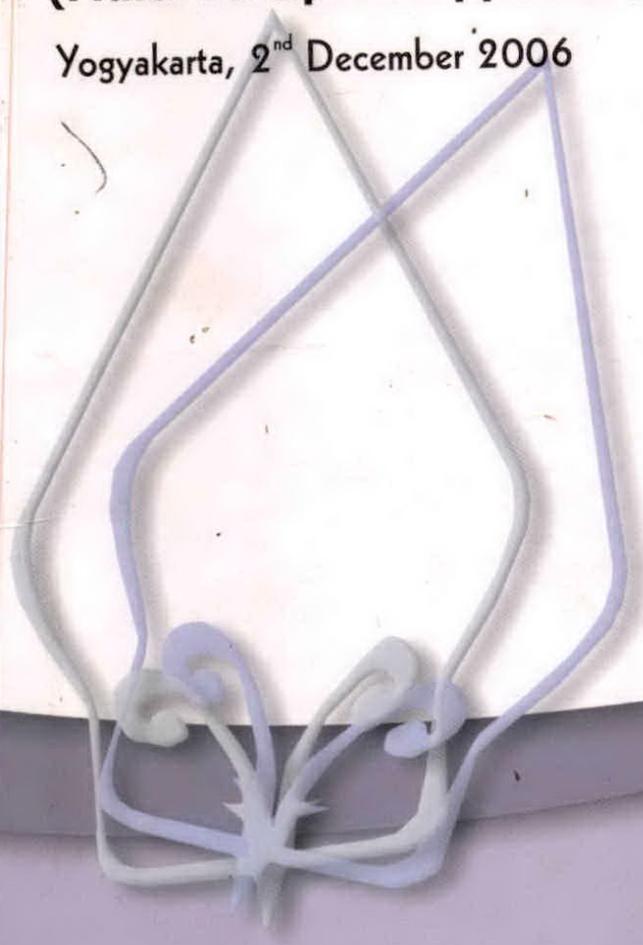


Proceeding

International Joint Seminar

**Muslim Countries and Development :
Achievements, Constraints and Alternative Solutions
(Multi-Discipline Approach)**

Yogyakarta, 2nd December 2006



Organized by:



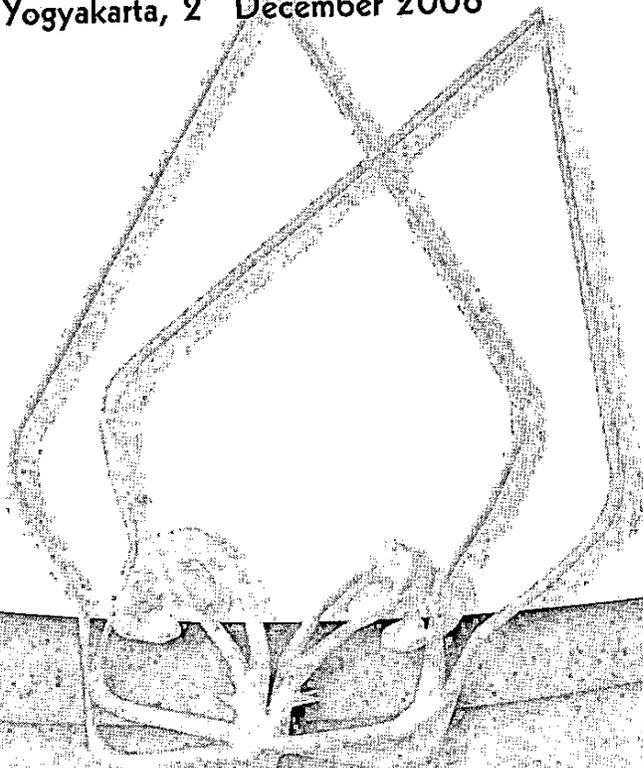
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Organized by:



Universitas
Muhammadiyah
Yogyakarta



International
Islamic
University
Malaysia



Education and
Cultural Attache
Embassy of The Republic
Indonesia in Malaysia

**MESSAGE FROM THE RECTOR OF
UNIVERSITAS MUHAMMADIYAH YOGYAKARTA (UMY)**

Assalamu'alaikum warahmatullahi wabarakatuh

All praise be to Allah SWT, Lord of the world. Peace and blessings on Muhammad SAW, His Servants and Messenger.

First of all, as the rector of Universitas Muhammadiyah Yogyakarta (UMY), I would like to welcome to the honourable guests, Rector, Dean of Postgraduate Studies (CPS), Dean of ISTAC, Dean of IRKHS, Deputy Deans and Head Departments from various Kulliyah, lecturers, postgraduate students of International Islamic University Malaysia (IIUM), and all participants in this joint seminar.

Academic cooperation between UMY and IIUM started several years ago. The cooperation between us is based on a solid foundation; both us are Islamic universities having same missions to develop Islamic society, to prepare future generations of Islamic intellectuals, and to cultivate Islamic civilization. In fact, improving academic quality and strengthening our position as the producers of knowledge and wisdom will offer a meaningful contribution to the development of Islamic civilization. This responsibility is particularly significant especially with the emergence of the information and knowledge society where value adding is mainly generated by the production and the dissemination of knowledge.

Today's joint seminar signifies our attempts to shoulder this responsibility. I am confident to say that this joint program will be a giant step for both of us to open other pathways of cooperation. I am also convinced that through strengthening our collaboration we can learn from each other and continue learning, as far as I am concerned, is a valuable ingredient to develop our universities.

I sincerely wish you good luck and success in joining this program

Wassalamu'alaikum Wr, Wb.

Dr. Khoiruddin Bashori

Rector, UMY

**MESSAGE FROM THE RECTOR OF
INTERNATIONAL ISLAMIC UNIVERSITY MALAYSIA (IIUM)**

Assalamu'alaikum warahmatullahi wabarakatuh

In the name of Allah, the most Gracious and the most Merciful. Peace and blessings be upon our Prophet Muhammad (S.A.W).

