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Islamic Economics, Finance, Entrepreneurial Development & Public Policy for the Ummah's Socio-economic Wellbeing

Under the above theme, the speakers / paper presenters will discuss the vision of Islamic economics, business and finance, public policy for entrepreneurial development and to enhance social inclusion and good governance, meaning how to develop Islamic countries' economies giving fair opportunity to all segments of the society and provide them not only suitable jobs / employment but also dignity and respect in the society and falah in this world and the Hereafter. As it is possible only through application of the principles of the Shariah, in letter and spirit, in all socio-economic disciplines and business and finance affairs, Shariah compliance of all institutions, products and activities would also be covered in the Theme of the ICIB-2016 event.

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Financial Reporting Practices and Injustice with the Stakeholders from Ethical Point of View

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Financial Reporting Practices and Injustice with the Stakeholders

- Seemingly, a terrifying ethical challenge to financial reporting is the phenomenon of untrue and discretionary financial reporting under the banner of ‘transparent financial reporting’.
- Such untruthful reporting intensified during the first decade of the 21st century when many of the personnel got involved to increase their own benefits and the result was a wide-spread financial fiasco

So What are Financial Reporting Practices ?

Following are the financial reporting practices:

- Flexible accounting policies with regard to asset valuations (IAS 40 *Investment properties*).
- Flexible accounting policies for inventory valuations (IAS 2 *Inventories*).
- Lawful misjudgments in the assessment of business assets (IFRS 5 *Non Current Assets held for sale and discontinued operations*).
- Lawful misjudgment in the measurement of costs (IAS 37 *Provisions, contingent liabilities and contingent assets*).
- Transferring recurring expenses to non recurring expenses.
- Existence of flexible accounting rules.

So What are Financial Reporting Practices ?

- Use of favorable accounting assumptions.
- Unrealistic recognition of revenues and expenses (IAS 18 *Revenues*).
- Elastic rule for overstatement of assets and income.
- Discretionary revenue and expense recognition (IAS 18 *Revenues*).
- Use of off-balance-sheet items (IAS 17 *Leasing*).
- Artificial increase of cash flow and profits (IAS 7 *Statement of cash flows*).
- Back dating of sales contracts (IAS 18 *Revenues*).
- Undervaluation of liabilities, are the areas exploited by management for financial reporting practices.

Who is Behind the Injustice

- Shareholders' pressure compels managers to show positive news before the annual general meetings (Dimitrov and Jain 2011).
- Manager's promotions, status, goodwill, perquisite, and bonuses compels them to show artificial disclosures (Ball, 2001).
- Managers usually shows abnormally positive returns during pre-meeting days to influences trading patterns in the stock exchange.
- Slippery slope rules and elastic behavior of regularity authorities.

Who is Behind the Injustice

- Directors having possession of large number of shares put pressure on managers to overstate revenues through the application of flexible accounting policies (Ranti and Olamide, 2012).
- Institutional ownership and CEO compensation also leads to vigorous performance before shareholders meeting (Dimitrov and Jain 2011).
- Accounting irregularities occurs when accounting based performance is used for compensation.
- Injustice happens in the absence of ethical values.

Who is Behind the Injustice

- How one can rely on financial reporting of Islamic Financial Institutions based on GAAP and IFRS? (Sarea and Hanefah, 2013).
- Lack of precautionary controls and improper regulations grant a trunk road to financial disaster of well reputed corporations (Soltani, 2014).
- Firms prefer to adopt flexible accounting policies in order to save their interest which provides open door for earnings management (Hellman, 2011).
- Auditor transparency and inadequate accounting standard leads to immoral auditing process (Enyi et al. 2012).

Who is Behind the Injustice

- The revenue recognition process vary in IFRS and US GAAP, IFRS report much high profit than the US GAAP (Fosbre, Kraft, and Fosbre, 2009).
- Payment of salary and retention as shari'ah advisor by same institution for which they approve Islamic rulings (*fatwa*) also put question mark on reliability and independence of shari'ah scholars (Anderson, 2010).
- Federal Accounting Standard Board (FASB), International Accounting Standard Board (IASB), American Institute of Certified Public Accountants (AICPA), seemed to be helpless to chase such manipulations.

Methods Used for Injustice Financial Reporting

- Inflating income through manipulation of recurring and non recurring expenses (Athanasakou, Strong and Walker, 2009).
- Expenditures are hided or treated as economic resources of business by capitalization.
- Revenue realization and asset's misreporting are most frequent techniques used by the businesses (Beasley, Carcello, Hermanson and Lapedes, 2000).

Methods Used for Injustice Financial Reporting

- Treatment of profit from operation instead from investment motivates managers for extension and overvaluation of projects (Benston, 2006).
- Revenue recognition and revenue restatements are the result of flexible accounting regulations (Peterson 2012).
- Management uses creative accounting techniques to inflate the value of securities (Bardos and Zaiats, 2012).

