**NOTE:** This paper has been published in *Journal of Islamic Accounting and Business Research*, Vol. 1, No. 2, 2010, pp. 92-113. DOI: 10.1108/17590811011086705. The printed version of the paper may differ slightly from the version below: the printed version is definitive.

# ACCOUNTING, RELIGION AND ORGANISATIONAL CULTURE: THE CREATION OF JORDAN ISLAMIC BANK

*Bassam Maali*\* *and Christopher Napier*†

\* Assistant Professor of Accounting,

University of Petra, Amman, Jordan

(E-mail: bmaali@uop.edu.jo)

† Professor of Accounting

Royal Holloway, University of London,

 Egham, Surrey, TW20 0EX, UK

 (Tel: +44(0) 1784 276121)

 (E-mail: Christopher.Napier@rhul.ac.uk)

Earlier versions of this paper were presented at the Accounting, Business and Financial History Conference, Cardiff, 2004, and the Global Accounting and Organisational Change Conference, Melbourne, July 2008.

# ACCOUNTING, RELIGION AND ORGANISATIONAL CULTURE: THE CREATION OF JORDAN ISLAMIC BANK

# ABSTRACT

**Purpose:** The paper examines the cultural factors that shaped the creation of one of the earliest Islamic banks, discussing the tensions that arise between religious and economic aims.

**Design/methodology/approach:** The research is a case study of a historically significant institution. The information on which the paper is based was obtained through interviews with participants in the process being analysed, review of archived documents, and observation. Edgar Schein’s theory of organisational culture and leadership is employed to provide theoretical structure for the analysis.

**Findings**: The paper shows that creating a new type of organisation – an Islamic bank – in Jordan required special legislation. A study of the development of this legislation reveals that the bank’s founder needed to convince both the religious and political authorities and potential investors that the bank would comply with *Shari’a* principles while at the same time generating profitable business. The outcome was to validate transactions that were *Shari’a*-compliant in form but similar in substance to those of conventional banks.

**Research limitations:** The study examined one bank, and the findings are not necessarily representative of the experience of other Islamic financial institutions.

**Practical and social implications:** The research highlights the problems faced in establishing businesses that seek to follow the moral and economic teachings of Islam. The paper contributes to the ongoing debate about whether it is possible to establish genuinely Islamic businesses within a conventional economy.

**Originality/value:** This is the first detailed academic study of the creation of an Islamic financial institution to make use of a wide range of documentary and oral evidence, including interviews with insiders.

**Key words:** Islamic banking, *Shari’a*, Jordan, bank regulation, financial reporting, *mudaraba*, *murabaha*

**Category of paper:** Research paper

# ACCOUNTING, RELIGION AND ORGANISATIONAL CULTURE: THE CREATION OF JORDAN ISLAMIC BANK

## Introduction

This is a study of how the assumptions and values of the founder of a comparatively new type of organisation, an Islamic bank, shaped the bank’s accounting and governance structures and processes. The notion that human groups share assumptions and values, and that not only the survival and success of specific groups, but also differences between groups, can be explained by reference to these shared assumptions and values, has formed the basis of cultural studies within many branches of the social sciences. Hofstede (1980, p. 25) has labelled “the collective programming of the mind which distinguishes the members of one human group from another” as *culture*, and his view of national cultures has influenced accounting research through the work of Gray (1988). Although Hofstede’s notion of national cultures has been criticised, most notably by McSweeney (2002), the concept of “organisational culture” may be more robust (see for example Alvesson, 2002; Martin, 2002; Schein, 2004). As Alvesson (2002, p. 6) observes, cultural phenomena “are related to history and tradition”, “are collective and shared by members of groups”, and “[have] to do with meanings, understandings, beliefs, knowledge, and other intangibles”.

How are organisational cultures formed? Several researchers in the field see an important role for human agency in this: founders and subsequent leaders may attempt to inculcate particular assumptions and values within their organisations. Schein (2004, p. 70) identifies stages of group evolution, the first of which is group formation. At this stage, group members tend to be dependent on the group’s leader to define the group’s values. This does not necessarily imply that all group members will unthinkingly share the leader’s values: it is possible that some members will resist (though resistance may mean that they do not remain members of the group for long). Schein (2004, p. 226) emphasises the impact of founders:

Founders not only choose the basic mission and the environmental context in which the new group will operate, but they choose the group members and bias the original responses that the group makes in its efforts to succeed in its environment and to integrate itself.

Unfortunately, it can be difficult to study the influence of founders on the culture of long-established organisations, because the founders may no longer be associated with the organisations being investigated. Studies of the influence of founders may have to depend on documentary evidence and oral history, and there is the danger that founders become idealised. Where founders are still available to be interviewed, the values that they attempted to inculcate, and their strategies for shaping the organisation’s culture, may be investigated more directly, though even here it is necessary to allow for the passage of time and fading of memory as potential distorting factors.

Organisational culture is an important factor in forming organisational structures and practices, what Schein (2004, p. 26) refers to as *artefacts*. Such artefacts include accounting and governance processes and structures. Artefacts of organisational culture can be observed, both directly as manifestations of human behaviour and through the testimony of individuals and the witness of documents. However, it is not always straightforward to identify from surviving artefacts the underlying cultural values that lead to a specific organisational culture. The aim of this paper is to identify how the values of an organisation’s founder influenced the organisation’s culture, with potentially long-lasting impact. The organisation under investigation is Jordan Islamic Bank (JIB), established in 1979. We discovered that establishing an Islamic bank implies the creation of a particular type of organisational culture, where two potentially conflicting forces have to be reconciled. The first of these is the need to establish a commercially viable enterprise capable of competing with existing banks operating on a standard capitalist model. For example, the Islamic bank must offer savings and investment products to potential depositors that offer returns comparable to those available in conventional banks. On the other hand, the bank must be seen to comply with the principles of *Shari’a*, and this may require the establishment of institutional structures that demonstrate this compliance to customers and outsiders. In principle, observant Muslims may be prepared to sacrifice *some* return in exchange for the confidence that their investments are *Shari’a*-compliant, but it cannot be assumed that any *significant* sacrifice of return, or security, will be acceptable to the majority of customers over a long period.

JIB was the first Islamic bank anywhere in the world to be established through specific legislation (Shallah, 1989, p. 225). The bank’s special act (*The Jordan Islamic Bank for Finance and Investment Act*, Act No. 13 of 1978) regulated many of its accounting practices and included profit measurement rules. This was the first time that specific profit measurement rules were included in any Jordanian regulations.[[1]](#endnote-2) As well as reflecting documentary archival evidence relating to the establishment of JIB, this paper also represents an example of oral history in accounting (Hammond, 2003), as it is based on long interviews undertaken by the first author with the founder of the bank, Dr. Sami Hamoud,[[2]](#endnote-3) and others involved in developing the JIB special act. This paper extends the work of Malley (2001, 2004), who discussed the effect of Islamic political parties on JIB, including the establishment stage, and Al-Malki (1996) who discussed some aspects of the establishment of JIB as part of his analysis of its performance. However, these studies have not discussed the effect of religion on accounting regulations and practices and the basis for the transactions of JIB. They have also not considered the different stages involved in creating JIB’s special act. This paper follows the three stages of developing the JIB special act: preparing the first draft of the act, the discussion of the act by the Jordanian government’s Fatwa Committee, and the government’s modifications to and approval of the act.

In the next section of the paper, we briefly review the emergence of Islamic banking and consider the principal banking transactions developed within the framework of the *Shari’a*. In the third section, we discuss the initial motivation for the establishment of the JIB, with the aim of identifying the potentially conflicting values that Hamoud attempted to impose on JIB. We then consider the process of establishing and regulating JIB, examining the main accounting-related issues dealt with in the bank’s act. Conclusions are set out in the final section.