First and foremost, I felt honoured, on behalf of the university to be warmly welcomed and to be given the opportunity to work hand in hand, organizing a respectable conference. Indeed, this is a great achievement towards a warmer bilateral tie between the International Islamic University Malaysia (IIUM) and Universitas Muhammadiyah Yogyakarta (UMY) after the MoU Phase.

I would also like to express my heartfelt thanks to Centre for Postgraduate Studies (CPS), Postgraduate Students Society (PGSS), contributors, paper presenters, participants and our Indonesian counterpart for making this program a prestigious event of the year.

This educational and cultural visit is not only an avenue to foster good relationship between organizations and individuals and to learn as much from one another but a step forward in promoting quality graduates who practices their ability outdoor and master his or her studies through first hand experience. The Islamic platform inculcated throughout the educational system namely the Islamization of knowledge, both theoretical and practical, will add value to our graduates. This comprehensive excellent we strived for must always be encouraged through conferences, seminars and intellectual-based activities in line with our lullaby: The journey of a thousand miles begin by a single step, the vision of centuries ahead must start from now.

My utmost support is with you always. Looking forward to a fruitful meeting.

Ma'assalamah

Wassalamu'alaikum Wr, Wb.

Prof. Dato' Dr. Syed Arabi Iddid

Rector, IIUM

**MESSAGE FROM EDUCATION AND CULTURAL ATTACHE
EMBASSY OF THE REPUBLIC OF INDONESIA
KUALA LUMPUR**

Assalamu 'alaikum warahmatullahi wabarakatuh

All praise be to Allah SWT. This is the moment where implementation of MoU between Universitas Muhammadiyah Yogyakarta (UMY) and International Islamic University Malaysia (IIUM) comes in the form of action by organizing this Joint Seminar. The efforts of both sides to implement the MoU are highly appreciated, especially, in the context of which both universities effort to enhance the quality of education.

Substantially, I believe that this Joint Seminar will bring many benefits. In term of the development of knowledge, it is a means for developing academic quality, for exchanging of information on academic development, as well as for constructing intellectual atmosphere at both universities. In term of international relations, both universities have taken part in increasing close relationship between Malaysia and Indonesia. RUM and UNY as well are using 'soft power' to increase bilateral relations among citizens which brings a lot of benefits for both nations.

Therefore, I hope that both RUM and UMY can make use of this program as a 'kick-off' for other programs in the future, especially in using UMY's vast networks with other Muhammadiyah Universities in various cities in Indonesia as well as IIUM's network. The support of IIUM for UMY also means a progress for IIUM and UMY. I hope such joint program will continue in future for betterment of both Indonesia and Malaysia. Embassy of the Republic of Indonesia in Kuala Lumpur will always support these efforts.

To our honorable guests, Rector, Dean of Postgraduate Studies (CPS), Dean of ISTAC, Dean of IRKHS, Deputy Deans and Head Departments from various Kulliyah, lecturers and students of IIUM, I warmly welcome you to Yogyakarta. I hope you enjoy your stay in the cultural city of Yogyakarta.

Finally, as the Attache of Education and Cultural, Embassy of the Republic of Indonesia, Kuala Lumpur, I sincerely wish you good luck *and a successful program with unforgettable memories.*

*Wabillahit Taufiq Wal Hidayah
Wassalamu 'alaikum warahmatullahi wabarakatuh.*

M.Imran Hanafi

Education and Cultural Attache, Embassy of the Republic of Indonesia

MESSAGE FROM DEAN CENTRE FOR POSTGRADUATE STUDIES

Assalamu'alaikum warahmatullahi wabarakatuh

Praise be to Allah. May the peace and blessings of Allah be on the last prophet and messenger, our master Muhammad and on his household and companions. It is a great privilege for me to foreword this message to this wonderful event that is jointly organized by the Universitas Muhammadiyah Yogyakarta (UMY) and International Islamic University (IIUM).

First and foremost I would like to record my special gratitude to management of Universitas Muhammadiyah Yogyakarta for their co-operation.

In order to obtain comprehensive excellence, the Centre for Postgraduate studies has always facilitates postgraduate students of the university to achieve the highest quality in their academic work. This seminar is one of the many programs that Centre for postgraduate studies has to ensure quality graduates.

I would therefore like to thank all the participants and programme coordinators who have worked hard to realize this event.

May Allah SWT shower His blessing upon us.

Wassalamu'alaikum Wr, Wb.

Prof. Dato' Dr. Wan Rafei Abdul Rahman
Dean, Centre For Postgraduate Studies

**MESSAGE FROM THE ACTIVE
PRESIDENT OF POSTGRADUATE STUDENTS'**

Assalamu'alaikum warahmatullahi wabarakatuh

On behalf of Postgraduate Students' Society (PGSS), my gratitude and appreciation to our beloved Dean of Studies, the Embassy of Indonesia in Kuala Lumpur, Muhammadiyah Yogyakarta and the organizing committee of IIUM and the Universitas Muhammadiyah Yogyakarta for their huge success. Postgraduate Students' Society (PGSS) under the supervision of the Center for Postgraduate Studies (CPG) is pleased to host this event.

As I strongly believe that the initial stages of unity are the key to building the new generation, who will represent the future more, such programs, not only achieve the mission of our universities but to achieve the global mission and vision. Therefore, I believe today, we have to have understanding and then only we can appreciate our diverse cultures. We should acknowledge the different strengths and weaknesses through knowledge in this age of information. I am sure this joint seminar will initiate unity among the future generations along with integrating them.

Thank you,

Mohd Nabi Habibi

Active President Postgraduate Students' Society (PGSS)

MESSAGE FROM PROGRAM DIRECTOR

Assalamu'alaikum warahmatullahi wabarakatuh.