Diversity of Islamic Banks from Theory

Theory of Islamic Banks	Practices of Islamic Banks
That operations of Islamic Banks would base on profit and loss modes of financing.	Very limited use of profit and loss modes of financing. (Yasseri 1999; Warde 2010, p. 240; Kayed 2012; Al-Deehani et al. 1999; Khan 2013; Warde 2010, p. 240; Chong and Liu 2009; Grassa 2012; Samad et al. 2005; Abdul-Rahman et al. 2014; Errico and Farahbaksh, 1998; Iqbal, and Molyneux, 2005, p. 27-28; Greuning and Iqbal, 2007: pp 50).
Full disclosure in the financial statements because Islam discourage to non compliance with full disclosure.	Highly non compliance rate as the case of full disclosures is concerned. (Belal et al. 2014; Harahap, 2003; Belal et al. 2014; Farook et al. 2011; Haniffa and Hudaib, 2007).

Diversity of Islamic Banks from Theory

Theory of Islamic Banks	Practices of Islamic Banks
No use of manipulative techniques like earning management, siphoning of revenues, overvaluation of assets , undervaluation of liabilities etc.	Excessive use and practice of earning management techniques. (Archer, and Karim, 2007: pp.366; Misman and Ahmad, 2011; Taktak et al. 2010; Archer and Karim, 2006; Visser, 2009: 82: Askari et al. 2010: 25; Hamdi and Zarai, 2011; Taktak, 2011; Elnahass et al. 2013).
Don't believe on IFRS and US GAAP because these standards are contrary to Islamic guidance.	Majority of Islamic banks use IFRS and US GAAP in the preparation of their financial statements. (Karim, 1999; Balala, 2010; Sarea and Hanefah 2013; Najeeb and Ibrahim, 2014; Maali et al. 2006; ACCA, 2010, p.

Diversity of Islamic Banks from Theory

Theory of Islamic Banks	Practices of Islamic Banks
Promotion of social justice and well being in the Society.	Promotion of wealth maximization in the Society. (Cebeci 2012; Balala 2010, p. 177-178; Imam and Kpodar 2010; Abeng, 1997)

Why We Can't Blame the Banks

- The accounting procedures in practice failed to serve the business and stakeholders, as company executives apply technical expertise to manipulate financial results (Spalding Jr and Oddo, 2011).
- The most leading corporate collapses imply failure of ethical management which is the result of change in the attitude of employees (Kottke and Pelletier, 2013).
- Various technical accounting terminologies are perceived differently by its users.

Why We Can't Blame the Banks

- Interpretation of standards varies from region to region because of culture, institutional settings and regulation structure.
- Such variations have huge impact on interpretation, comparability and reliability of financial statements (Drnevich and Stuebs 2013).
- This may be due to local rules and notions applicable in various jurisdictions which are difficult to be defined in accounting and economics (Killian, 2010).
- All this expresses the deficient accounting literature which failed to convert domestic factors, which leads to different interpretation.

Why We Can't Blame the Banks

- It is also very painful that 5 out of 56 countries in which Islamic banks operates considered AAOIFI standard for financial reporting, rest of the countries comply with their local GAAP and IFRS (Najeeb and Ibrahim, 2014).
- Regularity requirements of Security and Exchange Commissions of different countries for the preparation of financial statements in accordance with International Financial Reporting Standards (IFRS) and International Accounting Standards (IAS), compel banks to follow IFRS and IAS.
- Regularity requirements of international investors for audited account prepared in accordance with International Financial Reporting Standards (IFRS) and local Generally Accepted Accounting Principles (GAAP) compel banks to follow IFRS and GAAP.
- Regularity requirements of different Financial Institutions and Institutional Investors for audited accounts, compels the banks to use IFRS and IAS.

