Research Note

The Sharī'ah and its Implications for Islamic Financial Analysis: An Opportunity to Study Interactions Among Society, Organization, and Accounting

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I. Relevance of the Issue

By far the majority of articles in the world's leading accounting journals take as given the culture and religions of the Western world. Articles appear from time to time that make distinctions among accounting practices in different Western or ex-Commonwealth countries, but in so doing there is usually no need to re-examine whether the basic building blocks of accounting and finance are consistent with the cultures of those countries; that is taken as self-evident. A few authors have pressed further to show that it is inappropriate to impose unmodified Western accounting practices on developing countries,[1] while many others have illustrated the difficulties in harmonizing international accounting standards when they have to be applied to countries with different environmental business and social foundations.[2]

This line of development is followed in these pages to examine the situation in countries adhering to strict Islamic principles where the cultural background to business, and in particular the influence of religious law, are quite different from that in Western countries. It will be shown that differences between the Islamic and Christian religions imply different societal rules of business behaviour, which further imply differences in operating financial organisations, as well as in accounting for them and conducting financial analysis. In fact, the impact of religious principles are so different in these

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countries that there is reason to question whether even such fundamental concepts of Western financial analysis as interest, discounted cash flow techniques, and the cost of capital can have any place in analysing business decisions in such countries.

Of course, at present, the majority of Muslim countries do not pretend to carry out their business activities on strict Islamic principles. Also, until relatively recently the comparative wealth and influence of such countries was such that Western businessmen could dictate their own ways of doing things if Muslim countries wanted to do business with them. Now, however, the situation is changing. While oil prices may not for some time return to the same real level as they were in the 1970s, it is beyond question that a significant portion of the world's wealth now lies in the Middle East and has to be re-cycled to the rest of the world. Initially the greater commercial strength did not lead to substantial changes in business practice, but there are signs that some Middle Eastern followers of Islam are now using their wealth and position to re-align some of their business practices with their own religious beliefs and laws. In particular, there is, currently, considerable political pressure in Middle East countries for tighter adherence to Islamic orthodoxy following the Iranian revolution, the Mecca rebellion, and the growing strength of more fundamental strains of Islam in Egypt, Syria, and elsewhere.

Examples of this development commence, in modern times, from the establishment of the *Nasser Social Bank* in Cairo in 1971 although that was more of a social lending activity to the poor unable to meet unexpected debts arising from illness, family deaths, etc. Then in the late 1970s Prince Muḥammad al-Faisal al-Sa'ud of Saudi Arabia founded the Faisal Islamic Bank of Egypt and the Faisal Islamic Bank in the Sudan in direct competition with the existing banks which were operating on Western banking principles. A major step forward concerned the establishment of the Dār al-Māl al-Islami (House of Islamic Funds) in January, 1982, with an initial capital of $310 million. The House of Islamic Funds is now busy establishing insurance companies, banks, and commercial companies to be run on Islamic principles in 14 countries in order to provide Islamic believers with a full range of Western financial services in ways that do not offend their faith.

The movement towards a new strict observance of Islamic religious principles in business is therefore well under way and, given the growing importance of the Middle East in world finance, investment, and trade, it seems relevant to re-examine our basic tools of financial analysis to see whether the more fundamental religious foundation of life in that part of the world will permit their use. The purpose of so doing is not only to assist indigenous analysts in those countries, but also those in the West who want to transact business with them; one cannot conduct business discussions and make contracts unless both sides accept some common language and tools of analysis.

Moreover, Islamic Banking institutions are now known to be operating in London and the House of Islamic Funds is looking to establish a European headquarters in Switzerland and another division in the United States of America. The House of Islamic Funds intends to provide 51% of funds required to establish banks in each country of operation and obtain the balance locally. It seems that non-Islamic followers will be allowed to invest in such banks, but not have a controlling interest and such investors must be satisfied with an adherence to Islamic banking principles. The subject of this paper is not therefore a trivial question for Western investors, financial analysts, or accountants. If the Islamic banking movement maintains its current momentum it will become another major financial institution influencing business behaviour and will need to be understood.