Praise be to Allah. May the peace and blessings of Allah be on the last Prophet and Messenger, our master Muhammad and on his household and companions.

Honestly speaking, we are pleased to be trusted by Postgraduate Students' Society (PGSS) and Centre for Postgraduate Studies (CPS) to organize the programme named Educational and Cultural Visit to Yogyakarta, Indonesia. For this, We express our gratitude to the management of both PGSS and CPS. This programme is of immense value. It has the potentials to promote intellectual endeavor, develop leadership capabilities and enrich cross-cultural understandings. We sincerely believe and hope that program of this kind will be organized in a regular fashion in future.

It is a great privilege for us to play twofold role in organizing this event: *as a host* and *as guest*. In fact, this is a fascinating experience to manage this event. Since our inception here, we have found meaningful interaction of students in an interweaving of cultures into complicated, yet beautiful, embroidery of social fabric. We are proud to say that this dearly loved university has produced graduates of high quality, who are distinct from those of the local universities.

Finally, we wish to express our special thanks to Bapak M.Imran Hanafi, Education and Cultural Attache of Indonesian Embassy, Bapak Herdaus, S.H., Assistant of Immigration Attache of Indonesian Embassy, Bapak Tharian Taharuddin for their immensely valuable assistance and co-operation in making this program a success. I sincerely appreciate all local committees at Yogyakarta, the colleagues and program coordinators and committee members who worked diligently to materialize this event. We wish to pass on good wishes to the PGSS for their valuable efforts it expended for this event.

May Allah s.w.t shower His blessing upon us.

Wassalam,

Nasrullah

Programme Director

Todi Kurniawan

Co-Programme Director

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The Emerging Issues on the Objectives and Characteristics of Islamic Accounting for Islamic Business Organizations and Its Impact on Indonesia Islamic Accounting Development

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Abstract

Research on Islamic accounting is still at an exploratory stage; its pioneers try to develop a theoretical framework for Islamic accounting using various methodologies. In common with the development of conventional accounting, the search is on for the objectives and characteristics of Islamic accounting as a foundation on which to lay its principles, conventions, rules and standards. Hameed and Yaya's study found that the development of Islamic accounting can be classified into deductive, inductive or 'ibaha, and hybrid approaches. Their evaluation has shown that the hybrid approach is promising as compared to other approaches. However, in this further study on its application in Indonesia, the use of 'ibaha approach is more dominant than others in developing Islamic accounting standards. Meanwhile the use of hybrid approach in Indonesia is not in the context of the development of Islamic accounting.

Introduction

Islam recognizes the desirability of engagement in business activity. It does not denounce business or other worldly activities as such. Business activities can become part of *ibadah* (worship and obedience to Allah) if they are performed in accordance with the commands of Allah and the Islamic code of conduct (Ahmad, 1988). In Islam, man is the vicegerent of Allah on earth, and Allah has made the universe subservient to him (Al-Qur'an 2:30; 14:32-33; 22:65; 31:20; 35:39 & 45:12-13). As vicegerent, it is man's duty to work hard to build this world and to use its natural resources in the best possible manner in accordance with Divine rules (Al-Qur'an 2:5; 6:153).

However, current business practices are separated from religion, which to some extent has resulted in a contradiction with Islamic morality. Furthermore, current business practices are also equipped with an accounting system, which is more likely

established to achieve capitalistic socio-economic objectives (Sombart, 1919). This situation leads to the need for establishing an accounting system that could attain the Islamic socio-economic objective of *falah* (the success in the world and the hereafter). The importance of such efforts becomes even greater with the development of Islamic financial institutions in many parts of the world, which operate on the basis of Islamic teachings (*Shariah*). However since this concern is still in its infancy, the debates on this issue are still very vague.

This article tries to explore the emerging issues of the objectives and characteristics of what is perceived as Islamic accounting and tries to find patterns in the debate which will probably be needed in the future to formulate Islamic accounting theory with some exploration on its application in Indonesia. Section one of this article elaborates on the characteristics of Islamic business activities, followed by section two on the inappropriateness of conventional accounting for Islamic business organizations. Then, in section three, some emerging approaches in developing Islamic accounting system will be evaluated as well as its application in Indonesia. Finally, sections four and five will discuss the objectives and characteristics of Islamic accounting respectively.

Characteristics of Islamic Business Activities

Islam is premised on ethical and moral conduct. This can be inferred from the *Hadith* narrated by Abu Hurairah, saying that the Prophet Muhammad (pbuh) has been sent only for the purpose of perfecting good morals. Naqvi (1981) views that the Islamic ethical and moral code of conduct permeates human life whether individual or collective in a way that Islam considers ethics as an offshoot of the Muslim belief system itself.

Siddiqi (1979) notes that '*adala* (justice) and *Ihsan* (benevolence) (Al-Qur'an 2:177; 5:8; 4:36) could be considered as the summary of the entire morals in the economic enterprise derived from the *Qur'an*. These values, in his opinion, are the basic values, which offer guidance in almost every action in human life. Therefore, Islamic business should also be characterized with these manners.

The Inappropriateness of Conventional Accounting for Islamic Business Organizations

The characteristics of Islamic business activities above can be considered as an ideal practice for an organization controlled by Muslims. Such an organization then can be called an Islamic business organization. In order to maintain its characteristics, an Islamic organization is also recommended to be equipped with accounting tools with such characteristics (Hameed, 2001). However, conventional accounting has been criticized on its inability to support the Islamic objectives, in other words, it is not appropriate for the Islamic business organization.

The issue of the inappropriateness of conventional accounting for the Islamic business organization (IBO) can be categorized into three groups; (i) contradictory to Islamic teachings, (ii) irrelevance to Islamic accounting objectives, and (iii) insufficiency in focusing on Islamic socio-economic objectives. The following section will elaborate on them.

