A COMPARISON OF THE TRADITIONAL (WESTERN-STYLE) BANK AND ISLAMIC BANK MODELS

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There has been a remarkable increase in the number Islamic banks and Islamic Financial Institution since the 1970s. There are about a hundred Islamic Banks and Financial Institutions currently in the world. It is useful and interesting to know how Islamic banks differ from the Western (Traditional) style bank?

This paper surveys the differences between the two-style of bank. A comparison is made of the origin of each style of bank, their development, the types of products and services they offer, their organization and their financial statements.

The paper concludes that the basic difference is in the treatment of interest. But this in turn generates some other differences. Interestingly, in the sense of accounting concepts and practices, it seems that both styles are not significantly different. However, a close examination of this seems to be interesting and is the focus of study, because each style of bank has developed with different perspective.

Introduction

NOT less than thirty Islamic Banks have been established among about one hundred Islamic Financial Institution since the 1970s [Ahmad, 1407H/1987; Abbasi and Hollman, 1990; Metwally, 1991; Perwataatmadjaya, 1991]. Some of these are in Middle East countries like Egypt, Sudan, Saudi Arabia, Jordan and Kuwait. Some are in countries in which Muslims constitute the majority of the population, such as Pakistan, Bangladesh, Malaysia, Indonesia. However, some have been established in Western countries, or countries where Muslims are not in the majority, for example, Switzerland, United Kingdom, Bahamas and Philippines.

What is an Islamic bank? How is it different from a traditional or western-style bank?

This paper will compare the traditional (Western-style) bank and the Islamic bank models. The comparison will be made in respect of the early history of each bank model, the development, the types, the products and services they offer, the bank organization and management, and financial statements. The comparison will include the similarities as well as the differences between the two models, particularly in respect of the accounting concepts and practices employed.

The paper will be divided into five parts. The first part is an introduction. The second part elaborates on the early establishment, the types, development, product and service rendered, and the financial statements of the Western-style Banking system. In the third part Islamic banking will be discussed in the same. Part four, will be a discussion of the similarities and differences of those two different styles of banking. The paper will close with a summary of the points raised.

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2.Traditional or Western-Style Bank

2.1.The origin of Banks

No one knows for sure when the business of banking began [Rose and Fraser, 1985, p.143; Muslehuddin, 1990, pp. 11-12]. However, some authors have estimated that banking institutions and monetary systems were the heritage of the Romans Empire. It is also said that, banking and finance systems in Western countries began from trading system which were introduced by people from the East -through India- to West Asia. Based on the archaeological diggings in the Dajlah Valley, Furst and Babylon, it was found that the Indian people -not Semite- pioneered the trade between Asia Minor to the Far East about five thousand years before Christ. History also indicates that the Babylonian people applied lending and borrowing systems, had a currency, and held a complex credit contract a long time before 2500 BC

(Muslahuddin, 1990, p/12].

The Assyrians, Babylonians, ancient Greeks, and later the Romans, employed money to facilitate their trade and commerce. Money merchants provided the trader with a service of changing one form of coin into another, because at that time so many different coins existed, due to the fact every country or large-state issued its own coins. In some busy business of exchanging coins had become a full-time occupation, in which some merchants started to expand their services not only to exchange the coin, but also to accept deposits for safekeeping and discounting notes from other merchants.

One popular account traces the bank's origin to the shops of medieval goldsmiths [Rose and Fraser, 1985, p/ 143]. The merchants accepted deposits of gold coin and other valuables for safekeeping. The customers who deposited their gold, were issued with receipts indicating the amount of deposits. Later, the depositors found that it was much easier and safer to pay for the goods or services they had bought using the receipts issued by goldsmiths rather than by using the gold itself. Hence, the goldsmiths' receipts began to circulate as a money, the forerunner of a modern-day cheques.

On the other hand, the goldsmiths discovered that the deposits left with them were relatively stable, because, although some customers were always withdrawing their funds, others were establishing new deposits. Based on this, an enterprising goldsmith started to issue loans by creating more receipts than he had gold reserves in the vault. At this point, the goldsmith became a banker, because he was literally creating money. Thus, the concept of fractional-reserve banking was born.

It is also said that, the word "bank" came from "banco", an Italian word, which means bench. The use of this word came about because of the merchants who served the money exchange used a bench in delivering their services. The merchant who failed to serve his client honestly and faithfully, found himself without a customer and without furniture. That is why, he is called bankrupt, which literally means destroying a merchant's bench. Although, some scholars doubt the authenticity of this account, it is at least a plausible story.

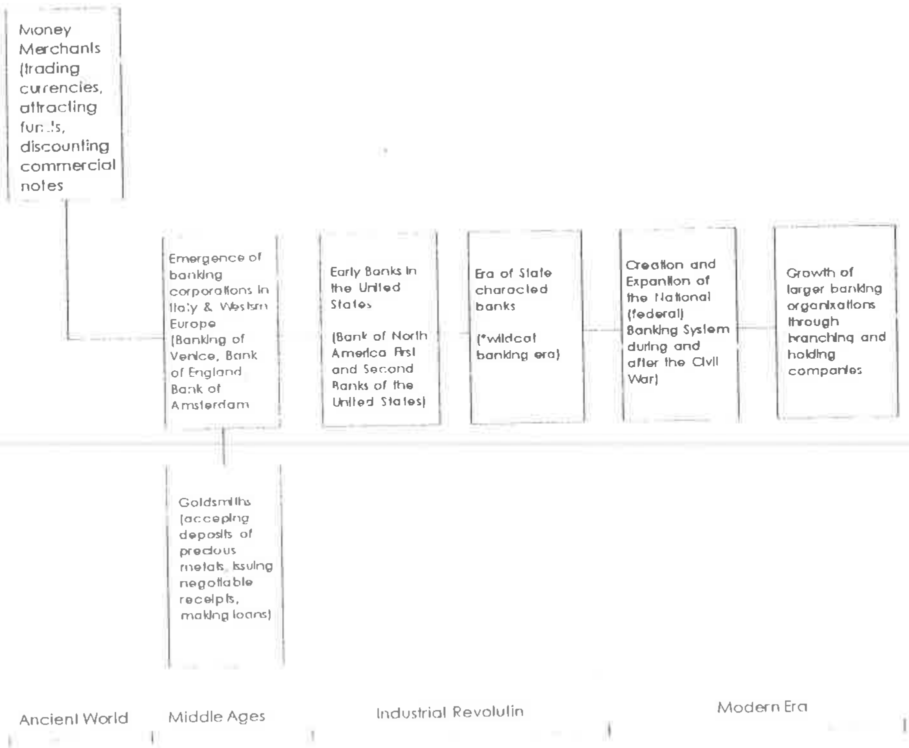
2.2.The Development of Banking

The development of the modern banking concept started in Italy during the Middle Ages. Muslehudding [1990, p. 12] specifically stated it was after the fall of Constantinople (Istanbul) in 1204, that the Lombard goldsmiths started to play an important role, particularly in money circulation. They established banks in many cities in Europe. Venice and Genoa are the most noticeable as the cities in which banking was started [Boreham et al, 1979, Sinkey, 1979]. Banco Di Rialto, for instance, was said to be the first private bank in Venice in 1584, which accepted the deposits from local merchants, discounted commercial notes, and made credit available for governmental activities [Rose and Frase, 1985, p. 145; Muslahuddin, 1990, pp. 12-13].