With this background in mind, this paper has the following structure. First, the guidelines taken from the *sharī'ah* will be described and discussed. There will then be discussion of the key tools of financial analysis that depend upon an interest concept, namely, discounted cash flow calculations and the capital asset model version of the cost of capital. The analysis will then be broadened to consider some operational difficulties banks may have in operating under strictly Islamic rules and the penultimate section of the paper will consider whether further implications exist for financial reporting. A concluding section will then summarise the key points.

II. The Sharī'ah's Guidelines for Financial Behaviour

The source of guidance for Islamic principles is the *sharī'ah*. This is the Islamic law of human conduct derived from the Qur'ān and the Sunnah (the deeds and sayings of the Prophet Mohammed, pbuh). The *sharī'ah* categorically outlaws *ribā*, translated strictly as usury, but interpreted universally as the prohibition of charging any interest at all on loans. The Qur'ān states that: "trading is permitted and usury is forbidden." (Qur'ān 2:275-6) The main reason advocated for the abolition of interest in all economic transactions, including bonds, debentures, etc., is that it concentrates wealth and promotes inequality through exploitation. It has been pointed out by Muḥammad Siddīqī that:

> In the case of consumption loans, it violates the basic function for which Allah has created wealth, which envisages that the needy be supported by those who have surplus wealth. In the case of productive loans, guaranteed return to capital is unjust in view of the uncertainty surrounding entrepreneurial profits.[3]

Elaborating on the above, Ḥamīd Allāh remarks that the principle of unilateral risk involved in the institution of interest is the basis of its prohibi-

tion in Islam.[4] Ghanameh (1973: 86) also believes it to be the main economic reason for Islam's prohibition of interest, along with two other reasons: that it violates justice and is contrary to the Islamic dictum that there should be no reward without personal effort.[5] The creation of an idle class of people who receive their income from accumulated wealth is also another way of arguing the same point. It also is argued that society is deprived of the labour and enterprise of these people if they are permitted to finance their existence from accumulated wealth, although this argument ignores the fact that such people may have exerted far more effort in order to achieve that wealth in the first place. The Islamic response would presumably be that everyone should make a reasonable effort for society at all times.

In his comprehensive study of the subject, Mawdūdī is of the view that interest disturbs the balance between production and consumption.[6] This is thought to take place because, first, interest on consumption loans transfers part of the purchasing power from a group of people with high propensity to consume to a group with low propensity to consume. Hence, this latter group mostly reinvests its income from interest which means that the decrease in consumption demand is accompanied by an increase in production.[7] Secondly, Mawdūdī also argues that interest on productive loans raises the cost of production and hence increases the prices of consumption goods. Once again, he argues, the amount taxed away from the people, in the form of higher prices, falls into the hands of a class with a lower than average propensity to consume. Thus, supply of interest-free loans to needy consumers and denial of a guaranteed return to capital removes this basic imbalance. In contrast the incomes generated by the process of production in the form of wages, profits, and profit-sharing are more equitably distributed. In addition to the above arguments against the practice of interest, some Islamic economists (e.g. Abū Sa'ūd) refute the notion of time preference in the sense that Western economists assume the preference of current consumption over future consumption. He notes that:

> The conception of future demand or the preference of present goods over future ones, seem to me more of an arbitrary postulate than a real fact.[8]

In this argument we feel that Abū Sa'ūd has misunderstood Western economists, but we will return to this point later.

All the above statements are, of course, merely *ex post* rationalisations of Islamic laws provided by Islamic economists. The ultimate reason for eschewing interest is that the Qur'ān (the highest authority in Islamic law) specifies that all usury transactions are prohibited. Nevertheless, the growing body of Islamic economic literature is influencing economic behaviour. For example, using similar arguments to those above, some Islamic economists

have gone so far as to state that Islamic project appraisers must resort to the accounting rate of return as a criterion for giving priority to one project over others rather than use methods depending upon the interest concept.[9] Therefore whatever one thinks of the above economists' logic, the problem is real and needs to be addressed.

