position:</p> <ol style="list-style-type: none"> <li>Asset</li> <li>Liability</li> <li>Equity</li> </ol> <p>Performance:</p> <ol style="list-style-type: none"> <li>Income</li> <li>Expenses</li> </ol>	<ol style="list-style-type: none"> <li>Assets</li> <li>Liabilities</li> <li>Equity</li> <li>Gains</li> <li>Losses</li> <li>Contributions from owners</li> <li>Distributions to owners</li> </ol>	
Recognition criteria	<ol style="list-style-type: none"> <li>Definitions --the item meets the definition of an element of financial statements.</li> <li>Measurability--the items has a relevant attribute measurable with sufficient reliability</li> <li>Relevance--</li> <li>Reliability-- (SFAC No.5, para 63)</li> </ol>	<ol style="list-style-type: none"> <li>Definitions-- the item meets the definition of an element of financial statements.</li> <li>Probable future economic benefit--it is probable that any future economic benefit associated with the item will flow to or from the enterprise; and</li> <li>Measurability--the items has a cost or value that can be measured with reliability. (para 83)</li> </ol>	<ol style="list-style-type: none"> <li>Definitions--the item meets the definition of an element of financial statements. (4.2)</li> <li>Sufficient evidence (4.6-4.8)</li> <li>Measurability--the items can be measured with sufficient reliability (4.6-4.7)</li> </ol>	
Measurement.	<ol style="list-style-type: none"> <li>historical cost;</li> <li>current cost;</li> <li>current market value;</li> <li>net realisable value; and</li> <li>present value of future cash flows.</li> </ol> <p>Concludes that 'the use of different attributes will continue' (SFAC No.5, paras. 66-70)</p>	<ol style="list-style-type: none"> <li>Historical cost</li> <li>Current cost</li> <li>Realisable (settlement) value</li> <li>Present value. (para. 100)</li> </ol> <p>No prescribed basis; only mentions that the measurement basis commonly adopted by enterprise is historical cost, sometimes combined with other bases. (para 101)</p>	<ol style="list-style-type: none"> <li>historical cost (-&gt; financial capital maintenance concepts)</li> <li>current value -&gt; value to the business (-&gt; real term capital maintenance system)</li> </ol> <p>ASB favour (support) the 'current value', to the extent that this is consistent with the constraints of reliability and cost. (5.38)</p>	
Capital maintenance concepts	<p>Fails to prescribe a particular 'concept of capital maintenance' that should be adopted. (paras. 45-48)</p>	<p>No prescribed concepts nor models. (para. 110)</p>	<p>Real term capital maintenance concepts ==&gt; current value (paras. 5.37-5.38)</p>	

Source: IAS: Framework for the Preparation and Presentation of Financial Statements, IASC, London (1988)

US: Statements of Financial Accounting Concepts, SFAC No. 1 (1978), No. 2 (1980), No. 5 (1984), No. 6 (1985), FASB.

UK: Statements of Principles for Financial Reporting, ASB (1995)

## CHAPTER 5

### INTRODUCTION TO ISLAM

#### 5.0. Introduction

This chapter introduces Islam from the ‘religious’ aspect. It includes the meaning of Islam, the concepts of God, Faith, and Worship in Islam, as well as the main sources of Islamic teaching: the Qur’an and the *Sunnah*. It also explains the spiritual and moral systems, which are common characteristics of all religion.

#### 5.1. The Meaning of Islam<sup>1</sup>

The term ‘Islam’ is an Arabic word derived from two root-words: *Silm* and *Salm*. The word *Silm* means submission, surrender and obedience. As a religion, Islam stands for complete submission and obedience to God, or a commitment to surrender one's will to the Will of God. The root-word *Salm*, meaning peace, signifies that one can achieve real peace of body and mind only through submission and obedience to God. Such a life of obedience brings with it peace of the heart and establishes real peace in society at large (Mawdudi, 1993, p.17).

There are two words in Arabic which are both translated in English as ‘religion’; those are *Deen* and *Millah*. *Deen* always refers to the way of life revealed by God, while *millah* usually refers to the way of life of people, for

instance: *millah* Ibrahim (Qur'an-2: 130); even though the people in fact also follows the *Deen*. Islam, therefore, is a *Deen* as always mentioned in the Qur'an (the Holy Book of Islam). For instance, the last verse revealed to the Prophet Mohammad (pbuh)<sup>2</sup> is: "This day have I perfected your *deen* for you, and completed My favour upon you, and have chosen for you Islam as your *deen*" (Qur'an-5: 3).

Religion, on the other hand, has been described as:

"human beings' relation to that which they regard as holy, sacred, spiritual, or divine. Religion is commonly regarded as consisting of a person's relation to God or to gods or spirits. Worship is probably the most basic element of religion, but moral conduct, right belief, and participation in religious institutions are generally also constituent elements of the religious life as practised by believers and worshippers and as commanded by religious sages and scriptures" (*Encyclopaedia Britannica* 1990, p. 1016).

Islam as a *Deen* is concerned not merely with those matters mentioned in the definition of religion (faith, worship, religious activities, and so on), but also with all human life (worldly) matters (such as political, economic, legal, social, etc.). In other words, it can be said that Islam as a *deen* functions both as a *religion* and an *ideology*. As a religion, Islam is concerned with faith, spiritual and moral systems, while as an ideology, Islam lays down the concepts of social life: economic, legal, political, and so on.



## 5.2. The Concept of God.<sup>3</sup>

It is a known fact that every language has one or more terms that are used in reference to God and sometimes to lesser deities. This is not the case with Allah. Allah is the personal name of the One true God. Nothing else can be called Allah. The term has no plural or gender. This shows its uniqueness when compared with the word 'god' which can be made plural, i.e. *gods*, or feminine, i.e. *goddess*. It is interesting to notice that Allah is the personal name of God in Aramaic, the language of Jesus and a sister language of Arabic.

The One true God is a reflection of the unique concept that Islam associates with God. To a Muslim Allah is the *Almighty, Creator and Sustainer* of the universe, Who is similar to nothing and nothing is comparable to Him. The prophet Mohammad was asked by his contemporaries about Allah; the answer came directly from God Himself in the form of a short chapter of the Qur'an, which is considered the essence of the unity or the motto of monotheism. This is chapter 112 which reads:

"(In the name of Allah, Most Gracious, Most Merciful);  
Say: He is Allah the One;  
Allah, the Eternal, Absolute;  
He begetteth not, nor is He begotten;  
And there is none like unto Him."

Some non-Muslims allege that God in Islam is a stern and cruel God who demands to be obeyed fully. He is not loving and kind. Nothing can be further

from the truth than this allegation. It is enough to know that, with the exception of one, each of the 114 chapters of the Qur'an begins with the verse: *"In the name of Allah, Most Gracious, Most Merciful."* In one of the sayings of prophet Mohammad (pbuh) we are told that *"God is more loving and kinder than a mother to her dear child."*

But God is also *Just*. Hence evildoers and sinners must have their share of punishment and the virtuous His bounties and favours. Actually, God's attribute of Mercy has full manifestation in His attribute of Justice. People suffering throughout their life for His sake and people who are oppressed and exploited by other people all their life should not receive similar treatment from their Lord. Expecting similar treatment for them will amount to negating the very belief in the accountability of man in the Hereafter and thereby negating all the incentives for a moral and virtuous life in this world. The following Qur'anic verses are very clear and straightforward in this respect. "Verily, for the Righteous are Gardens of Delight, with their Lord. Shall We then treat the people of Faith like the people of Sin? What is the matter with you? How judge ye?" (Qur'an-68: 34-36).

Islam refuses to characterise God in any human form or depict Him as favouring certain individuals or nations on the basis of wealth, power or race. He created human-beings as equals. They may distinguish themselves and get His favour through virtue and piety only. The ideas that God rested on the seventh day of creation, that God wrestled with one of His soldiers, that God is an envious

plotter against mankind, or that God is incarnate in any human being are considered blasphemy from the Islamic point of view.

The unique usage of Allah as a personal name of God is a reflection of Islam's emphasis on the purity of the belief in God which is the essence of the message of all God's messengers. Because of this, Islam considers associating any deity or personality with God as a deadly sin which God will never forgive, despite the fact He may forgive all other sins.

The Creator must be of a different nature from the things created because if he is of the same nature as they are, he will be temporal and will therefore need a maker. It follows that nothing is like Him. If the maker is not temporal, then he must be eternal. But if he is eternal, he cannot be caused, and if nothing caused him to come into existence, nothing outside him causes him to continue to exist, which means that he must be self-sufficient. And if he does not depend on anything for the continuance of his own existence, then this existence can have no end. The Creator is therefore eternal and everlasting: *"He is the First (Al-Awwal) and the Last (Al-Ahir)."*

He is self-sufficient or self-subsistent or, to use a Qur'anic term, *Al-Qayyum*. The Creator does not create only in the sense of bringing things into being, He also preserves them and takes them out of existence and is the ultimate cause of whatever happens to them (Qur'an 11: 6).<sup>4</sup>

*God's Attributes.* If the Creator is eternal and everlasting, then His attributes must also be eternal and everlasting. He should not lose any of His attributes nor acquire new ones. If this is so, then His attributes are absolute. Can there be more than one Creator with such absolute attributes? Can there be for example, two absolute, powerful Creators? A moment's thought shows that this is not feasible. The Qur'an summarises this argument in the following verses:

"No son did Allah beget, nor is there any god along with Him:  
(if there were many gods), behold,  
each god would have taken away what he had created,  
and some would have lorded it over others!"(Qur'an-23: 91).

"If there were, in the heavens and the earth, other gods besides Allah,  
there would have been ruin in both" (Qur'an-21: 22).

*The Oneness of God.* The Qur'an reminds us of the falsity of all alleged gods. To the worshippers of man-made objects, it asks: "Do they indeed ascribe to Him as partners things that can create nothing, but are themselves created? No aid can they give them, nor can they aid themselves!"; "But those ye call upon besides Him, are enable to help you, and indeed to help themselves" (Qur'an-7: 191-192; 197). And to the worshippers of heavenly bodies it cites the story of Abraham:

"When the night covered him over, he saw a star; he said:  
'This is my Lord.'  
But when it set, he said: 'I love not those that set.'  
When he saw the moon rising in splendour, he said: 'This my Lord.'  
But when the moon set, he said: 'Unless my Lord guide me,  
I shall surely be among those who go astray.'  
When he saw the sun rising (in splendour), he said:  
'This is my Lord; this is the greatest (of all).'

But when the sun set, he said: 'O my people!  
I am indeed free from your (guilt) of giving partners to Allah'.  
'For me, I have set my face, firmly and truly,  
towards Him Who created the heavens and the earth,  
and never shall I give partners to Allah'." (Qur'an-6: 76-78).

*The Believer's Attitude.* In order to be a Muslim, i.e. to surrender oneself to God, it is necessary to believe in the oneness of God, in the sense of His being the only Creator, Preserver, Nourisher, etc. But this belief, later on called *Tawhid Ar-Rububiyyah*, is not enough. Many of the idolators knew and believed that only the Supreme God could do all this. But that was not enough to make them Muslims. To *tawhid ar-rububiyyah* one must add *tawhid al-uluhiyyah* i.e. one acknowledges the fact that it is God alone who deserves to be worshipped, and thus abstains from worshipping any other thing or being.

Having achieved this knowledge of the one true God, man should constantly have faith in Him, and should allow nothing to induce him to deny truth. When faith enters a person's heart, it causes certain mental states which result in certain actions. Taken together these mental states and actions are the proof of true faith. The prophet said: "faith is that which resides firmly in the heart and which is proved by deeds."

Foremost among those mental states is the feeling of gratitude towards God, which could be said to be the essence of *ibadah* (worship). The feeling of gratitude is so important that a non-believer is called '*kafir*', which means 'one who

denies a truth' and also 'one who is ungrateful.' A believer loves, and is grateful to God for the bounties He has bestowed upon him, but being aware of the fact that his good deeds, whether mental or physical, are far from being commensurate with Divine favours, he is always anxious lest God should punish him, here or in the Hereafter. He, therefore, fears Him, surrenders himself to Him and serves Him with great humility. One cannot be in such a mental state without being almost all the time mindful of God. Remembering God is thus the life force of faith, without which it fades and withers away. The Qur'an tries to promote this feeling of gratitude by repeating the attributes of God very frequently (e.g. Qur'an 59: 22-24; 2: 255; 4: 171).<sup>5</sup>

### 5.3. The Concept of Faith in Islam: The Articles of Faith

Islam means obedience to God. To be obedient to Him, first of all, one should have an unshakeable belief in the existence of God. Then, one must know the attributes of God: the divine attribute that God is One (*tauhid*), and only one God who is the Creator, the Ruler and the Sustainer of the Universe and there is none else to share with Him even a shred of Divine power and authority. Moreover, one must know in detail 'the way of living' by following which one can seek the pleasure of God. One must also have full confidence and conviction that it is the Divine Law and that his salvation lies in following God alone. The knowledge of the *Divine Law* and *Revealed Code of Life* is essential, but not enough yet. One must also know the consequences both of belief and disobedience

and of disbelief and disobedience (Mawdudi, 1993, pp. 27-28). These all are called *Iman*, which is translated in English as Belief or Faith.

There are six *Articles of Faith* which should be followed by Muslims. If one does not believe in even one of these articles, he is not considered as a believer. These articles of faith are:

*Firstly*, belief in one God 'Allah', Who has absolutely no associate with Him in His divinity, Supreme and Eternal, Infinite and Mighty, Merciful and Compassionate, Creator and Provider.

*Secondly*, belief in God's Angels. They are purely spiritual and splendid beings whose nature requires no food or drink or sleep. They spend their days and nights in the worship of God.

*Thirdly*, belief in the Books of God, and in the Holy Qur'an as His Last Book. In the Qur'an a special reference is made to the books of Abraham, Moses, David and Jesus. But long before the revelation of the Qur'an to Mohammad, some of the books and revelations had been lost or corrupted. The only authentic and complete book of God in existence today is the Qur'an.

*Fourthly*, belief in all messengers of God without any discrimination among them, and Mohammad (pbuh) as His Last and Final Messenger. Every known nation had a warner or messenger from God. They were chosen by God to teach mankind and deliver His Divine message. The Qur'an mentions twenty five of them. Among them Mohammad stands as the last messenger and the crowning glory of the foundation of prophethood.

*Fifthly*, belief in Life After Death. This world will come to an end someday, and the dead will rise to stand for their final and fair trial. People with good records will be generously rewarded and warmly welcomed to the Heaven of Allah; and those with bad records will be punished and cast into Hell.

*Lastly*, belief in *Taqdeer*. Muslims believe in the timeless knowledge of God and in His power to plan and execute His plans and that nothing could happen in his Kingdom against His Will. His knowledge and power are in action at all times command over His creation. He is wise and merciful, and whatever He does must have a meaningful purpose. If this is established in human minds and hearts, they should accept with good Faith all that He does, although they may fail to understand it fully, or think it is bad.

#### 5.4. The Concept of Worship (*Ibadah*): The Five Pillars of Islam.<sup>6</sup>

Faith without action and practice is a dead end, as far as Islam is concerned. Faith by nature is very sensitive and can be most effective. When it is out of practice or out of use, it quickly loses its liveliness and motivation power. Those who believe in the above *Articles of Faith* enter the fold of Islam and become a member of the Muslim community. To be a fully-fledged Muslim, and as a consequence of his belief, one should follow all God's commands (and prohibitions) as mentioned in His Book and the Prophet's guidance. Among them, the primary duties are those which are called the *Five Pillars of Islam*; those are:



- (1) declaring the faith (*shahadah*), that is to bear witness that 'there is no deity but Allah, and Mohammad is the Allah's Messenger' (in Arabic: *La ilaha illa Allah, Mohammad-ur Rasul-Allah*);
- (2) performing *Salah* (ritual prayers). The compulsory *salahs* are offered five times a day at specific times and according to certain rules, as a duty towards Allah;
- (3) paying *Zakah* (it will be discussed broadly in the next Chapter);
- (4) compulsory *Siyam* (fasting during the month of *Ramadhan*); and
- (5) performing *Hajj* (Pilgrimage to the Holy City, Makkah).

Worship in Islam, however, does not merely lie in these five things, as usually misunderstood by many people, including some Muslims. This above limited understanding of worship is only one part (i.e. ritual worship) of the meaning of worship in Islam. That is why the traditional definition of worship in Islam is a comprehensive definition that includes almost everything in any individual's activities. The definition of worship goes something like this: "Worship is an all inclusive term for all that God loves of the external and internal sayings and actions of a person." In other words, worship is everything one says or does for the pleasure of Allah. This, of course, includes *rituals* as well as *non-rituals* including: beliefs, social activities, and personal contributions to the welfare of one's fellow human-beings.

Islam looks at the individual as a whole. He is required to submit himself completely to Allah, as the Qur'an instructed the prophet Mohammad to do so (Qur'an 6: 162-163).<sup>7</sup> The natural result of this submission is that all one's activities should conform to the instructions of the one to whom the person is submitting. Islam being a way of life, requires that its followers model their life according to its teachings in every aspect, religious or otherwise. This might sound strange to some people who think of religion as a personal relation between the individual and God, having no impact on one's activities outside rituals.

As a matter of fact Islam does not think much of mere rituals when they are performed mechanically and have no influence on one's inner life. The Qur'an addresses the believers and their neighbours from among the people of the Book who were arguing with them about the change of the direction of *Qiblat* in the following verse:

"It is not righteousness that you turn your faces toward East or West;  
but it is righteousness to believe in Allah and the Last Day,  
and the Angels, and the Book, and the Messengers;  
to spend of your substance, out of love for Him, for your kin,  
for orphans, for the needy, for the wayfarer, for those who ask,  
and for the ransom of slaves; to be steadfast in prayer,  
and gives Zakah, to fulfil the contracts which ye have made;  
and to be firm and patient, in pain (or suffering) and adversity,  
and throughout all periods of panic.  
Such are the people of truth, the God-fearing" (Qur'an-2: 177).

The deeds in the above verse are the deeds of righteousness and they are only a part of worship. The prophet told us about faith, which is the basis of worship, that it "is made up of sixty and some branches: the highest of which is the belief in

the Oneness of Allah, i.e. there is no God but Allah and the lowest in the scale of worship in removing obstacles and dirt from people's way" (narrated by Bukhari).

Decent work is considered in Islam a type of worship. The prophet said: "Whosoever finds himself at the nightfall tired of his work, God will forgive his sins." Seeking knowledge is one of the highest types of worship. The prophet told his companions that "seeking knowledge is a (religious) duty on every Muslim." In another saying he said: "Seeking knowledge for one hour is better than praying for seventy years." Social courtesy and co-operation are part of worship when done for the sake of Allah as the prophet told us: "Receiving your friend with a smile is a type of charity, helping a person to load his animal is a charity and putting some water in your neighbour's bucket is a charity."

It is worth to note that even performing one's duties is considered a sort of worship. The prophet told us that whatever one spends for his family is a type of charity; he will be rewarded for it if he acquires it through legal means. Kindness to the members of one's family is an act of worship, as when one puts a piece of food in his spouse's mouth, as the prophet informed us. Not only this but even the acts we enjoy doing very much, when they are performed according to the instructions of the prophet, are considered as acts of worship. The prophet told his companions that they would be rewarded even for having sexual intercourse with their wives. The companions were astonished and asked: "How are we going to be rewarded for doing something we enjoy very much?" The prophet asked them:

"suppose you satisfy your desires illegally, don't you think that you will be punished for that?" They replied: "yes.". "So" he said "by satisfying it legally with your wives you are rewarded for it." This means they are acts of worship. Thus Islam does not consider sex a dirty thing that one should avoid. It is dirty and sinful only when it is satisfied outside marital life.

It is clear, from the previous discussion, that the concept of worship in Islam is a comprehensive concept that includes all the positive activities of the individual. This, of course, is in agreement with the all-inclusive nature of Islam as a way of life. It regulates the human life on all levels: the individual, the social, the economic, the political and the spiritual. That is why Islam provides guidance to the smallest details of one's life on all these levels. Thus, following these details is following Islamic instructions in that specific area. It is a very encouraging element when one realises that all his activities are considered by God as acts of worship. This should lead the individual to seek Allah's pleasure in his actions and always try to do them in the best possible manner, since he is watched by the permanent supervisor, who knows everything, namely, Allah. Worship in Islam, whether ritual or non-ritual, trains the individual in such a way that he loves his Creator most and thereby gains an unyielding will and spirit to wipe out all evil and oppression from human society and make the world of God dominant in the world.

### 5.5. The Qur'an (Al-Qur'an)

The Qur'an is the Holy Book of Islam and Muslim. It contains the revelation (*wahyu*) of Allah (SWT) to the Prophet Mohammad (pbuh) sent to him for the benefit of mankind. It is a book of *hidayah* or guidance for the whole of mankind and the most authoritative guide for Muslims. It consists of 114 *surahs* (Chapters) and 6,235 *ayaats* (verses). More than 350 verses deal with *ahkam* or legal rulings on various matters. Around 140 verses deal with matters of *ibadah* (specific worships) such as *salah* (ritual prayer), *zakah* (alm tax), *saum* (fasting), *hajj* (Pilgrimage) and *jeehad* (struggle). About 70 verses deal with family and matrimonial matters such as marriage, divorce, fostering, maintenance and inheritance. A similar number of verses concern commercial transactions such as sale, lease and mortgage. Crimes and penalties, which is an area most readily associated with Islam and is a topic on which a lot of misconceptions exist and are nurtured, is the subject matter of about 30 verses, most of which deal more specifically with matters such as murder, highway robbery, adultery and false accusation. Conversely, an area of *Islamic Law* which is perhaps conveniently overlooked by many is concerned with equality, justice, consultation and the rights and obligations of citizens; and these constitute about thirty more verses. Very much related to these, there are about ten verses concerning the regulating of relations between the rich and poor, workers' rights and so on. It must be noted here, however, that the *fuqaha* or jurists are not in complete agreement over any of these figures, as calculations of this nature tend to differ according to one's

understanding of and approach to the contents of the Qur`an (Mohibur-Rahman, 1994, p. 48).

Most rulings in the Qur`an fall into a general category, which general guidelines are laid down on almost every major topic of Islamic Law. For example, on civil, economic, political and international matters the Qur`an largely enunciates general principles and the objectives these will pursue. The same applies to other areas such as civil transactions, property and trade. With regard to crimes and penalties the Qur`anic legislation is also quite general, except in relation to five offences: murder, theft, highway robbery, adultery and slander, which are very specific.

The generality of the guidelines given by the Qur`an does not mean that the Islamic rulings on any given matter is weak and vague. Flexibility on certain matters is essential, and the provision of general guidelines on some issues ensures that Islamic Law can be moulded and organised in accordance to the ever-changing socio-political situations that arise in each society. The Qur`an is, however, specific on matters which are deemed to be unchangeable, such as matters pertaining to belief and the basic principles of morality (Mohibur-Rahman, 1994, p. 48).

*The position of the Qur'an as the source of ideology (way of life).*

The Qur'an was revealed over a period of 23 years, in which the Muslims grew from a few number in Makkah (610-622 C.E.) to a large community in Madinah, and subsequently in Arabia (1-11 H/622-632 C.E.) within the Prophet's lifetime. The major Makkan Qur'anic themes were God's unity and transcendence (*tawhid*); the Day of Judgement (*al yaumul akhir*) when man's responsibility in worldly life would be judged; socio-economic justice and essential human egalitarianism, the two elements of the basic élan of the Qur'an; and collective responsibility of nations in history and God's judgement upon them. While these themes continued in the Madinan period, it was in the background of the community-state of Madinah, where the Prophet had political and administrative authority, that socio-political and economic legislation was given by God and enacted into law and put into practice. An implication of this point is that it points to the necessity of an organised Islamic state without which it would not be possible to realise the ideals of socio-economic justice, implement law or create an environment conducive to ethico-moral human and societal development (Ul-Haq, 1996, p. 21).

The process of change according to the Qur'an was one of *gradualism* in the sense that, before a major measure of social reform was introduced, the ground was well-prepared and the people sufficiently motivated to accept it and abide by it. In general, the strategy in social reform followed the sequential process of motivation, education and exhortation, legislation, and lastly the application of

sanction. Only in some cases were radical measures taken due to their urgency and need.

The immediate context of the Qur'an was the polytheistic Makkan society. As pointed out by Fazlur-Rahman (1980, p. 38), Makkan social order, although prosperous, was characterised by gross socio-economic disparities and a pernicious divisiveness of mankind. It had a subterranean world of exploitation of the weak (the tribeless, orphans, women and slaves); a variety of fraudulent commercial and monetary practices; callous uncharitableness and indulgent consumption on the one hand and grinding poverty and helplessness on the other; a single-minded pursuit of wealth and its abuse and an associated absence of belief in higher life. While the Qur'an condemned these conditions, practices, and policies severely, the ones it persistently criticised were the gross economic disparities and the lack of consideration for the weak because these lay at the heart of the social discord and were the most difficult to remedy. Moreover, the Makkan society was segmented, stratified and institutionally exploitative because a human's position was not determined by his intrinsic worth but by the accident of birth, sex, economic power or tribal customs/practices, etc. Thus, on the one hand, the Qur'an by its criticism established what a society should not be; on the other hand it pointed in a concrete way, through the rest of the revelation, to what a humane society ought to be like.

Therefore, while the Qur'an was addressing itself to a specific environment in a space-time context and providing solutions to the then-existing problems, it



simultaneously laid the foundation for guiding man in all possible situations for all times. This is precisely why God has declared the Qur'an to be the eternal guidance for man and has Himself ensured its preservation for that purpose. In other words, the methodology embodied in the Qur'an itself shows that the Qur'an is meant to be relevant, understandable and applicable to every age and place; hence the reason for its divine preservation.

What the Qur'an puts forward are essentially immutable or permanent moral-ethical values, i.e. values to distinguish right from wrong, good from evil, moral from immoral, and welfare-promoting from welfare-reducing. Allah, the Law-Giver and Guide, has delineated these permanent values in the form of specific and unambiguous commands or ordinances; a few concise legal ordinances and laws; some general principles; and largely through prescribed solutions to and rulings upon specific historical and concrete issues. These solutions and rulings provide, either explicitly or implicitly, the rationale behind them from which general principles and values can be deduced. The principles, ordinances, laws and the permanent values embodied therein are by their very nature independent of time and space and applicable at all stages and conditions of human development. In other words, the Qur'anic teachings are independent of temporal, sociological and technological considerations. Even when detailed legislation is provided by the Qur'an, it invariably relates to those aspects of individual and social life which are independent of all time-conditioned changes, i.e. the basic elements of human nature and human relations.

The Qur'an, in short, is a coherent, consistent and complete document. Therefore, the permanent values embodied in it form a set where the total teachings converge and this set provides the necessary guidelines for the construction of an Islamic polity, society and economy. On the one hand, it is inappropriate and incorrect to view the Qur'an and take its verses in an atomistic, discrete and unintegrated fashion without keeping in perspective the purposes of the Qur'an as a whole and without taking the whole text into account. On the other hand, it is very relevant to understand the historical context in which different passages of the Qur'an were revealed; particularly for those passages where the values or principles are embodied in concrete examples, paradigms or God's rulings on specific cases. Without this background understanding or knowledge of the occasions of revelations, one may not be able to fully comprehend the relevance of what is being taught as normative.

Thus, to understand the Qur'an and make it applicable to societal needs, not only do the permanent values have to be extracted from it, but also an internal ranking of the values has to be made so as to establish the priorities of Islam. Fazlur-Rahman (1980) points out the importance and the methodology of understanding and extracting the principles (or values) from the Qur'an, so many of the rulings or solutions of which were given in a specific historical context. He states:

“In building any genuine and viable Islamic set of laws and institutions, there has to be a twofold movement: First one must

move from the concrete case treatments of the Qur'an--taking the necessary and relevant social conditions of that time into account--to the general principles upon which the entire teachings converges. Second, from this general level there must be a movement back to specific legislation, taking into account the necessary and relevant social conditions now obtaining”

This, he concludes, is the only way to obtain the real truth about the Qur'anic teaching (Fazlur-Rahman, 1980, p. 20).

The thrust of the Qur'an is the improvement of the condition of man. It therefore operates at both the individual level and the collective levels. At the individual level, it guides and encourages the human being to develop his higher potentialities; and at the collective level, it assigns him the task of creating an ethical social order which would ensure a conducive environment for the development of the individual personality through societal interaction and protection, basic need fulfilment, and opportunities for altruistic contribution. Individual and society are correlated where influences and causality move in both directions. Therefore, the effort at reform has to be made at both levels, virtually simultaneously. These goals of Islam have to be kept in view in comprehending the Qur'anic teachings.

To insist on (1) the literal interpretation and (2) the literal application of all Qur'anic rules and laws without keeping in perspective the social change that has occurred and that is so clearly occurring at the present can be self-defeating and reflective of a lack of perception of Qur'anic socio-moral purposes, objectives and

methodology. For instance, the rule/law of payment of *zakah* (the levy on the relatively well-to-do Muslims for social welfare) cannot be interpreted to mean that some people must remain poor in the society to give the rich a chance to pay *zakah* and gain reward in the eyes of Allah. Quite to the contrary, the objective of the Qur'an is to eliminate poverty through human resource development and full-employment. To the extent that needy people are present (i.e. in the interim transformational period), the state/society uses *zakah* funds and other means to meet their needs. Therefore, *zakah* should be viewed as an institutional poverty-reduction measure which is legally enforceable. In the ideal poverty-free conditions that Islam wants to create, *zakah* becomes a general social development expenditure. Simultaneously, the categories of *zakah* recipients and its purposes need to be interpreted not in a purely literal fashion but more meaningfully, taking into account contemporary social conditions and the wide category of welfare expenditures it points to. Moreover, the assessment of *zakah* has to be re-evaluated under the conditions prevailing now and not exclusively by the categories of wealth it was levied upon in the days of the Prophet (Ul-Haq, 1996, pp. 24-25).

Similarly, the Qur'anic penal laws are meant to be a deterrent to undesirable individual behaviour as well as for protection of society. They cannot be indiscriminately applied in a non-Islamic environment nor without proper education and exhortation. Most importantly, it is necessary for the society that wants to apply Qur'anic laws to ensure to a substantial degree the removal of the

roots and causes (especially social and economic) of uncivil and criminal behaviour. Neither the Qur'anic teachings of compassion, leniency and forgiveness nor the very strict rules of witness in such matters can be neglected. The point that is being raised here is that the Qur'an is a complete whole--one cannot take parts of it and pass a judgement on that basis without taking into account its other relevant passages and its overall purposes.

The approach of the Qur'an in social and economic matters is holistic and integrated. It proposes an idealistic-rational integrated methodology toward problem-solving. It also supports radical measures for correcting gross socio-economic problems while in general pursuing a gradualistic evolutionary approach after the initial institutional changes have been made. Making things easier (*taysir*) in hardship, justice and beneficence/kindness (*al 'adl wal ihsan*) and overall public welfare are integral parts of the Qur'anic teachings in all realms of human life (Ul-Haq, 1996, p. 25).

#### 5.6. The Sunnah (*As-Sunnah*).

*Sunnah*<sup>8</sup> means way, habit, conduct, character or lifestyle. At the beginning, this term was generally used in the above meanings; however, Islamic '*ulama*' then use it in a specific sense to refer to the sayings (*qaul*), conducts (*fi'l*), and recognition (*taqrir*) of the Prophet (pbuh). By the *sayings* is meant any word the Prophet has said on any matters, such as the aspect of '*aqidah* (faith) and

belief, the law of *halal* (allowable) and *haram* (prohibitions), *akhlaq* (moral), *'ibadah* (acts of devotion), education, *mu'amalah* (relations between and among people and all creations), *jinayah* (criminal) and so on. By the *conducts* is meant explanations of all *shari'ah* rules in practical form, to make them easy to be understood and then practised by people. This practical aspect is very important because it explains through practical conducts and examples Allah's orders which are not explicitly mentioned in the Qur'an in detail. Examples include how to perform Prayers, the way to face *qiblat* (the direction) when performing recommended prayers on vehicles, how to calculate and pay zakah (alm tax), how to perform bathing to remove severe dirt, and so on.

*Taqrir* or recognition of the Prophet, furthermore, is his position to kept quiet upon what the companions did in his presence. The silence of the Prophet by not interrupting what the companions did means that such deeds are not sinful or prohibited. It is impossible that the Prophet would let the companions doing any sinful things in his presence. Moreover, there is another form of the Prophet's *taqrir* in which he explicitly orally agreed to what the companions did.

For the Muslims, the Sunnah is of three types: (1) that which is morally-legally binding, (2) that which is morally binding, and (3) that which is non-binding (Ul-Haq, 1996, pp. 26-27). The first type of *sunnah* is the realm of religious obligations and universal ordinances or commands which have a direct bearing on man's social behaviour and actions. Also included here are those Prophetic

*ahadith* (sing. *hadith*, traditions/sayings) which are not legal in nature (or legally enforceable in and by themselves) but contain moral-ethical principles and lessons. These are in matters within the purview of Prophethood, e.g., morals and ethics, lawful and unlawful, and all such areas that are dealt with by the Qur'an.

The second type of Sunnah contains the *ahadith* and actions based on normative judgement, reason and welfare of man. These are the Prophet's administrative rulings, judgements, decisions, rules and laws given in his capacity as head-of-state, judge and legislator. These also cover matters not directly covered by the Qur'an. Most of these decisions were made in specific space-time contexts or on specific matters or issues that were brought before him and involved value-judgements. The Prophet's companions and early Muslims took these decisions as legally and morally binding and abided by them. It should be noted that the Prophet had a 'beautiful pattern of conduct' (Qur'an-33: 21) and all his actions, thoughts and sayings were grounded in the ethics and the eternal verities of the Qur'an. As such, it was and still is the ideal criterion for human behaviour and human judgement. The Prophet's decisions in public affairs were based on Islamic ideological premises as well as the existing social realities of that time. As for now, the premises and the value-judgements embodied/subsumed in the decisions are ideally immutable or morally binding because they are based on the Islamic permanent values, but the decisions *per se* are amendable, revocable and legally non-binding. For instance, in the case of water laws and tax collection and disbursement, the rules or modes that the Prophet established are not legally

binding per se because they are time-conditioned but the values they contain are permanent and unchangeable.

The third type of Sunnah is the non-binding Sunnah which deals either with matters of universal rational, positive knowledge, or the Prophet's personal preferences, living standard, dress, habits or other personal issues. In the latter matters, Muslims are not obligated to copy or follow them. In other words, the essence is the value embodied in this Sunnah and not the form or mode. Where the Prophet made decisions or gave advice on matters of rational knowledge, his judgement was that of a common human being. For instance, once when his opinion in a matter of agricultural science was taken as an instruction and did not produce the desired result, he accepted his limited worldly knowledge and said: 'I am but a human being. Only when I order you to do something regarding your religious duties will you have to abide by it. But if I issue an instruction upon my personal opinion, then it is a mere guess and I am only a human being. Rather, you may know better your worldly affairs' (*Hadith* quoted by Husaini, 1980, p. 25). Therefore, the Prophet's statements involving positive knowledge are non-binding.

#### 5.6.1. The position of As-Sunnah towards the Qur'an.

Allah sent the Prophet (pbuh) to read and to explain the verses of the Qur'an to people. By his *sunnah*, the Prophet (pbuh) has explained all Allah's



commands and prohibitions orally and by example. The role of the Prophet (pbuh) concerning the verses of the Qur'an is as follows:

(1) Strengthening the verses of the Qur'an.

The verses of the Qur'an in fact contain clear matters which are easy to be understood by people reciting it. In this case, the role of the Prophet's *sunnah* is to strengthen those matters and place them in the position emphasised through the structure of the Prophet's sentences. For example, Allah says:

"O ye who believe! Believe in Allah and His Messenger, and the scripture which He hath sent to His Messenger, and the scripture which He sent to those before (him). Any who denieth Allah, His angels, His Books, His Messengers, and the Day of Judgement, hath gone far, far astray" (Qur'an-4: 136).

Through his *sunnah*, the Prophet said:

"Islam is based on five pillars: testifying that there is no deities except Allah, and Mohammad is His Messenger; performing Prayers; paying zakah; performing Hajj; and fasting in the month of Ramadhan" (narrated by Bukhari).

(2) Explaining the simple verses of the Qur'an.

There are some simple verses in the Qur'an which mention commands. Due to the simplicity of these verses, it is impossible for them to be performed by the believers without further explanations. In this case, the role of *sunnah* is to explain the commands contained in those verses. For example; Allah says: "For such prayers are enjoined on Believers at stated times"

(Qur'an-4: 103). There is no explanation in the Qur'an how and when the five compulsory prayers should be performed. Then, this problem has been explained by the Prophet's *sunnah*, either through his sayings or practices.

Also in the command to pay *zakah*, the Qur'an only mentions: "Of their wealth take alms, that so thou mightest purify and sanctify them;" (Qur'an-9: 103). Concerning the command of this verse, the Prophet's *sunnah* determined the types, subjects, amount to be paid, and due date of *zakah*.

### (3) Specifying the meaning of general verses of the Qur'an.

There are some verses of the Qur'an in general forms; such as: "Allah (thus) directs you as regards your children's (inheritance): to the male, a portion equal to that of two females;" (Qur'an-4: 11). The general nature of this verse has been explicated by the Prophet's *sunnah* by excluding the murderer who kills his descendants and also the Prophet himself and his children. He said: "We, the Prophets, are not inherited" (narrated by Bukhari).

### (4) Limiting the indefinite verses of the Qur'an.

There are some verses of the Qur'an which are definite and indefinite in nature. For example, Allah says: "As to the thief, male or female, cut off his or her hands," (Qur'an-5: 38). The indefinite nature of this verse gives the impression that whatever the things stolen and the conditions of

stealing, the punishment for the stealers (thieves) is for their hand to be cut off. The above verse also does not explain which part and how much of their hand should be cut off. The role of *sunnah* in this case is to explain the amount of things being stolen, the conditions, and which part of the hand is to be cut off.

(5) Determining laws and practices which are not mentioned in the Qur'an.

There are some laws which are not determined by the Qur'an explicitly, but the principles of that matters are there. In this case, the *sunnah* adds explicitly the laws of those matters according to the general principles mentioned in the Qur'an. An example of this is the prohibition against eating all wild-fanged animals and long-clawed birds. The principle of this law is the Qur'an *surah* Al-Maa-idah verse 3. Also, the Prophet has added some recommended practices such as *rawatib*, *dhuha*, moon and eclipse prayers and the like.

5.6.2. The position of *as-Sunnah* as a source of ideology (way of life).

The *Sunnah* is the second source of ideology for the Muslims after the Qur'an. All '*ulama*' have unanimously agreed that the Prophet's *sunnah* should become the proof and arguments in every matters relating to Islam (Qur'an 53: 3-4; 59: 7; 33: 21).<sup>9</sup> The *sunnah* cannot be separated from the Qur'an in guiding the

believers to the right path because the *sunnah* is the practical explanation and interpretation of the commands and teachings contained in the Qur'an. It is impossible that people follow Allah's commands without looking at the right ways to do so, while the right ways to follow His commands are only found through the Prophet (pbuh) because he has been sent by Allah for this purpose (Qur'an 3: 31; 4: 64; 4: 80).<sup>10</sup>

The command to obey the Prophet is by following his *sunnah*. The evidence of the importance of the *Sunnah* can be ascertained from the Prophet's last sermon, where he is reported to have said: "I have left two things among you. You shall not go astray so long as you hold on to them: the book of Allah and my *Sunnah*" (narrated by Bukhari, Muslim, and Malik).<sup>11</sup>

The Prophet (pbuh) has warned that any one does not hold his *sunnah* or *hadith* as the source of law and ideology, then surely (s)he denies Allah. The Prophet said:

"Almost one of you says: 'This is the Book of Allah, what is allowable (*halal*) in it, we make them allowable; and what is prohibited (*haram*) in it, we make them prohibited.' Remember, whosoever reach him one *hadith* from me, and then he denies it, surely he has denies Allah, His Prophet, and those who narrated it" (Ibn 'Abdil Barr).

In short, the Qur'an and the Sunnah form one integral whole, elucidating and complementing one another. "The Qur'an tends to concretise the ethical, to clothe the general in a particular paradigm, and to translate the ethical into legal or

quasi-legal commands. But it is precisely a sign of its moral fervour that it is not content only with generalisable ethics but is keen on translating them into actual paradigms" (Fazlur-Rahman, 1980, p. 154). The *Sunnah* itself, in its content and methodology, is an example of the concretisation of the ethical, a reflection of the Qur'anic paradigm building. Hence it is an ancillary to the Qur'an--a necessary instrument for the understanding of the Qur'anic purposes. The authentic (*shahih*) *Sunnah* or *hadith* cannot contradict the Qur'anic purposes or the Qur'anic world view. It only details, explains and concretises the Qur'anic position.

#### 5.6.3. The classification of the *Sunnah*.

One of the crucial differences between the Qur'an and the *Sunnah* is that the latter, as opposed to the former, is classified according to its reliability (of the transmitters, not its content). The transmitter of a *Hadith* (narration of the saying or conduct of the Prophet), must possess certain qualifications in order for his *Hadith* to be rendered authentic. The qualifications are, according to Imam Shafi'i:

"the transmitter must be of firm faith, well-known for his truthfulness in whatever he reported. He should understand its contents and shall know well how the change in expression affects the ideas therein. He shall repeat verbatim what he learnt from his teacher and not narrate in his own words the senses of what he had learnt. He must possess a retentive memory and if he has reported from a book, he should remember the book well. He should refrain from making a report on the authority of those whom he met but from whom he did not learn anything. His report must be in agreement with what has been reported by those are recognised to have a good memory, if they also have transmitted the same report" (in Mohibur-Rahman, 1994, p. 50).

Based on such requirements, then the body of *hadith* is broadly classified into three categories: *sahih*, the genuinely authentic Traditions, so declared after applying all tests; *hasan*, the reliable Traditions, which although inferior in authority to the *sahih* are nevertheless treated as authentic; and *dho'if*, the weak Traditions which lack the full establishment of their authenticity. For the extracting of legal rulings however, only the *sahih* and *hasan hadith* are taken into account.

The *Sunnah*, then, is a crucial source for Islamic law, but it is perhaps best to look at it in the light of its relationship with the Qur`an. It has been mentioned already that the *Sunnah* adds greater details to Qur`anic *verse*. Since certain seemingly ambiguous or difficult parts of the Qur`an were in need of elaboration, the Prophet (pbuh) was expected to provide the necessary details and determine the particular focus of the Qur`anic rulings. And in doing this, a unique relationship was forged between the Qur`an and the *Sunnah*, in that the two became so integrated that they are now almost inseparable.

It is clear then, that the Islamic ideology or concept takes its sources from the Qur`an and the *Sunnah*, not from any human mind or idea. And due to this reason, it is believed that Islamic concepts are applicable for all ages and places.

## 5.7. Spiritual System

The Spiritual is a matter concerning the deepest feeling within human's spirit or soul and heart. It is a power that knows and feels everything passing through the human's spirit. The matters concerning activities to achieve spiritual development or anything called spiritualism is not merely a matter for Muslims, but also the matter of all human-beings (Ansari, 1970, pp. 120-122; Ya'aqub, 1980, pp. 67-69; an-Nadawi, 1983b, p. 32). This matter is very difficult to be understood so that God says in the *Qur'an*: "They ask thee concerning the Spirit; say: 'The Spirit is of the Command of my Lord.' Of knowledge it is only a little that is communicated to you, (O men!)" (Qur'an-17: 85).

Spiritual matters in Islam are covered in a very well-organised system which are based on the following primary foundations (Abu 'Urwah, 1989, pp. 11-14):

(1) Based on *'Aqeedah Sahihah* (True Faith).

Any spiritual development which is not based on this, or out of its boundaries, is rejected. The Islamic spiritual system accepts only any concept of soul or spirit development which is aimed at achieving anything allowed or regulated by the Islamic teaching (*Shari'ah*).

(2) No separation between spirit and physical body.

The Islamic spiritual system rejects the idea that spirit and physical body are two conflicting entities, so that the spiritual development has no relationship with, and is even completely separated from physical and material interests. The separation between spirit and physical body has divided the life into 'spiritual' and 'secular' worlds.<sup>12</sup> According to this idea, those who want to achieve their secular interests should not fulfil their spiritual needs. On the other hand, those who want to achieve their spiritual satisfaction should leave any activity in their worldly life including social, economic, political, and so on.

Islam rejects the above idea. Allah has created men to perform certain duties, and the highest of these is to submit their life to Allah. To do so, Allah has completed men's bodies with all senses, so that they can be used by the spirit in order to perform the duties given by Him, and to fulfil their submission to Allah. In the Islamic spiritual system, the physical body is not a jail for the spirit; it is a laboratory for the development and growth of the soul/spirit (Mawdudi, 1993, p. 84)

(3) Laid on a balance construction system.

Because Islam does not accept the separation between spiritual and physical interests, both should be developed in balance. They should support each other.



(4) Developed from five strong pillars.

These five pillars are: *salah*, *zakah*, *saum* (fasting), *hajj*, and *jeihad* (strive). These five pillars reflect the relationship between men and the Creator, between men and others, and between believers and non-believers who oppose their belief.

(5) Free from any types of *takalluf*.

*Takalluf* is excessive, over-acting or self-forced conduct. As Allah says: "Say: 'No reward do I ask of you for this (Qur'an), nor am I a pretender'" (Qur'an-38: 86). Islam forbids any types of clergy and asceticism (Qur'an 57: 27).<sup>13</sup> The Islamic spiritual system forbids any types of *takalluf*, either in performing the ritual *ibadah* (such as prayers and fasting), or in performing any worldly-human life matters.

#### 5.7.1. The foundation of the Islamic spiritual system

The Islamic spiritual system, in order to strengthen the spirits or souls of believers, are based on three main things; those are: *taqarrub*, *muraqabah*, and *istiqamah*.

(1) *Taqarrub*.

*Taqarrub* is any effort to keep close with Allah, and it is commanded by Allah in the Qur'an (51: 50; 3: 133; 11: 61) and the Sunnah.<sup>14</sup> It is done by

obeying all of His commands and avoiding anything He prohibits, physically and spiritually. It is done in order to achieve the high and respected place in the sight of Allah. As Allah says: "Verily the most honoured of you in the sight of Allah is (he who is) the most righteous of you" (Qur'an-49: 13).

Doing *taqarrub* is the first foundation to develop the believer's spirits to achieve the pleasure of Allah. The way (*wasilah*) to do so has been laid down in the Qur'an as follows: "O ye who believe! Do your duty to Allah, seek the means of approach unto Him, and strive (with might and main) in this cause; that ye may prosper" (Qur'an-5: 35). The way to do so, as has been shown by the Prophet's examples, and as mention in the Qur'an (Al-Muzzammil) are: *qiyamul-lail* (keep awake at night to perform night prayers), *tilawatul Qur'an* (reciting the Qur'an), and *Zikr* (remembering Allah).<sup>15</sup>

## (2) *Muraqabah*.

*Muraqabah* means to be wary of the coming of the attacks of spiritual diseases. People should be aware that evils (*shaetan*) are always looking for any chance to attack and pull people away from obeying Allah's commands. It is a carefulness of self-weaknesses so that one will not be influenced to disobey Allah. The starting point of *muraqabah* is the belief

that Allah always watches and sees people's movements (Qur'an 26: 218-219; 50: 16).<sup>16</sup>

*Muraqabah* also means that a Muslim always calculates himself. This is because he understands that this is the only way to know his self-weaknesses and to try to improve himself. 'Umar ibn al-Khattab (the second righteous Caliph) has said: "Calculate yourself before your deeds are calculated (by Allah), and weigh yourself before you are weighed" (Rathony, 1981, p. 324). Carefulness and calculation will enable a believer to strengthen the *muraqabbah*.

### (3) *Istiqomah*.

*Istiqomah* means be steadfast or firm on the right path. It is the characteristic of noble and praised people, and is one of the Allah's commands; as Allah says: "..., and stand steadfast as thou art commanded, nor follow thou their vain desires" (Qur'an-42: 15); "..., that your God is One God, so take the straight path unto Him and ask for His forgiveness" (Qur'an-41: 6); "Therefore stand firm (in the straight path) as thou art commanded, thou and those who with thee turn (unto Allah)" (Qur'an-11: 112). The Messenger of Allah has said: "Say: 'I believed in Allah and then *istiqamah*'" (narrated by Muslim).

*Istiqomah* is needed in any activities concerning with the development and improvement of Muslim's spiritual. *Istiqomah* for spiritual power should be done with heart, oral and physical services (*ibadah*). It is one foundation of the Islamic spiritual system because by doing this a Muslim may be kept in *taqorrh* and *muraqobah*.

#### 5.7.2. Elements of spiritual power.

The spiritual power is based on some elements that will make a *believer*, if they are well-understood and fostered, have strong belief and a high spiritual defence. These elements are:

(1) Knows well the soul and how to maintain it.

The Qur'an describes in general some level of desires that show the spiritual position of the owners. Scholars of Islamic knowledge explain such levels into:

- (a) *Nafsu Ammarah*. This level is the spiritual level which tends to follow the beast desires and subject to the evil's influences. As Allah says: "...; the (human) soul certainly incites evil, unless my Lord do bestow His Mercy; ..." (QS-12: 53). This is the level for most ordinary believers, and this is the lowest spiritual level. This level can be lifted up through education and good deeds.

(b) *Nafsu Lawwamah*. This is a higher spiritual level, that can be achieved through self-control training, being wary of evil deeds and carelessness, and accurate in perform good deeds. In this level, people are able to realise, and then repent of, their bad deeds. The soul feels grief over his past bad deeds, but feels happy for the good deeds have been done. This level is as what Allah says: "I do swear by the Resurrection Day; and I swear by the self-reproaching soul (*nafsu Lawwamah*)" (Qur'an-75: 1-2).

(c) *Nafsu Mutma'innah*. When one has been able to lift up his spiritual level from *nafsu ammarah* to *nafsu lawwamah*, and then he is steadfast in being wary and careful of his own weaknesses, he will be able to reach the highest spiritual level, *nafsu mutma'innah*. This is the level of the righteous soul which always pleases Allah's will, and then is liable to accept His pleasure. Such a soul will find the true and eternal happiness from Allah (Qur'an 89: 27-30).<sup>17</sup>

## (2) Knows well the soul's nourishment

Spiritual improvement and maintenance needs nourishment according to its nature. Allah says: "By the soul, and the proportion and order given to it; and its inspiration as to its wrong and its right; truly he succeeds that purifies it, and he fails that corrupts it!" (Qur'an-91: 7-10). Knowing exactly the nourishment of soul is very important for strengthening the soul.

The soul's nourishment is everything that has been ruled in the Qur`an, and shown by the Messenger's *sunnah* in the form of: guidance, reminders, advice, warnings, good news, commands, prohibitions, good examples, and all deeds that bring happiness in the soul and *taqarrub* to the Creator.

(3) Knows well the enemies of the righteous soul.

Knowing well the enemies and their ways attacking soul, is needed in order to be prepared to protect the soul's development.

#### 5.7.4. Spiritual Diseases and Settlements

The Spirit of a believer may be infected by disease as *iman* always fluctuates, sometimes increasing and at other times decreasing. If the disease remains unhealed, it will spread and cause destruction to the believers' soul and life. The Islamic spiritual system pays serious attention to the types of soul diseases and how to heal or cure the sick soul, so that every Muslim is aware of this matter.

(1) The Diseases

The Qur`an and the *Sunnah* describe, for some aspects are even in detailed, the hazardous diseases for the *believer's* spirit. All diseases originally come from the mind, and then are reflected in terms of characteristics.

(a) *Inner diseases*, are mind diseases which are dangerous for the believer's spiritual growth, such as: *nifaq* (hypocrisy), *hasad* (envy),

*grudge, riya'* (hauteur, pride), complaints and sighs, lack of firmness, *su'uzhan* (bad thinking), *hubbud-dunya* (loving worldly matters), *'ijab binafsih* (self-pride), *hubbul-jah* (loving status), *hubbul-madh* (loving praise), and *ghurur* (self-deception).

- (b) *Outer diseases*, result from, or are the reflection of, the inner diseases, such as: *bakhil* (stinginess, avarice), *ghibah* (back-biting), *takabbur* (arrogance), falsehood, false witness, *khianat* (betrayal), greed, bad-temper, *jubun* (cowardice), laziness and the like.

## (2) The Settlement

The soul settlement process needs the following steps:

- (a) *Preventive actions*. It can be done by fencing the soul through stabilising the praised characteristics. In short, a *believer* should keep doing and increasing spiritual development deeds as governed in the Qur`an and showed by the Messenger's *sunnah*.
- (b) Calculate himself and knowing the diseases of himself. A believer who thinks that his soul is clean, in fact, is self-deceived. Conversely, a believer who keeps trying to know his own soul's diseases is one who may be able to protect himself from *ghurur* (self-deception).
- (c) Repentance and self-improvement. A believer who knows that there is disease in his soul should realise it and then blame himself that the disease has so long resided in his soul, and feel sorry because for so

long his soul has been infected. Then he should repent to Allah and form an intention to remove the disease. To remove the disease, he should replace the disease with something which totally opposes it. For example, he should replace *riya'* (haughtiness or pride) with *ihlas* (sincerity). He should remind himself that everything he does is because of Allah, not something else. Every time Satan comes and whispers to him to love people's acclaim, at that time he should prevent it by whispering to himself that everything he does is to seek the pleasure of Allah, not people's pleasure. He should tell his heart that Allah is the Great and His pleasure is above everything. He should trust the promise of Allah to the sincere people: "As for My servants (who are sincere), no authority shalt thou (Satan) have over them" (Qur'an-17: 65).

- (d) Make *do'a* (prayer). After removing the disease, a believer should keep praying to Allah, so that the disease will not return to his soul, and ask Allah to put goodness into his soul as replacement for the removed disease. Praying and asking protection to Allah is an act recommended by Him to His servants who keep looking for His pleasure, as He says: "And if (at any time) an incitement to discord is made to thee by the Satan, seek refuge in Allah. He is the One Who hears and knows all things" (Qur'an-41: 36).



(e) Looking for good healing. The process of purifying the spirit needs good teachings and advice. The Qur'an is the best healing for human spirit (Qur'an 10: 57; 17: 82; 41: 44).<sup>18</sup> The good healing contained in the Qur'an can be seen in practice in the life of pious people. Therefore, the process of purifying the spirit also requires believers to keep in touch with pious people and worshippers. They should be present in the group of such people.

#### 5.8. *Akhlaq* (Moral) System

*Al-khulq*, the singular form of *akhlaq*, literally means character or nature. In this context, it means all character or nature existing in the soul in which, based on the support and consideration of such nature, a deed can be said to be good or bad (Zaidan, 1980, p. 99). *Akhlaq* is a sacred term because it takes its source from Allah. As Allah says: "And surely thou hast sublime morals (*akhlaq*)" (Qur'an-68: 4).

The English terms' *morality* and *ethics* are not suitable to replace the Islamic *akhlaq* due to their different values and philosophical background. *Ethics* comes from a Greek word *ethos*, meaning customs and traditions owned by a certain group differing them from another. Then, this term has been used to explain someone's nature and behaviour. In ancient Greek, as stated by Socrates, ethics resulted from human experiences. The explanation of the values derive from

experiences demands a high intellectual and philosophical thinking. Therefore, in its original meaning, ethics is something based on the human mind and the values it can achieve (Muslehuddin, 1978, pp. 5-6; and 1979, pp. 54-55).

*Morality*, on the other hand, comes from the Latin *mores*, meaning a collection of social group conducts based on social evolution experienced by a group (MacIver & Page, 1950, pp. 33-35). In short, both ethics and morality are derived from human experiences, which differ from place to place, and change from time to time. Therefore, the term and meaning of *akhlaq* in Islam cannot be equated with morality or ethics.<sup>19</sup>

#### 5.8.1. Foundations of Islamic *Akhlaq*

There are three main foundations of Islamic *akhlaq*, namely: *ihlas* (Sincerity), *As-sidq* (Truth), and *As-sabr* (Patience). *Ihlas*, the first foundation, means doing every thing for nothing but to seek Allah's pleasure. As Allah says: "..., so serve Allah, offering Him sincere devotion. Is it not to Allah that sincere devotion in due?" (Qur'an-39: 2-3); and also, "Say: 'It is Allah I serve, with my sincere (and exclusive) devotion'" (Qur'an-39: 14).

*As-Sidq*, a truthful attitude, resulting from a sublime *akhlaq*, as the second foundation of Islamic *akhlaq*, covers truthfulness of a believer in his ideas, words, and conducts. Allah says: "O ye who believe! Fear Allah and be with those who are truthful" (Qur'an-9: 119); and, "..., it were best for them if they were true to

Allah" (Qur'an-47: 21); and also "That (Allah) may question the truthful about their truthfulness, and He has prepared for the Unbelievers a grievous Chastisement" (Qur'an-33: 8). In detail, Truth should include (Abu 'Urwah, 1989, pp. 48-57)<sup>20</sup>:

- (1) Truth in sincerity to Allah;
- (2) Truth in love of Allah;
- (3) Truth in fear and *taqwa* to Allah;
- (4) Truth in *wara'* (observance) of Allah;
- (5) Truth in *tawakkal* (resignation, trust) in Allah;
- (6) Truth in *haya'* (obedience) to Allah;
- (7) Truth in thankfulness to Allah;
- (8) Truth in *zuhud* to Allah;
- (9) Truth in pleasing to Allah;
- (10) Truth in repentance to Allah.

*As-Sabr* (patience), the third foundation of Islamic *akhlaq*, literally means restraint and prevention (Qur'an 3: 200; 16: 126; 52: 48; 8:46).<sup>21</sup> In this context, it covers three things: be patient in obedience, be patient from or against sin or wickedness, and be patient in facing difficulties. If all these could be done, they will guide a Muslim to (Abu 'Urwah 1989, pp. 58-59)<sup>22</sup>:

- (1) Be patient in performing duties.
- (2) Be patient in avoiding Allah's prohibitions.
- (3) Be patient in performing additional recommended deeds.
- (4) Be patient in accepting truthfulness.
- (5) Be patient in facing tests and difficulties.

These three foundations: sincerity (*ihlas*), truth (*as-sidq*), and patience (*as-sabr*), are also the foundations for all believer's deeds. Each of them gives different meanings, but together they unite in all believers' *akhlaq* and deeds; while deeds

and *akhlaq* will never be perfect without these three altogether. Moreover, each of these three supports and strengthens the others. If one of them becomes weak, then the others also become weak.

### 5.3.2. Factors devastating or breaking the *Akhlaq*

The factors which may devastate or break *Akhlaq* can come from 'internal factors' and 'external factors'. The internal factors are those which come from, and stay in, the human soul itself. They are closely related with someone's spirituality. Some of the internal factors potentially breaking the believers' *akhlaq* are:

- (a) *Al-Ajzu* (lack hardness, weak spirit). One with a weak spirit will have no ideas about what he has to do nor high spirit to achieve them. He will just follow others without considering the reason for doing so. The Prophet taught his people to ask protection to Allah from *al-ajzu*: "Ask Allah's help and do not lack hardness" (narrated by Muslim).
- (b) *Al-Huzn* (sorrow). It is a profound sorrow or unhappiness in the heart due to bad experiences, or bankruptcy, and the like. Everybody will feel sorrow due to unfortunate experiences. However, allowing the soul to be deeply influenced by such sorrow and sadness so that it may weaken one's spirit is a bad attitude. This attitude contradicts the true believer's attitude as explained by Allah. Allah says: "So lose not heart, nor fall into despair; for ye must gain mastery if ye are true in Faith" (Qur'an-3: 139).

(c) *Al-Khauf* or fear and worry. Fear expected by Islam is fear of Allah only.

Allah says: "..., so fear them not, but fear Me" (Qur'an-2: 150). To fear and worry about something other than Allah is one inner human factor that may destroy his *akhlaq*. If sorrow (*al-huzn*) is concerned about the past, e worry or fear (*al-khauf*) is anxiety about the future. Such a feeling contradicts the *tawakkal* ordered by Allah.

External factors may come from the surrounding society as well as the learning process (education). Friends and society will strongly influence human *akhlaq*. A friendship with good worshippers will make the soul tend to good, and in turn result in a noble *akhlaq*, and vice versa. Al-Qur'an (18: 28) encourages believers to keep their friendship with pious people, and discourages friendship with wrongdoers.<sup>23</sup> The influence of society, has even broader impact. A society which follows Allah Law will create an environment supporting the human soul. Conversely, a society which neglects Allah's Laws will encourage mischief to Allah; and in turn, it will bring destruction to the people.

Education is another external factor which may devastate or break *akhlaq*. Education is a process of familiarising the soul with what is expected to be achieved by the purpose and goals of that education. Openness, on the other hand, is a stimulant which helps and fastens the process of familiarising and adjusting the soul toward what it is expected to achieve. If the foundation of education is Islamic, it will create an Islamic result, and the converse is also true.

### 5.8.3. How to correct and to improve *akhlaq*

Generally *akhlaq* can be corrected, as Allah says: "By the soul, and the proportion and order given to it; And its inspiration as to its wrong and its right; Truly he succeeds that purifies it, And he fails that corrupts it!"(Qur'an-91: 7-10).

The ways to correct *akhlaq* are as follows (Abu 'Urwah, 1989, pp. 64-66):

#### (1) Improve the knowledge and know the types of *akhlaq*.

It is compulsory to a believer to learn which *akhlaq* are required by Islamic *shari'ah* and those which are condemned. Such a knowledge is very important so that the Qur'an has laid down the pious *akhlaq* which should be possessed by a believer, and the *sunnah* of the Prophet (pbuh) has also explained in detail each of them and has translated them into the real practice. Without such knowledge, is impossible for people to know which *akhlaq* are praised and which are condemned.

#### (2) High intention.

To manifest the knowledge concerning pious *akhlaq* into real life needs a high intention. Only through a high intention may the soul be strengthened to know exactly the pious attitudes. It is based on the essence that pious *akhlaq* and steadfast faith are two unseparable things. Strong faith needs a good and well-prepared protection. Therefore, the duty to maintain faith and form pious *akhlaq* are two parallel duties.

(3) Keep close with, and doing, good.

Bad *akhlaq* may be removed by replacing them with pious *akhlaq* which contradict them. To improve himself with pious *akhlaq*, a believer should review the following steps (Abu 'Urwah, 1989, p. 65):

- (a) Self-audit and knows exactly what the bad *akhlaq* reside in his soul.
- (b) Make sure to know the one which is the worst referring to the shari'ah.
- (c) Choose the best pious *akhlaq* to replace it, by referring to the shari'ah as well.
- (d) Self-improvement according to the rank of good *akhlaq* he knows.
- (e) Increase additional recommended deeds in order to smoothen his soul to approach Allah.

(4) Keep in touch with noble worshippers and keep away from wrongdoers.

This is the best way to improve one's *akhlaq*, because people naturally find it easy to copy someone they are close to. The Prophet stressed the important of being close to pious people through his saying: "Don't you make a friend except with the pious people, and don't let people eat your foods except the pious people" (narrated by Abu Dawud and Tarmidhi). Being close to pious people means keeping far away from wrongdoers, new innovators, and immoral people.

(5) Be Open to any advice.

Believers who want to improve themselves and increase their *akhlaq* should be openness to accept any advice. People always need advisers to show them their own weaknesses. They should be thankful for any advice and

critique. 'Umar ibn al-Khattab always says: "May Allah send His bounties to those who show my weaknesses."

## 5.9. Summary

Islam is not merely a religion; it is also an ideology which underlies all aspects of societal life (politics, economy, legal, social, culture). The single word to cover both meanings is '*ad-deen*', as it is used in the Qur'an and the Sunnah, and by Muslims.

Allah is the name of God in Islam. The term 'Allah' has no plural or gender forms; as He is the One True God. He is the Almighty, Creator and Sustainer of the universe, Who is similar to nothing and nothing is comparable to Him. He is also called by His attributes, such as *Ar-Rahman* (The Most Gracious), *Ar-Raheem* (The Most Merciful), *As-Somad* (The Eternal, Absolute), *Al-'Adl* (The Just), and so on.

The concept of faith in Islam lies in six 'Articles of Faith': (1) belief in One God 'Allah' (Tawhid); (2) belief in God's Angels; (3) belief in the Books of God, and in the Holy Qur'an as His Last Book; (4) belief in all Messengers of God, without any discrimination among them, and Mohammad (pbuh) as His last and final Messenger; (5) belief in Life After Death; and (6) belief in *Taqdeer*, the



timeless knowledge of God and His power to plan and execute His plans, whereby nothing can happen in His Kingdom against His Will.

The concept of worship, which is action and practice of the concept of faith, lies in five 'Pillars of Islam': (1) declaring the faith (*shahadah*); (2) performing *salah* (ritual prayers); paying *zakah*; (4) compulsory *siyam* (fasting during the lunar month of *Ramadan*); and (5) performing *Hajj* (Pilgrimage to the Holy City Makkah). These five 'Pillars of Islam' are only parts of worship, i.e. ritual worship. The term worship in a broader sense includes 'everything one says and does for the pleasure of Allah'. This includes *rituals* as well as beliefs, social activities, and personal contribution to the welfare of one's fellow human beings (non-rituals).

The Holy Book of Islam and Muslims is called *Al-Qur'an* (The Qur'an), which literally means 'Readings'. The Qur'an is a coherent, consistent and complete document. The contents of the Qur'an are essentially immutable or permanent moral-ethical values, i.e., values to distinguish right from wrong, good from evil, moral from immoral, and welfare-promoting from welfare-reducing. The principles, ordinances, laws and the permanent values embodied therein are by their very nature independent of time and space, and applicable at all stages and conditions of human developments. The Qur'an is a complete whole--one cannot take parts of it and pass a judgement on that basis without taking into account its other relevant passages and its overall purposes. The Qur'an by its criticism

establishes what a society should not be; and on the other hand it points in a practical way to what a humane society ought to be like.

The *Sunnah* consists largely of the Prophet *ahadith* (traditions) in the forms of: (i) guiding principles, commands, ordinances, rulings and decisions (*qoul*, or saying); (ii) details of his personal deeds, practices, and mode of behaviour in private and public life (*fi'l*, or conducts); and (iii) what he agreed to or tolerated during his life (*taqrir*, or recognition). In other words, the *Sunnah* is the documented sum total of Mohammad's conduct in his life as Prophet and in all other capacities. Therefore, the *Sunnah* embodies the Qur'anic ideals as teachings and sayings, and as concrete examples in practices and application. As a consequence, the *Sunnah* cannot be separated from the Qur'an; that is why the *Sunnah* constitutes, as the Qur'anic ancillary, a primary source of Islamic ideology.

In its spiritual system, Islam sees that man consists of two complementary components: spirit and physical body. Islam rejects the separation between spiritual and physical interests; both should be developed in balance. Strong spiritual power will create people's morals. As a 'religion', Islam emphasises the human being, i.e. to develop the morals (*akhlaq*) of people. As the Prophet (pbuh) has said: "I have not been sent but to perfect the morality" (Al-Hadith). Therefore, the core of Islamic teachings is morality (*akhlaq*). When *akhlaq* degrades or disappears, then all system in the societal life will collapse.

There are two ways to maintain *akhlaq*, internally and externally. Internally, *akhlaq* can be maintained through spiritual actions as has been explained in discussing the ‘spiritual system’ of Islam. This is a self-actualisation, which is a personal in nature. It also depends very much on the level of individuals’ *iman* (faith), as has been explained in discussing the ‘Pillars of Faith’. If the level of *iman* is ‘high’, then the feeling of need of spiritual action will increase, and in turn, it will influence the morality (*akhlaq*) of the doers; and vice versa.

However, as has also been mentioned by the Prophet, that “*iman* is up and down (fluctuates)”, and environment strongly influences individuals’ *iman*. Therefore, to maintain *akhlaq* of Muslims, external factors (i.e. environment) should be created so that they support the effort of *akhlaq* maintenance. The external factors are all systems in the society, including political, legal, economic, and social systems. Therefore, it is impossible for Islam not to concern itself with these matters.

In short, this chapter has tried to explain that as a ‘religion’, Islam stresses on how to create moral individuals. As a society is a collection of individuals, moral individuals will inevitably create a moral society. However, it is realised that ‘*shaetan*’ (Satan) will keep encouraging people to do the contrary, so that a ‘religion’ is not enough to create and maintain a morally/ethical society. There always a need for societal systems which work to enforce and guarantee the development of such society. The next chapter will be discussing the societal

systems in Islam, which are derived from the Shari'ah, covering the concepts of political, legal, economic, social and cultural systems.

## CHAPTER 6 THE CONCEPT OF ISLAMIC SYSTEMS

### 6.0. Introduction

For Muslims, Islam is a 'total way of life': a 'religion' and an 'ideology'. As a religion, it is concerned with the relations between man, individually and collectively, with God. It includes the system of faith and rituals which has been discussed in the previous Chapter. It also contains the spiritual and moral system. All these aspects are usually referred as *ibadah* (worship) in its specific (narrow) meaning.

Ideology, as has been discussed before, is a 'science of ideas': the human ideas that inspire and justify their social and political life. Due to the changes and development of human ideas from time to time, and the differences between people and their places, there have been a lot of ideologies in the world. Islamic ideology, however, is not based on human idea(s); it takes its sources from the *Shari'ah*. In Islam, idea(s) and mind should follow the *Shari'ah*. The societal systems (concepts) in Islam, therefore, should be deduced from the *Shari'ah*.