The bank of Sweden was also one of the pioneers. It was established in 1556 and was entrusted to issue the bank notes. Exchange banking had been established in Amsterdam in 1609, followed by Hamburg in the same year. These banks mainly dealt with foreign exchange. Later they started to develop the deposit bank system.

The industrial revolution of the 16th to 17th centuries, had a remarkable influence on the modern bank form. This is not surprising, because the revolution brought the tremen-

Figure 2-1:
The roots of Modern Banking



(*) Adapted from Rose and Fraser [1985] p.144.

dous need for both short and long-term venture capital. On the other side, a middle-class customers and saver began to emerge as major suppliers of bank funds [Rose and Fraser, 1985, p. 145]

because of this fact, most authorities agree that the institutional father of modern banking was the Bank of England, chartered in 1694. This institution was both a merchants' bank, accepting commercial deposit and lending against commercial notes, and an agent of the British Government. The banking industry in the United States began much as it had in Europe. The roots of modern banking is depicted in figure 2-1.

Recent developments in the banking industry have been very different, even in their form, from banking at the beginning of this century. The advanced of technology, particularly in last two decades, has brought the banking industry especially, and financial institutions generally, to a previously inconceivably sophisticated level. As part of this development many types of banking have arisen. There are, for example, 'so-called' saving banks, trading banks, industrial banks, investment banks and so forth. These types of banks will be discussed later in this paper.

2.3 Bank Types

Banks can be classified according to their particular objectives. In this respect, two main types of bank can be distinguished. They include banks without a profit-motive, and banks with profit motive. The latter can be classified further based on their services, or the group of consumers they are focusing on, such as Investment (Merchant) Banks, Mortgage Banks, Trading Banks, and Saving Banks. The following is a brief discussion of each type of bank.

2.3.1. Central Bank

In the 1920 International Financial Conference, convened by the League of Nations in Brussels, each country was encouraged to set up a central bank. [Boreham et al, 1968, p. 216, Muslehuddin, 1991, p. 36]. Because of this, almost every country has a Central Bank, and indeed the importance of a central bank existence's has been widely recognised [Boreham et al, 1968, p. 209].

This bank is directly controlled by the government. It is an expanded arm of the government, particularly in respect of monetary affairs and stability [Muslehuddin, 1990, p. 38]. The main role of this kind of bank is generally to control the monetary system of the country. The central bank is commonly the only authority to issue the currency of the country, hence it controls the supply of credit and outstanding money. It functions as the government agent to save the country's fund and wealth. It is also used by other bank as the custodian, and the last lending source. Moreover, it also regulates other (commercial) bank operations [Boreham et al, 1968, p. 210, Muslehuddin, 1990].

The main objective of this bank is not to earn a profit, but rather to establish a banking system in the country. Because of this, the central bank avoids contact directly with the public.

2.3.2.Mortgage Banks

Mortgage banks specialise in creating and placing mortgage loans. In general they are intermediaries among real estate purchasers using debt financing and investors desiring mortgages or mortgage-backed securities [Edmister, 1986, p. 261-267].

2.3.3. Industrial Banks

Industrial banks are those which accepts smaller consumer savings deposits, and makes certain types of loan, principally cash loans to wage earners [Rose and Fraser, 1985, p. 142].

2.3.4. Saving Banks

Saving Banks draw upon individual and family savings as their principal source of funds. They invest these funds mainly in mortgage, corporate bonds, and occasionally common shares [Rose and Fraser, 1985, p. 142].

2.3.5 Trading Banks

Trading banks accept term deposits, and mostly make short-term loans [Muslehuddin, 1991, pp. 4-5]. In Australia, during 1988, the Treasurer announced the removal of the difference between trading and saving banks. The reason was that bank assets were only separated accounts in trading banks rather than distinctly separate banking operations [Lucia, et al, 1990, p. 31].

2.3.6.Commercial Banks

Several types of bank have already been discussed. These types or names sometimes may be confusing, as so many financial intermediaries operate like banks, hence, as Rose and Fraser said, "a bank is what a bank does, regardless of the name given the institution by its owner or others."[1985, p. 142].

Many economists also prefer to call these commercial banks, especially since the term "commercial" has become anachronistic [Boreham et al, 1968, p. 84]. Accordingly, the term "commercial" came into wide usage because of a general belief in Great Britain, about a century ago, that banks which accepted liabilities on demand had to strictly limit their lending to short-term commercial loans. Only in the 20th century did the commercial banking industry begin to compete aggressively for consumer accounts, due to the fact that consumers were principal source of deposit, and at same time they (the counsumers) represent one of the more rapidly growing sources of loans [Rose and Frase, 1985, p. 143].

In this study, the term "Western-style bank" which is studied and compared to the "Islamic bank", is that referred to as a "Commercial bank". Therefore, for the rest of this study, whenever "Western-style" bank is mentioned, it is synonymous with the commercial bank.

2.4.Products, Services, and Functions

Referring to the services and products recently offered by the Western-style bank, there are many services and or products that can be noted. However, close examination of these services will show that they are still based on the original functions of the bank of long time ago. Two main functions that can be distinguishes are to attract the funds from saving-surplus units by issuing attractive financial assets (secondary securities) on one hand, and to provide the loans, or lend the money to the borrowers on the other [Rose and Fraser, 1985, p. 148]. Both activities -to attract deposit and to provide loans - can be gengerate a variety of names of products which essentially are the same.

In another word, the functions of commercial banks can be divided into two parts [Boreham et al, 1979, p. 85]. First, the money creating function or creditexpansion [Harris, 1965, pp. 28-33; Danten and Welshane, 1970, pp. 108-113; Rose and Fraser, 1985, p/ 148], and second, the services rendering function.

In the sense of service rendering, the bank can serve as (1) *paying and receiving stations for hand-to-hand currency* (2) *facility provider for domestic and foreign remittances* (3) *collector of cheques, drafts, notes, and other obligation of its customers* (4) *saving department for its customers* (5) *safekeeping valuables facilities provider and* (6) *special advisory services for individuals and corporations* [Boreham, 1979, p. 85].