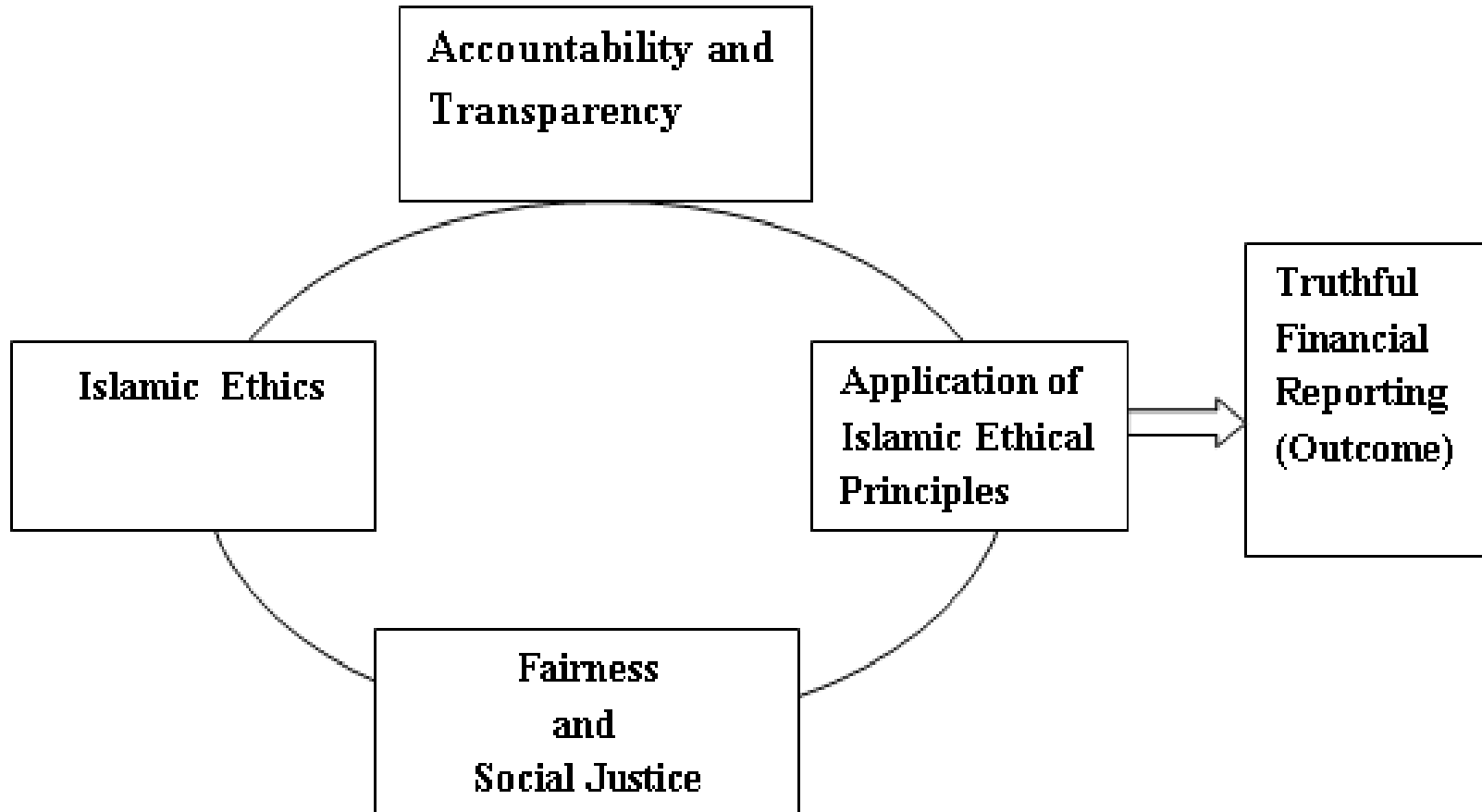
Solution of the Problem

- False reporting, can be removed by enhancing awareness among the stakeholders.
- As a measure against false reporting investors should have basic knowledge of reporting and the techniques use for misappropriation.
- The standards setting bodies should have power of enforcement to avoid manipulated financial statements.
- Media campaign should be initiated to highlight mechanics of misreporting in the financial statements.

Solution of the Problem

- Justice and independence must be observed as basic Islamic norms, which will stimulate managers to ensure that the interests of all stakeholders are safeguarded (Graafland et al. 2006).
- Islam recognizes accounting not merely a procedure, but it also considers it, as contractual relation with community and God (Haniffa et al. 2004).
- Teachers should develop ethics in accounting instead of just teaching accounting literature.
- Islamic ethics have great impact on manager's behavior which may lead them to responsible reporting.

Proposed Model for Truthful Financial Reporting



Recommendations

- We recommend that establishment of strong national bodies for ensuring the authenticity of shari'ah compliant practices.
- We recommend that nothing should be concealed in the financial reports and the disclosure must be comprehensive.
- We recommend regulatory supervision with mandate of enforcement of regulations in all Islamic countries.
- The area which needs attention is the application of Islamic ethics in financial reporting to eliminate injustice with stakeholders.

Recommendations

- There must be sole independent Shari'ah board which must have sufficient authority to reshape Islamic banking.
- Formation of main Shari'ah board will eradicate the need to buy fatwa from different shari'ah advisors.
- Organization of Islamic Countries (OIC) must gather Muslim scholars for the development of basic framework of IFIs.
- OIC must instruct IFIs to use fix portion of their profit on poverty eradication, education and health which are fundamental rights in Islam.

Recommendations

- Adoption of Islamic ethical principles at personal, organizational, and society level will make financial reporting transparent.
- The doctrine of ethics emerging from Quran and Sunnah would be helpful in ensuring the best quality of the financial reporting, transparency, fairness and justice in the financial reporting.
- Being complete code of life, Islam considered it core accountability of Islamic financial institution to considered Islamic ethical and moral principles in their decisions by avoiding all shapes of speculation (Ullah et al. 2014). Quran says; “O you who believers! Guard your duty to Allah (ittaquallah) and speak words straight to the point.” (Al-Ahzab 33:70).

Thanks