The term *Shari'ah* is often referred to or translated as *Islamic law*. *Shari'ah* is the basic moral-ethical code in Islam. The Qur'an states: "For everyone of you, We have ordained a *shari'ah* (Divine Principles or Law) and a

*minhaj* (an open way)” (Qur’an 5: 48). The *Shari’ah* comprises the explicit ordinances of the Qur’an and Sunnah which are simultaneously moral and legal. The *Shari’ah* is concise and small (Asad, 1980, p. 12). Strictly speaking, it is not law *per se*. It is a *way of life* lived under God’s commands and in obedience to His will. Since the *Shari’ah* embodies the Islamic moral imperatives, Islamic law has to be codified and derived from it. Therefore, the larger part of the time-and-space conditioned legal structure will have to be evolved on the basis of the principles (*‘usul*) and commands given in the *Shari’ah* and will thus be dynamic and responsive to societal needs. In other words, the societal institutions, legal details and policy-making (*minhaj*) are temporal and flexible, while the permanent values, religious obligations, legal principles and the non-time conditioned moral-legal code (*Shari’ah*) are immutable, fixed and non-temporal. Thus the *Shari’ah* is the point of reference for all society-building activities.

This chapter explains Islamic societal systems derived from the *Shari’ah*, which Muslims are bound to understand and follow. The systems explained include the social, political, economic, legal and cultural systems. All aspects regarding the relationship among men are usually referred to as *muamalah*, which also include the relationship between humankind with the natural life (flora and fauna). Before coming to these points, however, it is important also to understand the Islamic principles regarding innovation, imitation and assimilation.

### **6.1. The Principles of Innovation, imitation and assimilation in Islam.**

Any contemporary attempt at Islam-based societal development will have to be made in a creative spirit using all the beneficial tools available to mankind. Muslims will have to invent and innovate, making new departures on the basis of what has been revealed in the Qur'an. This was exemplified by the early Muslims in their enlightened understanding of the Islamic spirit and was manifested in their creation and application of policies. Moreover, part of the Sunnah itself is a matter of originality and innovation, especially in issues dealing with public interest and state policy.

The Qur'anic philosophy and methodology clearly establish that anything that is of utility or value, regardless of its origins, can be imitated and assimilated by Muslims as long as it does not violate the prohibited categories (Qur'an, 5: 4-5; 7: 32). For instance, the pre-Islamic democratic Arab institution of *shura* (consultative council or assembly where the will of the people can be expressed by representation) was confirmed and assimilated by the Qur'an, laying the principles of mutual counselling and consultation and representation (Qur'an 42: 38). The Prophet was instructed to decide matters after consultation with the people (Qur'an, 3: 159).

The Prophet also legitimised and absorbed into the emerging Islamic culture beneficial pre-Islamic customs/usage/virtues. But in most cases, he

modified or regulated the practices to suit Islamic teachings and then adopted them in Islam, especially in the realm of land-tenure and business transactions. His early followers applied the same principle of assimilation when new methods and techniques became known and available. A good example of imitation is the creation by 'Umar of the *diwan* (bureau), a special government department, in the year 20 H/641 C.E., for conducting regular population census. It was on this basis that he started the food-ration and social insurance scheme.

The Qur'an views knowledge--the creation of ideas and the pursuit of knowledge--as an activity of the highest possible value. After *Allah* (God), *knowledge* including its derivatives is the second most repeated word in the Qur'an. Man's creation and existence, his superiority over all other creatures, is based on his being given the faculty of understanding and knowledge as well as the freedom and ability to use them (Qur'an, 96: 1-5; cf. 2: 30-33). The function of knowledge is to enable man to lead an enlightened life and to fulfil the purpose of his creation, i.e., the will of God.

The Qur'an itself points to virtually all types of sciences as well as the scientific method (or observation). It refers to the knowledge of nature which has been made subservient to man, i.e., the physical sciences. It refers to history, geography and geology, biology and botany and numerous other sciences. The Qur'an also points to the knowledge of man and society as based on scientific observation, i.e., humanities and social sciences. But most importantly, the Qur'an



prescribes that all scientific and technological knowledge be used with a keen moral perception (in accordance with the ethics it gives) for the benefit of mankind and not for man's own self-destruction. Similarly, numerous traditions of the Prophet sanctify education, research and the pursuit of wisdom, along with pointing out the direction of their use. Thus, all positive knowledge and sciences, i.e., anything that is value-neutral, is potentially an integral part of the Islamic scientific-educational culture and should be promoted and disseminated. The Prophet was reported to have said: "A wise council is the lost property of the believer, wherever he finds it, he has greater right to it" (Hadith, cited by Husaini, 1980, p.30).

The implication of this philosophy is that knowledge and experience are the common heritage of mankind. Thus, everything useful proceeding from this accumulated heritage can and ought to be imitated--and where necessary reformed, amended, improved, synthesised and adapted--and assimilated into the Islamic culture. This applies to all humanistic-social sciences and natural-physical sciences and to technology, government, public administration, business management, etc. This equally applies to human and economic development strategies and policies.

## **6.2. Social System**

As has been mentioned previously (Chapter 3), people as social humankind create and naturally create an organisation that guides and controls their behaviour

in many ways. Islam, on the other hand, views that the community (*ummah*) is not only natural, but necessary. In Islam, it is not the society that creates the rules (through many theories) but the rules that create Islamic society. It is the Islamic rules (*shari'ah*) that decide the characteristics and framework, and then guide and develop the society. The changes in society show only the dynamic nature of human activities in terms of the fluctuation of their belief in God and as how strongly they follow the *shari'ah* (Qutb, 1975, p. 48).

An *ummah*, according to Islam, is a merging of people who are bound through a godly law in order to achieve a harmony and peaceful societal life; it is a group of people bound by a common faith. It is a rule of life based on *tauhidullah* (belief in the oneness of God) and obedience to His *illahiyyah* (godliness). The Islamic social system covers all societal inter-relationship (between one another) and its power lies in the regulation controlling the system. Since man has a purposive existence (“man has not been created in vain”, Qur’an 23: 115), he needs to be guided in a certain direction which is done by the Islamic primary sources (the Qur’an and the Sunnah). His essential purpose is to serve God and Him alone (Qur’an 51: 56). On the individual level, it means that man has to worship the one God, behave in an ethical manner and realise his higher tendencies. On the collective level, his task is to establish an ethical social order, the outline and principal features of which are spread all over the Qur’an.

Islam considers the social order not only natural but necessary because it is in this theatre that the human finds his growth, development and self-fulfilment. The social order is where the God-given human rights can be fulfilled, duties and obligations observed, and economic goals and policy objectives pursued (Ul-Haq, 1996, p. 43). The Qur'an states: "Those [are Muslims] who, when We give them power on earth, establish prayers (*salah*), pay *zakah*, command good and prohibit evil" (Qur'an 22: 40). Here *salah*, as elsewhere in the Qur'an, means not only the cardinal duty of prayer but also symbolises the overall normative moral-ethical behaviour; and *zakah* stands not only for the social welfare obligation alone, but is also symbolic of the philosophy of economic justice and support for the weak evidenced throughout the Qur'an. Similarly, "commanding good and prohibiting evil" (*amr bil ma'ruf wa nahy an al-munkar*) symbolises the upholding of the *Qur'anic-Sunnatic* permanent values in matters social, political, economic and cultural. The above passage, while pointing to the actual behaviour and ethics of true individual Muslims and their collectivity, also prescribes the desired and normative function of the Muslims as a group.

That Islam takes a holistic and integrated view of life and belief, of prayer and worship, and of social and moral teachings is demonstrated in the following passage:

"It is no virtue that you turn your faces east and west [in prayer]; Virtuous are they who believe in Allah, the Last Day, the Angels, the Book [or revelations], the Prophets, who give of their wealth--despite their love for it--to needy kinsmen, orphans, the poor, the wayfarer, those who ask for financial help and for the freeing of human beings in bondage, who establish prayer, pay *zakah*, fulfil their pacts when

they make them, are steadfast in misfortune and hardship and in time of peril--these are the true believers [or truly conscious of God]" (Qur'an 2: 177); (Refer also to Chapter 5, Section 5.4.-- *The Concept of Worship (Ibadah): The Five Pillars of Islam*).

"Verily, for all those who have surrendered to God of males and females, those who believe of males and females, those who are sincere of males and females, those who are truthful of males and females, those who are patient of males and females, those who fear Allah of males and females, those who give in charity of males and females, those who fast of males and females, those who preserve their private parts [from indecency] of males and females--Allah has prepared for them forgiveness and great reward" (Qur'an 33: 35).

As these two passages show, not only is Muslim society meant to comprise people of virtuous character but also, the God-consciousness of such people should logically move into the social arena and be exemplified in acts of social welfare and ethical social transactions.

It is when these tasks are performed and the character is so moulded that the Islamic community (*Ummah*) becomes the ideal and best community. The Qur'an points this out: "You are indeed the best community (*ummah*) that has ever been brought for [the good] of mankind: [because] you enjoin the doing of what is right and forbid the doing of what is wrong, and you believe in Allah" (Qur'an 3: 110). This and other passages of the Qur'an where the characterisation "commanding good, forbidding evil, establishing prayer and giving *zakah*" recur (Qur'an 2: 177; 9: 71; 22: 41) amply demonstrate that the task of the Muslim community is to establish an ethical social order on earth where social weal is promoted and injustice abolished. This task can be performed when Muslims heed

the call of the Qur'an to come together and stick together on the Islamic basis: "And hold fast, all together, unto the bond with Allah, and do not draw apart from one another" (Qur'an 3: 103).

The Qur'an also proclaims the function of the Muslim community in the following terms: "Thus We have appointed you as a median community (*ummatan wasatan*) that you may be the witnesses to mankind and the Messenger be a witness over you" (Qur'an 2: 143; cf. 22: 78). Here the term witness also implies the meaning of example--that the Muslims should be an exemplary nation, just as the Prophet was an example-model for Muslims. Historically, the above passage (*ummatan wasatan*, median community) probably meant the function of Muslims as the *intermediate/middle nation* between the rigidity and fluidity of the then existing communities. But now, by analogy, it can be taken to mean the position of the Muslim community as being one of justly balancing out extremes on the globe in all areas of life: of spiritualism vs. materialism, of ethnocentrism vs. absence of brotherhood and social concern, of totalitarianism vis-à-vis social anarchy, of command economy vs. directless economy. In other words, the Qur'an assigns the Muslims the task of being the community of the golden mean as well as the task of smoothing out social, political, economic and religious extremes on the earth (Ul-Haq, 1996, p. 45).

### 6.2.1. Foundations of Islamic Social System

The Qur'an and the Sunnah have set out rules for the primary foundations of human social life as follows (Mawdudi, 1976a, pp. 64-65):

- (1) *Co-operation for goodness.* The members of an Islamic society are ordered to co-operate with others in doing goodness, but not otherwise (Qur'an 5: 2; 9: 71).<sup>1</sup>
  
- (2) *Human inter-relationship is an act of devotion ('Ibadah).* Any types of relationship between and among people are aimed at fulfilment of obedience to Allah and seeking His pleasure (Qur'an 3: 102-103, 112).<sup>2</sup> To fulfil agreement with others and to be united in society are among Allah's commands. To fulfil Allah's commands is an act of devotion (*'Ibadah*).
  
- (3) *The aim of society development is to uphold the Belief in the Oneness of God.* The foundation of social life is to build an Islamic leadership which preaches and upholds the foundation of the belief in the oneness of God to all societies (Qur'an 22: 41).<sup>3</sup>
  
- (4) *Not to destroy nor help in destroying the society.* The foundation of societal life is to avoid any kinds of destruction to any society's members, either in term of conviction (*i'tiqad*), soul, mind (*'aqal*), descent (heredity),

or property. Allah says: "Do not mischief on the earth, after it hath been set in order,..." (Qur'an 7: 56).

#### 6.2.2. Characteristics of the Islamic Social System.

The characteristics of the Social System which are based on Islamic *shari'ah* are as follows:

##### (1) Equality among humankind.

The Islamic social system sees the differences in nations, race, colours, languages, and citizenship as something natural in the growth and development of human civilisation. Islam does not seek to eliminate nor to ignore these differences considering that the advantages in such differences, in fact, can ease people knowing one another. As Allah says:

"O mankind! We created you from a single (pair) of a male and a female, and made you into nations and tribes, that ye may know each other" (not that ye may despair each other) (Qur'an 49: 13).

However, Islam rejects the attitude of distinguishing the status of a group of people on the basis of nation, race, colour, language, citizenship, and the like. Islam sees such an attitude as a manifestation of misleading pagan ignorance. This is because Islam has proclaimed that people in the world from the beginning until the end of human civilisation originally come from one descent. Therefore, people are a brotherhood with the common status of humankind.

All people, irrespective of their race or language, are equal in the Islamic social system. Race and language cannot limit or lower their human status. What distinguishes them is only their faith and belief, as Allah says:

"Verily the most honoured of you in the sight of Allah is (he who is) the most righteous of you. And Allah has full knowledge and is well acquainted (with all things)" (Qur'an-49: 13).

Therefore, Islamic society is built on the foundation of faith. Whosoever follows this faith, he becomes a member of this society and has the same right as any others embracing this faith. Those who do not embrace the Islamic faith, are given rights and are allowed to live in Islamic society on the basis of human equality.

Islam is frequently accused of discriminating against women. In fact, Islam views men and women as equal but with some role differentiation. Islam views them as partners and co-workers complementing each other and helping each other in family responsibility as well as in ethical functions (Qur'an 9: 71). Men and women have equal status in terms of religious and ethical rights, duties and responsibilities (Qur'an 3: 195; 9: 71-72; 16: 97; 33: 35). They have equal rights to attain paradise (Qur'an 4: 124; 40: 40; 16: 97), and civil equality (Qur'an 60: 12; 3: 195). Where there are exceptions to the rule of equality, and these are very few, they largely pertain to human functions or responsibilities as husbands/fathers and wives/mothers.



The Qur'an, in general, envisages the division of labour. It assigns the overall guardianship responsibility of the household to the male, which includes financial support and maintenance, and the protection function (Qur'an 3: 34; 2: 233), due to differences in natural physical, psychic and emotional constitutions of the two sexes. While earning a livelihood requires a full-time struggle outside the home for which men are better disposed, child-rearing and home-care also require energy and self-exertion as well as qualities with which women are better endowed. Both are complementary honourable functions in Islam. There is nothing in the Qur'an against women earning or being economically self-sufficient. The Qur'an only exempts them from the responsibility of supporting a family.

In seeking knowledge, moreover, men and women have equal right and responsibility. The Prophet is reported to have said: "Striving after knowledge is a religious duty of all Muslims, men and women" (Hadith). Therefore, it is not true that there is sex discrimination in Islam; in general they have equal rights and duties. Only in some respects, due to their natural differences, do they have different roles.

## (2) Safeguarding the glory morality.

Among the characteristics of an Islamic social system is its clearness and power in maintaining the morals (*akhlaq*) of each member in the society. Maintaining the pious *akhlaq* is important because a society that is clean and holy

from any bad and crime will be able to create clean mind, good words, and perfect deeds in its members.

Based on these, the first and most important *institution*<sup>4</sup> in Islamic social system is *family* (Refer to Section 6.2.3.--*Islamic Methodology to develop Society*). Concerning family, Islam rules that the relationship between a man and a woman is only legal if it is made through the marriage bond. Through a family bond, the holiness of a man and a woman will be guaranteed; and with this guarantee, they may play their roles in creating their small own society, called a family, responsibly. The feeling of responsibility in creating a family is one of the best guidance systems in the Islamic social system. It is called a guidance system because, through this, children who will make a new generation will be educated and trained with Islamic *akhlaq* and values. The weakness of systems other than the Islamic social system is their ignorance of the role of parents and family in educating and training children with good values.

Moreover, the Islamic social system also prescribes some rules based on morality for determining relationships among people in the society. The good are identified very clearly; while the bad are condemned so that society members hate them. To be consistent with this, some bad conducts are classified as crimes and punished severely. Rules and punishments in Islamic society and states are aimed at maintaining the piety of the society members' morality.

### (3) Maintaining social justice.

All social life can be divided roughly into two main categories: political and economic. The Islamic social system upholds social justice by creating balanced and 'right' political and economic systems according to the Godly law. As a comprehensive way of life (*ad-deen*) Islam controls the society's needs, the way of finding occupations (sources of income), and the way to receive and use the income. In order to control this, Islam prescribes an economic system that stands on a base of pious morality. All economic activities in Islam are based on the attitude of love and co-operation among people. By this attitude, the Islamic economic system cleanses people from the diseases of greed and selfishness which are the peak of all social problems concerning wealth and property.

Social justice is guaranteed by the Islamic economic system, in that none of society members have any full opportunity to collect wealth by ignoring the rights of other members of society. This social justice stresses that wealth should not circulate among the rich only; it should be used by all society members through trade and transaction. Allah says: "..., in order that it (property) may not (merely) make a circuit between the wealthy among you" (Qur'an 59: 7). "O ye who believe! Eat not up your property among yourselves in vanities; but let there be amongst you traffic and trade by mutual good-will" (Qur'an 4: 29).

The social justice which is guaranteed in Islamic social system prescribes a fair distribution of the opportunity to obtain wealth among society members. By

doing so, all people will be able to use their own potentialities given by Allah to obtain their own income. Those who have more potentiality will earn more, and vice versa. However, no one will be ill-treated because all people have been given equal opportunities in the resources that they are allowed to use. Under this concept of differences in human potentialities, the Islamic social system decides that the rich should pay *zakah* and charity to help the poor. By doing so, the social justice in economic aspect according to Islamic social system will make sure that the wealth will be used for good purposes and in good ways, not otherwise, nor only possessed by some people.

Social justice in the political aspect, on the other hand, is related to the principle of equality of people in law. In the Islamic political system, no one is above the law. The ruler and the ruled, Muslim or non-Muslim, all are under the law for any matters concerning with social interest.<sup>5</sup> In this sense, the Islamic state is a *nomocracy*, i.e., where the rule of law is supreme (Ul-Haq, 1996, p. 71).

The social justice in the Islamic political system also makes sure that the government is not dominated by a certain group or class in the society. The government should not be inherited by nor an inheritance from any one. The government is a Muslims' trust which should be given to the most suitable person based on his *taqwa*, knowledge and administrative ability. Under this foundation, all members of Muslim society have the right to choose their leader, to give advice and to criticise.

#### (4) Protecting human freedom.

Freedom is one of the *human rights*.<sup>6</sup> The freedoms protected by Islamic social system are *freedom to have religion*<sup>7</sup>, *freedom to speak*<sup>8</sup>, *freedom to have education*<sup>9</sup>, and *freedom to seek and choose jobs*. However, the Islamic social system determines that the responsibility and duty to protect the safety of the society should be prioritised over demanding rights and realising freedom. This foundation is determined to avoid any misuse of freedom by any society members that may disturb public interests and the safety of the society. Through this foundation, in line with the purpose of creating a society, each individual in the society is expected to be fully committed to prioritising public and state interests over personal interest.

#### 6.2.3. Islamic Methodology to Develop an Islamic Society.

The Islamic (or ethical) social order can be viewed at three levels: the individual; the family; and the collectivity, or community or *Ummah*. Individuals are elements of a family; and families are elements of a community. A good family can only be achieved if the members of the family (individuals) are good; similarly, a good community can only be achieved if the members of the community (individuals and families) are good. Therefore, the development of a good community should start from developing good individuals (*ibda' bi nafsi*: start

from individuals), and then the family, and finally the society (community as a whole).

The foundation determined by the Islamic social system is aimed at creating a good and prosperous society. More than that, the Islamic social system wants to keep the existence of good and prosperity in the society. In order to achieve this goal, Islam has its own way to develop and eternalise a good society, which are:

(1) Create virtuous family units.

Creating pious family units is the first foundation of the Islamic social system. Islam considers that tranquillity of soul and peaceful and harmonious life result from the life of a man and a woman as a husband and wife couple within a family. Allah says: "And among His Signs is this, that He created for you mates from among yourselves, that ye may dwell in tranquillity with them, and He has put love and mercy between your (hearts)" (Qur'an 30: 21).

The human's need for continuity of descent makes the household (family) as an important foundation in their life. Allah says: "And Allah has made for you mates of your own nature, and made for you, out of them, sons and daughters and grandchildren" (Qur'an 16: 72). And the human's need for descendants is recorded by the Qur'an as: "And those who pray, 'Our Lord! Grant unto us wives and offspring who will be the comfort of our eyes, and give us (the grace) to lead the righteous'" (Qur'an 25: 74).

Household (family) is also the centre of love and children's awareness of their parents' sacrifice and difficulties. Allah says:

"We have enjoined on man kindness to his parents;  
in pain did his mother bear him, and in pain did she give him birth.  
The carrying of the (child) to his weaning is  
(a period of) thirty months" (Qur'an 46: 15);  
"In travail upon travail did his mother bear him;  
and in years twain was she weaning" (Qur'an 31: 14).

A family which is built on the foundation of *Iman* (belief) will be full of love and decorated with pious deeds. A pious family environment is the main foundation for the development of other good elements for the husband, wife, and children. This development involves any aspect of human life, whether spiritual, moral, discipline, the motivation to work for increasing income, on so on.

Household (family) is the first education centre for children, who will be the next generation. A pious household is also a centre to facilitate the activities of every believer, man and woman, in society.

## (2) Create pious society members.

A pious family in the Islamic social system will create pious individuals. They realise their responsibility to other members of their family, know the rights of relatives and respect their neighbours' rights<sup>10</sup>. Through the process of creating family units, the Islamic social system is aimed at creating responsible society members. The responsibilities expected by Islam are those which are based on piety, because there is no proper measure of good, other than piety. Allah says:

"Verily the most honoured of you in the sight of Allah is (he who is) the most righteous of you" (Qur'an 49: 13).

With piety as a foundation, the responsible attitude of society's members is not limited only to certain relatives and neighbours, but is broader than that. The attitude of responsibility of a Muslim will make him desirous to help any others in his society. He understands that Islam orders that anywhere there are still hungry people, all society will not be under Allah's protection. Such an attitude will make them become society members who co-operate in managing their life matters together.

The existence of the nature of piety and responsibility will create the existence of peace and safety in society. The society will be free from any crime and immorality; there will be love among people. Allah says:

"In the most of their secret talks there is no good; but if one exhorts to a deed of charity or goodness or conciliation between people (secrecy is permissible); to him who does this, seeking the good pleasure of Allah, We shall soon give a reward of the highest (value)" (Qur'an-4: 114).

### (3) To set up a trustworthy government.

*Ma'ruf* (good) cannot be developed, and *munkar* (bad) cannot be eliminated, without the existence of a government. It is also impossible to create a pure Islamic society that applies all Islamic law (*shari'ah*) without the existence of



sovereignty. Islamic government will not also be able to survive (emulating) if it does not practise the message of *shari'ah* laws revealed by Allah.

Pious and responsible society members will also choose pious and responsible leaders. On this foundation, Islamic government's role is to safeguard the interests of the people that have chosen them. The existence of trustworthy government will create a society and nation that follows the whole Islamic system and laws concerning the matters of politics, economics, social affairs, education, and so on. The existence of trustworthy government will maintain the growth of the good which exists within men. Through this, all humankind will be able to enjoy real safety and justice.

In short, an Islamic social order should be developed through three steps or levels: the individual level, the family level, and the collective (community) level. At the individual level, Islam wants to create pious, moral and ethical individual Muslims. At the family level, Islam wants to create a pious family unit as a basis of the community. At the collective level, Islam wants to create a societal system (political, and economic) based on Islamic *shari'ah*.

### **6.3. Political System**

The meaning and concept of politics or strategy in Islam are quite different from the meaning and concepts used by non-Muslims. Most political systems/

concepts currently practised by secular, non-Muslim countries are believed to follow the political concept proposed by Machievelli, an Italian scholar and patriot in the fifteenth century (Hayes, 1939, p. 17). The foundation brought by Machievelli is called 'ends justify the means'. Therefore, secular political ideology allows any means to obtain governmental and sovereignty, including crime, deception, terror, exploitation and the like. It is no wonder that politics has a bad and dirty image.

Politics in Islam guides people's activity to the effort of supporting and performing Allah's *shari'ah* through state and governmental system.<sup>11</sup> Politics in Islam is aimed at achieving a comprehensively Islamic society through an institution having power to balance and apply regulations (Zaidan, 1978, p. 16). This meaning is based on Allah saying:

"Say: 'O my Lord! Let my entry be by the Gate of Truth and Honour, and likewise my exit by the Gate of Truth and Honour; and grant me from Thee an authority to aid (me)'" (Qur'an 17: 80).

This verse of the Qur'an shows that authority, or governmental authority of a state is needed to uphold the truth, to abolish evils, to stop exploitation and crime, and to manage justice according to the godly laws. Based on this verse, *'ulama'* (Islamic scholars) have stated that: "Allah removes any problems through the authority of state what He does not remove through al-Qur'an." It means that disavowal (bad) cannot be removed merely with a call and advice; political authority is needed to removed all disavowal (bad) (Mawdudi, 1971, p.156).

### 6.3.1. The foundations of the Islamic Political System.

The Islamic Political System is based on the following foundations:

#### (1) Sovereignty of Allah (*Hakimiyyah Illahiyyah*)

Sovereignty<sup>12</sup>, or jurisdiction authority, the highest legal authority in the Islamic political system, is Allah's absolute right. It is impossible for such a right to belong to anyone other than Allah and no one possesses even a part of it. Allah says:

"No has He a partner in His dominion" (Qur'an 25: 2);  
"To Him be praise, at the first and at the last; for Him in the Command, and to Him shall ye (all) be brought back" (Qur'an 28: 70); and,  
"The Command rests with none but Allah" (Qur'an 6: 57).

The sovereignty of Allah brings the following meanings (Mawdudi, 1980, pp. 53-58):

- (a) It is Allah the Sustainer of the universe; He is the God Who sustains men, and there is no other ways for men but obedience and bow unto His Godness, He is the only God (Qur'an-6: 162, 164; 7: 54; 114: 1-3; 10: 31-32);
- (b) It is His right to judge and take trial, no one else has such right but Him. Therefore, people should obey Him and worship Him (Qur'an-42: 10; 12: 40; 3: 154);
- (c) It is only Him who has right to pass any law, because He is the only Creator (Qur'an-7: 54);
- (d) It is only Him who has right to enact any regulations, because He is the only Owner (Qur'an-5: 38, 40);
- (e) Allah's law is right because He is the only Most Knowing the substance of everything, and in His hand is the decision of guidance and safe and right way (Qur'an-2: 216, 232, 255; 4: 11, 176).

*Hakimiyyah Illahiyyah* means that the primary essence of Islamic political system is *tauhid* (belief in the unity) of Allah, either in term of His *rubbubiyah* or *illahiyyah*.

## (2) Risalah (Message)

The ways of life of messengers referred to by Islam as *sunan al-huda* or ways of guidance (an-Nadawi, 1983a, p. 89). Their ways of life are based on revelations from Allah for themselves and also their people. The messengers then pass Allah's regulations and laws to the people.

Message (*risalah*) means that the prophethood of some men from humankind, from the prophet Adam to Mohammed (pbuh), is an important foundation in the Islamic political system. According to this message foundation, the messengers become the trustees of Allah most sovereign in respect of the regulations of human life. The messengers then pass, interpret and translate Allah messages orally and by their conducts.

In the Islamic political system, Allah has ordered people to accept all the commands and prohibitions of the Messenger (pbuh). People should follow the Messenger's commands and take no one except the Messenger (pbuh) as the judge for any dispute between them (Qur'an 59: 7; 4: 64-65, 115).<sup>13</sup>

### (3) *Khilafah* (Vicegerency)

Khilafah means vicegerent or agent. In this context, it means that the existence of mankind on earth is as the agent or vicegerent of Allah. It also means that on the authority trusted to him by Allah, people should apply Allah laws within determined borders (Mawdudi, 1976b, p.8). The position of state leader or caliph in Islamic political system is as : (i) Allah's agent, (ii) the successor of the Prophet (pbuh) in managing Muslims *ummah*, (iii) the person chosen by the society as their representative (Ansari, 1970, p. 353). Based on this foundation, that person is not the ruler or owner, but only an agent or vicegerent of Allah, the real and absolute Owner (Mawdudi, 1980, p.64). Allah says: "Behold, thy Lord said to the angels: 'I will create a vicegerent on earth'" (Qur'an 2: 30). "Then We made you heirs in the land after them, to see how ye would behave!" (Qur'an-10: 14).

A vicegerent is a true vicegerent as long he follows Allah's law. Therefore, *khilafah* (vicegerency) as the third foundation of Islamic political system demands that this duty should be performed by those who meet the following requirements (Mawdudi, 1980, p.64):

- (a) They should consist of people capable to accept and support responsibility principles included in the meaning of *khilafah* (vicegerency) (Qur'an 4: 59; 3: 118; 9: 16);
- (b) They should not consist of despotic, godless, and *fajir* people and negligent toward Allah, and transgressors toward Allah rules (Qur'an 2: 124; 38: 28; 18: 28; 26: 151-152; 49: 13);
- (c) They should consist of knowledgeable people, mentally agile, intelligent, wise and good mentally and physically (Qur'an 2: 247; 38: 20; 12: 55; 4: 83; 39: 9);
- (d) They should consist of trustworthy people so that responsibility may be charged on them safely without any doubt (Qur'an-4: 58).

### 6.3.2. The Main Principles of the Islamic political system.

The Qur'an gives two fundamental socio-political principles--one in the realm of decision-making (*shura*) and the other in the nature and type of leadership (*ulu al amr*). The principle of *shura* was revealed in the late Makkan period. In the context of the people who will find success with God, the Qur'an characterises the faithful as:

“those who believe and put their trust in their Lord; those who avoid the greater sins and shameful deeds; and who, whenever they are moved to anger, readily forgive, and who respond to [the call of] their sustainer and establish regular prayers; and whose rule [in all matters of common concern] is mutual consultation (*shura*); and who spend on others out of what We provide for them as sustenance, and who, whenever tyranny afflicts them, defend themselves” (Qur'an, 42: 36-38).

The words used in the verse (Qur'an 42: 38) “*amruhum shura bainahum*” (their common affairs are decided by mutual consultation) imply several things. *Firstly*, Muslims are being instructed by God to conduct their communal business through mutual consultation and consensus. *Secondly*, *shura* does not mean that one person asks for advice and the other gives it. What it does mean is that public policy issues should be subject to debate, discussion and resolution among those representing the community. Once a decision is reached or consensus (*ijma'*) made, the representatives should be bound by such a decision. *Thirdly*, the process of constituting the assembly or council should itself be subject to the principle of consultation in the widest sense of the word. In other words, the community

representatives themselves should be chosen through public consultation or election, i.e., through public *shura*.

The Prophet who was the political head of the Islamic state and government in Madinah, was also instructed at that time to follow the *shura* method in public affairs. The Qur'an addresses him and states: "And take counsel with them in all matters of social concern; then, when you decided upon a course of action, put your trust in God. For, verily, God loves those who put their trust in Him" (Qur'an 3: 159). Asad (1980, p. 92) points out that the Prophet, when asked about the word *'azm* ("deciding about a course of action") which occurs in this verse replied: "[It means] taking counsel with the knowledgeable people (*ahl al ra'y*) and thereupon following them [therein]". This implies that in public policy matters, not only the will and trust of people are relevant but also the advice of specialists and technical/functional experts is necessary to reach optimal decisions (Ul-Haq, 1996, p. 70).

The second fundamental injunction relating to the Islamic political order (*ulul al 'amr*, or leadership) is given in the Qur'an as follows:

"Oh you who believe! Obey Allah and obey the Apostle and those entrusted with authority (*ulu al amr*) from among you. If you are at variance over any matter, refer it to Allah and the Apostle, if you [truly] believe in Allah and the Last Day. This is the best [for you], and best in the end" (4: 59).

There are several principles being established here as well as certain critical points being made (Ul-Haq, 1996, p. 71).

*First* and foremost, Muslims in all space-time situations should pay heed to the teachings of God and His Prophet, i.e., the Qur'an and the Sunnah. This equally applies to all Muslims--those in authority (the government) and those over whom they have authority (the governed).

*Second*, the Muslim community must always have a duly constituted leadership and government which has the responsibility of socio-political, economic and administrative matters. The term *amr* refers to all communal affairs. Moreover, the holders of authority or the leadership of the government should be from among the heeding Muslims, i.e., those who obey God and the Prophet. In such a case, the government can rightly demand and expect loyalty and obedience from its constituents.

*Third*, public affairs should be conducted in accordance with the Islamic teachings (Qur'an 5: 48). Where differences arise, it is essential that the decision-makers go back to the Qur'an and the Sunnah. Similarly, where an issue is not directly delineated in the primary sources, the criteria given in the Islamic value system should be rationally utilised in the problem resolution. This is the true test of Islamicity, i.e., the proof of "believing in God and the Last Day".

*Fourth*, the government of the Islamic state should be chosen by popular consent. The Qur'anic expression "from among you" clearly refers to the Muslim community as a whole. This means that the assumption of power through non-



elective means is neither legal nor acceptable even though the concerned person or persons be Muslim. Similarly, an imposition of power from outside the community cannot be morally binding on the Muslim community. Meanwhile, obedience to a properly constituted government is a Muslim's religious duty. This is what "obey those in authority from among you" means.

When the above quoted Qur'anic verse (Qur'an 4: 59) is read in conjunction with the verse 3: 26 of the Qur'an which speaks of God as the ultimate source of all moral and political authority, it becomes evident that in the Islamic perspective, (1) political power is to be held in trust (*amanah*) from God, and (2) His will, as manifested in the teachings of Islam and in the ordinances comprising the Law of Islam, is the real source of all sovereignty. It also means that in an Islamic state, the government and the people are all equally under the law. In this sense, the Islamic state is a *nomocracy*, i.e., where the rule of law is supreme (Ul-Haq, 1996, p. 71).

To sum-up, the principles of Islamic political system consist of the following matters:

(1) *Mushawarah* (Consultation or deliberation)<sup>14</sup>

The main foundation of *mushawarah* is connected with the election of the state leader and those who will perform the main duties of managing people.<sup>15</sup> The second foundation of *mushawarah* is connected with determination of ways and strategies to apply the regulations as covered in the Qur'an and Sunnah. The next

foundation is connected with the ways to determine new problems in the society through the process of *ijtihad*.

(2) 'Adl (Justice)

This is related to the social justice guaranteed by Islamic social system and Islamic economic system. Justice in socio-economic aspects is impossible to achieve without the existence of political authority that protects and develops it. In its broad application, the justice principle of the Islamic political system covers and controls any type of relationship existing in society, including justice between people and government, between two parties who have a legal dispute in the court, between husband and wife, and between parents and their children (El-Awa, 1980, p.101). Because the responsibility to be just and avoid mischief are among the main foundations of the Islamic political system, therefore, it becomes the main role in Islamic political system to maintain these foundations. Maintaining justice is the main principle of social because, by this, all aspects of human life may be built and strengthened.

(3) Freedom.

The freedom that the Islamic political system maintains is the freedom based on good and benevolence. To uphold the principle of true freedom is among the important purposes of the Islamic governmental and political system, and the foundation for the regulations of Islamic states' institutionalisation (El-Awa, 1980, p. 102).

(4) Musawah (Equality).

Equality in this context consists of equality to obtain and to demand rights, equality in responsibility according to the levels determined by institution regulation, and equality under the regulations authority.

(5) The right to question the government.

This principle includes the right to demand clarification from the government about their affairs. This principle is based on the responsibility of government to do *mushawarah* (consultation) in anything concerning with matters and administration of states and people. The people's right to consult means that it is the duty of everybody in the society to uphold the truth and abolish disavowal. In a broad sense, it is also the right to control and question the government's conduct and decisions. (This principle is based on Allah's creed in the Qur'an 2: 205, 38: 26).<sup>16</sup>

Maududi (1990, p. 160) prefers to refer to the Islamic governmental system based on the above principles as '*theo-democratic*', that is a 'godly democratic' governmental system, to distinguish it from the '*theocratic*'<sup>17</sup> and '*democratic*' systems in the West.

### 6.3.3. The Political Goals in Islam.

The goal of the Islamic political system is to develop a governmental and state system in order to apply Islamic *shari'ah*. The main objective is to create an

Islamic state or *Darul Islam*.<sup>18</sup> The existence of a government supporting *shari'ah* will uphold the *deen* and all human affairs will then follow the requirement of that *deen*. The purpose of the Islamic political order or the objectives of the Islamic state can be summarised as follows (Ul-Haq, 1996, p. 69)<sup>19</sup>:

- to prevent injustice and to establish all-encompassing justice-- legal, social, economic and political;
- to ensure freedom, dignity and equality of all;
- to enable all Muslim men and women to realise the ethical goals of Islam, not only in their beliefs, but also in the practical sphere of their lives;
- to ensure to all non-Muslim citizens complete physical security as well as complete freedom of religion, of culture, and of social development;
- to defend the country against internal subversion and external aggression; and
- to create an environment conducive to the teaching and preaching of the message of Islam.

#### 6.3.4. Some Aspects of Islamic State (Government)

##### (1) The Constitution.

A constitution means a document in which all basic principles of an organisation of state are codified and accepted as a single authoritative document. A constitution is usually in a form of a written document; however, it is not always necessary. In fact, until the eighteenth century, all governmental structures in the world were based on un-written constitutions; and even today, the UK government is still managed without a written constitution. The sources of Islamic constitution can be found in the following documents: (a) *Al-Qur'an*; (b) *Al-*

*Sunnah; (c) Some Conventions of The Rightly-Guided Caliphs; and (d) The Decisions of the Well-known Jurists (Fuqaha).*

(2) The Division of Authorities.

The governmental authorities (power) are usually distinguished into legislative, executive and judicial powers. The interrelation among them differs among countries. The legislative body is a body, which is according to *fiqh* (Islamic jurisprudence), is called a “mediator and advice-provider body” (*ahl al-hall wa al-'aqd*). As the main sources of law in Islam are derived from the Qur'an and Sunnah, the functions of the legislative body in an Islamic state are: (a) to clarify the divine laws into passages, using relevant definitions and details, and enact it; and (b) to interpret the interpretable guidance from the Qur'an and Sunnah. The executive body is what the Qur'an refers as *ulu al amr*; and *umara* (sing. *Ameer*) means leader (i.e. governmental leader). The function of this body is to uphold Allah's guidance and ensure that people accept and follow it in their daily life. This characteristic distinguishes the function of the executive body of an Islamic state from that of a non-Islamic state. Lastly, the Jury (judicial body) should decide all matters according to the *Shari'ah*.

The *Head of State* is the highest leader of all the three authoritative bodies. However, under the Head of State, these three bodies are independent of each other. In all important matters regarding the formulation of policies or in providing general guidelines in some governmental jurisdiction matters, the Head of State

(Caliph) must consult with the legislative body. Executive officials work directly under the Head of State; however, the Head of State cannot automatically fire the executives or influence the executive decisions. Therefore, if there is a case in which the executive leader as an individual or in a capacity as the executive leader sues the Head of States, the Head of State must defend himself before the *qodhi* (judge) as the common people do.

### (3) The election of the Head of State.

From the historical perspective, as the convention recognised from the era of the Rightly-Guided Caliphs in selecting the Head of State and *Ameer*,<sup>20</sup> the following points can be highlighted regarding election of the State's Leader:

- Within an Islamic state, the election of the Head of State and/or Amir is fully based on the consent of all people; nobody has the right to appoint himself by force as their leader;
- No group or clan/tribe/cliq can monopolise this position (i.e. by passing on this position to their descendants through inheritance);
- The election should be performed based on the principle of free opinion among people, without any force or intimidation.

The way to express and elect the leader is not specified nor limited in Islam, as it is a matter of technicalities. Different places, situations, and times may use different ways.

### (4) Consultative Assembly

From the conventions of the Caliph, and even the deeds of the Prophet, it can be found that the members of the 'consultative assembly' should not be appointed by the Amir (Caliph), but they should be representatives of all people.

They should be among those who are faithful, capable, and loyal to an exceptional degree. In other words, the members of the consultative assembly should be chosen from among those who are well-known among people as knowledgeable and outstanding in Islamic moral and ethics and mature.

#### (5) The Governmental Form and Type

The actual governmental structure or form in Islam is not fixed. It falls within the domain of each Ummah in each space-time to formulate their own model according to their needs and best understanding. Thus the form/structure of the government in Islam can vary over time and be different from state to state. In other words, creating the optimal political structure would fall within the purview of rational positive knowledge. However, what does not change is the Qur'anic *weltanschauung*, the Qur'anic purposes, the key Qur'anic principles, the ethical value-system and the *ummatic* function on which the state is to be based. Therefore, each Islamic state evolves in the social realities and the natural and technological environment of space-time within the above mentioned parameters.

#### (6) Authorities and Their Requirements

From Islamic point of view, the requirements for governmental officials are very important. Such requirements will guarantee the application of the Islamic constitutional system. There are two aspects regarding the requirements for government officials. The first aspect, which should be mentioned in the Constitution, is the *legal aspect* which is derived from the Qur'an; in this respect

the requirements are that officials be: (a) Muslim; (b) Male; (c) Mature and strong-minded; and (d) Citizens.<sup>21</sup> These are four legal requirements to be fulfilled by those who will be the members of consultative assembly and the leader. However, there are still some other requirements which are considered as secondary requirements. The Qur'an and the Sunnah clearly stated these requirements: (a) *amanah* (trustworthy); (b) the most pious; (c) knowledgeable; (d) modest; (e) honest; (f) humble.<sup>22</sup>

These requirements will be easily included in the application rules in the Constitution. An independent contestant should be rejected as not fulfilling the requirements. It is the duty of the election committee to inform and educate the people regarding the most important requirements to be fulfilled by the *Ulil Amri* (leaders) in Islam.

#### (7) Citizenship.

All people, regardless of their religion, may become citizens of an Islamic state. Technically, the citizens of an Islamic state may be distinguished between Muslims and non-Muslims (*Dzimmi*). The distinction, however, is for religious matters; the non-Muslims are not demanded to perform the Islamic religious duties, and vice versa. In general, as citizens, they have equal rights as well as duties and responsibilities.



Among the rights and freedoms of citizens, Muslim and non-Muslims alike, mentioned in the Qur'an are: right to life (5: 32; 6; 151); freedom of belief, religion, conscience and association (2: 256; 10:99; 18: 29); right to work, earn and own property (all verses pertaining to earning of wealth and *zakah*); right to personal honour and dignity (all verses referring to man's nobility and dignity); protection against one's religion or person being reviled (6: 108; 29: 46; 49: 11); right to privacy including freedom from surveillance (24: 27; 49: 12); right to offer advice, opinion and constructive criticism (all verses pertaining to "commanding good and forbidding evil"); right of participation in public affairs (verses on *shura*); right to equal treatment under law without discrimination (49: 11-13); right to justice (4: 58, 105, 135; 5: 8, 42; 7: 29; 60: 8); right to free provision by the state of necessities of life to those disabled and deprived in any way (all verses pertaining to *zakah*); right to free basic education (*Sunnah*); and right to be provided with economic security and productive and remunerative work (*Sunnah*).<sup>23</sup>

On the other hand, according to the explicit texts of the Qur'an, citizens have duties and responsibilities, among of them are: loyal to the state (government); co-operation with the government; and compliance with the laws of the land. The Prophet states that when the government fulfils the requirements imposed by the *Shari'ah* and positively upholds the Faith, i.e., what it operates in consistency and compliance with the Islamic teachings, then the citizens are bound to hear and obey, in hardship and in ease, in circumstances pleasant and unpleasant. The Prophet is reported to say: "No obedience is due in sinful matters; behold,

obedience is due only in the way of righteous” and “No obedience is due to him who does not obey God” (Asad, 1980, pp. 75-76).

In the case of the contrary, citizens have duties and responsibilities to question and give constructive criticism to the government. The Prophet is reported to say: “The highest kind of self-exertion (*jihad*) is to speak the truth in the face of a government that deviated from the right path”; and “If any one of you sees something wrong (*munkar*) he should correct it by hand [actions]; if he is unable to do so, then by his tongue [speaking, writing]; and if he is unable to do even that, then within his heart [by hating it]--this is the weakest form of faith” (Hadith, cited in Asad, 1980, pp. 75-76). This is the realisation of “enjoining right and forbidding evil”.

#### **6.4. Economic System**

In real life, people try to use their potentiality, power, and mind to fulfil their needs such as foods, clothes, and settlements. Such efforts are important for perfecting their life as individuals and as members of society. Any activity relating to efforts aimed at the fulfilment of needs is called economy. It can be known from this meaning that economy is anything which can provide benefit to human life. Therefore, the wealth from agriculture, animal husbandry, exploration products, and firm and industry products are important economic resources for people.

Economics, on the other hand, is a science concerning human habits to use resources to fulfil their needs. According to Islam, economics is a social science which studies *human economic problems*<sup>24</sup> based on Islamic foundation and values (Mannan, 1986, p. 3). Islamic economy is one of the foundations for, and inseparable from, an Islamic society and nation in which the Islamic social system is connected (Ibn-Taimiyah, 1985, p. 5). Based on these foundations and values the meaning and activity of Islamic economy differ from the meaning and practices of secular economy<sup>25</sup> (Mannan, 1986, p.5; Muslehuddin, 1980a, pp. 3-4; Al-'Assal & 'Abdul-Karim, 1980, pp. 2-4).

#### 6.4.1. The foundations of Islamic economy.

The foundation of Islamic economy is taken from Allah's saying in the Qur'an (Muslehuddin, 1980, p. 43):

"But seek, with the (wealth) which Allah has bestowed on thee, the home of the Hereafter, nor forget thy portion in this world: but do thou good, as Allah has been good to thee, and seek not (occasions for) mischief in the land: for Allah loves not those who do mischief" (Qur'an 28: 77).

The principles of Islamic economy that can be referred to this verse of the Qur'an are:

(1) Allah is the owner of all things. Allah gives wealth and property to men and

He is the Ultimate Owner of all things (Qur'an 31: 20; 20: 6).<sup>26</sup>

(2) Worldly property is used to seek life in hereafter. People should use their wealth and property collected from this world to obtain a good and peaceful life in the hereafter. The Messenger of Allah has said: "An honest and trustworthy trader will be among messengers, truthful people, and martyrdom" (Hadith, narrated by Bukhari).

(3) Worldly matters should not be neglected in order to obtain the hereafter. People should not neglect happiness in this world. They should do their best to obtain a good life in the world using just and legal ways (Qur'an 5: 87-88; 7: 32).<sup>27</sup>

(4) Be just to others. People should treat others in a good manner. They should perform their responsibility to society and help unlucky and poor people (Qur'an 16: 90; 30: 38).<sup>28</sup>

(5) Do not make any destruction. People are not allowed to make any destruction on earth. They should avoid doing sinful deeds including any activities to seek wealth unjustly, improper use of resources and property, and dishonesty in business (Qur'an 6: 142; 7: 31; 2: 188).<sup>29</sup>

#### 6.4.2. Primary principles of Islamic economy.

There are four principles which are considered as the primary principles of Islamic economic system: personal ownership right, freedom to seek income

sources, social justice, and inheritance right. These principles are explained briefly as follows:

(1) Personal Ownership Right.

Islam recognises individual ownership right and places this right in the most suitable place according to the human nature (*fitrah*)<sup>30</sup>. Islam determined that personal wealth and property is one of the six original matters which should be protected by Islamic law (*shari'ah*) (Al-'Assal & 'Abdul-Karim, 1980, p. 43).

Islam sees that people are created-humans who have desires to possess and love property (Qur'an 3: 14).<sup>31</sup> This natural desire encourages people to carry out development efforts and strive to be successful. However, Islam's recognition of personal ownership right does not mean that people are free, without any limitation and rules. To place the recognition of personal ownership in a way that is in line with good human nature, and does not follow bad desires, Islamic law provides strong and enforceable rules, which are (Zaidan, 1980, pp. 280-282):

- i. The peak of legal personal ownership right should be obtained by:
  - (a) Control over allowable matters;
  - (b) Agreement such as trading (buy and sale), donation, will, lease and the like;
  - (c) Inheritance.
- ii. Do not use ownership right in unlawful ways such as *riba* (usury), gambling, adultery, *risywah* (bribery), to exploit others and the like.
- iii. Do not use ownership right unwisely.
- iv. It is allowed to transfer any personal ownership right, with a fair replacement, when needed for public interests."

(2) Freedom to seek income sources.<sup>32</sup>

Islam provides right and freedom to individuals in choosing their life-style. They are free to choose any occupation they want as long as it does not contradict with Islamic law. Due to people's different desires in choosing their occupation and income sources there will be variety in the government income and people's needs. In Islam, occupations are much more respected than in other religions and cultures<sup>33</sup> (Al-Sa'id, 1985, pp. 1-3).

(3) Social justice.

Economic activity is part of the comprehensives of Islam. Therefore, whatever Islam wants to develop, any part of this should also be developed. Islam is aimed at creating justice; therefore, one of the foundations of the Islamic economic system is also to uphold justice. The social justice that the Islamic economic system will create is not an *empty slogan*<sup>34</sup> (Maududi, 1969, pp. 100-101), and it is free from any mistakes<sup>35</sup>. This is because justice in Islam has its own foundation, that is on the foundation of *taqwa* (piety) and *ma'ruf* (goodness).

(4) Inheritance right.

Among the principles that Islam determines in obtaining ownership right is inheritance right. This right is based on human nature, justice and the respect of the owner's will and idea. Everybody wants to guarantee the life of his descendants, and tries to keep his property intact. Therefore, the inheritance right

has become a respected principle in the Islamic economic system (Zaidan, 1980, pp. 282-283).

More than that, Islam sees that inheritance right is one main way to achieve social justice in the society (Mannan, 1986, p. 184). On this basis, Islamic inheritance regulations are unique regulations which do not exist in other systems<sup>36</sup> (Maududi, 1969, p. 124).

#### 6.4.3. The characteristics of the Islamic economic system.

(1) The Islamic economic system is part of the comprehensive Islamic system.

One of the main characteristics of the Islamic economic system is that economic activity has a close relationship with the comprehensive Islamic system, either in its *'aqidah* (faith, belief) or *shari'ah* (legal) aspects. The Islamic economic system cannot be separated from faith foundation and Islamic *shari'ah* values.

From the *faith* aspect, the Islamic economic system is based on the essence that Allah is the Creator and the Owner of the Universe (Qur'an 31: 20; 20: 6),<sup>37</sup> while from the *shari'ah* aspect, it connects all elements of relationship (*muamalah*) among people. Allah says: "In order that it may not (merely) make a circuit between the wealthy among you" (Qur'an 59: 7). The Messenger (pbuh) has also

said: "All Muslims are unlawful in their praise, properties, and blood for the other Muslims" (*Hadith*, narrated by Tarmidhi).

(2) Create balance between personal and public interests.

Another characteristic of the Islamic economic system which distinguishes it from other systems is that it balances personal interest and public interest. In the Islamic economic system, personal interest and public interest are equal and in line; they do not contradict each other. This relationship is not formulated within other systems such as socialism and capitalism. Socialistic economic systems sacrifice individual interest in order to fulfil public interest, while in a capitalistic economic system, there is a tough competition among individuals to fulfil their individual interests. An Islamic economic system, on the other hand, does not emphasise merely either individual or public interests; it stresses both together and strives to create balance between both interests (Al-Assal and 'Abdul-Karim, 1980, pp. 28-29).

To create such a balance, an Islamic economic system gives freedom to society members to be involved in various economic activities allowable (*halal*) in Islam (Siddiqi, 1985, p. 195), besides synchronising some of those aspects according to regulations and governmental authority.<sup>38</sup>



#### 6.4.4. Economic goals in Islam.

The economic system according to the Islamic concept is aimed at achieving the following goals:

(1) To fulfil a part of 'Ibadah Duties.

It is narrated in *hadith*:

"Truly, everything you spend from what you earned in the path of Allah, you will be rewarded in due course, even your spending to your wives"; "Muslims are a brotherhood. They should not torture and insult them. Whomsoever helps his brother, Allah will always help him. And whomsoever makes one trouble to his brother, Allah will make one trouble for him in the hereafter" (narrated by Bukhari and Muslim).

(2) To create social and economic justice in the society.

For economic activities to be based on equality, without exploitation and deception is the only system that will be able to create social and economic justice in the society. Based on this foundation Islam allows trade and forbids *riba* (usury)<sup>39</sup> and any kind of deception<sup>40</sup>.

Every economic system based on exploitation and deception will create instability in the society because its practices are selfish such as trade monopoly, market manipulation, and labour exploitation. Such a practice will create a strained situation not only between individuals, but also between countries.

Conversely, an economic system based on co-operation and equality will create the feeling of love, responsibility and mutual assistance among people. As a

result, not only can individuals develop themselves, but even countries will be able to create a mutual-relationship to fulfil all people's needs.

(3) To eliminate poverty and to create the condition of full employment and optimum economic growth rate.

Economic activity in Islam is an *'ibadah* (act of devotion) and it is an Allah's mandates to believers. Economic activity will influence the spirituality and the level of belief of Muslims. By doing this, other *'ibadah* will be able to be practised, and the practice of economic activity itself is a prerequisite for other *'ibadah* requirements.

In the sense that economy is a mandate of Allah to the Muslims, then, among the purposes of economy in Islam are: *firstly*, to eliminate or to overcome the poverty problem; *secondly*, to create full employment opportunity<sup>41</sup>; *thirdly*, to keep *optimum growth*<sup>42</sup> according to the development of society's materiality and spirituality (Chapra, 1979, p. 150).

According to Islam, poverty is the enemy of Muslims because it will be able to make people become *kufur* (infidels, unbelievers). As the Prophet has said: "Nearly the poverty makes people's unbelief." He has been reported to pray: "O my God! I seek refuge to You from the danger of unbelief and poverty" (*Hadith*, narrated by Abu Dawud). Islamic economic activity and social life foundations provide steps to overcome the poverty problem and to look for ways to avoid

unemployment because poverty and unemployment are among ways of neglecting the individual duties of society members.<sup>43</sup>

(4) To create the stability of goods in line with the value of currency.

The economic system creates the market stability through the attitude of each society member not to be selfish and to be ready to help and sacrifice in the interest of other society members. Islam does not reject the possibility that the price of market goods increases and are increased due to the lack of material resources or the increase of demands (based on the *Hadith* of the Prophet narrated by Abu Dawud and Tarmidzi). However, the decrease in resources should be caused by true or right reasons<sup>44</sup>; while the price increase due to the increase of demands should be based on good and logical reasons, and should not dominate and limit society's life.

The practice of an Islamic economic system which cannot be separated from the foundation of socio-economy and politics is aimed to make a balance between the value of money relative to goods and services available for each society member, and even among countries in the world.<sup>45</sup>

(5) To keep safety and obedience to regulations.

The feeling of dissatisfaction among the people living within a society, due to unbalanced economic distribution and activities which are oriented only to certain people's benefit, is dangerous to people and society. Even though Islam does not reject economy as the main foundation for the idea and forming of a

society (Mawdudi, 1968, pp. 10-11), however, at the same time, Islam emphasises that the society's efforts to seek safety and obedience to regulations can be achieved through some economic activities.

The foundations of Islamic economy are the demands of faith and morality and some regulations. However, in a true Islamic morality system, the demands of morality cannot be met firmly without being governed under a system which has authority to uphold regulations. Around this comprehensiveness of Islamic systems the achievement economic goal will create people's obedience to regulations and maintain safety.

(6) To Create harmonious International relationships and to determine national defence power (Chapra, p. 158).

The modern economy cannot be separated from the problems of geopolitics or world politics. In current international political affairs, economy is an important weapon in order to create influence power and sovereignty of a country. This can be done through strengthening each defence system and weaponry. (Lichtheim, 1971, p. 145; Burr, 1965, pp. 58-59).

According to Islam, harmony in international relationships rests on the foundation of social and economic co-operation, not on exploitation of both, as is happening now. Therefore, Islam does not believe that the national defence merely depends on faith, spirit and the size of the army, but also on economic power, either in terms of productivity or enemies' fear of Islamic nations (Hasanuz-Zaman,

1981, p. 332). Allah has ordered Muslims to be ready with everything that may create fear in the enemy (Qur'an 8: 60).<sup>46</sup>

#### 6.4.5. Business Enterprise in Islam

Business activities are part of economic activities, the activities of human beings to fulfil their material needs. Therefore, business should fall within the economic system; the former is the concrete action of the latter. Business is also a social phenomenon in which social activities take place in the business, and the business itself is also a part of social activities. Therefore, what applies to social systems i.e. social norms, rules, and ethics also, applies to the business. Moreover, business is also a legal phenomenon. There are some legal rules which should be followed by the business; there are some prohibitions which should not be broken, and some sanctions to be aware of. In Islam, especially, doing business is not only for economic reasons; it can be a kind of *ibadah* (worship) if it is properly intended, and follows the rules prescribed by the *Shari'ah*.

##### (1) The Purposes of Business in Islam.

Business, including commerce and merchants, are afforded a highly honoured place in Islam (Lieber, 1968, p. 230). The Qur'an mentioned: "O you who believe! ... let there be amongst you traffic and trade by mutual goodwill" (Qur'an 4: 33). The Prophet himself referred to the honour bestowed upon traders by saying: "The truthful, honest merchant is with the prophets and the truthful ones

and martyrs in the hereafter” (Tarmidhi, cited in Hamid et al, 1993, p. 136). Moreover, business is the way in which most of the bounties from Allah are sent down, as it is said in the Hadith: “You ought to be engaged in commerce because ninety-nine per cent of the bounties of God are contained therein” (Mansor, quoted in Hamid et al, 1993, p. 136).

The ultimate goals of business, like other activities of Muslims, should be directed to the ultimate goals of human life: to worship Him and to seek His pleasure (*mardhotillah*). In more concrete terms, the ultimate goal of human activity ‘should be directed towards the achievements of *falah*, a comprehensive term denoting all sided welfare of this life as well as that of the Hereafter’ (Siddiqi, 1988, p. 3). The welfare of the Hereafter, that is, the life in Paradise, is the ultimate and long-term goal, whereas the welfare of this life, is the short-term goal.

As mentioned in one *Hadith*, “The acts depend on intention. A man will get whatever he had intended for” (narrated by Bukhari). That means if the intention of the business is for this life only, which is short-term in nature, then the maximum to be gained is welfare in this life only, and in the hereafter, the perpetrator will be the loser. Similarly, if a man’s business activity is intended to seek the pleasure of God, he will be successful at least in the hereafter, the eternal life.

The business will pleased God if it is properly intended and run in the way which is allowable according to the *Shari’ah*. An individual should aim by doing

business to get the bounty of Allah so that he may fulfil his personal, family, and social duties. From the business, he will get income to fulfil his personal needs (shelter, food, clothes, etc.), so that he may be able to perform his duties as an individual towards Allah. For those who have families, they will be able to fulfil their duties to their family (providing food, clothes, shelter, etc.), as the Prophet used to say “... and he who works to meet the needs of his personal, family needs, he is in the path of Allah,...”.

Moreover, by doing business, he may also provide services or goods to the society so that they may satisfy their needs. As the Prophet also used to say, “The best people among you are the most useful ones to the society” (narrated by Bukhari). Therefore, business can be considered as one kind of *ibadah*, if it is intended to serve the needs of the individual personal, family and the society at large, in order to seek the pleasure of Allah.

### (2) Islamic Rules Governing Business.

The economic system in Islam, in order to enforce the Islamic morality, has laid down some rules regarding business activities. The rules can be classified into two: the rules regarding the subject (goods and services) and the rules regarding the way to conduct business. The general rule regarding *muamalah*, of which economic activity is part, is that everything is allowed EXCEPT those which are prohibited. Therefore, one should understand what is prohibited in Islam regarding business activity, so that he may avoid being involved in that.

As has been mentioned before, Allah has prohibited food products made or contained of: dead meat (flesh of un-slaughtered animals), blood, pork (the flesh of swine), and that on which had been invoked the name of other than Allah (Qur'an 5:3). In addition, the Prophet also prohibited the flesh of wild animals (animals with canine teeth and birds with claws) and *khimar* (the horse family, which are usually used as transportation). Allah also prohibited *khamr* (intoxicants) (Qur'an 5: 90), and any product which contain them, or have the same function (such as drugs, morphine, and the like) (Qur'an 2: 219). Allah has also prohibited gambling (Qur'an 5: 90) and *zina* (adultery/prostitution).

In terms of the way, Islam prohibits ways of business which involve: gambling, hoarding, speculation, injustice, uncertainties, and the like. Sometimes, there are products or ways whose status is not clear--whether they are allowed or prohibited. Such situations are called 'doubtful'; and Islam encourages Muslims to avoid the doubtful, because those who fall into doubtful things, are very close to *haram* (prohibition).

### (3) Business Forms.

There are three common business organisational forms in *Shari'ah*: sole proprietorship, *musharaka* and *mudaraba*. A sole proprietorship business form is a business which is owned and run by an individual person. Here, the owner sets



aside his own capital for the business, and manages that business himself, and takes the profits or bears all risk of the business himself.

*Musharaka* (or partnership) is an arrangement in which a group of people agree to contribute capital, or skills, and work together to run a business. They will also share the profits (and losses) according to a previously agreed ratio according to their shares. There are three kinds of partnership (Hamid et al, 1993, pp.138-139): *sharika mal* (finance partnership), *sharika a'mal* (labour partnership), and *sharika wujuh* (credit partnership).

(a) *Sharika mal* (finance partnership).

This is a partnership where all partners contribute capital, and it should be in the form of cash. It is like the Western joint-venture except that the contribution in form of goods is deemed invalid under *Shari'ah*. Therefore, in an Islamic joint-venture, there will be no dispute about the value of capital shared. This type of partnership can be distinguished into two: *company based on delegation* and *company based on guarantee* (Gambling & Karim, 1991, p.35).

In a partnership company based on *delegation*:

- each partner delegates to the other partner(s) the right to act as his or her agent, both in his or her absence, or presence;
- partners have equal voting rights, and contribute capital and share profit & losses equally;
- generally, they have an equal liability for the debts of the company, but some jurists differ on this point.

In a partnership company based on *guarantee*:

- partners may not always contribute the capital in equal shares;
- profit are distributed in a proportion agreed, which need not be the same as the proportion of contributed capital;
- losses are always distributed in the ratio of the partners' respective capital contributions;
- the operational basis of the company is the mutual agency of all the partners.

(b) *Sharika a'mal* (labour partnerships).

This is a partnership in which the partners' contribution consists primarily of the partner's labour (skills), such as professional practices, doctors, lawyers, accountants, etc. There is no joint investment of capital; profits are distributed by agreement between partners.

(c) *Sharika wujuh* (credit partnership).

This is a partnership in which the capital of the partners stems from their *wujuh* (good reputation) on the basis of which credit is extended to them. In this partnership, there is no capital contribution. They rely on their good reputation to obtain goods on credit, and sell them for cash. Profits are shared out as agreed between partners. It is similar to a 'joint venture', but with a limited life.

*Mudaraba* is an arrangement in which an investor or a group of investors (*rab al-mal*) entrusts capital or merchandise to an agent-manager (*mudarib*). The intent is that the agent shall trade with the capital or merchandise and then return the principal to the investor(s) together with the previously agreed upon share of

profits. As a reward, the agent receives the remaining share of profits. Losses from an unsuccessful business venture are borne exclusively by the investor(s); the agent is in no way liable from losses of this nature. The agent's loss is limited to the opportunity cost of time and effort expended in the business.

Both *musharaka* and *mudaraba* assume that all partners will take some part in the management of enterprise. Moreover, shares of profit (and losses) must always be expressed as a percentage, and never as a fixed sum. In case of insolvency, each partner is jointly and severally liable to make a good the whole of the debts of the company (except in *madaraba*).

'Joint stock companies', with independent legal entities and limited liability, have not been recognised by Islamic jurists. As Islamic law (and probably other laws) takes the human being (personality) as its subject, rights and duties should be put on the human's shoulders. Non-human beings (e.g. animals, abstract organisation, and the like) are not the subject of the laws; therefore, they cannot have any rights nor duties. This aspect of law would contradict the Western concept of entity, in which a business enterprise is a separate legal entity with its own rights and duties.

Some argue (e.g. M.A.Zarka, A.A.Khayyat, A.A.Sayed, as quoted in Elteгани, 1994) that a company can have such an entity *status*, as the case of a mosque, the state, and an endowment have been treated as independent financial

entities. In the writer's opinion, there is a fundamental difference between a company on the one hand, and a mosque, the state, or an endowment on the other hand, in terms of identifiability of the owners. The former has identifiable individual owners which are individually responsible to God; whereas the latter have no identifiable individual owners because they are 'public owned' institutions. Therefore, the latter should be treated as an nominal entities, but not the former.

Because 'joint stock companies' have not been accepted in Islam, discussion about 'stock exchange/market' is not relevant in this matter. A 'Capital market' in Islam would be different in nature from the contemporary system; Islamic banking and financial institution will play an important role for capital accumulation.

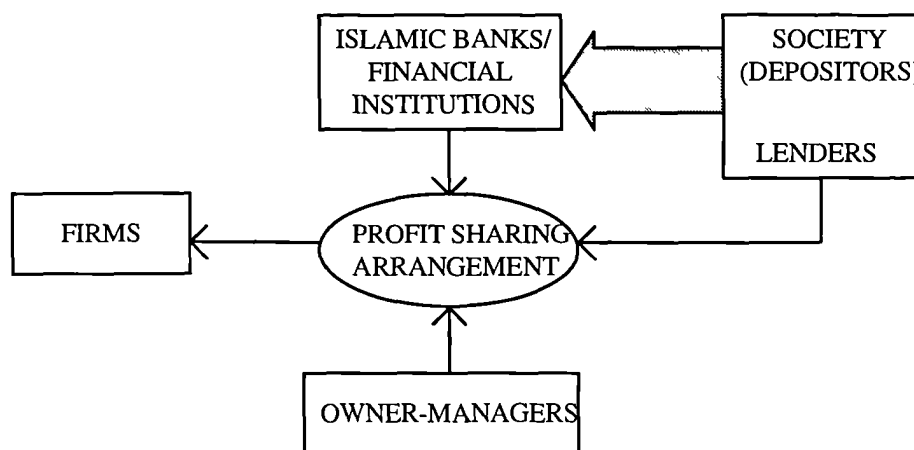


Figure 6.1. Islamic Form of Capital Market

#### (4) The Religious Duty of Muslim Businessmen.

Human beings are, personally, subject to laws, regardless their status or occupation. A Muslim, in relation with the business, as the owner of a business enterprise, has a religious duty, as do other individual Muslims, regarding the property they owned, that is to pay *Zakah*, which is one of the 'Five Pillars of Islam'.

*Zakah* should not be confused with Taxes; they are different in all respects. *Zakah* is a religious duty; the rules are divine. The payers should be Muslims; therefore, there is no duty for non-Muslims to pay *zakah*. The receivers of *zakah* (*muzzaki*) have also been mentioned in the Qur'an; therefore, *zakah* should not be used for other purposes. *Zakah* has vertical dimensions, i.e. *ibadah* (worship); those who do not fulfil this duty will receive sanction from Allah, in this life and/or in the hereafter.

Taxes, on the other hand, are governed by the ruler (government). Their rules will vary depend on time and place. Taxes are levied on all eligible persons (tax payers), regardless of their religion or faith. Because it is a duty to the government, people try to avoid paying taxes, even though there is a sanction if they are found out. Taxes are used as resources for the government to finance its activities.

## 6.5. Legal System

It has been mentioned in the previous Chapter that Islamic Law is one of the families of law recognised in the world. It also has been explained that Islam is the only *Deen* pleasing to Allah, so that there is nothing left or omitted in its rules. Allah Himself has promised to maintain it from any destruction and corruption. He said in the Qur'an: "Nothing have We omitted from the Book" (Qur'an 6: 38); and "We have, without doubt, sent down the Message; and We will assuredly guard it (from corruption)" (Qur'an 15: 9).

Its perfect foundations make Islam become a steadfast, permanent, and solid *Deen*. This foundation provides the main pillars in Islam and guidance in formulating systems to expand the pillars. The strong foundations will support firm and steadfast pillars, while systems born from the firm and steadfast pillars will be comprehensive in nature and enable to cover all aspects of human activity.

These conditions differ from other religions and ideologies, which are not based on firm foundations. Because their foundations are not strong, therefore, the philosophy, manifestations, and systems derived from them are imperfect. Their imperfection may exist in the form of imbalance or being overruled in specific aspects and underruled in other aspects.

### 6.5.1. The foundations of Islamic Law.

Islamic Law are based on strong foundations; two of them come directly from godly sources (the Qur'an and Sunnah), one is agreement among the best people of the Muslim community (ijma'), and another one results from a jurisdiction process that gives wide room for Muslim community to manage their worldly life (*ijtihad*).

#### (1) The Qur'an.

The Qur'an is the first and main foundation of Islamic Law. The Qur'an contains guidance, law and lessons to manage human life, to achieve happiness here and in the hereafter. The perfection and comprehensiveness of the contents enable it to manage and overcome problems and matters faced by people in all times. The foundations and approaches for law development in it are suitable for human nature and the universe, which enables it to meet human needs at any time and in any place.

#### (2) The Sunnah.

The Sunnah is the second foundation of Islamic Law. It has place after the Qur'an because it plays the role of explaining, interpreting and translating some of the Qur'an verses into real conducts and practices. The comprehensiveness of scope covered by the Sunnah about all human activities makes it as an easy source to refer to directly and indirectly, or as a source from which more general lessons can be derived.