2.1. The Contradictions of Conventional Accounting to Islamic Teachings

Many studies have indicated that conventional accounting has resulted in a situation, which contradicts the Islamic socio-economic objectives. For example, Gray (1994) asserts that conventional accounting has directed organizational growth at the cost of environmental degradation. He argues that this could happen because conventional accounting as the scorekeeper in evaluating the performance of an organization, does not take such a view into account. Briloff (1996) argues that it has led to the concentration of wealth by a few individuals at the expense of society. Further Arnold & Cooper (1999), find that it has led to the loss of jobs through downsizing and transfer of wealth through privatization. Therefore, we can conclude that conventional accounting often results in organizational practices, which are contradictory to Islamic principles.

In particular, Hameed (2000a) points out that these contradictions are caused by the use of decision usefulness objectives in conventional accounting. Although he admits that the term 'decision usefulness' seems rational, harmless and acceptable from an Islamic perspective, but, when one examines this concept in depth, a number of problems arise. Firstly, conventional accounting's focus on informational efficiency in the capital market from the perspective of the shareholders. This can imply that the resulting equilibrium may not be efficient from the perspective of other members of society such as employees, government and the community at large. Secondly, conventional accounting operates under an assumed pristine liberal economic society (Gray, 1996). In this type of society, the increasing gap between the rich and the poor is not questioned and there is no room for environmental and ethical values other than utilitarian self interest. Thirdly, the decision usefulness paradigm on which conventional accounting is based, was born in the countries with developed capital markets. Meanwhile, many Muslim countries have not established or developed stock exchanges¹ and the economy is non-monetized. Therefore, in such a situation, the decision usefulness of accounting oriented toward the market does not make any social or economic sense.

Hameed (2000b) views that the characteristics of conventional accounting would be utilized for the enrichment of shareholders and creditors even at the expense of damaging social and environmental consequences. In particular, Adnan and Gaffikin (1997) point out that some accounting concepts are contradictory to Islamic principles. The concept of historical cost and conservatism for instance, according to them, can be misleading and cannot guarantee the quality of justice and honesty within the information it carries. Therefore, they argue that such concepts have no room in the accounting for Islamic institutions (Adnan and Gaffikin, 1997). Meanwhile, the conservatism concept could also go against the *Qur'an* and *Sunnah* as it would distort accounting data. They argue that the conservatively reported data are not only subject to improper interpretation but also contradict the objective to disclose all relevant information related to the particular company (Adnan and Gaffikin, 1997).

¹ Although a few Muslim countries have established stock markets, the majority of the Muslim population are employed in agricultural, pastoral, and small business activities.

2.2. The Irrelevance of Conventional Accounting to Islamic Accounting Objectives

Adnan and Gaffikin (1997) assert that some of the accounting concepts in conventional accounting are irrelevant to Islamic accounting. The matching concept for instance, is considered irrelevant because it leads to the preference for the revenue-expense approach rather than the asset liability approach. In fact, if the objective of accounting in Islam is to uphold the accountability through *Zakat* as Adnan and Gaffikin (1997) propose, the asset-liability approach needs to be applied.

Besides the matching concept, the objectivity concept is also considered as irrelevant. Adnan and Gaffikin (1997) argue that putting objectivity in the context of qualitative characteristics indicates that it is related more to the secondary objectives of accounting information, which is to facilitate accounting users in making legitimate economic decisions for their own interests. Therefore, since the primary objective of Islamic accounting is for *Zakat* accountability (as they propose), the objectivity concept is basically not relevant to the main concern of a primary objective in *Zakat*.

2.3. The Insufficiency of Conventional Accounting in Achieving Islamic Socio-economic Objectives

Hameed (2000a) asserts that the main accounting reports of conventional accounting (e.g. the income statement, balance sheet, cash flow statement and other subsequent or extraordinary events information) are considered important in Islamic accounting and could continue to be applied. This is because the investors and other financial providers are also members of society and they must get their due rights. In this case, the calculation of profits is absolutely essential in order for various parties to get their just and fair share.

However, that information is insufficient for Islamic society which should uphold accountability to Allah (as the primary accountee) and to men (as the secondary accountee) (Hameed, 2000a). Therefore, the uniqueness of Islamic accounting would be to provide other types of information in an integrated manner in the accounting report or statement.

Khan (1994) observes that the point of reference is the overall objective of the *Shariah* and not users' rights or needs as claimed by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) (1996). Therefore, he proposes additional requirements so that Islamic socio-economic objective can be obtained, such as providing true figures of *Zakat* payable, the extent to which justice and benevolence are considered in the organization, treatment of the employees, the impact of the business on its environment and adherence to the Islamic code of ethics.

Approaches in Developing Islamic Accounting

Basically, there are two approaches that can be used in developing Islamic accounting; (1) based on Islamic teachings and (2) based on contemporary accounting which is in line with Islamic teachings. These two approaches have been noted by the AAOIFI (1996) when they initially started to develop accounting for Islamic banks. Each approach contains inherent weaknesses in terms of either its applicability or reliability to meet Islamic socio-economic objectives. Therefore, Hameed (2000a) proposes a hybrid of the first and the second approach, which later will be considered as the third approach.

3.1. Deduction from Islamic Teachings Approach

This approach starts by establishing objectives based on the principles of Islam and its teachings, and considers these objectives in relation to contemporary accounting thought (AAOIFI, 1996). This approach deduces the *Shariah* precepts into what ought to be the objectives of financial accounting. If necessary, these could be supplemented by Western objectives of financial accounting that do not breach *Shariah* precepts and are deemed to be appropriate for Islamic business organizations.

The proponents of this approach believe that this would help to minimize the influence of secular contemporary accounting thought on the objectives to be developed (Karim, 1995). However, Rashid (1987) argues that this approach is necessarily detached from certain features of reality and one cannot know *a priori* how influential these factors will turn out to be. As a result, the move from theory to practice turns out to be quite difficult when one has only this approach at hand.