The current development of the commercial banking industry has become more sophisticated with services such as credit cards it the form of Bankcard, Mastercard or Visacard. It is also widely known that commercial banks serve the travel service with travel cheques. They are also known as reliable money transfer institution. Lucia [1990, p. 30-1] for example lists seventeen products or services provided by trading banks in Australia from housing loans to investment products.

One thing, however, that should be noted is that any service rendered by a bank to its customers, usually incurs a charge to the customers either in the form of the interest or fees, with interest generally being applied to loans. It is a very important concept and is influential to the life and the survival of the bank. As can be seen in the discussion of the Bank Income Statement

[1] *This part is mainly adopted from Rose and Fraser (1985), pp. 152-156*

(see 2.6.2. of this chapter), where interest is the most important income of the bank, compared to other income. Fees in the other hand, are applied to services which are related to bank facilities such as money transfer, safety deposit box keeping rent and so on.

2.5. Bank Organization[1]

Commercial banks can be organized in different ways, depending on the size of organisation, the management philosophy, the complexity and range of products, services offered, and so forth. As with many other organizations, the most powerful institution in banking management are the shareholders. The power of shareholders is represented in the annual general meeting. This meeting -based on voting- has a right to elect or appoint the Board of Directors. The Board of Directors, in turn, lay down the bank operating policies, select and appoint management to carry out those policies, and monitor the bank's performance.

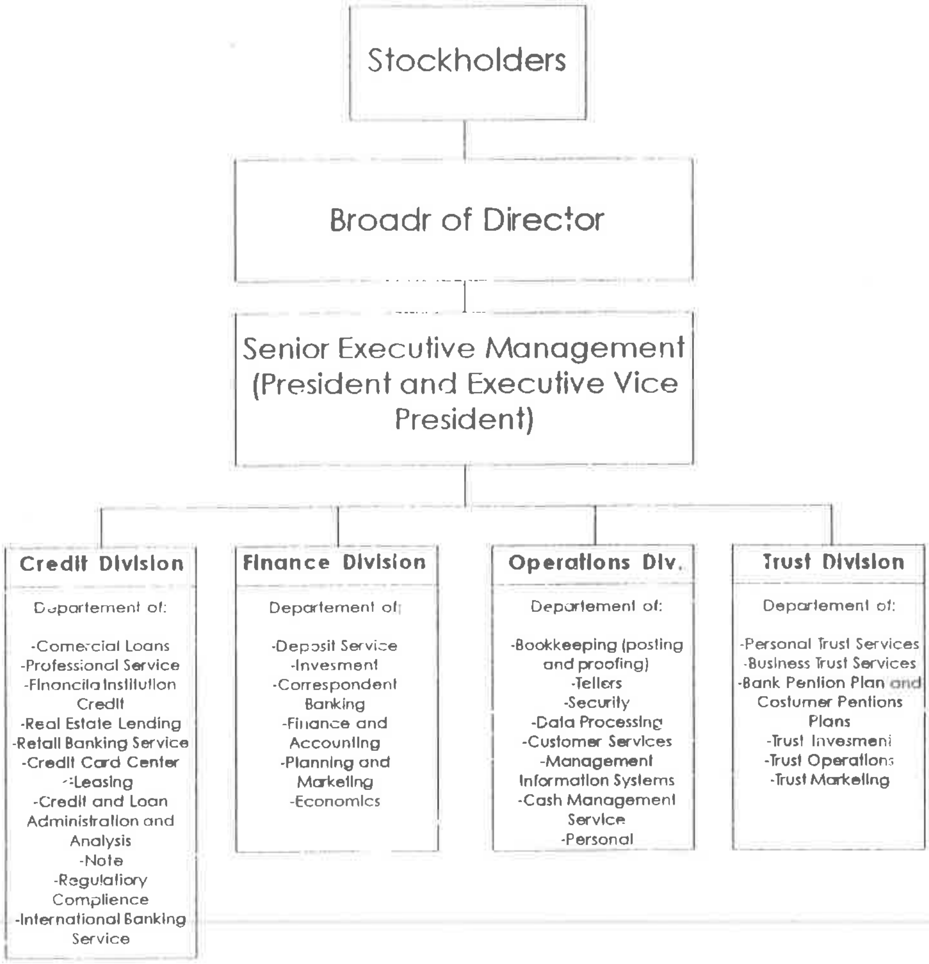
In respect of the day-to-day operations, management and control, the Board of Directors delegate authority to the Managing Director (oe Chief Executive Officer) and other members of senior management, including one or more vice president(s) who generally oversee the division(s) below them.

Due to similarities in their function, generally the organization of the modern commercial bank has at least four divisions. They are: the credit division, the finance division, the operation division and the trust division. The central focus of the credit division is in making loans, each major type of loan will be handled in a separate department, such as a loan for local business, corporations, self-employed professionals, individuals, and so on.

The other departments in this division are usually the credit (analysis) department, the note department, regulatory compliance, and international banking service. The first is responsible for analiyzing loan and lease application. Once a loan is made, a copy of the customer note is filed in the records of note department. This department also collects interest and instalment payment for loan customers. On the other hand, the regulatory compliance department functions to monitor the compliance's of loan processing. This is due to the risk in banking being centered in the making of loans.

The finance division is responsible for funds which in turn are allocated in making loans. As with the credit division, this division also contains several departments such as the deposit service, investment, correspondence banking, finance and accounting, planning and marketing and economics department. The first three departments mainly function as fund raisers from deposits -either personal chequing, new account, safety deposit, time and

Figure 2-2:
The Organization Structure of a Commercial Bank.



[Source : Rose and Fraser 91995) Financial Institutiaons, 2nd Edition, p. 153

saving account, business ahequeing or government account (by Deposit Service), -and from bond, or money market, securities, (by investment Department) and through offering money market certificate deposits and borrowing in the Eurodollar market (by Correspondent banking department).

The accounting department of the finance functions primary to keep and maintain the bank financial records and to make sure that all funds which flow into and out of the bank are fully accounted for. The planning and marketing department's task is to market existing products and services, to develop new products and services, and plan for the future growth and expansion. The economics department generally functions to assist the planning through preparing forecasts of economics and financial conditions, and to identify suitable new market and new financially related business the bank may choose to acquire as it grows.

The operation division is responsible for managing and protecting the assets physically owned or used by the bank and for the daily routine of bookkeeping. There fore, the bank's computer facilities are typically operated and maintained by this division. Generally, the operating division also houses the personnel department, which is responsible for keeping employees records, attracting and training new employees, or even promoting the employees. Human tellers as well as automatic teller machines are also under supervision of this division, as are security guards. The other department in this division is the cash-management department, which aids corporations and other firms in the day-to-day management of their cash balances.