### (3) The Ijma'.

*Ijma'* is the "unanimous agreement of the *mujtahidun* (scholars who are qualified to practise *ijtihad*) of the Muslim community, of a period subsequent to the demise of the Prophet Mohammed (pbuh), on any given matter" (Mohibur Rahman, 1994, p.50). *Ijma'* is proof and argument in the development of Islamic Law; and it is the third foundation of the development Islamic Law. The position of *ijma'* in terms of precedent is laid down in the Qur'an and Sunnah. It is based on the proofs from the Qur'an and Sunnah themselves. Allah says in the Qur'an:

"If anyone contends with the Messenger after Guidance has been plainly conveyed to him, and follows a path other than that becoming to men of Faith, We shall leave him in the path he has chosen, and land him in hell, what an evil refuge!" (Qur'an-4: 115);

"O ye who believe! Obey Allah, and obey the Messenger, and those charged with authority among you (*'ulil amri*)" (Qur'an-4: 9).

*'Ulil amri* in Islam are *'ulama'*, whether they involved in governmental duties directly or not. This is because, in Islam, those in charge of governmental duties should be people educated in the *Deen*. Islam cannot accept the segregation of duties by giving religion duties to a group of *'ulama* and governmental duties to people who have no understanding about religion. Therefore, obeying *'ulil amri* means obeying Allah and the Prophet in the matters related to Islam and believers. The Messenger has said: "My community shall never agree on an error" (narrated by Abu Dawud), and this is understood by the majority of scholars as an indication that *ijma'* is an acceptable source of Islamic Law. It is impossible that the gathering of pious and sincere *'ulama* is for evil purposes. Allah says: "Help ye



one another in righteousness and piety, but help ye not one another in sin and rancour" (Qur'an-5: 2).

Being only a secondary source (after the Qur'an and Sunnah as the primary sources), there are of course, limitations on the practice of *ijma'*. The most important one is that no amount of *ijma'* can alter the text of the Qur'an or the Sunnah, or any provisions that have already been laid down therein. Similarly, if there is already an existing *ijma'* on a given topic, based soundly on the texts of the Qur'an and Sunnah, then it cannot be repealed by a subsequent consensus. If however, the *ijma'* is based merely on public interest, then it may be altered if public welfare so requires (Kamali, 1989, p. 169).

#### (4) Ijtihad.

*Ijtihad* literally means an effort or an exercise to arrive at ones own judgement. In this context it is an exercise undertaken by the *mujtahidun* to deduce a conclusion as to the effectiveness of a legal precept in Islam, for the matters which are not divinely ruled either in the Qur'an or the Sunnah. *Ijtihad* should be done under the guidance of general foundation and spirit contained in the Qur'an and the Sunnah.

*Ijtihad* is the fourth foundation in the development of Islamic Law because by this, some new law and rules surrounding the general principles laid down by

the Qur'an and the Sunnah can be composed. With this flexibility, the Muslim community will enable to overcome any new problems in their life.

*Ijma'* (no (2) above), in fact, is also an *ijtihad* because before a matter is decided through *ijma'* (agreement), it should be exercised intensively. *Ijma'* has been decided as the third foundations by the '*ulama'*'; and it is a binding precedent and proof in Islamic Law. *Ijma'* may be done in the future under the condition that a matter should be exercised first through the process of *ijtihad*, and then agreed unanimously by '*ulama*'.

The most common way to do *ijtihad* is by performing what is called *Qiyas*. This is the process by which jurists look at two cases and try to extend the *Shari'ah* value, or the essence, of the ruling in the first case to a later case, where the later case has the same effective cause as the former. In other words, *qiyas* seeks to extend a principle of the Islamic law from an already established case, to a more recent case, where the situation is such that an analogy may be drawn between the two by referring to the principles that underlie both cases. Thus, for example, where the *Qur'anic* verse forbids the buying and selling of goods from the time of the last call to the Friday prayers until the prayers have finished (Qur'an 62: 9), this prohibition can by analogy be extended to all kinds of transactions, since the effective cause, which is the distraction from prayers, and the principle, which is to prevent this, would be common in all the latter cases, just as in the former. The practice of *qiyas* however, is not permitted in circumstances where

the solution for the case can be found in the Qur'an, the Sunnah or a definite *ijma'* (Kamali, 1989, pp.197-199).

Evidence for validating *qiyas* as a source of Islamic Law is found in the Qur'an: "(And) should you dispute over something, refer it to Allah and the Messenger, if you do believe in Allah" (Qur'an 4: 59). The understanding here is that as disputes can only be referred to Allah and the Prophet (pbuh) by following the signs and indications in the Qur'an and Sunnah, one way of achieving this is to identify the rationale of the *ahkam* (commands) and then to apply them to disputed matters, which is precisely what *qiyas* is all about. The Prophet himself resorted to analogical reasoning on occasions when he did not receive any revelation on a particular matter. For example, on one such occasion a woman known as *al-Khath'amiyyah* came to the Prophet (pbuh) and said that her father had died without performing *hajj*. She asked him whether it would be beneficial to her deceased father if she performed the *hajj* on his behalf. The Prophet (pbuh) asked her, "Supposing your father had a debt to pay and you paid it on his behalf, would this benefit him?". The woman replied that it would. The Prophet (pbuh) then told her, that "the debt owed to Allah merits even greater consideration" (Kamali, 1989, p. 218).

These four bases are accepted by all schools of Islamic law. There are, however, other principles of law accepted by only a few of them; those are:

(5) The Istishab.

*Istishab* means the presumption of continuity. Here, it is assumed, that whatever state of affairs existed in the past continues to exist until the contrary is proven. This is very similar to the English common law doctrine of innocent until proven guilty, but there are differences, especially since the presumption of continuity is applied to both positive and negative cases. *Istishab* is considered to be a valid source of law by both the Shafi'i and the Hanbali schools, but not so by the Hanafi and Maliki schools who insist that the continuing existence of the original state is still in need of proof in the same way as the claim which seeks to establish that the original condition has changed. Kamali (1989, p. 298) takes the view that since *istishab* consists of a probability that whatever happened in the past continues to exist, it is not a strong source for the deduction of Islamic law, and therefore it is inferior to the other sources. He adds, that due to this, *istishab* must be the last place that a jurist looks to find a *fatwa*, or Islamic ruling.

(6) The istislah

*Istislah*, or Public Interest, means the best solution for the general interest. It is recognised as a source of law by all the schools except the Shafi'i school, according to which, if it is allowed it can open the door to the unrestricted use of fallible human opinion, since public interest will vary from place to place and time to time.

### (7) Istihsan

*Istihsan*, which has been advocated by Hanafite School of law, literally means 'to hold something for good, right'. It 'technically denotes the abandonment of the opinion to which reasoning by analogy (*Qiyas*) would lead, in favour of a different opinion supported by stronger evidence.' Such departure from *Qiyas* may be based on evidence found in the Sunnah, or the *Ijma'*, on necessity (*darurah*), or on what the upholders of *Qiyas* claim to be another kind of *Qiyas* which, though it does not so readily occur to the mind as the first *Qiyas*, in reality is stronger than it.

When performing *ijtihad* for a certain case, the *mujtahid* (the person performing *ijtihad*) should also consider the following things:

### (8) The 'Urf

'*Urf* or local custom is defined as "recurring practices which are acceptable to people of sound nature". Custom, thus, before it begins to constitute a valid basis for legal decisions, must be sound and reasonable. Excluded from the definition of '*Urf* are practices which do not benefit people or practices which partake in prejudice and corruption. Therefore, particular customs of peoples of different regions and countries which do not contravene the principles of Shari'ah are valid. '*Urf* is recognised as a subsidiary source by all the schools, although the Maliki place more importance on it than do the other schools.

(9) The Masalihul Mursalah

In case of emergency (necessity), when there is no other alternative available, some things which are not really lawful may be considered; for example, taking an unlawful (*haram*) thing to eat, when there is no lawful (*halal*) one, just to survive, until lawful food is found. But it does not change the status of that thing.

(10) The Madhhab Sahabah (The way of companions).

This is how the companions, who were the first generation of the Muslim community and met the Prophet, used to apply Islamic teaching in their daily life. It is believed that they knew better about Islam than the next generations.

(11) The Shari'ah of Previous Prophets.

This is the teaching brought by the prophets before Mohammed (pbuh) contained either in the Psalms (*Zabur*), Torah (Old Testament), and Bible (New Testament) because Muslims believe that the 'original' teaching of all prophets are generally the same.

6.5.2. The purposes of Islamic Law.

The main purposes of Islamic Law are to protect six main matters which become the back-bone for the safety and happiness of all humankind either as an individual, family, community, states and world members. These purposes are fixed and unchangeable. They are:

(1) To protect the Deen.

There is nothing more fundamental for people than guidance to live in Islam. Therefore, the most principle of the enactment of rules, law and shari'ah in Islam is to protect the *Deen* itself. The freedom of the *deen* from any corruption by the bad and the doubt and confusion of the stupid will save people from going astray in life, without holding to Islam. Islamic Law lays down regulations to ensure that human life can be lived according to Islam, without any disturbances.

(2) To protect the soul (life).

Islamic Law places the human soul and every life creation in a respected place. If a high value is not given, especially to the human soul, then destruction will exist on the earth. Islamic Law lays down organised regulations to ensure that no soul (life) will be destroyed unjustly. Islamic shari'ah rules that a soul (life) may be taken away only if, by that, all human life can be guaranteed.

(3) To protect 'aqal (mind).

The human mind has special place in Islamic Law. This is because only mind enables people to value and choose alternatives for the good of themselves and society. Islamic Law protects the human mind because by doing so people have an opportunity to develop their society in piety and goodness. Islamic Law lays down regulations with the purpose of cleansing the human mind from anything which could disturb its potential, as the most important equipment of people.

(4) To protect human status (dignity).

Protecting human status and avoiding what degrades it is among the important purposes of the development of Islamic Law. By protecting human status, Islam seeks to keep the prestige and purity of any society member. By doing so, the society will be saved from any disturbance which may threaten their peace and safety. Through this protection, moreover, the purity and happiness of the society will be guaranteed forever.

(5) To protect property.

Islamic Law protects people's property because it is a right that should not be taken away without good reason. Using property, people may develop themselves and the society for the good of all. If the people's right in property is protected, it is hoped that they may improve their life according to the *Deen's* rules for the benefit of all.

(6) To protect family.

A family is the smallest but most important institution in the society. Within a family, children are reared and developed, and they are introduced to Islamic values. A family, through a marriage contract, is the only way allowed for a man and woman to fulfil their sexual need. And in a family, rights and duties between husband and wife, and between parent and children, and between/among children are laid down. A good and pious family will result in a good and pious society.



### 6.5.3. The Methodology to develop law in Islam.

With a strong foundation and clear purposes, Islam develops its law through a well organised methodology. The development of law in Islam entails the following steps:

#### (1) Exercising divine arguments from the Qur'an and the Sunnah.

The law applicable to the matter in hand should be determined firstly by examining arguments in the Qur'an and the Sunnah. If there are divine provisions concerning that matter, then the rules about that matter should follow the rules laid down in the Qur'an and Sunnah. There is no change allowed whenever the Qur'an and Sunnah have laid down the rules for certain matters.

#### (2) Exercising available Ijma'

If the rules about that matter cannot be found divinely in the Qur'an and Sunnah, then, examination should be carried out of the matters which have been the *Ijma'* among Islamic *ulama* from the past up to now. If there is any *ijma' sarih* (unanimous agreement among all *ulama* at a certain time for certain matters), then that should be taken as the law and should be followed (binding). If there is any *ijma' sukuti* (agreement among most *ulama*, while others kept quiet), then the proofs for the matters can be taken as inputs to perform *ijtihad*.

### (3) Performing Ijtihad.

If, after examining the three sources, no rules or law can be found concerning the case being faced, the last effort, then, is performing *ijtihad*. The reason for performing *ijtihad* is to look for any relevant proofs or arguments without going away completely from the spirit of Islamic shari'ah. It means that the *ijtihad* should involve:

- a. Understanding the reasons for determining law done in the Qur'an and Sunnah upon certain cases and trying to look for the similarity with the case being faced.
- b. Trying to understand the benefits and disadvantages of a certain case and determine the rules based on the cases which have the biggest benefits in the purpose of protecting the *Deen*, soul, mind, status, and property of community.
- c. Understanding people's and society's habits and determining something which does not contradict with the people's habits without contradicting any shari'ah aspects.
- d. Evaluating all proofs and arguments given by 'ulama' from the generation of the companions and others concerning the cases which did not reach the *ijma'*. Then, determining the law based on the strongest proofs among the available proofs.
- e. Reviewing the proofs, background or general teachings of the previous Prophets and then determining general or specific decisions from them which have not been replaced and mentioned divinely by the shari'ah of the Prophet.

The main foundation of the methodology in the development of law determined by Islam is laid down with the purpose that the Islamic Law may always be based on clear and strong proofs and arguments. By doing so, Islam has firmly existed from the era of the Prophet's life and after his death. The continuity

of Islam does not depend on the life of the Prophet and companions, but on the proofs and arguments that have been laid down for its guidance and approach by the Prophets. This spirit is based on what the Prophet himself has recognised. In sending Mu'adh ibn Jabal as the *wali* of Yemen, the Prophet said:

"How would you decide if there is a case appealed to you?". Mu'adh replied: "I will decide according to the Book of Allah; and if I would not find (any rules from the Book), I will decide according to the Sunnah; and if I would not find (any rules from the Sunnah), then I will do *ijtihad* and I will not neglect it." The Prophet (pbuh) grabbed Mu'adh's chest while saying: "All praise be to Allah, Who has given guidance to the messenger of His Prophet on something pleased by the Prophet" (narrated by Ahmad, Abu Dawud).

#### 6.5.4. Classification in Islamic Law.

According to its orientation, Islamic Law may be distinguished into two: *Qanun al-duwali* (International Law) and *qanun al-mahalli* (Municipal Law). International Law deals with the relationship between Islamic states with non-Islamic states. This includes the law of *jihad* (war), peace agreement, and so on. Municipal law, on the other hand, deals with internal affairs within the Islamic state.

Municipal law may also be classified into two: *qanun al-jina-i* (Criminal Law) and *qanun al-madani* (Civil Law). Criminal Law deals with crime and punishment. It is quite detailed and clear, being mentioned in the Qur'an and Sunnah. This is because the types of crime are principally unchanged from time to

time; only the way crime is practised differs. Therefore, the punishments for murder, robbery, stealing, adultery, and so on are very strict and divine in Islam.

Civil Law, on the other hand, deals with the relationship between citizen. It may also be divided according to some aspects. There are Contract Law (*qanun al-'uquud*), Partnership Law (*qanun ash-sharikah*), Family Law (*qanun al-usrah*), Law of Surety (*qanun al-touthiq*), Law of Torts or Compensation (*qanun al-dlamaan*), and Law of Procedure (*qarun al-muraf'at*). Contract law deals with activity of people when making contracts in their daily life. Partnership Law deals with the forming of a business, like Company Law in the Western law. Family Law deals with marriage, divorce, nursing, engagement, inheritance, wills, and the like. Surety law deals with mortgage, guarantorship, and the like. Law of Torts deals with compensation matters, and Law of Procedure deals with how the Civil law should be performed. The most relevant to the Study of Islamic Accounting are, probably, the Contract and Partnership Law.

## **6.6. Cultural System**

As has been explained in a previous chapter (Chapter 2), culture has been defined by Hofstede (1984, p. 21) as “the collective programming of the mind which distinguishes the members of one human group from another.” Culture is to a human collectivity what personality is to an individual. Culture determines the identity of a human group in the same way as personality determines the identity of

an individual. Cultural traits sometimes can be measured by personality tests (Guilford, 1959). Culture, therefore, is the characteristic of a community or society.

#### 6.6.1.Characteristics of Islamic Culture.

Symbols, heroes, rituals, and values are believed to be the characteristics (Hofstede, 1987, p.2).

*Symbols*, as has been mentioned, are “words, gestures, pictures or objects that carry a particular meaning which is only recognised by those who share the culture” (Hofstede, 1991, p.7). Since ‘Islam’ was sent down in Arab, and the Holy Qur’an is also in Arabic language, the words used as symbols in Islam are mostly in Arabic, for example: the name and attributes of the God, the proclamation to be a Muslim (*shahadah*), exclamations, etc. However, because not all Arab people are Muslims, the Arabic language itself cannot become the symbol of Islam, as it is often mistakenly believed by some Western people. Furthermore, the way Muslims perform prayers, *hajj* (pilgrimage), and fasting are unique, so that these gestures become symbols of Islam. Islam, however, does not use any picture as symbols; neither the picture of humans nor things. The picture of the Crescent (for the Red Crescent, instead of the Red Cross) and a Star, as usually put on top of mosques’ minarets and domes, is believed to be a new innovation. On the other hand, the object which is the symbol of Islam is the *Ka’bah* which is located in the Holy Mosque in Makkah. It is used as the central

direction to face when Muslims perform prayers; it is a symbol of unity among muslims.

*Heroes*, which have been mentioned earlier, are “persons, alive or dead, real or imaginary, who possess characteristics which are highly prized in a culture, and who thus serve as models for behaviour” (Hofstede, 1991, p.8). The Prophet Mohammed is the person whom Muslims take as their example. He was a real, ordinary person with a perfect Islamic character; as also mentioned by Allah in the Qur’an: “And surely thou [Mohammed] hast sublime morals (akhlaq)” (Qur’an 68: 4), whereby Muslims should take him as reference. He was also a perfect Islamic state leader and judge. However, the respect given to him by Muslims is not so excessive as to put him beyond human nature, as the Christians do toward Jesus (pbuh). Moreover, the respect to him does not denigrate other prophets prior to him, because Muslims are asked to respect all the prophets of God (the fourth Pillar of Faith). In addition, the first generation of the Muslim community, individually and collectively, are frequently referred to as examples, for they also have been mentioned in the Qur’an as ‘the best community’.

*Rituals*, furthermore, are “collective activities, technically superfluous in reaching desired ends, but which, within a culture, are considered as socially essential; they are therefore carried out for their own sake” (Hofstede, 1991, p.8). Rituals are one aspect of worship in Islam, a specific way of worship which is unique compared to the way of other religions. Among the rituals in Islam are

*shalah* (ritual prayers), pilgrimages, and fasting. Baagil (1984, pp. 7-10), after conducting deep observation on Bible, however, concluded that the way of performing prayers among the previous prophets were similar to what Islam orders. Even the previous prophets also performed rituals similar to Pilgrimage in Islam. This would not be surprising for Muslims, because Muslims believe that Islam is the religion of all prophets since the Prophet Adam.

*Values* are 'broad tendencies to prefer certain states of affairs over others.' Values are feelings with a direction: they have a plus and a minus side. They deal with: evil vs. good; dirty vs. clean; ugly vs. beautiful; unnatural vs. natural; abnormal vs. normal; paradoxical vs. logical; irrational vs. rational. Among all aspects of culture, values are the most difficult to change (Hofstede, 1991, p.8). This is quite true in the context of Islam, because what is related to value is divine in nature; so that they should be accepted by humankind regardless the time and place. In simple words, what is prohibited or discouraged by Islam is bad, or if there is some good aspect in that matter, the bad is greater than the good or benefits. Conversely, what is commanded, recommended or allowed is good, or if there is bad in it, the good is greater than the bad. If Hofstede considered values as the characteristic of cultures which is most difficult to change, Islam seems to see values as divine.

The Qur'an and Sunnah provide several values or principles on which the social order is to be based, as well as numerous ethics on which it is to be

operated. They include, as has been discussed in the previous sections (i.e. in social, political, and economic systems) (Ul-Haq, 1996, pp. 48-59):

- (1) Equality of people;
- (2) Mutual Co-operation for private and public good;
- (3) Social commitment and actionalism;
- (4) Organicness and social solidarity;
- (5) Altruism and self-sacrifice for the common weal;
- (6) The diffusion of responsibility.

#### 6.6.2. The Four dimensions of values.

Hofstede (1988, 1991) has mentioned that there are four dimensions of societal value: power distance, individualism-collectivism, masculinity-femininity, and uncertainty avoidance (refer back to Chapter 3--*Western Accounting Environment*, Section 3.6.--*Cultural System*).

##### (1) Power distance,

Power distance is defined as “the extent to which the less powerful members of institutions and organisations within a country expect and accept that power is distributed unequally” (Hofstede, 1991, p. 28). People in Large Power Distance societies accept a hierarchical order in which everybody has a place which needs no further justification. People in Small Power Distance societies strive for power equalisation and demand justification for power inequalities. The fundamental issue addressed by this dimension is how society handles inequalities among people when they occur.



Islam, on the one hand, seems to favour 'small power distance societies' as all human kind are equal in the sight of Islam. The thing that distinguishes them is their piety. Nationality, colour, ethnic group, and the like are just a matter of identity. Those in power (rulers) should not oppress the less powerful members; they should be just. On the other hand, however, Islam recognises that people are different in possessing wealth; some of them are rich and some of them are poor. However, it is '*sunatullah*' (natural) so that there are mutual relationships among them. This is probably why an Islamic society functions as a 'median community', which does not fall into the two extreme directions mentioned, but it tends to balance both extremes.

### *(2) Uncertainty Avoidance.*

Uncertainty avoidance is defined as "the extent to which the members of a culture feel threatened by uncertain or unknown situations." This feeling is, among other things, expressed through nervous stress and in a need for predictability: a need for written and unwritten rules (Hofstede, 1991, p. 113). Strong Uncertainty Avoidance societies maintain rigid codes of belief and behaviour and are intolerant towards deviant persons and ideas. Weak Uncertainty Avoidance societies maintain a more relaxed atmosphere in which practice counts more than principles and deviance is more easily tolerated. The fundamental issue addressed by this dimension is how society reacts to the fact that time only runs one way and that the future is unknown.

From an Islamic point of view, there are some principles and rules which are divine. These principles and rules are not changeable. “Those which are *haram* (unlawful) are clear, and those which are *halal* (lawful) are also clear. There are, however, some situations in between (doubtful or *subhat*). Those who falls in them, he falls in the unlawful” (Hadith, narrated by Bukhari). Besides these divine principles, however, there are some aspect of life which have been left to human kinds. These aspects are those related to *muamalah* (social relationships), which may vary from time to time, and from one place to another. In these matters, even Islamic jurists may have different opinions, depending on their *ijtihad* (interpretation). However, it is believed that Islam is complete and comprehensive, in that all aspects of life have been ruled, some in detail, while some in general principles only.

From this view, it seems that Islam stays between the two extremes: the strong and the weak uncertainty avoidance. Some rigid divine rules from the Shari’ah reflect strong uncertainty avoidance; while most rules regarding *muamalah* (societal relationships) which are flexible reflect weak uncertainty avoidance. This position, once more, accords with the ‘median community’ function of Muslim society.

### (3) Individualism-Collectivism.

Individualism is concerned with a preference for a loosely knit social framework in society whereas collectivism is concerned with a preference for a

tightly knit social framework. The fundamental issue addressed by this dimension is the degree of interdependence a society maintains among individuals.

*“Individualism pertains to societies in which the ties between individuals are loose; everyone is expected to look after himself or herself and his or her immediate family. Collectivism as its opposite pertains to societies in which people from birth onwards are integrated into strong, cohesive ingroups, which throughout people’s lifetime continue to protect them in exchange for unquestioning loyalty” (Hofstede, 1991, p. 51).*

In this matter, it seems that Islam falls in between these two opposite directions. Islam recognises ‘individualism’; a muslim is bound to look after himself or herself and his or her immediate family. At the same time, a muslim is bound to be loyal to the society as long as the society does not violate Islamic principles. But there is no loyalty for injustice. The concept of *ummatan wasatan* places in balance between individual and social rights and responsibilities.

#### (4) Masculinity-Femininity.

Masculinity stands for a preference in society for achievement, heroism, assertiveness, and material success. Femininity, on the other hand, stands for a preference for relationships, modesty, caring for the weak, and the quality of life. The fundamental issue addressed by this dimension is the way in which society allocates social roles to sexes.

Worldly matters are not the true objective of Muslims; but they should not be ignored. They should be achieved and then used as a vehicle to achieve the true

objective: eternal life in the hereafter. Islam encourages people to be kind rather than greedy, to be modest rather than assertive, to care for the weak rather than oppress them, to maintain good relationships among people, and to maintain a good moral quality of life. But at the same time, Islam also commands the Muslim *ummah* to have strong power in terms of military and other aspects of worldly life. Therefore, in this respect, as a median community, Islam keeps between the masculinity and femininity orientations.

#### **6.7. Summary.**

There is no aspect of life which is not touched by Islam. As an ideology, Islam lays down rules for all systems of life: social, political, economic, legal, and cultural. Some of them are very detailed so that they need no further explanation and interpretation, and some of them are in general principles which people are allowed to do their best to interpret, according to time and place (situation). The principles of innovation, imitation and assimilation in Islam provide guidance regarding this matter.

##### *Social system.*

Unlike other (e.g. Western) systems, Islam views *ummah* (community/ society) as not only natural, but necessary. In Islam, it is not the society that makes the rules (through many theories), but it is the rules (Shari'ah) that create Islamic society. The Shari'ah provides guidelines as to the foundations of an

Islamic social system, the characteristics of the Islamic social system to be achieved, and the methodology to develop an Islamic society, so that the ideal function of the Muslim Community as the best community (Qur'an 3: 110) and the median community (*ummatan wasatan*, Qur'an 2: 143) may be achieved.

The primary foundation of an Islamic social system, as laid down in the Qur'an and Sunnah, are: (1) co-operation for goodness, (2) human inter-relationship (*muamalah*) is a part of ibadah (worship, act of devotion), (3) society development aimed at upholding the belief in the Oneness of God (*tawhid*, faith), and (4) avoiding any kind of destruction in society.

The characteristics of an Islamic social system as laid down by the Shari'ah are: (1) equality among humankind (regardless of their nation, race, colour, language, citizenship, etc.), (2) safeguarding Godly morality, (3) maintaining social justice (economically, politically, legally, etc.), and (4) protecting human freedom.

The Shari'ah also laid down the methodology to develop an Islamic society, which starts from (1) creating virtuous individual and family units, in order to (2) create pious society members, and in turn (3) to set up a trustworthy government. In short, an Islamic social (life) order should be developed through three steps or levels: individual (refer back to 'Spiritual and Moral Systems' in the previous Chapter), family, and collective (community).

*Political system.*

An Islamic social order cannot be achieved nor maintained without an Islamic (trustworthy) government created through an Islamic political system. The Shari'ah has laid down the principal concepts of the Islamic political system, including the foundation for an Islamic political system, the main principles of an Islamic political system, political goals, and the main principles of an Islamic state (government).

The foundations of an Islamic political system are based on: (1) the absolute sovereignty belonging to Allah alone (*hakimiyah ilahiyah*), (2) revealed to humankind through the Prophet (*risalah*, message), (3) to be practised by humankind as His agent (vicegerent, caliph). The agent (caliph), therefore, should be one who is (1) capable, (2) pious, (3) knowledgeable, and (4) trustworthy.

The main principles of the Islamic political system laid down by the Shari'ah include: (1) *mushawarah* (consultation, deliberation) system, (2) *'adl* (justice), (3) freedom, (4) *musawah* (equality), and (5) the right to question (criticise) the government. The political goal of Islam is, ultimately, to create an Islamic state (*Darul Islam*) which guarantees the implementation of the above principles, so that people's faith and interests are protected.

The main principles of an Islamic state, moreover, cover: the constitution, division of authorities, governmental bodies, authorities and citizenship. The

constitution of an Islamic state should be formulated from the Qur'an, Sunnah, conventions of the Rightly-Guided Caliphs, and the decisions of well-known *fuqaha* (jurists). The governmental authorities of an Islamic state should be divided into (1) legislative, (2) executive, and (3) judicial power. The Head of State is the highest leader of these three authoritative bodies; but under the Head of State, these three bodies are independent of each other.

The State Leader should be elected through a public consensus (based on the principles of free opinion among people, without any force or intimidation from others. Nobody has the right to appoint himself by force, no group or clan/tribe can monopolise the position of leader through an inheritance system. The leader (*Ameer*) should appoint the members of the 'consultative assembly', but they should be representatives of all people.

The government officials (authorities) should be appointed constitutionally. The legal requirements for officials are: that they should be Muslims, male, mature and strong minded, and citizens of the state. The secondary requirements are that they should be among those who are: *amanah* (trustworthy), pious, knowledgeable, modest, and humble.

All people, regardless of their religion, may become the citizens of an Islamic state. They all have rights and responsibilities as citizens. Among their rights are: right to life, freedom of belief, religion, conscience and association, right

to work, right to equal treatment under law without discrimination, right to justice, right to free basic education, and so on. The duties of citizens, on the other hand, include: loyalty to the state, co-operation with the government and compliance with the law of the land.

### *Economic system.*

The foundation of Islamic economic system are the belief that: Allah is the owner of all things; worldly wealth is used to seek the eternal life in the hereafter; worldly matters should not be neglected in order to obtain the hereafter; one should be just to others, and not make any destruction.

The primary principles of Islamic economic system are: personal ownership rights; freedom to seek income sources; social justice, and inheritance rights. The characteristics of the Islamic economic system are: that it is part of the comprehensive Islamic system, and it creates a balance between personal and public interest.

The economic goals in Islam are: to fulfil a part of *ibadah* (worship) duties; to create social and economic justice in the society; to eliminate poverty and to create the condition of full employment and optimum economic growth rate; to create the stability of goods in line with the value of currency; to keep safety and obedience to regulations; and to create harmony in international relationships and to establish national defence power.



The purpose of business activities should be directed toward the achievement of the above goals and principles. Business activities are honourable in Islam, as the way to seek the bounty of Allah and as part of *ibadah*. The ultimate goal is to obtain the pleasure of Allah. Therefore, business activities should be performed according to the rules laid down by the Shari'ah, i.e. prohibited ways and products/services should be avoided.

Shari'ah laid down two main form of business: *musharaka* and *mudaraba*, in addition to sole proprietorship. *Musharaka* is an arrangement in which a group of people agree to contribute capital or skills and work together to run a business, and share profits and losses according to agreed ratio based on their share (contributions). It could be in the form of *sharika mal* (finance/capital partnership), *sharika a'mal* (labour partnership) or *sharika wujuh* (credibility partnership).

*Mudaraba*, on the other hand, is an arrangement in which an investor or group of investors entrusts capital or merchandise to an agent-manager. The agent then trades with the capital/merchandise and then returns the principal to the investor together with a previously agreed-upon share of profits. Losses from unsuccessful business venture are borne exclusively by the investor; the agent is in no way liable for losses of this nature, except for the opportunity cost of time and effort expended in the business. Joint stock companies, with independent legal entity and limited liabilities, are not acceptable in Islam.

### Legal system

The Islamic legal system is based on four foundations: the Qur'an, Sunnah, Ijma' (unanimous agreement among scholars), and *ijtihad* (reasoning). In doing *ijtihad*, *qiyas* (analogy) is the most common way. There are some other principles or techniques of *ijtihad*, which may be considered differently among scholars; these are: *istishab* (presumption of continuity), *istislah* (public interest), *istihsan* (to hold something for good, right), 'urf (local customs), *masalihul mursalah* (emergency or necessity), *madzhab sahabah* (the way of companions), and the shari'ah of previous prophets.

The purposes of the Islamic legal system and Islamic law are to protect the *deen*, the soul (life), the mind ('*aqal*), human status or dignity, property and family. The methodology in developing law in Islam is, *firstly*, to apply divine arguments from the Qur'an and Sunnah; *secondly*, to apply available *ijma'*; and lastly to perform *ijtihad*.

Contemporary *fuqaha* (jurists) also classify Islamic law into '*International law*' and '*municipal law*' according to their orientation. International law govern the relationship between an Islamic state and non-Islamic states; it includes the law of *jihad* (war), peace agreements, etc. Municipal law covers 'Criminal law' and 'Civil law'. Criminal law deals with crime and punishment. It is quite detailed and clearly laid down in the Qur'an and Sunnah. Civil law deals with the relationship

between citizens. It includes: contract law, partnership law, family law, law of surety, law of torts/compensation, and law of procedure.

### Cultural System.

Symbols, heroes, rituals and values are believed to be the characteristics of culture. Among them, values is the most difficult component to change. This is very true in Islam, as values are divine in nature. It deals with: evil vs. good, dirty vs. clean, ugly vs. beautiful, and so on. The Qur'an and Sunnah laid down several values and principles in dealing with societal, political and economic life, as has been mentioned before. Among them are: co-operation, equality, justice, etc.

Related to the 'four dimensions of values' proposed by Hofstede, i.e.: power distance, individualism-collectivism, uncertainty avoidance, and masculinity-femininity, Islamic values tend to balance between the two extremes of each dimension. This is consistent with the function of Islamic community as a 'median community' (*ummatan wasatan*).

On the whole, it is believed that Islamic ideological/societal systems, in terms of social, political, economic, legal, and cultural systems, tend to be different from the Western. Based on the premise that the conventional Western accounting concepts are a reflection of its ideological systems, it is believed that the Western accounting concepts could not be acceptable from the Islamic perspective. Islamic accounting concepts/principles should therefore be derived from the Islamic

ideology, the Shari'ah. The next chapter will identify the unsuitability of the conventional Western accounting concepts viewed from the Islamic perspective, followed by the concepts of accounting as they should be if derived based on the Shari'ah.

## CHAPTER 7

### ACCOUNTING CONCEPTS BASED ON SHARI'AH

#### 7.0. Introduction

Accounting's concern is with a 'business entity', i.e. to provide information about the financial matters of the business entity. Business is a part of economic activities, and it is encouraged by Islam. Muslims are encouraged to do business, as a way to obtain Allah's bounty (*rizki*) for themselves, their families, as well as for the society's welfare. However, Islam rules the way to do business: the lawful and unlawful ways. Muslims should follow the lawful ways and avoid and/or reject the unlawful.

“On the judgement day, all people will be questioned about .... [among of them] his property (wealth); from where (which ways) it has been obtained and to where (for what) it has been spent”. Therefore, everyone should prepare, from today's life, a report concerning his wealth. This report should account for his wealth and the changes in the wealth. In contemporary terms, every one should know the 'accounting' system and techniques.

A reference from the Qur'an regarding business and accounting can be found in Chapter (*Surah*) 2, verses (*ayaat*) 282-283.<sup>1</sup> Some important points that can be noted from this verse are:

- (1) Transactions may be performed on the spot (cash) as well as in credit (involving future payment or supply).
- (2) In the case of transaction involving the future (credit), a written document is recommended.
- (3) It is stated that the scribe in such matters assumes a *judiciary* capacity; the scribe should therefore remember to act as in the presence of Allah, with full justice to both parties. He should look upon the art of writing as a gift from Allah, and he should use it as in His service. In an illiterate population the scribe's position is still more responsible. In today life, *accountants* possess this function;
- (4) Such transactions should be witnessed. Regarding the witness, it is desirable that the men (or women) who are chosen as witnesses should be from the circle to which the parties belong, as they would best be able to understand the transaction, and be most easily available if their evidence is required in future. It seems that the involvement of lawyers in today complex business organisation is necessary in this matter;
- (5) Commercial morality is here taught on the highest place and yet in the most practical manner, both as regards the bargains to be made, the evidence to be provided, the doubts to be avoided, and the duties and rights of scribes and witnesses. Probity even in worldly matters is to be, not a mere matter of convenience or polity, but a matter of conscience and religious duty.

Even our every-day transactions are to be carried out as in the presence of Allah.

- (6) A pledge or security is allowed and recommended, especially when the parties involved in the transaction cannot find anyone to be the scribe/ (accountant).
- (7) There is a 'law of deposit' in Islam. The law of deposit implies great trust in the depository on the part of the depositor. The depository becomes a trustee, and the doctrine of Trust can be further developed on that basis. The trustee's duty is to guard the interests of the person on whose behalf he holds the trust and to render back the property and accounts when required according to the terms of the trust. This duty again is linked to the sanction of Religion, which requires a higher standard than Law.
- (8) There is a moral injunction in Islam not to conceal the evidence of any transactions. It sometimes happens that if some inconvenient piece of evidence is destroyed or concealed, we gain a great disadvantage materially. We are warned not to yield to such a temptation. The concealment of evidence has a serious effect on our own moral and spiritual life, for it taints the very source of higher life, as typified by the heart. The heart is also the seat of our secrets. We are told that the sin will reach our most secret being, though the sin may not be visible or open to the world. Further, the heart is the seat of our affections, and false dealing taints all our affections.

From the verse of the Qur'an mentioned above, it seems that the main objective of accounting in Islam is 'to avoid disputes' among parties. The disputes which would be avoided are: (1) disputes in calculating *Zakah*; (2) disputes in calculating profits to be distributed (in *musharakah* and *mudarabah* business forms); and (3) disputes between agent and principals (in *mudarabah* business form). All these are within the frame of "accountability" in its broadest meaning.

Therefore, it can be said that the role of the accountant is very respected and necessary in Islam. However, the Qur'an and *Sunnah* do not explain in detail the scope of functions, the concept or principles, and the technical standards to perform the duties of accounting. Gambling and Karim (1991), after examining the conceptual framework of accounting currently applied in the West [and it has also been adopted by some non-Western countries, e.g. through the International Accounting Standards], concluded that it 'finds its justification in a dichotomy between business morality and private morality'. Therefore, it cannot be implemented in other countries which have revealed doctrines and morals that govern all social, economic and political aspects of life, like Islamic community. Islam, Gambling and Karim argued, has its own cohesive rules which dictate how a business should be run. These rules can be applied at any time and in any culture. Accounting theory and practice have to pursue these rules if they are to be of any relevance to obedient Muslim users.



It seems, therefore, that Islamic accounting should be developed by using a 'normative-deductive approach'. It can be done by deducing from the *Shari'ah*, the primary source of Islamic law, the objectives of financial reporting, postulates and concept of financial accounting. In doing so, besides referring back to the Islamic concepts of *ibadah* and *muamalah* (spiritual, moral, and societal systems), it also considers the *Zakah* system for several reasons.

First of all, *Zakah* is a divine command, which is very important because it contains *ibadah* and *muamalah* values. Due to this reason, *Zakah* has been placed as one of the 'Five Pillars of Islam' (refer back to the discussion of this matter in Chapter 5). Moreover, *Zakah* is also very important because; (a) it is the basis for the need of periodical reports, (b) it is the source of some definitions, and (c) it is the determination of recognition and valuation basis. From the *Zakah* system, the elements of conceptual framework for an Islamic accounting can be traced.

Therefore, in this Chapter, the *Zakah* system is discussed first, before discussing the elements of conceptual framework from the Islamic point of view.

### 7.1. *Zakah* System

*Zakah* is one of the 'Five Pillars of Islam', after declaring the Faith (*Shahadah*) and Prayers (*Salah*). As a pillar, it is as important as other pillars, especially because, besides as a 'religious duty' it also contains a socio-economic dimension. In the Qur'an, the importance of *Zakah* is obvious as it is always

mentioned together with and after prayers (*salah*), e.g.: “However, if they repent, perform *salah* and pay *zakah*, then they become your brother in religion” (Qur’an 9:10-11).

Islamic scholars have paid much attention on the aspect and virtues of *zakah* according to their specialisation of knowledge. They have discussed *Zakah* not only in the aspect of ‘*ibadah*’ (worship), as it is seen as integral part of prayer, but also in Islamic law and economics as it is part of the socio-economic system in Islam. And in this section, it will be proven also that the *zakah* system is very important and relevant in deducing the accounting system from the *Shari’ah*.

#### 7.1.1. Definition, Status, and Virtues of *Zakah*.

Literally, *Zakah* means: to grow, to purify, and good. If something is called *zaka*, it means that it grows and blooms; and if someone is called *zaka*, it means he/she is good (e.g.: Qur’an 91: 9; 87:14; 53: 32, and 2: 43). Epistemologically, the meanings of *zakah* are covered within one verse in the Qur’an as follows: “Of their wealth take alms, that so thou mightest purify and sanctify them” (Qur’an 9: 103).

According to *Shari’ah* (Islamic law), *zakah* means ‘a right which should be taken out from wealth or property’. The Maliki school defines it as ‘to take out a specific amount of specific wealth when it has reached *nisab* (the minimum limit) to be given to those who are entitled (*mustahhiq*)’. The Hanafi school defines it as ‘Make a part of specific wealth to be specific wealth belonging to specific people,

according to *Shari'ah* because of Allah (SWT)'. According to the Shafii school, *zakah* is an expression for the outlays of wealth and goods in a specific way, whereas according to the Hanbali school, *zakah* is the right which should be taken out from specific wealth to (be given to) specific groups.

'*Specific amounts*' means that the 'rate' of *zakah* differs for different type of wealth (property). '*Specific wealth*' means that not all kinds of wealth (property) are *zakatable*; it also means that the wealth (property) is classified according to a certain classification, and each classification attracts different rules. The '*specific groups of people*' (as the receivers) are the eight groups as mentioned in the Qur'an (9: 60).<sup>2</sup> The '*specific time*' means that *zakah* should be paid at a certain defined time; e.g. after one whole lunar year of ownership (for *zakah* on property), or soon after harvesting time (for *zakah* on agriculture).

Moreover, *zakah* is *wajib* (compulsory), so that avoiding *zakah* will have some consequences, religiously and legally. Abubakar, the first '*rightly guided Caliph*', used to declare war against a tribe who neglected paying *zakah*. It is compulsory according to the Qur'an (as previously mentioned), *Sunnah* (about the five 'Pillars of Islam') and *Ijma'* (unanimous agreement among scholars).

The difference among people in term of wealth is natural, as each individual has different capabilities and opportunities. In Islamic terms, it is *sunnatullah* (Allah's law), as mentioned in the Qur'an: "And Allah makes some of you above the others in terms of wealth" (Qur'an 16: 71). And it is also His order for the

wealthy to spend out of their wealth for this compulsory duties; this is the right of the needy. Allah has said: “And within their wealth, there is the right of the needy, whether they ask or not” (Qur’an 51: 19). Compulsory *zakah* is one way to bridge the gap between the have and the have not. It is also a way or operationalising the co-operative feeling and social responsibility of the society.

In short, there are some *hikmah* (benefit, virtues) of paying *zakah*.

*Firstly, zakah* will keep and look after the wealth from the works of sinners and thieves. The Prophet use to said: “Look after your wealth with *zakah*. Cure your sick people with charities. And be ready with prayer to face the accidents”.

*Secondly, zakah* is a help for needy and suffering people. *Zakah* may stimulate them to work harder and to achieve a better life. In turn, the society may be protected from poverty, and the state may be freed from crime and weaknesses. All groups are responsible to satisfy the life of their needy. It is mentioned in one *hadith*: “Truly Allah (SWT) makes it compulsory for wealthy Muslims to spend for the needy a certain amount. Indeed, the needy will never suffer from hunger and be naked except because of the deeds of the wealthy. If so, truly Allah will punish them ...”. Also mentioned in another *hadith*: “In the hereafter, curse upon wealthy people who used to live within the poor. They (the poor) will say: ‘O my God, they (the wealthy) have ignored our rights you have make compulsory upon them for us.’ Then Allah (SWT) will say: ‘For my Holiness and Greatness, I will make you close to Me and keep them far away (from Me)’”.

*Thirdly, zakah* will purify the soul from greed and avarice. It also encourages Muslim to be generous and easy giving. They are discouraged from delaying the paying of *zakah*. They are encouraged to take part in fulfilling social duties, that is the creation of social welfare by giving some of their wealth to the needy when it is needed, and so on.

*Fourthly, zakah* is made compulsory as an expression of the feeling of gratitude for the wealth that Allah has given one to look after. Therefore, this *zakah* is called '*zakah al maal*' (*zakah* on property).

#### 7.1.2. Subject and Condition of Zakatable Property.

*Zakah* should be paid on owned-property (wealth) which already reaches the *nisab* (limit), and which is *productive*--even though only potentially. Additionally, the property is zakatable when: the ownership of the property has been held for one lunar year, and the owner is not in debt to another, and the (value of the) property exceeds the fundamental needs of the owner. Therefore, if the property has not reached the *nisab*, there is no duty to pay *zakah*. Furthermore, there is no *zakah* on *wakaf* property (property donated to the public-public property), because *wakaf* property has no identified owner. Also, there is no *zakah* for property occupied/controlled by others (enemy).

*Nisab* is a limit determined by the *Shari'ah* as a minimum amount (value) of property which becomes zakatable. Different types of property have different *nisab* (and *zakah* rate as well).

Based on the above explanation, there is no *zakah* on purchased merchandise which has not been received (owned) because the ownership is not complete yet. According to *ijma'*, fundamental goods are also exempted from *zakah*, such as: clothes, home utensils, home to live in, jewellery being used, vehicles being used, weapons being used, textbooks owned not for trading, and tools. These properties are considered as fundamental goods and non-productive. Included as non-productive is property lost for some reason, and goods which are under the control of other people for some reason, until they are found or return.

### 7.1.3. Conditions for Zakah.

There are two types of condition: the condition of duty (compulsoriness of *zakah*), and the condition of validity. The condition of duty is that the *zakah* becomes compulsory on, and if it fulfils, the following:

- (1) Free people; *zakah* is not levied on 'slaves'.
- (2) Muslim; *zakah* is not levied on 'non-Muslims'.
- (3) Matured (*baligh*); *zakah* is not levied on those who are not yet mature (children).
- (4) Mentally normal; *zakah* is not levied on those who are mentally-ill.
- (5) The property taken out is zakatable property. There are five groups of such property: (1) *Nuqud* (gold, and silver, money, whatever their forms and other personal properties), (2) natural resources and treasury, (3) merchandise goods, (4) agricultural goods, and (5) livestock.
- (6) The property has reached the *nisab*.
- (7) The property is fully owned.

- (8) The ownership has reached one lunar year.
- (9) The property is fully paid for (not on loan).
- (10) The property is not fundamental goods.

The conditions of validity is that the *zakah* will be considered as valid (acceptable) if it fulfils the following:

- (1) *Niyaat* (intention); the payment should be expressed to fulfil the duty of paying *zakah*, not something else.
- (2) *Tamlík* (transfer of ownership from the payers to the receivers).

#### 7.1.4. Types, due date, and rate of *Zakah*.

The appendix to Chapter 7 explains in detail the types, due date, and rate of *Zakah*, which can be summarised as follows:

##### (1) *Nuqud*.

*Nuqud* includes all 'wealth' in form of gold, silver, money and near money, investment in any kind of property, loans to other parties. For this type of wealth, the rate of *zakah* is 2.5% (one-fortieth), if the value of wealth reach the *nisab* (i.e. equivalent to 91.92 grams of gold, or 643 grams of silver, whichever is lower), and after completing the *hawl* (one lunar year on possession).

##### (2) *Rikaaz, ma'din, and kanz*.

The rate of *zakah* for *rikaaz* (treasures, properties found from the earth or seas, as they used to belong the ancient people), *ma'din* (natural resources), and *kanz* (property which has been kept in a secret place for

long time so that the original owner is unknown, and is then discovered) is 2.5% (one-fortieth) if it needs expensive technology to make usable, or 20% (one fifth) if there is relatively no expense to make it usable. The due date is immediately after the wealth is found. This *zakah* is payable once only, at the time of recovery.

(3) Merchandise goods.

The rate of *zakah* is 2.5% on the value of merchandise, if the value reaches the nisab. For the *mudir* (real trader), *zakah* on merchandise is payable yearly, for the first time the total value of merchandise (net of trade payable) reach the nisab. For the *muhtakir* (speculator, who keeps goods and sells them when the price increases), *zakah* is payable if the goods are sold.

(4) *Mudarabah/musharakah*;

For this type of business form, *zakah* is payable every year, at the rate of 2.5% of the 'net-working capital (cash, receivable, and merchandise inventory, after considering immediate debts owed) of the business, when the value reaches the *nisab*.

(5) Agriculture (crops).

The *zakah* rate is 10% if it uses a free-natural irrigation system, or 5% if it uses an expensive irrigation system, payable at harvesting time.



#### (6) Livestock.

There are three kinds of livestock which attract *zakah*: camels, cows, and goats. The 'rate', due date, and *nisab* are different for each of these livestock, as can be seen in the Appendix to Chapter 7.

#### 7.1.5. Summary on the Zakah System.

It can be summarised that *zakah* is compulsory for every Muslim. It has characteristics of purifying and growing. *Zakah* will purify and free the wealth from uncleanness and fulfil duties toward others, as well as purify the heart of the payers from greed and miserliness. It also cleanses the society from the feelings of jealousy and bad intention. Growing may mean that paying *zakah* sincerely will be rewarded; it is an investment for the hereafter. It may also mean that the *zakah* system should encourage Muslims to invest their spare money in a productive actions so that the wealth should not last just to pay *zakah* over time. Socially and economically, it may mean that *zakah* will help others to grow and do better in their life.

*Zakah* is levied on wealth in any form: money, investments, livestock, agricultural products, trade and industries. The wealth which is subject to *zakah* must have these characteristics (Gambling & Karim, 1991, p. 53): (1) it must be the beneficial and rightful property of the tax payer; thus it excludes *waqf* (endowment or trust property), and wealth of an illegitimate nature; (2) it must

have the capacity to grow in value; or otherwise produce further wealth; (3) it must be in excess of the *nisab*, which is the minimum amount of wealth which can attract *zakah*; (4) it must also be in excess of the basic needs of the tax payer; (5) it must be unencumbered by debt; and (6) it must have been held for one whole lunar year.

The general rate for *zakah* is 2.5% of most property (wealth). In agriculture, it is 5% or 10%, depending on the irrigation system used. For industry extracting treasures (*rikaz*), natural resources (*ma'din*) and hidden property (*kanz*), the general rate is 2.5%; except when they are easily discovered (*ghanimah*), in which the rate is 20%. Contemporary scholars include income from professional jobs (e.g. doctors, accountants, dentists and the like, which are generally well-paid easily) as *ghanimah*, so that they attract 20% *zakah*. Finally, there are specific rates for *zakah* on livestock, which are different for each group of livestock (camel, cows, and sheep).

There are some important points from the *zakah* system which are relevant to accounting:

1. *Assets*. Assets are recognised when 'received', because this is the time when 'ownership' is complete. Assets are zakatable if 'owned' and 'controlled'. Legal ownership is important in Islamic jurisdiction, because based on 'ownership', the rights and obligation are derived. Control, on the other hand, is a secondary

criterion for determining the obligation to pay *zakah*; a property which is legally owned, but not under the control of its owner for some reasons is not zakatable.

2. Loans (to others) are recognised as zakatable; while debts (from others) will reduce the total of zakatable property. Both loans and debts should be recorded in writing (Qur'an 2: 282). The recognition of loans and debts support the concept of accrual accounting.

3. Valuation base. For the purpose of calculating *zakah*, all property should be valued according to its market price (net realisable value). Gambling and Karim (1991, p. 92) argued that "It would not be an acceptable practice to use one valuation for the *zakah* calculation and another for the reporting purpose, since this would imply a division between matters of religion and business affairs". Therefore, the use of other valuation bases, such as: historical cost, replacement value, discounted values, etc. as proposed in Western accounting (e.g. US, UK, IASC, etc.), is unacceptable in Islam.

The conservatism principle as currently practised, such as the use of 'lower cost or market' (LCOM) price and allowance for doubtful debt, is totally rejected. All investments (securities or fixed assets) should also be valued according to their 'net realisable value'. Debts can only be excluded if they are uncollectible (bad debts).

4. For a business organisation, whatever its 'legal form', *Zakah* is assessed only on wealth acquired for trading (net working capital), not on wealth procured for utilisation. Therefore, the use of the term *current* refers to the wealth to be consumed, sold, or converted into cash during the *zakah* period. The term *non current*, therefore, refers to those which are retained beyond that time. This is the periodicity assumption in *zakah*, which should also be used in accounting.

5. For a business organisation such as *musharaka* and *mudaraba*, the organisation can be seen as an 'artificial body' for the *zakah* purpose only. The duty to pay *zakah* remain on the owners, not on the company, as a company cannot have any rights nor duties in Islam.

## 7.2. Islamic View towards Conventional Accounting Concepts

Regardless of the pros and cons of a conceptual framework, the framework is expected to give explanation about: (1) the objective(s) of financial statements, (2) the qualitative characteristics that determine the usefulness of information in financial statements, (3) the definition, recognition and measurement of the elements from which financial statements are constructed, and (4) concepts of capital and capital maintenance (IASB, 1988, para. 5). Using the structure of the IASB conceptual framework, the following is the Islamic view towards:

- (1) Users and their needs;
- (2) Objectives of financial statements;
- (3) Underlying Assumptions;
- (4) Qualitative Characteristics and Constraints;
- (5) Elements of financial statements;

- (6) Recognition of the elements of financial statements;
- (7) Measurement of the elements of financial statements; and
- (8) Concepts of Capital and Capital Maintenance.

#### 7.2.1. Users and their needs; Equity concepts.

In determining the objectives of financial statements, the IASC's framework identified seven group of users which are supposed to be those who need to get information from the enterprises. They are: present and potential investors, employees, lenders, suppliers and other trade creditors, customers, government and their agencies, and the public (IASC, 1988, para. 9). These individuals generally lack the authority to prescribe the information they want and must rely on the information management communicate to them in reports designed to meet their common information needs. Therefore, it is realised that their information needs cannot be met by a single financial statement, which prioritises the investors, as the providers of risk capital to the enterprise. It is only assumed that there are needs which are common to all users; and that financial statements which meet the investors' use will also meet most of the needs of other users (IASC, 1988, para.10).

For this reason, it is clear that the framework assumes that the owners (investors), as other users, are totally separated from the enterprise; investors are assumed not to be involved in the management of the enterprise so that they do not have any access to the enterprise for information. Moreover, the separation between owners and enterprise has been stated in legal form: that the enterprise is

a separate legal entity with its own rights and liabilities. Owners (investors) are not liable toward their company's liabilities. The most suitable legal form for this assumption is the Western type of 'corporation' (stock-limited company).

It is also mentioned that for different purposes (needs), different reports (statements) may need to be prepared, based on a different 'framework'. For example, for tax purposes, different statements should be prepared based on taxation regulations. The same applies for different needs, so that there will be more than one report to be prepared by the management.

This is totally different from the Islamic point of view. All users (investors, creditors, and others), as individual persons, have a similar primary religious duty regarding their wealth, i.e. paying *zakah*. Therefore, the primary information they need is that which can help them to assess their wealth, so that they may be able to calculate the *zakah* payable by them correctly. Public and government institutions, especially those which are directly concerned with the management of *zakah*, will also need information regarding zakatable assets of the firm. Information regarding 'profitability, liquidity, solvency, etc.' will come in the next priority; and it is believed that financial statements prepared based on the '*zakah* system' will at once also be able to provide such information.

Regarding the relationship between owners and company's assets, there are some explanations, which are called by some, 'equity theory' (Wolk et al, 1992), or by others, 'accounting point of view' (Kam, 1992). The West, following Paton

and Littleton (1940), adopts the 'Entity Theory' in this matter. The separation between company's and owners' assets and liabilities, and limited liabilities of owners, primarily from a legal point of view, is not allowed in Islam. Therefore, the 'Proprietary Theory' is the most suitable in this matter.

According to the proprietary theory, the company's owners are the focus of attention. Accounting plays the role of determining the net worth of the owners. This makes the balance sheet important as a major source of information. *Zakah*, the personal duty of the owners, is levied on the value of the owners' (stockholders') share of the company's assets. Because *zakah* varies with specific type of assets, the market price of the stocks (shares) itself is not appropriate for this purpose, but the market prices of assets are.

El-Ashker (1989) and Elteгани (1993, 1994), as part of their research on Islamic Banking, briefly examined the 'basic concepts/assumptions/ postulates' of conventional accounting from their Islamic point of view. El-Ashker came to the conclusion that '*Accounting postulates ... all apply to the Islamic approach*' (quoted in Gambling & Karim 1991, p. 95). Elteгани, moreover, came to almost the same conclusion for most of the postulates. Regarding the 'entity concept' (accounting entity), Elteгани said that it is acceptable in Islam for the reasons that:

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 a 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.

However, he forgot that he had mentioned before his conclusion that 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 reports the transaction of the firm rather than those of its owners.

*Shari'ah* can accept the treatment of a firm as a 'separate and distinct' entity from the owners and other firms, but not in a legal sense. For reporting purposes, indeed it is preferable to treat a firm as an 'independent' entity, in order to ease reporting the owners' assets invested in the business and the profit they gain from the business. In Islamic jurisprudence, a firm is not a real thing which may have rights and obligations; it is an abstract, non human thing; it cannot be responsible nor own properties. It is only a 'tool or vehicle' used by its owners to act. A non-owner manager or director, who is usually seen as the 'representative



person' of a firm, is actually an agent for the owners, not the firm. He is responsible to the owners, not the firm.

As has been discussed before, Islamic jurists cannot accept the idea of a 'joint-stock company', especially with a 'limited liability'; the owners' liability toward other parties' claims is unlimited. In order to accumulate huge capital (which is questionable from an Islamic perspective), Shari'ah has ruled out some acceptable alternatives; e.g. through an Islamic Bank, or in case of the essential nature of the business, it should be owned by the government to avoid un-Islamic business practices. The easiness with which clients can deal with the firm's representative, or accountants prepare financial statements, or the court deal with disputes, cannot be used to justify the acceptance of the 'entity concept/theory' from Islamic perspective. Indeed, the 'entity theory/concept' *per se* is not *explicitly* mentioned in the Qur'an nor *Sunnah*; but the morality underlying the idea of 'entity theory/concept' contradicts with the Shari'ah principles. Lastly, *Waqf*, *Baitul Mal*, and government are treated as a 'nominal personality' (or entity) merely because they, as abstract bodies, have no owners; they belong to all Muslims--the community (i.e. they are public institutions); there is no identifiable owner of them, and those who manage them are the agents (trustees) of the whole community.

### 7.2.2. The Objective of Financial Statements

Western accounting uses the 'decision usefulness' approach in determining the objective of financial statement/reporting. The IASC framework, for example, mentioned that the objective of financial statements is to provide information about the financial position, performance and changes in financial position of an enterprise which is expected to be useful to a wide range of users and meet the common needs of most users, even though it is realised that the financial statement do not provide all the information that users may need (IASC, 1988, para 12). This is because the financial statements largely portray the financial effects of past events and do not necessarily provide non-financial information. Furthermore, the financial statement also show the result of the stewardship of management, or the accountability of management for the resources entrusted to it (IASC, paras. 12-14).

To justify the above objectives, the framework then explains the supposed actions to be made by the users as a response to the information they acquire and evaluate. For example, information about *liquidity* and *solvency* is assumed to influence the present and potential creditors to decide whether they will extend their loan or not; information about *profitability* is assumed to be able to influence the present investors to retain or sell their investment; and so on. Both creditors and investors are assumed to escape from no risk regarding their loans and investments in the company.

From an Islamic point of view, such behaviour is not expected to happen, as both creditors and investors are supposed to be aware of this, and they have already agreed to share any risk and profits of the business. Especially for investors of a *mudaraba* enterprise, because they are supposed to be involved in the affairs of the business, they already know the running and prospects of the business in the future without analysing a formal report (financial statements). As Muslims, they are more concerned with how to account for their duties (i.e. paying *zakah* correctly) and how to make the business survive and expand. Therefore, they will do their best, with the real current resources, for a better future. They will not avoid any risk in the future, due to what has happened in business in the past. They are involved in business not to avoid the risk and only expect profits, but they realise that risk and profits should be there, and they share them.

As has been mentioned before, the main objective of financial statements in Islamic accounting is to avoid disputes; and the first dispute which needs to be avoided is in calculating *zakah*, as it is divine command. As *zakah* should be based on 'true' zakatable wealth, the financial statements will at once serve other needs based on the 'true' wealth, such as the determination of profits, liquidity and solvency, etc. Profit based on 'true' wealth will be a 'true' profit; similarly with other evaluation tools. Of course, notes and supplementary schedules are necessary to provide more detail and clear information and for other purposes. For example, the historical cost of (fixed) assets, when it is matched against its 'market value', will provide information regarding 'unrealised profits/gains or losses'.

The objectives will influence the 'approach' used to prepare financial statements. Western accounting, where the primary users are investor as the 'primary providers of risk capital', will place more emphasis on providing information about 'performance' because it is the most relevant for their decision, i.e. to hold or sell their investment, to re-appoint or change the directors (managers), and the like. The approach most appropriate to be applied is then the 'Revenue-Expenses' (Profit-Loss Statement) approach. This approach, in turn, will determine the 'assumptions' used in the accounting process.

Islamic accounting, on the other hand, stresses on the preparation of the Balance Sheet, which will provide information regarding the 'true' wealth (financial position) of the company. This approach is called the 'Assets-Liabilities' (Balance Sheet) approach. The determination of income, then, is also based on the balance sheet. Because the balance sheet provides information about 'true' wealth, the income derived from it will also be a 'true' income. It does not mean that other information is not important.

The second objective mentioned in the Western conceptual framework is regarding 'stewardship' or 'accountability' in its narrow meaning, i.e. 'the discharge of accountability'. This objective originally comes from the 'agency-principal' relationship, in which the 'agent' is the management of the reporting company and the 'principal' is the owner/investor.

From the Islamic point of view, *zakah*, besides being a divine command, also has a socio-economic function. Muslims believe that every divine command has a holistic function, which humankind may not be able to see. With its socio-economic function, at least, combined with its divine command, it can be argued that the objective of financial accounting based on the *zakah* system is a form of 'accountability' in its broadest meaning, i.e. an accountability report for all society members, or 'social accountability'.

#### 7.2.3. Underlying Assumptions.

The framework of IASC (and other Western accounting, such as US and UK) mentions two assumptions underlying the preparations of financial statements: *accrual basis* and *going concern*. The accrual basis recognises the effect of transactions and other events when they occur (and not as cash or its equivalent is received or paid) and they are recorded in the accounting records and reported in the financial statements of the periods to which they relate. Furthermore, the financial statements are normally prepared on the assumptions that an enterprise is a going concern and will continue in operation for the foreseeable future. These assumptions, however, have been criticised by some.

The going concern assumption is argued as providing another basic support for the utilisation of historical costing, besides other concepts such as *objectivity*, *matching* and *realisation* which are rationalisations of the use of historical costing,

and the use of the conservatism concept (Sterling, 1970, p. 111). The financial statements are prepared on the assumptions that an entity will survive long enough to carry out its commitments and fully realise its existing assets in the present life of the business. This leads to the *periodicity* assumption: that the users of financial statements cannot wait until the end of a firm's life before the success of its operation is measured. Primacy is placed on the *relevance* of the financial report at the expense of its objectivity. The periodicity assumption has led to the development of *accrual accounting*, and the principles of income recognition and matching (re. Figure 7.1. on the next page).

The going concern assumption, moreover, is said to be used mainly to justify: (1) the adoption of current-non current classification of assets and (2) the use of the historical cost of fixed assets as prepayments of expenses which can be matched against revenue for income measurement purposes (Gambling & Karim, 1991, p.93).

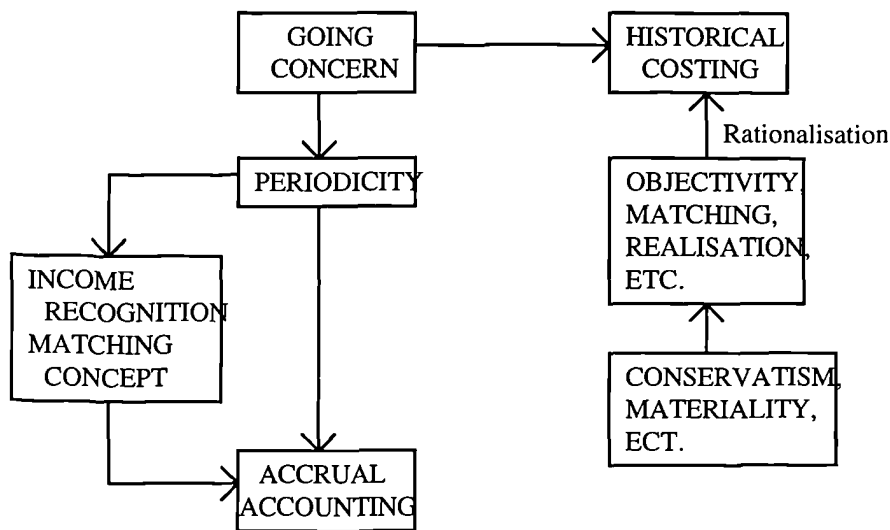


Figure 7.1.  
Logical relation between 'Going Concern' assumption and 'Historical Costing'.

From the Islamic point of view, the main purpose of financial reporting is to help the users in assessing their wealth so that they are able to calculate *zakah* (payable on the net wealth) correctly. Therefore, the primary purpose of classifying assets as '*current*' and '*non-current*' is to identify the wealth which is subject to *zakah*. This is important because *zakah* on business entities is assessed only on wealth acquired for trading (i.e. net working capital including cash), and not on wealth procured for utilisation (i.e. fixed assets) (Shahata 1970; quoted in Gambling & Karim, 1991, p. 93). Current assets, therefore, are those which are intended to be consumed, sold, or converted into cash during the *zakah* period (i.e. one lunar year); while non-current assets are to be retained beyond that time.

*Periodicity*, furthermore, is based on a different ground from the Western accounting. As *zakah* should be calculated every year (annually), it is clearly necessary to calculate the value of wealth annually (i.e. to prepare annual financial statements). Therefore, periodicity is not an 'assumption' in Islamic accounting; it is a 'rule'.

The Shari'ah rule regarding the *valuation* of assets, as applied to *Zakah*, is that assets should be stated at their market (selling) price. This rule applies to all assets, whether they are zakatable (for business entities: current assets) or not, as Islam does not allow the distinction (separation) between religious (*zakah*) matters and worldly (business) matters. Indeed, debts and loans, and accruals and prepayments, should be recognised in assessing the zakatable net working capital. However, it cannot be said that the 'accrual basis' has similar ground as in the Western accounting system. The recording and recognition of 'obligation to pay' and 'right to receive' cash in the future are merely the command of God (Qur'an 2: 282); that is all.

In short, the *going concern* assumption does not seem to contradict with Shari'ah; but this does not mean that it need to be an assumption in Islamic accounting. Similarly with *periodicity* and *accrual accounting*. The ideas or philosophy behind them are, however, questionable or unacceptable in Islam.



#### 7.2.4. Qualitative Characteristics and Constraints.

The IASC explains the qualitative characteristics which should be achieved by the financial statements, and the constraints to achieve them. The qualitative characteristics to be achieved are: understandability, relevance (including materiality), reliability (including: faithful representation, substance over form, neutrality, prudence, and completeness), and comparability. It is also said that the financial statements with such qualities will provide a 'true and fair view' (fair presentation). Other Western accounting concepts (US, UK, and Australia) also mention these qualitative characteristics. They differ in some expressions and details; but they are basically similar (Refer back to Chapter 4, Section 4.2.4).

##### (1) Understandability.

From an Islamic point of view, *understandability* is also important as communication needs understanding on the part of both the providers and receivers of information. However, the understandability should be in line with the Shari'ah; the use of terms and definitions should refer to the Shari'ah first. If the terms and definitions are not there, it is allowed to adopt new ones on condition that they do 'not contradict' with the common sense. All general terms and definitions, such as assets, liabilities, capital and the like, are available in the Islamic jurisdiction; therefore, it is not acceptable to use these terms and definitions to refer to something else. The use of technical terms, methods, procedures, and the like, is allowed only if they do not violate the general message of Islam.

### (2) Relevance

From an Islamic point of view, the primary concern of all users is the same, that is, to assess their wealth (assets and liabilities) in order to be able to calculate their divine duty of paying *zakah*; therefore, information provided will be relevant to all users if it is prepared based on the *zakah* system. *Zakah*, as it is a divine duty, should be calculated ‘correctly’; therefore, there will be no tolerable omission and/or misstatement. In other words, whatever its size--small or big--information regarding wealth is material for *zakah* calculation. Therefore, preparers have a ‘moral’ duty to do their best to find out all information about the wealth of the firm’s owners. Indeed, timeliness is very important, as delay in paying *zakah* due to untimely information would have ‘moral-religious’ consequences.

Moreover, the second primary benefit of such an approach is that the ‘profit’ calculated will be ‘true profit’ from the Islamic point of view, which is the concern of the owners and creditors, the primary interested parties. Other parties, which may need specific information, then, should consult with the directors and/or the owners.

### (3) Reliability

Reliability is subject to criticism in Western accounting, due to some ‘ambiguous definitions’ and ‘alternative measurement bases’ allowed (Refer back to Chapter 4, Section 4.3.3.). From an Islamic point of view, this would not be a problem, as Islamic accounting should use terms and definitions which refer to the

*Shari'ah* so that there would not be 'ambiguity'. Furthermore, 'net realisable value' is the only measurement base allowed to be used for presenting assets. Indeed, there will be some practical difficulties in determining the 'net realisable value' of certain assets, so that 'subjectivity' may be involved in this matter. Therefore, moral commitment is very important here. That subjectivity is realised does not mean that Islamic accounting would not be able to provide more reliable information than its Western counterpart.

Regarding objectivity; there is no 'objective, value free, or neutral' opinion in this world. If someone says that 'this is an objective one', at the same time he/she is already biased: expressing his/her own biased statement. Every opinion is subjective; even an agreement among a huge amount of people is subjective--a collective subjective statement/opinion. It is better to realise and recognise the subjectivity as a constraint, rather than to accept un-realistic 'objectivity or neutral' assumptions. In Islam, however, 'justice' should underlie any subjective opinion based on *Shari'ah*.

