

Shari'ah Non-Compliant Income in Accounting Studies

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ABSTRACT

The overall goals of an Islamic economics system is to realize the goals of Maqasid Al-Shari'ah (the Islamic law). It is realized through the offering of Shari'ah compliance products and services for the benefit of various stakeholders in the Islamic Finance. Most of these products and services are being offered by the Islamic Financial Institutions (IFIs) globally. Any products or services that are non-compliance to the Islamic law is considered as invalid or haram. The income or revenue which is declared haram by the Shari'ah Committee is called as Shari'ah Non-Compliant Income (SNCI). This study is conducted with an aim to explore the SNCI in the accounting studies as appear in the google scholar research. This preliminary study will review previous literatures related to SNCI from the perspectives of accounting, financial reporting and auditing as found in the google scholar search accessed on 5 September 2019 . It is hoped that, the study will shed some lights on the importance of SNCI studies not only in the area of Shariah but also in the area that is less explored for instance, accounting, financial reporting, auditing and the other accounting streams.

Keywords: Accounting, Shariah Non-Compliant Income, Financial Reporting, Islamic Finance.

INTRODUCTION

Shari'ah is the backbone of Islamic banks. It is instrumental for Islamic banking Institutions (IBIs) to maintain the confidence of stakeholders and the public at large through the offering of Shari'ah compliance products and services. An Islamic bank is expected to ensure beginning-to-end Shari'ah compliance in terms of its aims, activities, operations and management. Islamic banks have to ensure at all times their activities and products are consistent with Shariah principles (Radzi and Lonik, 2016). All financial instrument or transaction, based on Islamic canonical directives, must be free of Riba (interest or usury), Rishhwa (corruption), Maysir (gambling), Gharar (excessive risk), and Jahl (ignorance). But with businesses around the world becoming progressively multifaceted, companies will inevitably be exposed to a multisource of revenues, some of which may be haram (Franklin Templeton Investments, 2017) .

Shariah Non-Compliant Income (SNCI) is as a proxy for Shariah Risk Management systems due to Shariah Non-Compliance (SNC) event identified. The SNCI may originate from every process of products execution. Any SNC occurrences will be identified and recorded for the purpose of conducting sampling audit by the Shariah Auditor before the Shariah Review. SNC commonly detected by the Shariah Auditor and Shariah Reviewer after the audit and review processes are conducted. However, the detection of SNC incidence is dependent on the ability of the Shariah Auditor or Shariah Reviewer to detect the incidence. The detection on the number of occurrence pertaining to SNC indicate the effectiveness of IBs in exercising

Shariah risk management and control system within the Shariah Governance Framework. SNC is considered an offence where SNC events could cause a potential loss to the IBIs (IFSA, 2013). This is particularly relevant for financial SNC activities that has the potential to generate invalid income or SNCI from the IBIs business activities.

Although in some incident the SNCI tends to be of small amounts, it may still marginally erode the net gains of fund investors (Franklin Templeton Investments, 2017). Most companies of today have dealings with conventional banks and that could expose them to riba-related transactions (Franklin Templeton Investments, 2017). Thus, the management of shariah risks is important because failure to comply with Shariah by Islamic banks may have an impact on a bank's sustainability and reputation (Rosman et. al, 2017).

Objectives of the study:

1. To explore the area of SNCI in accounting studies recorded by the google scholars.
2. To explore the number of SNCI in accounting studies recorded by the google scholars.

LITERATURE REVIEW

There are many aspects of accounting that a researcher could embark on exploring for SNCI study. For instance, on SNCI transparency and disclosure which are the most important parts that constantly impacts the cost of capital, reputation, investors' decision and stock prices (Haqqi, 2014). As opposed by Md Zain & Shafii (2018), adequate disclosures in Financial Statement could improve comparability for users to better facilitate the assessment of an IFI's financial position, performance and Shariah compliance. In fact, disclosure provide confidence level among stakeholders towards the capability of the institution (Md Zain and Shafii, 2018). Compliance with IFRS results in Financial Statements' achieving fair presentation of the financial position, financial performance, and cash flows of an entity (Bellandi and Francesco, 2017). Reporting the activities in the annual report, allows the customers to review and evaluate the level of assurance in the banking operation (Md Zain and Shafii, 2018).