In Indonesia, this approach is advocated by Adnan (1997) and Triyuwono (2000). This can be inferred from their proposal of Islamic accounting development based on zakat concept. They argue that the issue of accounting in Qur'an and Sunnah is mainly related with zakat obligation. In Qur'an, a number of verses state the obligation of paying zakat, following the obligation of praying to Allah. As zakat is based on the wealth, there is a need to develop an instrument that can calculate one's wealth as well as his or her zakat. To meet this objective, the accounting concepts should be in line with principles in zakat i.e the principle of market value. In terms of practice this approach has not been used yet in developing accounting standard in Indonesia. It seems also in Indonesia, less research has been done on accounting by using this approach.

3.2. Contemporary Accounting Based Approach

This approach adopts the objectives of Western financial accounting currently available that are appropriate for Islamic business organizations and excludes any objectives violating *Shariah* precepts. This approach focuses on the moral dimensions that are absent in conventional accounting thought as a result of its development on the basis of the separation between spiritual and temporal affairs (Karim, 1995)

The proponents of this approach argue that it deals with the actual functioning institutions and is practicable in nature (Rashid, 1987). Abdelgader (1994) asserts that this approach is in line with the Islamic judicial principle of *Ibaha* which suggests that everything is permitted and lawful except that which is explicitly prohibited in the Holy *Qur'an* or in the *Sunnah*. Other proponents of this approach argue that most of the accounting issues in Islamic banks have fallen within the scope of existing accounting standards, so there is no need for their extensive overhaul except for those which conventional accounting has not covered i.e *musharakah* transactions (Ahmad and Hamad, 1992).

This approach has been objected to earlier by Gambling and Karim (1991) in that the conceptual framework of accounting currently applied in the West is justified in a dichotomy between business morality and private morality. Thus it cannot be implemented in other societies that have revealed doctrines and morals that govern all the social, economic and political aspects of life. Anwar (1987) calls such a model a partial approach to Islamization. He labels this kind of inductive approach as deceptive because they mostly contain un-Islamic assumptions while the norms and hypotheses

of the original models are retained even though partial adjustment has been made by allocating some Islamic components to it.

In Indonesia, this approach has been used by Indonesian Institute of Accountants (IAI) in developing accounting standard for Islamic Banks. Based on this approach, the development of Islamic accounting is based on the contemporary accounting practice, whereby, all practices are applied, except those violate Islamic teachings. Meanwhile the existence of accounting for Islamic banks in Indonesia is only to accommodate transactions that have no standard yet i.e. *mudharabah*, *murabahah*, *ijarah* etc. It can be inferred that the main reason of the need of Islamic accounting is the insufficiency matter of current standard to meet the need of Islamic banks (Siswantoro dan Muthalib, 2005). This approach is still used by the Islamic Accounting Committee – IAI in developing accounting standard for Islamic Financial institutions. These standards are developed to accommodate not only Islamic Bank Industry but also other Islamic financial institutions i.e. Islamic insurance and capital market.

3.3. Hybrid Approach

This approach is a combination of the two earlier approaches. It tries to bridge the weaknesses of the deductive approach and the inductive approach. Therefore, it is expected that the resulting Islamic accounting would be applicable and could achieve the Islamic socio-economic objectives. Hameed (2000a) proposes this approach by starting with; (1) identifying the ethical and accounting principles of the *Shariah* in relation to business activities and comparing it with what is currently being practiced; (2) identifying the main objectives and subsidiary objectives based on the Islamic ethical principles; (3) considering the development of socially related reporting that cannot be ignored by modern accounting; (4) identifying the theoretical foundation of Islamic accounting; and finally (5) identifying the users of Islamic accounting information and what information they need. Then, based on those identifications and considerations, try to develop the characteristics of Islamic accounting, which would incorporate Islamic business ethical principles and the achievement of the objectives of Islamic accounting.

This approach implies that the resulting Islamic accounting should be based not only on the understanding of *Shariah* principles related to business activities but also of the problems of society that it could probably contribute to solve. As Faruqi (1982) points out regarding the methodology of Islamization, an Islamic methodology must maintain its relevance to the *ummah's* (society) reality by addressing itself to the problems that have already been identified and analyzed from the standpoint of Islam.

This approach as far as the authors concern is not taken into consideration by the Islamic Accounting Committee – Indonesian Institute of Accountants (KAS-IAI) in developing Islamic accounting standards in Indonesia. However some works using this approach in developing accounting standards can be recognized in other standard development. For example in developing standard for Cooperation (Koperasi) organization, it is recognized to use a valued added statement, in order to see the distribution of cooperation revenue among the stakeholders. Currently, there is a number of initiatives in IAI to impose companies to disclose their corporate social responsibility. The disclosure policy so far is still a kind of voluntarily level, and in this case IAI has provided some guidance of disclosing company's social responsibility activity. This work, in IAI is advocated by management accountants' compartment.

In terms of academic research, some study in Indonesia has tried to use this approach in order to come up with a model of Islamic accounting that can contribute in solving the problem of society. Mulawarman (2005), for example has propose an Islamic value added statement, which is expected to be able to guide an entity to make sure that all it's revenue is halal as well its distribution is just to the stakeholders.

The Objectives of Islamic Accounting

Different approaches in developing accounting have resulted in different objectives of Islamic accounting. The AAOIFI, for instance, with its inductive approach has proposed objectives, which are similar to the current objectives of accounting practice based on the decision usefulness approach. Meanwhile, others (i.e. Hameed, 2000a; Adnan and Gaffikin, 1997), who develop it with different approaches, have also come up with other different objectives as well. This section will discuss the possible objectives of Islamic accounting, which so far have already been brought up in the issue of the objectives of Islamic accounting. They are; (1) decision usefulness, (2) stewardship, and (3) accountability.