As an alternative to interest, Islamic law considers profit sharing to be the appropriate base for economic transactions between the supplier of capital and the entrepreneur. An often used method of profit-sharing by the new Islamic banks is what is known as *Muḍārabah.*[10] Kahf defines Muḍārabah (Qirāḍ) as:

> An Islamic mechanism for introducting monetary assets into production activity by transforming them into real factors of production as a result of a joint action between the owner of the assets and the entrepreneur.[11]

According to this method, the lender supplies capital to an agent (Muḍārib) for trading purposes and the borrower would contribute only his work and experience. Afterwards, the net profit is divided between the two parties according to the ratios agreed in advance in the contract. In case of loss from normal business causes or natural causes, however, *the lender bears all the loss and the borrower receives no reward for his effort.* This is consistent with the prohibition of a guaranteed return of one's capital.

It should be stated, however, that two forms of guaranteed return of capital do exist in Islamic banking. One is called a "benevolent loan," which effectively is an interest-free overdraft to poor and small businesses, whereby the lender is expected to agree to a delay in repayments or to cancel the debt if the borrower is subject to real difficulties. The other is the issue by banks of "risk-free loan certificates" which bear no interest and simply guarantee return of the original loan: this is effectively equivalent to a cash deposit.[12]

Kahf attempts to identify two important differences between profit-share, in terms of Muḍārabah, and interest. He states that interest:

> Is a fixed burden on the firm, while (profit share) is a share of the benefit of the project which fluctuates with the fluctuation of the results of the activities of the firm. Hence ... the (profit sharer) has a direct interest and real concern in the activity of the firm, although he does not participate in the decision-making.[13]

The other difference is that:

> Profit-share is a long-term phenomenon in which the preference for liquid assets is almost negligible, whereas interest is both a short and long-term phenomenon (for which) economic thought has not provided any acceptable theory to explain ... its term structure.[14]

Hence, Kahf believes that, theoretically, Muḍārabah has a dual basis,

namely, the principle of constancy of ownership and the principle of co-operation. The former implies that the supplier of capital has full claim on his monetary assets as well as on the increase resulting from the growth of these assets brought by the extra labour applied to them by the entrepreneur. The principle of co-operation implies that the two parties, sharing the elements that create the project and the interest in it, also share the fruits of it in the full sense of the word "share," which cannot be realised by a fixed return to one party.

Another type of profit sharing contract is what is known as *Mushārakah* (partnership). In this form of contract the bank and the would-be customer agree to join in a temporary partnership (not much different from the Western joint venture concept) to effect a certain operation within an agreed period of time. In the case of an industrial concern, both parties contribute to the capital of the operation (taken to mean capital assets, technical and managerial expertise, and working capital, etc.) in varying degrees, and agree to divide the net profits actually realised in proportions agreed upon in advance. There is no fixed prescribed percentage for profit sharing and each case is dealt with on its own merits.

In addition to prohibiting *ribā*, the *sharī'ah* also prohibits speculation and hoarding. As regards speculation, the intention seems to be to prevent gambling or engaging in investment activity that does not attempt to increase society's wealth. There is also the notion that peasants may be tempted to sell crops before they have been grown or harvested and then financial stress may result for either the buyer or seller if the crops fail. No doubt some major commodity deals collapsed and caused disputes and hardship centuries before the *sharī'ah* was set down.

