

# **Using the Hofstede-Gray framework to argue normatively for an extension of Islamic Corporate Reports**

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## **Abstract**

### **Using the Hofstede-Gray framework to argue normatively for an extension of Islamic Corporate Reports**

Baydoun and Willett (2000) suggest that the inclusion of the current value balance sheet and the value added statement in Islamic corporate reporting may be considered as satisfying the concepts of full disclosure and social accountability in Islam. Using the Hofstede-Gray framework, this paper provides a theoretical support for Baydoun and Willett's (2000) Islamic corporate reporting model and also extends the model to include the reporting of the social and environmental aspects of the enterprise. What constitutes social reporting from Islam's perspective is developed from the *Shari'a* and the list of economic, social and environmental indicators proposed by the Global Reporting Initiative.

**Key words:** national culture, accounting values, Islamic corporate reporting, social responsibility, environmental accounting

# Using the Hofstede-Gray framework to argue normatively for an extension of Islamic Corporate Reports

## 1 Introduction

Baydoun and Willett (2000) argue that given the emphasis on responsibility and accountability in Islam, an information system that is relevant to such societies would be one that satisfies the principles of full disclosure and social accountability. Thus, Islamic societies would be better served by a corporate report that includes the current value balance sheet (CVBS) and the value added statement (VAS). The Islamic Corporate Reporting model proposed by Baydoun and Willett may be interpreted as a theory of what Muslims *should* actually desire or what they *ought* to desire. Further, what ought to be desired has to be examined through a process of logical inquiry. This is the primary objective of the paper. The paper also extends Baydoun and Willett's model to include the social and environmental issues in corporate reporting. Specifically, the paper provides the theoretical underpinnings of the rationale for the inclusion of the current value balance sheet and the value added statement in Islamic Corporate Reporting using Gray's (1988) framework.

Gray's is the framework most often used to relate cultural values to accounting systems (Perera, 1989; Gerhady, 1990; Fechner and Kilgore, 1994; Baydoun and Willett, 1995). Assuming that religion *is* a subset of culture (a point discussed later in the paper) the theoretical approach used in the "culture and accounting" literature provides a structure within which the relationship between religion and accounting may be examined. Baydoun and Willett (1995) argue that one possible use of Gray's (1988) theory as applied to developing countries is as a *definition* of the cultural relevance of accounting practices. Basically the same perspective is adopted in this paper. The importance of the Hofstede-Gray paradigm in the study is in relation to assessing the usefulness of Baydoun and Willett's (2000) Islamic corporate reporting model rather than to the determination of the descriptive "correctness" of such a model. The use of the Hofstede-Gray framework to develop an Islamic corporate reporting model is the primary contribution of our study to the literature on Islamic accounting. Our secondary contribution is the thorough discussion on the Islamic worldview and how this may significantly influence the manner accounting is practised in Islamic societies.

The paper is organised as follows. The next section discusses the various definitions of the term 'culture' and whether or not religion constitutes a sub component of culture. Section 3 briefly explains Hofstede's cultural dimensions and how these are linked to Gray's accounting sub-cultural values of Professionalism, Uniformity, Conservatism and Secrecy. This is followed by a discussion on the Islamic worldview in section 4. How Islamic beliefs affect the cultural dimensions of Power Distance, Uncertainty Avoidance, Individualism and Masculinity of Islamic societies are discussed in section 5. Section 6 evaluates Baydoun and Willett's (2000) Islamic Corporate Reporting model, examines the reasons why Muslims should find the current value balance sheet and the value added statement useful, and subsequently extends the model to include social and environmental issues. The last is important primarily because the reporting of externalities depict the social accountability aspects of Islamic societies to a greater extent than just reporting the current value balance sheet and the value added statement. Section 7 concludes.

## **2 Culture and religion**

Previous studies examining the cultural relevance of accounting systems using Gray's (1988) framework relate to nations (e.g. Gerhady, 1990; Baydoun and Willett, 1995). The focus on this study, however, is on Islam, a religion. Thus, it is of importance to examine if it is reasonable to treat religion as a sub set of culture.

There is no overall consensus as to the precise meaning of culture (Seymour-Smith, 1986). Soeters and Schreuder (1988) state that there are as many definitions of culture as there are authors writing on the subject. The classical definition of culture, as noted in Violet (1983), is learned behaviour<sup>1</sup>. Tylor (1929), considered by many to be the founder of modern anthropology, regards culture as the knowledge, belief, art, morals, law, custom, and any other capabilities and habits that are acquired by man as a member of society. Winthrop (1991) defines culture according to the context in which it was being used. In social anthropology, culture is said to be the arrangements of belief and custom through which social relations

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<sup>1</sup>The definition of culture as learned behaviour distinguishes it from instinctive reactions to environmental factors. The latter is generally determined through genetic codes while the former is a product of man's activities (Violet, 1983).

are expressed. Thus, culture is better understood as ‘the reflection of a continuous series of goal-seeking transactions between individuals, operating under the constraints of scarce resources’ (Winthrop, 1991, p56). In materials studies, culture is the patterned knowledge, technique and behaviour through which humans adapt to the natural world. In this context, culture is

made up of the energy systems, the objective and specific artefacts, the organisations of social and political relations, the modes of thought, the ideologies, and the total range of customary behaviours that are transmitted from one generation to another by a social group and that enable it to maintain life in a particular habitat

In ethno-science, culture is interpreted as a set of standards for behaviour considered authoritative within a society. As such, language is presumed to be a model for culture. Finally, in symbolic studies, culture is seen as a system of meanings through which social life is interpreted. Hence culture exists only in the meaningful interaction of individuals in a society. Thus, culture is a product of mankind; an integrated system of learned behaviour patterns characteristic of the members of a society. It is a social phenomenon invented to cope with the natural environment (Violet, 1983).

Faruqi (1989) contends that religion is the very essence and core of culture. However, religion is a complex notion and difficult to define (Acquaviva, 1979; Clark, 1958). Geertz (1973) defines religion as,

a system of symbols which acts to establish powerful, pervasive, and long-lasting moods and motivations in men by formulating conceptions of a general order of existence and clothing these conceptions with such an aura of factuality that the moods and motivations seem uniquely realistic (p 90).

Spiro and D'Andrade's (1958) definition of religion as an institution consisting of a culturally patterned interaction shifts the concept of religion from a concern with psychological questions of belief to a focus on cultural actions, patterned by a world view, and reflected in rituals. Similarly, the main sociological theories of religion emphasise its role as a variable that offers a socially shared set of meanings. Religious behaviour, beliefs and experiences are simply part of the culture, and are regularly transmitted from generation to generation in the same way as any other customs (Argyle and Beit-Hallahmi, 1975).

Acquaviva (1979) argue that religion has always exerted a profound influence on

many aspects of human life and personality. Every society has a religious dimension, which it shares and expresses in all aspects of the social life of individuals: their laws, their customs and habits (Gilkey, 1981). In fact, it has been proposed that capitalism owes its beginnings to the Protestant ethic, which emphasises frugality and industry (Weber, 1985). According to Faruqi (1989), religion is the lens through which all understanding and thinking take place, making it the foundation of all decisions and actions. As such, religious ideas and practices have always been at the centre of human activities.