This evidence was further supported by Rosly (2010), where he found that there are three more parameters that should be imbedded into the existing parameters. This is to avoid costly errors that might lead to litigations and loss of competitiveness in the Islamic financing business from the perspectives of Maqasid As Shariah, Financial Reporting and Legal documentation of contract. T. Hussin (n.d), believes that Financial reporting or accounting process would the next most important aspects of the banking sector. In addition to that, the Shariah regulators are urge to take additional measures, i.e standardizing SNCI-reporting values by facilitating effective and comprehensive Shariah Governance systems (www.internationalbanker.com, 2019)

One of most the important element of financial reporting, particularly on reporting the SNCI amount is the materiality. An item is considered material if it is capable of making a difference in the economic decision made by a user (Tong, 2017, Mukminin, 2018). Materiality should be assessed not only in relation to the size of an item, but also to the nature and incidence of the item occurring. An item that is otherwise insignificant in size may be a material item (Tong, 2017). Judgment is therefore required in deciding which items shall be considered as material or immaterial (Tong, 2017). To show that the issue of materiality is relevant and crucial in reporting of SNCI, Bank Negara Malaysia (BNM) has issued Shariah

Governance Exposure Draft in 2017 which requires a Shariah committee to disclosed sufficient information in the Islamic Financial institution's (IFI) annual financial report on the state of compliance of the IFI (BNM, 2017).

METHODOLOGY

This preliminary study is conducted using the google scholar search engine to trace the number of results recorded by the google scholars with the full keyword of 'Shariah Non-compliant Income in Accounting Studies'. This study sets a 3-year duration of studies on Shariah Non-compliant Income (SNCI) in Accounting studies since 2017 until 2019 which was accessed on 5 September 2019. All the research titles and contents with the full keyword 'Shariah Non-Compliant Income' were reviewed and recorded not limited to the area of accounting only, but include the area of Shariah, finance, economics and governance. Further screening was done to select only studies with the full keywords of 'Shariah Non-Compliant Income' only, excluding any partial keywords of 'Shariah Non-Compliant Income'. The results of findings were manually tabulated and categorized into the accounting study based on the area of accounting identified.

Shariah Non-Compliant Income vs. Shariah Non-Compliance Income

Besides searching the number of studies using the full keywords of 'Shariah Non-Compliant Income in Accounting Studies', we also try to explore other search using the full keywords of 'Shariah Non-Compliance Income in Accounting Studies'. This is due to we found that there is inconsistency in the use of the term SNCI as Shariah Non-Compliant Income or Shariah Non-Compliance Income in written communications and research papers. The search is conducted for studies range between a period of 2017 to 2019. The results of both searches will be discussed in the next section.

EMPIRICAL RESULTS AND DISCUSSIONS

Based on the review and screening conducted, it was found that not all the studies listed as per results were related to the area of accounting only. The search captures all the full and partial keywords of 'Shariah Non-Compliant Income' in any area of studies not limited to accounting or auditing but also cover other areas such as Finance, Shariah, Islamic Law, Economics, Governance and Management. The results were tabulated in Table 1 below:

Table 1: List of titles search for 'Shariah Non-Compliant Income in Accounting Studies'

No.	Title	Journal	Accounting	Others
1.	An empirical investigation into the impact of Shari'ah-compliant status and Muslim directorship on the accuracy of IPO management earnings forecasts.	International Journal of Islamic and Middle Eastern Finance and Management, March 2019		√
2.	Analysis on Impact of Macro-Economic and Returns on Shariah Compliant and Non-Compliant Portfolio: Evidence from the Capital Structure and Volatility of Pakistan Stock Market	SSRN: https://ssrn.com/abstract=3384215 May 7, 2019		√

3.	Effects of Shariah-compliant business practices on long-term financial performance	Pacific-Basin Finance Journal Volume 53, February 2019, Pages 254-267		√
4.	Capital structure and speed of adjustment in non-financial firms: Does sharia compliance matter? Evidence from Saudi Arabia	Emerging Markets Review Volume 39, June 2019, Pages 50-67		√
5.	Analysis of Shari'ah Based Equity Screenings: Developing a Shari'ah-Compliant Index for Qatar Stock Exchange	Islamic Economic Studies, Vol. 26, No. 2, 2019		√
6.	Does Ramadan influence the returns and volatility? Evidence from Shariah index in India	Journal of Islamic Accounting and Business Research, July 2019		√
7.	Capital Structure Determinants of Shariah-compliant Firms	Journal of Emerging Economies and Journal of Emerging Economies & Islamic Research 7(1) 2019, 65 – 75, January 2019		√
8.	Board diversity and corporate social responsibility: the moderating role of Shariah compliance	Corporate Governance: The International Journal of Business in Society. July 2019.		√
9.	Shari'ah Governance Framework in Different Jurisdictions	Research in Corporate and Shari'ah Governance in the Muslim World: Theory and Practice, May 2019.		√
10.	Crowdfunding and Fintech: business model sharia compliant	European Journal of Islamic Finance, No 12 (2019)		√
11.	Religiosity, Neglected Risk and Asset Returns: Theory and Evidence from Islamic Finance Industry	3rd Chapman Conference on Money and Finance - Financial Market Development in Emerging Asia: Impact on Corporate Performance, Capital Flows and Politics May 4, 2018		√
12.	On the post-financial crisis performance of Islamic mutual funds: the case of Riyadh funds	Journal Applied Economics Volume 51, 2019 - Issue 18		√
13.	Islamic Perspective of Corporate Governance: An Introductory Note	Research in Corporate and Shari'ah Governance in the Muslim World: Theory and Practice, Emerald Publishing Limited, pp. 17-26, May 2019		√
14.	Sharia supervisory boards, governance structures and operational risk disclosures: Evidence from Islamic banks in MENA countries	Global Finance Journal, 31 July 2019		√
15.	Islamic law, corporate governance, growth opportunities and dividend policy in Indonesia stock market	Pacific-Basin Finance Journal Volume 55, June 2019, Pages 110-126		√
16.	Sensitivity of Firm Size Measures to Practices of Corporate Finance: Evidence from Shariah Compliant Firms	Journal of Islamic Business and Management (Jibm.org)		√

