The Influence of Culture on Accounting Disclosure among Islamic Countries

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Abstract

The purpose of the paper is to explore the influence of cultural diversity on accounting disclosure among companies from Islamic countries. The methodology consists in analysing the literature on accounting disclosure and accounting information reported by companies operating in Islamic countries. We used the inductive reasoning, starting from a review on current scientific research over the changes occurred in accounting practices in developing economies. Islamic companies need to disclose clear and accurate financial and nonfinancial information in a trustworthy and reliable manner, while both Shari'ah-receptive investors and regulators care for environmental, social and governance impacts of Islamic investments. Analysing the governance scores, we came to conclude that companies with headquarters in countries that adopted Shari'ah standards as national ones, score higher than companies from countries where international accounting standards are used or in countries where both standards are used.

Key words: accounting, culture, Islam, corporate governance, corporate disclosure
J.E.L. classification: M41, M14, E42

1. Introduction

The motivation for making this research consists in highlighting some features rising from the influence of culture in the accounting, precisely in accounting disclosure of companies. Aside from the financial situations, rules and calculations, accounting is also about the professional reasoning and taking accounting decisions is influenced by the organizational culture promoted within the company, the accounting system used and the national culture of the state where the company operates.

Accounting practices, disclosure and corporate governance influence each other. Corporate governance leads the direction in accounting to fulfil the objectives of a company while accounting is a measuring instrument of the shareholders wealth and providing relevant and accurate information in real time. Therefore, accounting is a factor influencing the decisional process. Shareholders, as users of the accounting information are interested in the size of their dividends and in the company's capacity of continuing its activity. Not only shareholders are interested of the information, stakeholders too, as customers or potential investors, company's staff, they are all interested in the accounting disclosure, in addition to the financial statements.

The accounting system represents the ensemble of accounting processes, procedures, accounting methods, controls set to store information, to register, clarify, analyse, interpret financial data, and create reports to be used in making managerial decisions.

The differences that occur in practice come firstly from adopting the accounting standards. The International Accounting Standards Board (IASB) and the International Sustainability Standards Board (ISSB) settled the International Financial Reporting Standards (IFRS) that are adopted by most multinationals. The Financial Accounting Standards Board (FASB) provided the Generally accepted accounting principles (GAAP). The Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) elaborated the Islamic Accounting Standards, while the Islamic Financial Services Board (IFSB) outlined guidelines and procedures for preparation of Standards/Guidelines used in the Islamic Capital Market.

2. Theoretical background

Disclosure refers to supplementary information about an entity's financial statements, in the form of clarifications for actions that led to changes in the financial results of the company (Bragg, 2021). *Shari'ah* is the Islamic religious law controlling religious customs and daily life situations, along with the religious rituals, aiming to offer safety and fairness to people. Shari'ah law provides to the Muslims followers principles and guidelines for living their lives, for making decisions in finances and banking (El-Halaby and Hussainey, 2015; Investopedia, 2021).

Islamic law, Shari'ah, described as the divine code of Muslims, is based on the Qur'an, Sunnah and the explanations and interpretations of experts in Islam, being built on five principles: obligatory duty (*wajib*), recommended (*mandub*), allowed work (halal), the unrecommended thing (makruh), the forbidden thing (haram).

The Islamic accounting system is the perfect model in which religious perceptions are considered in accounting principles. The accounting rules come from Shari'ah. The concept of accounting comes from "Hesab", meaning "calculation", responsible before God. Shari'ah refers to accounting, transparency, trust.

Islamic finance or *Shari'ah-complaint* concerns the manner of managing money respecting the ethical principles of Islam and applies to savings, borrowings and investing. One main idea of Islamic finance is not considering money a value, but a way to convert products and services that are valuable. Thus, making money out of money is not endorsed, that means, there shouldn't be a price for money, and paying interest (*riba*) is prohibited in Islam. Any economic activity in the Islam must provide justice, fairness, and honesty to all parties, and to ensure their rights and obligations. Companies need to disclose financial and nonfinancial information clearly in a trustworthy and reliable manner. Transparency is key in corporate governance for generating quality information (Narastri, 2019).

