

Meta-analysis on Direction of Accounting Standards for Islamic Financial Institutions: Case Studies in United Kingdom and Indonesia

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Abstract. *This paper is to analyse determinants that influence implementation of accounting standards for Islamic financial institutions. It's done by examining the history of accounting standards and two different contexts as applied to Islamic financial institutions in the United Kingdom and Indonesia. The paper adopts meta-analysis method by exploring available texts and literature with the goal to learn 'what is going on here?' and to investigate social phenomena without explicit expectations. Employing the Ibn Khaldun perspective, this study analyses two determinants i.e. institutional setting that may be suitable in the context of the United Kingdom, and accounting needs in the case of Indonesia. The research shows the determinants are well fitted with interdisciplinary characters of Ibn Khaldun model of civilization.*

Keywords: *meta-analysis, accounting standards, Ibn Khaldun, Islamic financial institutions*

Abstrak. *Tulisan ini akan menganalisa faktor – faktor yang mempengaruhi implementasi standar akuntansi pada lembaga keuangan syariah berdasarkan sejarah perkembangan akuntansi di UK dan Indonesia. Metode meta-analysis digunakan untuk mempelajari teks dan studi pustaka yang ada dengan tujuan menjawab pertanyaan 'apa yang terjadi di sini?' dan untuk melakukan investigasi mengenai fenomena sosial tanpa membuat dugaan – dugaan. Studi ini menggunakan pemikiran Ibnu Khaldun yang fokus melihat tata letak institusi yang mungkin sesuai dengan konteks di UK dan Indonesia. Riset ini menunjukkan bahwa faktor-faktor penentu ternyata sejalan dengan karakter dari model peradaban Ibnu Khaldun.*

Kata kunci: *analisa arah, standar akuntansi, Ibnu Khaldun, lembaga keuangan syariah*

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Introduction

Islamic financial institutions (IFIs) have been developing not only in Islamic countries or countries with a predominantly Muslim population, but also emerged in countries where Muslim is minority. Maurer refers to this development as a world-wide phenomenon centred in Malaysia, Indonesia, the United States, Great Britain, and the Arabian peninsula (Maurer, 2002). These developments require accounting standards to be adopted to govern the setting up these institutions and contributing to the objective of high accounting quality and comparability as suggested by Ball (2006) and Barth, et al (2008). Furthermore, it may facilitate the ambition of Islamic banks to take the world markets as their developments are currently hindered due to lack of accounting and auditing uniformed standards for the institutions (Maurer, 2002).

There are several determinants that influence the adoption of accounting standards in a country. These are internal and external factors; depending upon its national legal and political system, tax and reporting system, accounting profession, history and language, economic globalization, and source of financing for industries (Cooke & Wallace, 1990; Elliot & Elliot, 2007; Nobes & Parker, 2012). Indonesia is not an Islamic country but it has been in the history that there are several Islamic organizations such as Islamic political parties that contribute a strong influence on the direction of the government policy, including in the financial sector. For instance, the Indonesian Association of Muslim Intellectuals (ICMI) initiated the establishment of Bank of Muamalat Indonesia as the first Islamic bank in Indonesia in 1992. On the other hand, the establishment of the first Islamic bank in the United Kingdom i.e. Islamic Bank of Britain (changed the name to Al Rayan Bank in 2014) was started due to different reason i.e. to serve corporate investors. In addition, UK financial system has always been strongly market-oriented (Benston, et al, 2011).

As such, some researchers argue that these IFIs should be reported according to its own Islamic based accounting standards; but to date there is no evidence that they refer to such uniformed standards (ACCA, 2010; Haniiffa, 2011; Ibrahim, 2007; Karim, 2001; Sarea & Hanefah, 2013; Wan Abdullah, et al, 2011). In fact, compliance studies on the existing international accounting standards for IFIs i.e. AAOIFI shows a declining trend. While studies the determinants influencing accounting standards adoption in developed and developing countries present mixed evidences, none of the studies highlights the determinants of accounting standards adoption by IFIs. Owing to the fact that the Islamic finance industry has been growing very rapidly in these two countries i.e. Indonesia and the United Kingdom but yet they live in different country settings, it is important to conduct a comparative study to explore determinants influencing the implementation of

accounting standards for IFIs. Thus, the main objective of this paper is to analyse the determinants on the implementation of accounting standards for Islamic financial institutions (IFIs) in the United Kingdom and Indonesia.

This research adopts a qualitative methodology using a meta-analysis method by exploring available texts and literature with the goal to learn ‘what is going on here?’ as proposed by Schutt (2001). The findings of this study suggest that the financial reporting standards in both countries have evolved through different histories and left distinct influences to IFIs industry. Strength or weaknesses found in each of the countries could provide some lessons for others, also to many other countries with growing Islamic finance industry. The main determinant influencing accounting standard adoption for IFIs in the UK is due to the institutional setting where the United Kingdom set up the IFIs with the objective to gain business opportunity, therefore no effort to govern its reporting mechanism with other than conventional accounting standards i.e. IFRS. As for Indonesia, the main determinant is due to the accounting needs that should serve the IFIs according to Islamic values in order to ensure going concern of the business, which is important for the stakeholders. Following Perera and Baydoun (2007) who argue that underlying theories on international accounting development proposed by several scholars i.e. Schweikart (1985); Adhikari and Tondkar (1992); Gray (1988); Douppnik and Salter (1995); and Nobes (1983) merely relied on the classification of accounting systems in the countries. Perera and Baydoun (2007) extended their research by adopting taxonomy proposed by Gernon & Wallace in examining the environmental factors on lack of support for IFRS adoption in Indonesia.

