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## Theory of Shariahization on Conceptual Accounting Framework: A Substantive Theory

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### Abstract

The purpose of this study is to formulate a theory that reflects the endeavors of Shariah Accounting Committee (KAS) in setting a contemporary conceptual framework to be in accordance with shariah. To formulate the theory, the study applies Strauss and Corbin's grounded theory (GT). Data are collected by interviewing deeply KAS members and are analyzed through GT's procedures. The study finds a theory that we call it as "Theory of *Shariahization* on Conceptual Accounting Framework" which reflects the endeavors of KAS members to accept, reject, and adjust the contemporary conceptual accounting framework to be in line with the shariah.

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### 1. Introduction

Various accounting professions over the world attempt to develop a conceptual framework based on their needs. Financial Accounting Standards Board (FASB) has initiated to use the conceptual framework since 1940s (Perks, 1993: 165). Then, other countries, such as UK, Australia, Canada, New Zealand, China, and Hong Kong, do the same thing (Peasnel, 1983; Hines, 1989; Karim, 1995: 285; Xiao and Pan, 1997; Deagen, 2004: 134; Gaffikin, 2008: 106; Goodfrey, et. al., 2009). International Accounting Standards Committee (IASC) has formulated a conceptual

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framework that is called as the Framework for Preparation and Presentation for Financial Statements (FPPFS) (1989) and Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI, 2001) also sets a conceptual framework that supports financial reporting for Islamic financial institutions.

Indonesian accounting profession has adopted the American accounting standards for approximately two decades (1973-1993). However, eventually on 24 August 1994 Indonesia switched its accounting standards to adopt FPPFS-IASC and the Financial Accounting Standards Board (DSAK) has approved the switch on September 7, 1994 (Ghozali & Chariri, 2007: 178). The shift is a culmination of an accounting reform process that has lasted approximately in twenty years (Rosser, 1999; Kurniawan & Indriantoro, 2000; Ghozali & Chariri, 2007).

Shariah (Islamic) banks † in Indonesia have started to operate in 1992 (Warde, 2000: 214). However, all transactions conducted by the banks must comply with conventional accounting standards, because at that time there were no shariah accounting standards.

Ten years later, precisely in 2002 Indonesia accounting standard setter issued the Framework for the Preparation and Presentation of Financial Statements of Islamic Banking (KDPPLKPS) (IAI, 2002a) and Statement of Financial Accounting Standards (PSAK) No. 59 about Accounting Standard for Shariah Banking (IAI, 2002b) to fulfil the need for shariah accounting standards for shariah banks. There was a little attention and a slow response from Indonesia accounting standards setter to accommodate the need for shariah accounting standards and its theoretical framework for shariah banking.

The concept of KDPPLKS was not purely based on shariah (the Islamic law), rather it was the product of adoption and adaptation of FPPFS. Some argued that FPPFS was not in accordance with the Islamic teachings. KDPPLKPS and SFAS No. 59 were also criticized. One of them was that they did not take into account the existence of other shariah business entities (non-bank entities) such as shariah insurance, pawnshop, and capital market. KDPPLKPS and SFAS No. 59 then have lost their momentum and relevance. Therefore, there was a need for KDPPLKPS and accounting standards that comply with the Islamic teachings and the interests of all sorts of shariah business entities. In other words, KDPPLKPS and shariah accounting standards should be revised. To meet the purpose, Financial Accounting Standards Board (DSAK) established Shariah Accounting Committee (KAS) on 18 October 2005 (IAI, 2010). There were twelve members of KAS with varied backgrounds and institutions who have a duty to revise KDPPLKPS and shariah accounting standards.

This study is concerned with the exploration of how the members of KAS take substantial endeavors to shariahize (Islamize) and set accounting concepts of the Framework for Preparation and Presentation for Financial Statements (FPPFS) in order to be in line with the principles of Islamic teachings. Data that collected from the process and interactions of the members in shariahizing the standards are analyzed by making use of Strauss & Corbin's Grounded Theory (GT) to finally generate a substantive theory.