Religion, therefore, can reasonably be seen as a part of the overall set of cultural values of a society. Given this fact, the Hofstede-Gray framework on the cultural relevance of accounting systems is an appropriate framework to adopt when examining the relationship between religion and accounting. The next section describes the Hofstede-Gray model.

### **3 The Hofstede-Gray framework**

Gray (1988) links Hofstede's national cultural values of Power Distance, Uncertainty Avoidance, Individualism and Masculinity to the accounting sub cultural values of Professionalism, Uniformity, Conservatism, Secrecy and to the form accounting systems may take (Gray, 1988).

#### ***Hofstede's cultural dimensions***

From an extensive empirical study of IBM and its subsidiaries in 1970 (Hofstede, 1991, p160) examining the differences and similarities of societal (cultural) values of different countries, Hofstede developed several culture based societal values, which, it was argued, captured the essential distinctive features of national culture: Individualism, Power Distance, Uncertainty Avoidance, Masculinity and Confucian Dynamism (Short versus Long Term Orientation). Subsequently, authors investigating the impact of culture on accounting have often had occasion to interpret and use Hofstede's cultural dimensions in a number of different contexts (e.g. Gray, 1988; Perera, 1989; Gerhady, 1990, Baydoun and Willett, 1995). Hofstede's five cultural values or dimensions are briefly described below:

##### Individualism versus Collectivism

This dimension addresses the degree of interdependence that a society maintains amongst individuals. Individualism is the preference for a loosely knit social framework where the "I" concept is prominent. On the other hand,

collectivism describes a society which prefers a tightly knit social framework where the concept of "we" prevails.

#### Large versus small Power Distance

Power Distance measures the way inequalities in status are handled by members of a society. Large Power Distance societies accept the established hierarchical order. In small Power Distance societies people strive for power equalisation and demand justification for power inequalities.

#### Strong versus weak Uncertainty Avoidance

Uncertainty Avoidance describes the extent to which the members of a society feel comfortable with uncertainty and ambiguity. Strong Uncertainty Avoidance societies tend to have rigid codes of belief and behaviour and tend to be intolerant towards deviant persons and ideas. In contrast, Weak Uncertainty Avoidance societies maintain a more relaxed atmosphere where pragmatism is more important than theoretical principle, and deviant behaviour is more acceptable.

#### Masculinity versus Femininity

Masculinity addresses the way societies allocate social roles. A society is said to be Masculine if it attributes higher value to the characteristics of achievement, heroism, assertiveness and material success. On the other hand, a society is said to be Feminine if it prefers 'nurturing' relationships, modesty, caring for the weak and quality of life.

#### Short versus Long Term Orientation<sup>2</sup>

This dimension refers to the way some societies take a short-term view of life while others go for a long-term outlook. The former is characterised (among other things) by a society that has high regards for maintaining traditions, a greater respect for social and status obligations, does not rank savings as a priority and the expectation of quick results. A society with a LongTerm Orientation is one which is willing to adapt traditions to be more in line with the modern world, only respect social and status obligations within limits, would tend towards thriftiness and would exhibit a perseverance for slow results.

### ***The Relationship between culture and accounting***

Gray (1988) argues that societal value orientations may be expected, in varying degrees, to permeate through to organisational and occupational subcultures. As such, he proposed that societal values can be expressed at the level of the accounting subculture. The latter, according to Gray, will in turn influence the manner in which accounting is practised. From a review of accounting literature and practice, Gray (1988) derives four accounting subcultural values (professionalism, uniformity, conservatism and secrecy) and he linked these to Hofstede's cultural dimensions. Figure 1 represents a more detailed framework identifying the specific linkages between Gray's accounting values and different dimensions of accounting

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<sup>2</sup>Few studies have yet used this dimension in the analysis of accounting issues. Willett *et al* (1997) briefly discussed the relevance of this cultural dimension to accounting.

practice. Such a framework, it is argued, enables one to gain a fundamental insight into the differences between national accounting systems and financial reporting of different countries (Gray, 1988; Radebaugh and Gray, 1993). Gray's accounting subcultural values are as follows:

Professionalism versus Statutory Control

Professionalism is a preference for the exercise of individual professional judgement and the maintenance of professional self regulation. Statutory control on the other hand, is the preference for compliance with prescriptive legal requirements.

Uniformity versus Flexibility

Uniformity is a preference for the enforcement of uniform accounting practices between companies and for the consistent use of those practices over time. Flexibility allows accounting practices to be in accordance with the perceived circumstances of individual companies, rather than to be set by predetermined, generally applicable rules.

Conservatism versus Optimism

Conservatism refers to the cautious approach to measurement preferring the understatement of profit to its overstatement. Optimism refers to the more optimistic, laissez-faire, risk-taking approach and a willingness to recognise uncertain future profits.

Secrecy versus Transparency

Secrecy refers to the 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

Gray then distinguishes the authority for and enforcement of accounting systems from the measurement and disclosure issues of accounting practice, linking the first two to the accounting subcultural values of professionalism and uniformity. Hence, by a direct application of Hofstede's theory, cultural values (and thus religion) will affect accounting practices through the way institutions are organised and the processes that they use (Baydoun and Willett, 1995). Measurement of assets and profits, for example, would be influenced by the value of conservatism. The value of secrecy, on the other hand, would influence the nature and extent of disclosure practices.

**FIGURE 1 ABOUT HERE**

The Hofstede-Gray model is based on the premise that there should be a close match between *national* cultural values and patterns of accounting systems, given

that cultural values presumably guide the design of a nation's social systems. One possible approach to determine if a particular accounting system is appropriate to a particular country's needs is to determine the cultural dimensions of that country and link them via Gray's accounting values to the specific form and content of financial statements most appropriate for that country. This is essentially what Baydoun and Willett (1995) attempted to do and the framework developed by them will be further extended to investigate the effect of religious values on accounting. By this method one may be able to translate a knowledge of religious values into a design for a set of financial statements most suitable for that specific religious group.

It is pertinent at this point to determine the relationship between Islam and Hofstede's cultural dimensions, as these apply to Islamic societies. Although Hofstede (1980, 1991) recognises the existence of different cultural groups within a country based on ethnic and religious differences (which he termed 'subcultural groups'), he emphasises that his cultural values relate to the characteristics of nations. The focus on Islamic societies in this paper, therefore, adapts this approach to the more specific characteristics of a religious community. Religion, like culture, is defined by a set of beliefs and is thus intimately related. As noted elsewhere in the paper, Faruqi (1989) maintains that religion is an important dimension of culture. Gambling and Karim (1986) support this contention when they argue that the collective personalities of the individuals, who comprise a society, form its culture and thus if those individuals are Muslims, their personalities are 'Islamic' and their collective culture is Islamic. Islam, as a code that permeates the social fabric down to the detail of everyday economic transactions (see for example Verses 2:282; 5:1; 5:8; 17:35), influences the consciousness of believers to a greater extent than many other religions. Further, in Islam, belief is a matter of action (Faruqi, 1992). As such, the purpose of life is not simply to affirm one's faith in God but to *actualise* that faith. Consequently, one would expect the cultural values of Islamic societies to be significantly influenced by the Islamic faith.