However, this paper adopts Ibn Khaldun model as it has a comprehensive explanation on development of a country towards a civilized society that in the context of international accounting development, the model explains not only environment but also the function of each variable. The model describes the circumstances in a way that interlinked elements must exist to ensure the continuation of a civilized society i.e. the function of government (G), the direction of Shari’ah (S), the role of people (N), the use of wealth (W), the development of a country (g), and the promotion of justice (j). This paper has a contribution to help setting accounting standards for Islamic finance industry by understanding determinants in each country with the purpose to maximize development of Islamic finance.

The remainder of this paper is organized as follows. Section Two reviews the relevant literature on accounting standard setting in the world and Section Three presents the research methodology, research method and sample of this study. Section Four delineates analysis of the study, Section Five summarises the analysis, limitations of study and the way forward.

Literature Review

Several researches have been identified which discussed the setting of international accounting standard adoption in general i.e. IAS and IFRS in both developed and developing countries (Briston, 1978; Chamisa, 2000; Cooke & Wallace, 1990; Perera & Baydoun, 2007; Rosser, 2009; Sudarwan & Fogarty, 1996; Tarca, 2004; Zeghal & Mhedhbi, 2006). Very little evidence is provided on the determinants influencing accounting standards adoption by Islamic financial institutions. There is a related study, in this case AAOIFI compliance by Islamic financial institutions carried out by Vinnicombe (2010, 2012) but the author does not address the reasons why a country adopts or does not adopt accounting standards. The following studies discuss arguments on the determinants on adoption of accounting standards, taking experiences from a developed country i.e. the United Kingdom and a developing country i.e. Indonesia.

Using environmental determinism theory, Cooke and Wallace (1990) suggest that the factors influencing international accounting standards disclosure in a country are due to internal and external environmental factors. The study concludes that the United Kingdom which is regarded as a highly regulated country which shows a high score on the Corporate Financial Disclosure Regulation (CRDR) index, which means the country discloses more accounting information in their reports. This study was conducted in 1990 and refers to the effort towards international harmonization of accounting principles and practices, which was at that time the United Kingdom has applied International Accounting Standards (IAS).

The study found that the United Kingdom (which is similar to other developed countries) is more likely influenced by internal factors i.e. stage of economic development, goals of society, legal rules, political systems, economic systems, level of education, financial press, and cultural variables. While Cooke and Wallace present very general factors, Tarca (2004) argues that the UK is among the five developed countries which confirm that the institutional framework leads to the voluntary adoption of international accounting standards. The institutional framework refers to features of the companies that tend to adopt the international accounting standards in the UK. They are large companies that receive more foreign income and listed at least on one stock exchange. Tarca (2004) asserts that the country direction to what extent the institutional framework allows the use of the international accounting standards. Meek, et al (1995) argue earlier that factors influencing voluntary annual report disclosure in countries like the US, UK and continental Europe are company size, country/region, listing status and industry. These studies are consistent with Marrero and Brinker (2007) that state:

“In the nations such as the United States and the United Kingdom, professional organizations are more established than in other countries in which statutory control prevails over individualism.”

Findings from the above studies suggest that the most important determinant that influences international accounting standards adoption rests at the institutional setting of the companies. As the nature of business environment in the UK is highly regulated, the institutional setting relates to socio economic and political structures that govern companies.

Briston (1978) states that the accounting professional qualification in Indonesia was Dutch in its structure but the professional training was American style but both influences are irrelevant to the context of accounting standards adoption as the country had different economic and cultural environment with that of the Netherlands and the US. Chamisa (2000) support this view and state that the key factors influencing accounting standard adoption of a country (especially in a developing country) are subject to the accounting needs of the country, size of public and private sector, existence of capital market, and the underlying environment. In addition, Zeghal and Mhedhbi (2006) consider other factors such as the relationship with Anglo-American culture and high literacy rate.

Stressing on the cultural relationship, Sudarwan and Fogarty (1996) emphasize that the practice of Indonesian firms on external financial reporting seems more adaptive to environmental changes rather than the process of accounting standard setting. Adaptive to the environment means Indonesian companies may prepare their reporting according to US GAAP, IAS, or other accounting best practices. Accounting needs as suggested by Chamisa (2000) best describes this adaptive to environment, which means the need arises due to environmental changes. That is why Indonesia, like Zimbabwe as the country Chamisa (2000) examined in her study adopts some of international accounting standards then adjusted to the local conditions. They do not however fully adopt all the standards. However, Rosser (2009) sees it from different view. He argues that when developing countries experienced changes in global and domestic economies, they shift the balance of power between foreign and domestic interest. As a result, it renders the climate conducive to accounting reform for the sake of the reproduction of capital. In conclusion, the above studies agree that in the case of Indonesia, the firms are more likely to adopt international accounting standards with the reason on the accounting needs that are directed by the government and these are derived from the economic needs of a developing country.

