

Accounting for Islamic Social Enterprises: An Islamic Perspective

Mohammad Rokibul Kabir¹ Nazmus Sakib^{2*}

1. Associate Professor, Department of Business Administration, International Islamic University Chittagong, Bangladesh.
2. Masters of Business Administration, Department of Business Administration, International Islamic University Chittagong, Bangladesh.

Abstract

Islam is a complete code of life which emphasizes on the social justice and welfare. As the traditional capitalist society failed to ensure an equitable society, the urgency of social enterprises cannot be overlooked. Again the proper record keeping of transactions of any organization is a must. It is given priority in Islam and its importance can be understood by several verses of the holy Quran as well from different hadiths. Again, the traditional accounting has some features conflicting with the Islamic principles of justice, equality and truthfulness. Thus, the study is an effort to propose an accounting framework for social enterprises. To develop an accounting structure for social enterprises, the existing accounting pattern of social enterprises has been critically evaluated under the light of Islamic Sharia'h and the conflicting ones have been replaced with the right ones from Islamic perspective.

Keywords: Social Justice, Social Enterprises, Islamic Accounting, Traditional Accounting

1. Introduction

The framework of the Islamic economy is based on a social consciousness that forbids isolated wealth creation. Some of the salient principles of Islamic society are unity, justice, and social and economic equality. Although, Islam permits, even encourages, a person to enrich oneself, it nevertheless places great emphasis on the social responsibilities due from entrepreneurs. Hence, the essence of developing social enterprises has got pace in recent years. Like all other ventures, a social enterprises needs to keep record in a proper way as it is mentioned in the holy Qur'an, "...Let a scribe write it down in justice between you" (AQ- 2:282). But Western mainstream accounting has been criticized by many scholars as it is inappropriate to be used to achieve Islamic economic objectives (Hameed, 2000; Adnan and Gaffikin, 1997; and Triyuwono; 2000). Meanwhile among the Western scholars, mainstream accounting has also been attacked, due to among other things; its partisanship to capital providers, its contribution to environmental degradation (Gray, 1994) and legitimating unemployment/downsizing practices (Berry et al, 1985). Even though the idea of those Western scholars' critics might not derive from the Qur'an, the substance of their argument is in line with the concern of Islam on one's behavior towards other people and the natural environment.

Various theories of traditional accounting such as legitimacy theory and stakeholder theory have been suggested by different scholars to explain the additional information reported by different organizations in the recent years (Gray et al. 1996). Legitimacy theory suggests that the corporation is a social institution needs legitimacy to operate in society. As such it owes social responsibilities to the public in addition to its shareholders and creditors. Stakeholder theory on the other hand, states that the corporations have to manage and balance the interests of various groups of its stakeholders. To ward off further reporting legislation which would result from public pressure on government, the corporations manages the public stakeholder by providing these additional information to show how responsible the corporation is to society.

The above efforts mainly focus accounting statements in addition to the traditional financial measures of economic activity. However, the financial bottom-line i.e. profits continue to drive the main feature and focus of accounting. Thus, an alternative approach is needed to replace the profit motive of business by a social welfare attitude. Establishment of social enterprises might be the solution of this problem which, as well, requires a different sets of accounting practice instead of providing additional value added statement. Hence, the study aims at developing Islamic accounting for social enterprises.

2. Objectives of the Study

The main purpose of the study is to propose accounting systems for social enterprises from the Islamic point of view to materialize which the following specific objectives have been identified.

- i) To explore the status of accounting and recoding in Islam.
- ii) To identify the conflicts of traditional accounting with Islamic principles.
- iii) To propose model of financial statement for Social Enterprises from Islamic point of view.

3. Methodology of the Study

The study is mainly based on extensive survey of literatures. Recording and accounting related verses of the holy Qur'an have been explored to justify the necessity of a separate set of accounting for a social enterprise. Again,

the existing accounting assumptions and principles have been critically evaluated under the light of Islamic principles to find the deviations. Finally the limiting factors of the conventional accounting have been eliminated through proposed financial statements.