The last division is the trust division. It functions primary in providing personal and business trust services. It plays a key role in managing retirement (pension) accounts for the bank itself, and for corporations, proprietorships, partnerships, and individuals. It also manages real property owned by customers, and actively trades securities on behalf of the clients. Consequently, this division may have several trust departments, such as Personal Trust Services, Business Trust Services, Bank Pension Plan and Customer Pension Plans, Trust Investments, Trust Operations and Trust Marketing.

An Illustration of an organization chart of a bank (as discussed above) can be seen in figure 2-2.

2.6. Financial Statement

Like other firms, bank issue financial reports. In the United States, commercial banks submit two basic financial reports to regulatory authorities each year. They are the "Report of Condition", or what are more popularly known as the balance sheet, and the "Report of Income", or statement of earnings and expenses [Rose and Fraser, 1985, p. 156]. The same regulation may be applied in any other countries. The following is a brief discussion about commercial bank balance sheets and income statements.

2.6.1.Balance sheet

As it is generally known, that balance sheets consists of two parts, that is, the list of assets owned by the company of the bank on oe hand, and a list of the liabilities and the equity. Unlike assets of manufactur-

Exhibit 2-1:
Example of Western-style Bank Balance Sheet

WESPAC BANKING CORPORATION AND ITS SUBSIDIARY COMPANIES

Balance Sheets

as 30 at September 1991

	Group (Holding Comp) $M	Bank $M
Assets		
Cash and Cash at Bankers	300.4	285.5
Bullion	624.6	-
Money at short call	-	-
Due from other banks	8,573.0	7,820.2
Trading Securities	8,891 1	7,164.3
Investment Securities	2,672.6	1,292.5
Statutory Deposits	804.1	759.4
Loans	60,858.3	36,942.1
Acceptances of customers	12,356.8	12,356.8
Subsidiary companies-share	-	3,968.0
-advances	-	10,525.0
Othor Investment	630,7	548.7
Fixed Assets	2,753.5	1,223.0
Other Assets	7,553.9	5,841.6
Total Assets	**106,019.0**	**89,091.0**
liabilities		
Deposits and Public Borrowing	60,230.3	40,396.2
Bonds, notes, and commersial paper	2,289.1	1,553.1
Acceptances	12,356.8	12,356.8
Due to other banks	12.540.1	12,643.6
Due to Subsidiary companies	-	5,321.8
Other liabilities	8.696.7	7,481.5
Total Liabilities excluding loan capital	**96,163.0**	**79,153.0**
Loan Capital		
Subordinated bonds, notes and debenturs	1,678.6	1,678.6
Subordinated undated capital notes	924.3	924.3
Mandatory convertible notes	8.1	-
Total Loan Capital	**2,611.0**	**2,602.9**
Shareholders'equity		
Share capital	1,353.7	1,353.7
Reserve	4,308.0	5,408.1
Retain profits	1,561.3	573.3
Shareholders' equity attributable to Propprietorsof Wespac Banking Corporation	**7,223.0**	**7,335.1**
Minority Shareholders' interest in subsidiaries	22.0	-
Total Share holders; equity	**7,245.0**	**7,335.1**
Total liabilities and capital resources	**106,091.0**	**89,091.0**

Exhibit 2-2: Example of Western-style Bank Income Statements

WESPAC BANKING CORPORATiON
AND ITS SUBSIDIARY COMPANIES

Profit and Loss Statements
for the year ended 30 september 1991

	Group (Holding Comp) $M	Bank $M
Interest Income	10,751.0	7,219.3
Less: Interest ekspenses	7,877.3	5,802.0
Net interest incvome	**2,873.7**	**1,417.3**
Non Interest Income	1,670.7	1,728.1
Total Opertaing Income	**4,544.4**	**3,145.4**
Less : Bad and doubtful debt	1,046.0	558.4
Non Interest Expenses	3,070.0	2,068.3
Operating Profit before abnormal items	428.4	518.1
Abnormal items	(70.3)	(164.8)
Operating Profit	**358.1**	**353.9**
Income tax attributable to operating profit before items	(104.7)	(107.4)
Income tax abnormal items	220.0	202.4
Operating profit after tax	**473.4**	**448.9**
Minority Interest	3.0	-
Operating Profit after Income tax attributable to Proprietors of Wespac Banking Corp.	476.4	448.9
Retained profits at the beginning of financial year	1,428.5	483.5
Total available for appropriaticn	**1,904.9**	**392.4**
Appropriations:		
Dividends provided for or paid	317.3	301.1
Aggregate of amounts trasferred to and from reserved	26.3	58.0
Retain profits at the end of financial year	**1,561.3**	**573.3**

ing companies which may be heavily dominated by fixed assets, the assets of banks are generally dominated by current asset in the current asset accounts groups, the loan item or account is the biggest. It is understandable because the major activity of commercial banks is to make or provide loans to its clients.

In the liabilities accounts group, the deposit and public borrowing account, again ranks as the most important. It is understandable because to attract and to collect public funds is the other major activity of any commercial bank. These funds in turn, will be spent by the bank to provide loans. In respect of the equity account, there is no significant difference compared to any other industry, except the small amount of equity capital compared to total asset indicates that the bank industry is a highly leveraged industry. Banks then, generally rely upon debt to support their assets. An example of a bank balance sheet can be seen in Exhibit 2-1.

2.6.2. Income Statement

The income statement, which are sometimes also called the reports of income, or the profit and loss statements disclose how well an individual bank is doing in balancing its revenues against its expenses and generating adequate net income [Rose and Fraser, 1985]. Because of that, the statements always consist of two parts, one is the amount of revenues generated from operations, and the other is the amount of expenses paid or payable for operations. Most revenues are derived from interest, either from loans or from various security investments, including deposits held by bank. The other sources are from fees generated from services rendered to the customers. In respect of expenses, interest expenses and employee wage and salary (including fringe benefits) are the most important. An example of an inb\come statement of the commercial bank is shown in Exhibit 2-2.

3. The Islamic Banking Models

3.1. The Origin of Banks

When Raymond de Roover [1954 in Udovitch, 179] concluded in his research that "there can be no bank where there are no banks", this could mean there was no bank in the early Islamic era. The first Islamic bank was established in 1950. However, Udovitch [1979] believes that de Roover's conclusion can only be applied to Western Europe from the middle ages until the mid-eighteen century. In the Islamic medieval world, sporadic evidence ad information found by Udovitch showed that banking activities had been practiced based on Islamic principles, where there was no interest charged on any credit.