4.1. Decision Usefulness

This objective is proposed by the AAOIFI (and later IAI adopt the same objective as well) for the Islamic banks. The AAOIFI (1996), (as well as Indonesia Institute of accountants)in its Statement of Financial Accounting (SFA) no.1, recognized that the objectives of financial accounting determine the type and nature of information which should be included in financial reports in order to assist users of these reports in making decisions (SFA para 25). Therefore, financial reports should provide the information which is useful for users, such as; (a) Information about the Islamic bank's compliance with the Islamic *Shariah* (SFA para 37); (b) Information about the economic resources and obligations and the effect of transactions, other events and circumstances and related obligations (SFA para 38); (c) Information to assist the concerned party in the determination of *Zakat* on the fund (SFA para 39); (d) Information to assist in estimating cash flows that might be realized from dealing with the Islamic bank, the timing of those flows and the risk associated with their realization (SFA para 40); (e) Information to assist in evaluating the Islamic bank's discharge of its fiduciary responsibility to safeguard funds and to invest them (SFA para 41); and (f) Information about the Islamic bank's discharge of its social responsibility (SFA para 42).

Henderson and Peirson (1988) assert that the decision usefulness can be extended to include the needs of those parties who seek to exercise an overview or monitoring role over the social performance of the corporation. However, most of the literature on decision usefulness relates only to the needs of shareholders and creditors (Kam, 1990). Therefore, useful information is mainly associated with, (1) the ability to predict when the investor will receive dividends and the amount involved (or how much they would receive if they were to sell their shares) and (2) the ability to know if the company is able to pay a creditor's loan (or how much they will receive if they were to sell or redeem their bonds).

Since naturally the investors and creditors hope that their cash receipts will exceed their cash outlays, the company then is directed towards increasing its ability to generate favorable cash flows (Kam, 1990). In this case, decision usefulness is a suitable objective to support an organization to achieve such goals.

The AAOIFI's and IAI's objectives for Islamic accounting are most likely the same as those currently being practiced in conventional accounting. For example, in the Statement of Financial Accounting Concepts (SFAC) no.1 issued by the Financial Accounting Standard Board (FASB) in the United States, it is stated that the financial report should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit and similar decisions (SFAC para 34). While in the SFA no.1 para 25, it also mentions that the role of financial reporting in the economy is to provide information that is useful in making business and economic decisions

4.2. Stewardship

Stewardship accounting has been practiced since ancient times and was particularly important at the time to establish the credibility of their tenant to the often-absent landlord (Mathews and Pereira, 1996). Chen (1975) notes that the concept of stewardship arose from the religious teachings, mainly Christian, that man is a steward of God for the resources given to him. Man as God's steward owes a responsibility to use the property effectively not only for himself but also as a social responsibility for others around him. This concept developed in the feudal version of stewardship where resources, especially lands were given to the serfs to manage on the landlord's behalf. Here the serf was responsible for taking care of the land for the landlord whereas the landlord had to take care of the social responsibility for others around him.

Then, since the middle of the nineteenth century, the concept of stewardship in accounting has referred to the separation of ownership and capital, which resulted from the development of the joint stock company structure. At this time, the classical form of stewardship, developed in a different way that the managers who were servants of the capital providers recognized only the stewardship to their masters and ignored, their social responsibility (Chen, 1975). Meanwhile, the financial statement became a way of demonstrating that the resources entrusted to management have been used in a proper manner. In terms of external reporting, the emphasis of stewardship is on showing that investments have been made in productive assets in an attempt to meet the organization's objectives. This requires a balance sheet and profit and loss accounts, so that owners can trace aggregate financial movements during a certain period (Mathews and Pereira, 1996). The current stewardship concept is quite close to the decision usefulness concept, but the information for stewardship is basically less than that under decision usefulness. This is because in stewardship (1) potential investors and creditors are not included as users; (2) it is not intended for the prediction model of users and (3) it mainly looks at the past to see what has been accomplished (Mathews and Pereira, 1996).

The AAOIFI (1996) (as well as IAI) also recognizes stewardship as one of its objectives. It points out that the objective of financial accounting is to contribute to the safeguarding of the assets, and to the enhancement of the managerial and productive capabilities of the Islamic bank while encouraging compliance with its established goals and policies (SFA para 33 – 34). Mirza and Baydoun (2000) support

this objective and suggest that the stewardship function must be the focus of attention of accountants of Islamic institutions in reporting to external parties.

Meanwhile, the SFAC no. 1 also suggests that financial reporting should provide information about how the management of an enterprise has discharged its stewardship to shareholders for the use of the enterprise resources entrusted. The stewardship is maintained not only in the custody and safekeeping of resources but also for their efficient and profitable use and for protecting them to the greatest extent possible from an unfavorable economic impact such as inflation, deflation and technological and social changes (SFAC para 50). Since the The AAOIFI (1996) (as well as IAI) uses the contemporary accounting based approach, their stewardship function in our opinion seems most likely to be the same as the one applied in conventional accounting.

4.3. Accountability

Accountability is said to be a broader concept than stewardship. Gray et.al. (1996) define accountability as the duty to provide an account or reckoning of those actions for which one is held responsible. This definition takes accountability as a form of principal agent relationship. In this form, an Accountee (principal) enters into a contractual relationship with an agent an Accountor (agent). The Accountee gives the power over resources along with instructions about actions and rewards to the Accountor. On the other hand, the Accountor is supposed to take certain actions and refrain from others in managing the resources given to him to meet certain objectives and to account to his principal by giving information about his actions to him.