4. The Status of Recording Transactions in Islam

Allah (Swt) directs us to record any transactions made for accurate dealings. Allah says in the Glorious Qur'an, "O you who have believed, when you contract a debt for a specified term, write it down. And let a scribe write [it] between you in justice. Let no scribe refuse to write as Allah has taught him. So let him write and let the one who has the obligation dictate. And let him fear Allah, his Lord, and not leave anything out of it.~~" [AQ - 2:282]

In the next verse, Allah says that we should keep a mortgage in case of loan disbursement while we are in journey, if there is no way to write it down.

"And if you are on a journey and cannot find a scribe, then a security deposit [should be] taken... ~" [AQ - 2:283]

It is clear from the above verse that it is highly recommended for us to keep a written document of all kind of transactions.

Clarifying the terms and conditions of a transaction is also specifically ordered by Prophet PBUH. The following hadeeth bear testimony to that.

Ibn 'Abbas (May Allah be pleased with them) reported that when Allah's Prophet (ﷺ) came to Medina, they were paying one and two years in advance for fruits, so he said: Those who pay in advance for anything must do so for a specified weight and for a definite time. [Sahih Muslim: 1604]

Hence, there is no doubt that a proper recording and reporting of financial transactions has been given utmost importance in Islam. But traditional accounting practices have some severe limitations and contradictions with Islamic Shariah and Principles which created a necessity for a separate set of accounts within the boundaries

4.1 Recording with Justice

It is a must for both the parties to maintain truthfulness and justice throughout the transaction. Any kind of deception or cheating is strictly prohibited by Allah. The need for recording the transactions and auditing as well is understood by the following verse from the Glorious Qur'an,

"Indeed, Allah commands you to render trusts to whom they are due and when you judge between people to judge with justice. Excellent is that which Allah instructs you. Indeed, Allah is ever Hearing and Seeing." [AQ - 4:58]

Therefore, the scribe is not allowed to cheat any party of the contract and is to only record what the parties of the contract agreed to, without any addition or deletion.

The importance is highly understood from the prophetic traditions as well:

Narrated Abu Hurairah: "The Messenger of Allah (ﷺ) prohibited the uncertain sale, and the Hasah (throwing pebbles) sale." [Sunan Tirmidi 1230: Authentic]

Abdullah b. Dinar narrated that he heard Ibn 'Umar (Allah be pleased with them) saying: A man mentioned to the Messenger of Allah (ﷺ) that he was deceived in a business transaction, whereupon Allah's Messenger (ﷺ) said: When you enter into a transaction, say: There should be no attempt to deceive. [Sahih Muslim: 1533]

4.2 Warning for Deception and False Testimony

The need for truthfulness in business transactions is beyond description. In the current economical world, we see that the backbone of economic stability depends highly on honesty. This is where accounting plays a huge role. The truthfulness in accounting is of great importance to ensure the economic honesty. Moreover, auditing bodies for strict monitoring whether the accounts are maintained according to true transactions are really important.

Islam puts a great deal of effort in abstaining the transacting parties from false entry and deception. The Prophet (PBUH) explicitly warned us to keep ourselves away from any kind of false testimony whether it is verbal or written. It is very crucial for an accountant or scribe to be truthful and just while being witness to a transaction.

Ubaidullah b. Abu Bakr said: I heard Anas b. Malik saying: The Messenger of Allah (ﷺ) talked about the major sins, or he was asked about the major sins. Upon this he observed: Associating anyone with Allah, killing of a person, disobedience to parents. He (the Prophet further) said: Should I not inform you about the gravest of the major sins, and (in this connection) observed: False utterance or false testimony. [Sahih Muslim: 88]

4.3 The Position of Accountability in Islam

What differentiates Islamic finance and accounting system from the conventional one, is that the level of ethical consciousness. In the conventional financial system, one is merely subject to accountability for his role in accounting records in practical. In Islam, it is obligatory for everybody to be accountable to himself. As for not complying with honesty and truthfulness regarding any type of act of a person, whether it is personal action or any job he is carrying out, he is to be taken into serious custody in front of the Mighty Creator in the day of final Account.