According to Islamic histories, the financial practices, including lending and borrowing of money, money exchange and such, had been practiced in the early era of Islam. It is claimed that, because usury (riba) had been widely practiced among business people who were borrowing and or lending money at time before Islam, the Islamic tenet then came to state clearly that usury or riba is prohibited [Perwitaatmadja, 1991] as it is said in the Qur'an, Al-Baqarah (2):275 as follows:

Those who devour usury
Will not stand except
As stands one whom
The Satan by his touch hath driven to madness
That is because they say:
"Trade is like usury"
But Allah hath permitted trade
And forbidden usury.
[Translated by Yusuf Ali, pp. 126-7]

However, the first attempt to establish an Islamic financial institution in the modern Islamic world began in Pakistan in the late 1950s with the establishment of a local Islamic bank in rural area [Wilson, 1983 in-Ashker, 1987, Naughton, undated]. This effort was initiated by some pious landlords who deposited their funds at no interest. The credits were made available to small landowners for agricultural development. There was no interest charged for credit made to borrowers, but they did, however, levy a small charge to cover the bank's operating expenses.

This encouraging experiment eventually failed due to two main reasons. First, deposits made were regarded by (landford) depositors as once-and-for-all deposits. Consequently, when the demand for credit increased, the supply could not keep up. In other words, the gap between supply and demand was too large. Second, there was a lack of autonomy in bank operations conducted by banking staff. The depositors showed considerable interest in the way their money was lent out.

The second attempt to establish an Islamic Bank was in Egypt in 1963. The bank was named the Mit Ghamr Saving Bank and was established in the rural area of the Nile Delta. Bank operations were also based on the Islamic principles where there was no interest either paid to depositors, or paid by borrowers. One difference that applied in this bank compared to the first in Pakistan, was the eligibility to have credit facilities subject to a deposit for certain periods of time. Therefore, a person who wanted to make a loan, had to have deposit.

This experiment was successful. Many branches were opened in different areas of the country. Ultimately, the bank which had started as a one bank operation expanded to form a network of local and savings banks [al-Naggar, 1973 in El-Ashker 1987]. However, because of the country's change in political atmosphere, the experiment suffered a setback. But in 1971, under Sadat's regime the bank revived under a new name, that is, the Nasser Social Bank, where the state was involved in funding [El-Ashker, 1987].

3.2. The Development

The most remarkable development in Islamic banking quantitatively occurred in the 1970s. During this time and until recently, at least forty Islamic banks -among about hundred Islamic financial institution -were established. These spread out from United Kingdom to Bahamas [Metwally, 1992]. The names of some these banks, the establishment year and their location listed in Exhibit 2-3.

3.3 Bank Types

Due to their relatively new existence, Islamic banks have not become differentiated as have Western-style banks, where there are known various types as discussed in part 2.3. of this paper. Classification of Islamic banks, however, can be made in two days, that is, in respect of ownership. and in respect of business motive. in respect of ownership, Islamic banking can be classified into three groups. They are the banks which are owned fully by Islamic government, the banks which are owned fully by the private sector, and those banks which are owned internationally (Ahmad, 1987, Perwitaatmadja, 1991). Unlike

Exhibit 2-3;
List of the Islamic Banks, the year of establishment and the countries where they are operated.

Name of Bank	Year of Establishment	Paid Up Capital (Million US $)	Coutry
Nasser Social Bank	1972	2.8	Egypt
Dubai Islamic Bank	1973	14	U.E.A
Islamic Development bank	1975	1.028	Saudi Arabia
Faisal Islamic Bank	1977	21	Egypt
Kuwait Finance House	1977	30	Kuwait
Jordan Islamic bank	1978	9	Jordan
Faisal Islamic bank (sudan)	1978	9	Sudan
Kuwait Finance House	1978	10	Turkey
Bahrain Islamic Bank	1979	15	Bahrain
Masraf Faisal Al-Islamic (Bahrain)	1980	20	Bahrain
Al-Amanah Isklamic Invesment Bank	1990	-	Philipines
Banque Mier	1980	-	Egypt
Islamic International for Islami Invesment and Development	1981	-	Egypt
Al Raijhi Company for Islamic Invesment	1981	-	U.K.
Islamic Institution Bank of Bangladesh	1981	10	Bangladesh
Iranian Banking System	1982	20	Iran
Masraf Faisal Islamic	1982	20	Turkey
Masraf Faisal Islamic	1982	0,6	U.K.
Masraf Faisal Islamic (DMII)	1982	20	Guinea
Kibris Islamic Bank	1982	1	Syprus
Islamic Bank Intremational	1982	Kr25m	Denmark
Dal Al- Mal Al-Islamic Trust	1982	16n	Bahamas
Islamic Banking System International Holding S.A. (27 coutries)	1982	20	Luxemburg
Islamic Bank Malaysia	1983	100	Malaysia
Masraf Faisal Islamic	1983	20	Niger
Masraf Faisal Islamic (DMI)	1983	20	Senegal
Pakistan Banking System	1983	20	Pakistan
Dar-Al-Mall (DMI)	Subsidies	-	Switzerland
Tadamon Islamic Bank	1983	-	Sudan
Qaton Islamic Bank	1984	-	Sudan
Al-Barka Islamic Bank	1984	-	Sudan
Bank Mua'malat Indonesia	1992	-	Indonesia

Western- style banking, in respect of a business motive, Islamic banking can only be classified into two, viz. commercial banks and development banks. However in some Islamic banks countries like Iran, where all banks have been islamized, there is also a central Banks which functions and operates more or less as those central banks in any other country.

3.3.1. Islamic Development Bank

So far, there is only one Islamic Development Bank (IDB) which is located in Jeddah, Saudi Arabia. The bank which was established in October 1975 - as its named implies - was more concerned with assisting a member countries in respect of non commercial projects, such as research, education, irrigation, infrastructures development and so forth. There are currently forty member countries (Abdul Rehman, 1986).

3.3.2. Islamic Commercial Bank

This kind of bank like other Western-style banks, is operated commercially and is profit-oriented. All Islamic banks at this time fall in this category except the Islamic Development Bank. Since there are a lot of products or services which can be provided by these banks (see: point 3.4 Products and services), the process of specialisation of Islamic banks as those in Western-style Banks is only a matter of time.

3.4. Product and Services [2]

The products or services offered by Islamic Banking are very typical. However, some money of them are still similar to those of Western-style banks. the legal principles of the products or services offered by Islamic banks are briefly discussed below :

(a). Wadi'ah

The Wagi;ah is an agreement between a party who owns the goods (including money) which are entrusted to another party (including bank) for the reason of safety of those goods. When the Wadi'ah agreement is free of other clauses or conditions, it is called "yad amanah". in this case, the keeper (bank) is not responsible for any damage or loss of the goods, unless the damage or loss is caused by an officer (a person) or a bank negligence.

