

PRIMARY RESEARCH

An Alternative Model in Financial Reporting to Reduce Flaws and Injustice with Stakeholders

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Abstract. Seemingly, a formidable ethical challenge to financial reporting is the phenomenon of fallacious and discretionary financial reporting as currently in practice. Such untruthful reporting intensified during the first decade of the 21st century when many of the personnel got involved to increase their personal benefits and the result was a wide-spread financial fiasco in the form of MCI WorldCom, Enron, Well Fargo, and Tesco accounting scandal, to mention a few. Most of the scandals were caused by false reporting, withholding information about financial troubles, revenue and earnings inflation, discretionary revenue and expense recognition, use of off-balance-sheet items, artificial increase of cash flow and profits, backdating of sales contracts and accounting for vendors allowances and financing. The research in hand is an attempt to discuss such issues in the light of ethical and moral values that are not only recommended teachings of Islam, but also accepted business ethics in the civilized world. Islamic ethical guidelines for business encompass discipline and rules as enjoined in the divine sources of Shari'ah - Qur'an and Sunnah (sayings of or the approved actions by the holy Prophet Muhammad PBUH). Implementation of these guidelines to make financial reporting ethical should be acceptable to the entire world, at personal, organizational, and society levels for broad based benefits of the mankind.

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INTRODUCTION

Recently cropped up problems in various companies have raised many questions regarding financial reporting. Financial statements found in annual reports, prepared by companies

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always look formal. They are prepared using such accounting policies which are favorable for the entities themselves (Gowthorpe & Amat 2005), and signed by upper level management, while the audit firms are accountable to verify them to capture users' attention. However, they may not be accurate because of lawful mis-judgments in the assessment of business assets, measurement of costs and existence of flexible accounting rules. Truthfulness and consistency of financial statements have become critical need for stakeholders. Over the past decade, accounting and financial reporting frauds harmed public trust, lost stocks' wealth and caused worldwide recession (Lail, MacGregor, Marcum, & Stuebs, 2017). This took place in the presence of leading accounting bodies like Financial Accounting Standard Board (FASB) and International Accounting Standard Board (IASB) who seemed to be helpless to chase such manipulative conduct. The conceptual framework of accounting addressed the issues to a limited extent while the accounting frame work failed to resolve many prominent issues (Mala & Chand, 2015).

Accounting standard setters have also over looked the social role of accounting and auditing that might be damaging for many stakeholders (Bayou, Reinstein & Williams, 2011). Managers' response to shareholders' pressure compels them to show positive news before the annual shareholders meetings (Dimitrov & Jain 2011). Manager's interest in false disclosure is also associated with their promotions, status, goodwill, perquisite, bonuses, etc (Ball, 2001). The managers usually show abnormally positive returns during forty days before shareholders meetings, which influences the trading patterns in the stock exchange during pre-meeting days. Directors, having possession of large number of shares, put pressure on managers to overstate revenues through application of flexible accounting policies (Ranti & Olamide, 2012). Companies with high institutional ownership and compensation show robust performance before shareholders meeting (Dimitrov & Jain 2011). Inadequate accounting standards are used to exhibit better financial position of the business (Nezlobin, 2012). Even the contamination in financial system has extended the use of fictitious algorithm (De Marco, Donnini, Gioia, & Perla, 2018).

Flexible accounting policies with regard to asset valuation methods, favorable accounting assumptions, recognition of revenue and expenses, exaggeration of assets turnover and income, and undervaluation of liabilities are the areas susceptible to manipulation (Spathis, Doumpou & Zopounidis, 2002). Therefore, the current study has been undertaken to capture the link between such reporting related practices and the ethics.

In recent years, number of researches on Islamic ethics in different dimensions can be traced (e.g., Ali, Aali & Owaihan, 2013; Fang & Foucart, 2014; Gümüşay 2014; Haniffa & Hudaib 2007; Khan, Abbas, Gul & Raja, 2013; Murtaza *et al.*, 2014; Possumah Ismail & Shahimi, 2013; Rice 1999; Rice 2006; Saeed, Ahmed & Mukhtar, 2001; Tlaiss, 2014; Uygur 2009). Profit maximization without caring for the ethics and society has been criticized even in the mainstream economics; more so in Islamic economics (Ayub, 2013). Many studies have suggested different models such as polytomous response logit models which are helpful for evaluating different risk factors and are helpful for detecting financial failures (Tinoco, Holmes, & Wilson, 2018).