Furthermore, to represent faithfully the transactions and other events that accounting purports to represent, it is said to be necessary that they are accounted for and presented in accordance with their substance and economic reality and not merely their legal form. Western accounting stresses the 'substance over form'; it clearly states that there is a dichotomy between economic reality and legal form. Such a dichotomy would not be acceptable in Islam as Islam does not allow the

separation between 'religious' matters and 'worldly' matters; both should refer to the Shari'ah. In other words, 'legal form' is considered first in Islam; and 'economic substance' should not violate the legal form (Shari'ah).

Moreover, to be reliable, the information contained in the financial statements should be free from bias (neutrality) and *complete*. *Neutrality* seems to be difficult to achieve in conventional accounting due to some alternative methods/procedures/ techniques available and allowable, which involve personal preferences in choosing among them; while *completeness* criteria would also be difficult to achieve due to materiality and cost-benefit limitations. In Islamic accounting, on the other hand, the choices of alternative methods/procedures/ techniques would seem to be restricted. Consequently, personal preferences would also be limited, so that neutrality would be more guaranteed. Furthermore, moral commitment would drive Muslims to consider less the materiality and cost limitations.

The prudence concept is also not allowable in Islam. Under-statement of assets and/or overstatement of liabilities would affect the calculation of *zakah*. Similarly, the use one valuation for *zakah* purposes (net realisable value) and another for other reporting purposes (e.g. historical cost, LCOM) indicates a division between matters of religion and business affairs; and this is not permitted in Islam.

Indeed, in the real complex world, it is difficult to estimate the 'market value' of certain assets. In such a case, a certain level of 'subjectivity' may be applied. However, the level of subjectivity will be reduced by using experts. Despite this technical problem, the use of 'net realisable value' will provide a value which reflects 'dated value' more than the 'historical cost based value' and 'future based value/present (discounted) value', so that the information provided will be more relevant and reliable. Moreover, the 'net realisable value' seems to accord with the principle of 'moderation' in Islam, as it bridges the two extremes, the 'past' (historical cost) and 'future' based values.

*(4) Comparability (and consistency).*

Comparability and consistency are crucial in conventional accounting (Refer back to Chapter 4, Section 4.3.). From the Islamic point of view, as Shari'ah is divine, there will be no changes in the principles underlying all the systems, including the economic and social system of which accounting is part. The consistency principle, therefore, would be more guaranteed, as Muslims should consistently follow the Shari'ah. Uniformity between companies will also be possible, so that comparability among companies will also be more possible. However, the users' conducts towards information in the financial statements would be different that of Western users, due to the Islamic principles regarding the 'objective of life', as has been discussed before.

#### *(5) Constraints*

Relevant and reliable information seems to be difficult (if not impossible) to achieve due to some constraints; i.e.: *trade-off between relevance and reliability*, *cost-benefit constraint* and *timeliness constraint*. There are also some critics regarding the 'qualitative characteristics' of the Western accounting framework. (Refer back to Chapter 4, Section 4.3.2.) From an Islamic point of view, it is not necessary to determine and to identify the qualitative characteristics or constraints, as it is not relevant in calculating the zakatable wealth. It is believed that the financial statement will by itself meet the 'best' qualitative characteristics combination if it provides information which enable to calculate 'correct' *zakah* and profit (for profit sharing). And the information presented in the financial statements will be more 'true and fair' if it is based on the 'true' measurement as the date of the statement. And it is the Islamic point of view that, whatever its cost, 'true' information should be gained in order to be able to fulfil the Shari'ah duties.

#### *(6) True and fair view (Fair representation)*

The concept of a 'true and fair' view is questionable (refer back to Chapter 4, Section 4.3.2.). This would not be the case in Islamic systems. As all systems in Islam should refer to the Shari'ah, there will be similarity in definitions, terms, and measurement bases between accounting, economic, finance, taxation etc. What is 'true' will be at once 'fair'; what is 'true and fair' from the point of view of accounting would also be 'true and fair' from the point of view of other systems;

and vice versa. Islam cannot accept the idea that what is 'true and fair' in accounting, or in the economic or any other system, would be different from the general meaning of 'true and fair'; as 'good' in business should not contradict with the meaning of 'good' in general.

#### 7.2.5. The Elements of Financial Statements

It is clear that Shari'ah emphasises the 'legality' aspect of items. Therefore, 'right' is the essential feature in defining 'assets'; while 'obligation' is the essential feature for defining 'liabilities'. A right will entitle the owners to 'control the use' or to 'transfer the right to use' of an asset item. Similarly, an obligation will entitle a party to 'use or transfer' its right of 'owning/controlling/transferring' of item in order to fulfil the obligation.

#### 7.2.6. Recognition of the Elements of Financial Statements.

As Islam places more emphasis on the 'legal aspects', the criteria for recognition of assets (and liabilities) seem to be different from the IASC (Western) framework. Assets, in Islamic accounting, should be recognised if the 'legal right' has been acquired; while liabilities should be recognised if there is 'legal obligation' incurred.

### 7.2.7. Measurement of the Elements of Financial Statements.

The Shari'ah only prescribes a single 'measurement' basis for reporting the elements of financial statement, i.e. 'net realisable value'. That means, following the explanation in paragraph 100(c) of the IASC's framework,

“Assets are carried at the amount of cash or cash equivalents that could currently be obtained by selling the assets in an orderly disposal. Liabilities are carried at their settlement values; that is, the un-discounted amounts of cash or cash equivalents expected to be paid to satisfy the liabilities in the normal course of business”.

This is because the primary objectives of financial statements is to provide information which enable users to assess their 'wealth' in order to calculate *zakah* payable to them. *Zakah* originally should be 'paid' by taking out, at certain rate varies for different assets, the 'physical' part of the zakatable wealth. Due to the development in 'money as exchange tools', contemporary jurists agree that *zakah* may be paid in the form of the monetary unit at the due date of *zakah*.

The Islamic approach to income measurement is quite different. One of the features of *zakah* is that it is assessed on wealth; this has the capacity to grow, irrespective of whether it has produced a profit or a loss (Al-Qaradawi, 1981). From an Islamic perspective wealth can grow as a result of:

1. Profit: realised gains resulting from the sale of current assets;
2. *Gil'ah*: unrealised gains resulting from the increase in the value of current assets; or
3. *Fa'edah*: realised and unrealised holding gains on fixed assets (Attia, 1984)



For the purpose of *zakah*, only growth in the form of realised and unrealised gains on net current assets is included in the calculation. For the purpose of income distribution (profit-sharing), only growth in terms of realised gains on current and fixed assets will be considered.

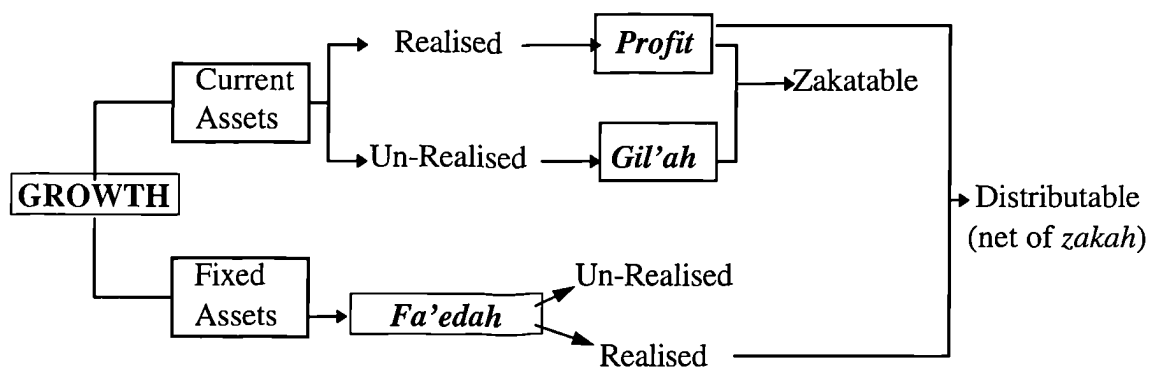


Figure 7.2. Classification of Growth in Islam

#### 7.2.8. Concepts of Capital and Capital Maintenance

The IASC's framework describes two concepts of capital, namely: the financial concept of capital and the physical concept of capital. The *capital concept* adopted will determine the *concept of capital maintenance* used and the determination of profit. The *financial concept* of capital gives rise the concept of *financial capital maintenance*; and the *physical concept* of capital gives rise the concept of *physical capital maintenance*. Furthermore, the selection of the measurement basis and concept of capital maintenance will determine the accounting model used in the preparation of the financial statements. Different accounting models exhibit different degrees of relevance and reliability and, as in other areas, management must seek a balance between relevance and reliability.

From an Islamic point of view, income is measured as the excess of the 'net realisable value' of net assets at the end of period over the 'net realisable value' of net assets at the beginning of the respected period, after excluding any distributions to, or contribution from, owners during that period. Seen from the western viewpoint, it seems that an accounting system based on Shari'ah (*Zakah* system) adopts the 'financial concept of capital'. However, the difference in the measurement basis, and the 'philosophy and ideology', distinguish it from the western model.

### 7.3. Summary.

Islam sees accounting as a religious duty. From history, it is also known that a 'double-entry' accounting has been practised in Muslim lands, long before the era of Pacioli, who is regarded as the 'father of modern accounting' in the West.

Analysing the conceptual framework of Western conventional accounting from the perspective of Islam (*Shari'ah*), it is found that there are some differences between the Western and Islamic concepts in accounting.

- (1) Users and their needs. *Zakah* is the primary motivation for the users to obtain a financial statement, as it is a divine-religious duty for every Muslim. Those who are directly involved in *zakah* are the owners of the property (business enterprise), and the *zakah* administration body. As the *Shari'ah* only

recognises *musharakah* and *mudaraba* business forms, the financial statements are also expected to provide information for determining 'profit sharing'.

- (2) The objective of financial statements is, therefore, primarily to provide information which enable the users to calculate what they have to pay, and to determine the profit for 'profit-sharing' determination.
- (3) Accounting assumptions. The *going concern* assumption does not seem to contradict with Shari'ah; but this does not mean that it is necessary to be an assumption in Islamic accounting. Similarly with the *periodicity* and *accrual accounting*. The ideas or philosophy behind them are, however, questionable or unacceptable in Islam.
- (4) Qualitative characteristics and constraints. From an Islamic point of view, it is not necessary to determine and to identify qualitative characteristics or constraints, as this is not relevant in calculating the zakatable wealth. It is believed that the financial statement will by itself meet the 'best' qualitative characteristics combination if it provides information which enables to calculation of 'correct' *zakah* and profit (for profit sharing). There is no dichotomy between the 'true' and 'fair' concept; what is 'true' in Islam must be 'fair' in itself. *Shari'ah* provides 'standards' for the truth; everything which accords with the *Shari'ah* can be said as 'true'. The information presented in the financial statements will be true and fair if it is based on the 'true' measurement as the date of the statement. And it is the Islamic point of view

that, whatever its cost, 'true' information should be gained in order to be able to fulfil the Shari'ah duties.

- (5) Definition of the elements of financial statements. It is clear that the Shari'ah emphasises the 'legal' aspect of items. Therefore, 'right' is the essential feature in defining 'assets'; while 'obligation' is the essential feature for defining 'liabilities'. A right will entitle the owners to 'control the use' or to 'transfer the right to use' of an asset item. Similarly, an obligation will entitle a party to 'use or transfer' its right of 'owning/controlling/transferring' of item in order to fulfil the obligation.
- (6) Measurement. Net realisable value is the only measurement basis which satisfies the purpose of the financial statement. Historical cost information may be useful, however, to determine the 'realised' profit and gains to be distributed among the owners/contributors of capital.
- (7) It seems, therefore, that Islamic based accounting will suit the adoption of the financial capital concept.

## CHAPTER 8

### ENVIRONMENTS OF ACCOUNTING IN INDONESIA

#### 8.0. Introduction

In order to judge whether the Western (i.e.: the US and the IASC) accounting systems, which have been are currently adopted, are in accord with the Indonesian environment, it is important to understand the concept of philosophy and ideology, as well as the social, political, economy, legal and cultural systems of the country. This chapter presents an evaluation of these concepts and systems, including the recent conditions, especially in the area of accounting (education and association), and the Islamic business enterprises in Indonesia. Before coming to those topics, it is necessary to provide a sort of 'general overview' about the country.

#### 8.1. General Overview

##### 8.1.1. Geographical Location

The name Indonesia combines the Greek words *Indos*, meaning East Indian, and *nesos*, meaning islands. Indonesia is the largest archipelago in the world, comprising the five main islands of Java, Sumatra, Kalimantan (Borneo), Sulawesi (Celebes), and Irian Jaya (New Guinea), and about thirty smaller archipelagos totalling 13,667 islands, of which approximately 6,000 are inhabited.

The archipelago straddles the equator from 6° North latitude to 11° South latitude, and extends from 95° to 141° East longitude. The greatest distance from east to west is 3,175 miles; from north to south the greatest distance is 1,173 miles. The total land area is approximately 772,204 square miles (2,000,000 square kilometres) and the sea area about four times larger. The islands are surrounded by the South China Sea, the Indonesian Ocean, and the Pacific Ocean. The terrain of Indonesia is varied. Much of the country is mountainous, and forest or jungle covers nearly two thirds of the land. It has approximately 400 volcanic peaks, of which 100 are active or dormant, and the remainder inactive (Price Waterhouse, 1986).

#### 8.1.2. Population

The population in mid 1997 was 200 million. It was 179,321,641 in 1990, and 147,331,823 in 1980. Nearly 60 percent of the population live on Java island. The people of Indonesia are predominantly Malay; however, the people of Irian Jaya are Papuan. In Eastern Indonesia, the people of Moluccas and Halmaheras tend to be a blend of these two dominant groups. Persons of Chinese origin make up about 3 percent of the population and there are small communities of Arabs and Indians in the main centres.

Approximately 85-90 percent of the Indonesian population are, at least nominally, Muslims. Roughly 6-7.5 percent are Christians of various denominations. The remainder include Hindus, Buddhists, Confucians and

animists. Despite the overall primacy of Islam, however, the regional distribution of its followers is uneven, and several areas have Christian majorities. Hinduism is the majority religion in Bali.

The national language is *Bahasa Indonesia* (Indonesian Language), which originated from the Malay language. Besides the national language, there are hundreds of local languages; each tribe has its own language and they are sometimes totally different from each other. The dominant languages among them, however, are Java, Malay, Sunda and Madura.

### 8.1.3. Historical Review

Indonesian history is a story of ancient kingdoms, invasions, colonisation, revolution and independence. Between 3,000 BC and 500 BC, migrations of *Neolithic* Malays took place from the Asiatic mainland. Nearly 2,000 years ago, small Hindu kingdoms grew up around sites frequented by Indian seamen and traders. The Hindu religion, customs and arts, and the Hindu language, Sanskrit, had a deep and lasting influence on the Indonesia culture and religion. By AD 700 and 800, Buddhist culture had spread over most of Indonesia and beyond, influencing commerce, art and learning.

The Muslim religion was introduced to Indonesia by traders from Persia and the west coast of India in the twelfth century. The religion rapidly gained prominence among the people, first in the coastal regions, and later in the interior

of the islands. Hindu followers who did not wish to embrace the Moslem religion fled eastward to Bali where they continued to follow a modified form of Hinduism.

In 1511 the Portuguese, in search of spices, entered Indonesia after conquering the Islamic Kingdom of Malaca on the Malay Peninsula. They were followed by the Spaniards. At the end of the sixteenth century, the Dutch arrived in Indonesia, and in 1602 established the Dutch East India Company (VOC) with the aim of exploiting the spice islands in Indonesia's archipelago for European markets. Subsequently, the Dutch progressively brought the Indonesian archipelago under their control as the Netherlands East Indies. There were short periods in which the sovereignty over Indonesia fallen to French (1796-1811) and the British (1811-1816).

The early twentieth century saw the emergence of popular nationalist independence movements. During the Japanese occupation from 1942 to 1945, major nationalist objectives were achieved. On 17th August 1945, two days after the surrender of the Japanese, a unilateral declaration of independence was made and Soekarno became the first President of the Republic of Indonesia. However, the sovereignty over the territory was transferred from the Dutch on 27-12-1949 after struggling bitterly for about four years (1945-1949), except for the Western Papua.

Originally, the Republic of Indonesia comprised the former territories of the Dutch East Indies. Since then, the Republic's territorial boundaries have been



extended on several occasions. On 1st May 1963, sovereignty over the territory of West Irian Jaya (formerly Dutch New Guinea), was transferred to Indonesia from the Netherlands. In July 1976, the former Portuguese colony of East Timor was declared to have been integrated into the Republic. Finally, Indonesia's long-standing claim to sovereignty over the seas separating its islands was accorded international recognition in April 1982, when the eleventh session on *the UN International Convention on the Law of the Sea* recognised the principle of an archipelagic state. This more than doubled the country's total area and permitted Indonesia to declare the archipelagic seas an exclusive economic zone in October 1983.

The first 20 years of Indonesia's history as an independent state were marked by political instability and economic decline. Indonesia's independence was only conceded by the Dutch after four years of bitter fighting, and the liberal democratic republic established in 1950 was characterised by a "revolving door" cabinet, regional revolts, and economic mismanagement. In 1959 the President, Soekarno, suspended the liberal democratic constitution of 1950 and reinstated the *1945 Constitution*, which had originally been drafted as a temporary document in the wake of the proclamation of independence and is based on the five principles, or *Pancasila*, as *state foundation and ideology*.

In September 1965 a group of army officers led an abortive *coup d'etat* in which the Indonesian Communist Party, supported by Chinese arms and money,

was allegedly involved. This coup marked the end of the Old Order, as the period of Soekarno's presidency later became known. It was crushed by the army with much bloodshed. In March 1966 the New Order was established when the executive power of government was transferred to Major General Soeharto. He became president in March 1968, and was re-elected for six further five-year terms by the People's Consultative Assembly in 1973, 1978, 1983, 1988, 1993, and 1998.

The establishment of the New Order resulted in a thorough reorganisation of political structures, although the formal framework of a constitutional republic based on the *1945 Constitution* was retained. Despite occasional increase in political tension, especially in the run-up to elections, Indonesia has enjoyed a remarkable degree of political stability since 1968.

## 8.2. The Indonesian Concepts and Systems.

### 8.2.1. Philosophy and Ideology

The Republic of Indonesia has been set up based on 'Five Principles' called *Pancasila*. The 'five principles' are stipulated in the Preamble of the 1945 Constitution, paragraph four. This has been agreed upon by the founding fathers of the Republic of Indonesia on 18th August 1945, all of which have been endorsed by the Decree of the Provisional People's Consultative Assembly No. XX/MPRS/1966 which has re-affirmed that:

“the Preamble to the 1945 Constitution, being the detailed Declaration of Independence, containing the lofty ideals of the 17th August Independence Proclamation which incorporated PANCASILA as the Foundation of the State, forms one linked chain with the 17th of August, 1945 Independence Proclamation, and can therefore not be altered by whomsoever, including the People’s Consultative Assembly being the product of a General Election ... as altering the content of the Preamble means the abolition of the state.”

Since *Pancasila* constitutes the rooted outlook of life within the nation’s identity, it was accepted to become the *foundation* of the state which arranges the life of the state. This is clearly manifested in history. Though expressed in some slightly different formulations, in all three Constitutions that Indonesia has had, i.e., in the Preamble to the *1945 Constitution*, in the Preamble of the *Constitution of the Federal Republic of Indonesia*, and in the Preamble of the *Provisional Constitution of the Republic of Indonesia (1950)*, *Pancasila* has been mentioned

*Pancasila*, as the state foundation, is also believed to be the state philosophy. *Pancasila* is not a philosophy created by an individual, such as the philosophy of Hegel, Aristotle, Kant, or other such philosophers. *Pancasila* philosophy was created as the nation’s philosophy to become the foundation of the state to live and to develop. It should therefore grow and stand firm in the dynamics of society and be preserved in line with the consensus developing at any time. Because it is not an individual creation, *Pancasila* therefore does not referring to any individual’s thoughts. Nor do the values which constitute the

essence of *Pancasila* philosophy refer to certain groups of society, since they belong is to the whole of the Indonesian people.

It is often said that *Pancasila* is a philosophy containing values unearthed from the soil of Indonesia itself. This means that *Pancasila* until it reached its formal formulation, was nothing less than the essence of the process of growth of the nation from one period to another. What are formulated in the principles of *Pancasila* could be found in the life of the nation in former times. Since those values are originated from the Indonesian nation itself, therefore, up to the time when a consensus was achieved, no difficulties were encountered. In addition further development has shown that there did not exist any group that succeeded in imposing its own will on the society, to become the will of the whole of the nation.

Every bit of development of the nation, be it in the ideological, political, social, economic, cultural, or defence and security fields, shows one thing, namely that they have all been achieved through a consensus by way of deliberation (*mushawarah*) and consensus (*mufakat*).

*Pancasila*, viewed from the process of its formulation, has shown its dynamic characteristic which is inherent with its basic concept. Due to that characteristic of dynamism, it is with this state foundation that the Indonesian nation has confidence to grow in line with the development of the world in general. The Indonesian nation has ample opportunities to develop its thought to advance its society, nation and state.

The five principles of *Pancasila* are comprehended by the Indonesian nation as an integrated, one complete entity, in which one principle cannot be separated from the other. These principles are:

**PANCASILA**

- 1. BELIEF IN THE ONE AND ONLY GOD**
- 2. JUST AND CIVILISED HUMANITY**
- 3. THE UNITY OF INDONESIA**
- 4. DEMOCRACY GUIDED BY THE INNER WISDOM IN THE UNANIMITY ARISING OUT OF DELIBERATIONS AMONGST REPRESENTATIVES**
- 5. SOCIAL JUSTICE FOR THE WHOLE OF THE PEOPLE OF INDONESIA**

*The First Principle: Belief in the One and Only God.*

This principle means that the state of the Republic of Indonesia is based on the belief in the One Supreme God. Every citizen is obliged to recognise that the Belief in the One Supreme God is the foundation of the state. This notion brings with it the consequence that the Republic of Indonesia guarantees freedom to every citizen to adhere to his respective religion and to perform his religious duties in conformity with that religion and that faith (Article 29 clause 2 of the 1945 Constitution). The state of the Republic of Indonesia appreciates and respects every religion without discrimination against them or differentiation and gives equal rights, facilities, assurances, protection and opportunities to every religion and every follower of a religion as well.

*The Second Principle: A Just and Civilised Humanity.*

This principle means and recognises equal respect to every person, of whatever descent, conviction, creed, sex, assets and political beliefs. As individuals, people do not differ one from other. No one is created with superior worth compared to others. All people are created equally. These similarities among people are not confined to only one environment, for instance to one group in society only, or to one country only. This equality in degree covers the whole of mankind without exceptions whether it belongs to one or the other nationality of an independent state, or a colonised nation, or belongs either to an affluent, or a backward state. On the basis of this outlook, hence, there exists the recognition that all people feel themselves to be brothers and sisters and live together within the realm of mankind.

*The Third Principle: The Unity of Indonesia.*

This principle shows the reality that nationhood itself indicates a unity and as such the Indonesian nation should constitute one nation which is indivisible. The Unitary state covers the whole of the Indonesian nation and state and it places unity, integrity, the interest and security of the nation and state above personal and group interests.

*The Fourth Principle: Democracy Guided by the Inner Wisdom in Unanimity Arising Out of Deliberations amongst Representatives.*

This principle contains several notions which in fact constitutes the basis of *Indonesian Democracy*. Indonesia does practice democracy--not Western democracy, but *Pancasila democracy*. Based on the 1945 Constitution, *Pancasila democracy* calls for decisions to be made by the people's representatives through a process of deliberation, or *mushawarah*, with the aim of reaching consensus, or *mufakat*. In line with the other principles of *Pancasila*, a person's democratic right must always be exercised with responsibility to Almighty God, respect for the dignity of others, a view to reinforcing national unity, and in pursuit of social justice.

*The Fifth Principle: Social Justice for the whole of the People of Indonesia.*

This principle contains a demand to form a society in such a way so that all layers of society are able to give their contribution and guarantees therefore the enjoyment of the gains of their contribution. The exploitation of man by man shall be abolished, to build an order of society in which there does not exist a strong group exploiting a weaker group. All groups are treated equally and justly so that they can work and life orderly, peacefully and normally.

These 'five principles', which are contained in the Preamble of the 1945 Constitution, paragraph four, then have been elaborated into passages in the body

of the constitution. As the passages cover the basic-main concepts and principles of political, economic, legal, social and cultural systems, the 1945 Constitution then became the primary source of reference in developing the political, economic, legal, social and cultural systems in Indonesia.

### 8.2.3. Political concept.

Indonesia does apply a democratic system in its political life. However, the democratic system in Indonesia, as stated in the fourth principle of *Pancasila*, and its deliberation in the passages of the 1945 Constitution, differs in some respects from the Western-Liberal style democracy. The *Pancasila* democracy, as it is usually referred to, is a democracy based on the “belief in One Supreme God”, the “just and civilised humanity”, the “unity of Indonesia”, and which is exercised according to “*mushawarah*” (deliberation) in order to achieve a “*mufakat*” (consensus), with the aim at achieving “social justice for the whole people of Indonesia”.

The mechanism of the institutions of *Pancasila* Democracy has clearly been stipulated in the 1945 Constitution of the Republic of Indonesia which can be summarised as follows:



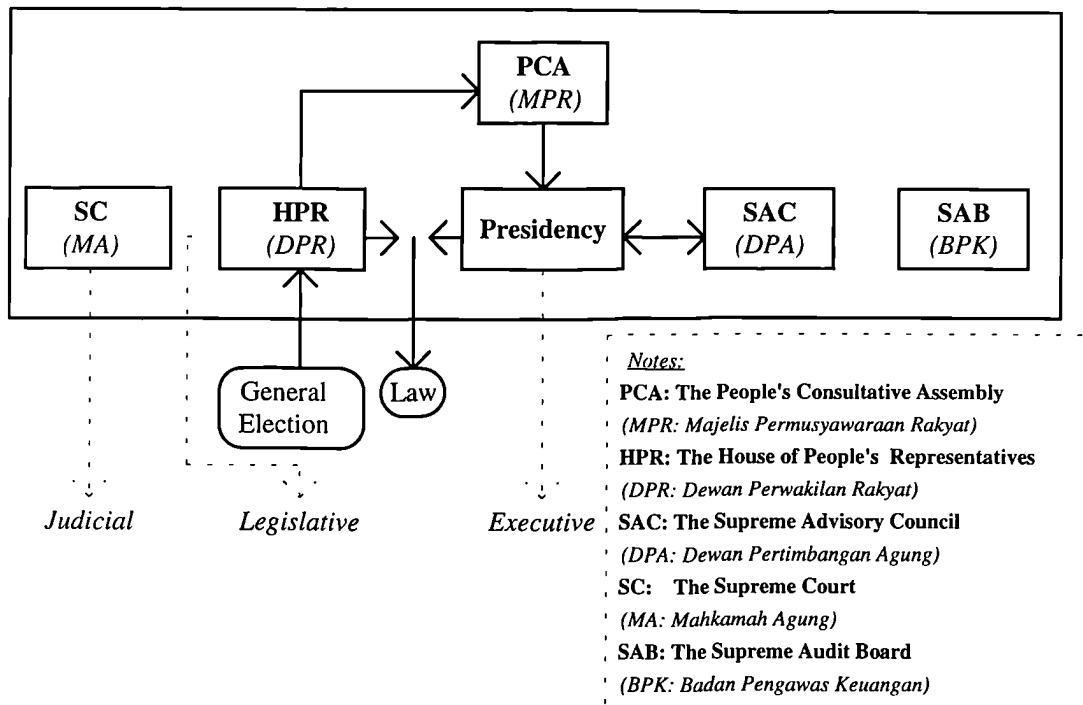


Figure 8.1. Indonesian Political Organ & Structure

(1) The People's Consultative Assembly (MPR)

Chapter I Article 1, clause (2) of the 1945 Constitution stipulated that: "Sovereignty shall be in the hand of the people, and shall be exercised in full by the People's Consultative Assembly." The elucidation of the 1945 Constitution emphasis the following: "The sovereignty of the people is held by a body named the People's Consultative Assembly being the embodiment of the whole of the Indonesian people.". It is this Assembly that determines the constitution and the guidelines of state policy. This assembly appoints the Head of State (President) and the Vice-Head of State (Vice-President). This assembly holds the highest authority of the State, whilst the President must execute the policy of the State according to the

guidelines which have been determined by the Assembly. The President, who is appointed by the Assembly, is subordinate and responsible to the Assembly. The President is the Mandatory of the Assembly, which is obliged to execute the decisions of the Assembly.

The above elucidation reflects the extensive authority and power of the People's Consultative Assembly. This is logical since the Assembly holds the sovereignty of the state. Moreover, since it is an institution which embodies the whole of the people, therefore all the decisions made by the People's Consultative Assembly shall reflect the desires and aspirations of the whole of the people as the members of the Assembly are derived from the House of People's Representatives (HPR, or DPR) who have been elected by the people through the general election. Article 2 of the 1945 Constitution stipulated on the membership of the People's Consultative Assembly as follows: "The People's Consultative Assembly shall be composed of members of the House of People's Representatives (*DPR*), augmented by delegates from the regions and sectors, according to regulation established by law." With such a composition it is expected that the People's Consultative Assembly will really reflect all groups and layers of society.

Furthermore, in Article 2 clause (2) of the 1945 Constitution, it is stipulated that the People's Consultative Assembly shall sit at least once in five years

in the State capital. All decisions of the People's Consultative Assembly shall be determined by a *majority vote* (Article 2, clause (3)). However, in practice, voting should be a last resort if consensus (*mufakat*) cannot be achieved.

In short, the duties or political power of the People's Consultative Assembly are:

- (a) to exercise fully the people's sovereignty (Article 1, clause (2));
- (b) to establish the Constitution (Article 3)
- (c) to establish the broad outlines of State *policy* (*GBHN: Garis-garis Besar Haluan Negara*) (Article 3);
- (d) to elect the President and Vice-President (Article 6, clause (2));
- (e) to alter the Constitution (Article 37);
- (f) to witness the President's or Vice-President's pledge or oath taken according to religious beliefs (Article 9);

## (2) The House of People's Representatives (DPR)

According to stipulations in the 1945 Constitution, the House of People's Representatives has the following tasks:

- (a) together with the Government [Presidency] to make laws (Article 5, clause (1) *jo* Article 20, clause (1));
- (b) to fix the Government budget (Article 23, clause (1));
- (c) to give its agreement to the President on his declaration of war, in making peace and concluding treaties with other countries (Article 11).

The authority possessed by the House of People's Representatives (DPR) is basically used in the frame of executing control over the implementation of the Government.

The composition of the members of the House of People's Representatives is to be fixed by statutes according to Article 19, clause (1). These members of the House of People's Representatives according to Article 2, clause (1) are automatically also members of the People's Consultative Assembly. In implementing its task, the House of People's Representatives sits at least once in a year (Article 19, clause (2)).

In the making of laws, according to Article 5. clause (1) and Article 20, clause (1) of the 1945 Constitution, it is stipulated that every law should obtain the approval of the House of People's Representatives. This does not necessarily mean that the House of People's Representatives should always give its approval, as Article 20, clause (2) allows the House of People's Representatives not to approve a bill submitted by the Government. If such a case happens, the mentioned bill of the Government shall not again be submitted to the same session of the House of People's Representatives.

Article 21. clause (1) stipulates the right of the House of People's Representatives to submit their own bill which is normally called the "right of initiative". Article 21, clause (2) further stipulates that should the bill of

the right of initiative of the House of People's Representatives not be ratified by the President, the bill concerned may not be submitted again during the same session of the House of People's Representatives.

*(3) The Presidency*

Article 4 clause (1) states that "The President of the Republic of Indonesia shall be invested with the executive power in accordance with the Constitution." Furthermore, the elucidation to the 1945 Constitution, clearly stipulates that "under the People's Consultative Assembly, the President is the Highest Executive of the Government of the State. In conducting the administration of the state, authority and responsibility are in the hands of the President (Concentration of power and responsibility upon the President)." Moreover, in carrying out his obligations the President shall be assisted by one Vice-President (Article 4, clause (2)).

The President and the Vice-President shall hold office for a period of five years, and may subsequently be re-elected (Article 7). The President and the Vice-President shall be elected by the People's Consultative Assembly by a majority vote (Article 6, clause (2)); and they shall be sworn in by religious oath or solemn pledge before the People's Consultative Assembly or the House of People's Representatives (Article 9). Should the President die, cease or be unable to carry out his obligations during his term of office,

he shall be replaced by the Vice-President until the expiry of his term (Article 8).

In addition, in conducting his duties, the President shall also be assisted by Ministers of State (Article 17, clause (1)). These Ministers (Cabinet) shall be appointed and discharged by the President (Article 17, clause (2)); therefore, they are responsible to the President (Presidential Cabinet system), not to the Parliament (Parliamentary Cabinet system). The Ministers, furthermore, shall head governmental departments (Article 17, clause (3)).

As the Head of State and executive leader, the President shall:

- (a) be invested with the power to draw up legislation in concurrence with the House of People's Representatives and establish Government regulation to implement the legislation expediently (Article 5);
- (b) hold the highest authority over the Army, the Navy, and the Air Force (Article 10);
- (c) with the approval of the House of People's Representatives, declare war, make peace and treaties with other countries (Article 11);
- (d) declare a state of emergency. The prerequisites to and the results of a states of emergency shall be established by legislation (Article 12);
- (e) appoint Envoys and Consuls, and receive Envoys from other countries (Article 13);
- (f) grant pardon, amnesty, abolition, and rehabilitation (Article 14);
- (g) bestow titles, awards of merit and other tokens of honour (Article 15).

However, the authority held by the President as the Head of State and Executive leader is not absolute, as there is a control mechanism exercised

by the House of People's Representatives. The position and role of the House of People's Representatives are very important here. The House of People's Representatives cannot be dissolved by the President (as within the Parliamentary democratic system); it has the power to give its agreement/disagreement to the President in the prescription of laws and setting of the Government budget, and it is also a body exercising control over the Government--in this case, the President--which is effective in power. The control mechanism by the House of People's Representatives constitutes a preventive means to prevent the eroding of the constitutional system into absolutism.

*(4) The Supreme Advisory Council (DPA)*

The Supreme Advisory Council constitutes the highest state institutions (organs). The Supreme Advisory Council is an advisory body of the government obliged to provide answers to questions posed by the President. It also has the right to submit propositions and is obliged to provide considered views to the Government (Article 16).

*(5) The Supreme Audit Board (BPK)*

The Supreme Audit Board constitutes a higher state institution with a special task to audit state finance accounts as to whether state finances have been spent in accordance with what has been endorsed by the House

of People's Representatives. This body is independent of Government influence, but its position is not above the Government.

The Supreme Audit Board audits all spending out of the Government budget. The findings of the auditing by this body are to be submitted to the House of People's Representatives to be used for evaluation or control and for discussion of the following Government's budget (Article 23, clause (5)).

*(6) The Supreme Court (MA)*

The Supreme Court holds the judicial power independent from the influence of the Government, while the composition and the authority of judicial bodies shall be prescribed by statutes (Article 24). One of the guarantees with regard to the independence of this judicial power other things lies in the juridical assurance with regard to the position of judges to be prescribed by statutes.

### 8.2.3. Economic Concept

The concept of economy is stipulated under the title of 'Social Welfare' (Chapter XIV of the 1945 Constitution). Article 33 of the Chapter says:

- (1) The economy shall be organised as a co-operative effort, founded upon the basis of family spirit.
- (2) Branches of production essential to the State and governing the life and living of the public shall be controlled by the State.
- (3) Land and water and natural riches contained there in shall be controlled by the State and used for the greatest possible prosperity of the people.



According to the elucidation, Article 33 above laid down the basis of economic democracy (that is the Indonesian economic system called), production by all for all, under the leadership or control of the members of the community. It is prosperity of the community which is stressed, not prosperity of the individual. For that reason, the economy is organised as a common effort, based upon ways of working that accord with the family principle. Therefore, it is believed that the *co-operative* is the form of enterprise mostly in harmony with this principle.

Because the economy is based upon economic democracy, prosperity is for everybody. Therefore, branches of production which are important for the state and which affect the life of most people should be under the control of the State. If they are not, the top management of production will fall into the hands of individuals who are in power and numbers of people will be oppressed by them. Only those enterprises which do not affect the life of most people may be in the hands of individuals.

Furthermore, the earth and waters and the natural riches contained therein are the fundamentals of the people's prosperity. Therefore, they should be controlled by the State and be made use of for the greatest possible prosperity of the people. However, there is no clear explanation how the state should exercise its right to control such resources. In the past, the government made all or most of the extractive companies 'state own companies'; and then used them as the main financial resources for the government. Recently, however, the government has

allowed some portion of ownership to be made public, i.e. to be owned by individuals, which has led to the rise of some conglomerations.

It seems that the economic democracy principles laid down in Article 33 need to be explained and discussed further by experts, as there are some differences in interpretation and implementation between the previous government (Old Order, led by president Soekarno) and the current government (New Order, led by president Soeharto). There have been many practices which have been claimed to contradict the spirit of the above principles.

The 1978 GBHN (State Guidelines), as one of the Decision of the People's Consultative Assembly for the period of 1978-1983, identifies eight 'good' characteristics of the Indonesian Economic System which should be established by the elected government. They are as follows:

- (1) The economy shall be organised as a co-operative effort, founded upon the basis of family spirit [Article 33, Clause (1) of the Constitution];
- (2) Branches of production essential to the State and governing the life and living of the public shall be controlled by the State [Article 33, Clause (2) of the Constitution];
- (3) Land and water and natural riches contained there in shall be controlled by the State and used for the greatest possible prosperity of the people [Article 33, Clause (3) of the Constitution];
- (4) The state's financial and rich resources shall be used according to the deliberation among the people's representatives assemblies, and the control towards its policies shall also be in the hands of the people's representatives assemblies;
- (5) Every citizen shall have the freedom to choose jobs, and have the right to work and to a living, befitting for human beings [Article 27, Clause (2) of the Constitution];
- (6) Personal ownership right is recognised, though the use of personal property must not conflict with public interests;
- (7) The potential, initiative and creativity of every citizen shall be developed fully within the limits which do not harm public interests;

- (8) The poor and destitute shall be cared for by the State [Article 34 of the Constitution].

In addition, the 1978 GBHN also mentioned three 'bad' characteristics which should be avoided or rejected; those are:

- (1) *Free-fight liberalism* system, which causes exploitation of other people and nations, and which in the history of Indonesia has caused and maintained the structural weaknesses of the Indonesian position in the world economy;
- (2) *Etatism* system in which the state and its economic organs are dominant, which oppresses and destroys the potential and creativity of economics unit outside the state's sectors;
- (3) Centralisation of economic power on a certain group in the form of monopoly, which harms the society.

From the above description, it can be said that the Indonesian economic system called the '*Pancasila* Economy' is a 'mixed economic system', which contains some 'positive characteristics' of both extreme economic systems in the world (i.e., liberal-capitalism and socialist-communism systems) but rejects their 'negative characteristics'. The problem now is how to determine the 'ideal point' which is suitable for Indonesia. In other words, the role of the state should be placed so that it may be able to control economic activities without being in the position of 'commander' as it used to be during the 'Guided Economy' period (1959-1965).

In mid-May of 1981 a forum on *Pancasila* economics sparked off a heated discussion, one of the highlights of which involved the five features of the type of *Pancasila* economic system. These five features of *Pancasila* economics in terms of their relation to the five principles of *Pancasila* are fully integrated and cannot

be seen as separate from one another (Mubyarto, 1985, p. 10). These features, and their explanations, are as follows (Mubyarto, 1985, pp. 6-10):

*(1) Incentives for economic activity are provided by economic, social and moral considerations:*

This point came under considerable review, particularly as it touched directly upon the idea of Indonesian 'humanism'. A variety of opinions were expressed as to whether Indonesians have a high degree of social and moral responsibility or whether they are as avaricious as the 'economic animal' characteristic of liberal economics. The first principle of *Pancasila* is definitely the moral basis for Indonesian "humanity's" economic behaviour. Although very difficult to prove empirically, it has often been said that Indonesians, including businessmen and the wealthy, do in fact demonstrate quite a lot of willingness to exercise self-restraint, show tolerance and practise the spirit of family co-operation (Nono A.Makarim and Siswono J. Husodo, 1981).

*(2) A strong desire on the part of the whole of society for egalitarianism, in accordance with humanitarian principles:*

The second principle of *Pancasila* will be brought to realisation when the spirit of family co-operation, compassion and mutual respect for others is found equally among all sections of the population, for when these qualities are transformed into social solidarity, this will lead to egalitarianism. On

the basis of hindsight, it can be said that the bonds of social solidarity become stronger during times of economic adversity and weaker when there is prosperity. However, there are many exceptions to the rule, since there is also a very strong tendency for people to develop a greater sense of social responsibility and to become involved in humanitarian activities when they have attained a certain measure of success in their job. In general, the virtue of charity increases as people become better-off, and this is especially true of those who really live by what their religion teaches, and do not merely “go through the motions”. Islam has an alms collection institution approaching the “taxation of self” mentioned in the Qur’an (59:7) in order that wealth does not circulate exclusively among the rich.

(3) *The creation of a sound national economy as a priority of economic policy, viz., economic policy inspired by nationalism:*

The spirit of political and economic nationalism is very strong among Indonesians. This is evident from the number of “wars” with the Dutch in various regions and kingdoms through the colonial period and also from the struggle to uphold the 1945 Constitution. Outcries against foreign domination of the economic sector have always been heard, as for example during the Old Order period with the expression: “go to hell with your aid”. Actually Western economics has also been very strong on teaching and

implanting a spirit of nationalism even to the point where, as Joan Robinson admits, this has been to the detriment of other nations:

“The very nature of economics is rooted in nationalism .... The classical economists were in favour of Free Trade because it was good for Great Britain, not because it was good for the world” (Robinson, 1962, in Mubyarto, 1981).

The Indonesian policy-makers and business class still seem to be guided by the spirit of economic nationalism and, when this spirit gives the impression of being dimmed, it is probably due more to constraints imposed by increasingly stiffer international competition than to anything else.

*(4) Co-operatives as the mainstay of the economy and as the most concrete form of collective enterprise;*

A great many people truly believe that the future of *Pancasila* economics will owe much of its distinctive character to progressive, developed co-operatives, active in all sectors of economic life. A large proportion of these people consider Hatta's formulation in the explanation to article 33 of the Constitution an analysis of remarkable and far-reaching vision. In the *Pancasila* economic system, co-operatives are really supposed to become the pillars of the national economy. However, no matter how firm the government may be in its political commitment, the obstacles to co-operatives are quite formidable and there will always be failures. The struggle will not be easy one, but experience shows that where co-

operatives have succeeded, it has been due to the unyielding efforts of their members.

(5) A clearly defined balance between planning at the national level and decentralisation in the execution of economic activity, in the interests of ensuring economic and social justice:

Beginning in 1969 (New Order), Indonesian development has been implemented through a series of five-year programmes (*Repelita*) controlled by the central government. It is with this *Repelita* planning that the government has been able to systematically extract and manage natural resources. However, due to the expanse of the Archipelago and great variety of resource situations, a rigid system of central planning could become ineffective, and even more to the point, resource management could become inefficient. On the other hand, central planning which over emphasises efficiency usually has difficulty in achieving the goal of equity, which is based more on regional potential. Indonesia has much valuable political experience showing the necessity of designing a more decentralised type of development policy. And with decentralisation there is a greater guarantee of achieving equity objectives. Thus, in the *Pancasila* economic system, the bottom line of development policy is to strike a balance between centralism and decentralism. The former ensures that there will be efficiency, while the latter guarantees the effectiveness of development and active participation of the whole regional community.

As mentioned in the Preamble of the Constitution, the Republic of Indonesia, besides being pledged to protect all of its citizens, and to promote their material welfare, and spiritual and intellectual development, should also make possible the achievement of the nation's final goal: social justice for all people. Social justice is not an independent variable: it is closely linked with legal, political and economic justice. Social justice concerns the problem of dividing up God's sustenance, i.e., the distribution of income throughout society.

To sum up briefly, then, suffice it to say that the *Pancasila* economic system includes ethical elements in production and consumption, and in turn contains a wealth of teachings on social justice in the distribution of national income. An ethical and socially just economic system has many normative elements regulating human behaviour which in the real world are not easily related to clear social sanctions. Consequently, the *Pancasila* economic system will only really and truly work when every member of society has made the principles of *Pancasila* the model for his daily life.

#### 8.2.4. Social and Cultural Concepts.

The citizens of Indonesia are all indigenous Indonesians and persons of other nationalities who have been granted citizenship according to the legislation (Article 26). There are more than 300 ethnic groups in Indonesia; as such, Indonesia may be called a "multi-ethnic" nation. However, there are no precise



data on the ethnic composition of the Indonesian population; the heavy preponderance of Java's population in the total implies a considerable degree of overall ethnic homogeneity. Apart from small remnants of aboriginal peoples, the indigenous populations of most of Indonesia's major islands (Sumatra, Java, Bali, Kalimantan, Sulawesi and West Nusa Tenggara, which together contain about 96 percent of the total population) are largely of Malay stock. The remainder of the indigenous population is largely of Melanesian origin.

Although insignificant as a proportion of the country's total population, this ethnic group predominates in Irian Jaya and some of the smaller islands of Eastern Indonesia, including Timor. These ethnic differences, reinforced by local resentment at government measures to alter ethnic balance in these regions through the transmigration programme, have contributed significantly to the political tensions currently gripping parts of these regions. In addition to the indigenous populations, there are sizeable concentrations of ethnic Chinese in the urban areas of most major islands, most of whom hold Indonesian citizenship and have come under increased pressure to assimilate with the indigenous communities of Indians, Arabs and Europeans holding Indonesian citizenship are also found in some islands (EIU, 1988-89, p.10).

Although there are a lot of ethnic groups, and some predominate in numerical terms, while some others are insignificant in numbers, compared to the entire population of Indonesia, they have equal rights and responsibility under the

Constitution. Among the rights and responsibilities of citizens guaranteed by the Constitution are:

- (1) equal status in law and in government and are obliged to respect the law and the government without exception (Article 27, clause (1));
- (2) entitlement to work and to a reasonable standard of living (Article 27, clause (2));
- (3) freedom of association and assemblage, to express oral and written opinions, et cetera (Article 28);
- (4) freedom of religion and to make observance in accordance with such religion and belief (Article 29, clause (2));
- (5) entitlement and obligation to participate in efforts to defend the State (Article 30, clause (1));
- (6) entitlement to receive education (Article 31, clause (1));

On the other hand, the Government is obliged to guarantee that the above basic rights can be exercised by each citizen without violating the rights of other citizens or the society. Therefore, it is the duty of the Government to make adequate regulations so that no personal rights are neglected, exercise of personal rights brings no harm toward the society as a whole.

Regarding “Social Welfare”, as also discussed in the section of on the “economic system”, the government is obliged to ensure that the basic needs of all people are fulfilled. Each citizen has equal right to employment, according to their capabilities. The government shall guarantee that there is no ‘privilege right’ for certain people over others, and no ‘monopoly, monopsony, oligopoly, and oligopsony’ in economy. “Branches of production essential to the State and governing the life and living of the public shall be controlled by the State” and “Land and water and natural riches contained therein shall be controlled by the

State and used for the greatest possible prosperity of the people” (Article 33, clause (2) and (3)). Moreover, the government is obliged to take care of the poverty-stricken and neglected children (Article 34).

In cultural terms, the Government are obliged by the Constitution to promote the ‘national culture of Indonesia’ (Article 32). Being a ‘multi-ethnic’ nation, Indonesia is also a ‘multi-cultural’ nation. Therefore, it is difficult to claim a certain culture of a certain ethnic group as being the ‘Indonesian culture’. Indeed, some dominating ethnic groups may also dominate in the cultural aspect, i.e., Java, Sunda, Malay, Bali, etc.; however, they are only parts forming the ‘national culture’. The motto “*Bhineka Tunggal Ika*”, meaning “Unity in diversity”, is the right phrase to express the Indonesian culture, like “the beauty of the rainbow”.

The articles from the Constitution which relates to the national culture are the “Flag” and the “National Language” which reflect the “symbols” of the Indonesian nation, as one of the cultural characteristic mentioned by Hofstede (1987). As the Constitution mentions, “The flag of Indonesia shall be the Red-and-White” (Article 35), and “The National Language shall be the *Bahasa Indonesia* (Article 36).

As has been mentioned before, the broad ethnic homogeneity causes a considerable degree of linguistic, religious, cultural and social diversity. There are about 250 separate regional (local) languages and dialects spoken throughout

Indonesia, with four major languages being spoken in the inner Indonesian islands complex of Java/Madura and Bali alone. To overcome the absence of a shared language and to promote national integration, the early nationalist leaders chose a variant of Malay, a common *lingua franca*, in the coastal trading towns of the archipelago, as a basis for a national language. This language, *Bahasa Indonesia*, was made the official language of the government after independence. It is the sole medium of instruction in Indonesian schools and is now understood by the vast majority of the Indonesian population. It is interesting to note that while Java is the majority ethnic group, its language has not been chosen to be the National language.

The characteristics of the Indonesian culture. However, referring to the *Pancasila* as the state philosophy, it is believed that Indonesian National Culture as an Eastern Culture should focus on *spiritualism, human feelings, mutual aid* and *solidarity* (Yani, 1991; quoted the opinion of Pane, 1935 and Purbatjaraka, 1935). These are contrasted with Western culture centred on: *materialism, individualism* and *intellectualism*. This proposition suggests conflict between Indonesian and Western cultures. However, many positive aspects of Western culture were adopted by most of the Indonesian leaders long before independence, and are accepted by most Indonesians in the present day (Yunus, 1992).

Some studies have been performed regarding the reality of the Indonesian cultures, especially in its relation to business activities. Draine and Hall (1986) in

their book, *Culture Shock! - Indonesia*, for example, mentioned seven areas of business life which are often misunderstood by foreigners; they are:

(1) function of Bapak-boss:

The *Bapak* or the boss, the most significant figure in the hierarchy, is the person who at any moment has the leader role and may expect deference and obedience. *Bapak* literally means father. In most aspects of life, including government or public service and private organisation, Indonesians view their boss or leader as a *Bapak*. This implies not only a paternalistic relationship between a superior and subordinate, but also holds up the model of good family relationships. No Indonesian can harbour hard feelings against her or his father (Draine and Hall, 1986, p.194).

(2) filter factor or go-between:

The filter factor is a common tool or channel in making contact in business, especially with those of rank or position in the organisation. The practice of using a mentor, adviser, guide, intermediary or facilitator to filter thought and signals is commonly adopted and widely regarded as an essential aspect of doing business in Indonesia (Draine and Hall, 1986, p.195).

(3) need for oblique straight-talk:

The need for oblique speech applies especially for the transmission of bad contrary news, which has to be done in private, or by a trusted, confidential adviser. Quoting Soemardjan (1975), Draine and Hall (1986)

point out the importance of recognising the sensitivity of the Indonesian and not causing him or her embarrassment in the presence of others.

*(4) elastic view of time:*

The attitude of Indonesians toward time is said to be elastic, due to long tradition of being tolerant of delay. Attitudes toward deadlines are extremely lax, and most Indonesians hesitate to make a commitment (Draine and Hall, 1986, p.196).

*(5) need for consensus in decisions making:*

The need for consensus in decision making arises from the desire for harmony whether in business, in the interpersonal relationships between domestic staff and the householder, or between friends. In a business negotiation, prior lobbying is very important; in many cases, agreement is reached before the formal meeting, which is an elegant affirmation of this harmonious consensus (Draine and Hall, 1986, p.197).

*(6) protective labour laws and cultural view of dismissal:*

Indonesia's protective labour laws basically follow international standards, especially legislation on female and child labour in accordance with the requirements of the International Labour Organisation (ILO). However, due to weaknesses in the application of laws and restrictions regarding termination of employment, companies have adopted several informal methods of encouraging termination. One of the most common is to allow

the employee to keep his title and salary but to diminish his responsibilities (Draine and Hall, 1986, p.199).

(7) importance of the acknowledgement of nationalism

The need to acknowledge nationalism derives from Indonesia's status as a young nation, which has recently achieved independence after an intense struggle and the depth of nationalistic feeling after more than 350 years of colonial exploitation. At the present time Indonesia is seeking the correct balance between these nationalistic aspirations and economic development (Draine and Hall, 1986, p.199).

Yunus (1992) relates these cultural elements to Hofstede's concepts of cultural values as follows:

- 1) The relationship in hierarchy between a superior and subordinate, identified in the concept of *Bapak*, reflects the existence of a *large power distance* in the Indonesian national culture value;
- 2) The filter factor represents *conservatism* in doing business. This conservatism, in some cases, might be inherent with *secrecy* and distrust behaviour to others. To some extent the filter factor can also be used as a tool to maintain the indirect relationship between a superior and subordinate, and to that extent, has been used as a tool to reflect a *large power distance*;
- 3) The custom of indirect talk, especially for bad or contrary news, relating to shame in the presence of others, reflects *femininity* and might suggest that Indonesian national values tend to honour *femininity* above *masculinity*. In business practice, this attitude can be construed as a conservative action or policy;
- 4) The elastic view of time, with its consequences of relaxed attitude toward deadlines, and reluctance to make a commitment, is related to *strong uncertainty avoidance*;

- 5) The need for harmony and hence consensus in decision making suggests a cultural value of *collectivism* as opposed to *individualism*;
- 6) Protective labour laws and the acknowledgement of nationalism are logical and natural in new nationhood; the new country needs to protect her labour as citizens of the country, and to proclaim her national identity.

In short, the Indonesian cultural values tend to be: large power distance (including conservatism and secrecy), femininity, strong uncertainty avoidance, and collectivism.

#### 8.2.6. Legal system.

Being the state foundation, philosophy and ideology, *Pancasila* inspires the legal system of Indonesia. Together with the 1945 Constitution, they constitute “the source of all sources of law”. All laws, acts, rules and regulations should refer to these two primary sources. Based on the 1945 Constitution of the Republic of Indonesia, the hierarchy of law and regulation in Indonesia can be mentioned sequentially as follows:

- (1) *Undang-undang* (UU), or Law.
- (2) *Peraturan Pemerintah Pengganti Undang-Undang* (PERPU), or Government’s Regulation in Lieu of Law.
- (3) *Peraturan Pemerintah* (PP), or Government’s Regulation.
- (4) *Keputusan Presiden* (KEPPRES), or the Decree of the President.
- (5) *Instruksi Presiden* (INPRES), or the Instruction of the President.
- (6) *Peraturan Menteri* (PERMEN), or the Minister’s Regulation.
- (7) *Keputusan Menteri* (KEPMEN), or the Decision of the Minister.
- (8) *Instruksi Menteri*, or the Instruction of the Minister.
- (9) The regulation or decision of non-departmental Government Agencies.
- (10) The regulation or decision of other Government Agencies.
- (11) The Provincial Government’s Regulation, and the Decision of the Governor.
- (12) The District Government’s Regulation, and the Decision of the Head of the District Government.



The law (UU) and the government's regulation as Provisional Law (PERPU) (No.1 and No.2 above) are classified as *formal regulation*; the PP, the KEPPRES, the INPRES, the PERMEN, the KEPMEN, the Instruction of the Minister, the regulations issued by non-departmental and other Government Agencies (No.3 to No.10), are classified as *executive regulations*; and the Provincial and the District Government Regulations including the Decision of the Governor and the Head of the District Government respectively, are classified as *local government regulations* (Syarif, 1987, pp.29-48).

The Law (UU) is a general and formal regulation on a certain aspect or area established by the government (the President) with the approval of the House of People's Representatives (DPR); and the PERPU, or the government's regulation in lieu of law, is a government's regulation issued by the President in an emergency situation and is imposed in the same capacity as the law but has to be approved by the DPR at the next consecutive assembly.

The Government's Regulation (PP) is a regulation which contains *general rules* to execute a law, statute or act (UU), or a Government's Regulation in lieu of Law (PERPU). The Decree of the President (KEPPRES) contains *specific rules and regulations* to execute the 1945 Constitution, the Decision of the People's Consultative Assembly (TAP MPR), the Law (UU), the Government's Regulation in Lieu of Law (PERPU), and the Government's Regulation.

The Decision of the Minister (KEPMEN) contains the decision of the relevant Minister in determination of the execution policy of the law(s) and regulation(s) issued by the higher institution(s) which relate to the areas or function of its Ministry or department.

The regulation or decision of a non-departmental Government Agency is a regulation issued by the non-departmental agency to execute some general policies of a high rank regulation (issued by the high ranking officer or institution) or to execute a policy decided by the President, such as the decision of the Chairman of the BKPM (*Badan Koordinasi Penanaman Modal*, Coordinative Agency for Investments) or the BAPEPAM (*Badan Pelaksana Pasar Modal*, Capital Market Executive Board). The decisions of other Government Agencies include, for example, the Decision of the Governor of the Bank of Indonesia (Central Bank), the decision of a state owned company etc.

In theory, no rule or regulation at the lower levels of the hierarchy should be produced without reference to a higher authority or other law statute or act. However, in practice, to meet the need of a specific situation, sometimes a lower regulation is issued in advance of the publication of the higher regulation.

The legal system of Indonesia is usually claimed as adopting the 'Romano-Germanic' system brought by the Dutch colonialist. In fact, however, the legal system is combination between the 'Romano-Germanic' system and the '*Hukum Adat*' (local customs), including 'Islamic law'.

### 8.2.7. Moral System

Being the state philosophy, *Pancasila* also provides a sort of ‘moral system’ for the Indonesian people, especially in conducting the societal and political life. The BP-7, a special body responsible to ‘construct, educate and implement’ the P4 (Guidance for comprehending and implementing *Pancasila* ideology) has specified “45 Points of P4”. The “45 Points of P4”, which are the ‘practical guidance’ to implement the ‘five principles’ of *Pancasila* are ‘normative moral guidance’ for Indonesian people in their daily life as a society members and citizen. This ‘moral guidance’, which can be seen in *Appendix to Chapter 8*, in principle is an explanation of how Indonesian people should implement the ‘teachings’ of *Pancasila*.

## 8.3. Accounting

### 8.3.1. Accounting Education.

Until 1961, all accountancy education followed the original Dutch concept with its orientation towards economics and business economics, and for those purposes they also used translated Dutch accounting texts. The confrontation with the Dutch brought a consequence in the early years of independence. Laws were enacted by the Indonesian government to nationalise all Dutch companies, and all the Dutch expertise fled, including accountants and professors. This circumstance was described as the process of the brain drain of the Dutch accountants and

professors, and Indonesia suffered from a lack of qualified accountants to handle hundreds of estates and manufacturing companies which had been nationalised, and a lack of professors of accounting in higher education. This was the situation in the period 1960-63, and the process ended when the Indonesian government got back full sovereignty over the territory of Irian Jaya or West New Guinea on 1st May, 1963.

The influence of the American accounting system is actually a consequence of political affairs. It began at a time of political turmoil just after the establishment of the Liberal Democratic Republic in 1950, when the Indonesian government and the people were unhappy with the Dutch influence. From 1951 onwards, Indonesia received grants and loans from the US, including grants and aid for updating and upgrading education in Indonesia. In this context, the influence of the US accounting concepts on Indonesian universities is mainly due to links with universities in the US. The University of California (Berkeley), developed a programme with the University of Indonesia at Jakarta between 1955-1963, and the University of Wisconsin one with the Gadjah Mada University at Yogyakarta between 1954-1964.

In 1962, the doctoral thesis of Suhadji Hadibroto at the University of Indonesia on '*A Comparative Study of American and Dutch Accountancy and their Impact on the Profession in Indonesia*' appeared, suggesting that the accounting profession in Indonesia should change its orientation to the American

system. Although some of Hadibroto's findings and recommendations are open to question, nonetheless his findings had tremendous impact on accounting education, professional accounting practices, and some government regulations concerning accounting, auditing and taxation.

Another factor in the influence of American accounting could be the open door policy on economic, foreign investment, and international relations, since the New Order government. Openness encouraged foreign investors, multinational corporations, and international accounting firms to bring in new technology, finance, modern management, and accounting theory and practice to Indonesia. This is in line with some previous studies that, beside colonialism (e.g.: Engleman, 1962; Heatly, 1979), the influence of western multinational companies (Seidler, 1969) and local professional associations that are usually founded originally by western counterpart organisations, and aid and loan agencies (Heatly, 1979), etc.), the western accounting systems have been transmitted to and adopted by non-western countries for various reasons.

It has also been stated by Briston (1979), that despite the structural inflexibility of the system, enormous philosophical changes took place within it, involving the almost total substitution of American for Dutch accounting principles. As a result of factors such as multinationals, international accounting firms, US aid, and the language factors, university courses came to be biased strongly towards American texts, and courses were structured with much emphasis

upon finance and management as opposed to administration and economic theory. At the same time, the Indonesian Institute of Accountants adopted a set of accounting and auditing standards virtually identical to those of the American Institute. As a consequence of this evolution, the Indonesian profession until recently was Dutch in its qualification structure, but the training (which is exclusively undertaken in universities) and philosophy were American (Briston, 1979, pp.112-113). However, from the 1990s, all accounting education at all levels and programmes has been totally changed to the American system.

#### 8.3.2. Indonesian Accounting Standards (Principles).

The Indonesian Institute of Accountants was established in 1957 by the four first accounting *Sarjana* of the University of Indonesia, Jakarta, together with one of the accountants who graduated from the Netherlands. In its development, all those who hold title of accountants may join the IAI, regardless their professions. Therefore, the membership of IAI is not limited to 'public or practising' accountants, but is open also all kinds of accountants, including: academicians, management accountants, government accountants, etc. This is probably mainly because the membership of IAI is also a condition for those who want to set up an accounting firm; while at the same time, a 'registered accountant' may hold more than one 'profession'. Therefore, in Indonesia there are academicians who are at the same time practising as 'public accountants', 'management accountants' etc.

The strong influence of American accounting impacted on the need for 'American' accounting principles (standards), so that the IAI formed a special committee to 'set' an Indonesian accounting principles/standards. However, because the committee worked part-time and voluntarily, it made a short-cut by only translating (or adopting) the American 'principles/standards'. In fact, the so-called Indonesian Accounting Principles (PAI, *Prinsip Akuntansi Indonesia*), issued in 1973 and then revised and reissued in 1984, were only a translation or adoption of Paul Grady's Accounting Research Studies No.7--*The Inventory of Generally Accepted Accounting Principles for Business Enterprises* (1965) and the APB Statement No.4--*Basic Concepts and Accounting Principles Underlying Financial Statements of Business Enterprises* (1970), respectively. At least, these PAIs had been useful for Indonesian 'practising accountants' in giving opinions regarding the companies' financial statements they had audited. It is difficult to understand why, when the APB Statement No.4 was already there (it was issued in 1970, three years before the PAI 1973 being issued), the IAI had to adopt (translate) Paul Grady's ARS No. 7 which was issued five years before the APB Statement No. 4, and also, why the adoption of the APB Statement No. 4 should have been delayed until 1984 (the PAI 1984 was only an adoption of the APB Statement No. 4).

The influence of the American accounting system seems to have decreased during the 1990s. This is due to various factors, including the increased influence of accounting academicians who graduated from overseas other than USA (e.g.,

UK and Australia), and also the inclusion of IAI as members of the International Accounting Standards Committee. Therefore, the IAI decided in 1994 to adopt the IASC Standards (IAS). The IAI then set the Indonesian 'Financial Accounting Standards' (SAK, *Standard Akuntansi Keuangan*) in 1994, which is in fact only a direct translation or adoption of the IASC Standards. Considering the national ideological and philosophical concepts, the adoption of American and IASC standards is questionable.

### 8.3.3. Some regulations related with accounting.

There are some laws which are related directly to accounting: the Limited Liability Company Act 1995 (*Undang-Undang Perseroan 1995*), Taxation Laws (*Undang-Undang Perpajakan*), Capital Market Law (*Undang-Undang Pasar Modal*), and the Accountants Law (*Undang-Undang Akuntan*) of 1954.

#### (1) Limited Liability Company Act (1995).

Before 1995, the company law in Indonesia basically referred to Commercial Code 1847 (KUHD, *Kitab Undang-undang Hukum Dagang*, originally the *Wetboek van Koophandle* 1847, of the Dutch), as amended (Article 36-56), and the Civil Code of 1847, as amended (Article 1618-1652), applied to business entities. These provisions were modelled on the Dutch system in effect in the nineteenth century. Although the *Company Law* had been based on the Dutch system, it had not kept up with subsequent changes made in the Dutch Commercial



Code. Consequently, many amendments, supplements and changes which had been made in the Netherlands, particularly with respect to the limited liability company from 1928 onwards, had never been incorporated into the that Commercial Code. Despite this, most of these Dutch provisions have had become common practice in Indonesia. Notaries public commonly inserted Dutch provisions into the memorandum of association (articles of incorporation) of a limited liability company. Thus, the rules governing the limited liability company in Indonesia were all based on *formal law*. The agreements inserted into the articles of incorporation by the notary public were binding and had the same effect as law (Price Waterhouse, 1986).

On 1995, the Government enacted Law No. 1, 1995 called “*Undang-Undang Perseroan Terbatas* (Limited Liability Company Act) ”, or UUPT-1995. This Act replaced the previous Company Act (KUHD, or Commercial Code 1947, Article 36-56) which had been applied for more than 100 years.

Under the UUPT-1995, it is clearly stated that a “PT” (*Perseroan Terbatas*, or Limited Liability Company) is a “*legal form*” (Article 1.1), even though the status will be granted after being legalised by the Minister of Justice. Moreover, the Act covers legal concepts of corporation as applied in developed countries such as: piercing the corporate veil, fiduciary duties of management, derivative action (the right of shareholders to sue the management), auditing, merger, consolidation and acquisition. Furthermore, passages therein provide a

foundation for other laws and regulations such as the regulation regarding Capital Market, and also create specify the relationship with other rules, for example it is clearly mentioned that annual calculation should be prepared according to the “*Standard Akuntansi Keuangan*” (SAK, the Indonesian Financial Accounting Standard) (Article 58-59).

The legal requirement to apply SAK in preparing financial statements is for both listed and unlisted companies. The previous regulation (the ‘old’ Capital Market Law) only obliged listed companies to apply SAK. However, as the Act only regulates the companies which are PT, it implies that other non-PT companies (such as proprietorships, partnerships, co-operative, etc.) are not obliged to apply SAK.

## (2) Taxation Law.

At the end of 1983, the government of Indonesia issued new taxation laws to replace the old-Dutch based taxation laws. These new taxation laws are:

- (1) Law No.6 of 1983 re General Tax Provision and Procedures;  
(*UU No.6/1983 tentang Peraturan Umum dan Tatacara Perpajakan*).
- (2) Law No.7 of 1983 re Income Tax (Corporate and Personal Income Tax);  
(*UU No.7/1083 tentang Pajak Pendapatan*).
- (3) Law No.8 of 1983 re Value Added Tax (VAT) on goods and services and Sales tax on luxury goods;  
(*UU No.8/1983 tentang Pajak Pertambahan Nilai atas barang dan jasa dan Pajak Penjualan atas barang mewah*).

Law No.7 of 1983 (Income Tax) imposed effectively on 1st January 1984, replaces: (1) Corporate Income Tax of 1925, as it had been amended by Law No.8/1970; (2) Income Tax Law of 1944 (for individuals), as it had been amended

by Law No.9/1970; and (3) Tax on Interest, Dividends and Royalty of 1970. The principle adopted under the law is that of *additional economic capability*, whereas the principle adopted under the old laws was *the source theory*. Additional economic capability is defined as anything received or accrued that increases the purchasing power and wealth of the recipient. A further principle of the new law is that of *self assessment*.

Law No.8 of 1983 (Value Added Tax on goods and services, and Sales Tax on luxury goods) replaces the Sales Tax of 1951. The Value Added Tax was effectively imposed on 1st April 1985; however, some provisions of the 1951 Sales Tax on luxury goods remain in effect. The new VAT aims to treat imports and domestically produced items similarly. The VAT on goods and services is imposed on importers, manufacturers, and activities by main distributors and those electing to be VAT entrepreneurs, as well as on providers of specified services. VAT operates on an input-output basis (Price Waterhouse, 1986).

There was an Audit and Investigation Section within each Inspectorate or District Tax Office. Since 1987, this section has been changed into an independent office which is named the *Tax Audit Office*. Tax Audit Offices are located in several districts to conduct tax audit of some District Tax Offices. These offices are responsible for auditing the tax-payer's books and accounts and preparing reports of its audit result and submitting it to the relevant District Tax Office. The District Tax Office will not issue clearances unless adjustments in the form of Tax

Assessments or Tax Collection Notices are made resulting from a tax audit within a period of five years from the date the payment was due (Mann, 1990, p.194).

The role of accounting is very important in providing financial statement which is timely, complete and reliable. Even though there are some treatments which differ between accounting and taxation, financial statements prepared in accordance with the SAK will be useful. The accounting profession will be able to directly perform the duties of taxation officers, such as co-operation between the Directorate General of Tax and the IAI (the Indonesian Institute of Accountants) in verifying the PPN (Value Added Tax) and PPnBM (Sales Tax on Luxury Goods). However, if the accounting profession (IAI) decides to adopt an 'alien' standard, such as the IAS, it should consider the factors of differences in national and culture background, economic conditions, and political aspect (sovereignty of the state).