Allah (SwT) mentions this several times in the Glorious Qur'an that everyone will be 'Accountable' for what he did in his life time. Every single deed of his will be audited at the day of reckoning. Allah says in the Qur'an, *"So whoever does an atom's weight of good will see it. And whoever does an atom's weight of evil will see it."* [AQ - 99: 7-8]

And Allah is warning us of a day when all of our Accounts will be brought before us and HE will be the Accountant and Auditor that day. Allah says in the Qur'an,

"To Allah belongs whatever is in the heavens and whatever is in the earth. Whether you show what is within yourselves or conceal it, Allah will bring you to account for it." [AQ - 2:284]
"[It will be said], "Read your record. Sufficient is yourself against you this Day as accountant. [AQ - 17:14]"
"Or do they think that We hear not their secrets and their private conversations? Yes, [We do], and our messengers (The Angels) are with them recording." [AQ - 43:80]

So, it is evident from the above discussion that, fair accounting and auditing is an innate part of Islamic ideology and one cannot simply just get over with neglecting his/her prescribed duties whether he is taking part in a transaction or being a witness to it through several ways. One is obligated to maintain a crystal clear account of any kind of transactions he is involved in, in order to save himself from the eternal punishment awaiting for him in the life hereafter. So, it is obvious that Islam has emphasized on fair accounting system from several points of view and 'Accounting' is indeed a prescribed and promoted subject in Islam.

It is worth mentioning the statement of Umar Ibnul Khattab (R), the second khalifa of the Khulafa e Rasheda, regarding auditing ourselves. He said, "Audit yourself, before being audited (at the day of judgment)".

5. Comparative View of Traditional Accounting and Islamic Accounting

5.1 Accounting Assumptions

5.1.1 Economic Entity Assumption

The accountant keeps all of the business transactions of a sole proprietorship separate from the business owner's personal transactions. For legal purposes, a sole proprietorship and its owner are considered to be one entity, but for accounting purposes they are considered to be two separate entities.

Islam does not contradict with this assumption. The proof of this can be driven from the concept of Waqf in Islam. In case of Waqf financing, 'Party A' donates a property/fund to 'Party B'. After the donation, neither 'Party A' nor 'Party B' is the owner of the property/fund. Rather, the property/fund itself is considered a separate juristic person. The Waqf can become owner of separate property, it can take loan, it can lease itself etc.

Another concept is Baitul Maal. It acts as a separate entity with no legal involvement of the people who contributes in it. A third example may be the leftover properties of a person who becomes a debtor and dies a debtor. His leftover properties act in the same way.

5.1.2 Monetary Unit Assumption

The monetary unit assumption assumes that all business transactions and relationships can be expressed in terms of money or monetary units. Money is the common denominator in all economic activity and financial transactions.

This assumption is not seen contradictory to Islamic accounting system, but can be seen as a drawback. The use of paper money as a form of unit has always been a drawback from Islamic point of view. By this assumption, the paper money is valued the same for different period, despite the inflationary effect. For example, the 1 dollar of 1990 and the 1 dollar of 2015 can be seen of equal value while recording. Although the value is not the same in real. Islamic financial system has encouraged using Gold and Silver as means of transaction rather than paper money. This is the safest way to chose as it hardly has any inflationary effect.

5.1.3 The Going Concern Concept

The going concern concept or going concern assumption states that businesses should be treated as if they will continue to operate indefinitely or at least long enough to accomplish their objectives. In other words, the going concern concept assumes that businesses will have a long life and not close or be sold in the immediate future.

Companies that are expected to continue are said to be a going concern. Companies that are expected to close in the near future are not a going concern.

Zaid (1995) claims that Islam recognizes the concept because continuity is one of the bases on which Muslim life is built. He further argues that Islam emphasizes the continuity of business activities because they are the source of Zakah, which should be paid every year.

Adnan and Gaffikin (1997) reject it on the basis that accepting this concept acknowledges the acceptance that there is something other than Allah that will live continuously or indefinitely – in this case the firm – which is not acceptable in Islam. This view is more correct according as far as Islamic perspective is concerned. Nothing can be deemed as continuing for ‘indefinitely’ in the light of Islam. It can be suggested that, an Islamic organization would try to rebuild this principle as ‘Organization will continue as long as Allah wishes it to continue’.