However, the area which needs attention in this perspective is the application of Islamic business ethics in financial reporting to eliminate injustice with stakeholders. The current research is an attempt to highlight the issues in financial reporting in ethical perspective in order to create fairness, justice and accountability in framework of financial reporting practices. Section two of this paper sheds some lights on the numerous issues like corporate fiasco of 2002, earnings management, siphoning of revenues, conversion of GAAP to IFRS, irrational expectation of from audit committee and role of audit committee in financial reporting. Section three of this research entails the model of Islamic Ethics containing three things, accountability and transparency, fairness and justice, and truthful reporting. In the fourth section, the conclusion of the study has been discussed. It also includes the implication of the study.

LITERATURE REVIEW

Historical Perspective on Corporate Fiasco of 2002

Financial fiasco of 2002 implies that standards being followed hide the weaknesses of boards, bad corporate governance and control systems; deceptive motivation plans, accounting frauds, auditor's lapses, CEO's discretionary actions, executives' irresponsible attitude and finally absence of ethical stance (Soltani, 2014). A corporate fraud ends up with distress of stakeholders, financial harm, employees' layoffs, legal actions, modification of possessions and corporate insolvency (Zona, Minoja & Coda, 2013). The financial statements were unable to forecast liquidity issue which led to the grounding of Swiss Air on October 2, 2001 (Krapf & Steger, 2002). The executive compensation in General Electric forced accountants to manipulate financial statements which caused collapse (Narayanan & Brem, 2011). Slippery slope rules, elastic behavior of regularity authorities, lack of precautionary controls or improper regulations grant a trunk road to episodic financial disaster of well reputed corporations. Even investment banks of Enron extended all possible help to manipulate its financial health with the intention of deception to shareholders, lenders and others (Government Accountability Office, 2002, PP. 4).

Collapse of Enron led formation of US senate permanent subcommittee which disclosed: *"Enron Board of Directors failed to safeguard Enron shareholders and contributed to the collapse of the seventh largest public company in the United States, by allowing Enron to engage in high risk accounting, conflict of interest transactions, extensive undisclosed off-the-books activities, and excessive executive compensation. The Board witnessed numerous indications of questionable practices by Enron management over several years, but chose to ignore them to the detriment of Enron shareholders, employees and business associates. The Enron Board of Directors knowingly allowed Enron's use high risk accounting practices"* (Permanent Senate Subcommittee Report, 2002; pp. 11-14).

The accounting procedures in practice failed to serve the business and stakeholders, as company executives applied their technical expertise to manipulate the financial results (Spalding Jr & Oddo 2011). 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 & Zaiats 2012). The most leading corporate collapses imply failure of ethical management which is the result of change in the attitude of employees (Kottke & Pelletier 2013). Enron meltdown is an example of immoral and corrupt business management. The chief human resource manager of Enron mentioned the following grounds of collapse:

"I believe that there are six main causes of unethical behavior for individuals in organizations. These include competence leading to success, increasing arrogance from past success, addiction to praise and status, faulty reward systems, self-deception, and the enabling behaviors of others. These are the core causes of ethical downfall and they certainly fit the case of Enron. I also believe that history will prove that these causes have been sparked and spread like wildfire across companies throughout the financial services industry, contributing significantly to our very recent economic disasters" (Madsen & Vance 2009; p. 222). In the same vein former vice president of Enron (Sherron, 2003; p. 122), said that: "The frauds may be different, but the basic bottom line has been the same: the top guys rode off into the sunset with multi-millions, and the shareholders and employees of the companies lost".

Regarding independence of auditors and Board of Directors, the US Senate Committee observed, "The independence of the Enron Board of Directors was compromised by financial ties between the company and certain board members. The Board also failed to ensure the independence of the company's auditor, allowing Andersen to provide internal audit and consulting services while serving as Enron's outside auditor (Permanent Senate Subcommittee Report, 2002; pp. 54)".