This contention appears to be consistent with Hofstede's (1980) theory. Although Hofstede (1980) argues that religious affiliation by itself is less culturally relevant than is often assumed, he apparently believes there are circumstances under which

religion may affect societal values. He suggests, for example, that his measurements of Pakistan's low Power Distance is due to the influence of Islamic values (p132). On this reading of Hofstede, it is therefore not really an 'open' question as to the extent those concepts are applicable to the analysis of religious groups (Baydoun and Willett, 1995). They are applicable. However, before determining the cultural values of an Islamic society, it is imperative that one understands what Islam stands for and what is its worldview. This is discussed next.

#### **4 Islam and its worldview**

The word 'Muslim' means 'one who submits' to God. As such, submission and obedience is the most natural and appropriate response. Muslims believe in the unity of God, His Angels, the Holy *Qur'an*, His Prophets, the Day of Judgement and Predestination<sup>3</sup>. Besides being a religion, Islam is also a social order with a complete code of life (Al-Buraey, 1990). Unlike Christianity, which epitomises the doctrine as an essential element of Christian belief, Islam's central expression is in its law, the *Shari'a* (Esposito, 1991). The *Shari'a*, the blueprint of an ideal Islamic society, is a code of behaviour which concerns the practical aspects of a Muslim manifesting his faith and belief. It consists of a set of divinely revealed general principles, directives and values. In the *Shari'a* one sees the impact of Islam on both the personal and the social aspects of life (Esposito, 1991) binding Muslims into a single community (Nasr, 1985). Even though faith places a Muslim on the straight path, it is his actions that demonstrate his commitment and faithfulness. Accordingly, as indicated elsewhere in the paper, the purpose of life is not simply to affirm one's faith in God but rather to *actualise* that faith. Merely professing belief in God is not enough; the main objective is to realise God's will for one will finally be divinely judged by one's book of deeds (Esposito, 1991).

According to Williams (1994), Christianity is a theological religion, deeply concerned with the right articles of faith to hold. Islam on the other hand, is primarily an ethical

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<sup>3</sup>Belief in predestination leads man to exert a continuous effort and activity in which he finds reward. The secrets of destiny keep his hopes high, for destiny is comprehensible through his deeds. Belief in predestination reduces anxiety when calamities befall man (Tabbarah, 1988). However, Muslims have misunderstood this concept, using it as a convenient way to justify laziness and irresponsible conduct. For a full discussion, see Kharofa (1992), pp35-37.

religion, deeply concerned with the right things to do. It sees civilisation itself as depending on the right way to live. Whether or not an action is ethical will depend on the beliefs we have, the values we uphold and the judgements we make about it. In the specific case of Islamic societies, because ethical principles come from one primary source, the *Shari'a* provides the foundation from which accounting systems in such societies may be developed (Gambling and Karim, 1991). Thus, one may argue that the key to a religion-oriented accounting lies in the individual's relationship to God, the world he lives in, his relationship with others, and the nature and purpose of his existence (Sulaiman, 1997). In order to draw out the implications of this worldview and to provide a premise upon which an Islamic Corporate Reporting model may be based, an examination of these will now be undertaken.

Naqvi (1981) suggests that Islamic ethical philosophy can be summarised by four ethical axioms: Unity, Equilibrium, Free Will and Responsibility. Unity, according to this viewpoint, constitutes the vertical dimension of Islam. At the level of the absolute, Unity differentiates the Creator from the created, requiring unconditional surrender of man to God's Will. Unity is a concept where the political, economic, social and religious aspects of an individual's life are integrated into a homogeneous whole, consistent from within the individual himself as well as integrated with the vast Universe. The doctrine of Unity preserves the absolute monotheism of Islam where God's sovereignty is recognised. This dominates Islamic belief and practices and consequently affects how Muslims view religion. To Muslims, Islam is viewed as integral to the state, law and society. This viewpoint differs from the modern Western perspective that regards religion as separate from the state (Esposito, 1991). To Siddiqi (1981) and various other writers (e.g. Ahmad, 1979; Al-Buraey, 1990; Chapra, 1992) the concept of Unity is *Tawhid*. *Tawhid* is the basis on which the Islamic worldview and strategy are founded (Chapra, 1992).

With every human being sharing the same relationship with God and His Universe, a definite relationship between individuals is also prescribed. The axiom of Equilibrium or *Al-Adl* prescribes the relationship amongst individuals. Related to Equilibrium is the concept of justice. From the perspective of the absolute, this refers to the

supreme attribute of God. God Himself promises justice for all (2:286)<sup>4</sup>. From the perspective of social action, Equilibrium is the binding moral commitment of individuals in society to uphold a delicate balance between individual rights and responsibility towards the *ummah*. Accordingly, in Islam, everyone is ultimately accountable to God and this accountability also encompasses accountability to society (Sulaiman, 1997; Baydoun and Willett, 1994).

Although Naqvi (1981) explains the axiom of Equilibrium in the context of justice, Equilibrium can also be considered as a reflection on the concept of balance in Islam. For example, the following verse in the *Qur'an* explicitly deals with a Muslim's need to balance worldly affairs with the hereafter.

But seek with the wealth which Allah has bestowed on thee, the Home of the Hereafter, nor forget thy portion in this world (28:77).

Specifically on the issue of expenditure, the following verse from the *Qur'an* explicates the concept of balance.

Those who they spend are not extravagant and not niggardly, but hold a just balance between those extremes (25:67).

The above concept, although very delicate, is of primary importance in the conduct of a Muslim's life for Islam encourages moderation (*i'tidal*).

One of the most original contributions of Islam to social philosophy is the concept of a "free" man and the axiom of Free Will is derived from this concept (Naqvi, 1981). Islam recognises human freedom as applying both to the individual man and the collective man and emphasises a correct balance between the two. Thus, the Islamic concept of freedom differs from that of Western social philosophy. The concept of private property in Islam helps clarify the Islamic concept of freedom further. Islam does not accord an unqualified sanction to an individual's right of private property for real ownership of property belongs to God and man holds property in trust for which he is accountable to Him (Naqvi, 1981; Siddiqi, 1981). Naqvi argues that the precondition of an Islamic society is the removal of the conflict between private and social interests. Further, he stresses that if human freedom is God-given and individuals act in accordance with the ethics of this freedom, the

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<sup>4</sup>On no soul doth God place a burden greater than it can bear (2:286).

element of coercion involved in reconciling private and social interests should be minimal. The fourth and final ethical axiom is Responsibility (Naqvi, 1981). Responsibility is related to Free Will. The axiom of Responsibility sets limits to what man is free to do by making him responsible for what he does and as such, individualism in the Western sense is constrained in Islam (Naqvi, 1981). As emphasised earlier, in Islam, there should be no contradiction between individual freedom and collective freedom. The difference between the two is bridged by the sense of social consciousness and responsibility. Thus, one's freedom of choice is exercised with a conscious effort to ensure that the wider interests of the community are safeguarded.

Chapra (1992) contends that self interest is automatically held in check if each and every individual fulfils his duties, thus safeguarding the rights of each individual. In a similar vein to Naqvi's ethical axioms, Chapra asserts that the Islamic worldview is based on three fundamental principles: *Tawhid* (Unity), *Khilafah* (Vicegerency) and *Adalah* (Justice). As explained above, *Tawhid* is the foundation of the Islamic faith. It refers to the Unity of God and the belief that the universe has been consciously designed and created by God and did not come into existence by chance or accident.