However, if the principle is understood the way it is stated by Kieso, Weygandt and Warfield as “Although the accountants do not believe that business firms will last indefinitely, they do expect them to last long enough to fulfill their objectives and commitments”, then it may be stated that it doesn’t contradict Islamic. The Sharikah business of Islamic finance mode is based on similar principle where it is assumed that the business will last as long as the objectives are fulfilled.

5.1.4. Time Period Assumption

This accounting principle assumes that it is possible to report the complex and ongoing activities of a business in relatively short, distinct time intervals.

This concept is not contradictory to Islam. As different type of calculations in Islam is done periodically/lunar yearly. Moreover, it becomes easy for an organization to calculate Zakah, if it reports its operation periodically.

5.2. Accounting Principles

5.2.1 Objectivity Principle

The objectivity principle states that accounting information and financial reporting should be independent and supported with unbiased evidence. This means that accounting information must be based on research and facts, not merely a preparer's opinion. The objectivity principle is aimed at making financial statements more relevant and reliable.

This principle is highly supported by Islam. Islam emphasis greatly on being honest and truthful with regard to his duties and obligations. Allaah says in the Qur’an “O you who believe! Be afraid of Allaah, and be with those who are true (in word and deeds).” [al-Tawbah 9:119]

Ibn Katheer (may Allaah have mercy on him) said (2/414): “It means: be truthful and adhere to truthfulness, and you will be among its people and will be saved from calamity, and this will make a way out for you from your problems.

Allah says,

“... if they had been true to Allaah, it would have been better for them.” [Muhammad 47:21]

‘Abd-Allaah ibn Mas’ood (may Allaah be pleased with him) said: “The Messenger of Allaah (peace and blessings of Allaah be upon him) said: ‘You must be truthful, for truthfulness leads to righteousness and righteousness leads to Paradise. A man will keep speaking the truth and striving to speak the truth until he will be recorded with Allaah as a *siddeeq* (speaker of the truth). Beware of telling lies, for lying leads to immorality and immorality leads to Hellfire. A man will keep telling lies and striving to tell lies until he is recorded with Allaah as a liar.’” (Reported by Muslim, 4721)

5.2.2 Revenue Recognition Principle

The revenue recognition principle states that revenue should be recognized and recorded when it is realized or realizable and when it is earned. In other words, companies shouldn't wait until revenue is actually collected to record it in their books. Revenue should be recorded when the business has earned the revenue. This is a key concept in the accrual basis of accounting because revenue can be recorded without actually being received.

This principle doesn’t contradict with Islam as it is justified to record revenue only when it is realized. Some argue that it has a drawback as it can harm the transitional investors of certain projects. Meaning, if the transitional investors withdraw their investment from a project before the complete liquidation of the investments and revenues being realized, they may lose some of their portion in profit. Though it is true to certain extent, but it is known that little amount of *Ghrra* (uncertainty) is allowed, moreover, when it is eradicating interest. On the other hand, if a business institute is investing the investment of people in more than one business and maintaining a port folio, the possibility of reduction in profit may be mitigated.

5.2.3 Matching Principle

The matching principle states that expenses should be recognized and recorded when those expenses can be matched with the revenues those expenses helped to generate.

This principle is highly in accordance with Islam as it confirms justice. As per matching principle, expense is allocated to related revenue, this ensures fair and just record for the stakeholders.

5.2.4 Consistency Principle

The consistency principle states that companies should use the same accounting treatment for similar events and transactions over time.

This principle is useful for the Islamic organizations as it makes it easy to prepare more accurate and clear financial statements. This eventually helps the organization to calculate Zakah with ease.

5.2.5 Materiality Principles

The materiality concept states that financial information is material to the financial statements if it would change the opinion or view of a reasonable person. Materiality serves as an implicit guide for the accountant in terms of what should be disclosed in the financial reports, enabling the accountant to decide what is not important or what does not matter on the basis of record-keeping cost, accuracy of financial statements and relevance to the user.

This concept is legitimate in a sense that, not every information is important to prepare the financial statements and not publishing unimportant information does not make an impact on the stakeholders to decide otherwise. There is no Shari'e objection over this concept as there is no proof addressing otherwise. However, this concept may arise some debate as the items that are perceived to be material may vary from accountant to accountant. For Islamic institutes, strict guidelines should be provided for ensuring the uniformity of materiality. AAOIFI, IFSB etc. can play important roles in this case.