## 2. Research Method

### 2.1. Primary Consideration

Grounded Theory (GT) is applied to this research. At the first time, GT was introduced by Glaser and Strauss through the publication of "The Discovery of Grounded Theory: Strategies for Qualitative Research" (1967) (Goulding, 2002: 38; Locke, 2003; Strauss & Corbin, 1990, 1994, 1998). The reasons of utilizing GT are: first, it can be applied to various phenomena (Strauss & Corbin, 1990, 1994); second, it can assist researchers to generate a concise and varied theory (Strauss & Corbin, 1994); third, it can adjust itself in various circumstances and data, say, the utilization of historical data combined with data interviews (Strauss & Corbin 1994), company reports and statistical data (Goulding, 2002: 44), and various documents of the company, including financial reporting data (Alberty-

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† In 1992, in Indonesia there were one Islamic commercial bank and three Islamic rural banks.

Ahltaybat & Ahltaybat, 2010); fourth, it has a capacity to analyze survey data, experimental, and case studies; including historical data.

GT has been applied to an extensive research in the fields of sociology, business, and information technology (Norris, 2002), total quality management (Leonard & McAdam, 2001), marketing (Goulding 2002), activity-based information system (Norris, 2002), logistics (supply chain) (Carter, et al., 2004), and accounting (Gurd, 2008) including the Islamic accounting (Abdul-Rahman & Goddard, 1998).

## 2.2. Strauss and Corbin's Grounded Theory

Strauss & Corbin's (1990) approach to GT is applied to this research by considering flexibility of data, literature review, and preconceptions that are beneficial for the purpose of establishing theoretical sensitivity. Another substantial consideration is: at the stages of axial coding and selected coding, a researcher may connect as far as possible actors' elementary action (interactions among members of KAS, across organizations such as KAS, FASB, and IAI, community, and country) to a very broad international level and in fields of politics, government regulations, culture, ideology, values, economics, environment, history, and even philosophy (Strauss & Corbin, 1990).

## 2.3. Informants, Data Collection, and Method of Analyzing Data

The research site is DSAK (Financial Accounting Standards Board) of Indonesian Institute of Accountants (IAI). Total informants of this study are fourteen people as presented in Table 1.

Table 1: A List of Informants

No	Informants	Background/Institution	Methods
1	Mr. MJ	KAS, FASB-IAI, chairman (2006 - 2010)	In-depth Interview
2	Mr JA	FASB-IAI, member (2006 – 2010)	Structured interview via email
3	Mr. CE	KAS, Central Bank	In-depth Interview
4	Ms. DE	KAS, Central Bank	structured interview via email
5	Mr. MU	KAS, Ministry of finance	In-depth Interview
6	Mr. IKB	KAS, National Shariah Council (DSN)	In-depth Interview
7	Mr. HA	KAS, National Shariah Council (DSN)	In-depth Interview
8	Mr. SE	KAS, National Shariah Council (DSN)	In-depth Interview
9	Mr. KA	KAS, National Shariah Council (DSN)	In-depth Interview
10	Mr. WI	KAS, Academia	In-depth Interview
11	Mr. HA	KAS, Islamic Bank Association	In-depth Interview
12	Mr. YA	KAS, Technical team	In-depth Interview
13	Mr. SR	KAS, Technical team	In-depth Interview
14	Ms. ME	Practitioners in Islamic insurance	Structured interview via email

Primary data are collected from informants by using in-depth interview and structured interview via email. Secondary data are collected from the archive of DSAK, the *fatwas* of DSN (National Shariah Council), and other sources.

Data are analyzed through three steps of analysis by using coding system. First step is open coding. At the step, some techniques can be utilized to find phenomenon, label and name categories. One of them is finding the main purpose that inherently exists in sentences or paragraphs (Strauss & Corbin, 1990). This is done by extracting main

ideas in the sentences and labeling them in brackets [...] (Strauss & Corbin, 1998). Most of the labels are based on information from informants (in vivo code) and some of them are a slightly modified by us.