## The Development of Islamic Banking

For centuries, Muslim societies managed their economies and carried on extensive domestic and international trade without the use of interest. Profit sharing and various kinds of participation arrangements served as adequate bases for savings and investment (Siddiqi, 1983, p. 9). Islamic financiers existed to provide financing based on profit sharing (Chapra and Khan, 2000, p. 1). However, after the fourteenth century, for historical and political reasons, the Islamic civilisation started to suffer from stagnation. Gradually,the Islamic world lost its strong economic position and became more affected by Western ideas. The nineteenth century witnessed the establishment of Western banks in the Islamic world (Wilson, 1995, p. 37); the role of Islamic financiers almost disappeared, and Islamic modes of finance were replaced by interest-based instruments.

The period 1940-1970 witnessed the independence of many Muslim countries around the world, especially in the Middle East. This process of independence, reinforced by factors such as the establishment of international Islamic organisations and the revival of Islamic economic literature (El-Ashker, 1987, pp. 28-9), led to growth in the number of Muslims who wanted to conduct their business transactions according to *Shari’a*. This was reflected in the emergence of Islamic banking. The earliest references to the recognition of banking on the basis of profit sharing rather than interest were found in the late 1940s (Siddiqi, 1976, p. 220). The first Islamic bank, the Farmers’ Credit Union, was established in Pakistan in the late 1950s, followed in Egypt by Mit Ghamr Saving Bank in 1963 and Nasser Social Bank. However, these banks were social welfare organisations rather than commercial banks. The oldest commercial Islamic bank, Dubai Islamic Bank in United Arab Emirates, was established in 1975 (Saleh , 1986, p. 87), followed by Faisal Islamic Bank in Sudan and Egypt in 1977, and Jordan Islamic Bank in 1979.

Islamic banking has recorded a rapid expansion throughout the last 40 years. By the start of the new millennium, according to data gathered by the Institute of Islamic Banking and Insurance in London (2000), there were more than 200 Islamic financial institutions (IFIs) operating in 63 countries around the world, and the past 10 years have seen continuing growth in the number of IFIs. These IFIs were managing funds of US$200 billion in 2004 (El-Hawari *et al*, 2004, p. 1), but by 2008 funds under management had grown to around US$500 billion, with the expectation that this total would double, despite the credit crunch, by the end of 2010 (Hijazi, 2009, p. 14). The industry has attracted major Western institutions such as Citibank, HSBC, BNP-Paribas and Deutsche Bank, which operate “Islamic windows within conventional banks” (Drummond, 2000, p. 98). The expansion of Islamic banking is not limited to Islamic countries. Many of these institutions now operate in Europe and America, two of the more recent being the retail operator Islamic Bank of Britain, established in 2004, and the wholesale operator Bank of London and the Middle East, established in 2006.

For mobilising funds from investors, Islamic banks use a developed model of the *mudaraba* contract, which, in its original form, has many similarities with commenda contracts used in Europe in the Middle Ages (Karim, 2001, p. 178). The principle of this contract is profit and loss sharing. Depositors place their funds with the Islamic bank (referred to as the *mudarib*). The bank invests these funds, with the profit from the investments being divided between the bank and the depositors according to a ratio agreed in advance. In case of loss, the depositors bear the losses and the bank receives nothing for its efforts. Thus, at least theoretically, there is no guarantee that the deposits will be repaid or that they will generate any returns (except in the case of misconduct on the part of the bank’s management, when depositors are entitled to be compensated for losses).

To provide finance to their customers, Islamic banks use profit sharing instruments such as *musharaka*, which represents a partnership arrangement between the bank and an investor, upon which both parties participate in funding and managing the project and both share the profits and losses. *Mudaraba* financing is another type of profit sharing arrangement, but in this case the bank provides the funds to an entrepreneur (who is therefore the *mudarib*). The *mudarib* invests these funds, and the bank cannot interfere in the process of managing the investment. If the invested funds yield profits, these will be shared between the two parties according to an agreed ratio, but in case of losses the bank bears all the financial losses and the *mudarib* receives no reward for its efforts in investing the funds.

In addition to profit sharing instruments, Islamic banks utilise mark up instruments, which are more common in practice. The best-known instrument is *murabaha*, which in its original form was a sale of goods with an agreed-on mark up. The *murabaha* contract is an example of transparency in trade, because the ultimate purchaser knows how much the seller paid the original supplier for goods, and hence can assess whether the seller is attempting to earn an inequitable profit on the transaction. In the current form as applied by Islamic banks, clients who wish to obtain finance specify what they want to acquire, and name a particular supplier. The bank then purchases the goods from the supplier for cash and resells them to the client at a higher price. The total amount due from the bank’s client is usually paid by instalments. The client must usually enter into a commitment before the commencement of the transaction to buy the goods after they come into the possession of the bank. Thus, in the legal form, this transaction includes two sale transactions, the first between the bank and the seller, and the second between the bank and the client. This new form of *murabaha*[[3]](#endnote-4)was originally suggested by Sami Hamoud (Al-Maliqi, 2000, p. 440; Hassanien, 1996, p. 21; Mullhem, 1989, p. 75). It dominates the activities of Islamic banks to the extent that by the end of the 1980s it represented around 70% of the investment activities of Islamic banks (Mullhem, 1989, p.89), reaching 90% in some banks (Hassanien, 1996, p.13). Islamic banks use other mark-up transactions such as *salam*, which is a forward sale contract, and long term *ijara*, which is similar to a lease.

Islamic banks are regulated under different arrangements in different countries. Errico and Farahbaksh (1998) point out that in the majority of countries in which Islamic banks operate, the same regulatory framework applies to both conventional and Islamic banks. Some countries have, however, passed laws facilitating (and in some cases requiring) Islamic banking (Karim, 2001, pp. 182-3). Islamic banks usually make use of *Shari’a* Supervisory Boards to ensure that appropriate religious principles have been followed in the banks’ transactions. Islamic banks around the world use a variety of accounting methods for recording and reporting their transactions. In many cases, they simply follow conventional accounting standards applied in the countries where they operate. Some utilise an in-house standard-setting process, in which the *Shari’a* Supervisory Board advises the management about relevant accounting treatments that do not violate *Shari’a*. A combination of these two approaches is present in some Islamic banks. There have been arguments (Janahi, 1994; Hamat, 1994; Karim, 2001) that, because of the unique transactions of Islamic banks, conventional accounting rules such as International Financial Reporting Standards are not relevant to Islamic banks. For example, Karim (2001) and Archer and Karim (2001) argue that, because depositors’ funds are not guaranteed, customer deposits cannot be reported as liabilities in the balance sheets of Islamic banks. Recently, many Islamic banks have been following the accounting standards set by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI).

## The Motivation for Establishing JIB

Although there had been some earlier interest in Jordan in *Shari’a*-compliant investment,[[4]](#endnote-5) the first serious attempt to apply Islamic banking in Jordan began with Dr Sami Hamoud, a Jordanian economist. Hamoud had worked in the Jordan National Bank, a conventional bank, for 22 years from 1956. He noticed many instances in which the charging of interest on loans led to the bankruptcy of clients and to other adverse social and economic consequences, especially affecting poor people. He also observed that many Jordanians refrained from depositing their funds in banks because of the Islamic prohibition of interest. Hamoud decided to study for a Ph.D. at Cairo University, researching how modern banking practices complying with Islamic principles could be developed. Hamoud’s thesis (he graduated in 1976) “was widely viewed as the most substantial academic piece on Islamic banking that had been written until that time” (Malley, 2004, p. 192). It became the basis not only for the act upon which JIB was established but also for many practices of Islamic banks more generally.

On his return to Jordan, Hamoud began his efforts to establish an Islamic bank, but this was not easy to achieve. The governor of the Central Bank of Jordan was scepticalabout the idea of establishing an Islamic bank in Jordan at that time (Al-Malki, 1996, p. 23), and the large conventional banks in Jordan were also unwilling to support his ideas. Hamoud encouraged public interest in Islamic banking by appearing on television, while at the same time (1977) he and his supporters established a Preparation Committee, to gain political and financial support for the idea of an Islamic bank in Jordan. Members of the committee without strong political or ideological orientations were chosen (Al-Malki, 1996, p. 25), because it was considered that there would be difficulties in gaining government acceptance if the committee were too closely associated with any Islamic party.

