

The Role of Islamic Accounting in the Banking

Development of Islamic countries

Case: Iraqi Islamic Banks

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Abstract

Today, Islamic banks are facing great challenge to successfully serve the Islamic societies in a way to increase the economic growth significantly. The clients in Muslim countries around the world currently represent an enormous opportunity for those willing to overcome financial challenges. The two dimension of Islamic accounting where applied in this research; Islamic Cost Accounting and Amanah. The problem for search is the inability to identify the suitable accounting systems in Islamic banks operating in Iraq. Iraq is one of the Muslim countries that face a great challenge in dealing with lack of understanding to Islamic accounting system. In addition to that it is found that the functional models for utilizing Islamic products are not effective to attract clients for Islamic accounting system. The aim of this study is to examine the relationship between 'Islamic cost accounting' and 'Amanah' together on the development in banking sector in Iraq represented in economic growth. The result showed that the influence of these two variables on economic growth is significant and important to Islamic banking in Iraq. It is concluded that the Islamic

financial accounting system is very important because it encourages investment also it improves capital allocation efficiency and the allocation of funds is a matter of success of the project.

Keywords: Islamic Cost Accounting, Amanah Deposit, Economic Growth

1 Introduction

A well-developed banking industry could enhance the effectiveness of financing judgements and favouring a much better allocation of resources and as a result, speed up economic growth. Islamic accounting is an alternative accounting system to replace the conventional accounting system which aims to provide bank clients with information enabling them to invest in projects, operate businesses according to Shariah, or Islamic law (Yousef, 2004).

Islamic financial institutions around the world use different accounting methods for recording and reporting their transactions (AI-Beseli, 2007). In many cases, they simply follow conventional accounting standards applied in the countries where they operate. Some utilize an in-house standard setting process, in which the Sharia Supervisory Board advises the management about relevant accounting roles that do not violate Sharia.

A more effective banking industry is a lot more likely to direct a country's scarce assets to their most effective use. As this takes place, economic progress could get to its full potential. In addition, since the main job of banking intermediaries is to route resources to the most lucrative investments they recognize, then effective financial markets enhance the level of quality of investments which ultimately boosts economic growth (Ali, 2012).

According to the Shariah law, all business procedures that require the usage of interest are forbidden. Likewise, procedures that employ prediction of future are also forbidden. It is required that parties to business dealings would draw up agreements that are in accordance with the Shariah. Accounting in a community exists to reveal the business procedures of that community; it has very little usage otherwise. In this was the Islamic accounting system comes as the solution for many problems facing the current conventional accounting in banks all over the world

2 Problem Statement

Today, the greatest challenges to Islamic accounting and finance in Muslim countries is the lack of knowledge about Islamic accounting system and complete understanding of the approaches to do financial transactions in Islam and its basic law. The clients in Muslim countries around the world currently represent an enormous opportunity for those willing to overcome these challenges. Iraq is one of the Muslim countries that face a great challenge in dealing with lack of understanding to Islamic accounting system.

In addition to that it is found that the functional models for utilizing Islamic products are not effective to attract clients for Islamic accounting system. Ahmed (2005) assumed that in order to resolve the issue of financing diverse growth factors, it is essential to work on establishing operational models of corporate finance in general and practical equity-based instruments and establishments in particular (Yudistira, 2004; Majid and Kassim, 2010).

3 The Purpose of this study

This aim of this study is to examine the relationship between “*Islamic Cost Accounting*” and “*Economic Growth*” in developing countries, and to evaluate the relationship between “*Amanah Deposit*” and “*Economic Growth*”. To achieve this

goal, the researcher conducted a survey in Baghdad Islamic Bank in Iraq in order to test the fitness of the following theoretical model:

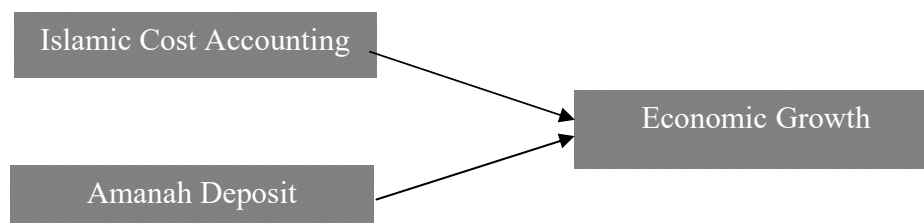


Figure-1: Theoretical model between Islamic Cost Accounting, Amanah deposit and Economic Growth

Two variables of Islamic accounting where applied in this research, they are; Islamic Cost Accounting and Amanah (Zarqa, 2003; Yudistira, 2004; Majid and Kassim, 2010).