If the keeper (bank) ask permission to use the goods or money, or the keeper (bank) utilizes the goods or money without permission from the owner this Wadi'ah is the classified as " yad 'dhamanah ". In this case the keeper (banks) is fully responsible for any damage or loss. However, any benefit raised from utilization of the trusted goods or money belongs to the keeper (bank).

[2] *This part is mainly adopted from blooklet published by Bank Islam Malaysia Berhard with additions from various source*

(b). Mudharabah

mudharabah is an agreement between the capital owner and the businessman or entrepreneur, where the capital owner has agreed to provide all the capital needed and the entrepreneur is fully responsible for management. The profit generated from the operations will be devided into agreed proportions. In case of loss resulting from normal business activities, the capital owner bears all the losses, and the entrepreneur loses only that profit which would have been the rward of this effort.

(c) Musharakah

Musharakah is an agreement between two or more parties, in which each party agrees to join in partnership for certain operations within an agreed period. Each party contributes to the capital of the project, and agrees to divide the net profit (and Loss) in the proportions determined in advance.

(d). Murabahah

Murabahah is a resale contrast between a bank and its client. The bank agrees to purchase equipment needed by the client, and then sell it to the client at the mark-up price which is agreed to by the client. The payment can be done in the basis of instalment. The validity of this contract is subject to the condition that both parties know the cost of the equipment or commodity, and the profit margiin made by the capital owner or bank.

(e) Bai'Bithaman Ajil

Bai'Bithaman Ajil is a purchase agreement for a specific commodity between seller and buyer, where the sellers will deliver the commodity immediately, but the buyer will postpone the payment until a certain period or will pay it on the basis of instalment. The price of the commodity can be higher than the each price, but once the price is determined, the seller is committed not to change it.

(f) Bai' ul -Salam

Bai' ul -Salam is the opposite of Bai' Bithaman Ajil, where the buyer pays immediately, but the delivery will be postponed until the certain period which is agreed in advance by both parties.

(g) Ijarah

Ijarah is a renting agreement between owner of fixed asset (moveable such as vehicle or other facilities, or unmoveable like land or building) -bank in this case -with another party or bank customer. The renter has to pay rent to bank on an agreed amount. The other kind of Ijarah is a wage agreement contract, where one party (bank) agrees to pay another party (customer) for a service rendered.

(h) Bai' al-Ta'jiri

Bai' al-Ta'jiri is just like a lease-sale contract. Or, similar to Ijarah with the additional condition where the owner agrees to sell his asset to the rentee at the specified price. The payment has been made is calculated as the part of price the asset.

(I) Wakalah

Wakalah is a contract between two parties, where the first is represented by the other in performing a specified task. The asset which is received by the representative in performing the task assigned, is assumed as the Wadi'ah.

(j) Qardhu ul-Hasan

Qardhu ul-Hasan is a credit facility provided especially to those who are in a financially difficult condition, particularly those who have incurred unavoidable expenses like health, a wedding, education and so forth. The only obligation to be fulfilled by the borrower is to return the principal. No interest is to be charged except, perhaps, a very small amount of administration fee.

(k) *Al-Rahn*

Al-Rahn is an agreement between two parties, where the party borrows money with an assurance of a certain asset which is "lent" to the second party. In the case that the borrower cannot return the money, the asset can be sold, and the money lender may take money back as much as the loan made by the borrower. The excess of money on the sold asset (if any) should be returned to the owner of the asset or borrower.

(l) *Al-Kafalah*

Al-Kafalah is a bank guarantee, that is the agreement between two parties, (bank and client) where the client will perform some task, or has to pay some amount to a third party. In this case if the client fails to perform that specified task, the bank will guarantee its performance fully.

(m) *Jo'alah*

Jo'alah is a contract on the basis of one party (the bank or employer) undertaking to pay a specified amount of money to the other party (the contractor) for rendering a specific service in accordance with the terms and conditions of the contract.

Based on these principles, the products or services that can be provided by Islamic banks, are discussed in the next section.

3.4.1. Products to attract or collect public funds

As the intermediary institution, the bank has to attract the public to deposit their fund with the bank. The products that can be offered are:

(a). *Wa'diah Current Account*

This product runs on the Wa'diah principle, where it can be classified as yad amanah (no guarantee) or yad dhamanah (guaranteed but able to be utilized by the banks). As with saving account in

Western-style banking, the client can withdraw the money at any time. In the Bank Mua'amalat Indonesia, the client may be rewarded with a bonus for not withdrawing for a certain length of time [Noor, 1992].

(b). *Profit Sharing Mudharabah Saving Account*

This account will accept money from a client on the basis of mudharabah. That means the bank may utilize the money in a certain project. If the project gains a profit, it will be distributed on an agreed proportion. One thing that should be noted with this account is, that the client still can withdraw the money at any time. But, the Bank Islam Malaysia Berhad, treats the saving account on the basis of Wadi'ah principle, Hence there is no profit sharing.

(c). *Mudharabah Deposit Account*

In this account, the bank will act as entity which is trusted to operated the business and the clients act as the capital owners. As it is stated in the mudharabah principle, when the project generates profit, it will distributed property on the basis of an agreed proportion, but if the project fails or incurs a financial loss (in normal business conditions), the capital owner bears all the finance risk.

Almost like a term deposit in a Western-style bank, the contract should mention a specific period. In the Bank Islam Malaysia Berhad for instance, the periods available to be chosen range from three, six, nine twelve until twenty-four months or more.

3.4.2. Products to distribute the funds collected

(a). *Mudharabah (Profit Sharing) Credit*

This credit is provided or "sold" to those who have the project(s), but have no capital. In this kind of credit, the bank will provide the total capital needed but will not participate in any part of project management. However, the bank still have a controlling right over the project, as well as the right to make a proposal.

(b). *Musharakah (Profit & Loss Sharing0 Credit*

As was explained earlier, in this kind of credit, both the bank and the client participate in capital and management. But, with permission of the bank the client can manage the project by himself. The profit or loss resulting from operation will be distributed on the basis of an advance agreement. The close example of this product to what has been known in Western financial society is probably what is called Venture Capital.

(c). *Murabahah (Purchase Credit On Maturity Date)*

The bank will purchase a certain commodity (moveable or unmovable) needed by the client, and resell it with a mark-up price. The cost and mark-up price are subject to agreement between bank and client. An instalment is payable on the maturity date which is agreed to by the bank and the client.