If speculation is prohibited, the obvious question to ask next is whether this also prohibits the establishment of a stock exchange. Most Western economists would argue that, while speculation takes place in a stock exchange, its basic purpose is to act as a market mechanism for trading returns and risks, which is a fundamental need in mobilising financial resources to make possible increased production. If this view were adopted, clearly the *sharī'ah* would not prohibit it. There are, however, Islamic economists who believe that Islamic jurists should condemn stock exchanges.[15] Qurayshī equally advocates prohibition of pure financial speculation and considers trade cycles to be the result of brisk activity in such transactions.[16] Also Shaikh examines the usual market oriented arguments advocated for financial speculation and finds them unconvincing. He states that:

> Money that ought to have been invested in industry and commerce finds its way into the speculative market where it is feeding disguised and parasitical workers like brokers and shrewd operators.[17]

Finally, *khaṭīb* equates financial speculation with gambling, and this is specifically prohibited.[18] *Khaṭīb* argues that such activity leads to gains and losses without increasing the usefulness of exchanged goods. It would appear then that many Islamic authorities would argue that stock exchange activities are not permitted by Islamic law, but the issue is not finally settled. As mentioned earlier these are only *interpretations* of the law made by economists and jurists who are mere mortals. Stock exchanges did not exist when the *sharī'ah* was set down and so there is scope for alternative interpretations or even modifications to operations of stock exchanges so that they do come within the current interpretations of leading religious figures.

On hoarding, the underlying logic is again that it would result in society having less resources in use than it has available. Hence the hoarder is depriving the needy of available assistance. Note, however, the Islamic code does not advocate equalisation of wealth; it recognises that personal wealth creation is a motivating factor in the economic process. It merely requires the wealthy to recirculate their wealth to increase production for others as well as themselves.

To summarise this section, it is clear that the *sharī'ah* prohibits *ribā,* which is universally interpreted as charging or earning interest. It also prohibits guaranteed returns of capital (except for "benevolent loans" and "risk-free loans"), speculation, gambling, and hoarding. There is scope for dispute, however, about *exactly* what current economic forms of behaviour these latter rules do prohibit.

III. The Islamicity of a Project Appraisal Discount Rate

In Western accounting and finance one fundamental set of tools of investment appraisal are the different discounted cash flow techniques. These techniques are well known to be based on the principle that equal sums of money may have different values to the recipient according to the time at which they are due to be received (time preference). Future cash flow streams therefore in the Net-Present-Value approach are discounted in order to make a fair comparison. The discount rate used is often described as the rate of interest[19] as well as the firm's cost of capital.[20] The question therefore arises whether "interest" and "time preference" as conceived by advocates of discounted cash flow techniques are "ḥalāl." As already mentioned, some Islamic economists have argued that they are not.

The key point which seems to be missed by most Islamic critics of DCF (discounted cash flow) is that the discount rate is not an interest rate in the sense of being a fixed rate of interest with no risk of capital loss; it is the yield investors expect given the uncertainties they face. Even Western Capitalist

finance theory says that, in the absence of capital rationing, the relevant discount rate is the firm's weighted average cost of capital (WACC). For a simple debt/equity financed company this would be the weighted average of the fixed interest rate on long term debt and the yield required by equity shareholders. In an Islamic economy with no fixed interest debt, but with Muḍārabah partners, the WACC simply becomes the weighted required yields of the Muḍārabah partners and the residual equity holders. Hence, there seems to be no deep conceptual problems for devout followers of Islam using a 'hurdle' rate provided those required Muḍārabah and equity yields can be derived without resort to an interest concept.

In capital rationing situations (highly likely in some Muslim developing countries – but highly unlikely in others), there appears to be even less conflict with the *sharī'ah.* The hurdle rate used by the company can then be above that required by Muḍarabah or equity holders and be the rate of return earnable on the next best project of equal risk (opportunity cost).