4 The contributions of the study

This paper is not only one of its type and issue, nevertheless it is presumed that it will bring a scientific benefit to comprehending and also the results have functional significance for the fact that the model would aid in the area of Islamic accounting and economic development

The study is designed to have an effect on governmental policy, business entities, academia, as well as societies to create a much better perspective of the nation's economic future.

5 The methodology

The analysis is based on a quantitative approach, where the survey employed in this research was quantitative in Iraq. A major advantage of quantitative research is

that hypotheses can easily be directly examined centered on the data gathered. The study sample consists of employees and staff as well as managers working in Baghdad Islamic bank. The total number of collected questionnaire equal to (278) completed forms.

6 The Principles of Islamic Accounting

Islamic financial system is a kind of moral investment and moral lending. According to this principle, loans and investments are made without interest. The history of Islamic accounting started from the emergence of Islamic finance. Islam experienced its golden age in the period between 6th and 12th century (DiVanna, 2006)). Although Islamic commercial contracts were used to structure many financial products at that period, they gradually disappeared when Islamic civilization declined in the 13th century (Jamaldeen, 2012). The cooperation's sense - to assist someone in accordance with kindness and piety notions- is central principle in Islam (The Financial Express, 2009). Islamic accounting follows the same precepts.

According to Johnson (2013) the Islamic accounting can be defined as the “accounting process” which provides appropriate information (not necessarily limited to financial data) to stakeholders of an entity which will enable them to ensure that the entity is continuously operating within the bounds of the Islamic Shari’ah and delivering on its socioeconomic objectives. Islamic accounting is also a tool, which enables Muslims to evaluate their own accountabilities to Allah (in respect of inter-human/environmental transactions).

In essence, Islamic accounting systems targets to get rid of exploitation as well as to create a just society through the application of the Shari'ah to the functions of banks as well as other financial organizations. Islamic banks work on the basis of Shari'ah scholars' religious advices, to guarantee conformity with the Shari'ah.

However, its experts and customers don't need to be Muslim but they have to agree to ethical limitations underscored by Islamic beliefs (Sufian, 2007).

7 The concept of Amanah

Amanah is one of the basic products in Islamic banking. The true role of accounting starts with its scarce role of a custodian of interests of all the stakeholders. In Islam the concept of "*Amanah*" is very broad and it ensures correct valuation of transactions.

"Amanah is not only what we perceive rather everything is Amanah which is subject to someone's right and its safe custody and repayment is mandatory"(Aslam). In IIIIE' Blueprint of Islamic Financial System (1999) it is defined as, "Keeping something in trust -for safe-keeping only." Zaher and Hassan defined "*Amanah*" as: "To keep in custody other's belongings by sacrificing own wants".

8 Economic growth

A more effective banking industry is a lot more likely to direct a country's scarce assets to their most effective use. As this takes place, economic progress could get to its full potential. In addition, since the main job of banking intermediaries is to route resources to the most lucrative investments they recognize, then effective financial markets enhance the level of quality of investments which ultimately boosts economic growth (Ali, 2012). Lastly, a well-developed banking industry could enhance the effectiveness of financing judgements and favoring a much better allocation of resources and as a result, speed up economic growth (Yudistira, 2004).

Beck et al (2013) and Levine (2005) highly backed the concept that there is a positive association between financial development and economic growth. Clearly or absolutely, in all studies, we note that an effective financial system speeds up the economic advancement.

Levine et al. (2000) as well as Beck et al. (2000) examine the function of financial development in stimulating economic growth, and discover that greater banking sector development signifies increased economic growth as well as total factor productivity growth. Sulaiman (2011) utilized OECD countries data and revealed that stock market as well as financial institutions accounting systems are strongly linked with economic growth.