People think of massive corruption while recalling the name of Enron, in which top management deceived thousands of workers by manipulating million of dollars. General Accounting Office (Government Accountability Office) also "raised doubt about the integrity of the management, financial reporting practices, quality of the audits, and the auditor's independence" (Government Accountability Office, 2002, P. 80). Auditors' independence is the basic requirement; otherwise there is no logic of appointing any external auditor in presence of internal auditor (Moore, Tetlock & Tanlu, 2006). Enron had very close relation with Stephanie Anderson Forrest, who was providing internal as well as external audit service. It is strange, however, that the same firm was recognized as a model of morality, success, altruism; responsible socially, environmentally and in terms of accountability, and hence an excellent corporation of 21st century (Sims & Brinkmann 2003).

Management's Incentives and Earnings Management

Earnings management has captured, since long, the interest of researchers, investors, regulatory bodies and other stakeholders (Zhang, Bartol, Smith, Pfarrer & Khanin, 2008). It is outcome of adoption of numerous accounting tools and techniques for integration of individual and firm goals (Greenfield, Norman & Wier, 2008). Executives while reporting profit are interested in reporting positive earnings to meet the expectation of the analysts (Degeorge, Patel & Zeckhauser, 1999; Healy & Wahlen, 1999). It has been evidenced that chief executive officers got involved for higher equity motivation by putting pressure on chief financial officers to manipulate financial statements (Feng, Ge, Luo & Shevlin, 2011). Even

the shareholders of the corporations influence management to report high/low earnings by practicing elastic accounting rules financial reporting (Davidson, Jiraporn, Kim, & Nemec, 2004). 'Impression Management' also influences the management to get involved in earnings management. Besides, companies located in different countries also manage earnings (Prencipe, 2012). Presence of opportunity, intention and means can damage ethical behavior of executives implying that if executives have opportunity then probably they can commit fraud (Pendse, 2012). Bruner (2006) observed that the mentality of growth at any price can warp the thinking of otherwise honorable people". Of course, the countries having strong legal enforcement automatically eliminate earning managements (Chih, Shen & Kang, 2008).

Conversion from Generally Accepted Accounting Principles (GAAP) to International Financial Reporting Standards (IFRS)

Movement from US GAPP to IFRS had rare but statistically momentous impact on reporting of assets, liabilities, and equity (Capkun, Cazavan, Jean Jean & Weiss, 2008). In IFRS revenues are recognized when sales occur, whereas under US GAAP revenues are postponed until procedure of earning materializes and cost of revenue is offset against the revenue of that particular period. Corporations that use IFRS report much high profit than US corporations who use local standards (Fosbre, Kraft & Fosbre, 2009). International Accounting Standard Board (IASB) and Financial Accounting Standard Board (FASB) need to develop sound conceptual framework as it will influence the formation of accounting standards for many years to come (Mala & Chand, 2015).

Density in accounting standards leads to revenues restatement which has adverse impacts on stakeholders (Peterson, 2012). Ambiguous framework of IFRS leads to huge flexibility of judgment, hidden and open options which are not illegal under principles based standards. The massive flexibility under IFRS is associated with inadequate direction about adoption of these innovative standards which may lead to income smoothing (Capkun, Collins & Jean, 2011).

Siphoning of Revenues

Entities with equal range of sales and expenditures can communicate their earnings in distinctive way by using flexible accounting policies. Entities also report higher earnings especially at the time of selling their stocks. Although it may not necessary that such types of practices are illegal, yet the same are clearly unethical (Madura, 2004, pp. 17). Treating a part of investment as operating profit leads to siphoning of revenue. Enron was allowed to adopt fair value of assets in accounting for energy contracts only, but it applied the same for other assets as well. This also leads to siphoning of revenue by treating profit from operations instead from investment. Siphoning of revenue motivates the managers for extension and overvaluation of projects, which led Enron to file bankruptcy (Benston, 2006). Highly paid CEOs got involved in siphoning of revenues in order to serve the interest of shareholders (Fogarty, Magnan, Markarian & Bohdjalian, 2009). Even expenditures are hidid or treated as economic resources of business by capitalization.

Treatment of expenditure as fixed assets can also be traced from accounting practices of American Telecommunication Company, named as MCI WorldCom (Zack, 2012, pp. 172). Revenue enhancement through short sales is another example under the umbrella of siphoning of revenue. From 1997 to 2007, large corporations had lost billions through misreporting and deceptive practices while communicating their financial results (Beasley, Carcello, Hermanson & Lapedes, 2010). The principle of fair value also contributed towards financial disaster along with the siphoning of revenue, which could be can be solved through the execution of transparent accounting policies (Kothari & Lester 2012).

