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INTERNATIONAL ISLAMIC UNIVERSITY MALAYSIA  
بِوَسْطَةِ رِضْوَانِي إِسْلَامِيَّةً أَنْبَاءُ رِجَائِي مَلِيَّةً

THE USEFULNESS OF CURRENT VALUE  
BALANCE SHEET, VALUE ADDED STATEMENT  
AND CORPORATE SOCIAL RESPONSIBILITY  
INFORMATION: A SURVEY OF ACCOUNTANTS  
AND INVESTMENT ANALYSTS IN MALAYSIA

BY

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@ WAN MUDA

INTERNATIONAL ISLAMIC UNIVERSITY  
MALAYSIA

2006

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requirement for the degree of Master of Science in  
Accounting

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## **ABSTRACT**

This study examines the perceived usefulness of the current value balance sheet, the value added statement and the social responsibility and environmental disclosures as components of the proposed Islamic Corporate Report model. Differences in perceptions between Muslim and non-Muslim corporate report preparers and users are examined through a questionnaire survey of accountants and investment analysts. A sample of 84 accountants and 62 investment analysts is obtained.

Generally, it could be concluded that both Muslim and non-Muslim corporate report preparers and users react similarly towards the current value balance sheet, the value added statement and the social and environmental disclosures (the proposed Islamic Corporate Report model). However, there were significant differences in perceptions noted between Muslims and non-Muslims towards Islamic-oriented disclosures. Accordingly, the contention that Muslim corporate report preparers and users consider the proposed Islamic Corporate Reports as more important than their non-Muslim counterparts is not supported.

Finally, conventional financial information is given more importance than religious-oriented, social responsibility and environmental information.

تقوم هذه الدراسة على اختبار الفائدة الملحوظة لبيان قيمة الرصيد الجاري، والقيمة المضافة، والمسؤولية الاجتماعية والاكتشافات البيئية لمكونات نموذج تقرير الشركات الإسلامية المقترح. إن الاختلاف في رؤية معدي ومستخدمي التقارير في الشركات الإسلامية وغير الإسلامية قد تم اختباره من خلال استبانة المسح للمحاسبين ومحلي الاستثمار، حيث تم الحصول على عينة مكونة من 84 محاسباً و62 محللاً استثمارياً. وبصفة عامة، تخلص الدراسة أن معدي ومستخدمي التقرير المشترك الإسلامي وغير الإسلامي يتفاعلان ويتشابهان تجاه قيمة الرصيد الحالي والقيمة المضافة والاكتشافات البيئية (نموذج عناصر التقرير الإسلامي المشترك). ورغم ذلك، يلاحظ بعض الفروق الكبيرة في وجهات النظر بين الإسلاميين وغير الإسلاميين تجاه المعلومات الإسلامية. وبناء على ذلك برز الرأي القائل بأن معدي التقارير ومستخدميها في الشركات الإسلامية يعتبرون تقارير الشركات الإسلامية أكثر أهمية من نظيراتها غير الإسلامية وليس هناك ما يدعم هذا الرأي. وأخيراً، فإن المعلومات المالية التقليدية لها أهمية أكثر من المعلومات الدينية والمسؤولية الاجتماعية والمعلومات البيئية.

## APPROVAL PAGE

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## DECLARATION

I hereby declare that this dissertation is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

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## LIST OF ABBREVIATIONS

AAOIFI	Accounting and Auditing Organization for Islamic Financial Institutions
ACCA	Association of Certified Chartered Accountants
CAPM	Capital asset pricing model
CIMA	Certified Institute of Management Accountants
CV	Current value
CVA	Current value accounting
CVBS	Current value balance sheet
CPA	Certified Public Accountant
CSR	Corporate social responsibility
e.g. (exempligratia)	for example
et al. (et alia)	and others
FASB	Financial Accounting Standards Board
GAAP	Generally accepted accounting practice
GRI	Global Reporting Initiative
HC	Historical cost
HCBS	Historical cost balance sheet
ICR	Islamic corporate report
i.e. (id est)	that is to say
IFI	Islamic financial institution
IS	Income statement
MIA	Malaysian Institute of Accountants
MICPA	Malaysian Institute of Certified Public Accountants
UK	United Kingdom
US	United States of America
VA	Value added
VAS	Value added statement
S.W.T	<i>SubhÉnahu Wa TaÑÉIÉ</i>