17.	Determinants of Capital Adequacy Ratio (CAR) in MENA Region: Islamic vs. Conventional Banks	International Journal of Accounting and Financial Reporting ISSN 2162-3082 2019, Vol. 9, No. 2		√
18.	Risk-adjusted efficiency and corporate governance: Evidence from Islamic and conventional banks	Journal of Corporate Finance Volume 55, April 2019, Pages 105-140		√
19.	Impact of Investment Efficiency on Cost of Equity: An Empirical Study on Shariah and Non Shariah Compliance Firms Listed on Pakistan Stock Exchange	Pakistan Administrative Review, 2 (2018) 3		√
20.	Shariah Audit Effectiveness In Islamic Banks: A Conceptual Framework	Journal of Humanities, Language, Culture and Business (HLCB) Vol. 2: No. 10 (December 2018) page 12-19	√	
21.	Change in Sharia Screening Methodology and Share Price Informativeness	Available at SSRN: https://ssrn.com/abstract=3109788 (January 25, 2018)		√
22.	Does the Choice of Stock Selection Criteria Matter for Shariah-Compliant Investors?	Available at SSRN: https://ssrn.com/abstract=3299238 (December 11, 2018)		√
23.	Determinants of capital structure: evidence from Shari'ah compliant and non-compliant firms	Pacific-Basin Finance Journal Volume 51, October 2018, Pages 198-219		√
24.	The Concept of Islamic Banking from the Islamic Worldview.	International Journal of Academic Research in Business and Social Sciences, 8(11), 539– 550.		√
25.	Effect of Shariah Compliance on Operating Performance: Evidence from GCC Countries	Journal Emerging Markets Finance and Trade Volume 54, 2018 - Issue 12		√
26.	The Concept Of Islamic Banking From Muslim's Perspective	Prosiding Seminar Kebangsaan Majlis Dekan Pendidikan Universiti Awam 2018		√
27.	A Review of Islamic Commercial and Social Finance in Pakistan	Journal of Islamic Banking and Finance July – Sept 2018		√
28.	From Screening to Compliance Strategies: The Case of Islamic Stock Indices with Application on 'MASI'	Islamic Economic Studies, Vol. 25, No. S, 2017		√
29.	Corporate governance and social norms during financial crisis: evidence from France and Saudi Arabia	Journal of Management and Governance, September 2018, Volume 22, Issue 3, pp 707–748		√
30.	What is the cost of faith? An empirical investigation of Islamic purification	Pacific-Basin Finance Journal, Volume 52, December 2018, Pages 134-143		√
31.	Voluntary Operational Risk Management Disclosures by Islamic Banks in Muslim Majority Countries	Available at SSRN: https://ssrn.com/abstract=3208380 (July 4, 2018).		√
32.	The impact of macroeconomic indicators on Qatar stock exchange: A	Journal of Transnational Management		√