(d). *Bai'Bithaman Ajil*

Bai'Bithaman Ajil is basically similar to Murabahah except in respect of the time frame of initial instalment payment, where there is no maturity date mentioned.

(e). *Ijarah*

The client rents something (a moveable or unmoveable commodity) from a bank, and for this he or she has to pay the rent.

(f). *Bai' Al-Ta'jiri*

Bai' Al-tajiri is exactly like purchase-leasing, where the client lease something from the bank, and at the end of leasing contract, the client has an option to purchase the leased commodity.

(g). Qardh ul-Hasan

Qardh ul-Hasan is a pure loan. The bank provides this loan any party who may need it, especially in relation to basic needs and unavailable expense(s) -such as health, education and so forth - for which the person can not pay for. The clients are not asked to returned the credit except the capital on agreed maturity date, plus some small charge for administration expenses. The return payment can also be done on the basis of an installment.

Although this credit is basically designed as consumptive product, to some extent it can be provided as a productive one, such as to assist the people who face bankruptcy.

3.4.3. Other Services

In respect of services, a bank can also provide the (a). *Al-Kafalah*, (b). *Al-Hiwalah (Transfer)*, (c). *Al-Jo'alah*, and (d). *Al-Wakalah*. In rendering these services the bank generally charges the client a fee.

From these various products or services of Islamic banks, it can be demonstrated that there is no single of the word interest. Therefore, they are not like the Western-style banking products or services, where almost every products or services (credit facilities) sold is priced on the basis of interest.

3.5. Bank Organization

In the Islamic Banking organization, generally there are three bodies which manage and supervise the activities of the bank. These include the Annual General Meeting, the Religious Supervisory Board, and the Board of Directors [El-Ashker, 1978]. The functions of the Annual general Meeting and Board of Directors are similar be slightly different. For example, in the Faisal Islamic Bank of Egypt, the Board of Directors may select a chairman from amongst its members and a Governor from amongst its members or from outside.

The Religious Supervisory Board is formed to ensure that the bank's dealings and activities are run in conformity with the principle of Islamic law (shari'ah). This board generally consists of three to five members who are selected from amongst Islamic scholars and jurists. The board members are appointed by a decision of the Annual General Meeting. This has the power to fix remuneration at the proposal of the Board of Directors.

More specifically, the task of the religious supervisory board, particularly in case of Faisal Islamic Bank of Egypt as written by El-Ashker [1987] is:

> *....to provide advice and undertake reviews concerning application of the Shari'a. In this respect the religious board has the status of financial auditor with all his capacity. It has the right to request the holding of a special meeting for the Board of Directors to explain its views on matters of Shari'a.*
> *More over, the religious board prepares a religious auditing report which is regarded as part of the annual report, similar to financial auditing. In this report the religious board verifies whether the bank's operation are in conformity with the Shari'a. The names of the members of the religious board are published in the bank's annual report alongside the names of financial auditors.*

However, these three bodies seem to function in a manner similar to the several divisions in Western-style banking, each having its responsibilities and sphere of influence.

3.6. Financial Statements

Regarding the example that can be seen from the Bank Islam Berhad, the bank also issues financial statements which consists of a balance sheet, income statement and statement of change in financial position. The discussion of each statement is as follows:

3.6.1. Balance Sheet

The basic structure of Islamic Bank's balance sheet is still similar to its Western counterparts' balance sheet that is, it consists of an assets group and liabilitiescapital equity group. However on close examination the individual accounts of this group indicates that there are several differences. In the asset items for example, there is no "loan" account which in the Western-style bank's assets generally is the biggest account. On the contrary, there is what is called "Financing and Investment of Customer" and "Investment" accounts. These two accounts, in the case of the example provided are also the biggest accounts in regard of their value, compared to other assets. In addition, there is also "Stock of Commodities" account which has a great value as well. In the liabilities and equity group of accounts, Islamic Banks do not have a bond or any security which bears interest. On the contrary, there is zakat payable beside taxation, and investment [of clients] which is classified as current deposits of customers.

These differences however, indicate the different way of operation of Islamic Banks compared to Western-style bank, where in any, any product or services bearing interest is heavily avoided.

3.6.2. Income Statement

The basic structure and ingredients of the Islamic Bank Income Statement is still similar to their Western-style bank counterpart. The major difference is, there is no interest account, whether in respect of revenues items, or in operational expenses. As mentioned in part 3.4, the revenue of Islamic banks is generated from profit sharing products, mark-up pricing, leasing, or fees. Whilst in respect of expenses, the banks also avoid any transaction bearing an interest cost.

3.6.6 Statement of Changes in Financial Position

Unlike Western-style banking [Rose and Fraser, 1987], or in the case of Western Bank, (see the example of the Financial Reports in Exhibit 2-1 and 2-2 above), Islamic Banks, -at least in the case of Bank Islam Malaysia -also issue a Statement of Changes in Financial Position. However, this report does not indicate any significant difference to a similar report or statement which is usually issued by any other company(3).

4. Differences and Similarities

After comparing these two kinds of banks, the differences as well as the similarities between them becomes more transparent. The following is a discussion of these differences and similarities.

4.1. Differences

In respect of its early history, it is obvious that Western-style banking existed much earlier than Islamic banking. Although no one knows for sure when the Western-style banking began [Rose and Fraser, 1987, Muslehuddin, 1990], its roots can be found in about five thousand years BC [Muslehuddin, 1990]. On the contrary, Islamic banking activities -at least according to Udovitch [1979] and various Islamic sources - started around the 7th century (by coincidence with the appointment of Mohammed [peace be upon him] as the last Prophet and Messenger who was responsible for the spread Islamic teaching).

Nevertheless, many authors agree that the modern western-style banking began on about 14th century, and develop rapidly on about the 16th and 17th centuries, coinciding with the industrial revolution in England [Rose and Fraser, 1985]. Whilst on the other side, to offer funds to those who need loans or credit, both banks are different in measuring the "price" of money either to depositors or to borrowers.

In this case, Western-style

banking uses interest either as reward for money saved or deposited by depositors, or to charge on loans borrowed. While Islamic banks mainly use a profit and loss sharing approach both to depositors and borrowers. In Islamic banking, interest is absolutely prohibited because interest is assumed as usury, and usury is stated clearly in the Qur'an as a prohibition. Hence, any transaction in Islamic banking, should be as possible avoid interest or usury.

The difference in viewing and treating interest is the most important point of difference between these two styles of banking. This, in turn, generate some other difference as will be discussed in the following paragraphs.

In relation to bank organization due to the commitment of Islamic Bank to Islamic legal principles, every Islamic bank has what is called

Exhibit 2-4; Profit and Loss Account Of Bank Islam Malaysia Berhad.