9 The difference between Islamic and Conventional Accounting system

Both Islamic and conventional accounting systems provide financial information about the banking products and define how that financial information is measured, recorded, and valued as well as communicated. The conventional accounting system provides good information about basic economic events and financial transactions, also measuring economic resources in terms of liabilities and assets and linking that information through financial statements for banks clients and users as well as investors, actually the conventional accounting system rely on decision-making process regarding their investments (Yueh, 2014). Islamic accounting in turns identifies socio-economic events and financial transactions which are measured in both non-financial and financial terms. In Islamic banking the financial information is used to ensure that Islamic firms of all types are compliant with Shariah and related objectives promoted by Islamic law. This is not to meaning that Islamic accounting is not focusing on the growth of money; but it is not concerned on increasing profit only but it is concerned with other dimensions of growing money (Rammal and Zurbruegg, 2007)

Islamic accounting, in many ways, is more reliable and all-inclusive. The Shariah of Islam prohibits any kind of interest which is based on income as well as usury and also using gambling, so it is obvious that Islamic accounting ensure companies or

financial institutes could not harm clients through making money or unfair of distribution of wealth, and this principle is not applied on shareholders of a specific organization but also among community in general, while the conventional accounting is achieving this in practice (Timur, 2005).

The dealings of Islamic banks are generally distinctive in nature and possess bear no comparison to conventional banking operations. This has brought up the matter of relevant accounting solutions for Islamic bank dealings (Maali 2005). The requirements for accounting principles is not very distinct from the requirements for some other type of standards, regardless of whether it be specifications for weights and measures, or specifications for apparel sizes, grades of beef, or baseball data. The purpose or objective is to assist in comparisons and therefore minimize the societal and economic costs of evaluating the options with which one is faced in helping to make rational judgements (Sufian, 2006).

10 Discussions and Results

Multiple linear regression is used to understand whether the dependent variable (Economic Growth) can be predicted based on the change of all variables at once (Islamic Cost Accounting, Amanah Deposit). A Multiple linear regression also allows the researcher to determine the overall fit (variance explained) of the model and the relative contribution of each of the independent variables to the total variance explained. In other words, the multiple linear regression will indicate how much of the variation "as a whole" in (Economic Growth) can be explained by the variance of (Islamic Cost Accounting, Amanah Deposit), also the "relative contribution" of each independent variable above in explaining the variance. The result of a multiple linear regression is achieved using the method "Enter" is indicated below:

1. Model Summary of Multiple Linear Regression

This table provides the R , R^2 , adjusted R^2 , and the standard error of the estimate, which can be used to determine how well a multiple regression model fits the data.

Table (4. 1)

The summary of the multiple regression model

Model Summary

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
|-------|-------------------|----------|-------------------|----------------------------|
| 1 | .917 ^a | .841 | .840 | .25962 |

a. Predictors: (Constant), Amanah, Islamic_cost

The "R" column represents the value of R , which it is a multiple correlation coefficient. R can be considered to be one measure of the quality of the prediction of the dependent variables; in this case (Islamic Cost Accounting, Amanah Deposit). A value of ($R = 0.917$) indicates a high level of prediction in the model.

The "R Square" column represents the R^2 value (also called the coefficient of determination), which is the proportion of variance in the dependent variable that can be explained by the independent variables (technically, it is the proportion of variation accounted for by the regression model above and beyond the mean model).

As shown in the model summary table, a value of ($R^2 = 0.841$) that the independent variables (Islamic Cost Accounting, Amanah Deposit) all together explain 84.10% of the variability of the dependent variable (Economic Growth), which is considered a significant interpretation percentage that shows a considerable level of correlation between the independent variables and Economic Growth in the model of the study. However, it is also need to interpret "Adjusted R Square" to accurately report the data. As found that the difference between Adjusted R^2 and actual R^2 is very small ($0.001 \approx 0$). Therefore, the fitness of data is considered high.