These arguments, however, really establish only whether a hurdle rate concept is acceptable to Islam and not whether it is "ḥalāl" to *discount* cash flows over time using it. It is, nevertheless, very, straightforward to justify discounting without violating the *sharī'ah.* The *sharī'ah* does not prevent personal choice; hence, individuals are free to choose among consumption time patterns. Most individuals will prefer a project yielding earlier money returns to a project yielding later money returns of equal absolute sum; not because they necessarily prefer current consumption (as Abū Sa'ūd seems to think), but rather because, if they want later consumption, and reinvestment opportunities are available at reasonable risk, the investor is likely to be able to consume *more* at a later date by reinvesting the early returns, than if he chose the project with *later* returns of equal money sum. Western economics has no dogmatic assertion of the preference for current *consumption* over equal amounts of future *consumption.* Hence, the use of the Western DCF concept does not violate the *sharī'ah:* it need not involve an explicit interest concept and the notion of time preference involved does not depend on the preference of current over future consumption. It is earlier *cash flows* that are preferred, not consumption per se.

One may conclude therefore that the general concepts of a "hurdle rate," the concept of time, preference, and the process of discounting does not violate the *sharī'ah.* Can one, however, determine, in practice, a specific discount rate using Western tools of analysis without breaching Islamic principles? Attention will now be given to this question.

IV. Can Equity and Muḍārabah Yields Be Determined By Western Cost-of-Capital Methods?

It has already been argued that required equity and Muḍārabah yields are valid as discount rates in Islamic societies provided that such yields can be determined in practice without reference to interest. This seems immediately to invalidate the capital asset pricing models where, as is well known,

$$K_e = i + \beta (r_m - i)$$

where k_e is the required equity yield, i is the risk free interest rate, r_m is the expected market portfolio return, and β is the familiar beta which reflects the degree to which the returns of this security co-vary with those of the market portfolio. Islamic economists may well be forgiven for wanting to keep clear from this approach to determining a discount rate, because interest appears quite explicitly. It will now be shown, however, that it is *not* the inclusion of an interest concept which makes the approach of the capital asset pricing model (CAPM) difficult to apply but the *Islamic* rules prohibiting speculation. This is important because, if the CAPM could not be used without an interest term, it certainly would be subject to universal prohibition by the Islamic faithful. As argued above, however, there is scope for interpretation about the rules on speculation, and so, with appropriate interpretation, the CAPM might, at some future date, be operational.

Let us suppose that a highly competitive market for securities is permitted and does exist. In that case a CAPM style of thinking can still be applied. The only difference is that the capital market line will have an intercept at zero returns for zero risk rather that at a positive rate. In other words portfolios will be divided between cash holdings (or cash equivalent loan certificates) and risky investment. This situation is shown in *Figure 1*.

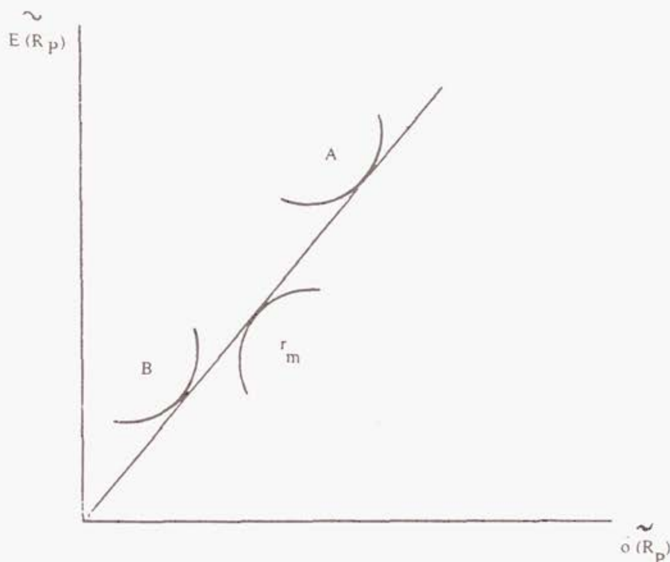

Figure 1. The Capital Asset Pricing Model with cash/equity Mudarabah portfolios

It will be noted that the separation theorem is still possible. Investors with indifference maps like B would prefer to have portfolios consisting partly of cash (or cash equivalent certificates) and risky equity, which reduces that risk compared to investing all their funds in equity.