The concept of *Khilafah* (vicegerency) defines a person's status and role, specifying the individual's responsibilities to himself and his responsibility to the *ummah*. Chapra suggests four implications emanating from the concept of *khilafah*. The first is universal brotherhood where mutual sacrifice and cooperation are the social order. Such a social order allows the development of the entire human potential. Accordingly, from the perspective of business enterprises, competition is encouraged if it is healthy, raises efficiency, and helps promote the well-being of society. Competition that results in jealousy, ruthlessness and destruction must be avoided. The second implication of *khilafah* is that the individual is regarded as the trustee for God's resources. This leads to a totally different meaning to private ownership as understood in the secular world. Although private ownership is recognised in Islam, ownership is not absolute. The property owner recognises his responsibility of using his resources in a manner that will provide benefits not only to himself but more

importantly, to society. The third implication of *khilafah* is the emphasis on a humble lifestyle. A lifestyle of extravagance may result in unnecessary pressure on resources which in turn may lead to the inability to satisfy the basic needs of society. Finally, *khilafah* also implies the concept of human freedom in Islam. An individual's freedom to act is not curtailed by any other individual but is constrained by the bonds of social responsibility. Hence there is a qualification as to what individual freedom entails in Islam. As Naqvi (1994) contends, unlimited freedom goes hand in hand with unlimited responsibilities. Consequently, it is inconceivable that anyone would want unlimited freedom. The concept of *khilafah* expounded by Chapra is similar to Naqvi's ethical axioms of Free Will and Responsibility and serves to illustrate these.

*Adalah* or justice is strongly emphasised in the *Qur'an*. The bonds of brotherhood would be a hollow concept if social justice and social responsibility do not exist (Chapra, 1992). Islam's commitment to brotherhood and justice demands that all God-given resources are at the disposal of every individual. Accordingly, wealth should not remain concentrated on a few individuals. Sardar (1987) contends that there are three basic criteria for the attainment of social justice: absolute freedom of conscience, complete equality of all men and the permanent mutual responsibility of society and individuals. It follows that if the social behaviour pattern and the economy of Islamic societies are strictly in accordance with Islamic teachings, there cannot exist extreme inequalities of income and wealth. However, Islam recognises inequalities in so far as these relate to skills, initiatives, efforts, as well as risk (Chapra, 1992; Nomani and Rahnema, 1995)<sup>5</sup>. Justice is strongly emphasised in the *Qur'an* as in the following verses.

Be just: that is next to piety: and fear Allah. For Allah is well-acquainted with all that ye do (5:8).

Say: "My Lord hath commanded Justice; and that ye set your whole selves to Him (7:29).

Ahmad (1979) argues that an Islamic economic system is rooted in the basic philosophic concepts of *Tawhid*, *Khilafah*, *Rubbubiyah*, and *Tazkiyah*. Arif (1984)

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<sup>5</sup>The distinction between equitable and equal is of importance. Islam recognises that all men are not equal in their characteristics, abilities and contributions to societies. As such the Islamic concept of equity does not imply equal reward for everyone. However every individual should be guaranteed a standard of living that is humane and respectable and in harmony with the dignity of man in his role as God's vicegerent (Nasr, 1985; Ghazali, 1990; Nomani and Rahnema, 1995).

adds a fifth concept, accountability. The first two of these five concepts were discussed earlier. *Rubbubiyyah* refers to God's arrangement for directing things towards a perfect state of human sustenance. Consequently, Muslims believe that there are sufficient resources to sustain everybody to achieve God's perfect plan for the universe. This is in conflict with the basic tenet of neoclassical economic theory that goods are in short supply (Gambling and Karim, 1991). It is in the context of this divine arrangement that human efforts take place. Because goods are adequately provided by God for every being, greed and self interest should not exist.

The meaning of *Tazkiyah* is similar to *zakat*, that is growth and purification. Muslims believe that the mission of all the Prophets was to perform the *Tazkiyah* of man in his relationship with God, with other men, and with society. Gambling and Karim (1991) assert that this concept is of great importance in Islamic economic theory. *Tazkiyah* endorses the ideas of change and expansion which, according to them, is absent from Christian canon law. It also requires an individual to expend his best efforts in order to achieve a better material life. However, material well being must lead to social justice and the spiritual enhancement of society.

Additionally, Muslims believe that everything created by God has a purpose and it is this purpose which gives meaning and significance to man's existence. As such, man is accountable to God and his success in the hereafter depends on his performance in this life on earth. The following verses elaborate the notion of accountability in Islam.

To Allah belongeth all that is in heavens and on earth. Whether ye show what is in your minds or conceal it, Allah calleth you to account for it (2:284).

Soon will God observe your work, and His Messenger, and the believers: soon will ye be brought back to the Knower of what is hidden and what is open: then will He show you the truth of all ye did (9:105).

And fear the Day ye shall be brought back to God; then shall every soul be paid what it earned, and none will be dealt with unjustly (2:281).

Sulayman (1993) asserts that there are three basic principles that guide the Muslim mind in its creative and intellectual movement towards an understanding of life and the universe: Unicity, Vicegerency and Responsibility. The first two have been

discussed earlier<sup>6</sup>. On Responsibility, Sulayman (1993) argues that it is a Muslim's belief that peace of mind in this world and his destiny in the hereafter is shaped by how well he fulfils his responsibility to work, strive, sacrifice and doing good in this life.

Al-Buraey (1990), writing on Islamic administration, emphasises the principle of *shura* (consultation). According to him, the process of *shura* (consultation) is fundamental to achieving the ideal Islamic society. Gambling and Karim (1991) concur and suggest that *shura* is important in Islamic business organisations. Further, it was reported that the Prophet himself consulted his followers on matters pertaining to the state, politics, wars and international relations (Al-Buraey, 1990). Evidently, the bonds of brotherhood will be further strengthened with *shura*. The following verse explicates the concept of *shura* in Islam.

Consult them in affairs (of moment), then when thou hast taken a decision,  
put thy trust in Allah, for Allah loves those who put their trust in Him (3:159).

Although *shura* is encouraged in Islam, no detailed descriptions have been given to its implementation. Thus, the basic concepts must be interpreted in light of the particular needs and circumstances of a particular situation (Al-Buraey, 1990).

Despite the different terms used by the various authors to clarify the Islamic worldview, there appears to be a general consensus as to what an ideal Islamic society should be. The concept of *Tawhid* (Unity) governs a Muslim's outlook in life, recognising that there is only one God and man's accountability is to Him. Additionally, an individual's relationship with other individuals mirrors his relationship with God. Both are equally important. *Khilafah* prescribes the Islamic social order formed on the basis of the principles of justice, equality and brotherhood. The general theme of the Islamic social order is cooperation and mutual consultation (*shura*). Further, in Islam, individual freedom is constrained by its ethical limits. Thus, an individual's freedom of actions must be combined with a sense of responsibility towards others. The Islamic worldview, just discussed, serves to portray the ideal Islamic society and will influence the way corporate reporting from

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<sup>6</sup>Unicity, in this context, is similar to the concept of Unity (*Tawhid*).

an Islamic perspective should be developed.

## **5 Islamic societies, Hofstede and Gray**

To use the Hofstede-Gray framework to delineate and define what information Islamic reports should contain, it is first necessary, following on from the preceding reasoning from section 3 above, to determine how Islamic beliefs affect the cultural dimensions of Power Distance, Uncertainty Avoidance, Individualism, Masculinity and the Long Term orientation of Islamic societies.