### (3) Capital Market Legislation

The frame of law for the Indonesian capital market has been improved by the enactment of *Undang-Undang No. 8/1995 Tentang Pasar Modal* (Law No. 8/1995 re The Capital Market), which strengthens the authority of the BAPEPAM (the Capital Market Executive Board) in upholding and implementing law in capital market. The Law has been combined with two Government's Regulations (PP, *Peraturan Pemerintah*)--those are, PP No. 45/1995 *tentang Penyelenggaraan Kegiatan di Bidang Pasar Modal* (re Performing Activities in Capital Market

Sector) and PP No. 46/1995 *tentang Pemeriksaan di Bidang Pasar Modal* (re Auditing in Capital Market Sector), and three Decisions of the Minister (KEPMEN, *Keputusan Menteri*) of Finance of the Republic of Indonesia, and 93 Decision Letter of the BAPEPAM Chairman which are expressed in 100 BAPEPAM Regulations.

The objective of the *new* Law No. 8/1995 re the Capital Market and its operational regulations is to create a strong law framework in the capital market sector which can cover the recent developments in the capital market, such as the law foundation for book-entry settlement, scriptless trading, custodian activities by the securities trader intermediaries, prohibition against any party committing untruth, market manipulation and internal trading, and the authority of the BAPEPAM as the only board with authoritative right in the capital market sector, including the authority to perform audit and investigation and to impose administrative sanction and criminal regulation. It also aims at improving transparency and guaranteeing security for investors, improving professionalism of the capital market actors, creating a safe, efficient and liquid trading system and opening opportunities for small investors through the *Reksa Dana* (financial institution system which pools funds from small investors to be invested in a share portfolio).

The BAPEPAM is a unit within the Department of Finance, which is responsible to develop, manage and control the daily activities in the capital

market. In performing its duties, the BAPEPAM has authority to give permission, agreement and registration to the capital market actors, to process the registration for general invitation, to issue operational regulations derived from the capital market sector regulations, and to uphold the law in relation to every violation from the regulations in the capital market sector.

The permission given by the BAPEPAM includes the operational permission for Securities Companies to operate as Securities Trading Intermediaries, Securities Issuance Guarantors, and Investment Managements. The operational permission for the Securities Companies covers the permission to act as custodians. According to the Law No. 8/1995, the BAPEPAM also gives operational permission for LKP and LPP (Capital Market Supporting Agency) because their activities are a continuation of the activities of the Securities Market, in order to execute Market Transactions. Considering that their activities involve public funds invested in securities, the LKP and LPP must fulfil certain technical requirements so that the execution of the Market Transaction may be performed smoothly, fairly and efficiently. Moreover, the BAPEPAM also have governance of the Capital Market Supporting Professions (i.e., Accountants, Lawyers, Solicitors and Surveillance), Securities Companies' Deputy, Investment Consultants, Securities Ratings, Securities Administration Bureau, Reksa Dana, and *Wali Amanat* (Custodianship).

Historically, the development of the capital market in kept pace with the development of accounting profession. The preparation of the first Indonesian Accounting Principles (PAI 1973), could not be separated from the government's plan at that time to re-activate the activities in Indonesian capital market. In its further development, the capital market development activities and the development of the accounting profession in Indonesia cannot be separated from each other.

Further aspects of the governance of the profession can be seen within the Law No. 8/1995. Different from other Capital Market Supporting Professions, the accounting profession has greater prominence in the Law, as stated in Articles 64, 68 and 69 of the Law. This shows that the accounting profession has a special role in the development of the capital market as a whole. The accountants are responsible for the openness of the information of their issuing company clients. Moreover, professionalism in accounting profession is increasingly demanded due to the increase in the number of listed companies, and those who are involved in the capital market. The independence of accountants is demanded by the Law (No. 8/1995) and by the society as the users of financial statements. The accounting profession must be able to follow the accounting developments due to the advances in financial engineering and securities derivatives. The globalisation era has also caused an increase in competition and in accountants' responsibilities.

#### (4) Investment Law and Regulation

The investment laws were formed in 1967 and 1968, for foreign investment (PMA, *Penanaman Modal Asing*) and domestic investment (PMDN, *Penanaman Modal Dalam Negeri*) respectively. The Foreign Investment Law (UU-PMA) 1967 was amended in 1970, and again in 1974. The Domestic Investment Law (UU-PMDN) 1968 was amended in 1970. Domestic and foreign investments are regarded by the government as essential contributors to Indonesia's development. Investment applications must be approved by the Investment Co-ordinating Board (BKPM, *Badan Koordinasi Penanaman Modal*), which is a one-step agency designed to cut bureaucratic procedures. BKPM issues *investment priority lists* which are frequently changed to reflect changing economic conditions.

The adoption of these laws, which specified the submission of financial reports to the Investment Co-ordinating Board (BKPM), also had a positive effect upon accounting developments in Indonesia. Since certain foreign companies keep their accounts in the foreign language, auditing is sometimes difficult (Enthoven, 1975, p.34).

#### (5) Accountant Law

The title of "accountant" in Indonesia is given by law, i.e., the *Accountants Law* (UU No. 34/1954 *Tentang Pemberian Gelar Akuntan*). According to the Law, an "accountant" is one who has completed a university *sarjana* (equivalent to a master degree, involving a minimum of five years) course, in a faculty of



*economics* majoring in *accounting*. While the education of accountants through university is under the Ministry of Education, the title of 'accountant' is given by the Ministry of Finance. After graduating from the faculty of economics, majoring in accounting, from a state university, one should register with the Ministry of Finance to be given the title of accountant; thus such a person is also called a 'registered accountant'. At present, not all students of universities running accountancy course, under the faculty of economics, will automatically be granted the title of 'accountants'; only some State Universities hold that privilege. Private universities, and some other State Universities in which their accountancy courses have not yet been accredited, should follow the "UNA" (*Ujian Negara Akuntan*, a sort of National Examination for Accountant), which is managed by the Ministry of Education c/q the Directorate General of Higher Education (DGHE). There are two levels of UNA: *UNA Dasar* (Basic or Pre-professional UNA) and *UNA Profesi* (Professional UNA).

The IAI (*Ikatan Akuntan Indonesia*, the Indonesian Institute of Accountants) is the organisation of these 'registered accountants', regardless of their main profession. Membership of the IAI is not limited to those who are 'public or practising accountants', but includes all kinds of accountants (e.g., academicians, managers, management accountants, government accountants, etc.). There are also many 'registered accountants' performing more than one 'profession', i.e., while they are formally academicians, at the same time they also run an accounting firm, and the like. Recently, there have been some attempts

either to limit the membership of IAI to practising accountants only, and to regulate the 'profession' of accountants so that there will be no overlapping.

#### 8.4. Islamic Business Activities

In general, all business activities may be called 'Islamic', whatever their legal form, as long as the 'product' and the methods involved do not violate Islamic principles and values. The next important aspect which distinguishes the Islamic system from the non-Islamic one is the matter of financing, especially in the matter of borrowing. Islam clearly forbids '*riba*' (interest). As an alternative, Islam suggests a form of partnership, in which each party involved should share the profits and risks together. Therefore, financial institutions in Islam do not apply an 'interest-based system', but a 'profit sharing system'.

According to legislation, there are four legal form of business in Indonesia: (1) sole proprietorship (*perseorangan*), (2) partnership (*persekutuan*), (3) limited liability company (*perseroan*), and (4) co-operative (*koperasi*). Principally, a proprietorship is a company set up by a person, who contributes his/her own capital, and has unlimited responsibility toward his/her company. A partnership, on the other hand, is a company set up by more than one person; each person contributes capital, and they share the profit/loss proportionally according to their share. There are two types of partnership in Indonesia: *firma* (Fa) and CV (*Commanditair Vennotschaap*). In a *firma*, all partners are active in the running of

the business, each represents the others, and all have unlimited liability toward the business. In a CV, on the other hand, there are some active partners and some passive (sleeping) partners. The active partners may have a bigger share of the profit than the passive ones, or receive salary; but both have unlimited liabilities. In both types, if a partner leaves, or a new partner joins, the legal status of the company will automatically cease. If the rest of the partners want to continue the existing business, they have to gain a new legal status.

A limited liability company (*perseroan terbatas*, or PT), is a company in which its capital is divided into shares. Anyone who wants to contribute capital may buy the shares. The share-holders' liability is limited to the amount each has contributed to the company. Those who run the business, the managers, may be chosen from among the share holders or non-share-holders (fee-paid manager), through a voting procedure in the annual general meeting. The status of the company will not be affected by a change in share-holders; i.e., if a share-holder wants to leave, he only needs to sell his shares to another person, without affecting the legal status of the company.

A Co-operative, on the other hand, is a business entity formed by several people. Each member should contribute a certain amount of capital as a 'compulsory contribution', in addition to other 'voluntary additional contribution'. They may add and take their contributions at any time, but not the 'compulsory contribution'. A member may leave or join at any time without affecting the legal

status of the entity. Profit or loss of the business should be distributed among members, according to the amount and age of their contribution. The government provides legislation regarding the allocation of the profits: what percentage should be appropriated for additional capital, and other uses, and what percentage may be distributed among members. The manager(s) of the co-operative should be members. This type of business legal form is the only one which is explicitly referred to in the elucidation of the Constitution. Its characteristic is more social oriented rather than pure-business oriented, in that, its main purpose is to increase the prosperity of its members. This type of business legal form differs from the PT in which the capital contribution of members may not be transferred to non-members. It also differs from the partnership (firma or CV) in which the member may leave without affecting the legal status of the entity.

The elucidation to the 1945 Constitution (Article 33) mentioned that “the co-operative is the form of enterprise in harmony with this”, i.e., the economic democracy as stated in the Article 33. It is not surprising, then, that this type of business entity is most popular in Indonesia. Co-operatives are spread over the nation, from the central to the rural areas, involving all business sectors, from governmental departments to private-owned entities. For this reason, the government of the Republic of Indonesia has a special ministry to manage this type of enterprise, i.e. the Ministry of Co-operatives.

Islamic values have been crystallised into, and form parts of, the Indonesian culture. They have been blended with local values which had been there for along time, and together they form the national identity. Even though Indonesia was colonised for about 350 years, these values remain significantly unchanged. Muslims remain the majority of the Indonesian people. Christian values brought by the missionaries who came together with the colonials could not significantly change the majority faith of the Indonesian people. Therefore, it is not surprising that the *Pancasila* and 1945 Constitution contained and are strongly influenced by Islamic principles and values.

However, it is not until 1990 that the government recognised the need for an Islamic financing system, and put it into a legal form. The Islamic financing system before that time, therefore, was 'illegal' according to the Indonesian law. The increase of demand by Muslims for an Islamic financing system have forced the government to allow the practice of Islamic financing system, in addition to the existing conventional 'commercial banking system'. The *Bank Muamalah Indonesia* (or BMI, the Indonesian Muamalah Bank) is the first Islamic bank in Indonesia. It was set up on 1 November 1991, but started to operate from 24 April 1992, after being granted operational permission from the Minister of Finance. The BMI has its central office in Jakarta, the capital of Indonesia, and has some branches in other big cities. It can be said that the BMI is the only Islamic bank in Indonesia which operates at the national level. The BMI has established

mutual relationships with the Islamic Development Bank (IDB) and Islamic banks in other countries such as Malaysia, Egypt, Sudan, etc.

In the rural and urban areas, there are some other Islamic banks called *Bank Perkreditan Rakyat Syari'ah*, or BPRS (lit.: *Shari'ah* Public Credit Bank). This type of bank operates like the BMI; however, its scope is for confined to the rural, or urban level. Therefore, its clients are relatively smaller investors and creditors. These banks are also under the supervision of the BMI. At the time of the survey (1996), there were about 52 BPRSs operating in Indonesia; but it is believed that some other new BPRSs have been set up recently.

Both the BMI and BPRSs have the legal form of PT (Perseroan Terbatas, or Limited Liability companies, or Corporations).

Moreover, there are also some other Islamic financial institution like banks, which have been legalised recently. They are called *Baitul Mal wat-Tamwil*, or BMT, or in some areas they are named *Baitul Mal* only, and in some other areas (such as Aceh province) they are called *Baitul Qirod*. This type of financial institution is more widespread than the BPRSs, because the procedure to set up a BMT is simpler than for the BPRSs. The legal form of the BMTs is not clear yet; however, it is believed that the most suitable one is the 'co-operative' (Mulyono, 1995, p. 40). Another alternative, when the BMTs have been developed, is for them to become BPRSs, so that they will have the 'PT' legal form (Binhadi, 1996, p. 17).

Since the declaration of the national programme for BMT by the President Soeharto on 7 December 1995, there have been hundreds of BMTs set up nationally. At the date of the declaration, there were more than 500 BMTs. By the end of 1996, it is believed that there were more than 2,000 BMTs. Habibie, the General Leader of the ICMI (*Ikatan Cendekiawan Muslim Indonesia*, the Association of Indonesian Muslims Intellectuals), the body sponsoring the national programme for BMTs, expected that by the year 2000, God willing, there would be 10,000 BMTs (Birton, 1996, p. 8).

Of course, due to their relative youth and lack of experience, these institutions still suffer from some weaknesses and low growth. However, with political and public support, it is believed that these financial institutions (BMI, BPRS, and BMT) will survive and will be the main alternatives to the conventional, interest-based financial institutions in the future. However, it must be noted that these financial institutions are only part of the socio-economic system. They will not work optimally if the other systems surrounding them (political, economic, legal, socio-cultural) do not support their existence.

Beside the financial institutions, which are very important in daily economic activities, there are also some Islamic insurance (*Takafol*) companies. All other economic activities, even though they are not explicitly stated as 'Islamic' companies or institutions, are called Islamic if they do not violate Islamic principles and values. All businesses which are not involved with unlawful (*haram*) things

(e.g., pork products, alcoholic drinks, drugs, etc.), unlawful ways of business (e.g., gambling, hoarding, etc.) and *riba* (e.g., interest, and the like) may be called Islamic.

The main differences between an Islamic banks and other financial institutions and conventional commercial banks and other financial institutions in Indonesia are as follows.

Islamic Banks

1. Based on 'Profit Sharing';
2. Profit and '*falah*' oriented;
3. The relationship with the clients in the form of 'partnership relations';
4. Users of real funds;
5. Invest in '*halal*' investment only;
6. The use of *Shari'ah* Advisory Board.

Commercial Banks

1. Use the 'interest' and/or 'profit-sharing';
2. Profit oriented only;
3. The relationship with the clients is in the form of 'debtor-creditor relationship';
4. Creators of money supply;
5. Lawful and Un-lawful investments;
6. No such body.

The main differences between 'interest-based' and 'profit-sharing-based' returns is that, in the interest-based borrowing, returns depend on the predetermined rate of interest, amount of borrowing and the length of borrowing time. In most cases, the rate is predetermined by the lender (bank); the borrowers have almost no right to bargain. Furthermore, whatever will happen to the borrowers, whether they gain a lot of profits or suffer from losses, the lender will enjoy accepting the interests. On the other hand, the borrower must work hard to make profits so that he/she may be able to pay the interests.

The relationship in the profit-sharing system, on the other hand, is like a 'partnership' or 'mutual co-operation', as opposed to the 'debtor-creditor' (lender-



borrower) relationship in interest-based system. In a profit sharing system, both parties agree in advance about the ratio applied for sharing the profits (or losses) of a certain project. How much each of the parties will receive depends on the real profits gained from the project. Therefore, both parties will share together the profits/losses of the project; there will be no situation in which one party enjoys receiving 'interest' while the other party suffers from losses.

Due to the development of Islamic bank and financial institutions, and other economic activities, there is also increased demand for 'Islamic' management and accounting systems. In the accounting area, there is a doubt whether the accounting systems adopted from Western countries (America, UK, IASC) are acceptable according to Islamic principles and values. According to UUPT-1997, it is compulsory for all Islamic financial institutions with PT legal form (BMI, BPRSs) to apply the SAK (Indonesian Financial Accounting Standards). On the other hand, it is known that the SAK is only the adoption of the IASC Standards. Therefore, there is an increased demand for an Islamic accounting system which should be applied by BMI and BPRSs, and other non-PT Islamic financial institutions, and other companies which have partnership relationships with them. Moreover, because it is believed that the Indonesian ideology and philosophy reflects predominantly Islamic values, as the dominant values in Indonesia, it is logically fair that the accounting system in Indonesia should be more Islamic.

## 8.5. Summary

The ideology of *Pancasila* and its concepts as stated in the 1945 Constitution and the elucidation to the Constitution reflect, in their general principles, predominantly Islamic values. This is because, not only is Islam the religion of the majority of Indonesian people and has been existed there for a long time, but also the formulators of the *Pancasila* and 1945 Constitution were also, for the most part, Muslims. Therefore, there are political, economic, legal, and social-cultural concepts in the Constitution which closer to Islamic concepts than otherwise. Probably, the only concept which is at odds with Islamic concepts is that of 'sovereignty' in the political arena. According to Islamic thought, the 'absolute sovereignty' is in God. Even though in the governmental system, this sovereignty will be performed by people, as God's agents (caliph), both the rulers and the ruled should act according to God's law.

According to *Pancasila* ideology, 'sovereignty' is in the hands of all Indonesian people (Article 1, clause (2) of the 1945 Constitution). However, if Indonesian people, who are mostly Muslims, purely and continually follow the principles of *Pancasila* as laid down in the 1945 Constitution, the political life in Indonesia will by itself follow Islamic principles, because the 1945 Constitution's political, economic, legal, social and cultural principles also reflect Islamic values. Therefore, although *Pancasila* and the 1945 Constitution do not explicitly state

that the 'absolute sovereignty' is in God, the concept of political life they embody does not contradict that principle.

As for economic concepts, which have not yet been discussed in detail in the form of theories, thereby creating some problems in real life, it seems that the economic concepts laid down by the *Pancasila* ideology and the 1945 Constitution do not contradict the Islamic view of the economic system. The Co-operative, a manifestation of the spirit of co-operation which is the core of the Islamic concept of economic life, has been agreed to be the most suitable business form in Indonesia. The role of government in controlling some production and natural resources which are basic needs for all people, to avoid the monopoly of them in the hands of one or a few people, is also in line with Islamic principles. While Islamic economic concepts are much more complete and comprehensive and have already broadly discussed and formulated, and even implemented historically, however, the economic concepts based on *Pancasila* and 1945 Constitution still need to be expanded and formulated.

As regards social concepts, the general principles according to *Pancasila* and the 1945 Constitution also do not contradict, and are even similar to, Islamic social concepts. Similarly with the cultural system and values. Due to Muslims' predominance in the population, Islamic values also seem to be dominant in Indonesia. However, due to Indonesia's heterogeneity, harmony with other existing cultural systems and values is strongly demanded; and indeed, Islam

recognises heterogeneity, and it is not compulsory for non-Muslims to follow the Islamic system.

Moreover, it is true that in Indonesia's legal products, in civil and criminal laws, there are some matters which do not exactly follow Islamic law, especially regarding the legal 'sanctions'. This is not surprising, because in fact some of the existing legal products were inherited from the colonial legal system. Therefore, it is time for the Indonesian government to make their own laws according to *Pancasila* ideology and the 1945 Constitution, as a reflection of the whole people of Indonesia. Since the majority of the people, are Muslims, the legal products are likely to be Islamic.

As the 'morality of Indonesian people', *Pancasila* also provides 'moral guidance', which is explained in the '45 points of *Pancasila*'. In general, it demands that the Indonesian people should uphold religious values, humanity, unity, deliberation to achieve consensus, and social justice. However, it is up to individuals, how to practise this moral guidance in their daily life.

In short, due to its relatively young age, the environmental concepts according to *Pancasila* ideology have not been comprehensively explained. Considering the majority of the population, however, the political, economic, legal, social and cultural systems and concepts of Indonesia should not contradict with *Shari'ah*; as such contradiction would raise some problem in their implementation. The fact that there is a concern from the government to allow the people to

practise *Shari'ah* principles, especially in economic activities, by promoting Islamic banks and financial institutions, indicates that Muslims may implement their faith in this matter freely. Furthermore, due to the fact that the 'interest-free based system' applied by Islamic banks and financial institution do not contradict with other faiths and values, it seems that there will be strong support from non-Muslims as well. Indeed, this financing system has been theoretically proved to be more just than the 'interest-based' system.

## **CHAPTER 9**

### **SURVEY FINDINGS**

#### 9.0. Introduction

This chapter presents the findings of the survey. The main purpose of the survey is to ascertain the perception of Muslim accounting lecturers about the IASC conceptual framework as currently adopted in Indonesia and the idea of Islamic accounting concepts. The purpose is to get an idea of the possibility of implementing the Islamic accounting concept in Indonesia, as the accounting lecturers, as has been mentioned before, play a very important role in the development of the Indonesian accounting system (they are involved in setting the national syllabus for accounting education, in the accounting standard setting process, practice, etc.).

#### 9.1. Sample Characteristics

The total sample was 54 respondents. They have been categorised by: groups of AGE, SEX, highest DEGREE of education, and whether they also work as practising accountants or as PARTNER in any accounting firm.

##### 9.1.1. Age groups.

According to their ages, they have been grouped into four groups: 'under 30', 'between 30 to 39', 'between 40 to 49', and '50 and above', referred to as

'AGE-1', 'AGE-2', 'AGE-3', and 'AGE-4' respectively. Of the 54 respondents, there were 6 respondents (11.1%) of AGE-1, 35 respondents (64.8%) of AGE-2, 11 respondents (20.4%) of AGE-3, and 2 respondents (3.7%) of AGE-4. That means, most of respondents fell within group AGE-2 (Refer to Appendix 9.2: Frequency analysis, variable A). One-variable chi-square yielded a significant probability value of  $< 0.0500$  (very small), which means that statistically, respondents were not 'equally likely distributed' among the age groups (Refer to Appendix 9.3).

#### 9.1.2. Sex.

There were 42 male respondents and 12 female respondents, or 77.8% and 22.2% respectively (Refer to Appendix 9.2: Frequency analysis, variable B). The significant value of one-variable chi-square applied is significant, i.e.  $< 0.0500$  (very small) which means that respondents were not 'equally likely distributed' between the gender groups (Refer to Appendix 9.3). From the above figures, it is also clear that the number of male respondents dominated the sample; male respondents was more than three times that of their female counterparts.

Moreover, given that most of the respondents were male, men dominated all the age groups. In the group of AGE-1 (<30 years), there were twice as many male to female respondents, i.e. 4 and 2 respondents respectively. For the group of AGE-2 (30-39 years), male respondents represented is 71.4% (25 out of 35). In

the other groups (AGE-3 and AGE-4), there were no female respondents (Refer to Appendix 9.4: Crosstabs, Age by Sex).

#### 9.1.3. Highest degree of education.

Lecturers were grouped into three categories by level and education: Stratum-1 (S-1), Stratum-2 (S-2), and Stratum-3 (S-3), equivalent to the UK 'graduate level', 'Master degree', 'Doctorate/Ph.D.' degree respectively. The difference is that in the Indonesian system, all these three levels require the presentation of a dissertation or thesis.

Of the 54 respondents, 22 respondents held an S-1 degree only, 25 respondents held an S-2 degree, and 7 respondents held an S-3 degree, or 40.7%, 46.3% and 13% respectively (Refer to Appendix 9.2: Frequency analysis, variable C). That means, respondents with an S-3 degree were in the minority. Applying one-variable chi-square test, it was found that the significant value is small, less than 0.0500, which means, respondent were not 'equally likely distributed' among groups of degree (Refer to Appendix 9.3).

According to their groups of age, moreover, there was no S-3 respondent for the groups of AGE-1 (<30 years). This is not surprising because to take the S-3 degree after the S-1 degree needs at least 5-7 years, excluding some other factors which may delay the opportunity to study further. To finish an S-1 degree in the Indonesian system, respondents needed to spend at least 5 years of study at a



University, after finishing High School. Therefore, it would be almost impossible, for those who take their S-1 degree in Indonesian universities, to hold an S-3 degree before the age of 30 years. On the other hand, there was also no S-1 degree for the group of AGE-3 (50 and above). That means, all 'senior' lecturers among respondents held at least a Master (S-2) degree (Refer to Appendix 9.4: Crosstabs, Age by Degree).

Most of S-3 degree respondents, furthermore, i.e. 5 out of 7, or 71.5% fell within the group of AGE-2 (30-39 years). Similarly with the S-1 and S-2 degrees,; the majority of respondents, i.e. 11 out of 22 (50%) and 19 out of 25 (70%) respectively, also fell within the group of AGE-2, as this age group dominated the sample. That means, all level of education (S-1, S-2 and S-3) dominated (and were dominated by) the group of AGE-2 (30-39 years) (Refer to Appendix 9.4: Crosstabs, Age by Degree).

It is worth noting that within the group of AGE-3 (between 40-49 years)--the second 'senior' group, the S-1 degree respondents still predominated, i.e. 7 out of 11 (63.6%), suggesting a need for action to improve their capability (or degree of education) if the quality of output (students) is to be maintained.

According to gender, males dominated at all levels of education (Refer to Appendix 9.4: Crosstabs, Sex by Degree), as is to be expected given that male respondents dominated the sample (77.8%) (Refer back to 9.1.2. Group of Sex). The interesting fact is that there was no female doctor (S-3) among the

respondents; all S-3 respondents were male. However, it is difficult to say that there is any sort of 'discrimination' in the opportunity to study further. The fact that there was no female doctor among respondents was probably due to the fact that there was no 'senior' female lecturers among respondents; all female respondents were under 40 years old. It is also difficult to say that females are less motivated to achieve a higher degree; as in fact, most female respondents (10 out of 12, or 58.3%) held an S-2 (Master) degree.

#### 9.1.4. Partnership.

Among the 54 respondents, 20 of them (or 37%) also worked as practising accountants or as partners in accounting firms (Refer to Appendix 9.2: Frequency analysis, variable D). Given that the significance value of one-variable Chi-square applied was not significant, i.e.: 0.05868 ( $>0.0500$ ), it can be said that statistically respondents, were almost 'equally likely distributed' among groups of 'partnership' (Refer to Appendix 9.3). According to their age group, most of them, i.e. 18 out of 20 (or 90%) were aged between 30-49 years old (AGE-2 and AGE-3) (Refer to Appendix 9.4: Crosstabs, Age by Partner). According to their sex group, most of them, i.e. 17 out of 20 (or 85%) were male (Refer to Appendix 9.4: Crosstabs, Sex by Partner), and according to their degree of education, most of them held at least an S-2 degree, i.e. 17 out of 20, or 85% (Refer to Appendix 9.4: Crosstabs, Degree by Partner).

### 9.1.5. Association between characteristics.

Probably, there are some questions regarding the association between respondents' characteristics. Applying chi-square statistics, however, it is difficult to reject the 'null hypothesis' that each category is independent. As seen in the following Table 9.1., all the significance values are quite large, i.e. much higher than 0.0500. That means, the variables being tested are independent of each other. In other words, it is difficult statistically to say that there is any association between categories (characteristics).

Table 9.1. Summary of Crosstabs and Chi-Square statistics on the possible association between categories. (Refer to Appendix 9.4: Crosstabs)

Possible association	Chi-Square	df	Significance
1. AGE-SEX	4.95918	3	.17481
2. AGE-DEGREE	8.59983	6	.19737
3. AGE-PARTNERSHIP	2.77137	3	.42824
4. SEX-DEGREE	2.48610	2	.28850
5. SEX-PARTNERSHIP	.95861	1	.32754
6. DEGREE-PARTNERSHIP	.11749	2	.94295

From the above table, however, it can be seen that among the possible associations, the most likely association is between AGE-DEGREE, given the Chi-Square value  $>5.0$  (i.e. 8.59983). This is in line with the fact that to get a higher degree of education takes several years, so that the higher degrees tend to be held by the older lecturers. The second most likely association is between AGE-SEX, given the Chi-Square value close to 5.0 (4.95918). However, it is difficult to conclude that the older groups tend to be dominated by males, as there was no female respondent for the group of AGE-3 and AGE-4 (40 years and above).

## 9.2. Respondents' Responses

Respondents were asked to answer questions regarding their perception about three groups of aspects: (1) accounting and its environment, (2) the International Accounting Standard Committee (IASC) Conceptual Framework, and (3) Islamic concepts of accounting and its environment.

### 9.2.1. Accounting and its environment.

All respondents (54) answered the question regarding the relationship between accounting and its environmental factors including ideological and political, economic, legal, social, moral and cultural systems. Among them, 90.7% (or 49 respondents) believed that these factors influence, or are closely related with, accounting (Refer to Appendix 9.2: Frequency, variable E). However, they had different perceptions regarding the strength of influence of each of these factors toward accounting. Table 9.2. below summarises their (49 respondents) belief in the strength of influence of the environmental factors toward accounting (summarised from Appendix 9.2: Frequency analysis, variables F to L).

Table 9.2. Percentage of Respondents who believed in the Influence of the Environmental Factors on Accounting, according to the strength.

Environmental Factors	Strong		Moderate		Weak	
	freq.	%	freq.	%	freq.	%
1. Economic System	46	93.9	2	4.1	1	2.0
2. Legal System	36	73.5	13	26.5	0	0.0
3. Political System	31	63.3	13	26.5	5	10.2
4. Ideology	26	53.1	13	26.5	10	20.4
5. Moral System	25	51.0	15	30.6	9	18.4
6. Culture	21	42.9	15	30.6	13	26.5
7. Social System	21	42.9	21	42.9	7	14.3

It can be seen from the above table that most respondents believed that all the environmental factors mentioned, except for the *Culture* and *Social* system, strongly influence the accounting. However, there were more respondents who believed that the *Economic* system is influential, followed by those who believed in the influence of *Legal*, *Political*, *Ideological*, *Moral*, *Cultural* and *Social* systems respectively.

Logically, as a consequence of the belief that accounting is strongly influenced by its environment, different environments will encourage the need for different accounting systems. This is consistent with the respondents' perception because most of them (39 out of 49 respondents, or 79.6%) believed that different environmental factors will create the need for different accounting systems (Refer to Appendix 9.2: Frequency, variable M). In respect of accounting conceptual framework, differences in environmental factors will cause differences in conceptual framework, including: *Users* and their needs, *Objectives* of financial reporting, *Basic Assumption* underlying the preparation of financial statements, *Qualitative Characteristics* to be achieved by the statements, *Elements* of financial statements, *Recognition and Measurement* criteria, and *Capital Concept* adopted. Table 9.3. below summarises the (39) respondents' beliefs regarding the influence of different environmental factors on the conceptual framework (summarised from Appendix 9.2: Frequency, variables N to U).

Table 9.3. Percentage of Respondents who believed/did not believe in the influence of Environmental Factors on the Conceptual Framework.

Aspects in the Conceptual Framework	Believed		Didn't Believe Not Sure	
	freq.	%	freq.	%
1. Users & their needs	34	87.2	5	12.8
2. Objectives of financial reporting	34	87.2	5	12.8
3. Basic Assumptions	31	79.5	8	20.5
4. Qualitative Characteristics	25	64.1	14	35.9
5. Elements of Financial Statements	25	64.1	14	35.9
6. Recognition criteria	33	84.6	6	15.4
7. Measurement criteria	31	79.5	8	20.5
8. Capital Concept	27	69.2	12	30.8

From the above table, it can be said that most respondents who believed that different environmental factors demand different accounting systems (more than 60% of 39 respondents) also believed that environmental factors influence accounting in respect of the conceptual framework. However, they did not exactly agree on the influence of environmental factors on the individual aspects of the conceptual framework. *Users and their needs*, and the *Objectives of financial reporting* were believed by most of them to be mostly influenced (87.2%), followed by the *Recognition criteria* (84.6), *Basic Assumption* and *Measurement criteria* (79.5%), *Capital concept* (69.2%), and *Elements of financial statements* and *Qualitative characteristics* (64.1%).

#### 9.2.2. Perception toward the IASC Conceptual Framework.

Respondents were asked to express their perception regarding the aspects of the IASC Conceptual Framework. It was expected that individual perceptions

would differ, as individual experience must be unique. Respondents' general perceptions were expected to be consistent with their belief in general that environmental factors influence accounting in respect of the conceptual framework, as previously described. Among the 54 respondents, only 44 gave responses regarding these matters. However, attention was paid to the 39 respondents who believed that different environmental factors demand different accounting systems, as conceptually, the Indonesian environmental factors seems to be different from the Western counterpart.

*(1) Users of Financial Reporting*

Respondents were asked to rank the supposed users of financial statements according to the IASC Conceptual Framework. Their ranks, which are summarised from Appendix 9.2: Frequency--variables V to AB, are as follows:

Table 9.4. Percentage of Respondents in Ranking the Users' priority

Priority	Users group	Respondents' Ranks						
		1st	2nd	3rd	4th	5th	6th	7th
1st	Investors	<b>71.8</b>	7.7	7.7	2.6	0.0	5.1	5.1
2nd	Creditors	7.7	<b>53.8</b>	28.2	2.6	5.1	0.0	2.6
3rd	Suppliers	0.0	12.8	30.8	<b>33.3</b>	15.4	7.7	0.0
4th	Employees	2.6	10.3	15.4	<b>28.2</b>	17.9	23.1	2.6
5th	Customers	2.6	0.0	2.6	7.7	<b>35.9</b>	30.8	20.5
6th	Government	7.7	7.7	15.4	20.5	17.9	<b>23.1</b>	7.7
7th	Society	7.7	7.7	0.0	5.1	7.7	10.3	<b>61.5</b>

The above table shows that 71.8% of respondents placed 'Investors' in the first rank; 53.8% of them placed 'Creditors' in the second rank; 33.3% and 28.2%

of them placed 'Suppliers' and 'Employees', respectively, in the fourth rank; 35.9% of them placed 'Customers' in the fifth rank; 23.1% of them placed 'Government' at the sixth rank; and 61.5% of them placed 'Society' in the seventh rank. These percentages quoted above are the majority responses for every 'User group', for each rank. Based on this matrix, it can be said that, overall, respondents believed that the financial statements should be prioritised first for 'Investors', then for Creditors, Suppliers, Employees, Customers, Government, and Society, respectively. This perception, which prioritises 'Investors' and 'Creditors' as the two top ranks, exactly corresponds with the Western concepts, especially that of the US (FASB, 1978, para. 34; IASC, 1988, para. 10; ASB, 1995, para. 1.5).

The ranks assigned by respondents seem to be 'not equally likely distributed', as the probability values provided by the one-variable Chi-Square statistic for all user groups are significant ( $<0.0500$ ), *except* for the 'Government' rank in which the significance value is 0.3092 (Appendix 9.3). Moreover, applying further Chi-Square statistics (two variables), the differences in the respondents' ranking are not related to the differences in their characteristics, except for the 'Employees', 'Creditors', and 'Customers' group of users. Given that the probability values are significant ( $< 0.0500$ ), the different rankings of the 'Employees' and 'Creditors' are influenced by respondents' DEGREE, and that of 'Customers' by their AGE and DEGREE (Refer to Appendix 9.5). However, the association between respondents' characteristics and their rankings of the user



groups are quite small, given that the *Spearman's correlation coefficients* are less than 0.2, except for the 'Employees', and 'Customers' ranks, in which the Spearman's R are .24256 and -.26835 respectively in their association with AGE, and for 'Customers' with DEGREE in which the Spearman's R is -.453 (Appendix 9.6). This means that the *older* respondents tend to put a *higher rank* on 'Employees', and the *older and the higher degree* respondents tend to put a *lower rank* on 'Customers' (Refer to Appendix 9.6; Ordinal variables AGE and DEGREE).

Furthermore, 18 respondents (46.2% of them) believed that financial statements which fulfil the need of Investors will also fulfil the need of all or most other users, while the other 21 (53.8%) did not (Refer to Appendix 9.2: Frequency, variable AC). However, this distribution is statistically non-significant given that the significance value for one-sample Chi-Square was large ( $> 0.0500$ ) (Refer to Appendix 9.3). In other words, the number of those who believed that financial statements which fulfil the investors' need will also fulfil other users' need is statistically equal to that of those who did not believe. Moreover, applying two-sample Chi-Square against the respondents' characteristics, it is found that their responses were not influenced by their characteristics, given that all significance values were much higher than 0.0500 (Refer to Appendix 9.5, Var. 'AC').

## (2) Information Needs

There are four types of information mentioned in the IASC Conceptual Framework, which are presented in the following form: Profit and Loss Statement (Income Statement), Balance Sheet (Statement of Financial Position), Cash-Flows Statement, and Notes and Supplementary Schedules. Respondents were asked to rank the priority or importance of these types of information according to their preference. Their responses are summarised in Table 9.5. below.

Table 9.5. Percentage of Respondents in Ranking the Information Needs.

Priority	Information Needs	Respondents' Ranks			
		1st	2nd	3rd	4th
1st	Profit & Loss Statements	<b>74.4</b>	20.5	5.1	0.0
2nd	Balance Sheets	20.5	<b>53.8</b>	25.6	0.0
3rd	Cash-Flows Statement	5.1	25.6	<b>69.2</b>	0.0
4th	Notes & Supplementary Schedules	0.0	0.0	0.0	<b>100.0</b>

The above table shows that 74.4% respondents placed 'Profit & Loss Statements' in the first rank; 53.8% of them placed 'Balance Sheet' in the second rank; 69.2% placed 'Cash-Flows Statement' in the third rank; and 100.0% placed 'Notes & Supplementary Schedules' in fourth place. From this matrix, 'Profit & Loss Statements' are believed by respondents to be the first priority in the financial statements, followed by 'Balance Sheets', 'Cash-Flows Statements', and 'Notes & Supplementary Schedules' as the second, third, and fourth priorities respectively. The ranks of each form of information need were not equally likely distributed, as the significance value for one sample Chi-Square applied to them was very small (nearly 0.0000, or very significant) (Refer to Appendix 9.3, variables AD to AG).

However, there was little tendency for the respondents' characteristics (age, sex, degree, partnership) to influence the ordering, given that all significance values for the two-sample Chi-Square tests applied to them were NOT significant ( $> 0.0500$ ) (Refer to Appendix 9.5, Vars. 'AD' - 'AG').

Applying an association test for categorical data (Spearman's correlation), however, it seems that there were relatively quite strong associations between the ranking of 'Balance Sheets' and 'Profit & Loss Statements' with respondents' AGES, given that the Spearman's correlation coefficients were 0.20414 and - 0.26538 respectively (Refer to Appendix 9.6; Ordinal variable by AGE). In other words, the *younger* respondents tended to give a *lower* priority to the 'Balance Sheet', but a *higher* priority to the 'Profit & Loss Statement'.

### (3) Basic Assumptions

There are two *Basic Assumptions* mentioned in the IASC Conceptual Framework, namely, the *Accrual* assumption and the *Going-Concern* assumption. Most respondents believed that the accrual assumption and the going concern assumption should be followed in practice, i.e. 94.9% and 87.2% respectively (Refer to Appendix 9.2: Frequency, variables AH and AI). Their belief seems to be independent, i.e. it is not influenced by their characteristics (age, sex, degree, partner), given that all significance values of two-variables Chi-Square statistics applied against respondents' characteristics were NOT significant ( $> 0.0500$ ) (Refer to Appendix 9.5). This fact shows that respondents' perception toward

basic assumption exactly follows the Western concepts, especially the US and IASC.

This fact, however, is not consistent with their beliefs that environmental factors do influence the accounting so that different environments would demand different accounting systems (Refer back to Table 9.3. on page 393, in which 79.5% of respondent believed that environmental factors do influence accounting, in respect of 'Basic Assumptions').

*(4) Qualitative Characteristics.*

Most respondents believe that the qualitative characteristics and constraints on relevant and reliability information mentioned in the IASC Conceptual Framework important and should be maintained. Table 9.6. below summarises the percentage of respondents who believed that these characteristics need to be maintained (Refer to Appendix 9.2: Frequency, variables AJ to AT).

Table 9.6. Respondents' Ranking of Qualitative Characteristics ranks.

Qualitative Characteristics	Perception			Rank
	Very Important	Important	Total	
1. Understandability	56.4%	41.0%	97.4%	2
2. Relevant	53.8%	38.5%	92.3%	3
3. Materiality	25.6%	53.8%	79.4%	6
4. Faithfulness	71.8%	25.6%	97.4%	1
5. Substance over Form	17.9%	51.3%	69.2%	10
6. Neutrality	23.1%	48.7%	71.8%	8
7. Consistency	20.5%	43.6%	64.1%	11
8. Comparability	20.5%	51.3%	71.8%	9
9. Comprehensiveness	23.1%	56.4%	79.5%	5
10. Timeliness	48.7%	43.6%	92.3%	4
11. Benefit-Cost	17.9%	61.5%	79.4%	7

As seen in Table 9.6., all qualitative characteristics were believed by most respondents to be important and/or very important, so that they need to be maintained. Since all significance values of one-variable Chi-Square applied to them were very significant ( $< 0.0500$ ), it can be said that the respondents' perception are not 'equally likely distributed' among the levels of perception (Refer to Appendix 9.3). Furthermore, applying the two-variables Chi-Square against respondents' characteristics, only the qualitative characteristics '*Relevance*' and '*Timeliness*' and the constraint '*Benefit-Cost*', seem to be associated with respondents' SEX, DEGREE and PARTNERSHIP respectively, given that the respective significance values were less than 0.0500 (significant) (Refer to Appendix 9.5).

However, applying an association test for ordinal data, '*Consistency*' and '*Comprehensiveness*' are qualitative characteristics which seem to be associated with respondents' AGE, with Spearman's R coefficients of -0.30735 and -0.21217 respectively. This means that the *younger* respondents tended to view these two qualitative characteristics as *less important* (Refer to Appendix 9.6; Ordinal variables by AGE). With the respondent's SEX, on the other hand, '*Substance over Form*', '*Comparability*' and '*Comprehensiveness*' characteristics were the ones which seemed to be associated, with Spearman's R coefficients of 0.25913, 0.26432 and 0.29622 respectively (Refer to Appendix 9.6; Ordinal variables by SEX). This means that *male* respondents tended to give a *higher* importance to these three characteristics than female counterparts. With the respondent's

DEGREE, furthermore, 'Comprehensiveness' and 'Timeliness' are those which seem to be associated, given that the respective Spearman's R coefficients are -0.26202 and -0.43225 (Refer to Appendix 9.6; Ordinal variable by DEGREE). This means that respondents with a *lower degree* tended to give a *higher* ranking to these two characteristics. With the PARTNERSHIP variable, moreover, 'Understandability', 'Consistency' and 'Comparability' characteristics, and 'Benefit-Cost' constraint were those which seemed to be associated, given that their respective Spearman's correlation coefficients were 0.32049, -0.25677, -0.29661, and -0.38964 respectively (Refer to Appendix 9.6; Ordinal variable by PARTNERSHIP). This means that respondents who *worked* as a partner in an accounting firm tended to put a *higher* rank for 'Understandability', but a *lower* rank for the other three factors.

#### (5) Elements of Financial Statements.

When asked about the acceptability and practicability of definition of the financial statements' elements, most respondents believed that the definitions of the elements of financial statements proposed by the IASC are acceptable and practicable. Table 9.7. below (which is summarised from Appendix 9.2: Frequency, variables AU to AY) summarises the percentage of respondents who accepted the definitions of financial statements' elements.

Table 9.7 Percentage of (39) Respondents who accepted the IASC definitions of the elements of financial statements.

Element of F/S	Accepted	
	freq.	%
1. Asset	36	92.3
2. Liability	37	94.9
3. Owners' Equity	32	82.1
4. Revenues	36	92.3
5. Expenses	35	89.7

It is clear that respondents' responses were not 'equally likely distributed', given that there is a big gap between those who accepted and those who did not. This interpretation is supported by the statistical Chi-Square test, which yielded zero significance values for all elements (Refer to Appendix 9.3). Moreover, the respondents' responses seemed to be independent of their characteristics, given that their significance values against their characteristics (Age, Sex, Degree, and Partnership) are quite large ( $> 0.0500$ ) (Refer to Appendix 9.5).

(6) Recognition Criteria.

The IASC proposed three criteria for recognition of elements of financial statements: (1) fulfilment of the respective definition, (2) the probability of future economic benefit of the respective element to flow into or out of the reporting entities, and (3) that the elements have a value or cost that can be measured reliably. Most respondents agreed with these criteria, 89.7% agreed with the first criterion, 64.1% agreed with the second criterion, and 56.4% agreed with the third criterion (Refer to Appendix 9.2; Frequency, AZ, BA, and BB variables). However, only responses for the first criteria were statistically significantly

distributed ( $P < 0.0500$ ) (Refer to Appendix 9.3). Applying two-variable Chi-Square tests, moreover, it seems that respondents' responses were independent of their characteristics, given that size of the respective significance values ( $> 0.0500$ ) (Refer to Appendix 9.5).

(7) Measurement criteria.

Furthermore, respondents were asked to rank their preference regarding the available measurement bases, i.e. historical cost, current value, realisable/settlement value, and present value. Table 9.8 below (which is summarised from Appendix 9.2; Frequency, variables BC to BF) summarises the result.

Table 9.8. Percentage of Respondents in ranking the Measurement Bases.

Measurement Bases	1st Rank	2nd Rank	3rd Rank	4th Rank
1. Historical Cost	<b>53.8%</b>	17.9%	7.7%	20.5%
2. Current Value	17.9%	<b>33.3%</b>	33.3%	15.4%
3. Realisable/settlement value	20.5%	25.6%	<b>28.2%</b>	25.6%
4. Present value	7.7%	23.1%	30.8%	<b>38.5%</b>

It can be seen in the above table that most respondents put *Historical Cost* in the first rank, *Current Value* in the second and third place, *Realisable/settlement value* third, and *Present Value* fourth. That means, most of them preferred *Historical Cost* as the first choice for measurement base, followed by the *Current Value*, *Realisable/settlement value*, and *Present Value* as the second, third and fourth alternatives respectively. Among them, respondents' responses for *Current Value* and *Realisable/ Settlement value* seemed to be 'equally likely distributed' among available ranks, with probability values more than 0.0500 (Refer to



Appendix 9.3). Furthermore, it seems that only *Historical Cost* is associated with respondents' AGE, according to the two-variable Chi-Square applied to them, which yielded a small P- value (0.00175) (Appendix 9.5). Applying the *Spearman's R* test, however, it was found that the correlation coefficient is very small, i.e. 0.02026. The highest Spearman's R coefficient associated with respondent AGE was for the '*Present Value*', i.e. 0.29958 (Appendix 9.6). That means, that *older* respondents tended to give a *higher* order to '*Present Value*'.

Furthermore, when respondents were asked about the possibility of using more than one measurement basis together for one financial statement, only 30.8% of respondents (i.e. 12 out of 39) agreed with; most of them (69.2%) did not agree nor were sure about it (Refer to Appendix 9.2; Frequency, BG variable).

#### (8) The concept of capital.

The IASC mentioned two concepts of capital, namely: the *financial concept* of capital and the *physical concept* of capital. These two concepts create two concepts of capital maintenance, namely: the *financial* and *physical* concepts of capital maintenance. Therefore, the choice of capital concept will determine the related concept of capital maintenance. Regarding this matter, most respondents (i.e. 20 out of 39, or 51.3%) believed that the *financial concept* of capital is the most suitable one to be adopted in preparing the financial statement, while 38.5% of them believed that *both* concepts may be adopted together in the same statement. Only 4.5% of respondents believed that the *physical concept* of capital

is the most suitable one (Refer to Appendix 9.2; Frequency, BH variable). As the IASC mentioned that conventional accounting adopts the *financial concept* of capital in preparation of financial statements, it means that most respondents' perception followed the IASC concept (and the US concept as well).

### 9.2.3. Islamic concepts of accounting and its environment.

All the 54 respondents were Muslims and believed that Islam is not merely a 'religion' in a narrow meaning, but it is also an ideology for all Muslims. Furthermore, 83.3% of them (45 respondents) believed that as an ideology, Islam differs from Western's ideologies (Refer to Appendix 9.2; Frequency, variables BI to BK). However, how was the difference between Islamic and Western concepts of politics, economics, law, society, and culture viewed by respondents?. Table 9.9 below summarises the level of difference between Islamic and Western political, economic, legal, social and cultural concepts in the perception of respondents who believed that Islamic ideology would be different from the Western ideologies (Refer to Appendix 9.2: Frequency, variables BK-BP).

Table 9.9. Percentage of Respondents in viewing the difference between Islamic and Western Concepts.

Aspects of	Level of Differences								Total (100%)
	Extremely Different		Strongly Different		Fairly Different		Not Really		
	Resp.	%	Resp.	%	Resp.	%	Resp.	%	
1. Political Concept	9	20.0	19	42.2	13	28.9	4	8.9	45
2. Economic Concept	12	26.7	25	55.6	7	15.6	1	2.2	45
3. Legal Concept	7	15.6	24	53.3	13	28.9	1	2.2	45
4. Social Concept	7	15.6	24	53.3	9	20.0	5	11.1	45
5. Cultural Concept	11	24.4	28	62.2	5	11.1	1	2.2	45

From the above table, it can be seen that the aspects where there is greatest difference between Islam and the West in the respondents' view, are in the concepts of economic, legal and cultural concepts; 97.8% (or 44 out of 45) respondents believed in these differences. The second greatest difference was seen to be in the concept of politics, perceived as different by 91.1% (or 41 out of 45) respondents. Social concepts were seen as least different, with 88.9% (or 40 out of 45) respondents believing there is a difference between Islamic and Western concepts.

Furthermore, due to the differences between Islamic and Western concepts of ideology, politics, economics, law, society, and culture, most respondents (i.e., 41 out of 45, or 91.1%) also believed that the conceptual framework of Islamic accounting would be different from the Western conceptual framework. As a result, all of them (i.e. 41 respondents who believed that Islamic Conceptual Framework would be different from the Western Conceptual Framework) also believed that the accounting standards would also be different. This is consistent with their belief that accounting is strongly influenced by its environment, so that different environments will encourage the need for different accounting systems. (Refer back to page 391-392).

In what way, according to the respondents, would Western and Islamic conceptual frameworks of accounting differ? Table 9.10 below summarises the findings about the respondents' belief toward the conceptual framework.

Table 9.10. Percentage of Respondents in viewing the Islamic Conceptual Framework compared to the Western counterpart.

Aspects in the Conceptual Framework	Will it be different?				Total (100%)
	Yes		No / Not-Sure		
	Resp.	%	Resp.	%	
1. Users & Users' Needs	22	53.7	19	46.3	41
2. Objectives of Financial Statements	28	68.3	13	31.7	41
3. Basic Assumptions	30	73.2	11	26.8	41
4. Qualitative Characteristics	20	48.8	21	51.2	41
5. Elements of Financial Statements	20	48.8	21	51.2	41
6. Recognition Criteria	26	63.4	15	36.6	41
7. Measurement Criteria	26	63.4	15	36.6	41
8. Capital Concepts	26	63.4	15	36.6	41

It can be seen in the above table that more than half of the respondents believed that the conceptual framework would be different, *except* for the aspect of *Qualitative Characteristics* and *Elements of Financial Statements*, which only 48.8% (20 out of 41) respondents believed would be different. Overall, this finding is consistent with their belief that in general the environmental factors do influence the conceptual framework (Refer to Table 9.3 on page 393).

### 9.3. Discussion

As has been described in the previous section, there were three groups of questions posed to the respondents: (1) accounting and its environment, (2) the International Accounting Standard Committee (IASB) Conceptual Framework, and (3) Islamic concepts of accounting and its environment. This section discusses the association between the answers for these three aspects, in order to know the consistency of the responses provided by the respondents. Firstly, the respondents'

general perception toward the influence of the environmental factors on accounting (the first figure) will be matched against their perception toward the IASC conceptual framework (the second figure). Secondly, the respondents general perception toward the influence of the environmental factors on accounting (the first figure) will be matched against their perception toward Islamic concepts and conceptual framework (the third figure).

#### 9.3.1. Perception toward the IASC conceptual framework.

At the beginning, 49 out of 54 respondent believed that environmental factors influence the accounting. Further, most of them believed that the influence is relatively strong (Refer to Table 9.2. on page 391). Consequently, most of them believed further that different environmental factors will cause differences in accounting in respect of the conceptual framework (Refer to Table 9.3. on page 393). Given that Indonesia's own concepts of ideology, politics, economics, law, society and culture are believed to be different from the Western concepts, it was expected that the respondents' perception toward the IASC conceptual framework would be unfavourable.

Looking back to Table 9.4. on page 394, however, it seems that the priority order made by the respondents, which put the investors and creditors as the primary users of financial statements, followed the conventional theoretical doctrines of Western conventional accounting. This is probably as a result of what Chambers (1994, p.79) called 'indoctrination'. In other words, as the respondents

have been educated to accept the Western conventional accounting systems, then they are in a difficult position to not accept the IASC concepts.

Furthermore, the suspicion that they were still under the influence of conventional doctrines is supported by the fact that:

- nearly half of them (39 respondents who believed that different environmental factors demand different accounting system), i.e. 46.2% believed that financial statements which fulfil the need of investors will also fulfil the need of all or most other users also (Refer to Appendix 9.2., frequency of all variables);
- most of them (39 respondents) put in order *the Profit & Loss (Income) Statements* as the first important information (74.4%), *Balance Sheet* as the second important (53.8%), *Cash-Flows Statement* as the third important (69.2%), and *Notes on the Financial Statements* as the fourth important (100.0%) (Refer back to Table 9.5. on page 397);
- most of them (39 respondents) believed that the *accrual assumption* and the *going concern assumption* should be followed, i.e. 94.9% and 87.2% respectively (Refer to Appendix 9.2);
- all *qualitative characteristics* and *constraints* were believed by most respondents to be important and/or very important, so that they need to be maintained (Refer back to Table 9.6. on page 399);
- most respondents believed that the definitions of the elements of financial statements proposed by the IASC are acceptable and practicable (Refer back to Table 9.7. on page 402);

- most respondents agreed with the IASC *recognition criteria*, provided that 89.7% agreed with the first criterion, 64.1% agreed with the second criterion, and 56.4% agreed with the third criterion (Refer to Appendix 9.2.).
- most respondents put *Historical Cost* in the first rank, *Current Value* in the second rank, *Realisable/Settlement Value* in the third rank, and *Present Value* in the fourth rank (Refer to Table 9.8. on page 403), which means that they favoured historical cost over any other valuation basis;
- most respondents (51.3%) believed that the *financial concept* of capital is the most suitable one to be adopted in preparing the financial statement, while 38.5% of them believed that *both concepts* may be adopted together, and only 4.5% of them believed that the *physical concept* of capital is the most suitable one (Refer to Appendix 9.2.).

In short, there is an inconsistency among most respondents in answering the question. On the one hand they believed that environmental factors do relatively strongly influence accounting, so that different environmental factors will cause different accounting in respect of the conceptual framework; on the other hand they also believe that the IASC conceptual framework is generally acceptable and practicable in Indonesia, where the environmental factors are conceptually believed to be different from the Western. It is probable that the reason for this inconsistency is that the respondents found it a difficult to free themselves from their existing belief regarding conventional accounting as a result of past 'indoctrination' to accept the conventional concepts. This is partly due to the

accounting education system in Indonesia, which is based largely on the Western system, particularly the US system (Refer back to Chapter 8; section 8.3.1).

### 9.3.2. Perception toward Islamic concepts & conceptual framework.

Among respondents who believed that environmental factors influence the accounting, most of them believed that the influence is relatively strong (Refer back to Table 9.2., in which those who believed that the influence is *moderate to strong* is more than 70%). On the other hand, among those who believe that Islam, as well as a religion, is also an ideology, most of them believed that the Islamic concepts of ideology, politics, economics, law, society and culture are different from the Western concepts (Refer back to Table 9.9. on page 405). It seems that there is a correlation between these two figures, i.e. those who believed (at the beginning) that the influence of the environmental factors on accounting is relatively strong *tended also to* believe that the Islamic concepts of ideology, politics, economics, law, society and culture differ from the western concepts (See Figure 9.1. as follows).



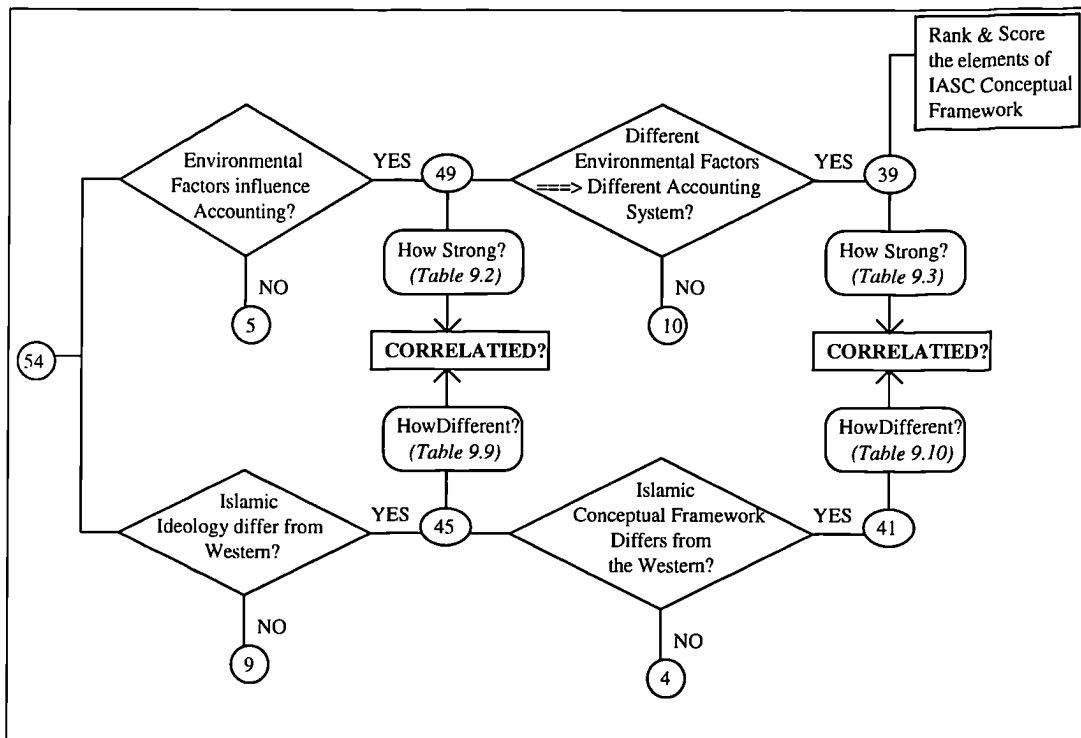


Figure 9.1. Diagram of Data Analysis

Applying a correlation procedure for categorical data, however, such correlations seem to be very weak, given that the Spearman's R coefficient is less than 0.2, *except* for the 'Legal' factor, in which the Spearman's R is more than 0.2 (i.e., 0.39598) (Refer to Table 9.11. below). This means that there is a strong correlation between "those who believed that the *Legal Factor* is strongly influence the accounting" and "those who believed that *Western* legal systems are different from the *Islamic* legal system". Apart from this 'Legal' factor, it is likely that respondents' perceptions about the strength of influence of environmental factors on accounting and their perception about the difference between Islamic concepts and Western concepts are independent of each other.

Table 9.11. Correlation analysis on 'Environmental Factors' between those who believed there is influence of environmental factors on accounting and those who believed that Islamic and Western environmental factors are different.

Environmental Factors	Spearman's Correlation		
	Coef.	N	Signif.
Ideology	-.09669	49	.50868
Political System/Concept	.01901	41	.90608
Economic System/Concept	.05454	41	.73486
Legal System/Concept	.39598	41	.01038
Social System/Concept	.18463	41	.24783
Cultural System/Concept	.03521	41	.82700

Furthermore, among those who believed that environmental factors influence the accounting (49 respondents), most of them also believed, as a consequence, that different environmental factors will result in a different conceptual framework of accounting (Refer to Table 9.3. on page 393). On the other hand, among those who believed that Islamic concepts (ideological, political, economic, legal, social, and cultural) differ from the Western concepts (45 respondents), most of them also believed that Islamic conceptual framework of accounting would be different from the Western conventional conceptual framework, except for the *Qualitative Characteristics and Elements of Financial Statements*, in which only 48.8% respondents believed to be different (Refer back to Table 9.10. on page 407). From these two figures, it seems that there is a correlation between these two figures, i.e. those who believed that different environmental factors will give rise to different accounting conceptual frameworks tended to believe that an Islamic conceptual framework would be different from

the Western conventional conceptual framework (See diagram of analysis on Figure 9.1).

When a correlation procedure for categorical data was applied, the correlations seemed to vary among variables (Refer to Table 9.12. below). The strongest correlation was for the variable '*Qualitative Characteristics*', for which the Spearman's correlation coefficient is 0.25678. This means that those who believed that different environmental factors will give rise to a different conceptual framework in respect of '*Qualitative Characteristics*' tended to believe that the Islamic and Western '*Qualitative Characteristics*' would be different. The next strongest association was for '*Objectives of Financial Statements*' for which the Spearman's correlation coefficient is 0.22787; followed by '*Users of Financial Statements*', for which the correlation coefficient was 0.20441. The rest of variables had weak correlations, with coefficient less than 0.2. In other words, it is likely that respondents' "perception to that different environmental factors will result in different conceptual frameworks of accounting" (the first figure) and "their perception that Islamic conceptual framework of accounting would be different from the Western conventional conceptual framework" (the second figure) are independent each other, *except* for the aspects of '*Qualitative Characteristics*', '*Objectives*' and '*Users of financial statements*'. However, considering that the significance values for the associations of these three aspects are NOT significant ( $> 0.0500$ ) it seems that the associations are very weak.

Table 9.12. Correlation Analysis for 'Conceptual Framework' between those who believed 'different environmental factors demand different accounting system' in respect of the conceptual framework and those who believed that Islamic and Western conceptual frameworks are different'.

Elements of the Conceptual Framework	Spearman's Correlation		
	Coef.	N	Signif.
Users of Financial Statements	.20441	34	.24621
Objectives of Fin. Statements	.22787	34	.19494
Basic Assumptions	.10699	34	.54701
Qualitative Characteristics	.25678	34	.14266
Element of Fin. Statements	-.06052	34	.73384
Recognition Criteria	.04089	34	.81840
Measurement Criteria	.08058	34	.65052
Capital Concept	.14704	34	.40665

#### 9.4. Summary

From the previous description regarding the survey, the findings can be summarised as follows:

1. The total number of respondents in the sample was 54 accounting lecturers of most state universities in Indonesia having accounting departments. Respondents were grouped according to their age, sex, highest degree held, and whether they worked as part-time practising accountant (or partners). The sample appeared to be dominated by: the group of AGE-2 (30-39 years old), being 35 respondents (64.8%) and male respondents, being 42 respondents (77.8%). Among respondents, 25 of them (46.3%) held an S-2 (Master) degree, and 22 (40.7%) held S-1 (First) degree. Among them, moreover, 24 (37%) also worked as part-time practising accountants.

According to the outcome of statistical tests, it is difficult to claim that there is any association between the groupings.

2. Most respondents, i.e. 49 out of 54 respondent (90.7%) believed that environmental factors influence accounting. Furthermore, most of them believed that the influence is relatively strong. As a consequence, most of them believed that different environmental factors will cause differences in all aspects of the accounting conceptual framework.
3. Consistent with these perceptions, most respondents, i.e. 45 (83.3%) believed that Islam as an ideology differs from Western ideologies. As a consequence, most of them also believed that the political, economic, legal, social and cultural concepts derived from Islamic ideology would be different from those derived from the Western ideologies. As a result, because different environmental factors will lead to different accounting conceptual frameworks, most of them then believed that an Islamic based conceptual framework would be different from the Western conventional conceptual framework.

However, applying Spearman's correlation test, it was found that respondents' perceptions toward the strength of 'Environmental influence' were independent of (or weakly associated with) their perceptions toward Islamic environmental factors, except for the 'Legal factors'. Similarly, their perceptions toward the influence the Environmental factors on the accounting

and the Islamic conceptual framework, also appeared to be independent (weakly associated).

4. Unexpectedly, moreover, most of them believed that the IASC conceptual framework would be acceptable and applicable (in Indonesia). This is inconsistent with their previous expressed beliefs, that Indonesian environmental factors conceptually are not to be similar to the Western ones, and that different environmental factors would result in different conceptual frameworks. It seems that respondents are still under the shadow of the Western accounting system's influence.
5. A few variables have been statistically proven to be associated with the respondents' characteristics (age, sex, degree, partnership). However, given that the correlation coefficients are relatively small (less than 0.5), it is likely that such association is accidental and due to the small size of the sample.

## **CHAPTER 10**

### **CONCLUSIONS**

#### 10.0. Introduction

This chapter summarises and concludes the whole study, which has been presented in the previous nine chapters. The chapter includes a summary of findings, including proposed recommendations to be implemented by those who are concerned with the development of accounting in Indonesia, together with an assessment of potential constraints and possible solutions in implementation, and also some suggestion for future research.

#### 10.1. Summary of Findings

The study examined the influence of ideological-environmental factors (systems) on accounting, with the emphasis on financial accounting concepts and principles, based on the belief that accounting is influenced by, and consequently reflects, its environmental systems. Because environmental systems are believed to be constructed based on certain ideological concept(s), that different ideologies are likely to inspire different political, economic, legal, social, cultural, and moral systems, it was argued that, in turn, different systems are likely to inspire different accounting concepts and principles.

In particular, this study aimed to:

- (1) examine the Western ideology(ies) and its (their) manifestation in political, economy, legal, social, cultural, and moral concepts or systems, and then examine the relationship of these systems with, or influence of them on, the Western accounting concepts and principles. The emphasis of the study was on the 'Anglo-American' (English speaking) countries, especially the US and the UK, and the IASC accounting concepts.
- (2) examine the Islamic ideology and its manifestation (explanation) into political, economic, legal, social, and cultural systems, including spiritual, moral and *Zakah* systems. Furthermore, by comparing and contrasting the Islamic ideological concepts with the Western ideological concepts, the study suggested some Islamic accounting concepts and principles. In doing so, the study analysed the Western concepts and principles from the Islamic perspective, in particular by applying the principles contained in the *Zakah* system.
- (3) examine Indonesian ideological concepts, i.e. the Pancasila ideology, covering its political, economic, legal, social, cultural, and moral concepts and systems, comparing and contrasting them with the Western and Islamic concepts in order to justify the accounting systems which have been, and are currently being applied in Indonesia.
- (4) analyse the perceptions of Indonesian Muslim accounting lecturers, as the dominant actors in accounting research and development in Indonesia, towards:



- (a) the influence of environmental factors on accounting concepts,
- (b) the IASC accounting concepts as currently adopted in Indonesia, and
- (c) accounting concepts from their Islamic perspective.

As internalisation of certain values will influence the perception of individuals, it is assumed that respondents, being Indonesian as well as Muslim, would have internalised the Pancasila and/or Islamic ideological as well as moral values and, with their intentions or objectives, have attempted to externalise the values in the form of developing accounting thought. If they believe that:

- (a) environmental factors influence the accounting concepts, and
- (b) the 'Pancasila' concepts of ideology, politics, economics, society, law, culture, and morality are different from the Western counterpart, then there is no reason for them to support the adoption of Western (IASC) concepts in Indonesia.

Furthermore, if they view Islamic concepts as being close to the 'Pancasila' concepts, they should consider Islamic accounting concepts in developing the Indonesian accounting system.

As has been summarised in the previous chapters, it is believed that the Western accounting concepts found their justification from specific ideological-environmental factors (their concepts of ideology, politics, economics, law, society and culture). While the Islamic ideological systems (or concepts) are believed to

be different from the Western concepts, it is also believed that the accounting concepts from the Islamic perspective should be different from the Western accounting concepts.

In short, Islamic concepts tend to balance most existing systems in the world, as the ideal Muslim *ummah* (community) is said to be the 'median community' (*ummatan wasatan*). In philosophical terms, Islam is concerned with both the spiritual and the physical; while Western philosophy(ies) tend to emphasise material aspects of life (materialism). Islamic ideology also tends to balance the two extreme ideologies: communism (Marxism) and liberalism. In political terms, the Islamic political concept of *shura*, also tends to balance the two extremes: authoritarianism and extreme liberalism. In the social system, the Islamic social concepts of '*Ummah*' also tend to balance the two extremes: collectivism and individualism. In the economic system, Islamic economic concepts also tend to balance the two extremes: state-planned (socialism) and free-enterprise (capitalism). Similarly, in the cultural system, Islamic concepts tend to balance between: individualism vs. collectivism, large vs. small power distance, strong vs. weak uncertainty avoidance, and masculinity vs. femininity. As regards the law, the Islamic legal system clearly differs from any other legal system in the world.

The main difference between Islamic concepts and Western concepts is probably that in Islam, all systems should be considered in relation to the 'moral aspect'. This is because the main goal of Islamic teaching is to perfect morality.

Therefore, all systems in Islam are prescribed in order to maintain and preserve 'good' morals. As has been explained, Islam prescribes some rigid rules in dealing with the secular, temporal areas of human activities. Most of the teachings are principles. As far as economics and accounting are concerned, the few rigid rules are:

- giving and taking interest and usury, both personal and commercial, is not allowed;
- gambling, alcohol (intoxicants), and other activities considered by Islam as immoral and anti-social activities (pornography, drugs, and the like) are not allowed;
- uncertain contracts prone to fraud (e.g. conventional insurance, futures and short-selling) are not allowed;
- solidarity and co-operation and the avoidance of disputes are encouraged;
- the giving of equal measure for measure (cheating or misleading by giving false information) is disallowed; (this implies 'full disclosure' and 'fair' measure of valuation);
- wastefulness and ostentatious consumption is prohibited.