5.2.6 Full Disclosure Principle

The full disclosure principle states that information that would "make a difference" to financial statement users or would be useful in decision-making should be disclosed in the financial statements. This way investors or creditors can see a total picture of the company before they choose to take any action.

This principle is in accordance with Islam as Islam doesn't allow concealing any information that have public interest. Islam has made Gheebah (Backbiting/telling the ill traits of someone in his absence) prohibited in general but made it permissible in certain cases when it is material for public such as before marriage, filing case, testifying etc. Similarly, it is also important to disclose any information that is material for public at any field.

5.2.7 Conservatism Principle

The principle of conservatism gives guidance on how to record uncertain events and estimates. The principle of conservatism states that you should always error on the most conservative side of any transaction. Most of the time this means minimizing profits by recording uncertain losses or expenses and not recording uncertain or estimated gains.

This principle clearly contradicts with Islamic view as this is deceiving. In conservatism principle, the accountant is allowed to record 'assumed' and 'uncertain' loss in order to minimize the amount of profit to be shown in financial statements. This is prohibited in Islam. Islam has made it unlawful to deceive anywhere in our day to day life. The Prophet (Pbuh) has said,

"Whoever bears arms against us is not one of us and whoever cheats us is not one of us." (Sahih Muslim: v.1)

Once the Prophet (Pbuh) passed by a pile of food in the market. He put his hand inside it and felt dampness although the surface was dry. He said; "O owner of the food, what is this?" The Man side; "It was damaged by rain, O Prophet of Allah." He said; "Why didn't you put the rain damaged food on top so that people could see it! Whoever cheats us is not one of us." (Sahih Muslim: v.1)

The accountant is trusted by the stakeholders. He is obliged to be maintain and upholding the trust of everybody. The prophet (Pbuh) marked that person as a hypocrite who breaks the trust he is given. The Prophet (Pbuh) said, "The signs of a hypocrite are three: When he speaks he lies, when he makes a promise he breaks it, and when he is given a trust he breaches it." (Sahih Bukhari: v.1)

5.2.8 Historical Cost Principle

The historical cost principle states that businesses must record and account for most assets and liabilities at their purchase or acquisition price. In other words, businesses have to record an asset on their balance sheet for the amount paid for the asset. The asset cost or price is then never adjusted for changes in the market or economy and changes due to inflation.

This principle is conflicting with Islamic view point as it violates justice. Presenting the value of something at its historical cost may mislead the stakeholders of its actual present value. The value of an item may increase or decrease over time. Yet, the value of that item is shown exactly the same over periods. It can also fall in the

category of deception which is made prohibited in Islam and it is discussed under the principle of conservatism. Moreover, this creates a serious problem while calculating Zakah, as the items on which Zakah may be calculated should project present value. Without calculating the present value of the item, the paid Zakah will not be justified and correct.

5.3 Summary of Assumptions and Principles which Supports and Contradicts Islam

On the basis of the above discussion the following summary can be made regarding the traditional accounting's acceptable and contradictory assumptions and principles with Islamic Shariah.

Accounting Assumptions/Principles	Acceptable	Contradictory	Remarks
Economic Entity Assumption	Yes	No	-
Monetary Unit Assumption	Yes	No	A drawback as Islam does not promote paper currency.
The Going Concern Concept	Yes (the authors of the study believe so)	Yes/NO (a few scholars believe Yes)	There is a deviation of opinions among the scholars. Some believe it to be in line with Islam while other things it is contradictory as only Allah is indefinite. But if the definition of the principle is understood as argued by Kieso and Kimmel, there will be no doubt about its Acceptance.
Time Period Assumption	Yes	No	-
Objectivity Principle	Yes	No	-
Revenue Recognition Principle	Yes	No	-
Matching Principle	Yes	No	-
Consistency Principle	Yes	No	-
Materiality Principles	Yes (the authors of the study believe so)	No	Though this principle does not directly contradicts with Islam, it is a limitations as the material importance is not easy to understand and it varies in opinion from person to person. To apply this principle for a Social Enterprise's accounting system, AAOIFI, IFSB etc. should play role for strict monitoring.
Full Disclosure Principle	Yes	No	-
Conservatism Principle	No	Yes	It is seemed to be a deception and hence highly contradicts with Islam
Historical Cost Principle	No	Yes	It is thought to be a big obstacle as the main principle of Islamic Financial System is based on Zakat Management and it is measured on the sale value of assets on the particular date of calculation.