Several studies argue that IFIs reflect unique characteristics that carry Islamic values in their transactions thus they require to apply Islamic based accounting standards on their financial reporting (ACCA, 2010; Haniffa, 2011; Ibrahim,

2007; Karim, 2001; Sarea & Hanefah, 2013; Wan Abdullah et al., 2011). There are 15 differences that have been identified by the Islamic Finance Working Group of AOSSG, which may conflict with Islamic values that must be observed by the IFIs. For instance: recognizing a sale of good with deferred payment under IAS is reporting all Islamic financial transactions that are similar to that of conventional financial transactions. IAS 18 requires the difference between the fair values and the nominal amount of consideration in a sale of goods to be recognized as interest revenue. Under Islamic principles, however, the staffs of Indonesian Institute of Accountants argues it:

“... according to Shari’ah fatwa in Indonesia, Murabahah sales of goods cannot be accounted for as sales and financing transaction, therefore this kind of transaction should be treated as sales transaction. Hence, the recognition of [a financing] effect in [the] form of effective interest rate shall not be used....Islamic financing based on sales contracts should be treated on the aqad base. The term ‘financing’ for sales contract[s] is not proper to be used. ... When sales [are] accounted as financing, it will eliminate the essence of [the] Shari’ah principle.” (AOSSG, 2012) – *emphasis supplied*

At present, Indonesian Islamic financial institutions record income from sales based transactions as “receivables” and the allocation of profits is recorded proportionately according to the period of the credit. From this example, it remains a debate on the consolidation between the current international financial reporting standards and Islamic based accounting standards. Perera and Baydoun (2007) identify the reason and state:

“Islam as a religion strongly influences every facet of a Moslem’s life, including business activities. For example, Islam advocates good behaviour in conducting business and, at the same time, discourages Moslems to advertise the fact that they have behaved that way. This is likely to cause challenges in enforcing the disclosure requirement of IFRSs (particularly in Indonesia).” Perera and Baydoun (2007) – *emphasis supplied*

Perera and Baydoun (2007) continue to argue as to whether transparency promoted by IFRS that is derived from Anglo-Saxon tradition should be accepted by Islamic tradition in Indonesia. From the afore-mentioned literatures, an important question emerges i.e. what are determining factors influencing accounting standard adoption for Islamic financial institutions given the fact that the UK is a developed country with minority Muslim population and influenced by Anglo-Saxon tradition while Indonesia is a developing country with majority Muslim population influenced by Islamic tradition and both have significantly contributed to the development of Islamic finance industry?

History of Accounting Standards Development in the United Kingdom

The history of accounting standards development in the United Kingdom can be divided into several phases; First, transformation period during 18th – 19th century; Second, formation of the first accounting profession and further development (1853-1855); Third, Convergence to IFRS (2005).

Transformation period (18th – 19th century)

Britain, as part of the United Kingdom, experienced the transformation from agricultural based economy to a trading (mercantile), and eventually an industrial based during the 18th and the 19th centuries. During this period, accounting was used largely to monitor debts and check honesty of employees (Day, 2000). Its role was expanded during the industrial period where managers required more advanced accounting techniques to deal with valuation and profit calculation. Day (2000) documents that in 1844, under Joint Stock Companies Act, books of account had to show a 'full and fair' balance sheet but yet without specific profit and loss account. In 1907, the Companies Act required all companies under Registrar of Companies to file balance sheet.

Formation of the first accounting profession (1853-1855) and further development

The accounting profession was formed through the setting up of Royal Charter to the Society of Accountants in Edinburgh and the Institute of Accountants and Actuaries in Glasgow between the years in 1853 - 1855. The institute of Chartered Accountants in England and Wales (ICAEW) was formed in 1880 and the Society of Incorporated Accountants and Auditors was formed in 1885. After the 2nd world war, accounting practice made important breakthrough by moving into a new era that consider accounting as important matters for all, beyond matters that are subject to directors and shareholders only (Cohen-Committee, 1947). In 1970, Accounting Standards Steering Committee (ASSC) was formed and it issued its first standard in 1971.

Then ASC members comprise of professional accounting bodies, academic advisers and observers from government bodies including Bank of England and Stock Exchange (Day, 2000; ICAEW, 2012). In 1990, Accounting Standard Board (ASB) replaced the ASC and, thereafter, standards issued were referred as Financial Reporting Standard (FRS). The amendment of Companies Act 1985 (ASB, 2012; ICAEW, 2012) and 1989 Companies Act contained the first legislative reference to accounting standards (Benston et al., 2011). Unlike its predecessor, the ASC, the ASB can issue accounting standards (known as UK GAAP) on its own authority.

In general, accounting standards released by each country is referred as “Generally Accepted Accounting Practice” or alternatively “Generally Accepted Accounting Principles” or “Generally Accepted Accounting Policies.” GAAP is a term used to describe the rules generally accepted as being applicable to accounting practices as laid down by standard, legislation or upheld by the accounting profession.

Convergence to IFRS (2005)

The ASB also collaborates with accounting standard-setters from other countries and the International Accounting Standards Board (IASB), both in order to influence the development of international standards and in order to ensure that its standards are developed with due regard to international developments (ASB, 2012). Thus, UK GAAP has been fully harmonized and converged into IFRS since 2005 following the EU’s motive for adopting the regulation towards more transparent and efficient capital market that will facilitate a lower cost of capital for EU firms as stated on EC16/06/2002 agreement (Christensen, Lee, and Walker, 2007).

History of Accounting Standards Development in Indonesia

The history of accounting standards development in Indonesia can be divided into several phases; First, Dutch colonialism (1609-1942); Second, Japanese occupation (1942-1945); Third, post Indonesian Independence (1945)/Formation of the first accounting profession; Fourth, issue of IFRS convergence (2008).