It is true that the above rules are not contradictory to early Christian ethics (Gambling & Karim, 1991); however, post enlightenment Western societies, having rejected religion, do not affirm these ethical principles in their collective behaviour, although they try to follow rationalistic/teleological ethics, e.g. in enlightened self-interest. Therefore, being secularistic, the current Western accounting environmental systems are believed to be developed, and have been developed, without considering such religious, moral/ethical values. As a result, the Western accounting system, as a manifestation of the 'secular' environmental system, also ignores such moral/ethical values.

In the case of Indonesia, the 'Pancasila' concepts of ideology, politics, economics, society, law, and culture, as well as the moral/ethical guidance, seems to be different from the Western concepts in orientation. Pancasila concepts seem, and are believed, to be close to Islamic concepts. This is not surprising, as Islam has survived for a long time in Indonesia, and is the religion of the majority of Indonesian people, so that Islamic values have crystallised with other local values, in forming the Pancasila ideology. Since Muslims predominate in the population and most aspects of life, it is not surprising that Islamic values are also dominant in the so-called Pancasila ideological concepts. The difference between Pancasila and Islamic concepts is mainly that Islam is believed by Muslims to contain 'religious' aspects which are divine, while Pancasila is not a divine 'religion'. As a relatively new ideology, Pancasila has not been explored in terms of detailed concepts; while Islam has prescribed more detailed concepts.

The 'core' differences of the Western, Islam and Indonesian (Pancasila) systems may be summarised as follows:

Figure 10.1. Summary Comparison between Western, Islamic, and Pancasila systems.

	<b>Western</b>	<b>Islam</b>	<b>Pancasila</b>
Nature	Secularistic, Materialistic	Religious; Balance between Materialistic & Spiritualistic	Not Secular nor Religious: More Materialistic, but honour religious values.
Social	Individualistic;	<i>Ummatan wasatan</i> : Balance between Individualistic and Collectivistic	In between Individualistic and Collectivistic; honour collective consideration
Politics	Nationalism; Democracy;	Egalitarianism; <i>Shura</i> (Deliberation, Consultation)	Nationalism; <i>Shura</i> (deliberation) in order to achieve <i>mufakat</i> (consensus)
Economy	Liberalism-Capitalism (Free Market); Goals: Development, maximisation of utilities.	Balance between Free-Market (Capitalism) and State-planned; Goals: Equitable income distribution.	Mixed between Capitalism and State-planned; Reject: free-fight liberalism, <i>etatisme</i> , monopoly; Goals: equitable income distribution
Legal	Common Law	Shari'ah (Islamic Law)	Mixed: Romano-Germanic, Islam, and local Customs.
Culture	Small power distance; individualism; masculinity; weak uncertainty avoidance;	Balance between two extremes, but ten to honour: large power distance; collectivism; femininity; strong uncertainty avoidance.	In between, but tend to honour: large power distance; collectivism; femininity; strong uncertainty avoidance.
Moral	Used to be ' <i>Christian</i> ', but after enlightened era, religious values tend to be ignored in collective actions.	Strongly uphold 'good/honoured' moral, as it is the 'main' purposes of the Prophet being sent.	Strongly uphold 'good' moral behaviour; Islamic moral teachings are prominent.

Furthermore, from the survey, it has been found that:

- (1) Most respondents believed that environmental factors, especially economic and political factors, influence accounting concepts (system), so that different environmental systems may have different accounting systems.

(2) Contrary to the above finding, however, instead of doubting the Western concepts due to different environmental factors between Indonesia and the West, they supported and agreed with most of the Western (IASC) accounting concepts currently adopted in Indonesia. It is argued by the researcher that this situation is due to the educational, political and economic factors. It is well-known that the Indonesian accounting system, including the curriculum and syllabus, has followed the Western systems; i.e. the US system since 1970s to 1994, and the IASC system from 1994 onwards. As an 'under-developed' country, moreover, Indonesia is politically and economically under Western influence (control). Therefore, it is not really surprising that in its accounting system, Indonesia also follows the West, as it has not been able to develop its own system.

(3) Most of respondents, moreover, also believed in Islam is an 'ideology', which prescribes unique concepts of political, economic, legal, social and cultural systems. Therefore, they believed that an accounting system based on Islamic 'ideology' would be different from the Western accounting system.

It was also found that the Indonesian ideological concepts (Pancasila) are close to the Islamic concepts. This is due to the fact that most of the Indonesian population are Muslims (more than 87%); and historically, Islam has been there for centuries, so that Islamic values have been adopted and crystallised with the local values, forming what so called 'Indonesian' values. In the current real world, there

is also increased demand for an 'Islamic' accounting system due to the blossoming of Islamic business entities, such as Islamic banks and financial institutions (BMI, BPRS, BMT) and insurance (*Takafol*), besides the re-assertion among Indonesian Muslims of Islamic teaching in all aspects of life. Due to these facts, therefore, it is suggested that Indonesian accounting should be considered from an 'Islamic perspective' in order to develop a national accounting system.

## 10.2. Implementation of the findings

From the above findings and facts, some policies can be proposed which may be implemented in order to develop an Indonesian accounting system which is more suitable for its ideological-environmental factors. The policies are as follows:

- (1) Efforts should be made to persuade the accounting 'society' that accounting is not a 'neutral, value-free' discipline as propagated by the 'positivist' proponent (Watt-Zimmerman supporters). This will be a difficult task, as it involves changing the people's perceptions. The dominant influence among the Indonesian accounting society is still the positivist view. Probably, the first question to be addressed is 'how to change the perception toward accounting' for those who are directly involved in education, as education is a process of transferring knowledge and perceptions. Therefore, a sort of 'short-term training' in accounting theory for accounting academicians is needed. The main courses should cover the development of accounting theory up to the present day, including: the subject matter of accounting, the failure of

conventional accounting, recent developments in accounting theory, the influence of ideology on accounting, and the like.

- (2) A reformation is needed in the national accounting education system, mainly in the curriculum and syllabus of accounting courses. Student at the University should be taught 'Ideological oriented courses', and Muslim students should also learn the Islamic ideological, political, economic, legal, social, cultural, and moral concepts, and their implications for accounting. In the 'Accounting Theory' course, the syllabus should cover the influence of ideological-environmental factors on knowledge and disciplines, including accounting concepts and principles.

In the past, students used to be required to study 'Pancasila' (State ideology), for 4 credits. The course was divided into two parts: 'Pancasila I', to be taken at the under-graduate level, and 'Pancasila II' (Pancasila philosophy), to be taken at the graduate (*Sarjana*) level. However, the main goal of this course was to emphasise the 'political aspect' of Pancasila, i.e. indoctrinating students with Pancasila as the state ideology, philosophy, and foundation, without explaining into detailed in its relationship to knowledge. After the reformation of the educational system into the so-called 'SKS system' (credit system) which replaced the 'class/level system', and the introduction of '*Penataran P4*' (P4 Training), these two courses have been abolished. Students now, instead of taking these two courses, have only to undertake P4 training prior to their study in university. The training itself takes 80-120 hours. Therefore,



it is suggested that these subjects should be re-introduced, at least, the 'Pancasila philosophy' (previously, Pancasila II), with an emphasis on its relationship with knowledge (Pancasila philosophy of knowledge).

Regarding the subject of 'Religion', students are required to take two courses in 'Religion', worth 4 credits in total, consisting of 'Religion I' (previously for the undergraduate level) and 'Religion II' (previously for the post-graduate level). It is suggested that these courses, especially 'Religion II', which is more philosophical and conceptual, be extended to cover the topic of 'knowledge', i.e. the importance and influence of religious values in the development of knowledge, including accounting (for accounting students). For Muslim students, it is compulsory to take the subject of 'Religion: Islam', and to study the Islamic values and concepts of politics, economics, law, society, culture, morality and other aspects of life; and for Muslim accounting students, the subject should include 'Islamic concepts of accounting'.

Moreover, in 'Accounting Theory', which has to be taken by final year accounting students, the syllabus should also be improved. In the past, the course mainly covered the 'theoretical logic' underlying conventional historical cost accounting. Now, the subject should also cover all other alternatives than the 'conventional, historical cost accounting', including the influence of ideological-environmental factors on accounting concepts and principles. By approaching the subject from this angle, it is expected that students will obtain a comprehensive view toward accounting, and in turn, will encourage and

improve the research in accounting (as students are obliged to submit a dissertation as a part of the curriculum).

- (3) It would probably be useful for the standard setting committee to study and examine the AAOIFI accounting concepts and standards (1996), even though those are intended only for Islamic Banks and Financial Institutions. There are some concepts and principles which are general in nature so that they can be applied to any kind of business activities. Moreover, since the Indonesian ideological values (Pancasila) are believed to be close to the Islamic ideological concepts, the AAOIFI accounting concepts and standards will provide valuable inputs in developing specific Indonesian accounting concepts and standards. However, it should be realised that the AAOIFI Standards are based mainly on 'decision-usefulness' criteria, although socio-economic objectives are also mentioned. Moreover due to lack of an enforcement mechanism, there is not much evidence of their adoption by Islamic banks (Pomeranz, 1997).
- (4) It should be realised that there is no 'stand alone' system in societal life; all systems are inter-related and influence each other. This applies also to accounting as a system or sub-system. Therefore, a Pancasila (or Islamic) accounting system will only work optimally if the other systems (the ideological, environmental systems) are applied consistently, or at least, they do not contradict with the general principles laid down by the ideology (Pancasila or Islam). This is the most difficult task in the case of Indonesia

(and probably also anywhere else). Therefore, a long-term programme to be implemented is 'how to implement all the prescribed systems consistently and properly', based on the state ideology.

*Constraints and solutions.*

As has been mentioned above, Western influence in almost all Muslim and developing and under-developed countries is very strong, and pervades almost all aspects of life, especially politics, economics and information. Due to this fact, it is realised that to develop an accounting system which is unique and suitable for a particular country is very difficult. This applies also to Indonesia, which is now 'forced' to adopt the IASC accounting system, and which used to adopt the US accounting system.

A possible solution is for both systems to be developed; the Western (IASB) accounting system to be applied by the conventional business enterprises, and the 'Islamic' accounting system to be applied by the 'Islamic' business enterprises. This is probably what has been called the "colonial model" proposed by Gambling & Karim (1986). Under the colonial model, there will be two accounting models and theories: the "official" model and theory for the "official" (dominant) society, and the "unofficial" or "tribal" model and theory for the "unofficial or tribal" (non-dominant, minority) society.

However, this dualism seems to add new problems, as there are currently two 'types' of accounting: financial accounting which is based on the IASC

accounting concepts and standards, and 'taxation accounting' which is based on the Taxation law. As it is common everywhere, there are some differences in some basic aspects between IASC and Taxation accounting, mainly in definition, recognition and measurement bases. Ideally, if accounting and taxation systems (and other societal systems of a country) were derived from its ideology, there should be no dualism in definition, recognition and measurement bases. This harmony will be more achievable if these two 'areas' are codified into the legal system. In the case of Indonesia, the 'national' accounting and taxation system, as well as other systems, should be derived from its ideology, Pancasila.

In the case of Indonesia, a reformation in almost all aspect of life including political, economic, and legal aspects, is necessary in order to be able to develop and implement an accounting system based on the country's ideology, Pancasila. There are some aspects of political, economic and legal, life in practice, which do not accord with the Pancasila ideology. As far as economics and accounting are concerned, there are some laws and practices which contradict with the values adopted by most Indonesian people, e.g. interest-based activities, gambling (speculative activities), monopoly, cartels, and the like. Especially since the rise of the 'New Order', which is biased towards individualism, hedonism, and capitalism the ideal 'Pancasila' values have been ignored.

It should be realised, that there are many ideologies which have been adopted world wide. Therefore, there should be a sort of 'international agreement'

regarding all aspects of life, which govern the relationships between and among countries. In accounting, there exist something like 'International Standards', set by the IASC. As Indonesia abides by these Standards, they should be applied for International purposes only, especially by the multi-national companies. Therefore, there will be two systems: the 'national' and 'international' systems. For internal purposes, companies should follow the 'national' system; and for 'international' purposes, companies should followed the 'international' system. Neither system can be avoided by the multi-national companies especially.

### 10.3. Suggestions for further research

This study has offered some ideas and information regarding the influence of environmental factors (ideological, political, economic, legal, social, and cultural as well as moral) on accounting systems. Therefore, the accounting system of a country (or group of countries) should be developed according to its (their) own environmental factors. Only in this way will the optimum usefulness of accounting information for the respective users be achieved. In particular, this study has provided some 'input' in order to develop Islamic accounting.

This study also provides 'input' for those who are involved in developing and setting the accounting standards in Indonesia, in order to develop an accounting system which accords with and is more suitable, to the Indonesian

ideological, political, economic, legal, social, cultural and moral concepts, which are based on 'Pancasila', as the state foundation, philosophy and ideology.

As the Pancasila ideology is a relatively new ideology, it has not been explored in enough detail. Therefore, it is important for those who are expert in this area to study and explore further the detailed concepts of politics, economics, law, society and culture, as well as the moral system, derived from the philosophy of Pancasila. Based on the results, then those who are expert in accounting may conduct research in, and propose an accounting system based on Pancasila. In doing so, the Islamic perspective toward accounting may be useful to be considered.

There are some topics in this regard which need to be studied and researched in the near future, including:

- the perception of the whole Indonesia society toward the 'current real life' compared to the 'ideal life' as contained in its ideology, philosophy, way of life, and moral systems, i.e. Pancasila. As the society may be stratified according to many 'characteristics', such study and research should be divided into some smaller but more intensive sub-studies or sub-researches according to the society's grouping.
- especially in accounting, there is a need for more intensive or deeper studies and researches regarding the perception of the whole 'accounting society', including the business society, managers, accountants, consultants, bankers,

consumers, and so on, regarding the 'ideal' accounting for the Indonesian situation (real and ideal).

To close, this study may be viewed as an effort to develop an ideal accounting system. As accounting may be viewed as a mean of reflecting reality, when reality is constructed in relation to ethical (moral) values, accounting should also be based upon such ethics. If it is not, the outcome may be misleading. The Western, conventional accounting reflects the Western reality; therefore, it is not always suitable for a society which adopts different ethical values, such as Indonesia, and Muslim society. It is suggested, therefore, that future research in accounting in Indonesia, especially, be focused on this concern.

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**Appendix to Chapter 1. Independent Muslim & Islamic Countries.**

<b>Countries</b>	<b>Muslim Population</b>	<b>Countries</b>	<b>Muslim Population</b>
<b><u>Far-East and Asia:</u></b>	<b>(&gt;%)</b>	<b><u>Africa South of Sahara:</u></b>	<b>(&gt;%)</b>
Afghanistan	99.00	Chad	50.00
Bangladesh	86.60	The Comoros	Majority
Brunei (official)	Majority	Djibouti	99.00
Indonesia	87.00	Eritria	50.00
Malaysia	53.00	Ethiopia	45.00
Maldives	99.00	The Gambia	85.00
Pakistan (Rep. of Islam)	95.00	Guinea	95.00
		Guinea-Bissau	40.00
<b><u>Middle-East &amp; North Africa</u></b>		Mali	80.00
		Mauritania (Rep. of Islam)	99.00
Algeria	99.00	Niger	85.00
Bahrain	90.00	Nigeria	47.20
Egypt	90.00	Senegal	90.00
Iran (Rep. of Islam)	90.00	Somalia	95.00
Iraq	95.00	Tanzania	97.00
Jordan	80.00		
Kuwait	95.00	<b><u>Ex-Soviet Countries:</u></b>	
Lebanon	60.00	Azerbaijan	
Libya	99.00	Kazakhstan	
Morocco	99.00	Kirgizia	
Oman	95.00	Tajikistan	
Qatar	99.00	Turkmenistan	
Saudi Arabia	99.00	Uzbekistan	
Sudan (Rep. of Islam)	99.00		
Syria	95.00		
Tunisia	99.00		
Turkey	99.00		
United Arab Emirates	99.00		
Yemen	99.00		

*Source:* African South of The Sahara 1994, 23rd Edition, Europa Publ. Ltd.  
The Far-East & Australasia 1995, 26th Edition, Europa Publ. Ltd.  
The Middle-East & North Africa 1992, 38th Edition, Europa Publ. Ltd.



**Appendix to Chapter 2: Questionnaire**

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**Part-A. About yourselves:**

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1. What is your age (in years)?  
 less than 30.    30 - 39    40 - 49    50 or more
2. What is your sex:    male                       female
3. Your formal education degree:    S1                       S2                       S3
4. Do you also work for, and/or as a partner of, an accounting firm?  
 Yes                       No

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**Part-B. Perception about Accounting and its Environment:**

---

5. Do you believe that accounting is closely related or influenced by its environmental factors such as ideology and political, economic, legal, social, cultural systems?  
 Yes                       No                       Not Sure

*(If your answer is YES, continue to the next question; otherwise, skip to Part-C)*

6. In your opinion, how strongly do these environmental factors influence accounting?
- |                     |                          |  |                 |
|---------------------|--------------------------|--|-----------------|
| a. Ideology         | <input type="checkbox"/> |  | 5 = very strong |
| b. Political system | <input type="checkbox"/> |  | 4 = strong      |
| c. Economic system  | <input type="checkbox"/> |  | 3 = not strong  |
| d. Legal system     | <input type="checkbox"/> |  | 2 = weak        |
| e. Social system    | <input type="checkbox"/> |  | 1 = very weak   |
| f. Cultural system  | <input type="checkbox"/> |  |                 |

7. In your opinion, will the differences in such environmental factors lead to the need for different accounting systems?  
 Yes                       No                       Not Sure

*(If your answer is YES, continue to the next question; otherwise, skip to Part-C)*

8. Will the differences influence the *Conceptual Framework* in terms of the following aspects?:
- |                                       | Yes                      | No                       | Not Sure                 |
|---------------------------------------|--------------------------|--------------------------|--------------------------|
| a. Users and Users ' Needs            | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| b. Objectives of Financial Statements | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| c. Assumptions                        | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

- d. Qualitative Characteristics
- e. Elements of Financial Statements
- f. Recognition Criteria
- g. Measurements
- h. Concepts of Capital and Capital Maintenance

9. The framework mentions seven groups of users and their information needs (Para.9). Could you please rank them according to the priority to whom the financial statements should be provided?

Rank (1 to 7)

- a. Investors
- b. Employees
- c. Lenders
- d. Suppliers and other trade creditors
- e. Customers
- f. Governments and their agencies
- g. Public

10. The framework also mentions that ‘As investors are providers of risk capital to the enterprise, the provision of financial statements that meet their needs will also meet most of the needs of other users that financial statements can satisfy’ (Para.10). Do you agree with this statements?

Yes       No       Not Sure

11. The framework mentions four types of information provided by the financial statements. Could you please rank them according to their importance?

Rank (1 to 4)

- a. Financial position (Balance Sheet)
- b. Performance (Income Statement)
- c. Changes in financial position (Cash-flow Statement)
- d. Notes and Supplementary Schedules

12. The framework mentions two assumptions underlying the preparation of financial statements. Do you think they are real or acceptable in practice?

- a. Accrual Basis  Yes       No       Not Sure
- b. Going Concern  Yes       No       Not Sure

13. The framework also mentions some Qualitative Characteristics (Paras. 24-45). According to their importance, how would you rank these Qualitative Characteristics?

- a. Understandability
  - b. Relevance
  - c. Materiality
- |                    |
|--------------------|
| Rank:              |
| 5 = very important |
| 4 = important      |

- |   |                          |  |                           |
|---|--------------------------|--|---------------------------|
| d. Reliability:                           |                          |  | 3 = neither important nor |
| i. Faithful Representation                | <input type="checkbox"/> |  | unimportant               |
| ii. Substance Over Form                   | <input type="checkbox"/> |  | 2 = unimportant           |
| iii. Neutrality                           | <input type="checkbox"/> |  | 1 = very unimportant      |
| iv. Prudence                              | <input type="checkbox"/> |  |                           |
| v. Completeness                           | <input type="checkbox"/> |  |                           |
| e. Comparability                          | <input type="checkbox"/> |  |                           |
| f. Constraint on Relevance & Reliability: |                          |  |                           |
| i. Timeliness                             | <input type="checkbox"/> |  |                           |
| ii. Balance between Benefit and Cost      | <input type="checkbox"/> |  |                           |

14. The framework defines the elements of financial statements as follows(Paras. 49-80):
- a. An *asset* is a resource controlled by the enterprise as a result of past events and from which future economic benefits are expected to flow to the enterprise.
  - b. A *liability* is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.
  - c. *Equity* is the residual *interest* in the assets of the enterprise after deducting all its liabilities.
  - d. Income is increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than relating to contributions from equity participants.
  - e. Expenses are decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to equity participants.

Do you think these definitions are acceptable in practice?

- |                |                          |     |                          |    |                          |          |
|----------------|--------------------------|-----|--------------------------|----|--------------------------|----------|
| a. Assets      | <input type="checkbox"/> | Yes | <input type="checkbox"/> | No | <input type="checkbox"/> | Not Sure |
| b. Liabilities | <input type="checkbox"/> | Yes | <input type="checkbox"/> | No | <input type="checkbox"/> | Not Sure |
| c. Equities    | <input type="checkbox"/> | Yes | <input type="checkbox"/> | No | <input type="checkbox"/> | Not Sure |
| d. Income      | <input type="checkbox"/> | Yes | <input type="checkbox"/> | No | <input type="checkbox"/> | Not Sure |
| e. Expenses    | <input type="checkbox"/> | Yes | <input type="checkbox"/> | No | <input type="checkbox"/> | Not Sure |

15. The framework provides criteria for recognition of the elements of financial statements as follows (Para. 83) Do you agree with these criteria?:
- |  | Yes                      | No                       | Not Sure                 |
|--|--------------------------|--------------------------|--------------------------|
| a. The item should meet the criteria provided.   | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| b. It is probable that any future economic benefit associated with the item will flow to or from the enterprise; and | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| c. The item has a cost or value that can be measured with reliability.   | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

16. The framework mentions some measurement bases which can be employed to different degrees in financial statements (Para. 100). Could you please rank them according to preferences?

- |                                   | Rank (1 to 4) |
|-----------------------------------|---------------|
| a. Historical cost.               | [ ]           |
| b. Current cost.                  | [ ]           |
| c. Realisable (settlement) value. | [ ]           |
| d. Present value.                 | [ ]           |

17. Do you think that these four measurement bases may be used altogether at the same time in preparing financial statements?

- Yes                       No                       Not Sure

18. The framework also mentions two ‘concepts of capital’: [a] Financial concept of capital, and [b] Physical concept of capital (Para.102). These concepts give rise to the ‘concept of capital maintenance’ for profit determination (Para.104). In your opinion, which one is the most appropriate to be adopted in preparing financial statements?

- Financial concept of capital  
 Physical concept of capital  
 Not sure.

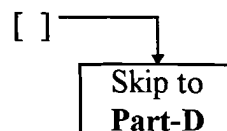
**Part-C. Your Perception Towards Islamic Accounting.**

19. Are you a Muslim?                       Yes                       No

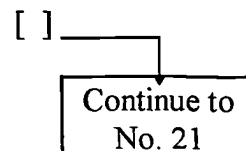
*(If your answer is YES, continue to the next question; if NO, skip to Part-D)*

20. How do you believe in Islam?

a. Islam is a *religion* which only governs the relationship between man and Allah (rituals); it emphasises the spiritual aspect of life only, and ignores the worldly-material aspect of life.



b. Islam is a ‘total way of life’ for all humankind which governs all aspects a human’s life including the spiritual and worldly-material aspects of life; it is not merely a religion.



21. Do you believe that the Islamic concepts of ideology, and its manifestations into political, economic, legal, social and cultural systems differ from other ideologies?

- Yes                       No                       Not Sure

*(If your answer is YES, continue to the next question; otherwise, skip to Part-D)*

22. According to your understanding, how strong are the differences, especially from the *Western* ideology?

- |                     |                          |                         |
|---------------------|--------------------------|-------------------------|
| a. Political system | <input type="checkbox"/> | 5 = extremely different |
| b. Economic system  | <input type="checkbox"/> |                         |
| c. Legal system     | <input type="checkbox"/> |                         |
| d. Social system    | <input type="checkbox"/> |                         |
| e. Cultural system  | <input type="checkbox"/> |                         |
|                     |                          | 4 = strongly different  |
|                     |                          | 3 = fairly different    |
|                     |                          | 2 = not so different    |
|                     |                          | 1 = no difference       |

23. In your opinion, will such differences affect the 'conceptual framework' so that there will be an 'Islamic framework' which differs from the 'western' or international framework?

	<input type="checkbox"/> Yes <input type="checkbox"/> Most likely Yes <input type="checkbox"/> Not Sure <input type="checkbox"/> Most likely No <input type="checkbox"/> No	Part-D
--	---	--------

24. If your answer is either 'Yes' on 'Most likely Yes', will the 'Islamic framework' result in a set of standards which differ from the International Accounting Standards?

	<input type="checkbox"/> Yes <input type="checkbox"/> Most likely Yes <input type="checkbox"/> Not Sure <input type="checkbox"/> Most likely No <input type="checkbox"/> No	Part-D
--	---	--------

25. If your answer is either 'Yes' or 'Most likely Yes', in which aspects will the differences be:

	Yes	Maybe	No
a. Users and Users ' Needs	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Objectives of Financial Statements	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Assumptions	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. Qualitative Characteristics	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
e. Elements of Financial Statements	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
f. Recognition Criteria	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
g. Measurements	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
h. Concepts of Capital and Capital Maintenance	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

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**D. If you have any comment or idea regarding this questionnaire or topic, please write down below, or on separate paper.**

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**Appendix to Chapter 3.**

Table 3.3(1). Key differences between small and large power distance societies.  
(general norm, family, school, and workplace)

<i>Small power distance</i>	<i>Large power distance</i>
Inequalities among people should be minimised	Inequalities among people are both expected and desired
There should be, and there is to some extent, interdependence between less and more powerful people	Less powerful people should be dependent on the more powerful; in practice, less powerful people are polarised between dependence and counter-dependence
Parents treat children as equals	Parents teach children obedience
Children treat parents as equals	Children treat parents with respect
Teachers expect initiatives from students in class	Teachers are expected to take all initiatives in class
Teachers are experts who transfer impersonal truths	Teachers are gurus who transfer personal wisdom
Students treat teachers as equals	Students treat teachers with respect
More educated persons hold less authoritarian values than less educated persons	Both more and less educated persons show almost equally authoritarian values
Hierarchy in organisations means an inequality of roles, established for convenience	Hierarchy in organisations reflects the existential inequality between higher-ups and lower-downs
Decentralisation is popular	Centralisation is popular
Narrow salary range between top and bottom of organisation	Wide salary range between top and bottom of organisation
Subordinates expect to be consulted	Subordinates expect to be told what to do
The ideal boss is a resourceful democrat	The ideal boss is a benevolent autocrat or good father
Privileges and status symbols are frowned upon	Privileges and status symbols for managers are both expected and popular

*Sources:* Hofstede, G., 1991, *Cultures and Organizations*, p. 37

Table 3.3(2). Key differences between small and large power distance societies.  
(politics and ideas)

<i>Small power distance</i>	<i>Large power distance</i>
The use of power should be legitimate and is subject to criteria of good and evil	Might prevail over right: whoever holds the power is right and good
Skills, wealth, power, and status need not go together	Skills, wealth, power, and status should go together
The middle class is large	The middle class is small
All should have equal rights	The powerful have privileges
Powerful people try to look less powerful than they are	Powerful people try to look as impressive as possible
Power is based on formal position, expertise, and ability to give rewards	Power is based on family or friends, charisma, and ability to use force
The way to change a political system is by changing the rules (evolution)	The way to change a political system is by changing the people at the top (revolution)
The use of violence in domestic politics is rare	Domestic political conflicts frequently lead to violence
Pluralist governments based on outcome of majority votes	Autocratic or oligarchic governments based on co-optation
Political spectrum shows strong centre and weak right and left wings	Political spectrum, if allowed to be manifested, shows weak centre and strong wings
Small income differentials in society, further reduced by the tax system	Large income differentials in society, further increased by the tax system
Prevailing religions and philosophical systems stress equality	Prevailing religions and philosophical systems stress hierarchy and stratification
Prevailing political ideologies stress and practice power sharing	Prevailing political ideologies stress and practice power struggle
Native management theories focus on role of employees	Native management theories focus on role of managers

*Sources:* Hofstede, G., 1991, *Cultures and Organizations*, p. 43

Table 3.4(1). Key differences between collectivist and individualist societies.  
(general norm, family, school, and workplace)

<i>Collectivist</i>	<i>Individualist</i>
People are born into extended families or other ingroups which continue to protect them in exchange for loyalty	Everyone grows up to look after him/herself and his/her immediate (nuclear) family only
Identity is based in the social network to which one belongs	Identity is based in the individual
Children learn to think in terms of 'we'	Children learn to think in terms of 'I'
Harmony should always be maintained and direct confrontations avoided	Speaking one's mind is a characteristic of an honest person
High-context communication	Low-context communication
Trespassing leads to shame and loss of face for self and group	Trespassing leads to guilt and loss of self-respect
Purpose of education is learning how to do	Purpose of education is learning how to learn
Diplomas provide entry to higher status groups	Diplomas increase economic worth and/or self-respect
Relationship employer-employee is perceived in moral terms, like a family link	Relationship employer-employee is a mutual advantage
Hiring and promotion decisions take employees' ingroup into account	Hiring and promotion decisions are supposed to be based on skills and rules only
Management is management of groups	Management is management of individuals
Relationship prevails over task	Task prevails over relationship

*Sources:* Hofstede, G., 1991, *Cultures and Organizations*, p. 67



Table 3.4(2). Key differences between collectivist and individualist societies.  
(politics and ideas)

<i>Collectivist</i>	<i>Individualist</i>
Collective interests prevail over individual interests	Individual interests prevail over collective interests
Private life is invaded by group(s)	Everyone has a right to privacy
Opinions are predetermined by group membership	Everyone is expected to have a private opinion
Laws and rights differ by group	Laws and rights are supposed to be the same for all
Low per capita GNP	High per capita GNP
Dominant role of the state in the economic system	Restrained role of the state in the economic system
Economy based on collective interests	Economy based on individual interests
Political power exercised by interest groups	Political power exercised by voters
Press controlled by the state	Press freedom
Imported economic theories largely irrelevant because unable to deal with collective and particularist interests	Native economic theories based on pursuit of individual self-interests
Ideologies of equality prevail over ideologies of individual freedom	Ideologies of individual freedom prevail over ideologies of equality
Harmony and consensus in society are ultimate goals	Self-actualisation by every individual is an ultimate goal

*Sources:* Hofstede, G., 1991, *Cultures and Organizations*, p. 73

Table 3.5(1). Key differences between feminine and masculine societies.  
(general norm, family, school, and workplace)

<i>Feminine</i>	<i>Masculine</i>
Dominant values in society are caring for others and preservation	Dominant values in society are material success and progress
People and warm relationship are important	Money and things are important
Everybody is supposed to be modest	Men are supposed to be assertive, ambitious, and tough
Both men and women are allowed to be tender and to be concerned with relationships	Women are supposed to be tender and to take care of relationships
In the family, both fathers and mothers deal with facts and feelings	In the family, fathers deal with facts and mothers with feelings
Both boys and girls are allowed to cry but neither should fight	Girls cry, boys don't; boys should fight back when attacked, girls shouldn't fight
Sympathy for the weak	Sympathy for the strong
Average student is the norm	Best student is the norm
Failing in school is a minor accident	Failing in school is a disaster
Friendliness in teachers appreciated	Brilliance in teachers appreciated
Boys and girls study same subjects	Boys and girls study different subjects
Work in order to live	Live in order to work
Managers use intuition and strive for consensus	Managers expected to be decisive and assertive
Stress on equality, solidarity, and quality of work life	Stress on equity, competition among colleagues, and performance
Resolution of conflicts by compromise and negotiation	Resolution of conflicts by fighting them out

*Sources:* Hofstede, G., 1991, *Cultures and Organizations*, p. 96

Table 3.5(2). Key differences between feminine and masculine societies.  
(politics and ideas)

<i>Feminine</i>	<i>Masculine</i>
Welfare society ideal	Performance society ideal
The needy should be helped	The strong should be supported
Permissive society	Corrective society
Small and slow are beautiful	Big and fast are beautiful
Preservation of the environment should have highest priority	Maintenance of economic growth should have highest priority
Government spends relatively large proportion of budget on development assistance to poor countries	Government spends relatively small proportion of budget on development assistance to poor countries
Government spends relatively small proportion of budget on armaments	Government spends relatively large proportion of budget on armaments
International conflicts should be resolved by negotiation and compromise	International conflicts should be resolved by a show of strength or by fighting
A relatively large number of women in elected political positions	A relatively small number of women in elected political positions
Dominant religions stress the complementarity of the sexes	Dominant religions stress the male prerogative
Women's liberation means that men and women should take equal shares both at home and at work	Women's liberation means that women will only admitted to positions hitherto only occupied by men

*Sources:* Hofstede, G., 1991, *Cultures and Organizations*, p. 103

Table 3.6(1) Key differences between weak and strong uncertainty avoidance societies. (general norm, family, school, and workplace)

<i>Weak uncertainty avoidance</i>	<i>Strong uncertainty avoidance</i>
Uncertainty is a normal feature of life and each day is accepted as it comes	The uncertainty inherent in life is felt as a continuous threat which must be fought
Low stress; subjective feeling of well-being	High stress; subjective feeling of anxiety
Aggression and emotions should not be shown	Aggression and emotions may at proper times and places be ventilated
Comfortable in ambiguous situations and with unfamiliar risks	Acceptance of familiar risks; fear of ambiguous situations and of unfamiliar risks
Lenient rules for children on what is dirty and taboo	Tight rules for children on what is dirty and taboo
What is different, is curious	What is different, is dangerous
Students comfortable with open-ended learning situations and concerned with good discussions	Students comfortable in structured learning situations and concerned with the right answers
Teachers may say 'I don't know'	Teachers supposed to have all the answers
There should not be more rules than is strictly necessary	Emotional need for rules, even if these will never work
Time is a framework for orientation	Time is money
Comfortable feeling when lazy; hard-working only when needed	Emotional need to be busy; inner urge to work hard
Precision and punctuality have to be learned	Precision and punctuality come naturally
Tolerance of deviant and innovative ideas and behaviour	Suppression of deviant ideas and behaviour; resistance to innovation
Motivation by achievement and esteem or belongingness	Motivation by security and esteem or belongingness

*Sources: Hofstede, G., 1991, Cultures and Organizations, p. 125*

Table 3.6(2). Key differences between weak and strong uncertainty avoidance societies. (politics and ideas)

<i>Weak uncertainty avoidance</i>	<i>Strong uncertainty avoidance</i>
Few and general laws and rules	Many and precise laws and rules
If rules cannot be respected, they should be changed	If rules cannot be respected, we are sinners and should repent
Citizen competence versus authorities	Citizen incompetence versus authorities
Citizen protest acceptable	Citizen protest should be repressed
Citizens positive towards institutions	Citizens negative towards institutions
Civil servants positive towards political process	Civil servants negative towards political process
Tolerance, moderation	Conservatism, extremism, law and order
Positive attitudes towards young people	Negative attitudes towards young people
Regionalism, internationalism, attempts at integration of minorities	Nationalism, xenophobia, repression of minorities
Belief in generalists and common sense	Belief in experts and specialisation
Many nurses, few doctors	Many doctors, few nurses
One group's truth should not be imposed on others	There is only one Truth and we have it
Human rights: nobody should be persecuted for their beliefs	Religious, political, and ideological fundamentalism and intolerance
In philosophy and science, tendency towards relativism and empiricism	In philosophy and science, tendency towards grand theories
Scientific opponents can be personal friends	Scientific opponents cannot be personal friends

*Sources:* Hofstede, G., 1991, *Cultures and Organizations*, p. 134

Table 3.7. Key differences between short-term and long-term orientation societies.

<i>Short-term orientation</i>	<i>Long-term orientation</i>
Respect for tradition	Adaptation of tradition to a modern context
Respect for social and status obligations regardless of cost	Respect for social and status obligations within limits
Social pressure to 'keep up with the Joneses' even if it means overspending	Thrift, being sparing with resources
Small savings quote, little money for investment	Large savings quote, funds available for investment
Quick results expected	Perseverance towards slow results
Concern with 'face'	Willingness to subordinate oneself for a purpose
Concern with possessing the Truth	Concern with respecting the demands of Virtue

*Sources:* Hofstede, G., 1991, *Cultures and Organizations*, p. 173

## Appendix to Chapter 7:

### Types, due date, and rate of Zakah.

#### (1) Zakah Nuqud

*Nuqud* originally meant gold and silver only. However, for *zakah* purposes, it covers also jewellery, money in any form, near money (cheques, savings accounts), loans to others, investment (in any form, e.g. shares, properties, etc.), and other personal property. The *dalil* (proofs) for the levy of *zakah* on these groups of property are obvious in the *Qur'an*, *Sunnah* and *Ijma'*, as has been mentioned before.

All these properties are zakatable when their amount altogether has reached the *nisab* (limit) and they have been in the possession of the owner for whole one lunar year. The due date starts from the first date the property reached the *nisab*. The general rate of *zakah* for this type of property is 2.5% (one-fortieth). There are, however, different rules for different property, and different schools of *fiqh*.

Type	Nisab
Gold	20 <i>mitsqal</i> , or 1 <i>dinar</i> , equivalent to 91.92 grams ( <i>Jumhur</i> ); and every full 4 <i>mitsqal</i> (1/5 of <i>nisab</i> ) of the excess.
Silver	200 <i>dirham</i> , equivalent to 700 grams (Hanafi), or 643 grams ( <i>Jumhur</i> ); and every full 40 <i>dirham</i> (1/5 of <i>nisab</i> ) of the excess.

*Jumhur*, except the Shafii school allow the combination between both gold and silver altogether, to calculate the *nisab*. Therefore, one who has 100 *dirhams* (silver) and 5 *mistqal* (gold) which has a value equal to 100 *dirhams*, should pay

*zakah* because his property has already reached the *nisab* (i.e. 200 *dirhams*). Golden and silver jewellery, whatever the forms, which are above the normal needs, are also zakatable. However, the zakatable value is not the current price of the jewellery itself, but of the original material, as they sometimes differ. If the jewellery is made of mixed materials, the most prominent one should be used as the base. In this matter, there are some different opinions among scholars.

For money (cash, saving in banks, near money, including cheque, shares, etc.), the *nisab* used is the price of gold or silver. If the amount of money reaches the price of 91.92 grams of gold or 643 grams of silver, the *zakah* should be paid on it. If they are different, the silver price should be used.

For loans (to others), there are different opinions. The Hanafi school distinguishes loans into three categories according to origin: (1) secured loans (*qawiy*), which occurred due to trading transaction (accounts receivable), (2) not well secured loans (*mutawassit*), which come from non-trading transactions, and (3) weak or insecure loans (*dha'if*), which were incurred due to some religious or legal duties, such as *mahar* (dowry), *kafarat* (fine for religious offences), unpaid inheritance, etc. For the first type of loans, the *zakah* is 2.5% when the amount reaches 40 dirham. For the second type of loans, the *zakah* is 2.5% when the amount reaches 200 *dirham*. Both are payable after the *hawl* (one lunar year) from the first time the loan was made. The last type of loan is zakatable only one lunar year (*hawl*) after the loan has been repaid.



In the Maliki school's opinion, the second and third types of loan referred to above need *hawl* after being received to be zakatable; while the first type of loan is zakatable once at the time of payment. The Shafii school, however, opines that *zakah* on loans of gold, silver and merchandise is cumulative, and should be paid when received back. The Hanbali school, on the other hand, opines that loans are zakatable, whether they are short-term or long-term, whether the debtors recognise it or not and whether they are able to pay immediately or not. However, the payment of *zakah* should be deferred until they are received back.

In short, most jurists agree that if the loan is 'life or developing', that is, the loan is recognised by the debtors and they are ready to pay when due or asked, then the loan is zakatable. However, if the loan is seemed to be non-payable, or the debtor asks for deferral, or if they even refuse to recognised it, then the loan is not zakatable.

Regarding shares and other *investments* (in any form, including lands, properties, jewellery, etc.), they should be valued according to their current market price (net-realizable value).

The key point for property to be zakatable is 'ownership', whether it is used by others (such as being rented or borrowed) or not. All these properties are calculated together, and after considering the immediate loan owed by the owner (long-term loans such as a mortgage on a house, should not be deducted from zakatable property).

**b. Treasures, Natural Resources, and Found Properties.**

There are some different opinions among scholars regarding the definition and the treatment of treasures (*rikaaz*, properties found from the earth or seas, as they used to belong to ancient people) and natural resources (*ma'din*), and *kanz* (property which has been kept in secret place for long time so that the original owner is unknown, and has been discovered).

	Hanafi	Maliki	Syafii	Hanbali
Definition	Both treasure and natural resources are the same, i.e. anything from the earth	Natural resources: gold and silver	Natural resources: anything from earth which needs to be melted and processed, such as gold and silver	Any form of natural resources, either it is solid, fluid or gas.
Rate	20% (1/5)	20% (1/5)	1/40 (2.5%)	1/40 (2.5%)

The rate of 20% (1/5) is because they are considered as '*ghanimah*', which needs no expensive processes to discover and make them usable. However, if the process of finding or extract them is expensive, then the rate should be 2.5%. For today, the Hanbali school seems to be most relevant because it includes all kinds of natural resources such as oil and natural gas, which are probably more precious than gold and silver.

**c. Merchandise Goods.**

Merchandise goods are anything which is intended to be traded. Therefore, golden or silver goods, vehicles, buildings and anything else that is for trading purpose falls in this category. However, buildings to live in (house), or use as offices and workplaces, shops and factories are not zakatable. The term

‘productive’ in this matter refers to goods which generate profit directly by being traded. Therefore, for manufacturing and extracting company, their products are considered as merchandise goods as they are intended to be sold.

Merchandise goods are zakatable under the following conditions:

- (1) The amount already reaches the amount equal to the *nisab* of gold or silver. The money value of the goods may vary from place to place. Maliki scholars distinguishes the *zakah* payers, i.e. the traders or sellers into two categories: *mudir* and *muhtakir*. A *mudir* is one who buys and sells goods at any time, without considering the changes in price so that he/she does not hoard the goods for a speculative purpose. A *muhtakir*, on the other hand, is a speculator who keeps goods to sell when the price increases. Every month, the former (*mudir*) should calculate his money and inventories owned altogether. By the end of the period (lunar year), if the amount reaches the *nisab*, and after considering the loans he owes, then he should calculate and pay the *zakah*. For the latter (*muhtakir*), he should not pay *zakah* until the inventories are sold. For *Jumhur*, both are the same, so they do not need different treatment.
- (2) *Hawl*: the goods should have been owned for one lunar year since the first goods were acquired and reached the first *nisab*.
- (3) *Niyaa*t: the intention to commit in trading at the first time setting up the business, or buying goods.
- (4) The goods are acquired through exchange transaction, i.e. buying-selling, or renting/leasing. Therefore, goods acquired otherwise, such as by

inheritance, donation, gift and the like, are not subject to this *zakah*. They will be subject to *nuqud zakah*, after one lunar year of possession.

- (5) The goods are not for personal use. Therefore, if the goods are intended for trade but, in the course of time, are used personally, the *hawl* is broken.
- (5) Within the course of *hawl*, the goods should not be converted into money which is less than *nisab*.
- (6) Those goods are not treated as the subject of any other type of *zakah*.

At the end of the *hawl* period, the value of goods should be calculated based on the 'price' when the *zakah* is paid, not on the 'purchasing price'. The value of all goods may be aggregated to calculate the aggregate value of zakatable goods. This means that the 'original value' (purchasing price) of goods ('capital') and the 'unrealised profit' are aggregated together to calculate *zakah*.

#### *Mudarabah and Musharakah enterprise.*

As has been discussed in the previous section/chapter, *mudarabah* is a business where the capital is provided by one party, while the management is run by other party (*mudharib*); and they agree to share the profits at a predetermined ratio. *Musharakah* (partnership), on the other hand, is a business where some individuals contribute capital; the running of the business could be in the hands of, one or some of them, or another party (a person paid to be manager). The contributors agree to share the profit in a predetermined ratio.

For the purpose of *zakah* calculation, the organisation can be seen as an 'artificial person'. Therefore, the *zakah* should be calculated and paid from the

‘net-working capital’ (cash, receivable, and profit generating capital after considering immediate loan owed) of the business, before the calculation and distribution of profits. In addition, for the parties which do not contribute any financial capital, the profit-share they will receive will also become the subject of *zakah* if it reaches the *nisab* and after the *hawl* (one lunar year) in possession. However, it is the duty of the owners, as they are the *zakah* payers, to obtain information regarding the value of assets of the business they own, in order to be able to calculate *zakah* payable by them. In this regard, and for technical matters, the directors of the business enterprise may represent them in calculating and paying the *zakah*. Accounting in an Islamic system should take this matter as the primary objective of financial reporting.

#### *d. Zakah on agriculture.*

What is meant by ‘agriculture’ in Islamic jurisprudence is ‘crops industry’ which produces fruits and other foods; therefore, cattle farming (animal husbandry) is excluded, because it is a different subject of *zakah*. In general, *zakah* on crops is due at the time of harvesting. The rates are 5% and 10%, depending on the way the crop is watered. For the crops which are naturally or freely watered by rain or from the rivers, the *zakah* rate is 10%; and 5% if it is watered by using paid technological helps.

However, there are some conditions for this type of *zakah*. The general conditions for the payers are the same as for other *zakah*, they must be mature,

mentally normal, Muslims, etc. The conditions for the land where the crops grow, however, differ for each school of *fiqh*.

The Hanafi school opines that, besides the above general conditions, there are some additional conditions:

- (1) The land where the crops grow is an *ushriyya* (un-taxed) land. Therefore, *zakah* is not levied on *kharajiyyah* (taxed) land, because *ushriyyah* and *kharajiyyah* could not happen on the same land at the same time.
- (2) Crops are grown on that land. If there are no crops, then there is no *zakah* on it.
- (3) The crop grown on it is intentionally grown by the owner to gain its fruits. Therefore, there is no *zakah* for other than fruit crops.

The Maliki school proposes two additional conditions:

- (1) The crops are 'seed plants' and *tsamrah* (such as dates, grapes, and olives). Therefore, there is no *zakah* for *fakihah* (such as apple and pomegranate), and also for vegetables.
- (2) The amount reaches 5 *wasaq* (653 kilograms).

The Shafii school proposes three additional conditions:

- (1) The crops are those which can satisfy the need for main food, can be stored for a reasonable time, and can be planted by other people; for example, in the group of 'seed plants' are: wheat, tobacco, corn, rice, and the like; among the fruits are: dates and grapes. There is no *zakah* for the group of

vegetables and *fakihah* such as: cucumber, melon, pomegranate, and bamboo shoot.

- (2) The amount reaches the *nisab* (653 kg.).
- (3) There is an identifiable owner of the land.

The Hanbali school proposes three additional conditions:

- (1) The crops can be stored for a relatively long time, can be measured, can be dried (these last two are for seed plants), and can be planted by other people. There is no *zakah* for *fakihah* (fruits, such as avocados and apple) and vegetables.
- (2) The amount reaches the *nisab* (5 *wasag*); for seed plants, after it has been skinned and cleaned; and for the fruit, after it has been dried.
- (3) The owners are free Muslim people. Therefore, crops of which the owner is unidentified are not zakatable.

Furthermore, in calculating the *nisab*, crops can be combined together with other crops in the same type; therefore, one type of dates can be joined together with other types of dates, a type of grapes with other types of grapes, and so on. However, combination is not allowed for different classes of crops; dates cannot be combined together with grapes, and so on.

#### *Crops zakah on rented or borrowed land.*

There are different opinions among schools regarding the *zakah* of crops on rented land, whether it is the renter or the owner of land who should pay the *zakah*.

*Jumhur*, except the Hanafi school, opine that *zakah* should be paid by the renter, because he is the one who will use the land and receive the benefit from it. “If someone rents a piece of land, and he grows crops on it; or he borrows the land and grows crops on it, the result of the crops is zakatable. The *zakah* should be paid by those who rent or borrow that land, not the owner, because the *zakah* is levied on the crops”. By renting or lending his land to another, the owner has sacrificed his right (opportunity) to utilise his land for his benefit; therefore, it is unjust for the *zakah* to be imposed on him.

Moreover, *zakah* on crops is payable regardless whether the land where the crops grow is taxable or not, because the subject matter is different. Tax on land is levied due to the ownership of land; therefore, the land will remain taxable even if no crops grow on it. The only exception is for crops which grow on a ‘*wakaf*’ land (a land donated for public use) because the owner is not identified.

#### *e. Zakah on Livestock.*

There are only three groups of cattle which are zakatable: camels, cows, and sheep, whatever their names. Therefore, included in the group of cows are buffalo and the like; and in the group of sheep is goats, and the like. Some jurists also include horses as zakatable, at a general rate 2.5% of the total value of the horses owned which are over and above those used by the owner for riding, hauling or farming. The jurists give five conditions for livestock being zakatable.

- (1) The livestock are in captivity (husbandry), not wild animals.



- (2) The amount reaches the *nisab*, which differs for each group of livestock.
- (3) The livestock have been owned for one lunar year. If the ownership is broken for some reason (e.g. the livestock have been lost or sold), a new calculation should apply. If the livestock are traded, the rule for 'merchandise' *zakah* will apply.
- (4) The livestock are naturally fed--grazing on the farms (*sa'imah*), not those who are fed (in close stables, cowsheds or pens and such enclosures--by the owner with costs (*ma'lufah*). However, the Maliki school does not agree with this condition. According to the Maliki school, *zakah* is payable on all types of livestock, regardless of the way they are fed, and regardless whether they are utilised to work or not.

#### Nisab and Zakah for Cattle.

No.	Nisab	Zakah
1.	30-39 cattle	1 <i>tabi'</i> or <i>tabi'ah</i> (1-2 years old bull or cow)
2.	40-59 cattle	1 <i>musinnah</i> or <i>tsaniyyah</i> (2-3 year old bull or cow)
3.	60-69 cattle	2 <i>tabi'</i> or <i>tabi'ah</i>
4.	70-79 cattle	1 <i>tabi'</i> or <i>tabi'ah</i> and 1 <i>musinnah</i> or <i>tsaniyyah</i>
5.	80-89 cattle	2 <i>musinnah</i> or <i>tsaniyyah</i>
And so on, for every multiple of 30 cattle, there will be 1 <i>tabi'</i> or <i>tabi'ah</i> for zakah; and for every multiple of 40 there will be 1 <i>musinnah</i> or <i>tsaniyyah</i> for zakah.		

#### Nisab and Zakah for Sheep/Goat.

No.	Nisab	Zakah
1.	40-120 sheep	1 sheep
2.	121-200 sheep	2 sheep
3.	201-399 sheep	3 sheep
4.	400 sheep	4 sheep
And after that amount, there will be 1 sheep to pay for every 100 sheep.		
The sheep used to pay zakah should be 1 year full old and healthy sheep ( <i>jumhur</i> ), or 2 years old and healthy sheep (Shafii).		

Nisab and zakah for camels:

No.	Nisab	Zakah
1.	5 - 9 camels	1 sheep
2.	10-14 camels	2 sheep
3.	15-19 camels	3 sheep
4.	20-24 camels	4 sheep
5.	25-35 camels	1 <i>bint makhdadh</i> (1-2 years old she-camel)
6.	36-45 camels	1 <i>bint labun</i> (2-3 years old she-camel)
7.	46-60 camels	1 <i>hiqqah</i> (3-4 years old she-camel)
8.	61-75 camels	1 <i>jadz'ah</i> (4-5 years old she-camel)
9.	76-90 camels	2 <i>bint labun</i>
10.	91-120 camels	2 <i>hiqqah</i>
11.	121-149 camels	2 <i>hiqqah</i> <u>plus</u> the rules no.1 to no. 5 for the excess.
12.	150-154 camels	3 <i>hiqqah</i>
13.	155- camels	3 <i>hiqqah</i> <u>plus</u> the rules no.1 to no. 5 for the excess.
<p>And so forth, for every multiple of 50 camels, there will be 1 <i>hiqqah</i> for zakah; and for every multiple for 5 in excess of this, there will be 1 sheep added until 25 excess, in which there will be 1 <i>bint makhdadh</i> added.</p> <p>When the amount reaches 200 camels, the zakah is 4 <i>hiqqahs</i>. Male camels should not been used to pay zakah, except when the price of a male camel is equal to the price of a female camel. This rule does not apply for cows and sheep.</p> <p>The sheep used to pay zakah should be over 6 months old (Hanbali), 1-2 years old (Hanafi), or a full 2 years old (Shafii).</p>		

## **Appendix to Chapter 8:**

### **“The 45 points of Guidance to Comprehend & Implement the PANCASILA”**

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#### **The First Principle: BELIEF IN THE ONE AND ONLY GOD**

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Indonesian people should:

1. express their belief in and devotion to the One and Only God;
2. believe in and be subject to the One and Only God, according to their own religion and faith based on just and civilised humanity;
3. develop a respectful attitude and co-operation among the followers of various religions and faiths;
4. maintain harmonious life among the followers of various religions and faiths;
5. [realise that] religion and faith toward the One and Only God is a personal matter between individuals and the One and Only God they believe in;
6. develop a respectful attitude in freedom to perform religious duties (ritual worship) according to their own religion and faith;
7. not force others to follow a certain religion and faith;

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#### **The Second Principle: JUST AND CIVILISED HUMANITY**

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Indonesian people should:

1. acknowledge and treat people according to their dignity and status as creatures of the One and Only God;
2. acknowledge equal status, equal basic rights and duties of all people, regardless their ethnic group, descent, religion, sex, social status, colour, and so on;
3. develop an attitude of mutual affection among people;
4. develop an attitude of consideration (*tenggang-rasa*) and being open-minded (*tepo-seliro*);
5. develop an attitude of not being unfair (*tidak semena-mena*) toward others;
6. uphold humane values;
7. delight in doing humane (social) activities;
8. have courage to defend the truth and justice;
9. realise that they are parts of the whole people in this world;
10. develop an attitude of mutual respect and co-operation with other nations;

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**The Third Principle: THE UNITY OF INDONESIA**

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Indonesian people should:

1. be able to place unity, oneness and interest and safety of the nation and state as a common interest above personal or group interests;
2. be able and pleased to sacrifice for the interest of nation and state, when needed;
3. develop the feeling of love (affection) toward their motherland and people;
4. develop the feeling of pride to be the people and to have the motherland, of Indonesia;
5. maintain the world order based on freedom, eternal peace and social justice;
6. develop the Indonesian unity based on “Unity in Diversity” (the motto, “Bhineka Tunggal Ika”);
7. advance association for Indonesian people unity and oneness;

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**The Fourth Principle:  
DEMOCRACY GUIDED BY THE INNER WISDOM IN THE UNANIMITY  
ARISING OUT OF DELIBERATIONS AMONGST REPRESENTATIVES**

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Indonesian people should:

1. [realise that] as citizens and society members, all Indonesian people have equal status, rights and duties;
2. not force their own will on others;
3. give priority to deliberation (*musyawarah*) in making decisions for common interests;
4. [implement] deliberation to achieve consensus based on the family spirit;
5. respect and uphold any decision reached as a result of the deliberation process;
6. with good intention and responsibility, accept and implement the results of deliberation;
7. within the deliberation process, put priority on common interest above personal and group interest;
8. perform deliberation open-mindedly and in accordance with noble inner-self;
9. [be aware that] the decision taken should be morally accountable to the One and Only God, upholding people’s dignity and status, truth and just values, prioritise the unity and oneness for common interest;
10. put trust in the representatives to perform deliberation;

---

**The Fifth Principle:**  
**SOCIAL JUSTICE FOR THE WHOLE OF THE PEOPLE OF INDONESIA**

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Indonesian people should:

1. develop noble deeds, which reflect the family and a co-operative attitude and situation;
2. develop the attitude of justice toward others;
3. maintain the balance between rights and duties;
4. respect other people's rights;
5. delight in giving help to other people so that they may be able to stand alone;
6. not use personal ownership rights for business exploiting other people;
7. not use personal ownership rights for wasteful, extravagant and luxurious life;
8. not use personal ownership rights for matters which contradict with or harm the common/public interests;
9. delight in working hard;
10. delight in respecting other people's deeds which are useful for common advancement and prosperity;
11. delight in doing any deed for creating equitable advancement and social justice;

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Source: Badan Pembinaan, Pendidikan dan Pelaksanaan P-4 (BP-7), 1996, *Bahan Penataran P-4: Pancasila/P-4* (Lampiran dari Tap. No. II/MPR/1978), Jakarta: BP-7.

**Appendix 9.1: Variables, Variable Names, and Scale.**

Var.	Variable Names	Scale
<b><i>Respondents' Characteristics Group:</i></b>		
A	AGE	Nominal
B	SEX	Nominal
C	DEGREE	Nominal
D	PARTNERSHIP	Nominal
<b><i>General:</i></b>		
E	Environmental Factors==>Accounting?	Nominal
F	Ideological Factor-Strength	Ordinal
G	Political Factor-Strength	Ordinal
H	Economical Factor-Strength	Ordinal
I	Legal Factor-Strength	Ordinal
J	Social Factor-Strength	Ordinal
K	Moral Factor-Strength	Ordinal
L	Cultural Factor-Strength	Ordinal
M	Different Environment ==> Different Accounting?	Nominal
<b><i>IASC Conceptual Framework:</i></b>		
N	Users Different?	Nominal
O	Objectives Different?	Nominal
P	Basic Assumption Different?	Nominal
Q	Qualitative Characteristics Different?	Nominal
R	Element of F/S Different?	Nominal
S	Recognition Criteria Different?	Nominal
T	Measurement Criteria Different?	Nominal
U	Capital Concepts Different?	Nominal
V	Investors Rank	Ordinal
W	Employees Rank	Ordinal
X	Creditors Rank	Ordinal
Y	Suppliers Rank	Ordinal
Z	Customers Rank	Ordinal
AA	Government Rank	Ordinal
AB	Society Rank	Ordinal
AC	For Investors ==>For All?	Nominal
AD	Balance Sheet Importance Rank	Ordinal
AE	Income Statement Importance Rank	Ordinal
AF	Cash-Flows Statement Importance Rank	Ordinal
AG	Notes Importance Rank	Ordinal
AH	Accrual Assumptions?	Nominal
AI	Going Concern Assumption?	Nominal
AJ	Understandability Score	Ordinal
AK	Relevant Score	Ordinal
AL	Materiality Score	Ordinal
AM	Faithfulness Score	Ordinal

**Appendix 9.1 (cont.):**

<i>IASC Conceptual Framework (cont.):</i>		
Var.	Variable Names	Scale
AN	Substance Over Form Score	Ordinal
AO	Neutrality Score	Ordinal
AP	Consistency Score	Ordinal
AQ	Comparability Score	Ordinal
AR	Comprehensiveness Score	Ordinal
AS	Timeliness Score	Ordinal
AT	Benefit-Cost Score	Ordinal
AU	Assets Definition OK?	Nominal
AV	Liability Definition OK?	Nominal
AW	Owners' Equity Definition OK?	Nominal
AX	Revenues Definition OK?	Nominal
AY	Expenses Definition OK?	Nominal
AZ	Recognition: Definition Agree?	Nominal
BA	Recognition: Future Benefit Agree?	Nominal
BB	Recognition: Value-ability Agree?	Nominal
BC	Historical Cost Rank	Ordinal
BD	Current Value Rank	Ordinal
BE	Realisable Value Rank	Ordinal
BF	Present Value Rank	Ordinal
BG	Combination of Valuation Possible?	Nominal
BH	Capital Concepts	Nominal
<i>Islamic Concepts:</i>		
BI	Muslim?	Nominal
BJ	Believe Islam = 'Ideology'?	Nominal
BK	Islamic Ideology =/= Western Ideologies?	Nominal
BL	Islamic Political Concept vs. Western's?	Ordinal
BM	Islamic Economic Concept vs. Western's?	Ordinal
BN	Islamic Legal Concept vs. Western's?	Ordinal
BO	Islamic Social Concept vs. Western's?	Ordinal
BP	Islamic Cultural Concept vs. Western's?	Ordinal
BQ	Islamic Conceptual Framework vs. Western's?	Ordinal
BR	Islamic Accounting Standards Different?	Ordinal
BS	Islamic Users Different?	Nominal
BT	Islamic Objectives Different?	Nominal
BU	Islamic Basic Assumptions Different?	Nominal
BV	Islamic Qualitative Characteristics Different?	Nominal
BW	Islamic Element of F/S Different?	Nominal
BX	Islamic Recognition Criteria Different?	Nominal
BY	Islamic Measurement Criteria Different?	Nominal
BZ	Islamic Capital Concept Different?	Nominal

**Appendix 9.2: Frequency, all variables.**

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**A AGE**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
30 - 39 years	2	35	64.8	64.8	64.8
40 - 49 years	3	11	20.4	20.4	85.2
<30 years	1	6	11.1	11.1	96.3
>=50 years	4	2	3.7	3.7	100.0
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 54 Missing cases 0

---

**B SEX**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Male	1	42	77.8	77.8	77.8
Female	0	12	22.2	22.2	100.0
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 54 Missing cases 0

---

**C DEGREE**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
S-2	2	25	46.3	46.3	46.3
S-1	1	22	40.7	40.7	87.0
S-3	3	7	13.0	13.0	100.0
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 54 Missing cases 0

---

**D PARTNER**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Non-Partner	0	34	63.0	63.0	63.0
Partner	1	20	37.0	37.0	100.0
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 54 Missing cases 0

---



**E Environmental Factors?**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Yes	1	49	90.7	90.7	90.7
No/Not-Sure	0	5	9.3	9.3	100.0
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 54 Missing cases 0

---

**F Ideological Factor Strength**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Strong	3	26	48.1	53.1	53.1
Moderate	2	13	24.1	26.5	79.6
Weak	1	10	18.5	20.4	100.0
	.	5	9.3	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 49 Missing cases 5

---

**G Political Factors Strength**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Strong	3	31	57.4	63.3	63.3
Moderate	2	13	24.1	26.5	89.8
Weak	1	5	9.3	10.2	100.0
	.	5	9.3	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 49 Missing cases 5

---

**H Economical Factor Strength**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Strong	3	46	85.2	93.9	93.9
Moderate	2	2	3.7	4.1	98.0
Weak	1	1	1.9	2.0	100.0
	.	5	9.3	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 49 Missing cases 5

---

**I Legal Factor Strength**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Strong	3	36	66.7	73.5	73.5
Moderate	2	13	24.1	26.5	100.0
.	.	5	9.3	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 49 Missing cases 5

---

**J Social Factor Strength**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Moderate	2	21	38.9	42.9	42.9
Strong	3	21	38.9	42.9	85.7
Weak	1	7	13.0	14.3	100.0
.	.	5	9.3	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 49 Missing cases 5

---

**K Moral Factor Strength**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Strong	3	25	46.3	51.0	51.0
Moderate	2	15	27.8	30.6	81.6
Weak	1	9	16.7	18.4	100.0
.	.	5	9.3	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 49 Missing cases 5

---

**L Cultural Factor Strength**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Strong	3	21	38.9	42.9	42.9
Moderate	2	15	27.8	30.6	73.5
Weak	1	13	24.1	26.5	100.0
.	.	5	9.3	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 49 Missing cases 5

---

**M Different Environmental Factors==>Different Accounting System?**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Yes	1	39	72.2	79.6	79.6
No/NotSure	0	10	18.5	20.4	100.0
	.	5	9.3	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 49 Missing cases 5

---

**N Users Differents?**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Yes	1	34	63.0	87.2	87.2
No/NotSure	0	5	9.3	12.8	100.0
	.	15	27.8	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

---

**O Objectives Differents?**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Yes	1	34	63.0	87.2	87.2
No/NotSure	0	5	9.3	12.8	100.0
	.	15	27.8	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

---

**P Basic Assumptions Differents?**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Yes	1	31	57.4	79.5	79.5
No/NotSure	0	8	14.8	20.5	100.0
	.	15	27.8	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

---

**Q Qualitative Characteristics Different?**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Yes	1	25	46.3	64.1	64.1
No/NotSure	0	14	25.9	35.9	100.0
	.	15	27.8	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

---

**R Financial Statements' Elements Differents?**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Yes	1	25	46.3	64.1	64.1
No/NotSure	0	14	25.9	35.9	100.0
	.	15	27.8	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

---

**S Recognition Criteria Different?**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Yes	1	33	61.1	84.6	84.6
No/NotSure	0	6	11.1	15.4	100.0
	.	15	27.8	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

---

**T Measurement Criteria Different?**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Yes	1	31	57.4	79.5	79.5
No/NotSure	0	8	14.8	20.5	100.0
	.	15	27.8	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

---

**U Capital Concept Different?**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Yes	1	27	50.0	69.2	69.2
No/NotSure	0	12	22.2	30.8	100.0
	.	15	27.8	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

---

**V Investors Rank**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
	1	28	51.9	71.8	71.8
	2	3	5.6	7.7	79.5
	3	3	5.6	7.7	87.2
	6	2	3.7	5.1	92.3
	7	2	3.7	5.1	97.4
	4	1	1.9	2.6	100.0
	.	15	27.8	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

---

**W Employees Rank**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
	4	11	20.4	28.2	28.2
	6	9	16.7	23.1	51.3
	5	7	13.0	17.9	69.2
	3	6	11.1	15.4	84.6
	2	4	7.4	10.3	94.9
	1	1	1.9	2.6	97.4
	7	1	1.9	2.6	100.0
	.	15	27.8	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

---

**X Creditors Rank**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
	2	21	38.9	53.8	53.8
	3	11	20.4	28.2	82.1
	1	3	5.6	7.7	89.7
	5	2	3.7	5.1	94.9
	4	1	1.9	2.6	97.4
	7	1	1.9	2.6	100.0
	.	15	27.8	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

---

**Y Suppliers Rank**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
	4	13	24.1	33.3	33.3
	3	12	22.2	30.8	64.1
	5	6	11.1	15.4	79.5
	2	5	9.3	12.8	92.3
	6	3	5.6	7.7	100.0
	.	15	27.8	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

---

**Z Customers Rank**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
	5	14	25.9	35.9	35.9
	6	12	22.2	30.8	66.7
	7	8	14.8	20.5	87.2
	4	3	5.6	7.7	94.9
	1	1	1.9	2.6	97.4
	3	1	1.9	2.6	100.0
	.	15	27.8	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

---

**AA Government Rank**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
	6	9	16.7	23.1	23.1
	4	8	14.8	20.5	43.6
	5	7	13.0	17.9	61.5
	3	6	11.1	15.4	76.9
	1	3	5.6	7.7	84.6
	2	3	5.6	7.7	92.3
	7	3	5.6	7.7	100.0
	.	15	27.8	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

---

**AB Society Rank**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
	7	24	44.4	61.5	61.5
	6	4	7.4	10.3	71.8
	1	3	5.6	7.7	79.5
	2	3	5.6	7.7	87.2
	5	3	5.6	7.7	94.9
	4	2	3.7	5.1	100.0
	.	15	27.8	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

---

**AC Investors = All Users?**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
No/NotSure	0	21	38.9	53.8	53.8
Yes	1	18	33.3	46.2	100.0
	.	15	27.8	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

---

**AD Balance Sheet Rank**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
	2	21	38.9	53.8	53.8
	3	10	18.5	25.6	79.5
	1	8	14.8	20.5	100.0
	.	15	27.8	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

---

**AE Profit & Loss Statements Rank**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
	1	29	53.7	74.4	74.4
	2	8	14.8	20.5	94.9
	3	2	3.7	5.1	100.0
	.	15	27.8	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

---

**AF Cash-Flows Statement Rank**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
	3	27	50.0	69.2	69.2
	2	10	18.5	25.6	94.9
	1	2	3.7	5.1	100.0
	.	15	27.8	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

---

**AG Notes & Supplementary Schedules Rank**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
	4	39	72.2	100.0	100.0
	.	15	27.8	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

---



**AH Assrual Assumption Important?**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Yes	1	37	68.5	94.9	94.9
No/NotSure	0	2	3.7	5.1	100.0
	.	15	27.8	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

---

**AI Going Concern Assumption Important?**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Yes	1	34	63.0	87.2	87.2
No/NotSure	0	5	9.3	12.8	100.0
	.	15	27.8	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

---

**AJ Understandability Score**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Very Important	5	22	40.7	56.4	56.4
Important	4	16	29.6	41.0	97.4
Moderate	3	1	1.9	2.6	100.0
	.	15	27.8	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

---

**AK Relevant Score**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Very Important	5	21	38.9	53.8	53.8
Important	4	15	27.8	38.5	92.3
Moderate	3	3	5.6	7.7	100.0
	.	15	27.8	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

---

**AL Materiality Score**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Important	4	21	38.9	53.8	53.8
Very Important	5	10	18.5	25.6	79.5
Moderate	3	7	13.0	17.9	97.4
	2	1	1.9	2.6	100.0
	.	15	27.8	Missing	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