Consequently, the interest term would simply be dropped in an Islamic society and the CAPM cost of capital formula would be

$$k_e = {}^{\beta}r_m$$

The CAPM *approach* is not therefore to be rejected simply because it incorporates an interest concept in Western applications.

There is, however, another rather obvious problem with the CAPM model: the CAPM is a market equilibrium model and the *sharī'ah* may be interpreted to prevent the formation of a market for equity or Muḍārabah certificates. Certainly one does not exist at present. Note, however, that it might be possible to establish such a market without full implementation of a stock exchange of a Western style. There might be rules formulated to limit speculative activities, which might include the specification of a minimum excluding investors with A-type Indifference maps in Figure 1) thus restricting the range of operations of applicability of the CAPM such that an Islamic portfolio theory would then seem to enable the separation theorem to operate in *part* of the risk/return space (i.e. for B-type investors) but only more basic Markotwitz notions in the rest of it.

The CAPM approach is not, of course, the only way to formulate cost of capital. The Gordon dividened yield plus growth formula would not meet obvious resistance over *ribā* because no explicit interest term is included. Nevertheless the Gordon formula still depends upon quoted share prices which require a market mechanism.

In the absence of a developed market for equities and mudarabah contracts, required yields on investment will therefore have to be estimated in all companies, however large, without recourse to an external index. Unquoted Western companies are in a similar position, but Islamic organisations have even less guidance than these. Western unquoted companies do have interest rate guides and can try to find comparisons with quoted companies. In this situation Islamic organisations may have to seek other ways for discovering muḍārabah investors; expectations.

V. Further Modifications in Bank Operations Required by the Sharī'ah

While it is not the intention to analyse bank operations in depth, it would be useful to make one or two observations on this matter before considering

how the *sharī'ah* might affect financial reporting. According to Cooper, there is not much of a problem in acting as a conventional bank on the liabilities side of the balance sheet.[21] He says that the bank just operates as a neutral fund, taking money from many investors to invest them Islamically and then distributing profits to them less a management fee. On the assets side, Cooper also says that the bank has little problem in using Islamic forms of contracts where investment is in real estate, leasing, or trade finance, but it is difficult to place short term funds. Cooper describes how banks have tried to overcome this by investing in constantly maturing commodity and currency contracts, but there are obvious risks of violating the *sharī'ah's* provisions on speculation and gambling. Similarly, fully hedged swaps fail the test of a risk element in investment and there is also a ban on trading in gold or other precious metals. As Cooper says:

> ... In-house religious advisers are increasingly sanctioning deals where the purchase and sale elements can be seen as separate transactions ... This does not always impress the purists such as Kuwait Finance House's resident mufti ... who sees hedged dealings as disguised *ribā* and forces his dealers to operate in the spot markets.

In fact, even the management of the liabilities side may not be as straightforward as Cooper suggests. A strict adherence to the *sharī'ah* will mean that each investor in the bank does not have a Muḍārabah share in the bank per se, but in the specific investment fund for which his money is being used. Hence, his profit must be related to the profitability of that specific investment fund. This further implies that the organisation in which the bank's investment is being made (if on a Muḍārabah basis) must also earmark those funds to specific projects; it cannot just pool the "loan" receipts with the rest of the organisation's funds. Consequently, there may be difficulties in establishing exactly what the profit share of each Muḍārabah partner may be if costs and revenues relevant to Muḍārabah contracts are not separable from other activities (e.g. owner financed projects) in both the productive organisation and the bank.