Hameed (2000a) extends this form of accountability into two parts; (1) the responsibility to undertake (or to refrain from) certain actions and (2) to provide an account of these actions. The Accountability objective has been proposed by many scholars as the primary objective of Islamic accounting. For example, Adnan and Gaffikin (1997) proposed accountability through *Zakat* as the primary objective and Hameed (2000a) suggests Islamic accountability as the primary objective. The following section will discuss each of the above suggestions.

a. Accountability through *Zakat*

Based on the deductive approach that they use, Adnan and Gaffikin (1997) assert that the primary objective of Islamic accounting information is the provision of information to satisfy an accountability obligation to the real owner (Allah). Therefore, the overall accountability will be better operationalized, if it is directed towards the fulfillment of the *Zakat* obligation. They argue that by making *Zakat* the primary objective, one tends to avoid the unwanted practice of cheating or window-dressing in any form, as he or she believes that Allah always watches him or her. Consequently, accounting information will indirectly fulfill its users' needs as well as its societal responsibility (Adnan and Gaffikin, 1997).

Triyuwono (2000) also suggests that Muslim organizations should be *Zakat* oriented instead of profit oriented as they are now. This means that the net profit is no longer used as a basis of performance measurement as it is replaced by *Zakat*. Therefore, an enterprise is directed to the achievement of higher *Zakat* payment. To achieve a *Zakat* oriented enterprise, it needs to maintain a *Zakat* oriented accounting system. Triyuwono (2000) believes that the use of *Zakat* oriented accounting would

result in a more Islamic organization as it implies certain features. Firstly, the transformation from profit maximization to *Zakat* optimization. Therefore, profit is only regarded as an intermediary goal while *Zakat* is the primary goal. Secondly, since *Zakat* has been taken as the ultimate goal, any activities policy of the enterprise must comply with the Islamic *Shariah*. Thirdly, it would inherently incorporate a balance between individual character and social character whereas the *Zakat* concept encourages Muslims to make profits (under *Shariah* guidance) some of which would then be distributed as *Zakat* representing one's concern for social welfare. Fourthly, the enterprise would be encouraged to participate in releasing humans from the oppression of economic, social and intellectual factors and releasing the environment from human exploitation. Fifthly, it provides a bridge between the world and the Hereafter as *Zakat* raises human consciousness that any worldly activities are related with their destiny in the Hereafter.

As far as the authors' concern, this objective has not been taken into consideration as the objectives of developing Islamic accounting by IAI. *Zakat* is just viewed as a social and religious activity of an entity and not as a basis of accounting development. Based on Statement of financial accounting standard (PSAK) no 59, an entity is subject to disclose their *zakat* payment. If the institution act as an *amil* (*zakat* organizer), it should disclose the source and distribution of *zakat* received.

b. Islamic Accountability

By using the hybrid approach, Hameed (2000a) starts his argument on Islamic accountability with Faruqi's (1982) description of the concept of *Khilafah* (vicegerency). This concept explains the vicegerent status of man in the world, in which Allah - God Almighty - has given *amanah* or trust of the earth to man (Al-Qur'an 35:39) while other creatures including angels, animals and non living matter have no ability to fulfill it. As stated in the Holy *Qur'an*, Allah indeed has offered the trust to the Heavens and Earth and the Mountains, but they refused to undertake it being afraid thereof but man undertook it (Al-Qur'an 33:72).

Tazi-Saud (1991) notes that the trust constitutes such a heavy responsibility that even the Heavens, the Earth and the Mountains did not feel prepared to bear it. Man as the one who accepted the trust, therefore should be aware of fulfilling it, since this will be accounted for. Man is not only accountable for the spiritual aspects but also for social, business and contractual dealings as Allah also commands man to give back things that have been entrusted, to whom they are due (Al-Qur'an 4:58). This command then is detailed in another verse of the *Qur'an* that man should fulfill (every contract) because for (every) contract will be questioned (on the day of the judgment) (Al-Qur'an 17:34)

Hameed (2000a) suggests that this kind of accountability can be used as the main objective of Islamic accounting which he then names Islamic accountability. From a practical point of view, this suggestion is supported by Khir (1992) who asserts that this concept is so ingrained in the Muslim community that it will give the greatest motivation for the practical development of Islamic accounting.

Islamic accountability is defined by Hameed (2000a) as a being premised on both Islamic/Muslim organizations and owners with dual accountability. The first or prime accountability arises through the concept of *Khilafa* whereby a man is a trustee of Allah's resources. This primary accountability is transcendent, as it cannot be

perceived through the senses. However, it is made visible through the revelation of the *Qur'an* and *Hadith*, which are the sources of Islamic teachings.

Meanwhile, the secondary accountability is established by a contract between an owner or investor and a manager. To discharge the secondary accountability, the company should identify, measure and report the socio-economic activities pertaining to Islamic, social, economic, environmental, and other issues to the owner. Further, based on Islamic accountability, subsidiary objectivities can be determined such as *shariah* compliance, assessment and distribution of *Zakat*, equitable distribution of wealth among stakeholders, the creation of a cooperative environment and solidarity and other type of reports that can contribute in providing information of and encouraging the enterprise to participate in solving contemporary the *Ummah's* (society) problems (Hameed, 2000a)

As well as the accountability through zakat, this objective has not been taken into consideration as the objective in developing Islamic accounting in Indonesia by the Islamic Accounting Committee-IAI. However this objective is currently being operationalized by management accountants' compartment in developing a concept of corporate social reporting. The main idea is quite similar that there are a number of problems in the society as the result of company operation i.e. social, environmental and economic problems. The company therefore should be responsible to reduce and eliminate the negative impacts of their operation. This is just similar with the way of the implementation of the Islamic accountability objective.

Characteristics of Islamic Accounting

After discussing the emerging issues on the objectives of Islamic accounting in the previous section, we will continue to delve deeper into the issues of the characteristics of Islamic accounting. Mainly, the debates on the characteristics of Islamic accounting are focused in two aspects (1) financial measurement and (2) disclosure presentation. Therefore, the following section will discuss those two aspects of Islamic accounting characteristics.