### 3. GT: Analyzing Data

In constructing a theory, a conceptual theory can be extracted from empirical phenomena. It can be explored from two main areas, i.e., the Islamic principles that have been formulated by the fatwa of DSN and the ways of KAS members in *shariahisizing* FPPFS. The following data are the statements of a KAS member by using code in vivo:

The shariah rules are very broad, what is the definition [of the *shariah*]? ... the reference of [the *shariah* principles], if any, is in the law in 2008 (the Islamic Banking Act), what are they? They are the principles of *mudharabah* and *musharakah*. Yes, it means that [the rules] are obeyed. *Murabahah* should also obey [the rules]. So, even if we use *shariah* principles, say *tawhid*, ... then in essence we must comply with shariah!. For example, we must avoid all transactions [such as usury, *maysir*, *gharar*...] that are forbidden by *shariah*. Well, that's what we mean the principles of *shariah*.

The above transcript indicates that shariah has a broad meaning. However, when it is used in a government jurisdiction, then its meaning is reduced to a specific area, say shariah economics, business, and accounting. A reduction also occurs in the areas, such as the rules of *murabahah*, *mudharabah*, and *musharaka*.

In the process of analyzing data, the study has 85 conceptual labels with 26 sub-categories. The 26 sub-categories are: the principles of shariah used in transactions, shariah transactions, forbidden transaction, adopting conventional practices, the terms of adoption, the method of shariahization, the rules of jurisprudence, Islam is not as an identity, the identity of shariah accounting, shariah as an identity, the motive of KDPPLKS formulation, a conceptual framework of AAOIFI, approaches the formulation, the method of pragmatic formulation, basic choice of pragmatic method, the elements of KDPPLKS, area settings, the philosophy of Islamic transactions, KDPPLKS structure, the substance of shariah bank transactions, tools, the source of dispute, the stakeholders financial statements, the nature of the information that is distinctive, the measurement and valuation of usury-based transactions, and the measurement and valuation of usury-free based transactions. These twenty-six sub-categories then are proceeded to a axial coding stage.

Axial coding stage is a stage that attempts to put the data back together to make the relationships between the categories and sub-categories (Strauss & Corbin 1990). To do so, the sub-categories that have united meanings are simplified into nine categories (temporary), i.e., shariah principles, shariahization of conventional practices, shariah as an identity and a substance, the reasons of FPPFS shariahization, approaches and methods of FPPFS shariahization, structure of shariah FPPFS, the dispute, the determination of the objectives of financial report for shariah entity, and the measurement and assessment based on shariah.

The term of 'shariah principles' is an example of category (temporary) that replaces 'shariah law' or 'Islamic law' in the field of muamalah. It is stated in Act No. 7/1992 about Banking that was amended in Act No. 10/1998 article 1 (13). Islamic principles are the rules of a contract (*akad*) based on Islamic law:

Shariah principles is the rules of a contract with other parties based on the Islamic law related to saving and depositing money and financing a business agreement between the bank and other parties for saving money or financing a business or other business activities that comply with *shariah*, such as, profit-sharing system (*mudharabah*), equity-based financing (*musharakah*), sale-based financing (*murabahah*), or capital lease without option (*ijarah*), or capital lease with an option of transferring ownership (*ijara wa iqtina*).

Other category is shariahization of conventional practices. In the axial coding, this category strengthens the tradition of Muslim to adapt the practices as long as in accordance with shariah. According to the teachings of Shariah, God gives freedom to human beings to do all businesses, except those that are forbidden. One of our informants says:

"We consider that the existing [conceptual framework] has already been good. We need to review whether some parts of the conceptual framework comply with *shariah* or not. Or, are there any *shariah* teachings that have not been included in the conceptual framework? If there is no contraction, then it's okay. But if there is a contradiction with *shariah*, then we have to make modifications."

Indonesian muslim scholars give a term ‘shariah’ to name an institution and a discipline, not using ‘islamic’. For example, they label shariah on shariah accounting and shariah bank, not islamic accounting and islamic bank. This is because of historical, social, and political backgrounds. Our informant tells us:

“...why does our society choose *shariah*? Because, perhaps, the word of 'Islam' tends to be primordial and a little bit ‘segmented’. *Shariah* is seen to be more universal [than Islam], Islam is perceived strictly as a religion, while *shariah* is not like a name of religion. *Shariah* is the bliss for non-muslims, because the term is calm...”

On the stage of selective coding, there are at least five procedures required to construct a theory: (1) compiling and analyzing the story, (2) connecting additional categories to main category by using a paradigm, (3) linking categories to an assessment level, (4) constructing and convincing theory that is supported by data, and (5) replacing the categories that still need to be improved (Strauss & Corbin 1990). The procedures are actually random. This study starts from procedure number 5, then number 1, 2, 3, and 4.