Hamoud made contact with a Saudi prince, Prince Muhammad Al-Faisal Al-Saud, who was interested in investing in the bank. Prince Muhammad used his friendship with Jordan’s royal family, especially with Crown Prince Hassan bin Talal (brother of King Hussein), to gain support for the idea and encourage acceptance of the presence of Islamic banking in Jordan. Prince Muhammad invited Hamoud to visit him in Jeddah, where he introduced him to Sheikh Saleh Kamel, a prominent Saudi investor. Kamel (through his Darrah Al Baraka group) was later to become JIB’s largest shareholder. Both Prince Muhammad and Kamel agreed to participate in the bank up to 40% of the capital, which was the maximum foreign participation allowed by Jordanian laws at that time. In the end, Prince Muhammad did not invest in the bank, and Saleh Kamel underwrote the Prince’s share of the bank’s capital.

The Preparation Committee wanted the government to issue a special act for regulating the Islamic bank, because subjecting the bank to the provisions of the general banking act was thought to represent a potential threat to the bank’s continuing presence in the future and would not be practical because of the different nature of Islamic banking. The Preparation Committee met the Crown Prince of Jordan, and Prince Muhammad visited the Crown Prince as well. To convince the Crown Prince and the government about the idea of an Islamic bank in Jordan, the committee stressed that many Jordanians were refraining from dealing with banks because of interest, and this led to a high percentage of idle funds in the Jordanian economy. They pointed out the important social role of Islamic banking and in particular the economic and social superiority of profit-sharing arrangements such as *musharaka* and *mudaraba* compared to conventional interest-based financing. Hamoudemphasised that non-Muslims would be able to participate in and deal with the bank. The Crown Prince responded positively to these approaches, the Preparation Committee’s request for a banking licence was approved, and in May 1977 the Prime Minister’s Officeissued a decision to establish an Islamic bank based on a special act. The Prime Minister’s Office asked the Preparation Committee to prepare a draft for the special act that would specify the rules under which the Islamic bank would operate.

## Developing JIB’s Special Act

The delegation of the drafting of the special act to the Preparation Committee was the result of a lack of knowledge in the government of Jordan about Islamic banking. The first draft of the act was mostly the work of Hamoud, and his committee colleagues saw him as particularly knowledgeable because of his previous training in banking, his first degree in Law, and his Ph.D. in Islamic banking. Many paragraphs in the first draft of the act and in the accompanying explanatory notes came directly from Hamoud’s Ph.D. thesis, and he also used wording from two earlier special acts for banks: the Industrial Development Bank Act (No. 5, 1972) and the Housing Bank Act (No. 41, 1973).

There were many objections to the first draft of the act, as some Islamic scholars viewed certain articles of the draft as violating Islamic principles. Therefore, arrangements were made between the Preparation Committee and the Religious Affairs Minister, who was a strong supporter within the government of the idea of an Islamic bank, for a review of the draft act to be undertaken by the Fatwa Committee. This group of mainly religious scholars had been established by the Jordanian government to issue pronouncements (fatwas) on religious matters, including the application of *Shari’a* law. To discuss the draft of the JIB act, three additional members joined the committee. Two of these (Sheikh Abdul-Hamid Al-Saih and Professor Muhammad Saqer) were knowledgeable in Islamic economics, and the third was Hamoud.

The enlarged Fatwa Committee held 15 extended meetings over a period of 10 weeks (6 July to 11 September 1977), and changed some important articles in Hamoud’s draft act. The discussions in the Committee and the resulting modifications to the draft act were a source of conflict with Hamoud as they reflected religious opinions different from those he considered most appropriate. The Committee issued a corrected second draft of the act which was sent to the Prime Minister’s Office for approval. However, the Prime Minister’s Office made other changes to the act. These were mainly beneficial to Hamoud in that they helped him to reinforce his control over the bank. The Prime Minister’s Office issued *The Jordan Islamic Bank for Finance and Investment Act* (Act No. 13, 1978) as a temporary act (the act became permanent in 1985), on the basis of which the bank started operating on 22 September 1979.

The main sources of disagreement related to the system by which the bank was to receive deposits and reward depositors, the role of religious auditors in the bank and the responsibility for paying *zakah* (a religious levy that all Muslims are required to pay). These issues gave rise to different interpretations of what the *Shari’a* required, and provided Hamoud with problems in developing the bank’s act along the lines he had envisaged. The Committee also discussed the recognition and measurement of revenue, whether the bank’s financial year should be based on the Western solar year or the Islamic lunar year, and the social role of the bank. To provide illustrations of how Hamoud’s personal values influenced the development of the bank’s special act, we consider three issues: the system for deposits, religious audit, and recognition and measurement of revenue.

### The System for Deposits

Islamic banks obtain funds from depositors mainly through the use of a developed form of the *mudaraba* contract. Funds are deposited in “investment accounts”, which represent the major source of funds for Islamic banks (Al-Deehani *et al*, 1999, p. 249). However, the original form of *mudaraba* contract included only two parties, the provider of the funds (*rabb al-mal*) and the *mudarib* (the entrepreneur). Because of the Islamic principle that no return should be earned without the assumption of risk, the traditional *mudaraba* contract stipulates that the *mudarib* guarantees neither the funds provided by the investor nor any profits. In addition, the profits generated from the investment of the funds are considered to be a recovery of capital rather than a return on capital, and cannot be distributed between the entrepreneur and the provider of capital before the liquidation of the investment (Abu-Zaid, 1996, p. 43). This principle is referred to by Islamic scholars as *tandid.* Furthermore, it is not permissible to mix different funds; for example, when two parties engage in a *mudaraba* contract, a third party cannot join after the start of the project.[[5]](#endnote-6)

In the first draft of the act, Hamoud relaxed many restrictions and conditions of the original form of the *mudaraba* contract in order to set up a deposit system that he considered could work as the basis for sound Islamic banking.[[6]](#endnote-7) However, one of the relaxations attracted extensive debate. This was the issue of whether depositors’ funds were guaranteed. Hamoud called for a guarantee of depositors’ funds, and he based his opinion on religious reasoning. He drew an analogy with “*ajeer mushtarak*”, a provider of a service such as laundry, who is liable, from an Islamic perspective, to keep and return what he is working on in safe condition. Hamoud suggested that the bank should also be liable to keep and return a customer’s deposit in safe condition. To achieve this, Hamoud suggested the creation of an Investment Risk Provision to cover any losses incurred in investing the depositors’ funds in investment accounts. This provision was to be created by setting aside 20 percent of the profits made from investing customers’ deposits every year. In the unlikely case that losses exceeded what was accumulated in the provision, the bank’s shareholders rather than customers would bear the losses. Thus, customers’ deposits were effectively guaranteed. The first draft of the act set this out in Article 22 (see Appendix I). In addition, Article 23 of the first draft suggested that in case of liquidation, the depositors would have priority over the shareholders. Although there was no explicit reference to a guarantee in the first draft, the existence of a guarantee was implied, and was mentioned explicitly in the accompanying explanatory notes.

While Hamoud was able to present religious grounds for his proposals, these were also affected by pragmatic considerations: Hamoud wanted to have a deposit system that could operate in an environment dominated by conventional banking. In introducing this deposit system, he argued (in the notes accompanying the first draft of the act):

The joint *mudaraba* allows the Islamic bank to compete with a *riba* [i.e., interest-paying] bank and allows it to operate in the market efficiently and systematically. There is nothing to prevent benefiting the people from the joint work in guaranteeing their capital.