2. ANOVA output

The F-ratio in the ANOVA table (see below) tests whether the overall multiple regression model is a good fit for the data. The table shows that the independent variables statistically significantly predict the dependent variable, $F(2, 48.914) = 725.669$, giving $\text{Sig.} = .0000$ (i.e., the regression model is a very good fit of the data).

Table (4. 2): ANOVA output

| Model | Sum of Squares | df | Mean Square | F | Sig. |
|--------------|----------------|-----|-------------|---------|-------------------|
| 1 Regression | 97.827 | 2 | 48.914 | 725.669 | .000 ^b |
| Residual | 18.536 | 275 | .067 | | |
| Total | 116.363 | 277 | | | |

a. Dependent Variable: Economic_growth

b. Predictors: (Constant), Amanah, Islamic cost

3. Estimated model coefficients

The general equation of multiple linear regression equation $Y = a + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3$

Is used to predict the dependent variable (Economic Growth) from the variables (Islamic Cost Accounting, Amanah Deposit), and after replacing the data from the coefficient following table:

Table (4. 3): Coefficients of Multiple Regression

| Model | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. |
|--------------|-----------------------------|------------|---------------------------|-------|------|
| | B | Std. Error | Beta | | |
| 1 (Constant) | -.054 | .107 | | -.508 | .612 |

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|------------------------------------|------|------|---|--------|--------------------------------|
| Islamic_cost | .619 | .025 | .679 | 24.700 | .000 |
| Amanah | .386 | .029 | .370 | 13.453 | .000 |

a. Dependent Variable: Economic_growth

The final equation of multiple regression equation of the model of this study is indicated below:

$$\text{Economic Growth} = -0.054 + (0.619 * \text{Islamic Cost Accounting}) + (0.386 * \text{Amanah Deposit}) + 0.107$$

Reading the values of standardized coefficient β in the below table for each variables shows a significance level below (0.05) for each β -value (0.000, 0.000) respectively. The Sig. column indicates that all coefficients of independent variables are statistically significantly ($p\text{-value} < 0.05$).

Based on the output of multiple linear regression, it is found that (Islamic Cost Accounting, Amanah Deposit) have significant multiple linear correlation, and a strong association between each independent variable and Economic Growth is positive. In other words, the theoretical model fits the data very well. It is evident that Islamic Cost Accounting is a significant determinant of economic growth followed by Amanah as a less significant variable but yet is a strong determinant of economic growth as well.

The result from the analysis of multiple linear regression shows that Islamic Cost Accounting, Amanah Deposit affects the economic growth of Iraq. In other words, the Islamic accounting has a significant impact on the economic performance of financial institutes in Iraq.



11 Conclusion

The role played by the Islamic banking sector in the economic growth of every nation around the world is one that cannot be overstated. Today, banks serve as the backbone for the survival of the economies of every nation. However, with the recent waves of economic downturns been experienced globally, and with the propagation of many concepts and theoretical models for the Islamic accounting systems and their principles to be adapted by individual nations, it is therefore important that newer models to be adapted that will see nations better suited to endure adverse and current economic problems. The constructs of the study framework was assessed by means of instruments created by researchers in other nations. Even though the instruments demonstrate scientific reliability as well as validity, yet this is the first research for which it has been used in Iraq.

In summary, as the level of Islamic cost accounting implementation in banking sector in Iraq increase so too does the positive development of the banking industry through economic growth. This findings is consistent with the findings of Zarqa (2003), Yudistira (2004), Sufian (2006), and Majid & Kassim (2010) who observed that the two variables of Islamic accounting (Islamic Cost Accounting, Amanah Deposit) help developing countries to achieve economic growth through banking industry. Hence they argue that Islamic Cost Accounting is a significant determinant of development in the banking sector and financial services industry followed by Amanah as a less significant variable but yet it is a strong determinant of economic growth as well.

12 Recommendations

Based on the results of the research, there is still a huge amount of unexplained deviation in outcome. Furthermore, other predictors can be discovered in a diverse

circumstance and the outcomes compared. The researcher suggests that further investigation on the effect of Amanah deposit on the performance of Islamic bank should be achieved in order to understand the direct effect of Amanah deposit to the economic growth on developing countries.

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