Lack of Knowledge and Irrational Expectations

Investors blindly believe on the financial reports certified by qualified auditor and, hence, make investments on the basis of these reports. As a result, they incur loss by building a lot of expectation about fairness of financial statements (Okafor & Otolor 2013). There is a need to create awareness in public about accounting, auditing and audit regulations. A gap occurs as a result of lack of knowledge among the public about accounting and auditing (Singleton, Singleton, Bologna, Lindquist, 2006, pp. 76). Users of financial statements are not able to discover misleading financial figures reported through choice while adopting different accounting policies (Blake, Bond, Amat & Oliveras, 2002). Manipulation of income by transferring recurring expenses to non recurring expenses is used by firms to meet the expectation of analyst's (Athanasakou, Strong & Walker, 2009).

Stakeholder's expectation and inadequate accounting standards lead to iniquitous auditing process (Enyi, Ifurueze & Enyi, 2012). Directors also express their biasness by taking wishful decisions in their own interest (Certo, Dalton, Dalton & Lester, 2008). 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 & Stuebs 2013). Similarly, some technical accounting terminologies are perceived differently by its users. 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).

Uses of Assumptions and Judgments

The theory of accounting model states that financial statements are prepared on the basis of assumptions and judgments, which allows management to overstate or understate firm's revenues (Chartered Financial Analyst, 2012; pp. 27). Profit reported under assumptions does not depict reality and lead to misconceptions about financial statements (Christodoulou & Mcleay 2009). Inventory valuation methods are the true example of assumptions used in financial reporting. Application of assumptions based valuation tends to report high profits (Williams, Haka, & Bettner, 2002; p. 327). Under accrual system of accounting, expenses and revenues are taken into consideration irrespective of the fact whether physical flow of cash takes place or not. Accrual system of accounting is based on judgment and estimations which allow flexibility judgment (Dechow & Skinner 2000). In such circumstances, a firm can overstate net income simply by recognizing revenues early and deferring expenses in

later period to present strong financial position (Chartered Financial Analyst, 2012; p. 48).

Although through application of flexible accounting practices the availability of accounting information could be broadened, but such practices might also equip the management with sufficient authority to require the auditors to incorporate complicated and confusing information for yielding desired results (Carcello, Hermanson & Neal, 2003).

While self-oriented judgments provide ground for earnings management, the auditors' opinions based on such financial reports don't display exact financial performance of the firms. The question remains for regulatory authorities to decide the criteria of judgment for management (Healy & Wahlen 1999). Manipulation through adoption of various accounting policies comes under GAAP, but choice of accounting policy is associated with management's judgments. No doubt that the judgment is required and it might not create falsified reporting if it is adopted within the stated range of GAAP, but when one crosses particular limit, then financial results would not be fair (Mulford & Comiskey, 2002, pp. 39).

Audit Committee and Financial Reporting

Different committees such as audit committee, compensation committee and nominating committee should consist of independent director of the Board (Uzun, Szewczyk & Varma, 2004). An independent audit committee has vital role to enhance transparency of financial reporting. Under Sarbanes-Oxley Act 2002, all public companies should have audit committee consisting of independent members from the board of directors.

On account of the manipulations in financial reporting, inefficient management and accountant's personal likeness, auditors as also standard formation bodies are accountable for recent issues of corporate failures which in fact are the ethical failures (Staubus, 2005). Stakeholders approach the management and external auditors for clean audit reports through utilizing their contacts, which has deteriorated independency of audit profession (Liu, Wang & Wu, 2011).

Expectations of the users of financial statements regarding audited reports are more than what auditors commit and perform while auditing (Tarr & Mack, 2013). The audit opinion expressed by auditor has great impact on business and society. Responsibility of an auditor is to express his true and fair view with regard to transparency of financial reporting. Though the users and practitioners have distinct perception with regard to the phrase true and fair view, such distinct view creates expectation among the interested parties (Kirk, 2006). External auditor is appointed to express unbiased external judgment regarding authenticity and accuracy of financial statements (Moore *et al.*, 2006).