Dutch Colonialism (1609-1942)

Dutch control over Indonesia began in Java (Java Island) in 1825, continued to South Bali (Bali Island) and Bone (Sulawesi Island) and extended to Aceh (Sumatera Island). Several sources that suggest that the occupation was for 350 years and is therefore misleading (Dick, 2002). During this period, there was evidence of several trading activities such as coinage in circulation (1820-1890), formation of modern financial institutions, development of rice prices (1829-1890), land and labour (1835-1880), crop payment and land rent (1835-1880), cotton imports (1830-1890), and crop exports (1840-1890). It was then extended to the preparation of a budget of the colonial state (1900-1939) and foreign exports of Indonesia (1900-1940). However it is argued that the Dutch East Indies Company (1609) was the first notion of early Dutch ruling in Indonesia. The establishment of the firm saw the first modern bookkeeping system introduced in Indonesia.

Japanese Occupation (1942-1945)

In March 1942, the Japanese became a new imperial power and imprisoned the Dutch. The new ruler was involved heavily in trading activities during the period and accountants in Indonesia prepared the bookkeeping both in Dutch and Japanese systems. However, as Japanese writing was used, only Japanese officers knew how to prepare the accounting documentation system (Suardikha, 2012).

Post Indonesian Independence (1945)/Formation of the first accounting profession

After Indonesia's independence in 1945, the foundation of accounting practice was laid out by well-known accountants, Abutari and Soemardjo, both studied accountancy in the Netherlands and graduated in 1956. These accountants together with their five partners made serious effort to form an association of accountants specifically for Indonesia and refused to become member of NIVA (*Nederlands Institute Van Accountants*) or VAGA (*Vereniging Academisch Gevormde Accountants*) formed by the Dutch colonials (IAI, 2012). On 17 October 1957, it was decided to form a committee called "Committee for Establishment of Indonesian Association of Accountants." The association was formerly established on 23 December 1957 and is now called *Ikatan Akuntan Indonesia* (IAI, or in English, Indonesian Institute of Accountants) (IAI, 2012). After its formation, IAI has progressed along with the growth of businesses in Indonesia. The association does not only focus on education and practices of accountants but also on the efforts to improve public trust in its role on formulating public policies.

In 1973, IAI formed a Committee to collect materials and structures from GAAP and GAAS. In 1974, the committee then set up a more permanent committee called Committee for Indonesian Accounting Principles (known as *Komite PAI*). *PAI* served its function for 20 years to formulate and develop financial accounting standards in Indonesia. After the 7th Congress of IAI on 16 September 1994, it was agreed that Indonesian accounting standards would be harmonized to International Accounting Standards (IAS) (Cahyati, 2011). Since then, the issue has arisen due to duplication in name, *PAI* was then altered to Financial Accounting Standard Committee (known as *Komite SAK*). At the IAI 8th Congress held on 23-24 September 1998, *Komite SAK* was again changed to Financial Accounting Standard Board (known as *Dewan Standar Akuntansi Keuangan* or *DSAK*) and still exists today (IAI, 2012). The IAI Rules and Regulation 2008 designate *DSAK* under IAI to formulate, develop and approve financial accounting standards in Indonesia. The standards cover the basic framework, statements, application guide, interpretation, implementation guide and technical bulletin. *DSAK* membership is representative of every association/compartment under IAI, government bodies, business association, non-government associations, and non-competent professional members. As per

Shari'ah standard, the board is referred to as Islamic Financial Accounting Standard Board (known as *Dewan Standar Akuntansi Syariah* or *DSAS*).

Issue of IFRS convergence (2008)

On 23 December 2008, IAI announced that the convergence of local standard to the international accounting standard (IFRS) should be completed by 2012. Even though the decision of IFRS convergence was decided only in 2008, the pressure has been increasing from time to time, as Indonesia is the only South East Asian country in the G20 Forum. Compliance with IFRS is one of the commitments in G20 with a target for completion in mid-2011, which will be implemented in 2012 (IAI, 2010a, 2010b). In line with this commitment, *DSAK* has been issuing new standards that are purely an adoption from IFRS standards issued by IASB. In IFRS Regional Policy Forum 2011, IAI declared 2012 as the year of IFRS Full Adoption (IAI, 2011).

Development of Islamic Finance

Forty-eight developing and emerging market countries, representing almost one-third of the International Monetary Fund (IMF) member countries, are increasingly involved, with varying intensity, in Islamic banking (Errico & Farahbaksh, 1998). In the Islamic Republic of Iran, Pakistan, and Sudan, all banks and financial institutions have adopted Islamic banking principles since the early 1980's and other countries, such as Malaysia, Indonesia, Bangladesh, Jordan and Egypt operate Islamic banking alongside conventional banking (GIFR, 2012; Maurer, 2002). Islamic banking is increasingly expanding the traditional borders of Muslim countries into western economies, notably the United Kingdom (Errico & Farahbaksh, 1998). As at 2010, it was estimated that there were approximately 200 Islamic banks operating in nearly 63 countries, engaging USD 246 trillion worth of assets. The Bankers' 2011 survey of financial institutions practicing Islamic finance further reveals that Shari'ah-compliant assets rose by 21.45% from USD 895 billion in 2010 to USD 1,087 billion in 2011 and expected to rise to USD 1,600 billion by 2012 (Maali & Napier, 2010; Mukhlisin, Hudaib, & Azid, 2015). In total both Islamic bank and finance industry recorded their development at USD 1,357 trillion at the end of 2011 (GIFR, 2012).