After refining the remaining categories, i.e., *shariah* principles, *shariah* as an identity and a substance, the reasons of FPPFS *shariahization*, approaches and methods of FPPFS *shariahization*, the dispute, the determination of the objectives of financial reporting for shariah entity, and the measurement and assessment based on shariah, then expressing a story on how the members of KAS *shariahize* accounting concept of FPPFS without breaking the structure of FPPFS.

The consequence of *shariahization* is that FPPFS becomes value-laden, i.e., full of *shariah*-values, whereas FPPFS was claimed as value-free, or other claims that it is full of capitalistic and materialistic values. The consequence gives rise to three types of *shariahization*. This is generated from analyzing main category that is related to descriptor categories via paradigm. They are: (1) accepting some parts of FPPFS that are in line with shariah principles, (2) rejecting some parts of FPPFS that are not in accordance with *shariah* principle, and (3) adjusting some parts of FPPFS to in line with *shariah* principles. Thus, the endeavors of *shariahization* generate three main propositions, namely: (1) accepting, (2) rejecting, and (3) adjusting.

The importance of the context of *shariahization* is the process that has consequences on attitudes of accepting, rejecting, and adjusting. A theory consists of interrelated concepts in a particular pattern. Validating the interrelated concepts is the main part of theorizing data. So, before validating the interrelated concepts, there is a need for finding the patterns of FPPFS *shariahization*.

The proposition of accepting denotes to the highest parts of FPPFS that are accepted, even though there are no special signs declaring that concepts or paragraphs are in line with *shariah*. The signs of accepting are only presented by inserting some concepts into FPPFS as they are.

The proposition of rejecting denotes to inserting concepts and paragraphs into FPPFS. Actually, the concept of *makruh* and *haram* can be regarded as *shariah* identity of rejection to be labeled to the concepts and paragraphs that are not in line with *shariah*. A rejection may be permanent and temporary both in terms of substance and technique.

The proposition of adjusting denotes to a course of actions of KAS members to add or replace the concepts and paragraphs in FPPFS. An act to add concepts and paragraphs means that there is no certain concepts and paragraphs that in accordance with shariah. Therefore, there is a need for adding *shariah* concepts and paragraphs in FPPFS. An act to replace means that there are some concepts and paragraphs that do not comply with *shariah*. Therefore, the KAS members replace them with others that are in line with *shariah*.

#### 4. Constructing Theory and Tracing Conceptual Relationships

Kerlinger (1986) explains that a theory is generally supported by propositions which show the relationships of variables useful for explaining and predicting phenomena. Based on the description, we have three propositions as mentioned above, (1) accepting, (2) rejecting, and (3) adjusting. Each proposition has to be theoretically described by giving an example. Under Strauss & Corbin’s (1994), the description is stated in deductive statement and matched with data.

#### 4.1. Concept and Proposition of Accepting

A theoretical description on the proposition of accepting:

Most of 110 paragraphs of FPPFS are not in contrary with shariah. However, there is no evidence or special mark stating that the concept adopted is in accordance with shariah, unless the whole words, phrases, sentences, or paragraphs of FPPFS are recognized in KDPPLKS. Hence, the concept of acceptance is on a non-*shariah* identity.

Proposition of accepting:

All accounting concepts of FPPFS are accepted to be the concepts of KDPPLKS when they are in line with *shariah* principles, although the *shariah* identity of the accepted concepts cannot be traced.

Tracing to data:

All conventional practices can be adopted, if they are not in contrary with shariah and there is no need to make some changes. This statement can be traced to this following data:

“I think the approach is the same as in the past. If we don’t find the principles in generally accepted accounting principles, and as long as the principles are in accordance with the shariah, then we don’t need to make new [principles]. That’s my opinion. The same as Umar bin Khattab when he studied Persian administration, *diwan*. We can use *qiyas* [analogy]...I repeat... as long as the principles are not in contrary with *shariah*, we can use them.”