THE MODEL OF THE STUDY

The IASB and the FASB need to develop sound conceptual framework as it will influence the formation of accounting standards for many years to come (Mala & Chand, 2015). Mala & Chand (2015) further argued that the accounting framework failed to resolve many prominent issues. The accounting standard setters have over looked the social role of accounting and auditing that might be damaging for many stakeholders (Bayou *et al.*, 2011).

Therefore, the current study proposes a model which permeates the ethical guidelines for transparent financial reporting in the light of Islamic principles emanating from the Divine sources of Qur’ān and Sunnah. This model tends to communicate that the doctrine and ethics emerging from Qur’ān and Sunnah would be helpful in ensuring the best quality of the financial reports, transparency, fairness and justice, and accountability of the relevant parties, thus leading to truthful reporting. Specifically, the application of this model would encourage and stimulate the transparency in the financial reporting mechanism.

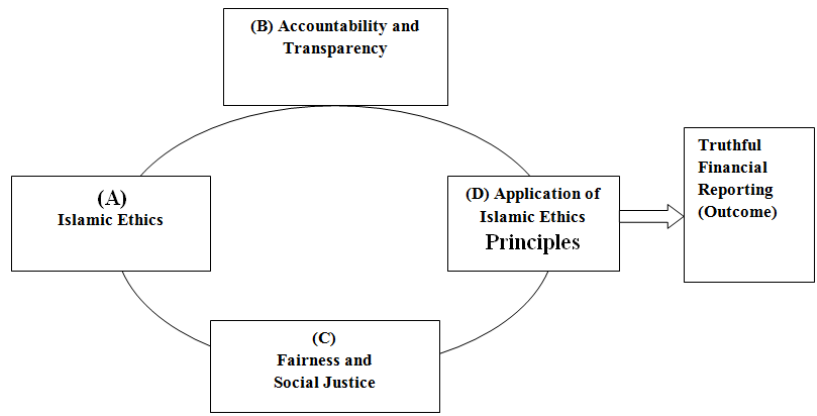


FIGURE 1. The way towards truthful financial reporting

Islamic Ethics

Islamic business ethics can be defined as set of ethical precepts approved by Qur’ān and Sunnah (Abuznaid, 2009). Business ethical system of Islam consists of value-maximization, fairness, and honesty with people (Mukhtar, Saeed & Ahmed, 2001). Society in Islam is founded on the principles of *tawhīd* (concept of oneness of God that covers the whole domain of human life to be strictly in line with the precepts of the Sharī‘ah. Thus a Muslim has to be a total submitter [to Allah]), doing *‘adl* (fairness and justice with all), *ma‘rūf* (virtue), giving the rights of others and performing *tazkīyah* (purification of the self or spiritual purity) and *ihsān* (kindness). "Surely Allah enjoin *‘adl*, kindness and doing of good to kith and kin, and forbids all that is shameful, evil and oppression. He exhorts you so that you may be mindful." (Qur’ān; Al-Nahl 16: 90).

Islam declares business ethics as the essential part of daily life (Beekun & Badavi 2005). Because of globalization and being the second prominent religion, Islamic ethics have captured the interest of researchers for last thirty years. (Khan et al., 2013). Islamic ethics requires faithfulness to ensure integrity, humanity and fairness by avoiding such norms which are harmful for others and society (Kamla, 2007). Hence, moral, social and business ethics are its part and parcel. The ethical and moral system of Islam ensures the rights of all stakeholders with justice and fairness by discouraging all entrenched habits of fraud. The Holy Qur’ān enjoins, "Cooperate with one another in acts of righteous and piety and do not help one another in sin and transgression, fear Allah, surely Allah is show in retribution" (Al-Maidah 5:2).

Islam requires individuals and the institutions to be dutiful every time, and when everyone is careful about his/her responsibilities. In business perspective, Islamic ethical values are based on rightly guided human nature while encapsulating its spiritual dimensions; and thus

cannot be compared with other artificial or manmade rules (Mukhtar *et al.*, 2001). Islamic ethics have great impact on managers' behavior leading to responsible business conduct. Justice and independence as basic Islamic norms stimulate managers and all those who are responsible to ensure that the interests of all stakeholders are safeguarded (Graafland, Mazereeuw & Yahian, 2006).