### ***Cultural values of Islamic societies***

The ideal Islamic society is largely egalitarian and should promote equality (Faruqi, 1978; Al-Sadr, 1982). Interpreted in the Hofstede-Gray framework, Power Distance is expected to be low (Baydoun and Willett, 1993). Hofstede describes three characteristics of a low Power Distance society: the first related to an interdependence between the less and more powerful members of the group, the second pertained to the existence of hierarchy not as representing unequal power but merely denoting an inequality of roles, and the third to the non-acceptable practice of privileges and status symbols.

On the basis of certain verse in the Qur'an on *shura* (consultation) and hadith, it is argued that Hofstede's characterisation of low Power Distance societies aptly describes an important aspect of the ideal Islamic society. The verse in the Qur'an referring to the need for interdependence is indicated in Verse 3:159 (see section 4 above). Regarding the evidence from *hadith*, it was also reported that when the Prophet gave less than useful advice on the growing of date palms, he was reported as saying (Nomani and Rahnema, 1995),

I am but a human being. If I give you order on religious matters, then you should obey. If I merely voice my opinion, you should know that I am a human being and you are more informed about your own worldly affairs (p18).

The Islamic position on privileges and status symbols can be discerned from the Prophet's farewell speech (Ahmed, 1978).

There is no superiority of an Arab over a non-Arab,....of a white over a dark complexioned..... person. All are equal before God. Only the pious and virtuous amongst you should command greater respect than others. And your slaves! See that you feed them with such food as you eat yourselves,

and clothe them with the stuff you wear; and if they commit a fault which you are not inclined to forgive, then part with them; for they are the servants of thy Lord and are not to be harshly treated (p30).

On the basis of these instances of prescriptions and advice it may be therefore be concluded that an ideal Islamic society should exhibit low Power Distance.

Islam is against speculation but preaches the need to accept uncertainty (Mannan, 1986; Hamid *et al*, 1993). Hofstede's Uncertainty Avoidance value should therefore be weak (Baydoun and Willett, 1994). Additionally, the belief in *Qadar* or predestination in Islam is a positive affirmation of God's power, suggesting that Islam actually helps in accepting uncertainties that an individual cannot defend against. Hofstede further contends that there is a greater emphasis on regionalism and internationalism (as opposed to nationalism) in weak Uncertainty Avoidance societies. The farewell message of the Prophet reported above supports the fact that, normatively, Islam does not recognise nationalism. These traits all suggest that Islamic societies should exhibit low Uncertainty Avoidance.

According to Baydoun and Willett (1994), the principle of *shura* gives the individual the right to be heard and the power to require information concerning the effect of the firm on the *ummah*. However, it is usually held that the larger interest of society takes precedence over the interest of the individual (Chapra, 1992). Kahf's (1991) viewpoint that Islam takes a middle path between Individualism and Collectivism reconciles these aspects of Islam, arguing that Islam strikes a balance between human drives and desires on the one hand and social needs and responsibilities on the other and calls for a balanced mix of pragmatism and dogmatism<sup>7</sup>. Baydoun and Willett (1994) reason that a regard to the rights of the individual on the part of the

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<sup>7</sup>On whether socialism is consistent with Islam, it was reported in Kahf (1991) that it is the individual who is more important in Islam than the community, society or nation for the individual is not meant to serve society. Rather, it is society which will ultimately serve the individual. No community or nation is responsible before God as a group but each individual is responsible before Him individually. The existence of a social system is to ensure an individual's welfare and happiness and not of the society. Thus, a true measure of a good social system is the extent to which it helps its individual members to develop their personalities and to improve their personal abilities and capabilities. Hence, Islam disapproves any type of social organisation and any social welfare scheme that suppresses the individual and ties him very strongly to the social regime so that, in the process, the individual loses his independent personality.

user, and a belief in the obligations to the collectivity on the part of the preparer, will both encourage full disclosure of information. Taken together these viewpoints do not conflict but suggest that Islamic values encourage a collectivist ethic but not in the extreme so that Islamic societies rank on the low side of Individualism<sup>8</sup>.

Regarding Masculinity, Baydoun and Willett (1994) argue that the effect of Islamic belief on Masculinity is uncertain. According to Hofstede's definition, however, a Feminine society is (amongst other things) a society that does not show off, puts relations with people before money, and helps others, particularly the weak. Since this accords with most Muslims' perception of desirable Islamic values, it implies that Islamic societies should rank low on Masculinity. The following verses attest to this.

If the debtor is in a difficulty, grant him time till it is easy for him to repay. But if ye remit it by way of charity, that is best for you if ye only know (2:280).

And those in whose wealth is a recognised right for the needy who asks and him who is prevented for some reason from asking (70:24-25)

Finally, consideration of Hofstede's fifth dimension, the Long versus Short term orientation of a society, places the Islamic *ummah* (community of believers) in the former. According to Hofstede (1991), a society that exhibits thriftiness and persistence (perseverance) may be regarded as one that focuses on the long term. The verses in the Quran referring to the need for Muslims to be thrifty and to be patient are as follows:

But squander not your wealth in the manner of a spendthrift. Verily spendthrifts are brothers of the Evil Ones and the Evil One is to his Lord (Himself) ungrateful (17:26-27).

...Eat and drink: But waste not by excess, for Allah loveth not the wasters (7:31).

Nay, seek (Allah's) help with patient perseverance and prayer: It is indeed hard, except to those who bring a lowly spirit (2:45).

And be steadfast in patience; For verily Allah will not suffer the reward of the righteous to perish (11:115)

Ye shall certainly be tried and tested in your possessions and in your personal selves;

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<sup>8</sup>According to Sulayman (1993), the collective dimension of social behaviour does not mean the suppression of an individual's will but it means that the individual's freedom of action in society must be controlled. Individual freedom which goes against societal norms makes that freedom a means of spreading confusion throughout society (p90).

and ye shall certainly hear much that will grieve you, from those who received the Book before you and from those who worship many gods. But if ye persevere patiently, and guard against evil – then that will be a determining factor in all affairs (3:186)<sup>9</sup>.

Additionally, Hofstede (1991) argues that a society which has a long term outlook tends to possess a “sense of shame” (Hofstede, 1991, p169). This, according to him, translates to a society that places much emphasis on fulfilling commitments. This is precisely what Islam demands of Muslims, as in the following verse,

O ye who believe! Fulfil (all) obligations (5:1).

### ***The Relationship between Islamic cultural values and accounting practice***

Based upon the preceding analysis, Islamic societies *ought* to rank Low on the first four of Hofstede's dimensions. Additionally, Islamic societies tend to focus on the “long term.”

Assuming that Gray correctly identified the linkages between Hofstede's cultural dimensions and his accounting sub cultural values, it is possible to use the Hofstede-Gray framework infer the type of accounting system an ideal Islamic society *should* deem appropriate by examining its cultural values

Following the linkages suggested by the framework, Low Uncertainty Avoidance and low Power Distance are consistent with Islamic societies advocating an accounting system that is low on secrecy and conservatism. Low Individualism and low Masculinity, however, seem to run counter to these prescriptions. Collectivist societies and those exhibiting low Masculinity should prefer an accounting system that is secretive in terms of its disclosure policies and conservative in its measurement practice<sup>10</sup>. This also appears to contradict Baydoun and Willett's (1997) contention that Islam should place an emphasis on social accountability and the need for full disclosure.