In an interview with the first author, Hamoud observed:

I argued with them (the Fatwa Committee) that, if the bank does not guarantee the deposits, the bank may become careless about the people’s funds, and the Islamic bank’s reputation will be harmed, and no one will deal with the bank. (Interview with Dr Sami Hamoud, Dubai, 25 December 2002)

We can observe here the potential conflict in Hamoud’s values. The new bank had to be both economically viable and Islamically pure. Economic viability required the bank to be competitive with conventional banks, and Hamoud believed that depositors in Islamic banks would not be willing to bear more risk than those in conventional banks. Hamoud saw the “agency” problem as being exacerbated in an Islamic bank unless deposits were *de facto* guaranteed, but this contradicted the principle that the bank’s transactions were *Shari’a*-compliant. Hence structures needed to be created that placated the Islamic scholars who would report on whether the bank’s arrangements were *Shari’a*-compliant while at the same time satisfying what Hamoud perceived to be the demands of potential depositors.

The implied guarantee of *mudaraba* deposits attracted strong criticisms from members of the Fatwa Committee and other scholars to the extent that some people accused Hamoud of blasphemy. The members of the Committee spent a long time discussing this issue, and returned to the original religious references used by Hamoud in supporting his proposals. Members of the Committee argued that the analogy with *ajeer mushtarak* did not hold. They appealed to the original form of *mudaraba,* which requires no guarantee for the investor’s funds. Although they were prepared to accept the relaxation of other conditions in the traditional *mudaraba* contract, they did not accept the implicit guarantee, considering that this would make the *mudaraba* deposits the same as the deposits in conventional banks. Hamoud came to accept the religious opinion of the Committee. The act in its final form, which was approved by the Fatwa Committee and later by the government, explicitly referred to the deposits as not guaranteed (see Appendix I).

Despite the inclusion of a reference that deposits were not guaranteed, the Committee had, as a result of pressure from Hamoud, taken many steps to ensure that depositors would not reach the stage of losing their deposits, such as creating the investment risk provision and allowing for revaluation of investments financed by joint investment accounts. Even though there were no statutory provisions for accounting measurement in any Jordanian act, and no specific accounting standards in force in Jordan in the late 1970s, revaluation of assets was considered a revolutionary accounting approach, as historical cost was the only valuation method then acceptable in practice to Jordanian accountants. However, despite the compromise between the Fatwa Committee and Hamoud on the guarantee issue, Hamoud, when he became the first general manager of the bank, continued to consider these deposits as guaranteed, and conducted the operations of the bank on this basis. This would have implications for the reporting treatments for *mudaraba* deposits: if there is no meaningful risk that depositors will lose their deposits, then the deposits should be accounted for straightforwardly as liabilities, as proposed by several commentators (for example, Janahi, 1994; Karim, 2001; Khan, 1994).

The first draft of the act recommended the creation of the investment risk provision. However, this was also seen as a problem by the Fatwa Committee. The difficulty was that transferring part of the investment profit in one year (when investments generate profits) to a provision may benefit depositors in other years (when investments yield losses). The original *mudaraba* contract involved only two parties and hence required the distribution of profits only between the parties involved in the contract. However, in a bank, the depositors constantly change. Deducting a percentage of profits to credit the investment risk provision means that third parties (future depositors) may benefit from the profit of the current year. The *Maliki* School of Islamic jurisprudence[[7]](#endnote-8) allows for distribution of profit to a third party as a gift, and this was the basis of Hamoud’s argument for the creation of investment risk provision in his Ph.D. thesis and later in the bank act’s first draft. In Jordan, though, the dominant school of Islamic jurisprudence has historically been the *Hanafi* and not the *Maliki*, and most members of the Fatwa Committee adopted the *Hanafi* view of *Shari’a*. Hamoud argued that following a single school could not provide a sound base for an Islamic banking system, and he drew on different schools to demonstrate how his thesis was based on *Shari’a*. During the discussions of the Fatwa Committee, Hamoud was able to convince other members of the eclectic approach, and he gained their acceptance for the investment risk provision.

###  The Religious Audit

The conflict between Hamoud and the members of the Fatwa Committee over the issues of guarantee of deposits, investment risk provision and other issues had a major effect on the form of religious audit in JIB. In his first draft of the act, Hamoud suggested establishing the position of “*Shari’a* Controller”, and he proposed the presence of two independent controllers, who should both be at least 40 years old with a degree in Islamic religious studies or Islamic law. In the explanatory notes to the first draft, he called for establishing this position because this would provide the necessary assurance for the shareholders that the bank was avoiding *riba*. Article 27 of the first draft (see Appendix I) contained the procedures for selecting the two controllers. In the first draft of the act, Hamoud was willing to have relatively independent *Shari’a* auditors: appointing the *Shari’a* auditor was the responsibility of the General Assembly, and the religious auditor reported directly to the shareholders.

The Fatwa Committee recommended, in the corrected second draft of the act, changes regarding the number of *Shari’a* controllers, their qualifications, and most notably, their duties. The Committee wanted three controllers, with an educational background in Islamic religious studies or law and at least 10 years’ experience as scholars. The revised Article 27 imposed a list of specific duties on the *Shari’a* controllers, involving both a review of the forms of standard transactions before they were introduced and an assessment of losses on investments financed through *mudaraba*. This duty was introduced indirectly through Article 23 of the second draft, which deals with cases when such investments yield losses. As there was a conflict regarding the guarantee of deposits, the Fatwa Committee was willing to include in the act the necessary assurance that the losses incurred would not be assigned to the bank itself unless necessary, rather than to the investment account holders. This was another way of assuring that deposits would not be guaranteed, as it was designed to prevent the bank simply absorbing any investment losses rather than allocating them to depositors. The Fatwa Committee recommended that the *Shari’a* Controllers, bank directors and in some cases external experts should examine losses in investments financed by investment account holders. The *Shari’a* Controllers would be responsible for deciding whether the bank or the investors were to bear the losses.

The Members of the Fatwa Committee, Hamoud, and the Religious Affairs Minister signed the second draft of the act, incorporating the amendments suggested by the Committee. The draft was sent to the Prime Minister’s Office to be issued as an act. However, when the act was issued, there were many unexpected changes. The whole of Article 23 as suggested by the Fatwa Committee had been deleted. More surprisingly, Article 27 had been entirely changed. A single *Shari’a* Consultant appointed (and subject to dismissal) by the Board of Directors replaced three *Shari’a* Controllers elected by the General Assembly. The Consultant was required to provide an opinion only on very specific matters: whether transactions involved *riba*, and whether there was religious authority in the event that the bank undertook to bear any losses. So why did the government make these radical changes? According to the interviewees, who included members of the Fatwa Committee as well as the bank’s founder, there was no benefit to the government as a result of changing the recommendations of the Committee. The government has no experience in Islamic banking, and considered Hamoud and the Committee to be the experts. The major shareholder (Saleh Kemal) had only a marginal role as well, as he relied on Hamoud to prepare the act properly. However, the conflicts between Hamoud and other members of the Committee during the discussion of the first draft and the development of the second draft were of significance here.