Theoretical Perspective

Perera and Baydoun (2007) assert that there are several scholars who put attempts to underline theoretical perspective in the context of international accounting such as Schweikart (1985) who suggests contingency theory, Adhikari and Tondkar (1992) who explains environmental factors, Gray (1988) who is known

with his cultural influence, Doupnik and Salter (1995) who combine Gray and other ideas, and Nobes (1998) who develops model from Doupnik and Salter. As classification of accounting systems is not sufficient to explain why a country respond or does not respond to IFRS adoption, Perera and Baydoun (2007) extended their research by adopting taxonomy proposed by Gernon & Wallace in examining the environmental factors in Indonesia. On the other hand, Ibn Khaldun model has a comprehensive explanation on development of a country towards a civilized society that in the context of international accounting development, the model could explain not only environment but also the function of each variable. Furthermore, Alatas (2006) argues from epistemological point of view, western thinker behaved different attitude that was not applied to non-western social thinker.

Alatas (2006); Chapra (2008) propose to refer to one Muslim great scholar, Ibn Khaldun (1332-1406 CE) with his theory of development and the decline, who died 600 years ago but his ideas have endured. Dhaouadi (1990) asserts that Ibn Khaldun's social thought has been ignored by sociologists in the West, although Yves Lacoste and Arnold Toynbee considered it to be the greatest work of its kind. Joseph Spengler wrote an article about Ibn Khaldun and he concluded that "the knowledge of economic behaviour in some circles was very great indeed, and one must turn to the writings of those with access to this knowledge and experience if one would know the actual state of Muslim economic knowledge" (Ghazanfar & Islahi, 1990). As Ibn Khaldun's work is 'explaining how and why things are as they are' (Dhaouadi, 1990), according to characteristics of alternative school of thought proposed by Laughlin (1995), Ibn Khaldun's school of thought can be grouped as critical theory that is placed as low level of theoretical nature of methods and medium level of emphasis given to critique of status quo and need for change.

Ibn Khaldun is well known with one of his books, *Al-Muqadimmah* (The Introduction), that suggests that understanding a history requires understanding the sociology or condition of the human community (Enan, 1941). Chapra, 2008/1429H:17Chapra (2008) condensed Ibn Khaldun's model on civilization as follows: 1. The strength of the sovereign does not materialize except through the implementation of the Shari'ah; 2. The Shari'ah cannot be implemented except by the sovereign; 3. The sovereign cannot gain strength except through the people; 4. The people cannot be sustained except by the wealth; 5. Wealth cannot be acquired except through development; 6. Development cannot be attained except through justice; 7. Justice is the creation by which God will evaluate mankind; 8. The sovereign is charged with the responsibility of actualizing justice.

Chapra adds that from these eight wise principles, the model links to socio economic and political variables, including the sovereign/political authority such as

government (G), the beliefs and rules of behaviour/Shari'ah (S), the people/nation (N), the wealth (W), the development (g), and the justice (j) that influence one another. For the interest of this research, it adopts the classification proposed by Ibn Khaldun as presented by Chapra above in examining the accounting history development in the United Kingdom and Indonesia in identifying determinants that may explain how these countries react to Islamic based accounting standards adoption. The short form of G, S, N, W, g, and j will be used throughout the analysis.

Method

A qualitative methodology using an exploratory approach is employed in this study. Social exploratory research seeks to find out how people get along in the setting under question, what meanings they give to their actions, and what issues concern them. The goal is to learn 'what is going on here?' and to investigate social phenomena without explicit expectations" (Schutt, 2001). This research adopts qualitative-narrative method for exploring the available texts and literatures (Easterby-Smith, Thorpe, & Jackson, 2008; Newman & Benz, 1998). Narrative study refers to the underlying materials of the story, including events, actors, time, and place (Bal, 1997).

Indonesia and United Kingdom are chosen as samples of this study due to their outstanding performance in Islamic finance industry in the past few years. Edbiz Consulting estimates that the global Islamic financial services stood at USD 2.14 trillion at the end of 2015, increased from USD 1.9 trillion in 2014 and USD 1.8 trillion in 2013 (GIFR, 2015). Indonesia recorded USD 5 trillion in 2010 increased to USD 9 trillion in 2011 while UK documented USD 27 trillion in 2010 and improved to USD 33 trillion in 2011. With regard to Islamic Finance Country Index, Indonesia was on the 4th ranking in 2011 and moved down to 7th ranking in 2012; United Kingdom was on the 15th ranking in 2011 and moved up to 11th ranking in 2012, out of 42 rankings (GIFR, 2012). The index is formulated based on total Muslim population, number of Islamic financial institutions, number of Islamic banks, size of Islamic financial assets, size of Sukuk, regulatory and legal infrastructure, central Shari'ah Supervisory Board, and education and culture (GIFR, 2012). As the only a developed country in the list with insignificant Muslim population and little Islamic influence, it is commendable to compare with Indonesia, as the largest Muslim population country.

The method starts from collecting texts and literatures on accounting history in the United Kingdom and Indonesia from 1800s time to the current stage of development. It also captures the accounting standards development for Islamic financial institutions in both countries. Determinants are categorized based on the past literatures that are mainly derived from international accounting journal and

text-books. Eight main papers are carefully selected from international accounting journals that recorded only those with more than 10 citations (see Appendix 1). These literatures suggest various determinants on accounting standards adoption both in the UK and Indonesia. Common suggestions that may represent condition in the UK and Indonesia are concluded and used in the analysis. The perspective of Ibn Khaldun as presented in the earlier section is to explain how these countries react to Islamic based accounting standards adoption and whether the suggested determinants would apply.