# CHAPTER 1

## INTRODUCTION

### 1.0 INTRODUCTION

The current research aims to examine whether religion has any influence on the manner in which accounting is practised. To achieve this, the present study examines the perceptions of corporate report preparers and users of the Islamic Corporate Report (ICR) model proposed by Baydoun and Willett (2000) as well as Sulaiman and Willett (2003). Apart from the currently mandated financial statements, the ICR model also proposed that the corporate reports should include the current value balance sheet (CVBS), the value added statement (VAS) and social and environmental information. The opinions of Muslim and non-Muslim financial statement preparers (accountants) as well as Muslim and non-Muslim users (investment analysts) are sought. Previously, Sulaiman (1998) tested the usefulness of the model from the perspective of accounting information preparers and users (which include accountants, bank lending officers, *zakĒt* officers and financial analysts) using 1995 data. However, there seemed to be a lack of support for the use of the proposed ICR model particularly by Muslim respondents. This study, therefore, seeks to provide recent evidence on whether there is any difference in the perception from those gathered a decade ago.

In addition, the study also investigates the usefulness of social and environmental information as a part of the proposed ICR model by Sulaiman and Willett (2003). In so doing, it is hoped that the findings could fill the gap in the ICR literature. Moreover, by having a better understanding of the type of ICR needed by



Muslim accounting information preparers and users, necessary action could be taken to improve the current financial reporting legislation in Malaysia.

## **1.1 BACKGROUND OF THE STUDY**

The arguments on the need for ICRs are divided into two main factors. Firstly, there is a strong need for ICRs to support the current developments in the banking and finance industry. It is noted that there has been a growing demand for Islamic financial products for both Muslims and non-Muslims. Islamic financial products such as *mudharabah* and *musharakah* require more than what is currently being made mandatory in the Malaysian financial reporting environment. The growth in Islamic financial products has resulted in the interested parties wanting to know more than what is currently being disclosed in the annual reports. Furthermore, Islamic financial products need the support of an accounting theory and framework that operate in line with the *Shariah* principles. Alternatively, these situations call for Islamic accounting that should be able to cater for the needs of Muslim corporate report users (Hameed 2000a), hence, the need for ICRs.

Secondly, although financial statements are prepared based on documents generated from business transactions, they cannot be assumed to be objective and value-free. Apart from promoting certain values, there are debates that the numbers generated by accountants could influence certain decisions (Arnold and Cooper, 1999; Boyce, 2000; Haniffa, 2002). For instance, they could distract the attention of annual reports users from focusing on social economic consequences to concentrating solely on the profit bottom line.

Due to its emphasis on profit maximization, decision usefulness objectives that govern conventional accounting are claimed to have certain negative impacts on

Muslim accounting information users. The sole focus on this decision-usefulness objective might lead to the stress on values such as materialism, utilitarianism<sup>1</sup> and secularism<sup>2</sup>. Accordingly, it might eventually result in inappropriate economic behaviour, for example, extreme competition, consumerism<sup>3</sup>, excessive advertisement, conflict and domination (Hameed, 2000b). With the sole focus on profit maximization, any social economic or cultural impact of the organization on its environment will be considered secondary.

The above discussions indicate that conventional accounting which utilizes a decision usefulness framework is clearly not in line with the Islamic socio-economic objectives. The framework aims to satisfy mainly the investors and shareholders, thus, limiting the scope of targeted users. The Islamic concept of accountability that is based on the concept of unity (*tawhîd*), justice (*ñadÉlah*), community (*ummah*) and benefit of the people (*maslahah*) (Abdul-Rahman, 2003b) is considered a more appropriate framework in the development of ICR as compared to the decision-usefulness framework.

Gambling and Karim (1986) have highlighted a few characteristics which are considered vital in constructing the design of the ICR. Firstly, the Holy Qur'an and *HadÉth* must be at the centre of its design; secondly, there must be integration between religion and other aspects of life; thirdly, the community must be considered as an integral dimension in the life of a Muslim; the fourth characteristic is the disclosure on *ribÉ*-related transactions and the fifth characteristic is that *zakÉt* must have an important place in the construction of the ICR model. Baydoun and Willett

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<sup>1</sup> "The doctrine that actions are right if they are useful or for the benefit of a majority (Oxford Dictionary, p. 1,546)".