**AM Faithfulness Score**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Very Important	5	28	51.9	71.8	71.8
Important	4	10	18.5	25.6	97.4
Moderate	3	1	1.9	2.6	100.0
	.	15	27.8	Missing	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

**AN Substance Over Form Score**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Important	4	20	37.0	51.3	51.3
Moderate	3	10	18.5	25.6	76.9
Very Important	5	7	13.0	17.9	94.9
	1	1	1.9	2.6	97.4
	2	1	1.9	2.6	100.0
	.	15	27.8	Missing	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

**AO Neutrality**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Important	4	19	35.2	48.7	48.7
Moderate	3	9	16.7	23.1	71.8
Very Important	5	9	16.7	23.1	94.9
	2	2	3.7	5.1	100.0
	.	15	27.8	Missing	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

**AP Consistency Score**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Important	4	17	31.5	43.6	43.6
Moderate	3	12	22.2	30.8	74.4
Very Important	5	8	14.8	20.5	94.9
	2	2	3.7	5.1	100.0
	.	15	27.8	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

---

**AQ Comparability**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Important	4	20	37.0	51.3	51.3
Moderate	3	10	18.5	25.6	76.9
Very Important	5	8	14.8	20.5	97.4
	2	1	1.9	2.6	100.0
	.	15	27.8	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

---

**AR Comprehensiveness Score**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Important	4	22	40.7	56.4	56.4
Very Important	5	9	16.7	23.1	79.5
Moderate	3	8	14.8	20.5	100.0
	.	15	27.8	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

---

**AS Timeliness Score**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Very Important	5	19	35.2	48.7	48.7
Important	4	17	31.5	43.6	92.3
Moderate	3	3	5.6	7.7	100.0
	.	15	27.8	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

---

**AT Benefit-Cost Score**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Important	4	24	44.4	61.5	61.5
Moderate	3	8	14.8	20.5	82.1
Very Important	5	7	13.0	17.9	100.0
.	.	15	27.8	Missing	
Total		54	100.0	100.0	

---

Valid cases 39 Missing cases 15

---

**AU Assets Definition Acceptable?**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Yes	1	36	66.7	92.3	92.3
No/NotSure	0	3	5.6	7.7	100.0
.	.	15	27.8	Missing	
Total		54	100.0	100.0	

---

Valid cases 39 Missing cases 15

---

**AV Liability Definition Acceptable?**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Yes	1	37	68.5	94.9	94.9
No/NotSure	0	2	3.7	5.1	100.0
.	.	15	27.8	Missing	
Total		54	100.0	100.0	

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Valid cases 39 Missing cases 15

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**AW Owners' Equity Definition Acceptable?**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Yes	1	32	59.3	82.1	82.1
No/NotSure	0	7	13.0	17.9	100.0
.	.	15	27.8	Missing	
Total		54	100.0	100.0	

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Valid cases 39 Missing cases 15

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**AX Revenues Definition Acceptable?**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Yes	1	36	66.7	92.3	92.3
No/NotSure	0	3	5.6	7.7	100.0
	.	15	27.8	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

---

**AY Expenses Definition Acceptable?**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Yes	1	35	64.8	89.7	89.7
No/NotSure	0	4	7.4	10.3	100.0
	.	15	27.8	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

---

**AZ Fulfill the Definitions: Agree?**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Yes	1	35	64.8	89.7	89.7
No/NotSure	0	4	7.4	10.3	100.0
	.	15	27.8	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

---

**BA Future Economic Benefit; Agree?**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Yes	1	25	46.3	64.1	64.1
No/NotSure	0	14	25.9	35.9	100.0
	.	15	27.8	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

---

**BB Measurable Cost: Agree?**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Yes	1	22	40.7	56.4	56.4
No/NotSure	0	17	31.5	43.6	100.0
	.	15	27.8	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

---

**BC Historical Cost Rank**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
	1	21	38.9	53.8	53.8
	4	8	14.8	20.5	74.4
	2	7	13.0	17.9	92.3
	3	3	5.6	7.7	100.0
	.	15	27.8	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

---

**BD Current Value Rank**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
	2	13	24.1	33.3	33.3
	3	13	24.1	33.3	66.7
	1	7	13.0	17.9	84.6
	4	6	11.1	15.4	100.0
	.	15	27.8	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

---

**BE Realisable/Settlement Value Rank**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
	3	11	20.4	28.2	28.2
	2	10	18.5	25.6	53.8
	4	10	18.5	25.6	79.5
	1	8	14.8	20.5	100.0
	.	15	27.8	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

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**BF Present Value Rank**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
	4	15	27.8	38.5	38.5
	3	12	22.2	30.8	69.2
	2	9	16.7	23.1	92.3
	1	3	5.6	7.7	100.0
	.	15	27.8	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

---

**BG More Than One Measurement Bases Possible?**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
No/NotSure	0	27	50.0	69.2	69.2
Yes	1	12	22.2	30.8	100.0
	.	15	27.8	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

---

**BH Capital Concepts?**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Financial Concept	1	20	37.0	51.3	51.3
Both Concepts	3	15	27.8	38.5	89.7
Don'tKnow/NotSure	0	2	3.7	5.1	94.9
Physical Concept	2	2	3.7	5.1	100.0
	.	15	27.8	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 39 Missing cases 15

---

**BI Are You Muslim?**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Yes	1	54	100.0	100.0	100.0
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 54 Missing cases 0

---

**BJ Belief in Islam as Ideology?**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Ideology	2	54	100.0	100.0	100.0
		-----	-----	-----	
Total		54	100.0	100.0	
Valid cases	54	Missing cases	0		

**BK Islamic Ideology =/= WesternIdeologies?**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
No/NotSure	0	9	16.7	16.7	16.7
Yes	1	45	83.3	83.3	100.0
		-----	-----	-----	
Total		54	100.0	100.0	
Valid cases	54	Missing cases	0		

**BL Islamic Political System-vs-Western**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Strongly Different	2	19	35.2	42.2	42.2
Fairly Different	1	13	24.1	28.9	71.1
Extremely Different	3	9	16.7	20.0	91.1
Not Different	0	4	7.4	8.9	100.0
.	.	9	16.7	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	
Valid cases	45	Missing cases	9		

**BM Islamic Economic System-vs-Western**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Strongly Different	2	25	46.3	55.6	55.6
Extremely Different	3	12	22.2	26.7	82.2
Fairly Different	1	7	13.0	15.6	97.8
Not Different	0	1	1.9	2.2	100.0
.	.	9	16.7	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	
Valid cases	45	Missing cases	9		



**BN Islamic Legal System-vs-Western**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Strongly Different	2	24	44.4	53.3	53.3
Fairly Different	1	13	24.1	28.9	82.2
Extremely Different	3	7	13.0	15.6	97.8
Not Different	0	1	1.9	2.2	100.0
.	.	9	16.7	Missing	
Total		54	100.0	100.0	

Valid cases 45 Missing cases 9

**BO Islamic Social System-vs-Western**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Strongly Different	2	24	44.4	53.3	53.3
Fairly Different	1	9	16.7	20.0	73.3
Extremely Different	3	7	13.0	15.6	88.9
Not Different	0	5	9.3	11.1	100.0
.	.	9	16.7	Missing	
Total		54	100.0	100.0	

Valid cases 45 Missing cases 9

**BP Islamic Culture-vs-Western**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Strongly Different	2	28	51.9	62.2	62.2
Extremely Different	3	11	20.4	24.4	86.7
Fairly Different	1	5	9.3	11.1	97.8
Not Different	0	1	1.9	2.2	100.0
.	.	9	16.7	Missing	
Total		54	100.0	100.0	

Valid cases 45 Missing cases 9

**BQ Islamic Accounting Conceptual Framework =/= Western?**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Yes	1	41	75.9	91.1	91.1
No/NotSure	0	4	7.4	8.9	100.0
.	.	9	16.7	Missing	
Total		54	100.0	100.0	

Valid cases 45 Missing cases 9

**BR Islamic Accounting Standards  $\neq$  Western?**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Yes/MostLikely	1	41	75.9	100.0	100.0
	.	13	24.1	Missing	
Total		54	100.0	100.0	

Valid cases 41 Missing cases 13

**BS Islamic Financial Statements Users  $\neq$  Western?**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Yes	1	22	40.7	53.7	53.7
No/NotSure	0	19	35.2	46.3	100.0
	.	13	24.1	Missing	
Total		54	100.0	100.0	

Valid cases 41 Missing cases 13

**BT Islamic Financial Statements' Objectives  $\neq$  Western?**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Yes	1	30	55.6	73.2	73.2
No/NotSure	0	11	20.4	26.8	100.0
	.	13	24.1	Missing	
Total		54	100.0	100.0	

Valid cases 41 Missing cases 13

**BU Islamic Basic Assumptions  $\neq$  Western?**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Yes	1	30	55.6	73.2	73.2
No/NotSure	0	11	20.4	26.8	100.0
	.	13	24.1	Missing	
Total		54	100.0	100.0	

Valid cases 41 Missing cases 13

**BV Islamic Qualitative Characteristics  $\neq$  Western?**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
No/NotSure	0	21	38.9	51.2	51.2
Yes	1	20	37.0	48.8	100.0
	.	13	24.1	Missing	
	Total	54	100.0	100.0	

Valid cases 41 Missing cases 13

**BW Islamic Financial Statements Elements  $\neq$  Western**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
No/NotSure	0	21	38.9	51.2	51.2
Yes	1	20	37.0	48.8	100.0
	.	13	24.1	Missing	
	Total	54	100.0	100.0	

Valid cases 41 Missing cases 13

**BX Islamic Recognition Criteria  $\neq$  Western?**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Yes	1	26	48.1	63.4	63.4
No/NotSure	0	15	27.8	36.6	100.0
	.	13	24.1	Missing	
	Total	54	100.0	100.0	

Valid cases 41 Missing cases 13

**BY Islamic Measurement Criteria  $\neq$  Western?**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Yes	1	26	48.1	63.4	63.4
No/NotSure	0	15	27.8	36.6	100.0
	.	13	24.1	Missing	
	Total	54	100.0	100.0	

Valid cases 41 Missing cases 13

**BZ Islamic CapitalConcept =/= Western?**

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
Yes	1	26	48.1	63.4	63.4
No/NotSure	0	15	27.8	36.6	100.0
	.	13	24.1	Missing	
		-----	-----	-----	
Total		54	100.0	100.0	

Valid cases 41 Missing cases 13

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**Appendix 9.3: Summary of Descriptive and Chi-square-One sample test,  
All variables.**

Var.	Variable Names	Valid N	Mean	Std.Dev.	Min.	Max.	Chi-Sqr.	df	Signif.
A	AGE	54	2.17	.67	1	4	48.6667	3	.0000
B	SEX	54	.78	.42	0	1	16.6667	1	.0000
C	DEGREE	54	1.72	.68	1	3	10.3333	2	.0057
D	PARTNERSHIP	54	.37	.49	0	1	3.6296	1	.0568
E	Environmental factors=>Acctg.?	54	.91	.29	0	1	35.8519	1	.0000
F	Ideology-Strength (score)	49	2.33	.80	1	3	8.8571	2	.0119
G	Politic-Strength (score)	49	2.53	.68	1	3	21.7143	2	.0000
H	Economic-Strength (score)	49	2.92	.34	1	3	80.8571	2	.0000
I	Legal-Strength (score)	49	2.73	.45	2	3	10.7959	1	.0010
J	Social-Strength (score)	49	2.29	.71	1	3	8.0000	2	.0183
K	Moral-Strength (score)	49	2.33	.77	1	3	8.0000	2	.0183
L	Culture-Strength (score)	49	2.16	.83	1	3	2.1224	2	.3460
M	Diff. Envtl=>Diff. Accounting?	49	.80	.41	0	1	17.1633	1	.0000
N	Users different?	39	.87	.34	0	1	21.5641	1	.0000
O	Objectives different?	39	.87	.34	0	1	21.5641	1	.0000
P	Basic Assumptions different?	39	.79	.41	0	1	13.5641	1	.0002
Q	Qualitative Ch. different?	39	.64	.49	0	1	3.1026	1	.0782
R	F/S Elements different?	39	.64	.49	0	1	3.1026	1	.0782
S	Recognition Cr. different?	39	.85	.37	0	1	18.6923	1	.0000
T	Measurement Cr. different?	39	.79	.41	0	1	13.5641	1	.0002
U	Cap. Concepts different?	39	.69	.47	0	1	5.7692	1	.0163
V	Investors rank	39	1.87	1.75	1	7	85.7692	5	.0000
W	Employees rank	39	4.28	1.45	1	7	15.7436	6	.0152
X	Creditors rank	39	2.54	1.14	1	7	49.7692	5	.0000
Y	Supplier rank	39	3.74	1.12	2	6	10.1026	4	.0387
Z	Customers rank	39	5.49	1.23	1	7	24.8462	5	.0001
AA	Government rank	39	4.33	1.71	1	7	7.1282	6	.3092
AB	Society rank	39	5.74	2.02	1	7	56.8462	5	.0000
AC	For Investors=>for All Users?	39	.46	.51	0	1	.2308	1	.6310
AD	B/S importance rank	39	2.05	.69	1	3	7.5385	2	.0231
AE	P/L importance rank	39	1.31	.57	1	3	30.9231	2	.0000
AF	C/F importance rank	39	2.64	.58	1	3	25.0769	2	.0000
AG	Notes importance rank	39	4.00	.00	4	4	n/a	--	n/a
AH	Accrual assumption OK?	39	.95	.22	0	1	31.4103	1	.0000
AI	Going Concern assumption OK?	39	.87	.34	0	1	21.5641	1	.0000
AJ	Understandability score	39	4.54	.55	3	5	18.0000	2	.0001
AK	Relevant score	39	4.46	.64	3	5	12.9231	2	.0016
AL	Materiality score	39	4.03	.74	2	5	21.6154	3	.0001
AM	Faithfulness score	39	4.69	.52	3	5	29.0769	2	.0000
AN	Substance over form score	39	3.79	.86	1	5	31.6410	4	.0000
AO	Neutrality score	39	3.90	.82	2	5	15.0513	3	.0018
AP	Consistency score	39	3.79	.83	2	5	12.3846	3	.0062
AQ	Comparability score	39	3.90	.75	2	5	18.9487	3	.0003
AR	Comprehensiveness score	39	4.03	.67	3	5	9.3846	2	.0092
AS	Timeliness score	39	4.41	.64	3	5	11.6923	2	.0029
AT	Benefit-Cost score	39	3.97	.63	3	5	14.0000	2	.0009

**Appendix 9.3. (Cont.).**

Var.	Variable Names	Valid N	Mean	Std.Dev.	Min.	Max.	Chi-Sqr.	df	Signif.
AU	Assets definition OK?	39	.92	.27	0	1	27.9231	1	.0000
AV	Liability definition OK?	39	.95	.22	0	1	31.4103	1	.0000
AW	O's Equity definition OK?	39	.82	.39	0	1	16.0256	1	.0001
AX	Revenues definition OK?	39	.92	.27	0	1	27.9231	1	.0000
AY	Expenses definition OK?	39	.90	.31	0	1	24.6210	1	.0000
AZ	Asset: definition agree?	39	.90	.31	0	1	24.6410	1	.0000
BA	Asset: future benefit agree?	39	.64	.49	0	1	3.1026	1	.0782
BB	Asset: Value-ability agree?	39	.56	.50	0	1	.6410	1	.4233
BC	Historical Cost rank	39	1.95	1.21	1	4	18.7436	3	.0003
BD	Current Value rank	39	2.46	.97	1	4	4.3846	3	.2228
BE	Realisable Value rank	39	2.59	1.09	1	4	.4872	3	.9217
BF	Present Value rank	39	3.00	.97	1	4	8.0769	3	.0444
BG	Combination of Val. possible?	39	.31	.47	0	1	5.7692	1	.0163
BH	Capital Concepts	39	1.77	1.04	0	3	25.9231	3	.0000
BK	Islamic Ideology=/=Western?	54	.833	.376	0	1	24.0000	1	.0000
BL	Islamic Pol. vs. Western's?	45	1.73	.89	0	3	10.7333	3	.0133
BM	Islamic Eco. vs. Western's	45	2.07	.72	0	3	27.8000	3	.0000
BN	Islamic legal vs. Western's?	45	1.82	.72	0	3	25.6667	3	.0000
BO	Islamic Soc. vs. Western's	45	1.73	.86	0	3	19.9778	3	.0002
BP	Islamic Cul. vs. Western's?	45	2.09	.67	0	3	37.7556	3	.0000
BQ	Islamic C/F vs Western's?	45	.91	.29	0	1	30.4222	1	.0000
BR	Islamic Acc. Standard different?	45	1.00	.00	1	1	n/a	--	n/a
BS	Islamic Users different?	45	.54	.50	0	1	.2195	1	.6394
BT	Islamic Objectives different?	45	.73	.45	0	1	8.8049	1	.0030
BU	Islamic Basic Assump. diff.?	45	.73	.45	0	1	8.8049	1	.0030
BV	Islamic Q/Ch. different?	45	.49	.51	0	1	.0244	1	.8756
BW	Islamic F/S Elements different?	45	.49	.51	0	1	.0244	1	.8759
BX	Islamic Recog. Cr. different?	45	.63	.49	0	1	2.9512	1	.0858
BY	Islamic Mear's't Cr. different?	45	.63	.49	0	1	2.9512	1	.0858
BZ	Islamic Cap. Conc. different?	45	.63	.49	0	1	2.9512	1	.0858

Appendix 9.4: Crosstabs, Respondents' Characteristics

A AGE by D PARTNER

		Count Row Pct Col Pct Tot Pct	D		Row Total
			Non-Part ner	Partner	
			0	1	
A	<30 years	1	5 83.3 14.7 9.3	1 16.7 5.0 1.9	6 11.1
	30 - 39 years	2	23 65.7 67.6 42.6	12 34.3 60.0 22.2	35 64.8
	40 - 49 years	3	5 45.5 14.7 9.3	6 54.5 30.0 11.1	11 20.4
	>=50 years	4	1 50.0 2.9 1.9	1 50.0 5.0 1.9	2 3.7
Column Total			34 63.0	20 37.0	54 100.0

Chi-Square	Value	DF	Significance
Pearson	2.77137	3	.42824
Likelihood Ratio	2.84707	3	.41581
Mantel-Haenszel test for linear association	2.40788	1	.12073

Minimum Expected Frequency - .741  
 Cells with Expected Frequency < 5 - 5 OF 8 ( 62.5%)

Number of Missing Observations: 0

A AGE by C DEGREE

A	Count	Row Pct	Col Pct	Tot Pct	C			Row Total						
					S-1	S-2	S-3							
					1	2	3							
<30 years	1	4	66.7	18.2	7.4	2	33.3	8.0	3.7	6	11.1			
	2	11	31.4	50.0	20.4	19	54.3	76.0	35.2	5	14.3	35	64.8	
	3	7	63.6	31.8	13.0	3	27.3	12.0	5.6	1	9.1	11	20.4	
	4					1	50.0	4.0	1.9	1	50.0	14.3	1.9	2
Column Total		22	40.7		25	46.3	7	13.0		54	100.0			

Chi-Square	Value	DF	Significance
Pearson	8.59983	6	.19737
Likelihood Ratio	9.15023	6	.16530
Mantel-Haenszel test for linear association	.56761	1	.45121

Minimum Expected Frequency - .259  
 Cells with Expected Frequency < 5 - 9 OF 12 ( 75.0%)

Number of Missing Observations: 0



A AGE by B SEX

		Count	B		Row Total
			Female	Male	
A		Row Pct			
		Col Pct	0	1	
		Tot Pct			
<30 years	1	2	4	6	
		33.3	66.7	11.1	
		16.7	9.5		
		3.7	7.4		
30 - 39 years	2	10	25	35	
		28.6	71.4	64.8	
		83.3	59.5		
		18.5	46.3		
40 - 49 years	3		11	11	
			100.0	20.4	
			26.2		
			20.4		
≥50 years	4		2	2	
			100.0	3.7	
			4.8		
			3.7		
Column Total		12	42	54	
		22.2	77.8	100.0	

Chi-Square	Value	DF	Significance
Pearson	4.95918	3	.17481
Likelihood Ratio	7.69123	3	.05284
Mantel-Haenszel test for linear association	3.86626	1	.04927

Minimum Expected Frequency - .444  
 Cells with Expected Frequency < 5 - 5 OF 8 ( 62.5%)

Number of Missing Observations: 0

B SEX by C DEGREE

		C			Row Total
		S-1	S-2	S-3	
B	Count				
	Row Pct	1	2	3	
Female	0	5	7		12
	Col Pct	41.7	58.3		22.2
	Row Pct	22.7	28.0		
	Tot Pct	9.3	13.0		
Male	1	17	18	7	42
	Col Pct	40.5	42.9	16.7	77.8
	Row Pct	77.3	72.0	100.0	
	Tot Pct	31.5	33.3	13.0	
Column Total	22	25	7	54	
Total	40.7	46.3	13.0	100.0	

Chi-Square	Value	DF	Significance
Pearson	2.48610	2	.28850
Likelihood Ratio	3.97837	2	.13681
Mantel-Haenszel test for linear association	.63519	1	.42546

Minimum Expected Frequency - 1.556  
 Cells with Expected Frequency < 5 - 2 OF 6 ( 33.3%)

Number of Missing Observations: 0

B SEX by D PARTNER

B	Count	D		Row Total
		Non-Part	Partner	
	Row Pct	ner		
	Col Pct	0	1	
	Tot Pct			
Female	0	9	3	12
		75.0	25.0	22.2
		26.5	15.0	
		16.7	5.6	
Male	1	25	17	42
		59.5	40.5	77.8
		73.5	85.0	
		46.3	31.5	
	Column Total	34	20	54
		63.0	37.0	100.0

Chi-Square	Value	DF	Significance
Pearson	.95861	1	.32754
Continuity Correction	.40982	1	.52206
Likelihood Ratio	1.00122	1	.31701
Mantel-Haenszel test for linear association	.94086	1	.33206
Fisher's Exact Test:			
One-Tail			.26524
Two-Tail			.50038

Minimum Expected Frequency - 4.444  
 Cells with Expected Frequency < 5 - 1 OF 4 ( 25.0%)

Number of Missing Observations: 0

C DEGREE by D PARTNER

C	Count Row Pct Col Pct Tot Pct	D		Row Total
		Non-Part ner	Partner	
		0	1	
S-1	1	14	8	22
		63.6	36.4	40.7
		41.2	40.0	
		25.9	14.8	
S-2	2	16	9	25
		64.0	36.0	46.3
		47.1	45.0	
		29.6	16.7	
S-3	3	4	3	7
		57.1	42.9	13.0
		11.8	15.0	
		7.4	5.6	
	Column Total	34 63.0	20 37.0	54 100.0

Chi-Square	Value	DF	Significance
Pearson	.11749	2	.94295
Likelihood Ratio	.11565	2	.94382
Mantel-Haenszel test for linear association	.05231	1	.81909

Minimum Expected Frequency - 2.593  
 Cells with Expected Frequency < 5 - 2 OF 6 ( 33.3%)

Number of Missing Observations: 0

**Appendix 9.5: Summary of Chi-Square Statistics for All Variables by AGE, SEX, DEGREE, and PARTNERSHIP.**

Var.	AGE			SEX			DEGREE			PARTNERSHIP		
	Value	d.f.	Signif.	Value	d.f.	Signif.	Value	d.f.	Signif.	Value	d.f.	Signif.
E	1.91440	3	.59036	1.00758	1	.31548	3.62191	2	.16350	3.24130	1	.07180
F	3.61459	6	.72867	2.68485	2	.26121	4.04744	4	.39962	.43866	2	.80306
G	2.53303	6	.86475	1.20915	2	.54631	3.13659	4	.53523	6.12838	2	<b>.04669</b>
H	12.09537	6	.05987	.81940	2	.66385	3.69656	4	.44863	3.64378	2	.16172
I	2.84648	6	.41591	1.16943	1	.27952	.63838	2	.72674	.04062	1	.84028
J	7.37908	6	.28721	.92137	2	.63085	1.78704	4	.77485	1.29540	2	.52325
K	10.27783	6	.11343	2.37545	2	.30491	5.52222	4	.23778	1.16398	2	.55878
L	4.78394	12	.57181	2.75250	2	.25252	1.08846	4	.89610	1.32573	2	.51537
M	.85362	3	.83660	.83793	1	.35999	.20068	2	.90453	.00347	1	.95305
N	1.10921	3	.77485	.03059	1	.86116	1.97846	2	.37186	.00249	1	.96017
O	1.95918	3	.58092	1.72059	1	.18962	1.97846	2	.37186	.00249	1	.96017
P	.66835	3	.88062	.63427	1	.42579	2.10939	2	.34830	1.91829	1	.16604
Q	4.19083	3	.24158	.37143	1	.54223	1.98519	2	.37061	.03028	1	.86186
R	4.08219	3	.25273	.37143	1	.54223	.66187	2	.71825	1.40012	1	.23670
S	.70614	3	.87176	2.12727	1	.14470	.02296	2	.98856	1.92688	1	.16510
T	.66835	3	.88062	1.17944	1	.27747	1.94799	2	.37757	.05171	1	.82012
U	7.73500	3	.05182	.03611	1	.84929	1.25031	2	.53518	.57699	1	.44749
V	15.49089	15	.41667	6.60833	5	.25144	8.27918	10	.60159	9.67430	5	.08501
W	13.93793	18	.73313	7.60616	6	.26840	23.76948	12	<b>.02186</b>	4.63162	6	.59185
X	18.47688	15	.23842	7.34603	5	.19615	19.37560	10	<b>.03574</b>	5.82351	4	.21272
Y	8.39675	12	.75341	7.69889	4	.10325	11.27425	8	.18664	5.82697	4	.21245
Z	29.25464	15	<b>.01491</b>	8.41905	5	.13460	20.11788	10	<b>.02816</b>	2.63810	5	.75557
AA	17.14607	18	.51308	11.93988	6	.06332	13.90152	12	.30704	10.25655	6	.11426
AB	18.14312	15	.25522	3.08750	5	.68650	9.85182	10	.45359	2.49049	5	.77793
AC	.13000	3	.98801	.41614	1	.51887	1.20241	2	.54815	.06308	1	.80169
AD	9.25321	6	.15983	2.54429	2	.28023	.95778	4	.91613	1.23086	2	.54041
AE	7.68233	6	.26231	.63506	2	.72795	.55318	4	.96812	3.72568	2	.15523
AF	10.08222	6	.12123	2.52938	2	.28233	1.24914	4	.86994	3.05688	2	.21687
AG	n/a	--	n/a	n/a	--	n/a	n/a	--	n/a	n/a	--	n/a
AH	1.18054	3	.80663	.63243	1	.42646	2.21906	2	.32971	.07017	1	.79108
AI	.84079	3	.85770	.03059	1	.86116	.19578	2	.90675	1.04794	1	.30598
AJ	2.71006	6	.84426	3.50360	2	.17346	2.05763	4	.72516	4.05608	2	.13159
AK	5.41543	6	.49174	12.28190	2	<b>.00215</b>	5.41783	4	.24705	.34519	2	.84148
AL	3.03921	9	.96272	.88111	3	.82998	6.00081	6	.42310	1.97877	3	.57683
AM	7.15511	6	.30674	.61286	2	.73607	3.03112	4	.55263	3.60250	2	.16509
AN	5.18282	12	.95159	6.04500	4	.19581	13.57530	8	.09353	3.18919	4	.52668
AO	8.83658	9	.45249	7.44016	3	.05912	3051865	6	.74149	2.35755	3	.50159
AP	6.92250	9	.64519	5.11716	3	.16342	7.50332	6	.27679	5.51944	3	.13748
AQ	8.74575	9	.46107	4.35500	3	.22559	6.31062	6	.38931	4.07486	3	.25349
AR	11.78864	6	.06685	4.28956	2	.11709	7.99733	4	.09168	.48654	2	.78406
AS	10.02167	6	.12374	1.13051	2	.56821	10.40609	4	<b>.03412</b>	1.05519	2	.59002
AT	2.98304	6	.81097	.20377	2	.90313	1.06035	4	.90051	8.98544	2	<b>.01119</b>

**Appendix 9.5: (cont.)**

Var.	AGE			SEX			DEGREE			PARTNERSHIP		
	Value	d.f.	Signif.	Value	d.f.	Signif.	Value	d.f.	Signif.	Value	d.f.	Signif.
AU	1.82000	3	.61059	.97500	1	.32344	.72086	2	.69737	2.26087	1	.13268
AV	1.18054	3	.75768	.63243	1	.42646	2.21906	2	.32871	1.46651	1	.22590
AW	1.65402	3	.64720	.37143	1	.54223	1.55191	2	.46026	.01183	1	.91340
AX	.76375	3	.85812	.97500	1	.32344	1.51504	2	.46883	.88315	1	.34734
AY	.81204	3	.84659	1.33714	1	.24754	.93416	2	.62683	.14837	1	.70010
AZ	2.49600	3	.47601	.00929	1	.92323	2.49981	2	.28653	.47312	1	.39156
BA	2.01797	3	.56868	.37143	1	.54223	.02472	2	.98772	.72701	1	.39385
BB	2.90675	3	.40623	.68128	1	.40915	2.11300	2	.34767	.45338	1	.50073
BC	26.40393	9	.00175	1.34385	3	.71875	6.80836	6	.33893	2.90872	3	.40591
BD	10.66607	9	.29929	3.18810	3	.36352	7.18690	6	.30391	3.51242	3	.31915
BE	5.80125	9	.75963	1.35909	3	.71515	6.89231	6	.33092	2.39342	3	.49486
BF	7.59308	9	.57561	4.04204	3	.25696	6.46878	6	.37277	3.63859	3	.30323
BG	3.79164	3	.28486	2.12253	1	.14515	.05611	2	.97233	.57699	1	.44749
BH	5.98650	9	.74127	2.19556	3	.53282	4.43841	6	.61757	4.14375	3	.24635
BI	###	#	###	###	#	###	###	#	###	###	#	###
BJ	###	#	###	###	#	###	###	#	###	###	#	###
BK	3.18234	3	.36436	.00000	1	1.00000	.07294	2	.96419	1.58824	1	.20758
BL	7.00974	9	.63610	2.96443	3	.39714	11.20413	6	.08227	3.16751	3	.36651
BM	9.28471	9	.41142	3.39520	3	.33461	9.04558	6	.17103	2.09143	3	.55365
BN	4.93749	9	.83972	7.91209	3	.04786	4.08866	6	.66468	2.60440	3	.45672
BO	6.21911	9	.71780	3.58393	3	.31004	10.22279	6	.11558	4.07321	3	.25367
BP	5.19258	9	.81721	2.42240	3	.48948	14.04893	6	.02909	1.61299	3	.65645
BQ	1.98269	3	.57601	.01960	1	.88866	.70557	2	.70273	2.19512	1	.23845
BR	n/a	--	n/a	n/a	--	n/a	n/a	--	n/a	n/a	==	n/a
BS	4.84346	3	.18363	.01669	1	.89721	2.76459	2	.25100	.00101	1	.97470
BT	2.58321	3	.46044	.24848	1	.61814	3.13058	2	.20903	.50971	1	.47526
BU	2.58321	3	.46044	.24848	1	.61814	3.13058	2	.20903	.50971	1	.47526
BV	3.81121	3	.28259	1.10126	1	.29399	.94547	2	.72989	.47784	1	.39292
BW	2.01384	3	.56954	.08677	1	.76832	.69971	2	.70479	4.62965	1	.03142
BX	.39180	3	.94193	.05256	1	.81866	.47319	2	.78931	.11888	1	.73026
BY	.93058	3	.81804	.30699	1	.57953	1.90522	2	.38573	.11888	1	.73026
BZ	5.71975	3	.12607	1.02537	1	.31125	.47319	2	.78931	1.00303	1	.31658
A	---	--	---	4.95918	3	.7481	8.59983	6	.19737	2.77137	3	.42824
B	4.95918	3	.17481	---	--	---	2.48610	1	.28850	.95861	1	.32754
C	8.59983	6	.19737	2.48610	1	.28850	---	--	---	.11749	2	.94295
D	2.77137	3	.42824	.95861	1	.32754	.11749	2	.94295	---	--	---

## **Appendix 9.6: MEASURING ASSOCIATION**

All Variables are measured by:

1. AGE
2. SEX
3. DEGREE
4. PARTNERSHIP

The measurement tools used differ as the different scale used to measure the data, i.e. NOMINAL or ORDINAL; they as follows:

Nominal variables:

1. Phi coefficient
2. Contingency Coefficient (C)
3. Cramer's V
4. Lambda

(Norusis, M.J., 1991, The SPSS Guide to Data Analysis for SPSS/PC+, 2nd edition, SPSS Inc. Chicago, Ill., pp. 312-320)

Ordinal variables:

1. Goodman & Kruskal's Gamma
2. Kendall's Tau-b
3. Tau-c
4. Somer's D
5. Spearman's R

(Norusis, M.J., 1991, The SPSS Guide to Data Analysis for SPSS/PC+, 2nd edition, SPSS Inc. Chicago, Ill., pp. 320-324)

They are all used to:

1. assess the strength & nature of relationship;
2. test the hypotheses about the various measures of association

**1. All Nominal Variables by AGE (Independent)**

Var.	Phi Coefficient		Cramer's V		Contingent Coef. (C)		Lambda		
	Value	Approx. Signif.	Value	Approx. Signif.	Value	Approx. Signif.	Value	ASE1	Value/ ASE1
E	.18829	.59036	.18829	.59036	.18504	.59036	.00000	.00000	.00000
M	.13199	.83660	.13199	.83660	.13085	.83660	.00000	.00000	.00000
N	.16865	.77485	.16865	.77485	.16630	.77485	.00000	.00000	.00000
O	.22413	.58092	.22413	.58092	.21871	.58092	.00000	.00000	.00000
P	.13091	.88062	.13091	.88062	.12980	.88062	.00000	.00000	.00000
Q	.32781	.24158	.32781	.24185	.31150	.24185	.14286	.13226	1.01307
R	.32353	.25273	.32353	.25273	.30782	.25273	.00000	.00000	.00000
S	.13456	.87176	.13456	.87176	.13336	.87176	.00000	.00000	.00000
T	.13091	.88062	.13091	.88062	.12980	.88062	.00000	.00000	.00000
U	.44535	.05182	.44535	.05182	.40683	.05182	.00000	.11785	.00000
AC	.05774	.98801	.05774	.98801	.05764	.98801	.00000	.00000	.00000
AH	.17398	.75768	.17398	.75768	.17141	.75768	.00000	.00000	.00000
AI	.14683	.83969	.14683	.83969	.14527	.83969	.00000	.00000	.00000
AU	.21602	.61059	.21602	.61059	.21115	.61059	.00000	.00000	.00000
AV	.17398	.75768	.17398	.75768	.17141	.75768	.00000	.00000	.00000
AW	.20594	.64720	.20594	.64720	.20171	.64720	.00000	.00000	.00000
AX	.13994	.85812	.13994	.85812	.13859	.85812	.00000	.00000	.00000
AY	.14430	.84659	.14430	.84659	.14282	.84659	.00000	.00000	.00000
AZ	.25298	.47601	.25298	.47601	.24526	.47601	.00000	.00000	.00000
BA	.22747	.56868	.22747	.56868	.22180	.56868	.00000	.20203	.00000
BB	.27301	.40623	.27301	.40623	.26337	.40623	.11765	.19141	.57955
BG	.31180	.28486	.31180	.28486	.29767	.28486	.00000	.00000	.00000
BH	.39179	.74127	.22620	.74127	.36479	.74127	.05263	.24568	.20863
BK	.24276	.36436	.24276	.36436	.23591	.36436	.00000	.00000	.00000
BS	.34370	.18363	.34370	.18363	.32504	.18363	.15789	.26009	.55921
BT	.25101	.46044	.25101	.46044	.24346	.46044	.00000	.18182	.00000
BU	.25101	.46044	.25101	.46044	.24346	.46044	.00000	.18182	.00000
BV	.30489	.28259	.30489	.28259	.29163	.28259	.20000	.14142	1.29034
BW	.22163	.56954	.22163	.56954	.21638	.56954	.05000	.25323	.19254
BX	.09775	.94193	.09775	.94193	.09729	.94193	.00000	.09428	.00000
BY	.15066	.81804	.15066	.81804	.14897	.81804	.00000	.16330	.00000
BZ	.37351	.12607	.37351	.12607	.34990	.12607	.13333	.23222	.53639



## 2. All Nominal Variables by SEX (Independent)

Var.	Phi Coefficient		Cramer's V		Contingent Coef. (C)		Lambda		
	Value	Approx. Signif.	Value	Approx. Signif.	Value	Approx. Signif.	Value	ASE1	Value/ ASE1
E	.13660	.31548	.13660	.31548	.13534	.31548	.00000	.00000	.00000
M	-.13077	.35999	.13077	.35999	.12967	.35999	.00000	.00000	.00000
N	-.02801	.86116	.02801	.86116	.02799	.86116	.00000	.00000	.00000
O	-.21004	.18962	.21004	.18962	.20556	.18962	.00000	.00000	.00000
P	-.12753	.42579	.12753	.42579	.12650	.42579	.00000	.00000	.00000
Q	.09759	.54223	.09759	.54223	.09713	.54223	.00000	.00000	.00000
R	.09759	.54223	.09759	.54223	.09713	.54223	.00000	.00000	.00000
S	-.23355	.14470	.23355	.14470	.22743	.14470	.00000	.00000	.00000
T	.17390	.27747	.17390	.27747	.17133	.27747	.00000	.00000	.00000
U	.03043	.84929	.03043	.84929	.03041	.84929	.00000	.00000	.00000
AC	-.10330	.51887	.10330	.51887	.10275	.51887	.05556	.16197	.33381
AH	-.12734	.42646	.12734	.42646	.12632	.42646	.00000	.00000	.00000
AI	-.02801	.86116	.02801	.86116	.02799	.86116	.00000	.00000	.00000
AU	-.15811	.32344	.15811	.32344	.15617	.32344	.00000	.00000	.00000
AV	-.12734	.42646	.12734	.42646	.12632	.42646	.00000	.00000	.00000
AW	-.09759	.54223	.09759	.54223	.09713	.54223	.00000	.00000	.00000
AX	-.15811	.32344	.15811	.32344	.15617	.32344	.00000	.00000	.00000
AY	-.18516	.24754	.18516	.24754	.18207	.24754	.00000	.00000	.00000
AZ	.01543	.92323	.01543	.92323	.01543	.92323	.00000	.00000	.00000
BA	.09759	.54223	.09759	.54223	.09713	.54223	.00000	.00000	.00000
BB	.13217	.40915	.13217	.40915	.13103	.40915	.05882	.17120	.33381
BG	.23329	.14515	.23329	.14515	.22719	.14515	.00000	.00000	.00000
BH	.23727	.53282	.23727	.53282	.23086	.53282	.05263	.15368	.33381
BK	.00000	1.00000	.00000	1.00000	.00000	1.00000	.00000	.00000	.00000
BS	-.02018	.89721	.02018	.89721	.02017	.89721	.00000	.00000	.00000
BT	-.07785	.61814	.07785	.61814	.07762	.61814	.00000	.00000	.00000
BU	.07785	.61814	.07785	.61814	.07762	.61814	.00000	.00000	.00000
BV	.16389	.29399	.16389	.29399	.16173	.29399	.10000	.26833	.35409
BW	.04600	.76832	.04600	.76832	.04596	.76832	.00000	.00000	.00000
BX	-.03581	.81866	.03581	.81866	.03578	.81866	.00000	.00000	.00000
BY	.08653	.57953	.08653	.57953	.08621	.57953	.00000	.00000	.00000
BZ	-.15814	.31125	.15814	.31125	.15620	.31125	.00000	.00000	.00000

### 3. All Nominal Variables by DEGREE (Independent)

Var.	Phi Coefficient		Cramer's V		Contingent Coef. (C)		Lambda		
	Value	Approx. Signif.	Value	Approx. Signif.	Value	Approx. Signif.	Value	ASE1	Value/ ASE1
E	.25898	.16350	.25898	.16350	.25071	.16350	.00000	.00000	.00000
M	.06400	.90453	.06400	.90453	.06386	.90453	.00000	.00000	.00000
N	.22523	.37186	.22523	.37186	.21973	.37186	.00000	.00000	.00000
O	.22523	.37186	.22523	.37186	.21973	.37186	.00000	.00000	.00000
P	.23257	.34830	.23257	.34830	.22652	.34830	.00000	.00000	.00000
Q	.22562	.37061	.22562	.37061	.22008	.37061	.00000	.26726	.00000
R	.13027	.70825	.13027	.71825	.12918	.71825	.00000	.00000	.00000
S	.02426	.98859	.02426	.98859	.02425	.98859	.00000	.00000	.00000
T	.22349	.37757	.22349	.37757	.21811	.37757	.00000	.00000	.00000
U	.17905	.53518	.17905	.53518	.17625	.53518	.00000	.20412	.00000
AC	.17559	.54815	.17559	.54815	.17294	.54815	.11111	.19598	.53649
AH	.23854	.32971	.23854	.32971	.23203	.32971	.00000	.00000	.00000
AI	.07085	.90675	.07085	.90675	.07067	.90675	.00000	.00000	.00000
AU	.13595	.69737	.13595	.69737	.13472	.69737	.00000	.00000	.00000
AV	.23854	.32971	.23854	.32971	.23203	.32971	.00000	.00000	.00000
AW	.19948	.46026	.19948	.46026	.19563	.46026	.00000	.00000	.00000
AX	.19710	.46883	.19710	.46883	.19338	.46883	.00000	.00000	.00000
AY	.15477	.62683	.15477	.62683	.15295	.62683	.00000	.00000	.00000
AZ	.25318	.28653	.25318	.28653	.24543	.28653	.00000	.00000	.00000
BA	.02517	.98772	.02517	.98772	.02517	.98772	.00000	.00000	.00000
BB	.23277	.34767	.23277	.34767	.22670	.34767	.00000	.22010	.00000
BG	.03793	.97233	.03793	.97233	.03790	.97233	.00000	.00000	.00000
BH	.33735	.61757	.33735	.61757	.31965	.61757	.15789	.19914	.73260
<b>BK</b>	.03675	.96419	.03675	.96419	.03673	.96419	.00000	.00000	.00000
BS	.25967	.25100	.25967	.25100	.25134	.25100	.15789	.24149	.60265
BT	.27633	.20903	.27633	.20903	.26634	.20903	.00000	.00000	.00000
BU	.27633	.20903	.27633	.20903	.26634	.20903	.00000	.00000	.00000
BV	.15186	.62330	.15186	.62330	.15013	.62330	.10000	.11619	.82322
BW	.13064	.70479	.13064	.70479	.12954	.70479	.10000	.18974	.50153
BX	.10743	.78931	.10743	.78931	.10682	.78931	.00000	.00000	.00000
BY	.21557	.38573	.21557	.38573	.21073	.38573	.00000	.00000	.00000
BZ	.10743	.78931	.10743	.78931	.10682	.78931	.00000	.00000	.00000

**4. All Nominal Variables by PARTNERSHIP (Independent)**

Var.	Phi Coefficient		Cramer's V		Contingent Coef. (C)		Lambda		
	Value	Approx. Signif.	Value	Approx. Signif.	Value	Approx. Signif.	Value	ASE1	Value/ ASE1
E	.24500	.07180	.24500	.07180	.23796	.07180	.00000	.00000	.00000
M	.00841	.93505	.00841	.95305	.00841	.95305	.00000	.00000	.00000
N	.00800	.96017	.00800	.96017	.00800	.96017	.00000	.00000	.00000
O	.00800	.96017	.00800	.96017	.00800	.96017	.00000	.00000	.00000
P	-.22178	.16604	.22178	.16604	.21652	.16604	.00000	.00000	.00000
Q	-.02786	.86186	.02786	.86186	.02785	.86186	.00000	.00000	.00000
R	.18947	.23670	.18947	.23670	.18616	.23670	.00000	.00000	.00000
S	-.22228	.16510	.22228	.16510	.21698	.16510	.00000	.00000	.00000
T	.03641	.82012	.03641	.82012	.03639	.82012	.00000	.00000	.00000
U	-.12163	.44749	.12163	.44749	.12074	.44749	.00000	.00000	.00000
AC	-.04022	.80169	.04022	.80169	.04019	.80169	.00000	.00000	.00000
AH	-.04242	.79108	.04242	.79108	.04238	.79108	.00000	.00000	.00000
AI	.16392	.30598	.16392	.30598	.16176	.30598	.00000	.00000	.00000
AU	.24077	.13268	.24077	.13268	.23408	.13268	.00000	.00000	.00000
AV	.19391	.22590	.19391	.22590	.19037	.22590	.00000	.00000	.00000
AW	-.01741	.91340	.01741	.91340	.01741	.91340	.00000	.00000	.00000
AX	-.15048	.34734	.15048	.34734	.14881	.34734	.00000	.00000	.00000
AY	-.06168	.70010	.06168	.70010	.06156	.70010	.00000	.00000	.00000
AZ	.11014	.49156	.11014	.49156	.10948	.49156	.00000	.00000	.00000
BA	-.13653	.39685	.13653	.39385	.13528	.39385	.00000	.00000	.00000
BB	-.10782	.50073	.10782	.50073	.10720	.50073	.00000	.23529	.00000
BG	.12163	.44749	.12163	.44749	.12074	.44749	.00000	.00000	.00000
BH	.32596	.24635	.32596	.24635	.30991	.24635	.05263	.18470	.27762
BK	-.17150	.20758	.17150	.20758	.16903	.20758	.00000	.00000	.00000
BS	-.00495	.97470	.00495	.97470	.00495	.97470	.00000	.00000	.00000
BT	-.11150	.47526	.11150	.47526	.11081	.47526	.00000	.00000	.00000
BU	-.11150	.47526	.11150	.47526	.11081	.47526	.00000	.00000	.00000
BV	-.13342	.39292	.13342	.39292	.13225	.39292	.10000	.24187	.39297
BW	-.33603	.03142	.33603	.03142	.31853	.03142	.30000	.21331	1.19708
BX	-.05385	.73026	.05385	.73026	.05377	.73026	.00000	.00000	.00000
BY	-.05385	.73026	.05385	.73026	.05377	.73026	.00000	.00000	.00000
BZ	.15941	.31658	.15641	.31658	.15453	.31658	.00000	.00000	.00000

### 1. All Ordinal by AGE

Var.	Tau-b		Tau-c		Gamma		Sommer's D		Spearman's R	
	Value	ASE1	Value	ASE1	Value	ASE1	Value	ASE1	Value	Signif.
F	.13718	.12091	.11745	.10408	.24479	.21402	.14574	.12933	.15173	.29800
G	-.03471	.12897	-.02749	.10237	-.06471	.23874	-.03411	.12694	-.03839	.79342
H	-.09983	.14329	-.03748	.05677	-.37500	.43268	-.04651	.06925	-.10486	.47332
I	.14379	.13396	.13161	.12414	.31225	.29068	.12248	.11547	.15063	.30155
J	.05229	.14181	.04498	.12218	.08738	.23596	.05581	.15158	.05637	.70043
K	.09153	.10758	.07872	.09233	.15789	.18600	.09767	.11545	.10698	.46438
L	.00563	.13912	.00500	.12351	.00943	.23318	.00620	.15332	.00547	.97022
V	.07639	.13136	.05084	.08724	.14010	.23647	.07143	.12210	.08611	.60219
W	.20329	.13822	.17708	.12207	.30514	.20203	.24877	.16698	.24256	.13681
X	.08452	.15291	.06487	.11682	.13357	.24178	.09113	.16459	.09468	.56640
Y	.03121	.14096	.02630	.11877	.04823	.21783	.03695	.16697	.03536	.83080
Z	-.24692	.17169	-.20513	.14434	-.35780	.24736	-.28818	.19883	-.26835	.09859
AA	-.12437	.15203	-.11045	.13676	-.18156	.21893	-.15517	.18891	-.14011	.39492
AB	.00703	.14228	.00526	.10655	.01091	.22109	.00739	.14951	.00251	.98790
AD	.18784	.17088	.15976	.14846	.30112	.26688	.19951	.17984	.20414	.21255
AE	-.24683	.15287	-.17160	.11456	-.47027	.28014	-.21429	.13506	-.26538	.10252
AF	-.02676	.17686	-.01972	.13023	-.04808	.31734	-.02463	.16244	-.02367	.88626
AG	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
AJ	.06031	.14487	.04734	.11360	.11650	.27924	.05911	.14252	.06419	.69783
AK	-.08687	.13292	-.07101	.10930	-.16216	.24527	-.08867	.13381	-.09392	.56957
AL	.09206	.12918	.07013	.09890	.16393	.22777	.09852	.13893	.10409	.52830
AM	-.06123	.15505	-.04339	.11053	-.12500	.31102	-.05419	.13658	-.06410	.69826
AN	-.11042	.14413	-.08591	.11343	-.18774	.23996	-.12069	.15673	-.12313	.45521
AO	.11799	.15983	.09292	.12691	.19134	.25661	.13054	.17730	.13635	.40785
AP	-.26811	.09588	-.21389	.08323	-.44853	.14584	-.30049	.10687	-.30735	.05700
AQ	-.09080	.15508	-.07013	.12065	-.14925	.25212	-.09852	.16865	-.09951	.54670
AR	-.18800	.13835	-.15779	.12119	-.32787	.22737	-.19704	.14238	-.21217	.19473
AS	-.03586	.15776	-.02959	.13082	-.06276	.27499	-.03695	.16221	-.04030	.80756
AT	-.06570	.13956	-.05325	.11401	-.12217	.25684	-.06650	.14074	-.07187	.66370
BC	.02721	.13269	.02104	.10240	.04196	.20428	.02956	.14381	.02026	.90255
BD	-.15039	.14626	-.12448	.12266	-.23432	.22347	-.17488	.17074	-.16824	.30592
BE	-.04373	.14804	-.03682	.12485	-.06796	.22960	-.05172	.17496	-.05208	.75285
BF	.26922	.12528	.21915	.11348	.43554	.21280	.30788	.15563	.29958	.06391
BL	.05468	.13965	.04214	.10806	.09249	.02378	.06531	.16687	.06216	.68499
BM	-.08647	.13313	-.06189	.09628	-.15512	.23555	-.09592	.14827	-.09442	.53728
BN	.10201	.13808	.07374	.10090	.18543	.24731	.11429	.15454	.11169	.46512
BO	-.06394	.09780	-.04741	.07316	-.12162	.18324	-.07347	.11190	-.07227	.63709
BP	.00000	.10930	.00000	.07452	.00000	.22634	.00000	.11548	.00182	.99051
BQ	.08466	.05329	.04741	.03516	.42857	.24147	.04898	.03625	.08835	.56388
BR	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a

## 2. All Ordinal Variables by SEX

Var.	Tau-b		Tau-c		Gamma		Sommer's D		Spearman's R	
	Value	ASE1	Value	ASE1	Value	ASE1	Value	ASE1	Value	Signif.
F	.21019	.13164	.18659	.12140	.42424	.23186	.28718	.17687	<b>.22092</b>	.12715
G	.11767	.13981	.09663	.11601	.26364	.28596	.14872	.17581	.12175	.40463
H	-.12839	.04145	-.04998	.02964	-1.00000	.00000	-.07692	.04267	-.12926	.37607
I	.15449	.15395	.10995	.11218	.37931	.32065	.16923	.16897	.15449	.28921
J	-.02615	.14693	-.02332	.13103	-.05691	.32097	-.03590	.20153	-.02735	.85204
K	.20919	.13325	.18659	.12362	.42748	.23919	.28718	.18047	<b>.21974</b>	.12925
L	.21715	.12479	.19992	.12023	.44118	.22857	.30769	.17343	<b>.22976</b>	.11225
V	.04522	.15172	.03682	.12357	.11475	.39953	.05185	.17371	.04772	.77298
W	-.04443	.12362	-.04734	.13209	-.08036	.22348	-.06667	.18553	-.04979	.76341
X	.36976	.09158	.34714	.10859	.80488	.13598	.48889	.11566	<b>.39379</b>	.01313
Y	.25768	.12753	.26561	.13885	.47418	.21938	.37407	.17995	<b>.28343</b>	.08038
Z	-.29244	.11279	-.29717	.12591	-.54067	.18358	-.41852	.15527	<b>-.31920</b>	.04762
AA	.18398	.11297	.19987	.12710	.30933	.18963	.28148	.16947	<b>.20875</b>	.20219
AB	-.20679	.11258	-.18935	.11146	-.49315	.28622	-.26667	.14718	<b>-.22258</b>	.17321
AD	-.13650	.17200	-.12623	.16074	-.26667	.32960	-.17778	.22343	-.14341	.38377
AE	.05566	.14520	.04208	.11051	.15385	.41769	.05926	.15516	.05678	.73135
AF	.13125	.16036	.10519	.12937	.29412	.32082	.14815	.17965	.13397	.41615
AG	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
AJ	.04931	.16982	.04208	.14561	.10959	.37132	.05926	.20471	.04989	.76296
AK	.10652	.18645	.09467	.16870	.20455	.34277	.13333	.23602	.10971	.50613
AL	-.05362	.15946	-.04997	.14893	-.11111	.32972	-.07037	.20925	-.05667	.73186
AM	.05119	.16046	.03945	.12377	.12821	.38610	.05556	.17394	.05178	.75424
AN	.24318	.12558	.23143	.12888	.50575	.22471	.32593	.16881	<b>.25913</b>	.11117
AO	.08736	.16512	.08416	.16055	.17021	.31641	.11852	.22480	.09328	.57219
AP	-.18055	.16198	-.17620	.16232	-.34010	.29394	-.24815	.22289	-.19312	.23883
AQ	.25887	.12001	.24458	.12259	.54386	.21180	.34444	.15760	<b>.27432</b>	.09103
AR	.28241	.14830	.25773	.14502	.56322	.26158	.36296	.19025	<b>.29622</b>	.06710
AS	.16416	.15182	.14727	.13872	.35000	.30069	.20741	.19070	.16911	.30341
AT	-.02089	.16175	-.01841	.14262	-.04575	.35412	-.02593	.20078	-.02181	.89515
BC	.13069	.14085	.12360	.13501	.28485	.31544	.17407	.18677	.13952	.39694
BD	-.15324	.15272	-.15516	.15777	-.29064	.28167	-.21852	.21764	-.16657	.31082
BE	-.09193	.15174	-.09467	.15711	-.17647	.29003	-.13333	.21958	-.10061	.54223
BF	.15054	.13814	.14990	.13928	.28934	.25137	.21111	.19133	.16228	.32362
BL	.10917	.13588	.10667	.13471	.21951	.26678	.15429	.19241	.11764	.44153
BM	.21550	.12616	.19556	.12026	.46479	.24744	.28286	.16457	<b>.22690</b>	.13390
BN	.35780	.11530	.32790	.12362	.72174	.16244	.47429	.15181	<b>.37706</b>	.01067
BO	.25848	.11814	.24296	.12066	.53247	.20080	.35143	.15987	<b>.27691</b>	.06555
BP	.17598	.12596	.15210	.11301	.41176	.27661	.22000	.15747	.18377	.22689
BQ	.02087	.15469	.00988	.07332	.08475	.60303	.01429	.10601	.02087	.89176
BR	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a

### 3. All Ordinal Variables by DEGREE

Var.	Tau-b		Tau-c		Gamma		Sommer's D		Spearman's R	
	Value	ASE1	Value	ASE1	Value	ASE1	Value	ASE1	Value	Signif.
F	.01788	.12711	.01624	.11566	.02948	.20951	.01791	.12724	.01588	.91373
G	.12788	.12532	.10746	.10708	.23118	.22266	.11846	.11665	.13583	.35206
H	-.19761	.09198	-.07872	.05106	-.70787	.17942	-.08678	.05591	<b>-.20920</b>	.14913
I	.06176	.12959	.05998	.12633	.12950	.27090	.04959	.10408	.06457	.65939
J	.06160	.12704	.05623	.11647	.10158	.20863	.06198	.12773	.06628	.65091
K	-.09446	.12655	-.08621	.11457	-.15232	.20264	-.09504	.12745	-.10897	.45606
L	.04642	.12900	.04373	.20539	.07400	.20539	.04821	.13379	.05066	.72958
V	.19219	.14166	.15385	.11801	.34211	.24023	.16810	.12696	<b>.21240</b>	.19424
W	-.01318	.15238	-.01381	.15969	-.01781	.20585	-.01509	.17439	-.01768	.91494
X	.13035	.16167	.12032	.15055	.18769	.22969	.13147	.16047	.13969	.39634
Y	-.07006	.15103	-.07101	.15291	-.10000	.21414	-.07759	.16765	-.08208	.61934
Z	-.40470	.11350	-.40434	.11827	-.57746	.14644	-.44184	.12146	<b>-.45271</b>	.00381
AA	.07571	.15291	.08087	.16333	.10276	.20755	.08836	.17778	.09621	.56014
AB	.15555	.15495	.14004	.13833	.24567	.24605	.15302	.15234	.16813	.30627
AD	.02603	.13405	.02367	.12186	.04317	.22218	.02586	.13326	.02913	.86026
AE	-.07962	.14287	-.05917	.10701	-.16304	.29054	-.06466	.11658	-.08497	.60702
AF	.04005	.14143	.03156	.11185	.07767	.27393	.03448	.12185	.04192	.79998
AG	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
AJ	-.00470	.15525	-.00394	.13023	-.00833	.27517	-.00431	.14229	-.00441	.97876
AK	-.18509	.12545	-.16174	.11067	-.31298	.20534	-.17672	.12001	<b>-.20451</b>	.21172
AL	-.13563	.14497	-.12426	.13443	-.21951	.23027	-.13578	.14580	-.14937	.25410
AM	-.08070	.15265	-.06114	.11534	-.15736	.29540	-.06681	.12599	-.08535	.60545
AN	.12648	.17220	.11834	.16172	.18987	.25648	.12931	.17600	.13795	.40233
AO	-.08746	.14238	-.08284	.13515	-.13636	.22080	-.09052	.14681	-.09918	.54803
AP	-.00206	.15426	-.00197	.14799	-.00310	.23235	-.00216	.16175	-.00443	.97866
AQ	-.08281	.15234	-.07692	.14088	-.12871	.23724	-.08405	.15454	-.08851	.59207
AR	-.23521	.13415	-.21105	.12408	-.37282	.20689	-.23060	.13291	<b>-.26202</b>	.10710
AS	-.40698	.12877	-.35897	.12102	-.64539	.16885	-.39224	.12601	<b>-.43225</b>	.00600
AT	.00000	.15319	.00000	.13275	.00000	.26087	.00000	.14505	-.00096	.99539
BC	-.09545	.15639	-.08876	.14438	-.14107	.23121	-.09698	.15957	-.10349	.53069
BD	-.01189	.14106	-.01183	.14042	-.01724	.20461	-.01293	.15338	-.01642	.92095
BE	.17531	.13801	.17751	.13839	.25000	.19648	.19397	.15423	.19888	.22483
BF	-.10678	.16374	-.10454	.16038	-.15727	.23924	-.11422	.17536	-.11565	.48326
BL	.14678	.13965	.14222	.13787	.21818	.20357	.15686	.14744	.17083	.26186
BM	.01975	.15348	.01778	.13838	.03093	.24003	.01961	.15226	.01447	.92481
BN	.04401	.14390	.04000	.13122	.07087	.23112	.04412	.14449	.04937	.74740
BO	-.23838	.14665	-.22222	.13780	-.36232	.22164	-.24510	.15323	<b>-.25711</b>	.08819
BP	-.12271	.15721	-.10519	.13490	-.20000	.25606	-.11601	.15066	-.12699	.40582
BQ	.09469	.12100	.05926	.07916	.31915	.39088	.04902	.06509	.09885	.51825
BR	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a

#### 4. All Ordinal Variables by PARTNERSHIP

Var.	Tau-b		Tau-c		Gamma		Sommer's D		Spearman's R	
	Value	ASE1	Value	ASE1	Value	ASE1	Value	ASE1	Value	Signif.
F	-.06925	.13690	-.07497	.14840	-.12676	.24748	-.07759	.15352	-.07279	.61918
<b>G</b>	-.26617	.13710	-.26656	.13720	-.47059	.21301	-.27586	.14122	<b>-.27542</b>	.05545
H	-.12634	.14229	-.05998	.07228	-.47368	.47270	-.06207	.07473	-.12719	.38381
I	.02879	.14192	.02499	.12323	.06667	.32992	.02586	.12753	.02879	.84432
J	-.15010	.13492	-.16327	.14738	-.27072	.23565	-.16897	.15226	-.15697	.28142
K	-.06126	.13848	-.06664	.15095	-.11111	.14884	-.06897	.15617	-.06435	.66045
L	-.10091	.13667	-.11329	.15373	-.17708	.23607	-.11724	.15897	-.10676	.46530
V	.10513	.15475	.09993	.14647	.20430	.29160	.10326	.15122	.11095	.50132
<b>W</b>	.17970	.13905	.22354	.17379	.28428	.21739	.23098	.17907	<b>.20140</b>	.21891
<b>X</b>	.20395	.14795	.22354	.16442	.35864	.24840	.23098	.16936	<b>.21720</b>	.18410
<b>Y</b>	.24039	.14376	.28928	.17474	.37462	.22282	.29891	.17971	<b>.26441</b>	.10382
Z	.07537	.14822	.08941	.17582	.12593	.24671	.09239	.18159	.08227	.61856
<b>AA</b>	-.23846	.14496	-.30243	.18442	-.25826	.21317	-.31250	.18968	<b>-.27056</b>	.09573
AB	-.16483	.14834	-.17620	.15896	-.29258	.24990	-.18207	.16391	-.17742	.27991
AD	.08282	.14778	.08941	.15996	.15315	.27164	.09239	.16519	.08701	.59840
AE	.02384	.16098	.02104	.14244	.05263	.35323	.02174	.14717	.02432	.88318
AF	-.15177	.15763	-.14201	.15041	-.31034	.30340	-.14674	.15518	-.15492	.34634
AG	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
<b>AJ</b>	.31676	.14235	.31558	.14450	.60000	.22500	.32609	.14809	<b>.32049</b>	.04669
AK	-.04562	.15491	-.04734	.16059	-.08738	.29450	-.04891	.16591	-.04699	.77637
AL	-.12329	.14809	-.13412	.16129	-.22467	.26545	-.13859	.16646	-.13029	.42920
AM	.14908	.15571	.13412	.13993	.32484	.33576	.13859	.14436	.15080	.35949
AN	-.04497	.15238	-.04997	.16899	-.07884	.26608	-.05163	.17459	-.04792	.77204
AO	.14030	.14702	.15779	.16655	.24590	.25445	.16304	.17183	.14982	.36265
AP	-.24006	.15214	-.27350	.17326	-.38806	.23483	-.28261	.17827	<b>-.25677</b>	.11458
AQ	-.27896	.14114	-.30769	.15897	-.48548	.22816	-.31793	.16321	<b>-.29561</b>	.06769
AR	-.10614	.15089	-.11308	.16127	-.19816	.27856	-.11685	.16650	-.11133	.49984
AS	-.02009	.15883	-.02104	.16652	-.03774	.29811	-.02174	.17206	-.02069	.90050
AT	-.37315	.14285	-.38396	.15442	-.62931	.21738	-.39674	.15787	<b>-.38964</b>	.01421
BC	-.06907	.14797	-.07627	.16381	-.12446	.26723	-.07880	.16920	-.07374	.65551
BD	.00000	.15174	.00000	.17937	.00000	.24712	.00000	.18534	.00000	1.00000
BE	.11593	.14924	.13938	.17956	.18861	.24054	.14402	.18535	.12688	.44148
BF	-.04072	.14642	-.04734	.16988	-.06870	.24592	-.04891	.17551	-.04390	.79075
<b>BL</b>	.21218	.13068	.23506	.14638	.37539	.22324	.26444	.16230	<b>.22863</b>	.13089
BM	-.03072	.14510	-.03160	.14946	-.05882	.27753	-.03556	.16810	-.03234	.83297
BN	-.16348	.13269	-.16988	.13918	-.31387	.24503	-.19111	.15528	-.17228	.25779
BO	-.13900	.15408	-.14815	.16505	-.23659	.25734	-.16667	.18485	-.14891	.32894
BP	.10884	.14763	.10667	.14535	.21260	.28372	.12000	.16303	.11366	.45723
<b>BQ</b>	.22086	.06061	.11852	.05656	1.00000	.00000	.13333	.06206	<b>.22086</b>	.14485
BR	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a

**Appendix 9.7: Correlation Analysis for ‘Conceptual Framework’ and ‘Qualitative Characteristics’ Related Variables.**

**F (Ideological Factor Strength) by BK (Islamic Ideology  $\neq$  Western Ideology?)**

Number of valid observations = 49

Statistic	Value	ASE1	Val/ASE0	Approximate Significance
Pearson's R	-.09669	.13048	-.66598	.50868 *4
Spearman Correlation	-.09464	.13353	-.65173	.51775 *4

\*4 VAL/ASE0 is a t-value based on a normal approximation, as is the significance

Number of Missing Observations: 5

---

**G (Political Factors Strength) by BL (Islamic -vs-Western Political System)**

Number of valid observations = 41

Statistic	Value	ASE1	Val/ASE0	Approximate Significance
Pearson's R	.03425	.15941	.21403	.83164 *4
Spearman Correlation	.01901	.16526	.11875	.90608 *4

\*4 VAL/ASE0 is a t-value based on a normal approximation, as is the significance

Number of Missing Observations: 13

---

**H (Economical Factor Strength) by BM (Islamic -vs-Western Economic Systems)**

Number of valid observations = 41

Statistic	Value	ASE1	Val/ASE0	Approximate Significance
Pearson's R	.02851	.04330	.17815	.85953 *4
Spearman Correlation	.05454	.05554	.34109	.73486 *4

\*4 VAL/ASE0 is a t-value based on a normal approximation, as is the significance

Number of Missing Observations: 13

---



I (Legal Factor Strength) by BN (Islamic -vs-Western Legal Systems)

Number of valid observations = 41

Statistic	Value	ASE1	Val/ASE0	Approximate Significance
Pearson's R	.38023	.14476	2.56735	.01420 *4
Spearman Correlation	.39598	.14756	2.69305	.01038 *4

\*4 VAL/ASE0 is a t-value based on a normal approximation, as is the significance  
Number of Missing Observations: 13

---

J (Social Factor Strength) by BO (Islamic -vs-Western Social Systems)

Number of valid observations = 41

Statistic	Value	ASE1	Val/ASE0	Approximate Significance
Pearson's R	.13659	.14850	.86111	.39444 *4
Spearman Correlation	.18463	.15872	1.17319	.24783 *4

\*4 VAL/ASE0 is a t-value based on a normal approximation, as is the significance  
Number of Missing Observations: 13

---

L (Cultural Factor Strength) by BP (Islamic -vs-Western Culture)

Number of valid observations = 41

Statistic	Value	ASE1	Val/ASE0	Approximate Significance
Pearson's R	.03479	.15095	.21737	.82905 *4
Spearman Correlation	.03521	.16358	.22002	.82700 *4

\*4 VAL/ASE0 is a t-value based on a normal approximation, as is the significance  
Number of Missing Observations: 13

---

N (Different Env. Factor => Different Users?) by BS (Islamic Users=/=Western?)

Number of valid observations = 34

Statistic	Value	ASE1	Val/ASE0	Approximate Significance
Pearson's R	.20441	.15715	1.18124	.24621 *4
Spearman Correlation	.20441	.15715	1.18124	.24621 *4

\*4 VAL/ASE0 is a t-value based on a normal approximation, as is the significance  
Number of Missing Observations: 20

---

O (Different Env. Factor => Different Objectives?) by BT (Islamic Objectives /= Western?)

Number of valid observations = 34

Statistic	Value	ASE1	Val/ASE0	Approximate Significance
Pearson's R	.22787	.20004	1.32383	.19494 *4
Spearman Correlation	.22787	.20004	1.32383	.19494 *4

\*4 VAL/ASE0 is a t-value based on a normal approximation, as is the significance  
Number of Missing Observations: 20

---

P (Different Env. Factor => Different Basic Assumptions?) by BU (Islamic Basic Assumptions /= Western?)

Number of valid observations = 34

Statistic	Value	ASE1	Val/ASE0	Approximate Significance
Pearson's R	.10699	.18617	.60872	.54701 *4
Spearman Correlation	.10699	.18617	.60872	.54701 *4

\*4 VAL/ASE0 is a t-value based on a normal approximation, as is the significance  
Number of Missing Observations: 20

---

Q (Different Env. Factor => Different Qualitative Characteristics?)  
by BV (Islamic Qualitative Characteristics ./= Western?)

Number of valid observations = 34

Statistic	Value	ASE1	Val/ASE0	Approximate Significance
Pearson's R	.25678	.16330	1.50294	.14266 *4
Spearman Correlation	.25678	.16330	1.50294	.14266 *4

\*4 VAL/ASE0 is a t-value based on a normal approximation, as is the significance  
 Number of Missing Observations: 20

---

R (Different Env. Factor => Different F/S Elements?)  
by BW (Islamic F/S Elements ./= Western?)

Number of valid observations = 34

Statistic	Value	ASE1	Val/ASE0	Approximate Significance
Pearson's R	-.06052	.17113	-.34300	.73384 *4
Spearman Correlation	-.06052	.17113	-.34300	.73384 *4

\*4 VAL/ASE0 is a t-value based on a normal approximation, as is the significance  
 Number of Missing Observations: 20

---

S (Different Env. Factor => Different Recognition Criteria?)  
by BX (Islamic Recognition Criteria ./= Western?)