Others fundamental ideas in Islamic finance are to not cause harm to others, and it also advocates for partnership. This means that Islamic companies do not invest in alcohol, tobacco, and gambling. Islamic finance encourages wherever possible sharing profits and risks. The Islamic banking system is one based on the equity financing. It is present in more than 75 countries worldwide (Tabash, 2019) and has proven its stability in times of financial struggle and volatility. Islamic banks are expected to include in their business models social responsibility and ethics.

Even though there are many Islamic cultures, there are some constant elements that are accepted by all Muslims, based on the Qur'an and the Sunnah Law, but also several variable elements based on the local traditions of the people. Following, we will proceed to explain the basic principles of Islamic finance or Shari'ah-compliant and the requirements imposed by the Islamic disclosure reporting for Islamic capital market products.

There are three guiding principles in Islamic finance. First one refers to "clear and accurate information", second is about disclosing "sufficient information" and third is about offering "timely information"(Islamic Financial Services Board, 2017).

Table no. 1 Guiding principles of Islamic finance

General principle	**Explanation**
Clear and accurate information	Information disclosed to stakeholders must be clear, accurate and not misleading. Investor (and potential investors) commit on the offered information to make their investment decisions. Offering accurate, clear, and not misleading information protect investors interests and the probity of their decision making. Not misleading information refers to not disclosing untrue information or fail to disclose material information
Sufficient information	Full disclosure of information to be used justly by investors as material for their intention or investing or maintain their investment. Disclosed elements will be justly reachable to investors. The information will be related to Shari'ah compliance.
Timely information	It is required a timely disclosure of information that is significantly material to an investment decision. The information will be disclosed as soon as possible, depending on their nature and circumstances

Source: (Islamic Financial Services Board, 2017)

In Islamic countries, it is not possible to discuss a certain influence of culture on accounting because culture is what generated the accounting.

As the pursuit of social justice is essential in Islam, Muslims have a responsibility to care for others and to avoid selfishness and greed (Kamla et al., 2006). It then became one of the most important principles in the development of Islamic accounting.

AAOIFI (2010) considers that the purpose of financial accounting is the link between Islamic financial institutions and their affiliates in the Islamic context, which must:

1) to establish the rights and obligations of all stakeholders, in accordance with Shari'ah and the concepts of equity, charity and respect for Islamic business values;

2) to help maintain the assets of Islamic banks, their rights and the rights of others in an appropriate manner;

3) to enhance the managerial and productive capacity of the Islamic bank and to encourage compliance with established objectives and policies and, above all, respect for Shari'ah, and

4) to provide useful information to users to make legitimate decisions in their dealings with Islamic financial institutions.

3. Research methodology

The methodology consists in analysing scientific literature concerning accounting disclosure of companies in the Islamic countries. Using inductive reasoning, we started from a review on current scientific literature over the changes occurred in accounting practices in developing Islamic economies. The research can offer an answer on the question *Does Islamic culture influence sustainability reporting in companies?*

We have chosen for this research companies from 5 Islamic countries, Bahrain, Saudi Arabia, the United Arab Emirates, Indonesia, and Malaysia. From a number of 2276 companies, only 172 reported on Eikon scores on Environment, Social and Governance, and from these, only 100 companies reported scores for the last five years (Y-5).

Foreword we analysed the scores on Environment scores. We drew our conclusions correlating the country of the headquarters with the industry field. Entire data was retrieved from Eikon Reuters platform.