Result and Discussion

Development of Accounting Standards in Islamic Civilization

Most of accounting historians agreed that accounting as a practice grew due to the existence partnership in business transactions (Bedford & Ziegler, 1975). On the other hand, partnerships exist due to normal rapid growth of the business and cannot be claimed as the beginning of accounting. In history, the people of Babylon, ancient Egypt, Greek and Roman, had initiated, practiced and developed a kind of financial transaction recording system (Edwards, 1960). This was practiced and also known as *maskud dafatir* (bookkeeping) in Islamic history, with the purpose to record revenue and expenditure of the government. Islamic world had also used a book keeping system referred as *al-Qaidul Muzdawaj*, 800 years before the Italian/European renaissance In which time Luca Pacioli (1445-1517) lived and later declared as “father of accounting” (Weis & Tinius, 1991). In addition, when Islamic state was established in 622, the zakat system was introduced which then required a formal body, an office where accounts were held called *al-Diwan* and it was further developed during *Addawlatul Abbasyiah* (Abbaside Chaliphate during the year 750-847). The term “book keeping” was later known as *muhasabah* (accounting) in the Islamic civilization up to its decline in 1924 with the fall of Ottoman Empire. From chronological history, Zaid (2000) argues that Muslim and Italian traders would have influenced the development of accounting as what we see today. With regard to the decline of Muslim’s society, it was not the first time in the human’s history, as Muslims believe that there are 25 prophets as messengers of Allah who were assigned to correct the world. As the Prophet Muhammad is declared as the last prophet, there is no more a new prophet that will lead the world and therefore it is the duty of all socio economic and political structures in a country or society such as the government (G) to uphold justice (j) and improve the society (N) in terms of their prosperity/wealth (W) and socio economic development (g) which is argued by Ibn Khaldun that this is interlinked with other crucial element i.e. the way of life or Shari’ah (S).

The term *muhasabah* is still being used in the Islamic society today, although such Islamic government is no longer in existence. *Muhasabah* has at least five

meanings according to (Hayashi, 1989); *Yabsaba* which means to count, to compute, to measure; it also means to record and to continuously count somebody's deeds; *Hasaba* means responsibility, to be neutral; *Tahasaba* means to keep, try to obtain, expect reward in the hereafter; and lastly to become attention or accountable. Haniffa and Hudaib (2002) highlight two objectives of Islamic based accounting standards that include: i) To demonstrate accountability of companies not only to God but also to the community, and ii) To increase transparency of business activities by providing relevant information in conformance to the spiritual needs of Muslim decision makers. In line with the call to promote justice (j) that is according to Ibn Khaldun is so crucial element in the society development, Haniffa and Hudaib (2007) further suggest an Islamic perspective of accounting in order to seek economic justice through its formulised procedures, routines, objective measurement, control and reporting in accordance with Shari'ah principles. This important element must be imbued not only in governmental policies and procedures but in the sector like accounting as well towards refining the wealth (W) of the nation in the economic development (g).

This refinement of definition and purpose have strengthened the existence of accounting and auditing standard for Islamic financial institution, as released internationally by Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI). AAOIFI, based in Bahrain, released its first standard on Islamic financial reporting standard in 1991. To date, AAOIFI has issued a total of 86 standards for international Islamic finance industry, covering areas of accounting, auditing, ethics, governance, and Shari'ah. As an international governing body, AAOIFI is supported by over 200 institutional members from over 45 countries, including central banks/regulatory authorities, financial institutions, accounting and auditing firms, as well as law firms (AAOIFI, 2010). AAOIFI asserts that all Islamic financial institutions must adhere with the several objectives of financial accounting, for instance, objective number 3.1.1; to determine rights and obligations of all interested parties resulting from incomplete transactions in accordance with Islamic principles and its concepts of fairness, clarity and ethical compliance. This is according to Ibn Khaldun, fits to role of the development (g) and justice (j), which must be acted by the accountants, and the rest of stakeholders (N) to apply Islamic law (S) even in financial activities. Perera and Baydoun in this case is right that states Islam influences every part of a Moslem's life, including business activities by showing the teaching of good behaviour in conducting business.

Development of Accounting Standards for Islamic Financial Institution in the United Kingdom

For all periods up to and including the five months period ended 31 December 2004, all Islamic financial institutions in the UK prepared its financial statements in

accordance with UK Generally Accepted Accounting Principles (UK GAAP). From 1 January 2005, all financial institutions elected to prepare its financial statements in accordance with the International Financial Reporting Standards as adopted by the European Union (EU) countries based on regulation number 1606/2002 and effective for the reporting year ended 31 December 2005 (IBOB, 2012). This reflects the abiding company law that requires the directors to prepare financial statements for each financial year. Under the current law, IFIs directors have elected to prepare financial statements in accordance with IFRS, which has been adopted by the EU, hence applicable and mandatory to financial institutions in the United Kingdom. Islamic Bank of Britain as the first Islamic financial institution in the country experienced this IFRS implementation. It was declared that the transition from UK GAAP to IFRS in August 2004 has had no material impact upon the figures previously reported in the financial statements. Consequently, no material adjustments were required of the figures previously reported under UK GAAP to those now reported under IFRS, and, hence, reconciliations of the UK GAAP and IFRS figures are not provided in financial statements of UK Islamic financial institutions (IBOB, 2012). From 2005 onwards the presentation of financial reporting of IBOB has been following the IFRS standards. For instance, in its annual report, the financial report section starts from Statement of comprehensive income, then followed by Statement of financial position, Statement of changes in equity, Statement of cash flow, and Notes to the financial statement.