After the Fatwa Committee had approved the second draft, the government took more than a year to issue the act. During this time, Hamoud met the Prime Minster regarding the act and joined the Ministers’ meeting at which the act was discussed. It was during this period that the changes to the form of religious audit and the rights and duties of the religious auditor took place. The strong resistance of the religious experts on the Fatwa Committee over many issues revealed a possible threat to Hamoud’s future management discretion, as he became the bank’s first general manager. In interviews with the first author, Hamoud indirectly admitted his role in the change by referring to consultation with him on the religious audit issue by the Prime Minister’s Office during the process of approving the act by the government. Hamoud described the changes to the first draft recommended by the Fatwa Committee as “unnecessary and were added because of non-relevant opinions by some members of the Fatwa Committee”. Regarding the Committee’s proposed (but finally deleted) Article 23 concerning the role of the *Shari’a* Controllers in deciding who bears investment losses, and the changes in the form of religious audit, Hamoud noted:

We were afraid of having different opinions. In addition, we did not want the bank to incur huge costs. It should be one consultant and not a *Shari’a* Control Board, because a *Shari’a* Board would imply that the members have the necessary knowledge. The knowledge is an understanding of the details of the work, such as an accounting audit. When a Sheikh [senior religious person] testifies on a balance sheet that it is correct or not, and he does not know a debit from a credit, or an asset from a liability, this just becomes a joke. … Many Sheikhs now testify on balance sheets when they do not really understand them. (Interview with Dr Sami Hamoud, Dubai, 25 December 2002)

Although Hamoud suggested that the change was made to avoid the risk of disagreement, this ignores his own first draft, where he recommended two controllers (not consultants): this could lead to differences of opinion as well. The second reason advanced by the founder was that having more than one religious auditor would be costly. However, the cost of three religious experts would not be very high as such experts usually work only on a part-time basis and their remuneration would certainly not be “huge”. The third reason was that religious controllers would usually lack the necessary knowledge about banking issues. This was largely true at that time; however, the religious controllers could overcome the lack of knowledge with training. In addition, not all the religious audit work would require technical banking knowledge, indeed, the members of the Fatwa Committee, most of whom would have similar backgrounds to likely religious auditors, were able to have extensive and relevant discussions of the first draft of the act despite their lack of knowledge of banking transactions. The issue of technical knowledge was probably more related to the range of different religious opinions and Islamic schools of thought, which could have limited the bank’s operations in the future. Most significantly, given the authority and independence recommended by the Fatwa Committee, the religious controllers could have had a very powerful position, stronger even than the General Assembly. This could easily be perceived as a threat to power and authority of the bank’s management, particularly as Hamoud, the bank’s founder, was to become the first general manager of the bank. Support for this view comes from a member of the Fatwa Committee:

They (the founder and Preparation Committee) have felt that the *fuqaha* (religious scholars) will restrict them, especially if those *fuqaha* have different religious opinions. They said that if we appoint a Religious Control Board, this would represent a kind of control on the bank, so they preferred one consultant, where they might accept his opinion, and might not. (Interview with Dr Abdul-Salam Al-Abadi, Amman, 13 March 2002)

###  Revenue Measurement and Recognition

The JIB special act was the first legislation in Jordan to contain specific regulations dealing with accounting measurement. These provisions went well beyond the requirements of earlier acts such as the Companies Act (Act No. 12 of 1964) and the Banking Act (Act No. 23 of 1971). These acts required balance sheets and income statements, but did not state rules for recognition and measurement of profits. Hamoud feared that the accounting practices regarding recognition and measurement of profit at that time in Jordan – although there were no specific accounting standards at that time, the British and American standards were widely used in Jordan (El-Issa, 1984, p. 53) – would be applied inappropriately to the new Islamic bank unless alternative accounting practices were included in the act. The Fatwa Committee briefly discussed the provisions included in Hamoud’s first draft of the act, but found Hamoud’s arguments convincing, as neither the Fatwa Committee nor the government made any changes to the accounting articles in the final version of the act.

These revenue measurement rules covered two aspects. Article 18 addressed the need to keep separate the accounts of activities financed through *mudaraba* deposits from other activities, while Article 19 addressed the point of time at which profits from the bank’s financing activities should be recognised. This article reflected the concept of *tandid*, under which profits from *mudaraba* activities should be distributed only on final liquidation of the transaction. The Articles required the separation of the profits and expenses related to operations financed by the investment accounts from those of the bank itself. This differs from the suggestion of Al-Arabi (1967, quoted by Abu-Zaid, 1996), who called for pooling all of the bank’s own revenues and investments with those of depositors in investment accounts. Although the appropriate treatment was not discussed in detail during the discussions of JIB’s act, Hamoud had supported in his Ph.D. thesis the accounting method that came to be adopted by JIB. His support reflected the two value systems within which he was working: religious and commercial/pragmatic. Hamoud argued that all schools of Islamic jurisprudence (except the *Hanbali*) agreed that the *mudarib* (the entrepreneur) was not allowed to charge his own expenses to the *mudaraba* contract (and even the *Hanbali* permitted only a few categories of expense to be charged). In addition, Hamoud argued that “charging *mudaraba* with the bank’s own expenses and its employees’ salaries might lead to these expenses and salaries consuming all the profits, … and the bank will not be able to attract investors” (Hamoud, 1982, p. 445). The difference in view between Hamoud and Al-Arabi has been reflected subsequently by Islamic banks in different countries making use of both methods.

Article 19 of the act made it clear that the bank should not take into account estimated or expected profits from investment activities, by setting specific rules for the recognition of profits from the different investment activities undertaken by the bank. These rules did not apply to the bank’s own financing, and the *tandid* condition was effectively relaxed for the *mudaraba* contracts upon which most deposits were based. Even though the *tandid* principle was considered important, its application to the deposit system of Islamic banks was regarded as impractical, as the bank could not liquidate all its investments at the end of each year in order to determine and distribute profits. However, in *mudaraba* financing undertaken by the bank itself, Hamoud incorporated *tandid* by requiring that profits should be recognised only on the basis of final settlement of accounts between the bank and the party utilising the funds. A similar requirement was set for *musharaka* financing. The inclusion of these accounting articles in the JIB act shows how Hamoud perceived it necessary to allow for religious sensibilities by ensuring that the Islamic financing transactions were accounted for in a way consistent with Islamic principles (rather than through an automatic application of essentially Western accounting), while at the same time Hamoud’s eclectic approach to the use of religious argument meant that *mudaraba* transactions where the bank was the *mudarib* would be accounted for differently from those where the bank was the *rabb al-mal*.

The current form of *murabaha* financing was unknown to Islamic banks before Hamoud’s Ph.D. thesis in 1976. Hamoud based this transaction on the opinions of Imam Muhammad Al-Shafi’i, the founder of the *Shafi’i* school of Islamic jurisprudence.[[8]](#endnote-9) How should the bank recognise profits from such a transaction? Hamoud’s view was that *murabaha* is a single sales transaction (where the bank buys goods, takes the risks of holding them, and sells them at a mark-up to the client), and he recommended that profit should be recognised when the sale to the client occurs. However, the practice of the bank when it started operations reflected the use of *murabaha* as a financing transaction rather than as a sale. When the bank started providing this transaction, it used (and it still uses) the market interest rate to set the “*murabaha* price”, and this price increased with time in a similar way to the increase of interest charges with time. This led in 1980, a year after JIB started operating, to discussions by JIB’s Board of Directors regarding different revenue recognition possibilities, and some of the members suggested proportional allocation of the profit on a time basis over the period of credit, rather than recognising all of the profit when the sale to the client was deemed to take place. Although recognition on such an “accruals” basis was not accepted, the debate led to tensions between Hamoud and some directors, and was subsequently one of the factors that led to his resignation from JIB in 1982.

## Analysis and Discussion

For an Islamic bank to be possible in the Jordan of the late 1970s, the support of the government was crucial, and this could only be achieved if the government could be assured that such a bank would not be an instrument of Islamist political groupings. Government support became even more necessary when it was decided to establish the bank through a special act rather than using existing banking law. Hence Hamoud, the founder of the bank, and his allies on the Preparation Committee not only made efforts to gain public support but also contacted powerful figures such as the Saudi Prince Muhammad Al-Faisal and later the Crown Prince of Jordan. The founder and the Preparation Committee stressed the role that an Islamic bank could play in economic development, as well as the bank’s potential social role, to justify the formation of the bank. The bank’s religious commitments were presented as paramount.