VI. Implications for Financial Reporting

The financial reports of organisations observing Islamic business principles have to be sufficient to enable a review from two dimensions: normal investment-style commercial law and a review by a *sharī'ah* Board. Major institutions like the Islamic Banks will have their own *sharī'ah* Board to sanction that business methods are in accordance with religious principles. This Board has also to make an annual report to the Islamic general assembly appointing it. Smaller organisations may also need to present accounts to exter-

nal *sharī'ah* agencies for certification of compliance with religious laws. The interesting point arising then is whether there is likely to be a conflict between two sets of external requirements: the more normal requirements of commercial audit often conducted by firms using Western principles and the requirements of the *sharī'ah* Board. Even if there proves to be no direct conflict between the two types of "audit," it is quite possible that different accounting procedures will be needed to satisfy the needs of each. It would seem, for example, that a "*sharī'ah* Board" would wish to be able to check that no speculation, hoarding, or illegal financing transactions had taken place. In addition it might well take an interest in the way Muḍārabah profits are calculated as distinct from residual equity yields. This has quite a different emphasis from the normal commercial audit required to see a true and fair view of a business on a consolidated basis.

Each bank will have not one but two independent sets of auditors. One representing the normal commercial interests and the other representing the Muḍārabah certificate holders. The investment fund financed by Muḍārabah finance must be kept separate from the rest of the bank's activities. Muḍārabah profits must be calculated on such activities before the equity income can be calculated. An interesting problem here concerns the way joint costs are allocated between Muḍārabah financed investment and other activities. Clearly, conflicts of interest between the two sets of auditors can arise over these profit calculations – especially as, in practice, profit sharing ratios are often not specified in advance.[22]

The major financial institutions (i.e. the Islamic Banks) would also have a differing need for information on organisations in which they invest in comparison to the information needs of their Western banking counterparts. The fact that Islamic Banks cannot invest by way of secured, interest bearing loans means that they face much larger investment risks than Western Banks. This may further imply the need for a reporting mechanism that reveals far more about the risks, market attractiveness, and competitive position of a business than reported in Western company accounts. This may not be made public, but merely available to the banks who are large investors. On the other hand the market for Muḍārabah contracts (if established) may also demand such information.

These issues have not been completely resolved. It would seem that such issues will have to be resolved in discussion between 'ulamā', lawyers, and accountants. Enough has been written, however, to show how the Islamic code might lead to a different emphasis in financial practice and reporting.

VII. Conclusions

This paper has tried to illustrate the difficulties that will occur when trying

to introduce Western economic and accounting technologies into Islamic societies. This article has taken as its topic the effect of contrasting religions upon financial management and accounting, which is a topic rarely explored in academic accounting or financial journals. We have argued that discounted cash flow techniques and at least the broad ideas underlying the CAPM approach to determining equity yields (with some modification) should not automatically be dismissed as offending the *sharī'ah* just because they seem to rely upon the interest concept, although the prohibition of speculation may be more troublesome for an easy transfer of Western finance theory. Nevertheless, we have quoted Islamic literature which seems to take a different view in relation to the interest concept and we have met financial practitioners in Muslem countries who are confused on the issue. In obeying their religious beliefs they therefore perceive themselves to be faced with a real problem with the concept of interest if they wish to apply Western textbook methods in their own countries.

Ultimately the religious 'ulamā' will give a definitive ruling on these matters and, when they do, one may rest assured that these Western techniques will not be approved if it is considered that there is a chance of them encouraging *ribā*, hoarding, or speculation. The *sharī'ah* was, however, written well before the development of economies to the stage where stock exchanges, major financial institutions, and large companies became necessary for continued economic growth and social well-being. Consequently, the *sharī'ah* cannot be specific about the desirability of such institutions. The *sharī'ah* must be *interpreted* in the light of modern day circumstances. One may not therefore see a deterministic religious dictation of business practice, but, as Islamic businesses develop, one may see a fascinating social interaction of business pressures and religious principles. In strictly religious societies, clearly the latter must be seen to dominate, but those principles, written down centuries ago and internally quite consistent, would have to be carefully understood if modern forms of business are needed to generate greater social well-being and such forms of business depend upon devices, such as a market for Muḍārabah contracts, that may be seen as speculation. The 'ulamā' will have to decide what terms like speculation and usury are meant to imply in the presence of modern methods of creating and storing wealth and portfolio theories of investment which did not exist when the *sharī'ah* was set down.