<sup>2</sup> Secular means not religious, sacred or spiritual. Secular refers to a situation where there is a separation between religion and other aspects of life, for example politics, economics and social aspects. Religion is used for guidance on private matters. In this context, the Westerners are becoming separated from their religious and spiritual beliefs.

<sup>3</sup> "The preoccupation of society with the acquisition of goods (Oxford Dictionary, p. 287)."

(2000) further added that the corporate report focus must be balanced with the socio-economic aspects of an organization. In view of this, they have proposed an ICR model that should include the VAS, the sources and application of *zakÉt* and *qard* funds, the cash flow statement, the statement of changes in equity, the statement of changes in restricted investment and the balance sheet (with both historical cost and current value). However, due to the time and cost constraints, the scope of this study is restricted to the usefulness of the CVBS, the VAS and social environmental disclosures only.

The CVBS in Baydoun and Willett's proposed model is argued to be able to facilitate the calculation of *zakÉt* as well as profit on *mudhÉrabah* and *mushÉrakah* contracts. It is also argued that the CVBS could also help in fulfilling the requirements of social accountability. The VAS, on the other hand, focuses on the distribution of wealth to various stakeholders (for example, *zakÉt* beneficiaries, government, shareholders, investors, creditors and employees instead of stressing only the shareholders, investors and creditors). Hence, the VAS is claimed to be able to better serve justice and fairness as compared to the income statement (IS). Sulaiman and Willett (2003) extended the model proposed by Baydoun and Willett by proposing that social responsibility and environmental reporting should also form an integral part of ICRs.

## **1.2 MOTIVATION FOR THE STUDY**

The fact that only a few empirical studies were conducted on either Islamic accounting or ICRs (Sulaiman, 1997; Hameed, 2000a; Yaya and Hameed, 2004) inspires the researcher to provide additional evidence on the demand for ICRs.

Sulaiman (1997) found that less importance was placed by Muslim respondents on the usefulness of the CVBS for the purpose of the *zakĒt* office achieving their objective. This raises some concern as to whether, after a decade of rapid development in Islamic banking and finance, there will be an increase in awareness among Muslim preparers and users of the corporate reports based on Islamic values?<sup>4</sup>. However, Hameed's (2000a) and Yaya and Hameed's (2004) findings indicate encouraging support for accounting practices based on Islamic values. Therefore, hopefully, this study is anticipated to provide more recent evidence on the usefulness of this type of corporate report.

This type of analysis is also becoming particularly crucial due to the growth in the Islamic banking and finance industry. Islamic financial products require more extensive disclosures than is currently provided by conventional accounting. However, Islamic finance has developed more rapidly than Islamic accounting and ICR literature. This phenomenon causes the researcher to become concerned about ICRs hence motivating the researcher to identify the existence of a relationship between religion and accounting. In so doing, this study aims to understand what Muslims actually desire instead of what ought to be desired in the proposed ICR. This study also examines the perceived usefulness of the proposed ICR elements to various stakeholders (in this case, perceptions of accountants and investment analysts are used to represent corporate report preparers and users). Apart from that, any results of the study may help accounting policy makers in ascertaining the importance of various disclosures in the corporate reports from the perspective of preparers and users of corporate reports.

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<sup>4</sup> Sulaiman (1997) used 1995 data.

### 1.3 OBJECTIVES OF THE STUDY

This study examines whether religion has any influence on accounting practices. To achieve this objective, the usefulness of the ICR model (the CVBS, the VAS and the social environmental information) from the perception of Muslim as well as non-Muslim preparers and users of corporate reports is investigated. The perceptions of accountants and investment analysts (representing corporate report preparers and users respectively) are sought by using survey questionnaires. It is hoped that this study can also provide better insights into the difference in perceptions between Muslim and non-Muslim respondents, thus identifying the relationship between religion and accounting. Additionally, this study, therefore, investigates what Muslim preparers and users actually desire and evaluate whether these perspectives are aligned with the *SharĒÑah*. In addition, this study looks into the level of importance placed by respondents on social and environmental information disclosure.