Baydoun and Willett's (1997) way around this apparent contradiction was to separate the individualism of the user from the collectivism of the producer. An

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<sup>9</sup> See also verses 10:109, 16:126-127, 20:130-132, 40:55, 46:35, 50:39, 70:5, 73:10-11.

<sup>10</sup>One could also argue that, contrary to what Gray has hypothesised, it is the highly Individualistic society that would much prefer a more secretive disclosure policy primarily because of the competitive spirit that is rife in such societies.

alternative more simple, reconciliation of the position is, as Gerhady (1990) suggests, to use Gray's framework, one needs to determine a 'dominant' cultural value. In the case of Germany, for example, Gerhady argued that there was a cultural value that overshadowed the influences of the other three societal values. He concluded that the society's desire to minimise uncertainty and ambiguity far outweigh the society's preference for equality, Individualism and Masculinity. This explains why the German accounting system takes its present form.

Similarly, Salter and Niswander's (1995) argument that Uncertainty Avoidance has a more significant relationship to Gray's accounting subcultural values than the other Hofstede dimensions of culture supports the concept of a dominant cultural value, in this context. Islam's emphasis on the need to accept uncertainty and its emphasis on equality would rank Power Distance and Uncertainty Avoidance as the two prominent cultural values. Accordingly, an Islamic society would favour a more transparent disclosure policy and less conservative measurement practice.

While on the one hand, Gray suggests that those societies exhibiting low Masculinity would tend towards greater secrecy, on the other, he acknowledges that such societies would 'tend to be *more open* especially as regards socially related information' (Gray, 1988, p11). In Hussein's (1996) study of Dutch society, it was noted that within the Feminine, egalitarian Dutch society, information was readily disseminated and that Dutch culture demands more accountability, especially those pertaining to social issues<sup>11</sup>. Collectivist societies with their anti-individualistic values tend to favour information of a social nature while highly Individualistic societies tend to disclose user-oriented information (Perera, 1989).

Baydoun and Willett's (1995) extended Hofstede-Gray framework introduced the attributes of accountability and decision usefulness into the analysis of the cultural relevance of accounting, suggesting that a society exhibiting low Masculinity, (such

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<sup>11</sup>Gray (1988) argues that societies that exhibit Masculine tendencies tend to place more emphasis on material achievements and success and with that comes a need to publicise those achievements. This, as the reasoning goes, would lead to greater disclosure. However, at variance with his hypothesis, Gray concedes that the more caring societies (Low Masculinity) tend to be more inclined to disclose socially related information. Such societies, he added, place greater emphasis on the quality of life, people and the environment.

as an Islamic society) would emphasise accountability, while highly Masculine societies would prefer information that is geared towards investment decision making (decision usefulness). Consequently, the emphasis on accountability would render Islamic corporate reporting to have a wider focus.

On uniformity, Gray (1988) argues that a society exhibiting low Uncertainty Avoidance and low Power Distance would favour an accounting system that was low on uniformity. This appears to be relevant in Islamic societies. The principles of the *Shari'a* are broad enough to accommodate more than a single interpretation to accord with the time and locality in which the rules are to be applied (Denny, 1994). Further support for 'low uniformity' position in Islamic reporting can be discerned from the rules of precedence in Islamic jurisprudence<sup>12</sup>. Islamic jurisprudence does not recognise the case law system of legally binding precedents. A prior ruling may be overruled by a new ruling primarily because the principles in the *Shari'a* are dynamic and may change with the passage of time or in accordance with a particular situation. Hence, jurists in each city should rely on local practice when interpreting the *Shari'a* (Kamali, 1994).

Gray (1988) did not address the effects of the fifth cultural dimension, that of the long versus short term orientation, on accounting. However, in the context of corporate reporting, an Islamic society's long term orientation may translate to a greater emphasis on sustainable development<sup>13</sup>.

In Islam, an individual's freedom of action must be combined with a sense of responsibility towards others (Naqvi, 1994). Since social awareness and a concern for individuals are inextricably blended, working for the welfare of others is the most promising way of extending one's usefulness in pleasing God. The following verses in the Quran explicate the above.

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<sup>12</sup>The authority of the *Qur'an* is irrevocable and binding on all Muslims. However, the principles laid down in the *Qur'an* are dynamic and to be applied and interpreted in accordance with the a specific situation and time. For Muslims, God is the Legislator and jurisprudence is a system designed to facilitate human obedience to and service of God. As such, the science of the law is a product of human intelligence and experience (Denny, 1994).

<sup>13</sup> Development that meets the needs of the present without compromising the ability of future generations to meet their own needs (The Brundtland Commission Report, 1987).

You will never come to piety unless you spend of things you love (3:92)

Ah, what will convey unto thee what the Ascent is: (it is) to free a slave, and to feed in the day of hunger an orphan, near of kin or some poor wretch in misery (90:20-26)

The emphasis on the well-being of the community is paramount. To satisfy this religious and cultural perception, Islamic Corporate Reporting must have a wider focus than one which concentrates on the needs of the traditional users of accounts (such as the investors, creditors and shareholders). This brings to the fore the concepts of accountability and decision usefulness in corporate reporting. As indicated earlier, accountability is a broader concept than decision usefulness. In particular, in Islam, accountability is to God as well as the community of believers (*ummah*). Thus, disclosure policies should not be dependent on self interest. The following Hadith aptly describes this concept in Islam,

No one is truly a Muslim until he wishes for his brother what he wishes to have himself

Rather, disclosure practices should be guided by what is best for the society. In combination these requirements demand a greater emphasis on social responsibility accounting and the reporting of environmental issues. A firm operating in an Islamic environment should not regard itself as operating independently from the community. The emphasis on accountability is paramount.

Benston (1982) asserts that accountability is a consequence of responsibility. Social accountability is also the responsibility to account for actions for which one has under an established contract (Gray *et al*, 1987). In the former context, responsibility must be clearly defined to satisfactorily discharge accountability arising from that responsibility. In the latter context the responsibility must be comprehensive. In Islam, man has a covenant with God (Ishaque, 1978). Accordingly, this covenant requires that the individual discharges his accountability in accordance with the responsibilities laid down in the *Shari'a* (Islamic Law). Further, from Islam's perspective, an individual is ultimately accountable to God whereas that of the Western accounting tradition it is deemed to be accountability to the stakeholders. Islam teaches the individual to regard life as a matter of mutual cooperation and personal responsibility so that accountability to God can be interpreted as accountability to the *ummah* (community of believers) (Baydoun and

Willett, 1994). As it is generally understood in non-Islamic accounting, the purpose of social responsibility accounting is primarily to determine the effects corporate actions have on the quality of life of society and hence the emphasis on accountability<sup>14</sup>. The primary objective of social responsibility accounting may be similar to Islamic accounting but it should have a wider focus. The stress on social justice in Islam not only refers to disclosure issues such as reporting on the environment, minority employees and the like (see Gray *et al*, 1987). Financial statements from an Islamic perspective should enable a Muslim shareholder to determine the liability for *zakat*, a tool for income redistribution. Additionally, while issues pertaining to interest and unfair trading practices are not explicitly considered as social issues from a Western perspective, in Islam these matters are specifically addressed in the *Shari'a* because of their potential to affect the well-being of the community. Thus, such issues must form part of the disclosure practices of a firm operating in an Islamic environment. The scope of social responsibility accounting in Islam is, of necessity, wider than in western secular financial reporting.