5.1. Financial Measurement Aspects

Most of Islamic accounting literature takes *Zakat* as a cornerstone of determining measurement tools. There are, at least, three reasons for taking *Zakat* as the main focus of measurement issues. Firstly, *Zakat* is a concept in Islam that deals specifically with the measurement of assets. This can be inferred from some verses in the *Qur'an* and *Hadith* of the Prophet Muhammad (pbuh) regarding the timing and the way in which *Zakat* is calculated. Secondly, *Zakat* has been decreed in many verses directly after the ordinance of prayer and considered as one of the five pillars of Islam. This implies that Muslims are encouraged to establish instruments (including accounting instruments) in order to ensure this obligation can be fulfilled in accordance with the *Shariah* of Islam. Thirdly, the development of accounting in the early Muslim government are closely related with the practice of *Zakat*. During that time, the Islamic State had already provided accounting books and reports for the determination and accountability of *Zakat* (Zaid, 1997).

The majority of jurists appear to have concluded that the valuation of *Zakat* should be based on the selling prices prevailing at the time *Zakat* falls due (al-Qardhawi, 1988). This implies that in accounting, Islamic business organizations should apply current cost rather than historical cost which is widely used at this time (Adnan & Gaffikin, 1997; Baydoun & Willet, 1997 & 2000; Clarke et al, 1996; and Haniffa & Hudaib, 2001). Besides that, some accounting principles related to the measurement also need to be redefined. For instance, Haniffa & Hudaib (2001) argued that what is meant in Islamic accounting by the conservatism principle is not the selection of the accounting techniques that has the least favorable impact on owners but more towards the selection of accounting techniques with the most favorable impact on society i.e. better to overestimate funds for *Zakat* purposes.

The AAOIFI (1996) recognizes the current value concept of assets, liabilities and restricted investments in its statement of accounting concepts. However, due to the lack of adequate means, such a concept is not recommended. Instead of that, historical cost remains to be applied and the use of the current value financial statement is only regarded as supplementary information if the enterprise considers its importance for the potential investor and other users. Therefore, in practice, it is the historical cost which is applied by Islamic banks (Shihadeh, 1994). In Indonesia, the use of historical cost is mandatory in for accounting in Islamic financial institution. There is no significant debate in this particular issue. Unlike AAOIFI, IAI in their standard does not recognize that current value as an ideal concept for Islamic accounting practices.

5.2. Disclosure and Presentation Aspects

Haniffa & Hudaib (2001) propose that the importance of disclosure and presentation is to fulfill the duties and obligations according to the Islamic *Shariah*. To achieve this purpose, an Islamic enterprise is expected to disclose at least: (1) any prohibited transactions they made; (2) *Zakat* obligation they have to pay and have already paid; and (3) social responsibility. Social responsibility would include charities, wages to employees, and environmental protection. This means that financial reporting in an Islamic society is likely to be more detailed than what is currently prevalent in Western societies.

So far in Indonesia, only social responsibility activities that has been applied consistently. However the practice to disclose prohibited transactions and *zakat* obligation is not practiced consistently yet. For example, although an Islamic financial institution is not allowed recognize interests from conventional bank as revenue, but they it is still allowed to receive it as liability which later be distributed to the society as a social fund. This fund is then combined with other fund called *qardh hasan* fund. Banks usually do not disclose explicitly *qardh hasan* fund from the interest. In terms of *zakat*, a number of Islamic financial institution apply cash basis, which means *zakat* obligation they have to pay would not be disclosed until it is paid. *Zakat* in this case is disclosed as subsequent event. This practice is actually different from PSAK no 59 which requires bank to use accrual basis for income statement.

Baydoun and Willet (2000) view that social accountability and full disclosures are the basis of Islamic corporate reports. They suggest the current value balance sheet be included as part of the reporting requirements of firms operating in an Islamic economy. Meanwhile, the income statement should be relegated to the notes because

of its corruptive influence in directing people to become highly profit oriented. Instead of that, from an Islamic perspective, a Value Added Statement (VAS) should be applied. This is because the distributional characteristics of the VAS would support accountability in Islam (Baydoun and Willet, 1994).

From an Islamic perspective, growth should lead to social justice and a more equitable distribution of power and wealth. Meanwhile, the VAS could provide information on wealth distribution between the different sectors of society and is likely to facilitate focusing a firm's performance from the stakeholders' point of view (Mirza & Baydoun, 2000). Hence it would promote a conscious policy of redistribution and resource transfers among various groups of society (Sulaiman, 1997).

In Indonesia, value added statement has not been suggested for Islamic banks. So far value added statement is only suggested for Cooperative (Koperasi) organization. However in practice, it is hardly found value added statement in the financial statement of cooperative organization.

Conclusion

As a way of life, Islam has a great concern for business activities. Through the revelation of the Qur'an and His Apostle, Allah has shown His guidance to mankind on how to be successful in this world and in the Hereafter while doing business. Since business is closely related to the economic problems which involve a wide and complex area, a single instrument e.g. *Zakat*, would not be sufficient to solve those problems. In fact, it needs all instruments that can be used to achieve success (*falah*)

Therefore, it would also be appropriate to direct an Islamic accounting system towards the achievement of the Islamic socio-economic objective of *falah*. Hence, in designing an Islamic accounting system, its objectives and characteristics should be able to direct the enterprise not only to provide a true picture of the enterprise but also to encourage them to be *Ihsan* (benevolence) and discourage them from being unjust. Some of the proposals for the objective and characteristics of Islamic accounting have been introduced in the discussion of Islamic accounting. However only few concepts that has been applied in developing Islamic accounting in Indonesia. Interestingly, hybrid approach in developing Islamic accounting has been taken into consideration by Indonesian Institute of Accountant, but not under development Islamic accounting in Indonesia,

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