Accountability and Transparency

Accountability is fundamental to human being each one of us is accountable to God, the Creator and actual owner of this world and the resources, as also to the society and the fellow beings. Islam provides clear guidelines regarding reporting and accounting practices (Bhatti & Bhatti 2010). "O you who believe! fear Allah and speak words straight to the point." (Al-Ahzab 33:70). This verse comprises two parts: the part "Guard your duty to Allah" addresses that human being is accountable towards his God while the second part that commands to speak words straight to the point implies that human beings are also accountable to society for their acts. Islam condemns contracts and transactions which entail interest, *gharar* (lack of disclosure), *qimār* (gambling) and *maysir* (games of chance involving deception) (Iqbal & Mirakhor, 2011: pp 57). Islam recognizes accounting not merely a procedure, but it also considers it as contractual relation with community and God (Haniffa, Hudaib & Mirza, 2004).

The presentation of financial statements is a process of communication within organization as well as outside of the organization. All (CEOs, CFOs, Accountants and Auditors) have to follow magnificence in communication as mentioned regarding accountability and transparency by Qur'ān: "*And fulfill the covenant for you will be called to account regarding the covenant (al-'ahd)*" (17:34). To convey the importance, Allah Almighty says that individuals as also the groups must fulfill their commitments and that they are accountable regarding fulfillment of commitments at the day of judgments. If anyone shows inefficiency or conducts badly knowingly while performing committed obligation he is deemed to be committing crime and hence will be punished and accountable at the Day of Judgment. It requires not just accomplishment of covenant but fulfillment in the most befitting and transparent manners according to best of one's abilities.

While Islam allows profits and earnings made in line with the relevant observance of rules and ethics, it does not allow profit maximization by spoiling or ignoring the rules emanating from the Islamic ethical system (Ali *et al.*, 2013). Businesses and organizations have right to make efforts for profits for their regular operation as also for growth. But just ensuring and maximizing profit without caring for impacts on others and the society is not an axiom in Islamic economic system which actually cares for welfare (*falāh*) of individuals and society as a whole giving equal opportunity to all without any discrimination on the basis of cast and creed (Khan, 1991).

Islam permeates logical guidance with regard to business dealings, what is allowed or prohibited and what should be the acceptable behaviour in dealings with different parties, and this has been done by acquainting human being with the concept of Judgment's day (*qīyāmah*) and fool-proof accountability with resultant punishment or rewarded to each and

every individual from the mankind (Williams & Zinkin, 2010). Islam wants peace and tranquility and tends to start this process from each and every individual himself. "And do not cast yourselves into destruction with your own hands" (al-Baqarah, 2:195). Hence, personal morality, self-preservation and self-respect alongwith respect for others, are the qualities of good auditor, accountant as also manager. If and when the above mentioned qualities are exercised in true spirit by the individuals and the relevant authorities, there remain no chances left for the wrong financial reporting causing harm or loss to any of the stakeholders. Islamic ethics and principles of morality are essentially a matter of rights and obligations towards family, society, state and humanity at large, and in turn, towards the Creator of the universe, Almighty Allah. The sense of accountability infused in the human beings properly can eradicate injustice and unfairness from society.

Islamic perception about contracts [*‘uqūd*] has great significance for all stakeholders in business. It guides us regarding numerous contractual aspects and reminds us to fulfill promises and the covenants (Qur’ān. 5:1) and pay or perform what we are liable to others. Islam also restricts people from telling lie, reporting falsely or be involved in any type of dishonesty and corruption (Uddin, 2003). Any auditor, based on the nature of its job, is deemed to be entering into a contract with organization and society, and ultimately to God. Similarly when an accountant prepares any financial report or discloses any information regarding financial performance of a company, he/she is considered to be in contract with many stakeholders and the society and is, therefore, accountable to all. As such, any bad practice like disinformation, maneuvering the information or any operations leading to any harm to the society, the auditors have to sincerely report the fact to serve the interest of society.

Fairness and Justice

The ethical system of Islam is based on fairness, justice, generosity and excellence and kindness in the society (Kamla, 2007).). *‘adl* [justice] and *ihsān* [benevolence] both have to be recognized as fountainhead of moral and ethical values in economics and accounting practices. *‘adl* which also implies fairness tends to serve the rights of all stakeholders by prohibiting exploitation and discrimination along with other moral evils (Beekun & Badavi, 2005). It means accomplishment of agreements, contracts and pacts in which individuals are required to be obedient and submissive (Graafland et al., 2006). Al-Ghazali, the most prominent Islamic scholar of Islamic social sciences, articulates the term *ihsān* as practicing excellence for and to whom you are dealing over and above what is specified by rules and regulations (Sidani & Al Ariss, 2015).