#### 4.2. Concept and Proposition of Rejecting

A theoretical description on the proposition of rejecting:

Proposition of rejecting is a decision of not accepting FPPFS both in terms of concepts and paragraphs to be included in KDPPLKS. Rejection also means to defer substantively or artificially. Only a few concept and paragraph of FPPFS that is not included in KDPPLKS. There is no *shariah* identity that is labeled to the rejection [*makruh* or *haram*].

Proposition of rejecting:

There is a few accounting concept in FPPFS that is rejected or deferred to be included in KDPPLKS. The rejected or deferred concepts cannot be traced their *shariah* identities.

Tracing to data:

In the process of *shariahization*, KAS members evaluate the paragraphs of FPPFS. When the paragraphs are in contrary with *shariah*, then the KAS members reject them to be included in KDPPLKS without signing shariah identity. An informant says:

“In short, everything that is in contrary to *shariah*, then it should be rejected.”

#### 4.3. Concept and Proposition of Adjusting

A theoretical description on the proposition of adjusting:

The meanings of adjusting are addition and replacement. Adjusting in the sense of addition denotes to words, phrases, sentences, or paragraphs that do not exist in FPPFS, but they are found in KDPPLKS. Their shariah identities can be traced to their substance. An adjustment that basically is reductive means that there are words, phrases, sentences, and paragraphs that are excluded. Their shariah identities cannot be traced. Adjusting in the sense of replacement refers to choosing new words, phrases, sentences, and paragraphs that have similar meanings. Shariah identities can be traced. Adjustments in KDPPLKS are relatively moderate.

#### Proposition of adjusting:

There is variation in adjustment in the sense of addition and replacement. The amount of adjustment is found moderate, and *shariah* identities can be traced.

#### Tracing to data:

The following data shows that various adjustments can be made, especially if FPPFS has not set paragraphs:

“But, the approach is actually selective. Something [concepts or paragraphs] in the conventional conceptual framework [that we regard they are] not consistent [with shariah], we reject them. But, if they are consistent [with the shariah], then we use them... and if they have not been regulated, then we add [them to the KDPPLKS].”

An adjustment may also utilize a specific sentence or create a new paragraph if there is no initial ideas in FPPFS:

“[...as long as it's practicable, we can] look for some paragraphs in FPPFS that cannot be applied in the area of shariah accounting. [we can] make new paragraphs to replace them. [It's okay] to make new paragraphs that are not found in FPPFS...”

### 5. Labeling a Theory

Based on the elaboration of the concept, encoding process, and sociological and regulatory contexts, we can use a term that is very closed (grounded) to data to the KAS members to make FPPFS is in accordance with *shariah*. The term is "*Shariahization*." We can formulate *shariahization* of FPPFS as:

The whole endeavors, actions, and ways that are conducted for accepting, rejecting, and adjusting the conventional concepts of accounting to be accordance with *shariah*.

We can put a label to the new “theory” as “Theory of *Shariahization* on Accounting Conceptual Framework.” The theory reflects the fact on the endeavors of KAS members in *shariahizing* the conceptual framework of FPPFS to be in compliance with the *shariah*.

### 6. Conclusion

There are two types of theory that might be found in grounded theory, i.e., substantive theory and formal theory (Glaser & Strauss, 2006). Substantive theory applied to a given situation, while formal theory applied to many situations and various contexts (Glaser & Strauss, 2006; Strauss & Corbin, 1990, 1994, 1998). A Substantive theory usually precedes the formal theory and in general is closely related to the scope of practice (Locke, 2003: 35), or of a certain empirical area (Glaser & Strauss 2006: 32). Both substantive theory and formal theory belong to middle-range theory (Glazier & Grover, 2002: 321; Glaser & Strauss 2006: 321).

Theory of *shariahization* on Accounting Conceptual Framework is a substantive theory that is conceptualized based on the context of Indonesia accounting standard setter. However, if we broaden our horizon, we find that the process of *shariahization* is similar to AAOIFI (2001) that formulates accounting standards for Islamic financial institutions. AAOIFI (2001) holds contemporary accounting thought, then tests it with Islamic law, accepts it when it is in accordance with *shariah*, and rejects it when it is in contrary with *shariah* (AAOIFI, 2001:32 ). The decisions of accepting and rejecting are the act of "Islamization" or "Shariahization ".

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