But at the same time, Hamoud wanted a bank that would be successful and would compete with more conventional banks operating on a Western model. Hence, Hamoud developed a set of banking transactions that, in his opinion, met the requirements of Islam while allowing the bank to operate competitively. His long experience of conventional banking affected his view of the kinds of transaction that an Islamic bank should undertake. Hamoud considered that *mudaraba* and *musharaka* financing could not serve some financing needs such as consumption loans. Before he began his doctoral research, Hamoud was searching for a kind of transaction that could compete with interest-bearing consumption loans, and by chance, he found support for his interpretation of the *murabaha* mark-up sale in a book written by the founder of the *Shafi’i* school of jurisprudence. Despite the wide adoption of this transaction by the Islamic banking industry around the world, it has been viewed as substantially the same as an interest-bearing loan (Al-Azzizi, 2000). Both the *mudaraba* deposit system suggested by Hamoud and *murabaha* financing were consciously designed to be similar to conventional banking practices.

However, there is no evidence that Hamoud and his colleagues on the Preparation Committee regarded the religious structuring of the bank’s main transactions as mere Islamic forms for essentially conventional practices. Different religious opinions were advanced by Hamoud and the other members of the Fatwa Committee to help shape the bank’s special act and the transactions that the bank was to undertake. Religious arguments were advanced to support and oppose the effective guarantee of deposits and the religious concept of *tandid* was used to determine the measurement of revenue and profits from *musharaka* and *mudaraba* financing. The existence of different schools of jurisprudence among Sunni Muslims presented a problem. Hamoud considered that adopting the opinions of one school consistently would not provide a solid foundation for Islamic banking systems. He therefore selected what he thought appropriate from each school. Thus, the *murabaha for purchase orderer* transaction, accepted only by the *Shafi’i* school, and the extraction of part of the investment profit as a loss provision, accepted only by the *Maliki* school, were important elements of Hamoud’s proposals. However, this represented a problem to the Fatwa Committee, because Jordan had historically followed the *Hanafi* school and most Islamic scholars considered that mixing schools was undesirable.

The existing regulatory framework in Jordan provided a context for the development of the special act. In many aspects that did not have a religious background, regulations similar to those in previous special bank acts were adopted. However, because the Jordanian government had to admit that it lacked experience of Islamic banking, it was prepared to delegate the initial development of the special act to Hamoud and the Preparation Committee. Hamoud described that time as his “full control period”, despite some resistance from the Fatwa Committee. The Fatwa Committee agreed with the founder’s suggestions in most areas, though there was disagreement over the guarantee of deposits, the form of religious audit, and some other minor issues. Even though Hamoud agreed with the Committee’s changes, he was able to obtain the outcome he wanted. On the religious audit issue, Hamoud was able to secure changes by the Prime Minister’s office so that the final provisions were, if anything, more favourable to the bank’s management than even the first draft. Although Hamoud concurred in the changes to the guarantee issue recommended by the Fatwa Committee, his position as the bank’s first general manager allowed him to operate the bank on the basis that the customers’ *mudaraba* deposits were guaranteed. Hamoud was also able to ensure that the act contained revenue recognition and measurement rules, thus avoiding the application of those Western accounting practices that formed the basis of Jordanian financial reporting at that time.

The creation of Jordan Islamic Bank, and the development of its special act, demonstrates how accounting regulation can emerge as a by-product of the process by which a knowledgeable individual and his allies applied religious ideas within an existing regulatory framework. Once it was realised that a special act was the most effective way of establishing an Islamic bank in Jordan, control over drafting the act was crucial. Hamoud was successful in establishing a bank that could undertake transactions for which religious justification could be demonstrated, yet which at the same time provided fair competition with conventional banking practices. The organisational culture of JIB was to reflect the potential conflict between the religious and economic values of the founder, Hamoud, as evidenced in the process of establishing what Schein (2004) would refer to as the “artefact” of the bank’s special act. JIB has grown to be a significant part of the Jordanian banking sector, and has been emulated by many other Islamic banks over the last 30 years.

However, tensions remain over the eclectic intellectual basis of the bank and the mixing of ideas from different schools of Islamic thought within the Sunni Muslim tradition. The founder’s success was achieved at the cost of a diluted religious audit and acceptance of transactions that could easily become counterparts of conventional interest-based banking transactions. As Warde (2000, p. 240) concludes, Islamic finance is “a failure insofar as it did not fulfil its original promise of becoming an original and innovative system, based on risk sharing, that would bring social and economic benefits to the Islamic world.” Though this may be a harsh judgement, the contradictions arising from attempting to create a bank based on contested Islamic principles that was able to compete with more conventional organisations, within a regulatory framework that did not explicitly recognise religious concerns, led to compromises that made it easier for the founder and subsequent managers to emphasise the commercial activities of JIB over the religious goals. So, while our paper shows how religious considerations were central to the development of the JIB special act, and helped to shape the first specific accounting recognition and measurement rules to appear in any Jordanian law, we also show how it was possible for the founder to advance his own ideas and protect his position as the bank’s first general manager by using the regulatory process creatively. The organisational culture embedded at the time of the bank’s creation has continued to reflect this compromise between religious and secular goals, with continued use of *Shari’a*-compliant transactions, for both deposits in and investments by the bank, whose underlying economic structure, as critics of the current form of Islamic banking such as El-Gamal (2006) observe, is virtually the same as equivalent deposits and loans within conventional Western-style banking.

## Notes

## References

## *Primary sources*

*(A) Interviews:*

Al-Abadi, Dr Abdul-Salam, Member of Fatwa Committee (now Head of Jordan Humanitarian Assistance), 13 March 2003, Amman.

Daradkah, Dr Yasin, Member of Fatwa Committee, (now with University of Jordan), 5 November 2002, Amman.

Hamoud, Dr Sami, Founder of JIB and first General Manager (now deceased, lately with Dubai Islamic Bank, part of the Saeed Ahmed Lootah Group), 25 December 2002 (morning and evening), Dubai.

Saqer, Dr Muhammad, Member of Fatwa Committee (now Professor at University of Jordan), 20 October 2002.

Al-Shanteer, Saleh, the first employee of JIB (now with JIB), 12 November 2002, Amman.

## *(B) Archives:*

## Documents in Jordan Islamic Bank archives:

Prime Minister’s letter to Central Bank of Jordan No. 16/34/6393 dated 24 May 1977 concerning allowing Islamic banks to operate in Jordan.

Preparation Committee of Jordan Islamic Bank, 1977, Jordan Islamic Bank Act, the Suggested First Draft.

Preparation Committee of Jordan Islamic Bank, 1977, the Explanatory Notes accompanying Jordan Islamic Bank’s Suggested First Draft of the Act.

Minister of Islamic Affairs, letter to Government of Jordan concerning suggested act regulating JIB (with attachments) 22 September 1977.

Fatwa Committee, 1977, Jordan Islamic Bank Act: the Corrected Second Draft.

Fatwa Committee, 1977, Jordan Islamic Bank Act: the Corrected Second Draft’s accompanying Explanatory Notes.

## *(C) Governmental Regulations and Acts:*

Government of Jordan (1964) Act No. 12, Companies Act.

Government of Jordan (1971) Act No. 23, Banking Act.

Government of Jordan (1972) Act No. 21, Orphans’ Funds Management and Investment Act.

Government of Jordan (1972) Act No. 5, Industrial Development Bank.

Government of Jordan (1973) Act No. 41, Housing Bank Act.

Government of Jordan (1978) Act No. 13, The Jordan Islamic Bank for Finance and Investment Act.

## *Secondary sources*

Accounting and Auditing Organization for Islamic Financial Institutions (1999), *Accounting, Auditing and Governance Standards for Islamic Financial Institutions*, Manamah: AAOIFI.

Abu-Zaid, M. (1996), *Mudaraba and its Empirical Applications in Islamic Banking*, Cairo: The International Institute of Islamic Thought [in Arabic].

Al-Abadi, A. (1988), “A comprehensive view for murabaha to purchase orderer”, paper presented at the Fifth Islamic Fiqh Academy Conference, Jeddah [in Arabic].

Al-Azzizi, M. (2000), *Some Shari’a Violation Aspects in the Investments of Jordan Islamic Bank*, Amman: Cooperative Press [in Arabic].

Al-Maliqi, A. (2000), *Islamic Banks, the Experience between the Fiqh, Law, and Application*, Beirut: Arabic Cultural Centre [in Arabic].