The Qur’ānic verse relating to incurring debt/credit and keeping its record provides best guidance in this regards and requires the parties to write and take record of the credit fairly: "*O those who believe, when you transact a debt payable at a specified time, put it in writing. And let a scribe write [it] between you in justice. No scribe should refuse to write as Allah hath taught him, so let him write*". [Al-Baqarah, 2: 282].

The scribe has been instructed to write justly and fairly to avoid the possibility of loss to any of the parties. The scribe’s right has been equally protected as Qur’ān says, "Let no

scribe be harmed or any witness. For if you do so, indeed, it is [grave] disobedience in you." In case a credit is involved, collateral has been suggested so as to avoid risk of loss to the creditor in case the debtor is not able to repay the debt. Verse 2: 283 says in this regard, *"If ye are on a journey, and cannot find a scribe, a pledge with possession (may be given). And if one of you deposits a thing on trust with another, Let the trustee (faithfully) discharge his trust, and let him fear his Lord, Allah Almighty. Conceal not evidence; for whoever conceals it, his heart is tainted with sin. And Allah is aware of what you do"*. It reflects the best code for anyone who is involved in preparation of financial reports and their disclosure and presentation.

In financial reporting perspective, the above code of writing and taking care of the rights of all related parties implies that the management and the personnel involved must disclose in the financial reports all relevant information regarding financial health of the company. Thus the human beings have been motivated to behave fairly and justly for building of ethical, just and fair society in which people would be careful for one another. *"Indeed, Allah commands to do justice and be good, and to give relatives (their due), and forbids immorality, shameless acts and bad conduct and transgression. He instructs you so that you may take heed Al-Nahl; 16 : 90"*. Allah says three things in this verse: (1) To do justice, (2) to be good and benevolent, and (3) to give relatives (their due). Then, He forbids three things. These are: (1) Shameful acts, (2) evil deeds, (3) transgression.

Islam offers a universal ethical basis for restructuring of social behavior. Going forward for humility, it demands an attitude of thankfulness (*shukr*) and not arrogance, unfairness (*ẓulm, kufr*) and excess (*ṭughyān*). To build an equitable, fair and just society, Qur'ān calls for inculcation of truthfulness (*ṣidq*) and God-consciousness (*taqwā*) which allow a person to be constantly aware of both God's presence and attributes and a reminder of their relationship and responsibility to God as His creation and servant. According to this scheme of building an ethical society, accountants and auditors have been guided by the holy Qur'ān: *O ye that believe! Betray not the trust of Allah and the Messenger, nor misappropriate knowingly things entrusted to you (8:27)*. Hence, if an organization is making hefty profits through hoarding, deceiving its stakeholders or showing profit by manipulating the financial reports for any foul play, it will not be recognize as successful organization in Islamic perspective because Islam condemns such type of material success that could be attained by ignoring the sublime Islamic ethics. Success and wellbeing have to be evaluated in broader perspective performing ethical and just religious duties with firm faith in accountability for deeds and action towards the Almighty (Abu-Tapanjeh, 2009).

Islam also incorporates the philosophy of public welfare and doing good for benefit of others. Holy Qur'ān says in this context, *"Surely, Allah commands you to fulfill trust obligations towards those entitled to them, and when you judge between people, to judge with justice. Excellent is that which Allah instructs you. [4:58]*. Here, the fulfillment of trust obligations has been given precedence to equity and justice perhaps for the reason that the establishment of a system that guarantees equity and justice in any society is not possible if its members do not fulfill their obligations to other.

Truthful Reporting

From an Islamic standpoint, transparency in financial reporting can be enhanced by observing the injunctions like fairness and honesty as discussed above, and the concepts of *ḥalāl* (what is permissible and allowed) and *ḥarām* (what is prohibited and has to be abstained). It also has to take into account the concept of compliance with the Sharī‘ah principles (Lewis, 2005). It requires that if you are working as an accountant, analysts, director or auditor in an organization you must serve the interest of society, which must not be caused harm just to serve the interest of one’s business. This is the only way through which we can successfully eradicate many evils from earth and can establish just and ethical societies.