BANK ISLAM MALAYSYA BERHARD
Profit and loss Account
Year Ended 30th June 1988

	Group 1988 $'000	Bank 1988 $'000
Operating revenue	73,082	71,095
Profit before zakat and taxation	6,458	6,187
Zakat	(365)	(358)
Taxations	(3,725)	2,858)
Profit after zakat and taxation but before minority inters and extraordinary item	2,198	2,971
Exatraordinary item	-	-
Profit/(Loss) after zakat, taxation, minority intert and extraordinary item	2,198	2,971
(Accumulated losss)/retained profits brought forward	(1,233)	2,027
	965	4,998
Transfer to reserve fund	(1,490)	(1,490)
Proposed dividend of 2% (1987:Nil) less 35% tax	(1,039)	(1,039)
(Accumulated losses)/retained profit carried forward	(1,564)	(2,496)

(3) *Recent changes in accounting standars in respect of statments of changes in financial positiuos have resulted in statements of Cash Flows becoming more common*

Exhibit 2-5
Consolidated Statement of Changes in Financial Position of Bank Islam Malaysia Berhad.

BANK ISLAM MALAYSYA BERHARD
Consolidated Statement od Changes In Financial Position
For the Year Ended 30th June 1988

	Group 1988 $'000	Bank 1988 $'000
SOURCE OF FUNDS		
Profit for the year after Zakat and taxations but before minorrity interst and extraordinary item increase in takaful fund	2,368 4,737	397 2,912
	7,105	**3,309**
Adjustments for items involving the movement of fund:		
Deferred taxation	1,300	1,900
Amortisation of intagible assets	97	97
Depreciation	3,219	2,693
Fund generated from operations	**11,721**	**7,999**
Increase in:		
Current, saving, invesment and other deposits of customers	213,084	242,240
Other liabilities (Including taxation and zakat payable)	1,833	3,125
Bill Payable	2,437	-
Descrease in:		
Bill receivanle	-	162
Cash and Balances with banks and agents	-	5,515
Stock of Commodities	91,374	-
	320,449	**259,041**
APPLICATION OF FUNDS		
Purchase of fixed assets	2,477	3,13
Purchase of invesments	119,828	180,811
Increase in:		
Cash and balance with banks agents	3,836	-
Financing and invesment of costumers	182,553	33,260
Statuory deposits with Bank Negara Malaysia	8,370	7,156
Stock of commodities	-	31,650
Other assets	2,489	101
Bills rceivable	896	-
Decrease in bulls payable	-	2,924
	320,449	**259,041**

a "Religious Supervisory Board" or RSB -some banks have named this "Shari'ah Supervisory Board or Council" or SSB/C -which is responsible for the supervision of bank operations to ensure that they conform with the Islamic principles. This body, however, is never found in

Western-style banking.

The other differences are obviously the products or services offered. As discussed earlier, the differences in products are also clear. Western-style banking cannot be separated from any product bearing interest while Islamic banking cannot accept any product bearing interest.

In relation to financial reports - unless the difference of types of report issued- the differences can be seen in the sense of the composition of each account. This is indeed the consequence of how each bank views and treats the interest. For example, interest is the major revenue gathered by Western-style banking. On the other hand, revenues in Islamic Banks are mostly generated from profit sharing.

The other difference in the balance sheet of each bank, particularly in the current accounts group, is the loan account. It is one of the major account in the Western-style banks' balance sheet, while in the Islamic banks, loans do not exist, or if they do, it is in very insignificant amount.

However, conceptually there seem no significant difference between accounting concepts applied by the Western-style banking and Islamic banking. Both styles use an "historical" concept, for example. The difference so far can be seen is, the Bank Islam Malaysia Berhad uses the the "cash basis" concept, as used generally by Western-style banks. However, still has not been uniformity amongst Islamic Banks around the world, because some Islamic banks use the "accrual or time basis" in order to recognize their income [Gambling and Karim, 1990].

The difference in the sense of variety of bank types between two styles of banks -even exists- will not be discussed more. Although it is not so relevant to the topic of study, the variety of types of bank in Western-style model, might be the consequence of their long age and the severe competition amongst themselves as well as other financial institutions. In the Islamic bank life, the different bank types may exist after these banks become more mature and more severe in competition, hence one bank should concentrate in a specific field only. Therefore, this is only a matter of time.

4.2. Similarities

Some similarities are found between Western-style bank and Islamic bank. They are discussed as follows. First, both are financial intermediary institutions. Because of this, both attract money surpluses from individuals or institutions in the form of deposits -whatever a particular bank has named them -and then offer these funds to those who need them. Through this way, both are functioning as money creators.

The other similarity is the way the bank is organized. Apart from the religious Supervisory Board in Islamic banks, the bodies are organizationally essentially similar, including the divisions or departments within the bank.

The financial reports which consists of the balance sheet and the income statement (and statement of changes in financial position issued by the Bank Islam Malaysia Berhad) basically do not indicate the essential differences. This might be due to the fact, that accounting concepts and practices which have been develop well in Western countries are viewed by the Islamic banks -which just existed since about the last two decades -as the acceptable and applicable concepts, which are not contrary to Islamic law, although to some extent, these concepts have been adjusted.

The adjustments, nevertheless indicate that the Western accounting concepts and practices do not totally fit into Islamic law. This is perhaps, because Western accounting concepts were developed on the basis of capitalism and or liberalism, while in Islamic teaching, this philosophy is not generated from what Allah (SWT) has revealed (the Qur'an) or Al-Hadith.

However, the similarities of accounting concepts and practices and how they possibly should be different, will be studied deeper in later. It is actually the main topic of this study overall.

5. Conclusion

Two models of bak -Western-style and Islamic-style- have been discussed and compared considerably. The study indicates that there are some important differences between the Western-style compared to Islamic one. The most essential difference was the commitment of Islamic banks to obey Islamic law in their operations. Hence interest which was the most important concepts in Western-style bank, is totally avoided by Islamic banks.

One thing that has not been answered through this review is the question whether the concepts of accounting which have been adopted and practised by Islamic banks at the present should be rejected. Should they be different in Islamic banks, due to rejection of the concepts of interest, and to some extent the derived concepts of the accrual basis. This question, however, will be answered in subsequent studies.

The study also showed that there are some similarities between the two different models of bank. They are the main function of bank as the financial intermediary institution which attracts money surpluses from the public, and at the same time offer loans or credit to those who are in need. A similarity also exists in the sense that both banks function as institution which offer particular services such as money transfer, money exchanged, bank guaranty, safe deposit box, leasing and so forth.

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