As the United Kingdom from the beginning of the IFIs establishment was mainly with the purpose to serve business objective per se i.e. to enhance economic development (g), therefore there was no inclination towards the establishment of Islamic based accounting standards to govern the IFIs. Ibn Khaldun considers development (g) is an element that must be interconnected with other elements to ensure its continuity or “avoid destruction of civilization” and free from unfairness to the rest of stakeholders of the IFIs which serve the same level of justice (j). This equal justice seems disappears in the context of capitalism as Marx states that capitalism is founded upon a class division between proletariat, or working class, on the one hand, and bourgeoisie, or capitalist class, on the other (Giddens, 1973). These classes are in conflict with regards to distribution of production output; the labours must work and produce profit that exceeds their wages while the capitalist enjoy the bigger portion. In the context of capitalism, although the United Kingdom has been declared as capitalist country, but Giddens (1973) still questions “is it still capitalist society?” Promoting justice is belong to every human’s right thus for a country with whatever type they adopt either socialist or capitalist, there is no rejection towards it. Therefore, reporting activities of IFIs according to Islamic based accounting standards is a part of justice and here the case is closed.

Development of Accounting Standards for Islamic Financial Institutions in Indonesia

In Indonesia, the issuance of accounting standard is not through enactment of a company law as in the UK. When Bank of Muamalat Indonesia was established in 1992, there was no meaningful change in the regulation? The bank was legalized and established using an existing Law. No. 7/1992 on Banking; this later on replaced, amended and ratified as Law No.10/1998 on Banking (Bank of Indonesia, 2012). As such, the accounting standard adopted was an existing one, which is Accounting Standard for Banking (PSAK 31) that was applied for all commercial banking operations. Indeed, the development of accounting standards for Islamic financial institutions in Indonesia only started in 2002, with the issuance of Statement of Accounting Standard No. 59 (PSAK 59), or known as Islamic Banking Accounting Standard. PSAK 59 was released by IAI on 1 July 2002 and taken into effect starting 1 January 2003, with 5 years of implementation period or up to accounting year ended 31 December 2007.

The reference of the standard was derived from the standards released by AAOIFI with some modifications to suit local context and needs. In 2008, PSAK 59 was replaced by new PSAKs known as Statement of Accounting Standards for Islamic Business Entity. The new set of standards consists of PSAK 101, 102, 103, 104, 105, 106 and 107 that were approved by Islamic Financial Accounting Standard Board (*DSAS*). These standards, which were pronounced and taken into effect from 1 January 2008, cover not only Islamic banking operations but also other entities that are categorized as Islamic business entities. PSAK 101 sets out a standard for financial statement presentation; whereby PSAK 102 specifically refers to Accounting for Murabahah; followed by PSAK 103 (Accounting for Salam), PSAK 104 (Accounting for Istishna), PSAK 105 (Accounting for Mudharabah), PSAK 106 (Accounting for Musyarakah), and PSAK 107 (Accounting for Ijarah). It was then followed with other development such as the release of PSAK 108 for Islamic Insurance, PSAK 109 for Zakat and PSAK 110 for Sukuk.

Undoubtedly, the development of accounting that is instilled with Islamic values nowadays have been flourishing as Napier (2009) states the influence of Islam in accounting process in countries where Islam becomes the religion of the majority:

“The term “Islamic accounting” can also have a temporal and spatial implication. It can be a form of shorthand meaning “accounting in parts of the world where Islam is the majority religion during periods when Islam has been dominant”. Geographically, “Islamic accounting” would cover North Africa and a large part of sub-Saharan Africa, the Middle East, the territories of the Ottoman Empire, the Indian sub-continent, much of South-East Asia and Indonesia, as well as large parts of the former Soviet Union.”

Napier in this context is right that the objective of establishing IFIs in Indonesia was for the purpose proposing a better alternative for the Muslims in Indonesia and continued to the legitimacy initiative of using Islamic based accounting standards. After the independence, Indonesian started to live freely which is in the accounting development context, the Indonesian accountants succeeded their own accounting ideology and movement through the Institute of Indonesian Accountants that has never been affiliated with the accounting institutes set up by Dutch as ex-colonial. This is then continued with Islamic influences by more practising Muslims (S) in accounting standard setting following the establishment of IFIs in Indonesia. The idea of setting special board in IAI in charge of Islamic based accounting standards (G) did not appear to face any meaningful challenges perhaps this is due to understanding of Islam that must be comprehended with the establishment of IFIs in Indonesia. This is supported by Ibn Khaldun model, which explains that justice (j) to promote social solidarity (all levels of stakeholders) by ensuring fulfilment of mutual obligations and an equitable sharing of the fruits of the development. Although Indonesia has enjoyed this privilege of promoting justice (j) in a way of adopting Islamic based accounting adoption that provides more disclosures but this element must be ensured at all times with the presence of other elements as suggested by Ibn Khaldun. This is still lacking and has become the biggest challenge faced by the Muslim nations in the developing countries coupled with the ignorance or less consistent adherence of Islamic practices according to Shari'ah (S).

Determinants in Implementation of Accounting Standards for Islamic Financial Institutions

The above literatures and understanding the context of development of accounting standards for IFIs in the UK reach a conclusion that the most important determinant that influence international accounting standards adoption rests at the institutional setting of companies. As the nature of business environment in the UK is highly regulated market, therefore the institutional setting relates to other structures to follow. As Financial Services Authority, 2007 in its special publication on Islamic Finance in the UK; Regulation and Challenges, states that:

The UK financial services industry has a proven record of developing and delivering new products and a large pool of legal, accounting and financial engineering skills on which to draw.