In Islam, caring for the environment is a duty of all. According to Nasr (1990), planting trees and preventing pollution are as good as feeding the poor and attending to the sick. Further, if one harms the environment, one is indirectly harming others and the principle of *maslahah* (well-being of the masses) specifically provides that community's interests is of primary importance. Thus, protecting the environment is implicit. The following verses in the Quran further illuminate this issue.

Do not work corruption on the earth after it has been set right (7:85)

Do not corrupt the land (11:85)

God also warns those who abuse the environment as in the following verse:

Corruption has overtaken in land and sea for what the hands of the people have earned, that He may let them taste some of what they have done (30:41)

On the basis of the above, one may thus conclude that in the context of corporate

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<sup>14</sup>The Corporate Report (1975) advocating a public accountability framework in financial reporting suggested that public accountability is separate from and broader than the legal obligation to report and that it arises from the custodial role played in the community by economic entities.

reporting, reporting on the environment is highly encouraged (if not mandatory) in Islam. The normative conclusion that is drawn from the foregoing is that accounting systems in an Islamic society should advocate transparency in disclosure, less conservative measurement practices and greater variability in reporting practices between companies and across time. Further, transparency in disclosure shall also include social and environmental issues. These accounting subcultural values and the concept of accountability in Islam discussed earlier need, however, to be operationalised to show their possible impact on the physical characteristics of Islamic Corporate Reports.

## **6 An extended Islamic Corporate Reporting model**

Baydoun and Willett (2000) proposed that low conservatism implied an Islamic society's preference for current values while low secrecy pointed to the need for full disclosure in Islamic financial reports and that the current value balance sheet be included as part of the reporting requirements of firms operating in an Islamic economy. It was also argued in the same, suggested reporting framework that the profit and loss statement should be relegated to the Notes to the financial statements because of its corruptive influence and be replaced by a value added statement<sup>15</sup>.

Baydoun and Willett's suggestions, as they acknowledge, may be regarded as providing a bare minimum towards satisfying Islam's social accountability obligations. With Islam's emphasis on safeguarding the welfare of the community, a more complete Islamic Corporate Reporting model is required to include information on corporate social responsibility and the environment. The argument that there is a need for greater awareness of the social impact of firms' activities in Islamic societies necessitates the detailed description of externalities and trading practices harmful to the *ummah*. The three main elements in the extended Islamic reporting framework, the current value balance sheet, the value added statement and what constitutes social responsibility reporting in an Islamic context are discussed next. The mostly existing arguments for the current value balance sheet and the value added statements are recounted and related to the additional need

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<sup>15</sup> See Sulaiman and Willett (2001) for an extended discussion of the potentially corrupting effect of the profit and loss account in a reporting regime.

for further social responsibility accounting.

### ***Current value balance sheet***

Three main theoretical arguments for the perceived usefulness of the current value balance sheet to Islamic users are evident from the literature. First, according to Baydoun and Willett (2000), current value information allows the inclusion in financial statements of market values that are based on information obtained from outside the firm's database. Historical cost information, based mainly on a firm's own transaction costs and little else, ignores the potential relationship that accounting may have with its wider social environment. As such, it was contended that the current value balance sheet can be considered as a method of extending the accountability of firms into the social domain. Second, the use of current values relates to the 'justice and equity' aspects that Islam emphasises with regard to the payment of *zakat*. *Zakat* constitutes one aspect of social accountability in Islamic societies and the current value balance sheet (to determine *zakat*), supports the Islamic principle of justice to a greater extent than the historical cost balance sheet (Gambling and Karim, 1991; Sulaiman, 1997)

Third, further support for the use of current values follows from practices pursued during the Prophet's time (Clarke *et al*, 1996). According to Clarke *et al* (1996), 'value in exchange' may be derived from the implicit common monetary denominator used in the Prophet's time to establish the *nisab* (the minimum threshold of wealth above which *zakat* is payable) for various assets subject to *zakat*. 'Value in exchange' is simultaneously the selling price (exit value) for the vendor and the entry price for the purchaser. Thus, it is implied, the current value balance sheet may be regarded as simultaneously satisfying an Islamic society's need for full disclosure and social accountability.

### ***The Value Added Statement (VAS)***

The process by which an Islamic society can achieve social and economic justice is through mutual support and cooperation. The Islamic concepts of brotherhood, equity and justice imply the presence of a conscious policy of redistribution and resource transfers amongst various groups of society. Where social accountability is paramount, a VAS showing how the benefits of the efforts of the business are being shared amongst employees, shareholders, society and the government

would be especially useful to those embracing the Islamic faith. The VAS has a 'social dimension' since the distribution of wealth between the different sectors of society is, by definition, a matter of social interest. From an Islamic perspective, it is this distributional characteristic of VAS that supports accountability in Islam (Baydoun and Willett, 1994). Consequently, it may be inferred that the greater awareness of the social impact of the firm's activities in a Muslim community should favour a VAS over the conventional profit and loss account.

Baydoun and Willett (2000) emphasise the issue of social accountability but, apart from suggesting that an Islamic Corporate Report should include the CVBS and the VAS for reasons similar to those just stated, they did not elaborate further on the basis that pragmatic considerations would dominate more idealistic considerations. As a result, unethical business practices that are provided in the *Shari'a* as having the potential to affect the well being of the community are not dealt with. This and other more general matters matter will now be examined.

### ***Social responsibility and environmental accounting***

The arguments recited in favour of including a current value balance sheet in Islamic corporate reports address issues pertaining to the disclosure of the private costs impacting upon the social environment but not necessarily to the disclosure of social costs that may have such an impact. The extension of a firms' accountability to its wider social environment necessitates the reporting of externalities. Consequently, social responsibility and environmental accounting issues would be essential components that need to be disclosed in Islamic corporate reporting. The Global Reporting Initiative's (GRI) sustainability reporting guidelines may provide a basis on which the social and environmental performance indicators of an Islamic corporate reporting model may be developed. It must be emphasised, however, that while the GRI has come up with a very comprehensive list of social and environmental issues that a company needs to disclose, for the specific case of Islamic corporate reporting, the guidelines need to be enhanced by incorporating the dictates of the *Sharia*.

The GRI's emphasis on sustainability reporting focuses on the economic, environmental and social performance indicators, both qualitative and quantitative

(though not necessarily monetary) of companies. From the perspective of Islam, in addition to the list of economic performance indicators suggested by the GRI, information on the amount of *zakat* paid by the company, the number of Muslim shareholders and their shareholdings, whether or not the company is a monopoly in the provision of particular goods and services, whether or not the company (in the case of listed companies) is listed as a *halal* (permitted) counter and whether or not the company or any of its subsidiaries is engaging in *haram* (forbidden) activities should also be disclosed (Sulaiman, 1997; Haniffa, 2002). Islamic business enterprises should not engage in any transactions pertaining to interest. Although the provisions for the disclosure of interest payments in external financial reports currently in force in many countries are not legislated with Islam in mind, they are nevertheless consistent with what a devout Muslim would advocate<sup>16</sup>. However, while current practice is usually to simply show the amount of interest paid, under an Islamic system, companies would have to avoid such payments altogether (for instance by borrowing from Islamic banks). Additionally, a firm following strictly the tenets of Islam in its conduct would also disclose activities that may be categorised as having the possibility of impairing social and economic justice such as the hoarding of necessary goods, fraudulent business practices and price manipulation (al-Qaradawi, 1994). Full disclosure in such cases would include the steps that would have to be taken to ensure that such activities are not continued, how the income (if any) from such activities was to be dealt with and why the company undertook such activities. It is unlikely that such disclosures would happen voluntarily but that fact is *not* an argument against disclosure *per se*.