For researchers interested in the relationships among society, organisations, and accounting, the chance will exist over the next few decades to study the process by which one of the world's major religions interacts with the development of business and its financial structures, management, and accountabilities. This is possible now because until relatively recently the Muslim countries were not wealthy enough to develop their own modern business and financial institutions. The process never really ceases, because

business requirements change and need to be tested against interpretations of religious doctrines, which may themselves then need re-interpretation or even be left aside in some societies. The more gradual economic development in the West perhaps conceals the influence that religion has had upon business formation. Some Islamic countries are likely to compress this experience into a relatively small number of years as they try to modernize rapidly. The interaction between Islam and the development of business practice will therefore be more visible and easily studied. Once these formative years are past, it is doubted whether such a good opportunity to study such processes as they occur will present itself again for centuries.

Notes

1. R. J. Briston, "The Evoluation of Accounting in Developing Countries, *International Journal of Accounting,* 1978; and J. M. Samuels and J. C. Oliga, "Accounting Standards in Developing Countries," *International Journal of Accounting,* Fall 1982.
2. G. G. Mueller, "Accounting Principle Generally accepted in the United States Versus Those Generally Accepted Elsewhere," *International Journal of Accounting,* 1968; and D. McComb, "International Harmonization: Myth or Ideal?" presented to the Fourth Annual Conference, European Accounting Association, Barcelona, 1981.
3. Muhammad N. Siddiqi, *Muslim Economic Thinking: A Survey of Contemporary Literature* (London: The Islamic Foundation, 1981), p. 63.
4. M. Hamidullah, "The Economic System of Islam," *Introduction to Islam* (I.I.F.S.O., 1970), pp. 140–168.
5. Abdel Hadi Ghanameh, "The Interestless Economy," *Contemporary Aspects of Economic and Social Thinking in Islam* (Gary, Indiana: MSA of the United States and Canada, 1973), p. 86: It is interesting to note the similarity with the labor theory of value which dominates another culture quite different from Islam or Western Capitalism.
6. Sayyid Abdul A'la Mawdudi, *Sud (Interest)* (Lahore: Islamic Publications, 1961), pp. 85-87.
7. We stress that this is Maududi's view, not ours. He seems to ignore the impact on consumption of the initial loan provided to the high propensity groups and has not traced through the equilibrium effects of increased production. We are merely describing the attitude towards interest as argued by various Islamic economists.
8. Mahmoud Abu Saud, "Interest-Free Banking," paper presented at the First International Conference on Islamic Economics, Mecca, 1976, p. 46.
9. S. Wager Ahmad Husaini, "Principles of Environmental Engineering Systems Planning in Islamic Culture Law, Politics, Economics, Education, and Sociology of Science and Culture," *Program in Engineering and Economic Planning,* Stanford University Report EEP. 47, December 1971; and 'Ali Awsaf, *Political Economy of the Islamic State,* Ph.D. Thesis, University of Southern California, 1970; and M. S. Abdul-Baqi, "Al Iqtisad al Islami: Fardiyat al Zakat wa Hurmat al Riba," paper presented at the First International Conference on Islamic Economics, Mecca, 1976.

10. The owners of the Islamic bank will hold ordinary shares and have a residual equity interest, but investors not wishing to have an ownership interest in the whole bank may acquire an interest in the bank's direct investments by acquiring Mudarabah certificates.
11. Monzer Kahf, *The Islamic Economy: Analytical Study of the Functioning of the Islamic Economic System* (Plainfield, Indiana: Muslim Students Association of the United States and Canada, 1978), p. 71.
12. No adjustment is made for inflation and so one might question whether it is risk-free. This form of certificate does enable the risk-averse to hold funds without offending religious views or hoarding cash.
13. Kahf, *op. cit.*, p. 71.
14. Id.
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