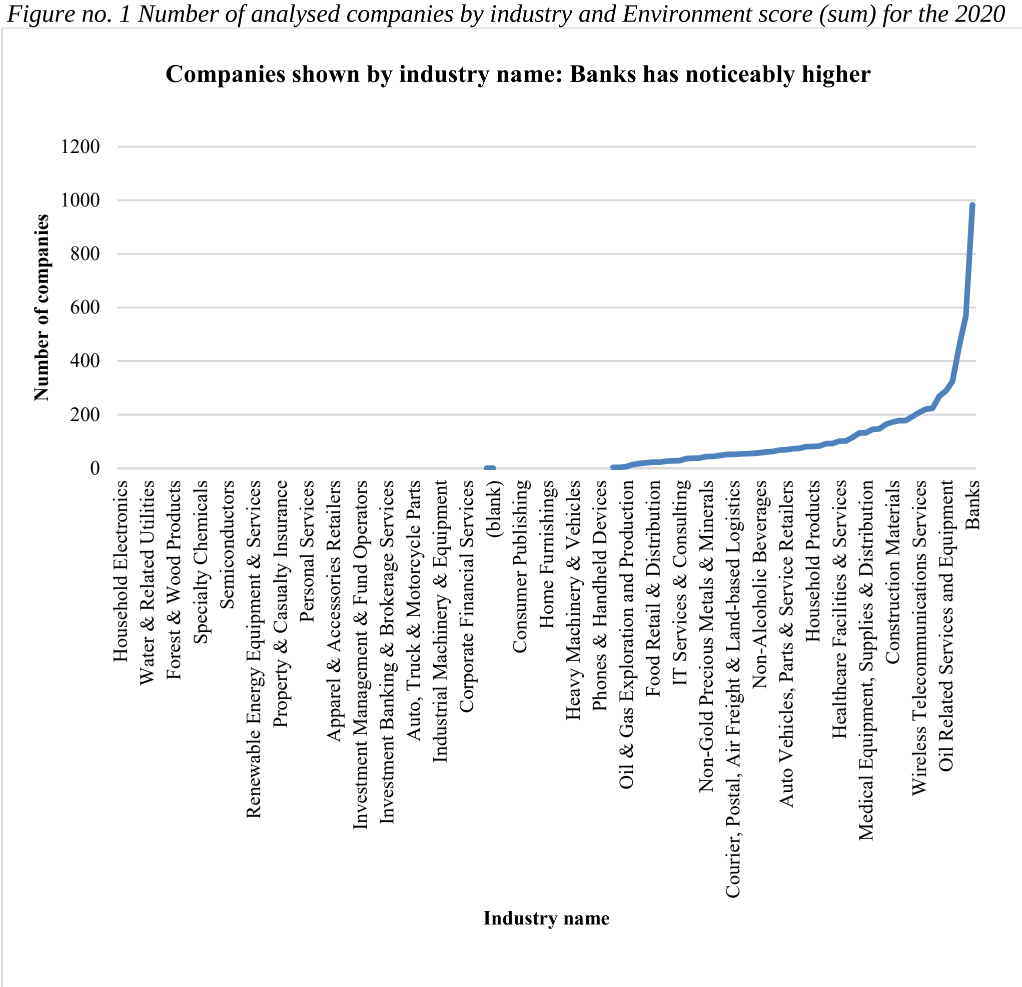
Table no. 2 Sample distribution of companies by country and industry name

Country of headquarters Industry name	**Malaysia**	**Indonesia**	**Saudi Arabia**	**United Arab Emirates**	**Bahrain**	**Grand Total**
Real Estate Rental, Development & Operations	98	71	13	15		197
Construction & Engineering	91	30	2	4	1	128
Food Processing	49	36	9	5	1	100
Banks	11	47	11	19	10	98
Fishing & Farming	38	31	5	1	1	76
IT Services & Consulting	50	6	3			59
Construction Materials	19	11	19	9		58
No. of Islamic companies	**72**	**48**	**26**	**23**	**3**	**172**

Source: data extracted from Eikon Reuters Islamic countries disclosed data on ESG

Companies that score highest for the Environment data are the ones shown in Figure no.1 – banks, Food processing, Real Estate, Coal, Oil Related services, Wireless telecommunication services, Casinos and Gaming, and Healthcare.