	comparative study between Qatar exchange index and Al Rayyan Islamic index	Volume 23, 2018 - Issue 4		
33.	Can UGITs promote liquidity management and sustainable development?	ISRA International Journal of Islamic Finance, Vol. 10 No. 2, pp. 126-142		√
34.	Returns and Volatility Spillover between Islamic and Conventional Indexes: Evidence from Selected Emerging Asian Markets.	Journal of Islamic Business and Management 2018, 8(2), 361-385		√
35.	Stock Screening Process for Shari'ah compliance Global Practices	Islami Ain O Bichar Vol. 14, Issue: 54 April-June, 2018		√
36.	Volatility Spillover Among Equity Indices and Crude Oil Prices: Evidence from Islamic Markets	Journal of King Abdulaziz University: Islamic Economics, Vol. 31, No. 1, 2018		√
37.	Measuring Shariah non-compliance risk (SNCR): claw-out effect of al-bai-bithaman ajil in default	Journal of Islamic Accounting and Business Research, Vol. 8 No. 3, pp. 272-283		√
38.	ISRA-Bloomberg Shari'ah stock screening and income cleansing methodologies: a conceptual paper	ISRA International Journal of Islamic Finance, Vol. 9 No. 1, pp. 27-42.		√
39.	Islamic and conventional equity index co-movement and volatility transmission: Evidence from Pakistan	Future Business Journal Volume 3, Issue 2, December 2017, Pages 98-106		√
40.	Revisiting The AAOIFI Shariah Standards' Stock Screening Criteria	International Journal of Business and Society, Vol. 18 S1, 2017, 151-166		√
41.	Towards a Robust Shariah Screening Criterion for Stocks	Developments in Islamic Finance pp 89-119		√
42.	Islamic Wealth Management Theory and Practice	Monograph Book Published in print: 29 Dec 2017 ISBN: 9781786439383		√
43.	Purging of impure income: a comparative study of the existing purging methodologies	ISRA International Journal of Islamic Finance, Vol. 9 No. 1, pp. 62-80.		√
44.	Examining anomalies in Islamic equity market of Pakistan	Journal of Sustainable Finance & Investment Volume 7, 2017 - Issue 3		√
45.	A Comparative Study On The Risk-Return Analysis Of Islamic Mutual Funds With Conventional Mutual Funds: An Empirical Evidence From Indian Capital Market	Consortia Vol.3 No.2 January – June 2017		√
46.	Are Islamic risk factors blessings or curse for stock return? evidence from Malaysia based on dynamic GMM and quantile regression approaches	https://mpru.uni-muenchen.de/id/eprint/79738		√
47.	The recent development and performance of ethical investments	Routledge Handbook of Social and Sustainable Finance (2017)		√
48.	Economic Forces and Islamic Stock Market: Empirical Evidence from Malaysia	Asian Journal of Business and Accounting 10(1), 2017		√

Due to inconsistency found during the authors search for literature on ‘Shariah Non-Compliant Income’ in Accounting Studies’, we have decided to embark a similar search through the google scholar platform for the keywords of ‘Shariah Non-Compliance Income in Accounting Studies’. We found out that most of the results for the keywords of ‘Shariah Non-Compliance Income’ were in the area of risk and shariah compliance or shariah governance. The results for both searches performed were tabulated in Table 2 below:

Table 2: The results for Shariah Non-Compliant Income vs. Shariah Non-Compliance Income in Accounting Studies

No.	Research Objectives	Results
1.	To explore the area of Shariah Non-Compliant Income in accounting studies recorded by the google scholar.	Area: Audit Shariah Audit Effectiveness In Islamic Banks: A Conceptual Framework. Journal of Humanities, Language, Culture and Business (HLCB) Vol. 2: No. 10 page 12-19 (December 2018)
2.	To explore the number of Shariah Non-Compliant Income in accounting studies recorded by the google scholar.	(2017 – 2019) - 299 results of search for ‘Shariah Non-Compliant Income in Accounting Studies’.
		(2019) - 84 results of search for ‘Shariah Non-Compliant Income in Accounting Studies’.
		(2018) – 107 results were recorded by the same searched
		(2017) - 109 results were recorded by the same searched
3.	To explore the number of Shariah Non-Compliance Income in accounting studies recorded by the google scholar	(2017 – 2019) - 631 results of search for ‘Shariah Non-compliance Income in Accounting Studies’.
		(2019) - 158 results of search for ‘Shariah Non-compliance Income in Accounting Studies’.
		(2018) – 223 results were recorded by the same searched
		(2017) - 253 results were recorded by the same searched

Based on the results tabulated in Table 1 and Table 2, we found that only 45 research titles out of a total of 299 research titles are related to Shariah Non-Compliant Income (SNCI) with full keyword of ‘Shariah Non-Compliant Income in Accounting Studies’. These could be due to the total output of 299 including the mixed of full and partial keywords of this study.

CONCLUSION

From the results and discussions in the previous section, we can conclude that the SNCI in accounting studies is still under explored. This grey area need to be further explored particularly but no limited to the accounting areas i.e. financial accounting, financial reporting, auditing, management accounting etc. Furthermore, the potential studies could cover various context of studies - local, global, regional, segmental, interval etc. It is also suggested that the term ‘Shariah Non-Compliant Income’ should consistently apply in any written communications and research papers, in a case of revenue or income generated from the non-compliance activities of shariah compliance business and Islamic financial or non-financial institutions. This is important to avoid any confusion among the users of financial reporting on the term use, so that it is inline with the term used by the regulator as stated in Financial Reporting for Islamic Banking Institutions issued by BNM (BNM, 2018).

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