Al-Malki, A. (1996), *Encyclopaedia of the History of the Jordanian Banking System,* Amman: Al-Doustor Commercial Prints [in Arabic].

Al-Sader, M. (1974), *Interest Free Banking in Islam*, Kuwait: Jami Al-Naqi [in Arabic].

Alvesson, M. (2002), *Understanding Organizational Culture*, London: Sage

Archer, S. and Karim, R. (2001), “Presuppositions behind accounting standards and the issue of economic reality: the case of Islamic financial instruments”, paper presented at the EIASM Workshop on Accounting and Regulation, Siena.

Chapra, M. U. and Khan, T. (2000), “Regulationand supervision of Islamic banks”, Occasional Paper No. 3, Islamic Development Bank*,* Jeddah.

Drummond, J. (2001), “A risk free return? It’s forbidden”, *Accountancy*, April, pp. 98-99.

El-Ashker, A. (1987), *The Islamic Business Enterprises*, Kent: Croom Helm.

El-Gamal, M. (2006), *Islamic Finance: Law, Economics, and Practice*, New York: Cambridge University Press.

El-Hawary, D., Grais, W. and Iqbal, Z. (2004), “Regulating Islamic financial institutions: the nature of the regulated’. World Bank Policy Research Working Papers, Washington: World Bank.

El-Issa, Y. (1984), *Financial Reporting Requirements and Practice in Jordan*, unpublished M.Sc. thesis, University of Wales, Cardiff.

Errico, L. and Farahbaksh, M. (1998), “Islamic banking: issues in prudential regulation and supervision”, Working Paper WP/98/30, International Monetary Fund, Washington.

Gambling, T. (1994), “Accounting for Islamic banking”, paper presented at the International Conference on Developing Accounting Standards for Islamic Banks, London.

Gambling, T. and Karim R. (1991), *Business and Accounting Ethics in Islam*, London: Mansell Publishing Limited.

Gray, S. J. (1988), “Towards a theory of cultural influence on the development of accounting systems internationally”, *ABACUS*, Vol. 24, No. 1, pp. 1-15.

Hamat, M. (1994), “Accounting standards for Islamic banks”, paper presented at the International Conference on Developing Accounting Standards for Islamic Banks, London.

Hamid, S., Craig, R. and Clarke, F. (1993), “Religion: a confounding cultural element in the international harmonization of accounting”, *ABACUS*, Vol. 29, No. 2, pp.131-48.

Hammond, T. D. (2003), “Histories outside the mainstream: oral history and non-traditional approaches”, in Fleischman, R. K., Radcliffe, V. S. and Shoemaker, P. A. (eds) *Doing Accounting History: Contributions to the Development of Accounting Thought*, Oxford, Elsevier Science, pp. 81-96.

Hamoud, S. (1982), *Development of Banking Operations to Accommodate the Islamic Shari’a*, Amman: Al-Sharq Print [in Arabic – based on Ph.D. thesis (1976), Cairo University].

Hassanien, F. (1996), *Murabaha Sale in Islamic Banks*, Cairo: The International Institute of Islamic Thoughts [in Arabic].

Hijazi, S. (2009), “Islamic finance: from east to west”, *KPMG State of the Investment Management Industry in Europe* (December), pp. 13-15.

Hofstede, G. (1980), *Culture’s Consequences*, London: Sage.

Institute of Islamic Banking and Insurance (2000), *International Directory of Islamic Banks and Institutions*, London: IIBI.

Janahi, K. (1994), “Auditing of Islamic banks: a practitioner’s perspective”, paper presented at the International Conference on Developing Accounting Standards for Islamic Banks, London.

Karim, R. (2001), “International accounting harmonization, banking regulation, and Islamic banks”, *The International Journal of Accounting*, Vol. 36,No. 2, pp. 169-93.

Khan, M. (1994), “Accounting issues and concepts for Islamic banking”, paper presented at the International Conference on Developing Accounting Standards for Islamic Banks, London.

Maali, B., Casson, P. and Napier, C. (2006), “Social reporting by Islamic banks”, *ABACUS*, Vol. 42, No. 2, pp. 266-89.

Malley, M. (2001), “The political implications of Islamic finance in Jordan”, paper presented at the Annual Meeting of the Middle East Studies Association, San Francisco.

Malley, M. (2004), “Jordan: a case study of the relationship between Islamic finance and Islamist politics”, in Henry, C. M. and Wilson, R. (eds) *The Politics of Islamic Finance*, Edinburgh: Edinburgh University Press, pp. 191-215.

Martin, J. (2002), *Organizational Culture: Mapping the Terrain*, Thousand Oaks: Sage.

McSweeney, B. (2002), “Hofstede’s model of national cultural differences and their consequences: a triumph of faith – a failure of analysis”, *Human Relations*, Vol. 55, No. 1, pp. 89-118.

Mullhem, A. (1989), *Murabaha Sale and its Applications in Islamic Banks*, Amman: Al-Risalah Al-Haditha [in Arabic].

Ruthven, M. (1997), *Islam: A Very Short Introduction*, Oxford: Oxford University Press.

Saleh, N. (1986), *Unlawful Gain and Legitimate Profit in Islamic Law*, Cambridge: Cambridge University Press.

Schein, E. H. (2004), *Organizational Culture and Leadership*, San Francisco: Jossey Bass.

Shallah, R. (1989), *Islamic Banking in an Interest-Based Economy: A Case Study of Jordan*, unpublished PhD thesis, University of Durham.

Siddiqi, M. (1976), “Muslim economic thinking: a survey of contemporary literature”, paper presented at the First International Conference on Islamic Economics, Makkah.

Siddiqi, M. (1983), *Issues in Islamic Banking*, Leicester: The Islamic Foundation.

Warde, I. (2000), *Islamic Finance in the Global Economy*, Edinburgh: Edinburgh University Press.

Wilson, R. (1995), “Islamic banking and its impact on the international financial scene”, *Journal of International Banking Law*, Vol. 10, No. 10, pp. 437-45.

Yousef, T. M. (2004), “The *murahaba* syndrome in Islamic finance: laws, institutions and politics”, in Henry, C. M. and Wilson, R. (eds) *The Politics of Islamic Finance*, Edinburgh: Edinburgh University Press, pp. 63-80.