Number of valid observations = 34

Statistic	Value	ASE1	Val/ASE0	Approximate Significance
Pearson's R	.04089	.17515	.23150	.81840 *4
Spearman Correlation	.04089	.17515	.23150	.81840 *4

\*4 VAL/ASE0 is a t-value based on a normal approximation, as is the significance  
 Number of Missing Observations: 20

---

T (Different Env. Factor => Different Measurement Criteria?)  
by BY (Islamic Measurement Criteria != Western?)

Number of valid observations = 34

Statistic	Value	ASE1	Val/ASE0	Approximate Significance
Pearson's R	.08058	.17605	.45733	.65052 *4
Spearman Correlation	.08058	.17605	.45733	.65052 *4

\*4 VAL/ASE0 is a t-value based on a normal approximation, as is the significance  
Number of Missing Observations: 20

---

U (Different Env. Factor => Different Capital Concept?)  
by BZ (Islamic Capital Concept != Western?)

Number of valid observations = 34

Statistic	Value	ASE1	Val/ASE0	Approximate Significance
Pearson's R	.14704	.17422	.84090	.40665 *4
Spearman Correlation	.14704	.17422	.84090	.40665 *4

\*4 VAL/ASE0 is a t-value based on a normal approximation, as is the significance  
Number of Missing Observations: 20

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**END-NOTES**

## Chapter 3:

### <sup>1</sup> *Rationalism.*

Greek philosophers such as Plato (427-347 BC) believed that people may achieve real truth through deductive reasoning and thinking, or being rational. His speculation upon human habits made him believe that human behaviours come from three main sources: desires (according to him, sexual desires), feeling or emotion (according to him it comes from the warmth of human blood), and knowledge which comes from the mind. In his Utopian society, as mentioned in his book *Republic*, Plato stated that people with strong desires should control trading companies, people with strong emotion should be trained to become soldiers, and people with strong minds should become philosophers which would govern and manage the Utopian society (Muslehuddin, 1979, p. 28).

Unlike Plato, Aristotle combined rationalism with empiricism (using observation) and applying scientific method in making deductions. In his book *Politics*, he rejected full human role in politics and government. For him, people in general are only a small part of polity. Aristotle's deduction was supported by his student, Alexander, who then built the Macedonian Empire. But then Alexander returned back individual character to human. When Alexander's Empire fell, chaos arose which then forced the rise of the feudal system. The feudal system, once more, jailed people in general with their individualistic. (Muslehuddin, 1980a, p. 4).

### <sup>2</sup> *Feudalism*

Feudalism is a social system based on the full authority of landlords over lands in society. The foundation of the feudal system is land, which is utilised by the lower class in society, in exchange for rent paid to the feudal class. They should obey and follow the feudal class at all times. The obedience of the lower class to the feudal class is a political aspect of the feudal system. Therefore, such obedience replaced the involvement of the lower class in economic activities in society. In the feudal system, people were grouped into two classes:

- (i) The class of land owners or feudal class, and
- (ii) The class of tenants, which consisted of farmers and slaves (Ajijola, 1977, pp. 38-41)

### <sup>3</sup> *Individualism.*

Individualism is a social theory which stresses the importance of freedom and independence of individual behaviours. Each individual has full rights over his property, behaviour and also himself. They have the right to use everything they possess to achieve their own interests in society. The reformation brought by the individualist theory led to the capitalist movement led by the bourgeoisie, which reached its peak when it successfully toppled the feudal system in the French Revolution in 1737. The capitalist movement based on Capitalism was a reaction to feudal system.

Capitalism contains some concepts which may be formulated as follows:

- (a) Each individual has the right to obtain and use private property;
- (b) Each individual has the right to choose their own way to expend for his own economic activity;
- (c) Each individual has the right to use his property in his own way.

The Capitalist movement has been supported by economic theories proposed by those who supported individualism such as Adam Smith (1723-1790). This movement became stronger after the addition of ethical theories to justify the materialist movement led by Capitalism. These ethical theories were founded by Jeremy Bentham (1748-1832) of England. Bentham founded Utilitarianism theory that stressed the doctrine: "the greatest good for the greatest number." This theory values the human as a perfect human who can determine goodness for

himself with his mind. Utilitarianism also argued that people are controlled and moved by their desires to guarantee pleasure in order to avoid losses and pain from society.

The individualist foundation of the Capitalist movement resulted in a lot of conflict of interest among people in the society. In England, John Stuart Mill (1806-1873) reviewed individualism theory and finally replaced the individualism absolutism in the society with the Liberalism Modernised movement. This replacement added the element of the state role in directing people's economic activities and also added the element of regulations into individualism and capitalism. The element of regulation was called Positivism.

Positivism or Positive Law, proposed by the Frenchman, Auguste Comte (1798-1857) that the evolution of human thinking may be classified into three levels called *Loi des Troisages*:

- (a) The first Level is the theology level, that is, a level where people explain a phenomenon based on godly explanations;
- (b) The Second Level is the philosophical level, that is, the level where people have a foundation which may respond to ideals and principles through philosophical creation;
- (c) The Third Level is the Positive level, that is, an emphasis that the "truth" refers only to matters that can be verified through testing, proved with facts, to which scientific methods can be applied.

Most of the social, economic and political systems of most Capitalist countries today are based on this Liberalism theory. Even though there have been some changes, their original foundation is individualism, which has been modified and justified with governmental rules and regulations called Liberalism. (Muslehuddin, 1979, pp. 67-72; *ibid*, 1980a, pp. 8-12; *ibid*, 1980b, p. 33; Yasin, 1982, pp. 104-105)

#### <sup>4</sup> *Collectivism.*

Collectivism is the antithesis of individualism. Collectivism is a social theory which propose that all people's interests should be achieved collectively in a society which is not controlled by a kingdom system. This theory is the basis of called Socialism and was coined by Karl Marx based on materialist dialectic.

According to Socialism, all ownership rights and means of revenue should be given to the society. No individual has the right to possess them. This is based on the premise that people are aggressive and greedy. Socialism rejects the Natural Law supported by individualism, which stresses that people are naturally good, because Socialist believes that if people are given authority, i.e. ownership right and control of means of revenue, they will exploit other people to fulfil their individual interests.

Marx's Socialism theory was then promoted through a revolutionary movement by Lenin, to become Communism. Lenin stressed that a proletariat revolutionary body was temporarily needed to lead people opposing the Capitalist group led by the bourgeoisie. It was argued that when the peak of social evolution has been achieved, then, an ideal communist society will exist, where the economic machinery is not possessed by anyone and central control will not be needed; people will be able to live well and without economic exploitation from any party. (Abu Urwah, 1989).

- <sup>5</sup> The Continental European countries, in particular France and West Germany, are high on the uncertainty avoidance scale, whereas Anglo-American countries are relatively low on the same scale. The characteristics of the uncertainty avoidance dimension are reflected in the fact that, in cultures which are high on the scale, behaviour tends to be more rigidly prescribed, either by written rules or by unwritten social codes. The presence of these rules satisfies people's emotional needs for order and predictability in society, and people feel uncomfortable in situations where there are no rules. Therefore, in general, one can expect more formalisation

and institutionalisation of procedures in strong uncertainty avoidance societies than in weak uncertainty avoidance countries.

There is a preference for the exercise of individual professional judgement, the maintenance of professional self-regulation, and flexibility in accordance with the perceived circumstance of individual companies in the accounting sub-culture of Anglo-American countries, whereas there is a preference for compliance with prescriptive legal requirements and statutory control, the maintenance of uniform accounting practices between companies, and the consistent application of such practices over time in the accounting sub-cultures of Continental Europe. Also, there is more support in the latter group for a prudent and cautious approach to income measurement to cope with the uncertainty of future events and the confidentiality of the information by restricting disclosure to only those involved with the management and financing of the organisation.

These characteristics, in turn, tend to influence the degree of disclosure expected in the respective accounting system or practices. For example, in France and West Germany, where the level of professionalism is relatively low and the preference for conservatism and secrecy is relatively high, the combined effect on the degree of disclosure will be negative. On the other hand, the collectivist or anti-individualist values of the society require business enterprises to be accountable to society by way of providing information. Therefore, it becomes necessary for the Government to intervene and prescribe certain disclosure requirements, including those in regard to social accounting. Furthermore, this situation is not likely to be rejected by the accounting profession, because, as discussed earlier, there is a preference for compliance with prescriptive legal regulation and statutory control in the accounting sub-culture. By comparison, in the US and UK, although the relatively high level of professionalism and low level of preference for conservatism and secrecy tend to have a positive combined effect on the degree of disclosure in accounting practices, the individualistic values of the society are more concerned with the provision of information to shareholders or investors than with those issues involving accountability to society at large.

- <sup>6</sup> As national differences in accounting systems and practices became increasingly evident, attempts were made to identify international patterns and to classify countries on the basis of those patterns. Two alternative approaches have been taken. The first involves the identification of relevant environmental factors (economic, social, political, and culture) and links them to national accounting practices (e.g. Mueller, 1967, 1968; Nobes, 1983, 1984), which is called a 'deductive approach' (Gray, 1988). The second involves the classification of accounting practices by using statistical analysis and then attempts to explain the patterns discovered by reference to environmental factors (e.g. Frank, 1979; Nair & Frank, 1980), which is called an 'inductive approach' (Gray, 1988). Many of the classifications developed through the above approaches suggest, *inter alia*, significant differences between Anglo-American and Continental European countries in terms of their patterns of accounting development. The Anglo-American countries are grouped as micro-business practice based systems, whereas the European countries, with the exception of the Netherlands, are grouped as macro-uniform systems (Mueller, 1967; Nobes, 1983, 1984).

The differences identified in the accounting systems between Anglo-American and Continental European countries can be explained in terms of their cultural environments. The growth of economic activity in the UK occurred in an atmosphere of *classical liberalism* with a broadly *laissez-faire* approach to government. This was also true of the economic growth that began to gain momentum in the US in the middle of the nineteenth century. In such a highly *individualist* atmosphere, the promotion of investment, by trying to interest people with uncommitted funds in various investment projects, became an important activity. Once prospective investors began to assess investment that included some kind of earnings amount



became a necessary for the functioning of the entire system. This was the background for the development of capital market activity which is the main source of funds for investment in both countries. The activities of these markets have resulted in continuous pressure being exerted for the provision of financial information for investors, making investors the most important recipients of accounting reports from companies.

The pressure for disclosure has a significant effect on the development of accounting principles and practices in these countries and the requirements of the capital markets became a major influencing factor in their disclosure patterns. Furthermore, financial reporting and capital market activity were so closely related that they became interdependent. Similar development took place in other Anglo-American accounting countries, such as Australia, Canada, and New Zealand. It was assumed that these developments should be implemented by accountants, independent of legal direction or government intervention (in Perera, 1989, p. 50).

The position in much of Continental Europe is quite different from that outlined above. In both France and West Germany there has been a tradition of state intervention in economic affairs. Unlike in the UK and the US, the influence of the classical economists was far more limited in Continental Europe. Instead, there have been a succession of economic theories with a common thread of anti-individualism. Financial accounting in France is generally influenced by legislation, a result mainly of the determination of the French Government to obtain data for macro-accounting purposes. The 1947 *Plan Comptable General*, which has been adopted by virtually all enterprises in the country, contains a detailed chart of accounts and a series of model financial and statistical reports which are considered necessary for micro- and macro-accounting purposes. The French plan makes clear that among its objectives in seeking data on an enterprise are:

- (1)the promotion of more reliable national economic policies,
- (2)the minimisation of social misunderstandings,
- (3)ensuring the availability of data for government studies of market trends, and
- (4)assistance to the government authorities in exercising control over the economy.

Furthermore, French companies have traditionally relied much less on an active new issue market as a source of long-term funds than have UK and US companies. This has resulted in a lower emphasis on the provision of investor-oriented corporate financial reporting and on the audit function as a safeguard for investors. Therefore, the primary influence on the development of accounting principles and practices in France has been the General Accounting Plan, rather than the pronouncements of the accounting profession. Similarly, in Germany, as demand for industrial capital increased during the second half of the nineteenth century, strong banks, rather than individuals, organised by a promoter, emerged as suppliers of a significant portion of that capital.

## Chapter 5:

1. There are a lot of religions in the world; and every religion has been named according to either its founder or the community or nation in which it was born. For instance, *Christianity* takes its name from its prophet (or claimed god) Jesus Christ, *Buddhism* from its founder Sidharta Buddha Gautama, *Zoroastrianism* from its founder Zoroaster, and *Judaism* (the religion of Jews) from the name of tribe Judah (of the country of Judea) where it originated. The same is true of all other religions except *Islam*, which enjoys the unique distinction of having no such association with a particular person or people or country, even though it is cynically misnamed as *Mohammadanism* by some orientalists to refer to the prophet of Islam--Mohammad (pbuh). Islam is a universal religion. Its objective is to create and cultivate in man the quality and attitude of Islam. "Islam, in fact, is an attributive title. Anyone who possesses this attribute, whatever race, community, country or group he belongs to, is a *Muslim*" (Mawdudi, 1993, p. 17).
  2. Muslims are asked to say "salallahu 'alaihi wa salam" which means 'peace be upon him' (pbuh) when the name of the Prophet is mentioned.
  3. Summarised from: World Assembly of Muslim Youth (WAMY), WAMY Series On Islam No. 9, Riyadh, Saudi Arabia: WAMY.
  4. "God is the Creator of everything. He is the guardian over everything. Unto Him belong the keys of the heavens and the earth. There is no moving creature on earth but its sustenance dependeth on Allah; He knoweth its resting place and its temporary deposit: all is in a clear Record" (Qur'an-11: 6).
  5. "Allah is He, than Whom there is no other god; Who knows (all things) both secret and open; He, Most Gracious, Most Merciful. Allah is He, than Whom there is no other god; the sovereign, the Holy One, the Source of Peace (and Perfection), the Guardian of Faith, the Preserver of Safety, the Exalted in Might, the Irresistible, the justly Proud. Glory to Allah! (High is He) Above the partners they attribute to Him. He is Allah, the Creator, the Originator, the Fashioner, to Him belong the Most Beautiful Names; Whatever is in the heavens and on earth, doth declare His Praise and Glory; and He is the Exalted in Might, the Wise" (Qur'an-59: 22-24).  
  
"Allah! There is no god but He, the Living, the Self-subsisting, Supporter of all, no slumber can seize Him, nor Sleep. His are all things in the heavens and on earth. Who is there can intercede in His presence except as He permitteth? He knoweth what (appeareth to His creatures as) Before or After or Behind them. Nor shall they compass aught of His knowledge except as He willeth. His Throne doth extend over the heavens and the earth, and He feeleth no fatigue in guarding and preserving them for He is the Most High, the Supreme (in glory)" (Qur'an-2: 255).
- "O People of the Book! Commit no excess in your religion, nor say of Allah aught but the truth. Christ Jesus the son of Mary was (no more than) a Messenger of Allah, and His Word, which He bestowed on Mary, and a Spirit proceeding from Him; so believe in Allah and His Messengers. Say not "Three": desist; it will be better for you; for Allah is One God, Glory be to Him; (far Exalted is He) above having a son. To Him belong all things in the heavens and on earth. And enough is Allah as a Disposer of affairs" (Qur'an-4: 171).
6. *ibid*, WAMY Series On Islam No. 8.

7. "Say: 'Truly, my prayer, and my service of sacrifice, my life and my death, are (all) for Allah, the Cherisher of the Worlds; no partner hath He, this am I commanded, and I am the first of those who submit to His Will (i.e. Muslims)'." (Qur'an-6: 162-163).
8. Most '*ulama*' of *hadith* do not distinguished between *hadith* and *sunnah* in their meaning, even though literally they are different.
9. "Nor does he say (aught) of (his own) Desire. It is no less than inspiration sent down to him" (Qur'an-53: 3-4); "So take what the Messenger gives you and refrain from what he forbids you" (Qur'an-59: 7);  
"Ye have indeed in the Messenger of Allah an excellent exemplar for him who hopes in Allah and the Final Day, and who remember Allah much" (Qur'an-33: 21).
10. "Say: 'If ye do love Allah, follow me; Allah will love you and forgive you your sins, for Allah is Oft-Forgiving, Most Merciful'" (Qur'an-3: 31);  
"We sent not a Messenger, but to be obeyed, in accordance with the leave of Allah" (Qur'an-4: 64);  
"He who obeys the Messenger, obeys Allah; but if any turn away, We have not sent thee to watch over them" (Qur'an-4: 80).
11. Also:  
"You will never have perfect *iman* until your desires follow what I have ruled out" (Al-Hakim).  
"I left nothing from what Allah has commanded you with that, except I surely have also commanded you with that; and I left nothing from what Allah has prohibited you to do, except I surely have also forbidden you to do that thing" (Ibn 'Abdil Barr)  
"O men, there is nothing makes you close to the Heaven and far away from the Hell, except I have commanded you with that; and there is nothing make you close to the Hell and far away from the Heaven, except I have prevented you from that" (Imam Al-Baghawi).
12. Secularism is an idea that rose from *materialism*, which separates between worldly life and heavenly life. An understanding of the idea of secularism can only be gained if one understands the meaning of materialism and the socio-political history of European society from the 3rd to the 15th Centuries and beyond. Materialism, philosophically, means a theory based on the belief that the real world is the material world only (*matter*), that is, anything that can be seen, heard, and touched. Anything that cannot be felt by the human senses cannot be accepted or believed. Therefore, anything which is metaphysical or godly is unacceptable. Materialism as a belief system rejects the existence of God, prophets, angels, revelation, the life after death, and *taqdir*. (*The Ideas of Karl Marx*, 1973, Educational Audio Visual Inc., London, p. 4; an-Nadawi, pp. 44-46)

Historically, it has been known that the civilisations of European countries owe their origins to the civilisations of ancient Greece and Roman. At the beginning, the foundations of their governmental systems followed the Roman system, while their philosophical foundation followed the Greek philosophy. By these foundations, the Roman Empire existed as a great power in Europe, while it had no religious foundation because the Greek philosophy which was based on *rationality* did not support any clear godly (religious) concept. After some eras, Christian teachings influenced the Roman Emperor and put religious elements into the governmental system. However, this Christian influence has been mixed with pagan beliefs and made Christianity just as a name, so that today many Christian rituals in fact are the ancient rituals of people who did not believe in god.

After that, Europe an society and history witnessed conflict between the Church and the government for influence and power. There have been eras when the Church held power, and eras when kings took power, and eras when kings ruled under the Church (such as The Holy Roman Emperor), and eras of division between both in religious and governmental authority. (an-Nadawi, *Islam and The World*, pp. 111-126; Atta'ur-Rahim, *Jesus the Prophet of Islam*, pp. 82-111)

Until the 15th Century, when Europe was under feudalism, these conflicts still continued. The 16th Century, marked the flowering of European screne through such scholars as Copernicus. and new innovations such as printing machines and the like, which were prohibited by the Church. During this Reformation era, there was great conflict between the Church and scientists. The Church strictly banned, or even executed, scientists so there a rose a feeling of antipathy among scientists toward the Church and also toward the religious life itself.

When the collapse of feudal system and the social evolution showed the support and sympathy of people to the anti-Church groups, this was the beginning of the end of the conflict between the Church and Crown for influence and power. What happened at that time was that the Church and religion lost their power and no longer played a major role in social and governmental life. (Hayes, *Modern Europe To 1870*, pp. 149-218; an-Nadawi, pp. 111-126)

From the above history, it can be seen that secularism is a separation between two powers, religious and worldly. Or, it is separation between the rulings of religion and state. Each ruling has autonomy to act, in its own sphere without the involvement of the other. Therefore, the Church has freedom to govern religious rituals, while the state has freedom in political and governmental aspects. (al-Bahi, p. 16)

13. "Then, in their wake, We followed them up with (others of) Our messengers; We sent after them Jesus the son of Mary, and bestowed on him the Gospel; and We ordained in the hearts of those who followed him Compassion and Mercy. But the Monasticism which they invented for themselves, We did not prescribe for them; (We commanded) only the seeking for the Good Pleasure of Allah, but that they did not foster as they should have done. Yet We bestowed, on those among them who believed, their (due) reward, but many of them are rebellious transgressors" (Qur'an-57: 27).

14. "Therefore flee unto Allah; I am from Him a Warner to you, clear and open!" (Qur'an-51: 50); "Be quick in the race for forgiveness from your Lord and for a Garden whose width is that (of the whole) of the heavens and of the earth, prepared for the righteous" (Qur'an-3: 133); "Then ask forgiveness of Him, and turn to Him (in repentance); for my Lord is (always) near, ready to answer" (Qur'an-11: 61);

"If a servant approaches Me one span (of the hand), I will approach him one cubit; and if he approach Me one cubit, I will approach him one fathom; and if he walks to approach Me, I will run to approach him" (*Hadith Qudsi*, narated by Bukhari).

15.

(a) *Qiyamul-Lail*, that is, keeping awake to perform night prayer (*shalat tahajjud*) through the last one-third of the night. It is a primary way (*wasilah*) as has been done by all prophets and pious people. Some verses of the Qur'an mention the excellencies and benefits of doing so (Qur'an-26: 26; 52: 49; 17: 79; 73: 20; 39: 9; 25: 63-64; 51: 15-17; and 32:16-17). For example, in verse 79 of surah (chapter) 17, Allah says: "And as for the night, keep awake a part of it as an additional prayer for thee; soon will thy Lord raise thee to a Station of Praise and Glory".

(b) *Tilawatul Qur'an*, that is reciting the Qur'an and trying to comprehend it and think seriously about it, and make intercession to Allah. It will give a very deep impression which is useful for improving a muslim's spirituality. As Allah says:

"Allah has revealed (from time to time) the most beautiful Message in the form of a Book, consistent with itself, (yet) repeating (its teaching in various aspects); he skins of those who fear their Lord tremble threat, then their skins and their hearts do soften to the remembrance of Allah. Such is the guidance of Allah" (Qur'an-39: 23).

(c) *Zikir*, that is remembering Allah in the heart and calling His name orally. As Allah says in many verses of the Qur'an, for example in Qur'an-33: 41-42; "O ye who believe! Remember Allah, with much remembrance; and glorify Him morning and evening" (Similarly are in: Qur'an-20: 14; 7: 205; 8: 45; 13: 28; 2: 186; and 40: 60). As addition to *Zikir* and *do'a* (prayer), *istighfar* (asking God's forgiveness) and *zikrul-maut* (remembering the dead) are two heart deeds which can help to improve the *taqarrub* of *believers* unto Allah.

16. "(Allah) Who seeth thee standing forth (in prayer), and thy movements among those who prostrate themselves" (Qur'an-26: 218-219); "It was We Who created man, and We know what suggestions his soul makes to him; for We are nearer to him than (his) jugular vein" (Qur'an-50: 16);

17. "(To the righteous soul will be said): 'O (thou) soul, in rest and satisfaction! Come back thou to thy Lord, well pleased (thyself), and well-pleasing unto Him! Enter thou, then, among My devotees! Yea, enter thou My Heaven'" (Qur'an-89: 27-30).

18. "O mankind! there hath come to you an admonition from your Lord, and healing for (the diseases in) your hearts, and for those who believe, a Guidance and a Mercy" (Qur'an-10: 57); "We send down (stage by stage) of the Qur'an that which is a healing and a Mercy to those who believe" (Qur'an-17: 82); "Say: It is a guide and a healing to those who believe" (Qur'an-41: 44).

19. In the systems that exist in the world today, concepts and philosophies concerned with ethics or anything called morality or ethics can be grouped into two main types:  
(i) System which are based on the belief in god and life after death;  
(ii) Systems which come from secularist sources and reject godly belief.

In general, all systems which are based on godly concepts, other than Islam include the element of *shirk* (paganism). Systems which reject the godly concept argue that of all systems are aimed at achieving the goodness. The foundation of morality is also a way of achieving the goodness, and it need not be achieved through religion. Therefore, morality is something which is free from the belief in god and life after death. (al-Mawdudi, p. 7-14)

Based on these arguments, then, what is called moral and ethics today are not similar or equal to the meaning of *akhlaq* in Islam. The differences are due to the following reasons:

- (i) *Akhlaq* is godly in nature, and is a part of the comprehensive Islamic concept and nature;
- (ii) *Akhlaq* laws can bring people to achieve a happy life because they cover both people's spiritual and material growth, while morals and ethics emphasise only the achievement of human matters;
- (iii) *Akhlaq* laws create or influence human life, while ethical laws are created by people according to their desires and understandings about life; (Abu 'Urwah, pp. 151-152)

20.

(1) Truthful in sincerity to Allah.

That means that a believer should show his full attention to Allah only in all of his deeds, conducts, movements, either practically or intentionally. He expects nothing for his works except for and because of Allah. Allah says: "Whosoever expects to meet his Lord, let him work righteousness, and, in the worship of his Lord, admit no one as partner" (Qur'an-18: 110).

(2) Truthful in love to Allah.

That means that a believer should love Allah more than any matter of himself and his desires. He always prioritises the command of Allah over any matter of his own. Allah says: "But those of Faith are overflowing in their love for Allah" (Qur'an-2: 165); and "Say (to them, O Mohammad): If ye do love Allah, follow me; Allah will love you and forgive your sins" (Qur'an-3: 31).

(3) Truthful in fear and *taqwa* to Allah.

Allah says: "And fear none but Me" (Qur'an-2: 40); "And fear Me, and Me alone" (Qur'an-2: 41); "Fear not men, but fear Me" (Qur'an-5: 44). A believer who truly loves Allah will be worried that Allah will not love him due to his sins and faults. Those who have true fear of Allah are believers who have peace in their hearts due to fear of Allah. That peace comes because they believe that Allah always sees their actions and intentions.

(4) Truthful in *wara'* (observance) of Allah.

A believer who is truthful in *wara'* to Allah is one who avoids any doubtful and deceiving thing and chooses the clear and undoubtful thing in all matters. The Prophet said: "One is never truthful in Fear until he pleases to leave allowable things because of worry that those things are not allowable" (narrated by Ibn Majjah and Tarmidhi).

(5) Truthful in *tawakkal* (resignation, trust) to Allah.

Allah says: "But in Allah put your trust if ye have faith" (Qur'an-5: 23). Truthful in trust means to rely fully on Allah, be dependent and seek to please Him and feel secure in everything guaranteed by Allah for His servants. It also means that a believer should free his heart from any worry about worldly matters because the duty of people is only to put forth effort, and the results are returned to Allah. "For Allah loves those who put their trust (in Him)" (Qur'an-3: 159).

(6) Truthful in *haya'* (obedience) to Allah.

Truthful in *haya'* means protecting himself from all Allah's prohibitions because of trust that Allah always sees him. A true believer in *haya'* to Allah will be aware of the essence that there has been a lot of good given by Allah to him, while he has too often not realised it and not been thankful. The Prophet said:

"Be *haya'* to Allah with true *haya'*. Whosoever be *haya'* to Allah with true *haya'*, he should maintain his mind and desires, maintain his stomach and foods. He should keep remembering the grave and being destroyed in there. And whosoever expects the hereafter, he should leave any worldly-neglectful life possessions" (narrated by Tarmidhi).

(7) Truthful in thankfulness to Allah.

A true believer in thankfulness to Allah is one who realises that he has received many bounties from Allah. Allah says: "But if ye count the favours of Allah, never will ye be able to number them" (Qur'an-14: 34). As a result, he will always be thankful to Allah with his heart, words, and deeds.

(8) Truthful in *zuhud* to Allah.

A true believer in *zuhud* to Allah is one who never condemns the worldly wealth nor exalts it. If worldly wealth comes to him, he is not over-glad; and when it leaves him, he is not sad. Allah says:

"No misfortune can happen on earth or in your souls but is recorded in a Book before We bring it into existence; that is truly easy for Allah. In order that ye may not despair over matters that pass you by, nor exult over favours bestowed upon you" (Qur'an-57: 22-23).

(9) Truthful in pleasing Allah.

If the attitudes of *zuhud*, *tawakkal*, love of Allah, trust and *haya'* within a believer are perfect, then he is truthful in pleasing Allah. Allah says:

"Well-pleased is Allah with them, as are they with Him; for them hath He prepared Gardens under which rivers flow, to dwell therein for ever. That is the supreme Triumph" (Qur'an-9: 100); "O (thou) soul, in (complete) rest and satisfaction! Come back thou to thy Lord, well pleased (thyself), and well-pleasing unto Him! Enter thou, then, among My Devotees! Yea, enter thou My Heaven!" (Qur'an-89: 27-30).

(10) Truthful in repentance to Allah.

The truthful summarising all truthful characteristics is truthfulness in repentance to Allah. Allah says: "O ye who believe! Turn to Allah with sincere repentance" (Qur'an-66: 8); "And O ye Believers! Turn ye all together towards Allah in repentance that ye may be successful" (Qur'an-24: 31). A believer who is truthful in repentance is one who realises his omissions and then intend not to repeat his faults, and asks forgiveness of Allah. He also always feels worry if he does not do true and sincere repentance; therefore, he keeps making repentance over repentance.

21. "O ye who believe! Persevere in patience and constancy; vie in such perseverance" (Qur'an-3: 200); "But if ye have patience, that is indeed the best (course) for those who are patient" (Qur'an-16: 126); "Now await in patience the command of thy Lord; for verily thou art in Our eyes" (Qur'an-52: 48); "And be patient and persevering; for Allah is with those who patiently persevere" (Qur'an-8: 46).

22

(1) Be patient in performing duties.

A patient believer in fact is a believer who is patient in performing all Allah's commands that are compulsory upon him; in every circumstances he keeps performing anything commanded to him. His patience in performs religious commands makes him as one who continually performing compulsory orders, whether he is in happy or unhappy conditions, wealthy or poor, healthy or not, and in peace or trouble.

(2) Be patient in avoiding Allah's prohibitions.

Be patient over Allah's prohibitions means to refrain oneself from any unlawful desires, which are not pleasing to Allah. It also means to be serious in ignoring the whispers of Satan who always tries to persuades people to do mischief.

(3) Be patient in performing additional recommended deeds.

It means that a believer is patient in performing deeds which may bring him to closer to Allah. He keeps performing all recommended deeds such as: *qiyamullail*, recommended fasting, reciting the Qur'an, remembering Allah, and the like. It also means that he keeps adding his additional deeds to make him closer to Allah.

(4) Be patient in accepting truthfulness.

It means to keep trying to seek truth by learning from scholars or their books. It also means that a believer should always be open to accept any warning and advice, and never feels hurt by it, even though it concerns to personality.

(5) Be patient in facing tests and difficulties.

A true believer should be patient in facing any form of tests and difficulties in the path of Allah. He should complain to Allah only, in all of his matters. Allah says: "I only complain of my distraction and anguish to Allah" (Qur'an-12: 86).

23. "And keep yourself content with those who call on their Lord morning and evening, seeking His Face; and let not thine eyes beyond them, seeking the pomp and glitter of His Face; nor obey any whose heart We have permitted to neglect the remembrance of Us, one who follows his own desires, and his affair has become all excess" (Qur'an-18: 28).



## **Chapter 6:**

1. "Help ye one another in righteousness and piety, but help ye not one another in sin and rancour." (Qur'an-5: 2); "The Believers, men and women, are protectors one of another; they enjoin what is just, and forbid what is evil; they observe regular prayers, pay zakat, and obey Allah and His Messenger" (Qur'an 9: 71).
2. "Shame is pitched over them (like a tent) wherever they are found, except when under a covenant (of protection) from Allah and from men" (Qur'an 3: 112);  
"O ye who believe! Fear Allah as He should be feared, and die not except in a state of Islam. And hold fast, all together, by the Rope which Allah (stretches out for you), and be not divided among yourselves" (Qur'an 3: 102-103).
3. "(They are) those who, if We establish them in the land, establish regular prayer and give zakat, enjoin the right and forbid wrong. With Allah rests the end (and decision) of (all) affairs." (Qur'an-22: 41).
4. Social institution is a social structure and mechanism by which human society manages, controls and performs various activities needed to fulfil human needs (Barnes, p. 29).
5. Essentially, what is believed by all people as justice, then Islam also has a similar view about such matters. For example, all societies in the world see that murder, stealing and bribery are not good. Islam also has a similar position toward these matters. However, in the life of most societies today, they distinguish between what is bad from a social point of view and bad from a legal point of view. When something is bad from a social perspective, but according to the decision of the democratic system that thing is not illegal, then doing that thing cannot lead to someone being sued or punished. For example, many Western people see drinking intoxicants, prostitution, and homosexuality as bad deeds from the social point of view. However, from the legal point of view, doing these things cannot be seen as illegal except when someone drives a car while drunk, thereby endangering people, or practising prostitution without a licence or beyond the permitted area, or when homosexuality is practised by politicians.

Islam as a comprehensive religion does not accept such dualism policy in determining what is good and what is bad, or what is false and what is true. Therefore, anything seen by the normal human mind as mischief, is viewed by Islamic law also as mischief, and Islamic law determines the fair and just punishment for it.

6. Some Western people believe that every good thing comes from them. They will argue that because of them this world owns its goodness, and they think that without them, people would be still in the darkness and stupidity. The issue of human rights is one that they have been launching as if only they have human rights. They claim further that human civilisation in the world found its rights from the Magna Carta of Britain. They ignore the fact that Magna Carta was signed six hundred years after the coming of Islam in Makka (year 611). Moreover, no-one in among Western society realises that the Magna Carta contains the foundation of Habeas Corpus, that is discussion using jurist, and government authority upon taxation law until the 17th century. Even, if those who wrote Magna Carta were still alive today, they would be surprised to that the above foundation has been given by people today to the Magna Carta. In fact, Western society had no concept of human rights before the 17th century. Before the end of the 18th century, the concept of human rights existed in the form of declarations in America and France. After that, reference was made to human rights in other Western countries institutions. However, what has really been happening is that human rights is only something beautifully written down on the paper and inapplicable. For example,

after World War II, the United Nation Organisation was established and adopted the Declaration of Universal Human Rights, through the issue of a resolution to stop killings (genocide) in the world, such as was happening toward Muslims in India and other places. However, till today, this resolution has had no direct power to stop the killings. The human right promoted by the UN is only an empty slogan.

In Islam, human rights in its broad aspects was known 14 centuries ago. Moreover, this human right was not only known, but also written down in the Madinah Treaty (or as-Sahifah or as-Dustur al-Madinah), which was the first written treaty in the world. In Islam, human right is something given by Allah. This right is as fixed as Islamic shari'ah. This godly human right is unchanged and cannot be removed by people. No legal authority can change, add to or remove the human rights laid down by Islam. Human right is a part of faith toward Allah. Allah says: "If any do fail to judge by what Allah hath revealed, they are unbelievers; .... wrong-doers; ....those who rebel" (Qur'an 5: 44, 45, 47).

This is different from human rights created by people. Those rights change according to people's wants and may be removed by the authority of law or a change in the authoritative body. Within the UN itself, there are nations which are called major powers, such as the US and UK which have veto right to pass or reject any resolution they do not like, even though such a resolution may condemn those who transgress human rights (Mawdudi, 1976b, pp. 13-15).

7. The freedom to embrace any religion:

In short, religious freedom according to Islam consists of the following matters:

- (i) All people have the right to follow and practise their religious teaching freely and peacefully;
- (ii) No-one is allowed to force others to follow or accept any religious teachings and rituals other than those of his own religion;
- (iii) No-one is forced to follow or to give donation to any religion other than his own religion;
- (iv) Each religious group has the right to possess property, and to form and manage their own institutions;
- (v) Each religious group has the right to teach their religion to their own members and their children;
- (vi) No-one is banned from holding a position in government due to religious differences, except for the position of top leader and some other positions which are open only to Muslims. Similarly, no student is banned from entering an educational institution because of religious differences;
- (vii) Every religious group has the right to form a body to discuss cases relating to that religion and some other cases that the body is allowed by the Islamic state to deal with;
- (viii) Muslims have the right to preach to non-Muslims. They also have the right and responsibility to ask other Muslims to perform their religious duties, and they also have the right to correct other Muslims who are misguided. (Yaacob, 1986, pp. 65-66).

8. The freedom to speak for Muslim within an Islamic society is based on the Islamic *mushawarah* (consultation) concept. A Muslim is free to express his opinion as long as the matter he express does not concern the following:

- (i) matters which have been ruled clearly in the Qur'an and Sunnah;
- (ii) matters which contradict the spirit of Islamic shari'ah.

The freedom to speak is given to believers in order to improve their society. A muslim even has the right to express his opinion concerning the leader himself when there is something done by the leader which does not follow the shari'ah, or which conflict with the public interest.

Toward non-Muslims, the freedom to speak is given according to the religious freedom given to them. Freedom to speak is specifically given to them in managing their own matters. They are also allowed to give opinions on governmental and social management in general, under the same guide and rules as Muslims do.

9. The freedom to have education, for Muslims, means to have full freedom to gain education without any problems or limitations. This freedom does not mean that people are free to choose any type of education they want. This is because according to shari'ah, it is the duty of parents to educate children in the Islamic faith and morality. Therefore, a child has no freedom to choose which religious subjects he wants to follow. (Abu 'Urwah, 1989, p. 94)
10. Imam al-Ghazzali (1970b, p. 190) stresses that the neighbour's rights means that people should greet their neighbours, to visit them when they are sick, to see them and feel sorrow when they suffer misfortune and help them, to congratulate them on happy occasions, to forgive their carelessness or fault, not to disturb their family members, not to block their way entering their house, to cover their exposed feebleness, to guard their house when they are out, not to listen to bad words about them, to be kind to their children, and to teach them anything they do not know yet in religious and worldly matters. Imam al-Ghazzali adds that poor neighbours will seize their rich neighbours in the Day of Judgement, screaming: "O my God. Ask this man why he was reluctant to help me and closed his door when his stomach was full while my stomach was empty".
11. Sherwani (1977, p. 123) states that political activity in Islam has given birth to some political thinkers among the 'ulama' (Islamic muslim scholars) who have been involved, directly and indirectly, in administering government during certain eras in Muslim history. Sometimes they have been involved in strengthening a just government, and sometimes they proposed ways to solve problems in any crisis. Among those who have wrote about the foundation of Islamic politics and were sometimes involved in political affairs are: Imam al-Mawardi (974-1058) with his main work *Al-Ahkamus Sultaniyah*; Amir Kaika'us (1021-1082) with his main work *Qabus Namah*; Nizamul Mulk at-Tusi (1017-1091) with his main work *Siyasah Namah* or *Siyarul Mulk*; Imam al-Ghazzali (1058-1111) with his main works in political affairs *Tibrul Masbuk* and *Sirrul Alamain*; Ibn Taimiyyah (1263-1328) with his main works *Minhajus Sunnah* and *Siyasatusy-syar'iyyah*; and Ibn Khaldun (1332-1406) with his work *Kitabul 'Ibar*. In contrast, most of the theories of founders of Western politics such as Plato, are not applicable; Aristotle based his political thinking on the foundation of the coastal-states of Athens and Sparta which were extinct in his era; Rousseau, a European thinker in a later era, was exiled and then died without any respect from his people (in Abu 'Urwah, 1989, p.135).
12. In Western political philosophy, the meaning of sovereignty is given to people and state or constitutional authority. The word sovereignty take its source from Latin word "*supernuus*", that is "*supreme*". This word is used in political science to refer to the authority. Among Western philosophers, the meanings of sovereignty are (Muslehuddin, 1980b, pp. 56-57):
  - i. According to Bodin, the first Westerner to develop this concept, sovereignty means human right which is everlasting, unlimited, and without conditions to make, interpret and apply laws.
  - ii. According to Grotius, sovereignty is the highest political authority owned by someone in which his conducts are above everything and his will cannot be thwarted by anybody.
  - iii. According to John Austin, sovereignty is the highest authority within society, to which obedience is due.

In today's meaning, the sovereignty of a state is a certain area in which a state, according to international law, has full autonomy and is not under any other state's authority or under international law itself (Bullock & Stallybrass, 1988, p. 591).

13. "So take what the Messenger gives you, and refrain from what he prohibits you" (Qur'an-59: 7); "We send not a Messenger, but to be obeyed, in accordance with the leave of Allah" (Qur'an-4: 64); "But no by thy Lord, they can have no (real) Faith. Until they make thee judge in all disputes between them. And find in their souls no resistance against thy decisions, but accept them with the fullest conviction"(Qur'an-4: 65).  
 "If anyone contends with the Messenger even after guidance has been plainly conveyed to him, and follows a path other than that becoming to men of Faith, We shall leave him in the path he has chosen, and land him in Hell; what an evil refuge!" (Qur'an-4: 115);

14. *Mushawarah* differs from democracy because the sovereignty in *mushawarah* belongs to Allah, while in democracy it belongs to people, either in the form of majority votes or in the governmental bodies. In the *mushawarah* process people only have the right to express and decide a case when there is no explicit argument from the Qur'an, Sunnah or Ijma'. In the *mushawarah* process people only play the role of Caliph in matters regarding laws and regulations. On the other hand, in a democratic system people make and decide laws and regulations according to the interest of the majority. The foundation of democracy is the concept that legal sovereignty is in the people's hands. It can be summed up, then, that a democratic system stands on the popular sovereignty concept, while *mushawarah* is based on the popular khilafah principle. In a democratic system, people make laws for themselves, while in the *mushawarah* process, people are bound to follow Allah's laws.(Maududi, 1976b, p. 8-9).

Currently, there is no agreement on the exact meaning of democracy as a practical form of political system. This is because of differences in the meaning of *equality* and social and economic structures of societies. This disorganisation is more obvious when the Western democracy concept is applied in Muslim countries where Islamic and non-Islamic values and cultures contradict each other (Enayat, 1982, pp. 126-127).

15. The process of electing the state leader according to *mushawarah* was applied in the history of Islam in the era of righteous Caliph governments. Even though the form differed in detail, the foundation was the same, that is, election through *mushawarah*:

- i. Abu Bakar, the first Caliph, was elected as Caliph on a *mushawarah* decision made by *Anshar* (the helpers, the local Madina residents) and *Muhajirin* (the emigrants from Makka) groups in Thaqifah bani Sa'adah.
- ii. 'Umar, the second Caliph, was proposed by Abu Bakar before his death, then this proposal was expressed to the Muslims *ummah*. On this basis, 'Umar was elected as Caliph through *mushawarah*.
- iii. 'Uthman, the third Caliph, was elected as Caliph after a board set by 'Umar to elect Caliph decided to elect him as Caliph. This decision was the *mushawarah* result made by 'Abdul Rahman ibn 'Auf, one of the board member, with the Muslim *ummah* at that time.
- iv. 'Ali was proposed by a group of Muslims who came to his place and asked him to be Caliph after the murder of 'Uthman. This proposal was brought to the mosque and *mushawarah* then decided that 'Ali become the Caliph.

Included in *mushawarah* is when someone is elected as state leader in an Islamic state through a general election which allows all Muslims to express their opinion (Asad, 1980, p. 45).

16. "When he turns his back, his aim everywhere is to spread mischief through the earth and destroy crops and progeny but Allah loveth not mischief" (Qur'an 2: 205);  
 "...so judge thou between men in truth (and justice): nor follow thou the lust (of thy heart), for it will mislead thee from the Path of Allah; for those who wander astray from the Path of Allah, is a Chastisement Grievous, for that they forget the Day of Account" (Qur'an 38: 26).

17. *Theocratic* is a governmental system in which God (or gods) is (are) the absolute king or leader, and his (their) law is the constitution for that state. The laws are usually expressed in the structure of priests as ministers, and therefore a theocracy is a governmental system with a sacerdotal structure whose ministers claim themselves as God's intermediaries. (The Shorter Oxford Dictionary, Vol. II, 1956, p. 2166).

18. Some 'Ulama' have interpreted *Darul Islam* in different ways either *de facto* or *de jure* in nature. For example, Ash-Sharkashi defined it as 'the name of a place under Muslim authority'. This is a *de facto* meaning, which is referred to the position of true Muslims. That is, if Muslims govern, they should apply Islamic laws. It should be noted that this meaning is no longer suitable because most Muslim countries today support secular law and their governmental structure clearly does not place Islam as the foundation for state government and management. Therefore, today, countries led by Muslims do not automatically become Islamic countries, because their foundations are not to uphold Islam as their main basis.

Another interpretation is that *Darul Islam* is 'a place where the message of Islam has clear legal power or Muslims' power. This is a *de jure* interpretation because originally the existence of a state is aimed at supporting and upholding Islamic laws.

19 Islamic jurists, on the other hand, have laid down ten important things as the purposes of an Islamic political and governmental system (El-Awa, 1980, p. 77). They are:

- (1) to maintain belief according to principles agreed by the '*ulama' salaf* (the first generation of '*ulama*') of Muslim community;
- (2) to practise the court process in the society and to overcome problems between disputers;
- (3) to keep safety in Islamic areas so that people may live in safety and peace;
- (4) to apply punishment determined by *shariah* in order to protect human right;
- (5) to protect the state's border with any weaponry from any possibility of attack from outsiders;
- (6) to wage *jihad* on those who oppose Islam;
- (7) to control the affairs of collecting tax, *zakah*, and charity as has been ruled out by the law;
- (8) to manage the states budget in order to avoid any misuse (wastefulness or stinginess);
- (9) to recruit capable and just officials in order to protect state properties and to carry out the state's administration;
- (10) to do orderly guarding and investigation in public affairs in order to lead the state and to protect the *Deen*.

The first and sixth purposes are regarded as the main purpose of Islamic state, i.e. maintaining *iman* (Faith). The second, third, fifth, eighth and ninth purposes concern the protection of people's interests. The fourth, seventh, and tenth purposes are aimed at protecting the faith and people's interest at the same time.

[(6) Those who oppose Islam are:

- i. *Ta'ifah baghiah*, or the group of rebels, which oppose the legal Islamic state due to their atheism.
- ii. *Murtaddin* or the group of former Muslims who then became non-Muslims and gathered to oppose the legal government.
- iii. *Ahlul zimmah* living under an Islamic government which then opposes the Islamic state.

- iv. *Ahlul musta'min*, that is, the group of non-Muslims which were previously bound by a peace agreement with the Islamic state, but then broke the agreement and attacked the Islamic state.
- v. *Kafir harbi* or the group of non-Muslims who are hostile to an Islamic country.

20. Historically, the Prophet became the Head of State of Islamic state of Madinah, and at the same time also the executive leader (Amir) and the judge, because Allah (God) had chosen him, and people (Muslims) did not dissent. He, however, did not leave any explicit clear order nor did he appoint certain people to replace him. Because there was no explicit clear sign in this matter, and by referring to the Qur'an, the companions concluded that after his death, the selection and appointment of the Head of State (Caliph) should be based on the consent of all Muslims--a democratic system.

Therefore, the first Caliph (Abu Bakar) was elected openly. And when he felt that he was no longer able to be the Caliph, due to old age, he opined that the most proper one to be the next Caliph was 'Umar. However, he did not straight away appoint 'Umar to replace him; instead, he consulted on this matter with some prominent companions, and then they all agreed to appoint 'Umar as the second Caliph.

When 'Umar (the second Caliph) was approaching death, he saw that among the companions left, only six of them were considered to be capable to replace him. Therefore, he then formed a 'consultative assembly' comprising these six companions and delegated to them the task of selecting a new Caliph from among themselves. The assembly then delegated one of them, 'Abdurrahman bin 'Auf, to go around the territory in order to gain people's opinion regarding this matter. He also asked women, different *madzhab* (schools) followers, and pilgrims from other territories, and analysed their responses regarding this matter. Based on these inputs, there were two potential assembly members preferred by the people, 'Ali and 'Utsman. After an open election among the assembly members, 'Utsman was selected to be the third Caliph.

After the assassination of 'Utsman (the third Caliph), some companions met together in 'Ali's house and stated that there was nobody capable to be the Caliph except him ('Ali). At that time, 'Ali refused it. But the companions forced him, so that he ('Ali) then agreed on these conditions: "If you really want it, go to the Mosque because my appointment as *Amir* must not be done secretly and without the agreement of all Muslims". Then 'Ali went to the Mosque, when all the people were there. The people then agreed to appoint him as their leader. And when 'Ali was ready to leave this world, people asked him to appoint his son, Hasan, to be the new Amir. He replied: "I did not ask you to do it, but I cannot forbid you to do it. You can decide it according to your own opinion."

21. Legal requirements for authorities:

- (a) They must be Muslim, as mentioned clearly in the Qur'an:  
"O ye who believe! [Muslims] Obey Allah, and obey the Messenger, and those charged with authority among you" (Qur'an 4: 59).
- (b) They must be men, as the Qur'an has mentioned: "Men are protectors and maintainers [leaders] of women" (4: 34). And the Prophet has also said: "Truly a nation will never be developed/advanced if it is led by a woman" (Hadith, narrated by Bukhari).
- (c) They must be mature and strong-minded. The Qur'an states: "To those weak of understanding, give not your property which Allah has assigned to you to manage" (Qur'an 4: 5).
- (d) They must be citizens of that state. The Qur'an states: "As to those who believed, but did not emigrate, ye owe no duty of protection to them" (Qur'an 8: 72).

22. Other additional requirements for authorities:

- (1) *Amanah* (Trustworthy). "Truly Allah has commanded you to put trust in [give responsible positions] those whose are able to hold *amanah* [trust]" (Qur'an 4:58);
- (2) *The most pious*. "Truly the most honourable among you in the sight of Allah is (he who is) the most pious" (Qur'an 49: 13);
- (3) *Knowledgeable*. "He [their Prophet] said: "Allah hath chosen him above you [to be your leader /king], and [He] hath given him abundantly with knowledge and bodily prowess"" (Qur'an 2: 247);
- (4) *Modest*. "And do not obey any whose heart I [God] has permitted to neglect the remembrance of Me, one who only follows his own desires! And his affair has become all excess" (Qur'an 18: 28);
- (5) *Honest*. Those who respect and honour a liar [big mouth] (in religious affairs), are helpers in destroying the pillars of Islam (Hadith, narrated by Al-Baihaqi);
- (6) *Humble*. "By Allah, do not give the governmental affairs to those who want it, or to those who are arrogant" (Hadith, narrated by Bukhari & Muslim); "We view those who want a position as those who are the most un-trustable" (Hadith, narrated by Abu Dawood).

23. Regarding the last two rights above (from the Sunnah), it is reported that the Prophet said: "The Imam [or the government] is a guardian of his people and responsible for them [i.e., their welfare]" (Hadith, narrated by Bukhari). He also mentioned that "The head of the state is the guardian of him who has nobody to support him" (Hadith, cited in Mawdudi, 1976, p. 34). Therefore, an Islamic state would have to guarantee, constitutionally as well as through economic policies:

- a minimum living standard for all citizens;
- provision of remunerative work for working age and healthy persons;
- training for such productive work;
- public health services;
- public transportation.

Whereas Islam views work as the primary means of meeting one's basic needs, both the Qur'an and Sunnah emphasise the provision of adequate nourishment, clothing and shelter for those with insufficient incomes or those disabled due to any valid reason like illness, orphanhood, widowhood, old age, underage, or unemployment arising out of circumstances beyond individual control, and for those engaged in social uplift programmes.

24. Economic problems according to secular economists are based on the point of view that people's needs exceed the available resources. In their opinion, the resources available for people will never be enough to fulfil people's needs. In the Islamic point of view, the real economic problems of people are related to how economic distribution is managed, to give everyone enough opportunities to develop their life in a way that allows them to use all their potentialities and skills (Mawdudi, 1969, p. 12).

25. Western classical economists such as Adam Smith, Ricardo and Mill interpreted economics as "the science of wealth", or what Alfred Marshall called the human life in the business world. Lionell Robins defined economics as "a science which studies human behaviour as a relationship between ends and scarce means and which have alternative uses." According to him, a resource may be used to meet various human needs. Therefore, using a resource to meet one certain need means leaving its uses for other needs. According to Ruenez, economics is "a science which studies human behaviour in facing a lot of needs with limited resources which have various uses."

26. "Do ye not see that Allah has subjected to your (use) all things in the heavens and on earth, and has made His bounties flow to you in exceeding measure, (both) seen and unseen?" (Qur'an-31: 20); "To Him belongs what is in the heavens and on earth, and all between them, and all beneath the soil" (Qur'an-20: 6).
27. "O ye who believe! Make not unlawful the good things which Allah hath made lawful for you, but commit no excess; for Allah loveth not those given to excess. Eat the things which Allah hath provided for you, lawful and good; but fear Allah, in Whom ye believe" (Qur'an 5: 87-88);  
 "Say: Who hath forbidden the beautiful (gifts) of Allah, which He hath produced for His servants, and the things, clean and pure, (which He hath provided) for sustenance? Say: They are, in the life of this world, for those who believe, (and) purely for them on the Day of Judgement. Thus do We explain the Signs in detail for those who know" (Qur'an 7: 32).
28. "Allah commands justice, the doing of good, and giving to kith and kind, and He forbids all indecent deeds, and evil and rebellion; He instructs you, that ye may receive admonition" (Qur'an 16: 90);  
 "So give what is due to kindred, the needy, and the wayfarer, that is best for those who seek the Countenance of Allah, and it is they who will prosper" (Qur'an 30: 38).
29. "Eat what Allah hath provided for you, and follow not the footsteps of Satan: for he is to you an avowed enemy" (Qur'an 6: 142);  
 "O Children of Adam! Wear your beautiful apparel at every time and place of prayer: eat and drink: but waste not by excess, for Allah loveth not the wasters" (Qur'an 7: 31);  
 "And do not eat up your property among yourselves for vanities, nor use it as bait for the judges, with intent that ye may eat up wrongfully and knowingly a little of (other) people's property" (Qur'an 2: 188).
30. A capitalist economy based on individualism is laid down on the belief that personal ownership right is absolute. One has the right to possess everything he likes, of everything available. This freedom to possess, produce and exploit wealth is not bound by any rules. A socialist economy based on collectivism does not recognise personal and individual ownership right. No-one is allowed to possess wealth and property or production factors (land, labour, capital) as personal possessions. In a socialist economic system, production factors are public goods managed by the state. It is only the state that has the right to possess all production factors and determine the economic activities.
31. "Fair in the eyes of men is the love of things they covet: women and sons; heaped-up hoards of gold and silver, horses branded (for blood and excellence), and (wealth of) cattle and well-tilled land. Such are the possessions of this world life; but with Allah is the best of the goals (to return to)" (Qur'an 3: 14).
32. The freedom to seek income sources in Islam is based on Allah's creeds: "And when the Prayer is finished, then may ye disperse through the land, and seek the bounty of Allah; and remember Allah frequently that ye may prosper" (Qur'an 62: 10);  
 "It is He Who has made the earth manageable for you, so traverse ye through its tracts and enjoy of the Sustenance which He furnishes; but unto Him is the Resurrection" (Qur'an 67: 15).
33. Examples of these facts are:
- (i) *Greek Culture*. Greek culture did not respect occupation and some people under-valued it. In Greece, occupations which were not based on thinking have been seen as a social disgrace and caused humiliation for the workers ( Hunter, 1959, Part 2, p. 28);



- (ii) *Judaism and Christian*. They see occupations as Allah's punishment on man due to the sins committed by Adam when he lived in the Paradise. This is based on "The curse on earth is caused by your sin, you will need to work hard to find foods on earth in your life." (Old Testament, Part 3, 17);
  - (iii) *Capitalist System*. Free choice of occupation proposed by the capitalist system is based on the idea that to provide enough special workers for a certain industry, when workers are also needed for other industries, then the wages for certain jobs should be high enough to attract workers to the needed sectors. Therefore, free choice of occupation in a capitalist society creates imbalance between compensation and work. Such a condition will create unlimited full competition, monopoly, and destroy cooperative feeling (Mannan, 1986, p.33);
  - (iv) *Communist System*. Socialists and communists believe that occupations and production factors are dangerous weapons that can be used by people if they possess them. For these groups, people tend to use production factors to obtain power more than to fulfil their greed for property or wealth (Siddiqi, pp. 16-17). In these systems, wealth and all production factors are possessed by the state. People work according to state determination, and people follow the society's needs and are not oriented to gain profit at all. Wages are measured according to the productivity in predetermined tasks, not on the types or sectors of work (Mannan, 1986, pp. 38-39).
34. The social justice propogandised by capitalism and secular democratic systems in the name of liberalism is, in fact, an empty slogan. So-called social justice, in fact, is exploitation of people based on usury and a banking system which is an institution to gain profit without any risk of losses. Similarly, social justice in socialism and communism is also an empty slogan because essentially these systems seize human rights and stop human growth and development (Mawdudi, 1969, p. 100-101).
35. From an Islamic point of view, there are big differences between social justice and socialism. The differences are as follows:
- (i) Socialism suppresses the personal characteristic of individuals, while social justice in Islam develops the individual's personality and his right.
  - (ii) Socialism destroys the human incentive to work, while social justice in Islam supports and seeks cooperation among people;
  - (iii) Socialism disallows personal ownership right, while social justice in Islam allows it with some healthy rules (Muslehuddin, 1980, pp. 88-94; Yusuf, 1977, pp. 169-190; al-Ghazali, 1970c, pp. 105-176).
36. The main principle in systems other than Islam is that the property which was amassed by the dead person should be given to one or some certain people only. As a comparison, the following can be noted:
- (i) *Christian*: Concerning inheritance, Christianity determined that all property owned by the dead person was the right of his first child.
  - (ii) *Judaism*. Concerning inheritance in Judaism, the first person to inherit the property of the dead is his son. If he has more than one sons, then the first son obtains twice as much as the others. There is no difference between his legitimate and illegitimate sons. Therefore, the first son cannot be ignored due to illegitimacy. Daughters, if they are under 12 years old, have the right to basic necessities and education until they reach the age of 12. After that, they have no right any more (Syalabi, 1970, p. 268).
  - (iii) *Socialist system*. Socialism rejects the existence of inheritance after someone's death because essentially and originally, people are not allowed to possess property and any production factors.
  - (iv) *Capitalist system*. Essentially, in this system, there are no specific laws concerning inheritance. However, it is only a secular system based on liberalism today. The

Inheritance laws in this system are based on individualism in the use of property. Therefore, people are allowed to make wills without any limitation. In this system also, inheritance of property is based on nomination, that is, one nominates another or some others who will inherit his property after his death. The nomination is not limited to the importance of family ties or relationship (Mannan, 1986, p. 182).

37. "Do ye not see that Allah has subjected to your (use) all things in the heavens and on earth, and has made His bounties flow to you in exceeding measure, (both) seen and unseen?" (Qur'an 31: 20);  
 "To Him belongs what is in the heavens and on earth, and all between them, and all beneath the soil" (Qur'an 20: 6).
38. The roles of the state in Islam toward economic activity are:
- (i) To make sure that each individual's behaviour follows Islamic regulations through education, and if necessary, through regulatory authority;
  - (ii) To maintain good market conditions to make sure its functions run smoothly (Ibn Taimiyah, 1985, pp. 36-58);
  - (iii) To adjust resource allocation and income distribution resulting from the market mechanism by guiding and controlling through involvement and taking part in that process;
  - (iv) To take positive actions in production and capital formation sectors to push economic growth to make sure the social justice (Siddiqi, 1980a, pp. 208-109).
39. *Riba* first controls 'aql (mind) through the influence of selfishness. Miserliness, narrow mindedness, stubbornness, competition in worldly matters and other bad attitudes are the foundation of *riba* practice. Therefore, *riba* destroys the moral and spiritual elements within humankind and creates disunity in society, because people's needs and poverty have been made an opportunity to increase the wealth and capital of others. *Riba* divides people into groups of dominator and dominated. That is what has been happening in human life. A government which gives a *riba* loan to another government divides the people of these two countries and destroys good and friendly relation (Mawdudi, 1970, pp. 40-43).
- There are two types of *riba*:
- (i) *Riba Fadal*; that is *riba* in interchange of goods. It is the excess obtained by someone from another through the interchange of similar food-materials or currency.
  - (ii) *Riba Nasi'ah*, is *riba* concerning postponed payments, which happens when someone borrows something from another and fails to return it at the predetermined time, and is therefore charged an additional amount above the principal (Al-'Assal and Karim, 1980, pp. 88-90).
40. Islam prohibits all types of trade consisting the elements of *gharar* and *khatar*, which are something unclear and unknown, and *maisir* or gambling. According to Islam, *bai'atul gharar* or trade containing *gharar* elements is doubts and not valid. Among examples of *mu'amalah gharar* which commonly exist today are insurance (excluding Islamic *takaful*), especially motor insurance which clearly contains the element of *gharar*. In the secular insurance system, the agreement made contains the element of *gharar* for the buyer, while the statistical and probability techniques used guarantee profits for the seller.
41. Islam emphasises the full opportunity to get an occupation on the basis of the respected position of every occupation and individual freedom in choosing occupations. The foundation called by the capitalist economy, Full Employment, is closely related to the meaning of Gross Domestic Product (GDP), that is the production values of goods and services made by a society (Baxter & Rees, 1972, p. 152, 192). "The economy is said to be at full employment

when only frictional unemployment (i.e. unemployment resulting from the time lags involved in the redeployment of labour) exists. That is, everyone who wishes to work at the going wage-rate for his type of labour is employed."

From the above definition, and the meaning of goods and service which are valued in matters and money, neither are suitable to Islam, especially regarding creation of work opportunity to society. This is because not all production, either goods or services, can be valued merely in terms of GDP. Some of them, such as the duty to do good and to prevent evil are also important services for the society, which are intangible. Also the duty of housewives to manage the household and provide the basis of education for children is an important service which is difficult to value in monetary terms. If the human standard of living is assessed on the basis of per capita GDP, this is misleading, according to Islam, because standard of living is related to social stability, safety and peacefulness, while these matters and other matters are also achieved through good family foundations and the broad performance of doing good and preventing evils (Siddiqi, 1980b, pp. 155-158; Chapra, 1979, pp. 148-149).

Therefore, the concept of work opportunity stressed by Islam from the materialistic view stands on the basis of fulfilling personal and societal duties in the society. Everyone who is responsible for his burdens is given the opportunity to fulfil his responsibility through occupation. If this cannot be done due to tragedy, the market situation or other factors, then it become the responsibility of the society through state management to provide him with help without destroying his spirit of independence. From the point of view of society's duty, it is the duty of the state to synchronise the activities and occupations of its society.

42. In the capitalist system, Economic Growth is defined as "the steady process of increasing productive capacity of the economy, and hence of increasing national income" (Baxter & Rees, 1972, pp. 144-145). The symptom of economic growth in capitalistic system is on the basis of "maximisation of profit and minimisation of loss". Human values, such as helping each other, love and the like are ignored. Islam sees that economic growth, even though within a society practising Islam comprehensively, still brings certain images to the human spirit and faith. Therefore, economic growth in Islam generally is not based on maximising production, but more on the balance between high production level and the eternalising and strengthening human values based on faith and spirit.

43. The ways laid down by Islam to destroy poverty are:

- (i) To work and exert effort;
- (ii) To protect the weak such as orphans, widows and disables people;
- (iii) To pay *zakah* in order to guarantee the right of the poor in the property of the rich. *Zakah* is charged on: (a) livestock, (b) Crops, (c) Gold and Silver, (d) Exploration, (e) *Rikaz* or treasury, (f) Merchandise Inventory, (g) *Fitrah* (soul).
- (iv) To help the poor using the state's financial resources such as: (a) *Kharaj*, that is tax levied on non-muslims' lands if their countries are under the Islamic state's sovereignty; (b) *Jizyah*, that is a special tax levied on *ahluz-zimmi* (non-muslims living in an Islamic state) as a guarantee for their safety and protection given by the Islamic state; (c) *Ghanimah*, that is booty of war taken from unbelievers after being defeated in war; (d) *Fa'i*, that is bounties taken from unbelievers without war (when they have run away before the war, leaving their property); (e) *Ushr*, that is, trading tax levied on *ahluz-zimmi* and *musta'min* (people bound by a peace treaty with Islamic state); (f) Loan, any loan received by an Islamic state from other Islamic states or *musta'min* countries.
- (v) To help the poor from other than *zakah* and state's money: (a) The neighbourhood right, that is the right of the poor to receive any help from their neighbour; (b) Sacrifice on Pilgrimage Holy Day ('Iedul Adha), that is giving flesh of the sacrificed animal to the poor; (c) The breaking of oath: those who break their oath should provide food for ten

poor, or provide clothes for them, or free a slave (Qur'an 5: 89); (d) *Zihar* penalty: one who swears that it is harmful for him to approach his wife, then, it is compulsory for him to free a slave, or (if he cannot afford it) to fast continuously for two months, or (if he still cannot afford it) to provide food for sixty poor (Qur'an 58: 3-4); (e) The penalty for having sexual intercourse during the day of fasting: it is same as the penalty for *zihar* above; (f) *Fidyah*: the elders, pregnant women, and those who are seriously ill are exempted from fasting in the month of Ramadan by paying *fidyah* (providing food for the poor); (g) *Al-Hadyu*, or paying a fine (*dam*) due to committing something forbidden during Pilgrimage; (h) The right of the crops during harvesting time. Soon after the crops are harvested, a certain part of them should be given to the poor on the same day; (i) The right to meet the needs of the poor.

(vi) Individual charity and donation (al-Qardawi, 1985b, pp. 62-233).

44. One of the problems of the lack of materials is caused by keeping and tying up needed merchandise. In today's system, stored stock is among the weapons used by big capitalist institutions to kill and destroy the small, and by the big countries to destroy the economy of the small countries.
45. Imbalance between money values and goods and service available is called inflation. In the West, inflation is defined as: "a process of steadily rising prices, resulting in diminishing purchasing power of a given nominal sum of money" (Baxter & Rees, 1972, p. 235). Or, "In economics, [it is] a term used most commonly to denote a process whereby the general price level, as measured by some broad index number of prices, rises significantly and persistently for a period of several years or more, looked at the other way up, it means a persistent decline in the purchasing power of the monetary unit" (Bullock & Stallybrass, 1988, p. 309).
46. "Against them make ready your strength to the utmost of your power, including steeds of war, to strike terror into (the hearts of) the enemies of Allah and your enemies, and your besides, whom ye may not know, but whom Allah doth know" (Qur'an 8: 60).

## Chapter 7:

1. "O ye who believe! When ye deal with each other, in transactions involving future obligations in a fixed period of time, reduce them to writing. Let a scribe write down faithfully as between the parties: let not the scribe refuse to write: as Allah has taught him, so let him write. Let him who incurs the liability dictate, but let him fear Allah his Lord and not diminish ought of what he owes. If the party liable is mentally deficient, or weak, or unable himself to dictate, let his guardian dictate faithfully. And get two witnesses out of your own men. And if there are not two men, then a man and two women, such as ye choose, for witnesses, so that if one of them errs, the other can remind her.

The witnesses should not refuse when they are called on (for evidence). Disdain not to reduce to writing (your contract) for a future period, whether it be small or big; it is juster in the sight of Allah, more suitable as evidence, and more convenient to prevent doubts among yourselves. But if it be a transaction which ye carry out on the spot among yourselves, there is no blame on you if ye reduce it not to writing. But take witnesses whenever ye make a commercial contract; and let neither scribe nor witness suffer harm. If ye do (such harm), it would be wickedness in you. So fear Allah; for it is Allah that teaches you. And Allah is well acquainted with all things." (Qur'an-2: 282)

"If ye are on a journey, and cannot find a scribe, a pledge with possession (may serve the purpose). And if one of you deposits a thing on trust with another, let the trustee (faithfully) discharge his trust, and let him fear Allah his Lord. Conceal not evidence; for whoever conceals it, his heart is tainted with sin. And Allah knoweth all that ye do." (Qur'an-2: 283)

2. The eight groups of *Zakah* receivers mentioned in the Qur'an (9: 60) are:
  - (1) *Fuqara* (the poor), that is those who have no source of income;
  - (2) *Masakin* (the needy), (i) those whose possessions do not reach the minimum *Nisab* limit, (ii) those whose earnings are not enough to satisfy the essential needs of themselves and their dependents;
  - (3) *Amilun*, those employed to administer the *zakah*, which means all expenses for administering the *zakah* funds could be paid from that fund;
  - (4) *Mu-allafatu al-Qulub*, men who have been weaned from hostility to truth, who would probably be persecuted by their former associates, and require assistance until they establish new connections in their new environment;
  - (5) *Riqab* (those in bondage), literally and figuratively means: captives of war must be redeemed, slaves helped to freedom, those in bondage of ignorance or superstition or unfavourable environment should be helped to freedom to develop their own gifts;
  - (6) *Gharimun* (debtors), those who are held in the grip of debt should be helped to economic freedom;
  - (7) *Fi Sabilillah*: those engaged in the way of Allah. This term originally applied to those actively engaged in fighting for the defence of Islam in the battlefields; but, included in this category are: (i) those who are engaged in acquiring religious education and who cannot afford the requisite expenses, such as tuition fees, boarding, lodging, clothes, etc., (ii) those who are engaged in missionary work for the propagation of Islam without receiving any payment for their services, and/or can only maintain their families with great difficulty, (iii) those who are engaged in the work of imparting knowledge of Islam (teachers) through educational centres (e.g. schools or *madrassa*), but who do not receive adequate salaries to maintain themselves and their families, and (iv) those who are poor students in secular schools and colleges. Money from *Zakah* funds could be given to them for fees, text books, boarding and lodging expenses, for clothes, etc.
  - (8) *Ibn as-Sabil* (the wayfarer), the traveller who is not poor but finds himself in financial difficulties (stranded abroad without funds) for some reason; e.g. the money is lost or stolen.