Much has changed since then but there is no evidence of rigorous support from the government, especially on the implementation of accounting standards for the Islamic financial institutions in the United Kingdom. Although socio economic and political structures have been established in this much developed country, but

implementation of full element of Shari'ah (S) is absent in activities of the society although promoting justice exists but it is interpreted in different way as the country shows no evidence from adopting any religious belief. Hence, Islamic financial institutions in the United Kingdom are treated similarly with their conventional counterparts in terms of adopting accounting standards; is to follow UK GAAP before 2005 and to follow IFRS after 2005 (IBOB, 2012). Apart from following IFRS, there is no evidence of accounting standards for Islamic financial institutions exist in the history of accounting standard development in the United Kingdom. Although Islamic banks by virtue of their nature that must adhere with Islamic values among others to show their commitment to the society by offering and managing Zakat, charity and Qardul Hassan (Adnan & Furywardhana, 2009; Haniffa & Hudaib, 2007; Ibrahim & Yaya, 2005) but Islamic banks in the United Kingdom express a clause that the Bank does not pay zakat on behalf of its shareholders and it is the sole responsibility of the individual, however the banks calculate and disclose the amount of Zakat due per share (BLME, 2012; IBOB, 2012).

The literatures share common understanding that Indonesia is more likely to adopt international accounting standards due to its accounting needs that are derived from the economic needs. This is in line with Rosser (2009) who argues on major cause of accounting reform in Indonesia from mid-1960's to 1998 that was due to structural pressures generated by periodic economic crises. When the World Bank and IMF came to intervene the Indonesian financial system during the crisis that was the time they required the accounting reform. Rosser (2009) asserts that the influence over the accounting policy shifted away from the politico-bureaucrats and their corporate clients towards liberal technocrats within the government. The economic crisis in 1997/1998 presents the evidence that IFIs were not sensitive to the economic downturn (Dewi & Prasetyono, 2011) thus more rigorous efforts have been taken to further strengthen the development of IFIs and including the governing procedure i.e. introduction of Indonesian Islamic based accounting standards in 2002. As it goes along, Bank Indonesia shows its support to this market response towards IFIs particularly Islamic banks by producing a blueprint known as Blueprint of Islamic Banking Development in Indonesia 2002 that states full support to further development of Islamic banking. As the Islamic finance industry in Indonesia is progressing, the accounting standards are adjusted to the industry needs from the adoption of PSAK 31 that was applied for all commercial banking operations in 1992, to the issuance of PSAK 59 for Islamic Banks in 2002 and to the latest development, that is the release of PSAK 101 to PSAK 107 for Islamic business entities. Moreover, more disclosures are adopted by the IFIs in Indonesia (see BSM), such as Statement of sources and uses of zakat and Statement of sources and uses of benevolent

loan, which are absent in the context of IFIs in Indonesia (see IBOB). Mukhlisin et al. (2015) assert that accounting discipline works parallel with Indonesian government policy evidenced by compliance disclosure of PSAK 101 to PSAK 107 in all Islamic banks' annual reports. The government i.e. Bank Indonesia endorses accounting standards to be used by all Islamic banks that is first proposed by Institute of Indonesian Accountants and approved by the National Shariah Board – Indonesian Council of Ulama.

The role of government i.e. Bank Indonesia is online with Ibn Khaldun model with the purpose to ensure development (g) of the nation (N) by promoting justice (j). In this context, Al-Qur'an 16:10 also mentions the role of government in the economy:

“Indeed, Allah orders justice and good conduct and giving to relatives and forbids immorality and bad conduct and oppression. He admonishes you that perhaps you will be reminded.”

God clearly states His command to be just, i.e., fair and moderate, and that He encourages kindness and good treatment (Tafsir, 2012). Justice and good conduct are not only applied in individual life but also in the socio-economic circle. Justice in the economic field refers among others; all the avenues of economic exploitation must not be permitted and an economic system that will ensure justice and fair play between individuals and institutions and even countries.

Conclusion

Accounting standards development in the United Kingdom and Indonesia experienced different path and history. Legal foundation as well as political and social differences of the two countries exhibits unique development and results. From the narrative literatures and understanding on the Ibn Khaldun perspective, it can be concluded that determinants in the implementation of accounting standards for Islamic financial institutions are mainly contributed by institutional setting as the case of the United Kingdom and accounting needs for the context of Indonesia. The start of Islamic finance development in the United Kingdom was not evidenced driven by the Muslim population in the country (being a minority of 3 per cent in total). Instead, according to Financial Services Authority, it was mainly due to market-based economy where London financial markets activity highlighted the existence of Shari'ah-compliant transactions. The direction for the IFIs comes from Financial Services Authority and Accounting Standard Board where Islamic message is not considered as important values to be yet instilled in the accounting standard process. While Indonesia that was witnessed with the moral duty of the Muslims to develop Islamic based financial institutions, the factor in adopting the Islamic based

accounting standards is due to its accounting needs that the government believes it is to govern the IFIs to be more prosperous in the future. Therefore, in Indonesia, there is a strong enforcement from Bank Indonesia together with The Institute of Indonesian Accountants and National Shariah Board – Indonesian Council of Ulama on such implementation. The existence of Islamic financial institutions should be guarded by reliable accounting standards so they will be able to learn and strive to create value and bring benefits to every market they are operating in the world.

This study is far from perfect; there may be some limitations in the context of interpreting Ibn Khaldun's model on the development of society and the samples of this study are taking two different countries with different background and context. It is then recommended that other researchers may take samples of similar countries for the study i.e. GCC countries to see how this research would contribute both to the knowledge and practice.

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