# APPENDIX I

# EXTRACTS FROM DRAFTS OF JORDAN ISLAMIC BANK ACT

|  |  |  |  |
| --- | --- | --- | --- |
| **Article** | **First Draft** | **Second Draft** | **Final Act** |
| 18 | Profits and losses relating to financing and joint investment activities shall be separated in the accounts from the other income and expenditure relating to other activities and services offered by the bank. The same applies to the income and expenditure from investments for specific purposes, in respect of which separate accounts must be kept for each particular project.  | As First Draft. | As First Draft. |
| 19 | In accounting for profit resulting from financing and investment activities, the bank may not adopt a method of accounting that takes into account estimated or expected profits. The bank must confine itself to the profits realised in accordance with the nature of the operation that the bank finances, and in accordance with the following rules: 1. In the case of *mudaraba* financing, the profits shall be realised on the basis of final settlement of accounts carried out between the bank and the party utilising the funds. Such settlement should be based on actual receipt of the cash and realisation of the income and should be duly approved and accepted. The profits of each year shall be entered in the accounts of the year in which such settlement is carried out whether in respect of the complete project or part of it.
2. In the case of decreasing *musharaka*, the profit shall be realised on the basis of the net income derived from the project concerned until the end of financial year, even if such income has not been received in cash. In such case, the income realised shall be treated as money due but not received.
3. In the case of *murabaha* financing, the profit shall be realised upon the conclusion of the subsequent contract and on the basis of the difference between the actual cost and the price agreed upon with the party who ordered the purchase.
4. The various financing operations shall be charged with all the direct expenses and costs arising from them, and should not be charged with any part of the general overhead expenses of the bank.
 | As First Draft. | As First Draft. |
| 22 | 1. The losses incurred on investments that exceed the profits generated in any financial year should be deducted from the investment risk provision.
2. If the accumulated balance in the investment risk provision is not enough to cover the losses incurred from investing the depositors’ funds in the year, then the Board of Directors may carry forward the losses to the following years to be covered from the profits of the bank and the investment risk provision funds of the following years.
3. If the losses continue in the following years to the extent that they exceed half of the bank’s capital, the Board of Directors shall call a meeting of the general assembly to discuss the possible alternatives to cover the accumulated losses and to make a decision about liquidating the bank to reserve the rights of shareholders and depositors.
 | 1. The bank, as joint venturer, shall bear any losses resulting from any cause for which it is legally liable, including any cases where authority is exceeded or insufficient care or caution is exercised by the members of the Board of Directors, managers, employees or workers of the bank. Insufficient exercise of care for which the bank is answerable shall include any cases of fraud, abuse of trust, collusion and similar forms of misconduct which fall short of the standards of honesty expected in the management of joint venture operations by the bank.
2. Losses incurred, which are not attributable to misconduct, shall be deducted from the total profits realised in the year in which such losses are incurred. Any excess losses over the profits which were actually realised during that year shall be deducted from the investment risk provision.
3. If the total profits realised in the year together with the accumulated balance of the investment risk provision are not sufficient to cover the incurred losses, the bank must then undertake a comprehensive evaluation of expected profits and losses, based on market prices for the investments financed by ventures (joint deposits and bank’s funds invested together) which had not reached the stage of final settlement by the end of financial year.
4. If the result of such evaluation indicates that the estimated profits are sufficient to cover the excess loss, the bank must carry forward the excess loss so that it could be covered from the proceeds of the expected profits when they are realised from the operations which were included in the comprehensive assessment.
5. If on the other hand the estimated profits are less than the excess loss, the bank may treat the excess loss as a loss carried forward provided that the amounts withdrawn from the joint investment deposits and Joint *Mudaraba* Bonds shall be charged with a pro-rata part of the excess loss in proportion to the percentage of participation of the amount withdrawn in the investment operations.
 | As Second Draft. |
| 27 | 1. The General Assembly of the bank shall select, in the same way as selecting the auditors, two *Shari’a* controllers. They should be chosen from experts in *Shari’a*. They should undertake the duties of religious audit with respect to the bank’s procedures and transactions to ensure that *riba* is to be avoided.
2. Each person to be selected as a *Shari’a* controller should be at least 40 years old, and should have at least a bachelor degree in Islamic religious studies or legal studies concerned with Islamic Law.
3. The *Shari’a* controller should cooperate with the Board of Directors. He must not reveal any information related to the bank or its transactions except the written report. The oldest controller should read this report before the General Assembly at their annual meeting.
4. The Board of Directors may terminate the *Shari’a* controller from work if there are reasonable grounds. However, the General Assembly should meet in 30 days of that date to choose another controller.
 | 1. The General Assembly of the bank shall select, in the same way as selecting the Auditors, three *Shari’a* Controllers. They should be chosen from experts in *Shari’a.* They should ensure that the bank follows Islamic *Shari’a*, especially avoiding *riba*.
2. A candidate for this position should:
3. Have at least a bachelor degree in Islamic religious studies or other practical Shari’a studies.
4. Have at least 10 years of experience.
5. Be known for the ability to make religious opinions based on Islamic *Shari’a*, without being committed to a particular school of thought.
6. The duties of *Shari’a* Controllers are:
7. Undertaking the duties described in Article 23 of this Act.
8. Undertaking a comprehensive study of the bank’s articles, procedures and forms of contract to make sure that they do not violate Islamic *Shari’a*.
9. The *Shari’a* controllers may ask the Board of Directors to provide information about any transaction that they suspect violates Islamic *Shari’a*.
10. In the event that the *Shari’a* Controllers agree that there is a *Shari’a* violation in any of the above transactions, they should ask the Board of Directors to correct the violation. If no agreement is reached between the Controllers, it would be enough to inform the Board of Directors about the issue.
11. The *Shari’a* Controllers shall issue an annual report, and it should be read by the oldest member before the General Assembly. This should be done before presenting the balance sheet and income statement for discussion.
12. The *Shari’a* Controllers must not reveal any information regarding the bank’s work or transactions.
13. The Board of Directors can terminate any *Shari’a* Controller from work if there are reasonable grounds to do so. However, the General Assembly should meet in 30 days of that date in order for the General Assembly to discuss the reasons for such decision. If the General Assembly agrees on the termination, it should select another Controller to continue for the remaining period.
 | 1. The Board of Directors shall appoint, within fifteen days from the date of its selection, an Islamic legal consultant who is learned and specialised in the field of practical applications of Islamic Law.
2. The consultant appointed to this post may not be dismissed except on the basis of a Board of Directors’ resolution adopted by a two thirds majority of the members at least, and giving the grounds for such dismissal.

New Article 28:The Board of Directors shall determine the functions of the aforesaid *Shari’a* Consultant on the basis that the Board of Directors shall be under the duty to request the opinion of the *Shari’a* Consultant regarding the following matters:1. Studying the practical regulations and rules applied by the bank in its dealings with others, with a view to ensuring that they do not contain any form of *riba*.
2. Studying the causes that require the bank to bear any losses with a view to finding the legal doctrinal basis to support the resolution of the board in this regard.
 |

1. . At that time, no specific accounting standards were applied in Jordan, and the only accounting regulation was found in the Companies Act (1964, Act No. 12). This required public shareholding companies to present every year an audited balance sheet and profit and loss account, in addition to notes clarifying revenues and expenses. [↑](#endnote-ref-2)
2. . This is the most widely used transliteration from Arabic. Jordan Islamic Bank itself often transliterated the name as ‘Hmoud’, while transliteration according to the widely used Library of Congress conventions produces ‘Humūd’ (this is used by scholars such as El-Gamal, 2006). [↑](#endnote-ref-3)
3. . This new form of *murabaha* has been heavily criticised by many Islamic scholars (for example, Siddiqi, 1983; Al-Abadi, 1988; Al-Azzizi, 2000; Yousef, 2004) on the basis that in practice, it is similar to loans provided by conventional banks in the sense that the Islamic bank bears no material commercial risk. [↑](#endnote-ref-4)
4. 5. The Orphans’ Funds Management and Investment Act (No. 21 of 1972) required that orphans’ funds should be invested in interest-free transactions. [↑](#endnote-ref-5)
5. . The other conditions include: (1) the proportion of profits to which each party is entitled should be agreed between the two parties when contracting, and should be a percentage, not a lump sum; (2) the capital provided should be in cash (though some Islamic jurists would allow it to be in the form of non-monetary assets, it cannot be in form of debt – AAOIFI, 1999, p. 171); (3) the entrepreneur is the one who works, not the provider of capital (Abu-Zaid, 1996, p. 28). [↑](#endnote-ref-6)
6. . Hamoud was not the only one to suggest such a deposit system: two other Islamic scholars participated in developing such a system, Muhammad al-Arabi in 1967 [quoted in Abu-Zaid, 1996, p. 46] and Al-Sader (1974). [↑](#endnote-ref-7)
7. . Schools of Islamic jurisprudence) (*Madhdab*)are different ways of thinking about and methods of interpretation of the sources of *Shari’a*. These schools, the most famous of which appeared in the two centuries after the death of the prophet Muhammad, provide different rulings on some issues. The four best known schools of Islamic thought for Sunni Muslims are *Maliki,* *Shafi’i*, *Hanafi* and *Hanbali* (Ruthven, 1997, p. 78). [↑](#endnote-ref-8)
8. . Because his transaction was justified by reference to the *Shafi’i* school, Hamoud had a similar problem in justifying the transaction to the Fatwa Committee (who tended to follow the *Hanafi* school) as he faced over the investment risk provision. [↑](#endnote-ref-9)