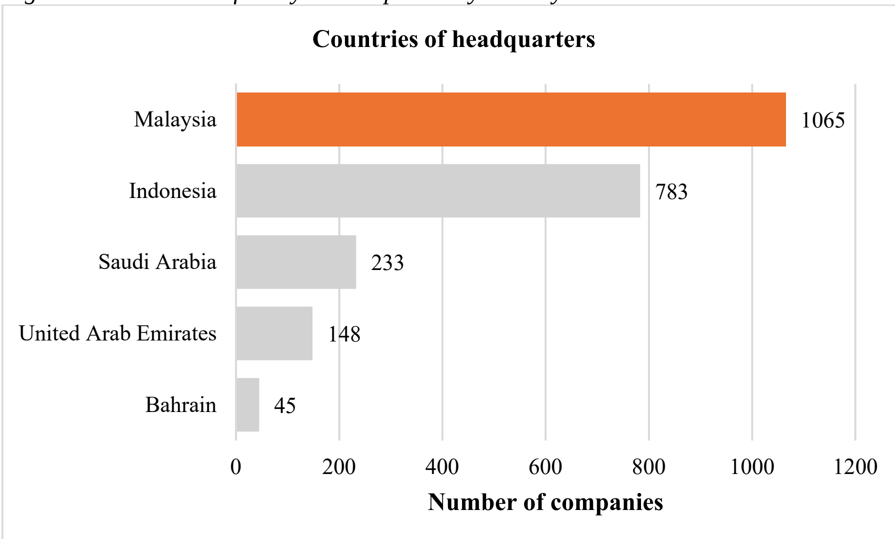
Figure no. 1 Number of analysed companies by industry and Environment score (sum) for the 2020



Source: authors analysis on extracted data from Eikon Reuters ESG Islamic finance database

A more precise situation of selected companies by their headquarters is shown in the figure below.

Figure no. 2 Number of analysed companies by country



Source: authors analysis on extracted data from Eikon Reuters ESG Islamic finance database

4. Findings

Bahrain uses international accounting standards, together with international auditing standards and Shari'ah complaint standards. The analysed companies all reported under IFRS.

Kingdom of Saudi Arabia uses the international accounting standards, as well as the United Arab Emirates, while Malaysia and Indonesia both follow the Islamic standards, Shari'ah complaint.

Further data analysing, we can state that companies disclosing most data are from the bankingindustry, real estate, constructions & constructions materials, food processing, banks, fishing & farming, and IT services & consulting industries, most of them having their headquarters in Malaysia and Indonesia. The logic comes from the fact that Malaysia and Indonesia adopted Shari'ah guidelines as national ones (Hassan et al., 2019), while Saudi Arabia and United Arab Emirates use the Accounting Standards and Bahrain uses all standards combined – auditing standards, accounting standards and Shari'ah Standards (GAAP, IFRS, AAOIFI).

According to Shari'ah Standards, companies need to be transparent in their reports, disclosing financial information in a fair and accurate way. Entire society is considered companies stakeholders. Being accountable and responsible in front of all stakeholders and Allah, as final owner. Success and welfare are measured in a moral and ethical way as being accountable in front of Allah, the ultimate authority.

5. Conclusions

Analysing the corporate governance scores in companies that reported on Environment, Social and Governance Eikon database, we can notice that companies with headquarters in countries that adopted Shari'ah standards as national one score higher than companies from countries where international accounting standards are used or in countries where both standards are used.

Islamic finance requires more disclosure aiming to reduce information asymmetries specific in Islamic contracts companies. Moreover, disclosing information would introduce more flexibility and would provide a wider understanding to stakeholders, as supervisors and public over risks and companies' strategies. As other scholars already enhanced, Islamic accounting is characterized by lower uncertainty tolerance and higher commitment to community (Dima et al., 2010; Neifar and Jarboui, 2018) I align on the same opinion (Neifar and Jarboui, 2018) that to improve transparency, companies are encouraged to disclose information at a wider extent, particularly regarding risk.

To answer the research question is required a more profound analysis on companies that report their scores. What we can state is that Islamic culture only cannot influence the accounting disclosure, as most of companies do not report their scores. Only 172 of 2276 companies disclosed information on all sustainability pillars, and not all of them reported data in the last five years.

6. References

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