Islamic teachings are for the benefit of the whole human society. In fact, many of the economic principles in Islam can be traced back through the earlier Holy Books. The concept of *risālah* in Islam is based on the teachings of all of Allah’s Prophets, inter alia, including Muhammad (PBUH), Jesus (PBUH), Moses (PBUH), and Abraham (PBUH), who delivered the message of Allah in different times in human history. A true Muslim would see the divine worldview through all divine messages, however, recognizing Muhammad (PBUH) as the last messenger of Allah. "Indeed, to protect society’s integrity and means of self-support for its members, every religion in history perceived that the system of usury was opposed to the proper workings of society." (Choudhury, 2007; p. 59). By using a system of knowledge based on *tawḥīd*/One-Allah epistemology we can deduce a set of moral teachings, which should guide us in the creation of a transparent and just system in which all stakeholders have to be governed by a well-defined discipline.

The Qur’ānic verse, "And give full measure and weight with justice" (6: 152) points to an order to release all required information in just and fair way without concealing anything in the interest of any party (Lewis, 2001). It is not possible to measure or weigh with justice in presence of manipulated financial reporting. Islam strongly condemns earning or profit taking through illegal practices like deceiving stakeholders and controlling the market. According to the Qur’ānic verse the true righteousness (is attained of those) who, inter alia, are faithful to their promise once they have made it..." (2:177).

CONCLUSION

Under Islamic ethical system, fulfillment of responsibilities with honesty and commitment is a core religious obligation. To build an equitable, fair and just society, Qur’ān and the Sunnah provide a vivid framework for the individual and society as building block of a well-mannered and successful society. It calls for inculcation of truthfulness (*ṣidq*) and God-consciousness (*taqwá*) in the behavior of all stakeholders of the corporate world. Accordingly, what Muslims perform in daily life individually or on institutional basis should be coined with ethical guidelines of Islam, out of which truthful speaking and God-consciousness are the most important. "*O you who believe! Guard your duty to Allah and speak words straight to the point.* (Qur’ān 33:70). Ethics and morality require that one should focus more on fulfilling duties towards God as also the human beings, than to making money one way or the other.

Uplift in ethics at personal, organizational and society levels would resolve the issue of earnings management and confusing financial statements. Corporate frauds occurring due to false reporting, use of assumptions, management incentives, and irrational expectation from auditors can be removed by enhancing awareness among the stakeholders at broader level about the mechanics of financial reporting and by observing the Islamic ethics with regard to transparency and disclosure.

The traditional financial reporting does not provide complete information as required by Global Financial Initiative (Villiers & Sharma, 2017). The individuals when selected as a focused group having related knowledge can influence the standard setting process even if they are small in number (Himick, & Brivot, 2018). Therefore, the path towards refining the financial reporting system is the application of virtuous professionalism (Lail *et al.*, 2017). Islam motivates all members of a society to work for the establishment of truthful and equitable system through ethical guidance. Therefore, integration of ethics in finance demonstrates that ethical approach and decent governance go beyond the compliance of the law (Fassin, and Drover, 2017). The standards setting bodies also need to be given power of effective enforcement to avoid manipulated financial statements. It is further recommended that initiatives should be taken to initiate media campaign to highlight mechanics of financial reporting used in manipulation of financial reporting.

Religion has played a great role by promotion of ethical behavior in individuals through concept of reward and punishment (Noreen, 1988). This concept is best ingrained in the concept of broad-based accountability of all human beings to Allah Almighty. Accountants and auditors have to undertake the financial reporting function, as being accountable to the society. Ethical principles and teaching of Islam would foster goodness of present and future accountants (Mahdavikhou & Khotanlou 2012). Knowledge and religious faithfulness has close association with financial reporting to reflect financial transparency (Dyreg, Mayew & Williams, 2012). Practice of ethical system reflects true and fair view of the firms' affairs. Compliance with ethics will enhance transparency in financial reporting, and earnings. Business ethics would lead to improved financial reporting quality (Choi & Pae, 2011). There is also a strong relationship between the education and moral development. Therefore, teachers should develop ethics in accounting instead of just teaching accounting literature (Ponemon, 1993). Lastly, the study could serve as an impetus for furthering the research on the role of Islamic ethical values in removing injustice with any of the stakeholders by means of fictitious financial reporting.

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