From the above discussions it is seen that almost all the assumptions and principles (about 83%) have no conflict with Islamic principles except for Conservatism and Historical Cost principles which directly contradict with Islam. Again, a few assumptions and concepts like Going Concern, Money Measurement and Materiality have some limitations though these do not directly contradict with Islamic principles. Hence, in preparing financial statements for a social enterprise from the Islamic point of view, the above things must be taken under consideration.

The above two statements have been proposed on the basis existing structures of value added accounting while Islamic values and Shariah principles have been taken under consideration. Instead of traditional profit and loss statement an Income and Distribution Statement has been proposed where income from social business unit and charity are the main sources of revenue. On the other side, distribution includes payment for tax to the government, dividend to the shareholders, social welfare expenses etc. The proposed balance sheet is expected to eliminate the main drawback of traditional one where assets are recorded at historical cost. In the proposed balance sheet assets are revalued to record at market price at the balance sheet date and to adjust the excess or

deficit value an asset revaluation fund has been created. Besides, a zakat fund is proposed to ensure the proper and smooth disbursement of zakat.

6. Proposed Financial Statements

6.1 Statement of Income and Distributions

Statement of Income and Distributions		
X Social Enterprise		
For the period ended...		
Descriptions	Amount in BDT	Amount in BDT
A. Sources of Income:		
Net Revenue from Social Business Unit(s)	XXX	
Revaluation of Assets	± XXX	
Charity of Revenue Nature	XXX	
Zakat Received for Distribution	XXX	
Other Receipt	<u>XXX</u>	
Total Income		XXX
B. Distributions:		
Employees (Wages and Salaries)	XXX	
Beneficiaries (Zakat-Received for Dist. & on Own Assets)	XXX	
Government (Taxes)	XXX	
Shareholders (Dividend)	XXX	
Charities (Social welfare)	<u>XXX</u>	<u>XXX</u>
Total Distribution		<u>XXXX</u>
C. Contribution for Future Growth (A-B)		
D. Reinvestment Fund		
Contribution for Future Growth from Operating Activities	± XXX	
Revaluation of Assets	
Total Fund for Reinvestment		XXXX

7. Conclusion

Islam provides general principles for the Muslims in all areas of life. However, those principles have not been adequately incorporated in the efforts towards developing accounting for social enterprises. On the other hand, the principles of justice and benevolence as the core principles in business activities have been recently developed under the head of social enterprise. A minority of accounting academicians and practitioners have initiated a new trend in accounting from Islamic perspective. This development arises as a result of the efforts of searching for alternative accounting practices with a wider accountability for social and environmental issues. This is most likely in line with the achievement of Islamic socioeconomic objectives. Thus, this study is conducted to provide a brick in the wall of accounting for social enterprises from Islamic point of view.

6.2. Balance Sheet

Balance Sheet		
X Social Enterprise		
As on...		
Descriptions	Amount in BDT	Amount in BDT
A. Funds		
Shareholders' Fund	XXX	
Reinvestment Fund:		
Contribution for Future Growth from Operating Activities	XXX	
Revaluation of Assets	± XXX	
Zakat Fund	XXX	
Special Fund	<u>XXX</u>	
Total Fund		XXX
B. Liabilities		
i) Current Liabilities	XXX	
ii) Long-term Liabilities	<u>XXX</u>	
Total Liabilities		<u>XXX</u>
C. Total Funds and Liabilities (A+B)		XXXX
Assets		<u>.....</u>
D. Current Assets		
Cash	XXX	
Other Current Assets	<u>XXX</u>	
Total Current Assets		XXX
E. Fixed Assets:		
Fixed Assets after Revaluation (Market Price on B/S date)	<u>XXX</u>	
Total Fixed Assets		<u>XXX</u>
F. Total Assets (D+E)		XXXX
		<u>.....</u>

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