Specific to environmental issues, the list of environmental performance indicators provided by the GRI appears comprehensive. Accordingly, one would not expect there to be differences between environmental performance indicators disclosed by secular and Islamic enterprises.

Finally, the social dimension of sustainability, according to the GRI, emphasises on

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<sup>16</sup>In Western accounting systems interest payment is disclosed primarily to indicate the ability to service such interest; in Islam such a disclosure is an indication of the extent Islamic injunctions have not been followed.

an enterprise's impacts on the social systems in which it operates. The GRI identifies key performance measures pertaining to labour practices, human rights as well as broader issues concerning the consumers (as in product responsibility), community and other stakeholders in society (GRI, 2002). However, from Islam's perspective, social performance indicators may enjoy less of a consensus than environmental performance indicators. In particular, in Islamic corporate reporting, social performance indicators should include (amongst others) whether or not employees from the higher echelons in the company perform the congregational prayers with lower and middle level managers, whether Muslim employees are allowed to perform their obligatory prayers during specific times of their working day and whether or not there is a proper place of worship for the employees. Specifically under "product responsibility", whether or not a product is forbidden (*haram*) or allowed (*halal*) in Islam should be clearly indicated. For example, the selling of food that contains alcohol, however minute its content, should be reported.

An important concept in Islam that is somewhat related to social responsibility and which is fundamental to determine if a particular transaction is allowed is *al-gharar* (uncertainty or lack of clarity). The Prophet forbade any transaction that would lead to a dispute or conflict or which would result in a litigation due to the uncertain nature of a particular transaction. For example, Muslims are prohibited from selling unripened fruits that are still in the orchards (Al-Qaradawi, 1994, p254). This may be interpreted that in Islam therefore, transactions or events that are not well-defined or not properly specified are forbidden. Although the concept may be of significance to Islamic accounting, its effect on corporate reporting remains unclear at the present time. However, one would envisage that *al-gharar* ties in with the concept of full disclosure suggested by Baydoun and Willett (1994). For example, if a subsidiary engages in activities that are specifically forbidden in Islam (such as gambling, importing liquor, etc), the holding company's accounts would have to reflect such information; thus ensuring that information disclosed does not lack clarity. Such a disclosure would enable Muslim shareholders to make informed decisions as regards their investments in the holding company.

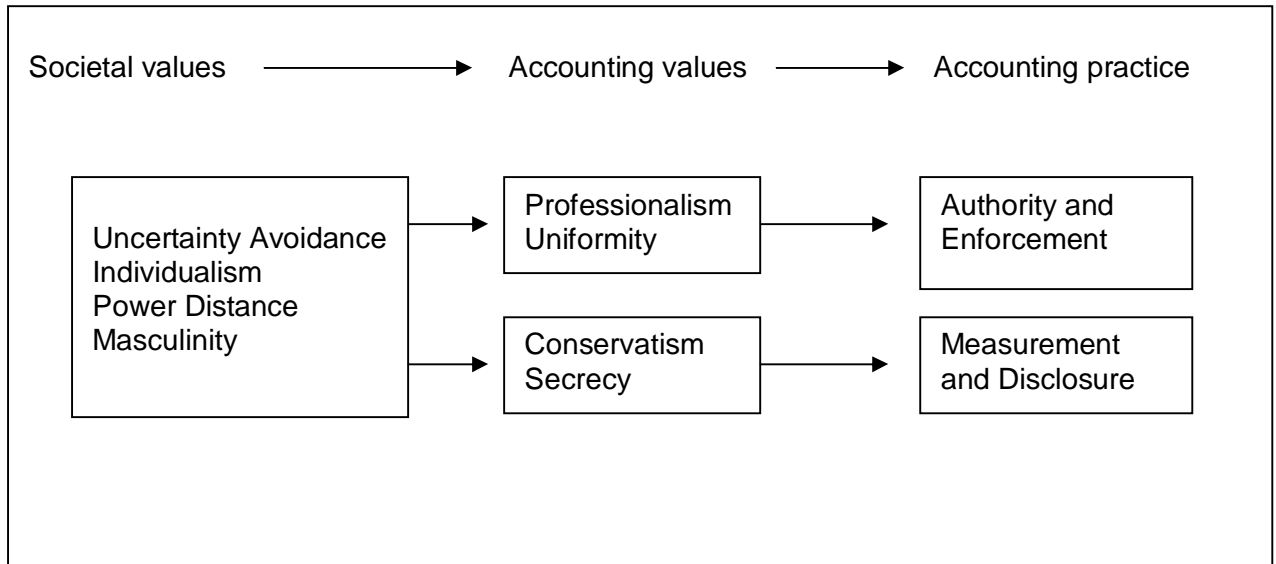
Full disclosure should not, in any case, cause embarrassment to any party if transactions are undertaken to accord strictly with Islamic principles. An Islamic Corporate Report should not be concerned with social and political ideals of secular financial reporting nor with the political processes that have become part of the game that multinational organisations play. Most important of all, an Islamic Corporate Report should be about how the individual (and more specifically the accountant) discharges the task of social accountability before God.

## **6 Conclusion**

Baydoun and Willett (2000) argue that two essential principles underlie the concept of accountability in Islam: the precept of full disclosure and social accountability. Accordingly, they suggest that the current value balance sheet and the value added statement would better meet Islam's objectives of socio-economic justice and accountability than would the traditional historical cost balance sheet and the profit and loss statement. The appropriateness of this model was assessed using the Hofstede-Gray paradigm. On the basis of this analysis, it is argued that Islamic societies should favour a more transparent disclosure policy, greater variability in reporting practices between companies and across time, and less conservative measurement practices. It was found that Baydoun and Willett's (2000) model would not, by itself, satisfy the precepts of full disclosure and social accountability in Islam. Given Islam's emphasis on justice and the well being of the larger community, it was concluded that social responsibility accounting and the reporting of externalities should also be disclosed if these are to correspond to what Muslim's 'ought to desire' from an Islamic corporate reporting framework. The reporting guidelines of the Global Reporting Initiative was taken as a basis on which a more comprehensive framework of Islamic corporate reporting was developed. While the guidelines deal with a myriad of issues, it is argued that from Islam's perspective, further issues as explicated in the Quran, *Sunnah* and the *Hadiith*, should be reported.

Finally, the model suggested here is based on what Muslims *ought* to desire in their annual reports. However, what they *actually* desire may not align with the desirable. Thus, future research should embark on the testing of the model amongst Muslim users of accounting information.

**FIGURE I**



**Gray's hypothesised relationships between societal values, accounting values and accounting practice**

**Source: Gray (1988)**

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