Realizing the lack of research in this area, it is hoped that this study can add to the Islamic accounting literature as well as the social environmental accounting literature. By answering all the research questions raised in this study, it helps to determine whether Muslim preparers' and users' views are in line with the *SharĒÑah* in demanding more comprehensive disclosure. Thus, the following research objectives have been formulated:

- i. to examine the difference in perceptions between Muslim and non-Muslim corporate reports preparers of the usefulness of the CVBS, the VAS and social and environmental information. The preparers are represented by accountants.
- ii. to examine the difference in perceptions between Muslim and non-Muslim corporate reports users of the usefulness of the CVBS, the VAS and social

and environmental information. The users are represented by investment analysts.

#### **1.4 CONTRIBUTION**

This study contributes in several aspects. The first aspect deals with the contribution towards the body of knowledge. It enhances the existing literature with the discussion on the effect of the Islamic accountability framework on the ICR. Furthermore it reviews past studies on current value (CV), the VAS and social and environmental information. In so doing, this study highlights the usefulness of CV, the VAS and social and environmental information not only from the Islamic point of view but also from the Western point of view.

The second aspect concerns the contribution towards the financial reporting practices. The results of the study will give an insight into the type of disclosure preferred by the preparers and users of corporate reports. This will help in structuring financial reporting policy in Malaysia by considering disclosures that are required by Muslim preparers and users of corporate reports. This study could also provide a reference on the future development of Islamic accounting in Malaysia.

This study is also undertaken as a measure to understand the level of awareness of the importance of religious-oriented information, social responsibility as well as environmental disclosures. This study will also provide evidence on the level of readiness among the preparers of corporate reports to incorporate more disclosures in corporate reports.

## **1.5 ORGANIZATION OF THE CHAPTERS**

The study will be presented in seven chapters, including this chapter, which represents the introductory part of the study. The second chapter reviews the literature on the need for ICRs. Generally, it highlights the unsuitability of conventional accounting for Muslims. It also explains the Islamic worldview and the relationship between the Islamic concept of accountability and the contents of the proposed ICR.

The third chapter briefly reviews literature on the proposed components of ICR. It also analyzes the importance of the CVBS, the VAS and social and environmental disclosures. It also attempts to integrate the literature reviewed in the previous chapters, and highlight the gap found in the previous studies on the CVBS, the VAS and social responsibility and environmental disclosures.

Chapter four outlines the theoretical framework of this study before formulating the sixteen hypotheses. The fifth chapter presents the methodology adopted for the study and explains the procedures involved in the data collection and the data analysis process.

Chapter six analyzes the data collected and provides findings for the statistical tests performed. It also discusses findings for each hypothesis developed. Finally, chapter seven provides a brief summary of the study and highlights a few limitations from the study. It also brings to light the contributions and implications of the study and presents some suggestions for future research.

## **CHAPTER 2**

### **THE NEED FOR ISLAMIC CORPORATE REPORTS**

#### **2.0 INTRODUCTION AND ORGANIZATION OF THE CHAPTER**

The purpose of this chapter is to review the literature pertaining to the need for Islamic corporate reports (ICRs). This chapter consists of four sections. The first section discusses the need for and the relevance of ICRs to Muslim societies. It also highlights the consequences of conventional accounting. The second section clarifies the notion of accountability from the Western and Islamic perspectives. The third section examines the relationship between the concept of accountability and accounting practices. The fourth section focuses on the need for Islamic accounting practices to achieve the socio-economic objectives of the Islamic business organization. The fifth section concludes with the summary of the chapter.

#### **2.1 THE RELEVANCE OF WESTERN BASED ACCOUNTING SYSTEMS TO THE ISLAMIC SOCIETY**

Conventional accounting (Western-based accounting), according to various authors, is not value-free (Hines, 1988; Gray, Owen and Adams, 1996; Buhr, 1998; Arnold and Cooper, 1999; Mirza and Baydoun, 2000). In fact, it is driven by the demands of society and various environmental factors such as the political climate, social surroundings, economic environment, degree of statutory intervention in the business, ownership, size and complexity (Radebaugh and Gray, 1993<sup>5</sup>). Furthermore, there are many hidden values, for instance, materialistic and capitalistic values, within

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<sup>5</sup> As cited in Sulaiman (1997).