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Sharia disclosures
An exploratory study from the perspective of Sharia-compliant companies and professional users

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Abstract
Purpose – This paper aims to examine the reasons behind the low level of Sharia-related disclosures, particularly Sharia-compliant companies, to gain an understanding on how these companies disclose Sharia-related information in their annual reports, and how professional users of these reports search for such disclosures.

Design/methodology/approach – The study is an exploratory research based on structured interviews with individuals involved in the preparation of annual reports of Sharia-compliant companies and professional users of annual reports.

Findings – Most Sharia-compliant companies and professional users interviewed agree that the most relevant Sharia-related information is most commonly understood as the information found in the financial statement and its notes (accounting-related disclosures). Their responses indicate that there is a disjoint between the conventional disclosure practices on corporate social responsibility items and the Sharia-related information.

Research limitations/implications – The idea of full disclosure needs to be further understood from the perspectives of Sharia. This study provides insights into the types of Sharia-related information that are important for disclosure. Future research should focus on examining a larger number of companies and interviewing more professional users from different jurisdictions to generate more knowledge about the nature of Sharia information and its disclosure.

Practical implications – Users of the Sharia screening methods, especially regulators, such as the Securities Commission Malaysia should encourage the disclosure of the required aspects of Sharia in the annual reports of Sharia-compliant companies, as professional users are interested in this type of information.

Originality/value – This study offers insights into the reasons behind low Sharia disclosures in annual reports of Sharia-compliant companies.

Keywords Corporate social responsibility, Sharia disclosures, Sharia-compliant companies, Socially responsible investing

Paper type Research paper
Introduction
The socially responsible investing (SRI) industry is worth $13 trillion and presents an opportunity for the growth of Islamic capital markets and Islamic funds (Global Islamic Finance Forum, 2014). Investors in SRI are not only concerned with environmental, social and governance issues, but they also include ethical issues as part of their investment decisions (Scholtens and Sievänen, 2013), and Islamic capital markets and Islamic funds are aligned to the motivations and objectives of the SRI. Islamic-based investments are obligated to follow Sharia, which means that they must not only be free from elements of riba’ (interest) and gharar (uncertainty) but also from activities related to maysir (gambling), alcohol, tobacco, drugs or any form of activity that could pose potential harm to the society or nation (Ullah et al., 2014).

The disclosure of Sharia information is important for several reasons. It is through these disclosures in their annual reports that companies are able to communicate to Muslim investors that they are Sharia-compliant. Corporations that manage their disclosures well in annual reports are able to enhance their corporate image and reputation (Alessandri and Westcott, 2001). This will result in increased confidence, of not only Muslim investors but also non-Muslim investors who are interested in investing in organisations that embody strong ethics. However, studies by Ousama and Fatima (2010) and Al-Shammari (2013) have shown that the level of Sharia-related disclosures is low, in the range of 13-22 per cent for Sharia-compliant companies. To our knowledge, users of the Sharia screening method do not require mandatory Sharia-related disclosures from Sharia-compliant companies, and this is also true for Islamic financial institutions located in predominantly Muslim countries (Maali et al., 2006; Haniffa and Hudaib, 2007). The lack of pressure from their stakeholders, the secretive culture of the country and the reluctance of these organisations to portray a decisive Islamic image are some of the possible reasons behind the low level of Sharia disclosures (Maali et al., 2006; Haniffa and Hudaib, 2007).

Observations made in the literature (Maali et al., 2006; Haniffa and Hudaib, 2007; Ousama and Fatima, 2010; Al-Shammari, 2013) on Sharia disclosures were from annual reports, and they found that there were low levels of this type of disclosures. What appears to be lacking in the literature is a study that examines the actual reasons for the low level of Sharia-related disclosures in the annual reports of companies, particularly those that are Sharia-compliant. Thus, the objective of our study is to examine the reasons behind the low level of Sharia-related disclosures, particularly Sharia-compliant companies. This study compliments existing studies by offering a new perspective on how Sharia disclosures are perceived and presented in the annual reports by the Sharia-compliant companies. In addition to this, we also examined the views of professional users of these reports. The implication of our study is that the Sharia-related information found will provide not only Sharia-compliant companies but also regulators with guidelines for crafting their Sharia disclosures more effectively. As a result, investors and professional users of annual reports will benefit from more consistent Sharia disclosures.

The remaining sections are organised as follows. In the next section, conceptual aspects regarding Sharia-related information and observations on its disclosure are identified and discussed with reference to the existing literature. Next, the methodology for the research is presented, followed by its findings. The paper then continues with a discussion and conclusion of this study, followed by an outline of some of its limitations and recommendations for future research.
**Sharia-compliant companies in Malaysia**

Sharia-compliant companies are one of the products of the Islamic capital market. They are unique from Islamic banks because they are not specifically established with Islamic principles in mind. Sharia-compliant companies do not have a Sharia advisory board to act as a monitor to ensure that the business operations are adhering to Sharia and also to provide assurance to investors of this adherence. These are companies that were established in the conventional setting, rather than in an Islamic setting, but they are treated as Sharia-compliant if they pass the screening requirements. Listed companies in major stock exchanges are filtered by the users of the Sharia screening method according to a set of screening requirements. Ho et al. (2012, p. 241) defines Islamic finance users as not only capital market regulators but also portfolio managers and providers of market intelligence. Each user of the Sharia screening method practices its own screening methods. One common screening method common to these users is Islamic financing. Thus, the increase in Sharia-compliant companies has resulted in a steady growth of the Islamic finance industry, of between 15-20 per cent per annum over the past years (Alvi, 2012).

The Malaysian Islamic Capital Market was established to accommodate the growing needs of Muslim investors. In 2011, Malaysia recorded a share of 21.8 per cent of the total Islamic funds, the second largest after the Kingdom of Saudi Arabia at 33.2 per cent (Global Islamic Finance Forum, 2012). Sharia-compliant companies are among the various investment choices offered by the Malaysian Islamic Capital Market. Publicly listed Malaysian companies that desire to attract investment participation from Muslim investors need to be awarded Sharia-compliant status. The Sharia Advisory Council (SAC) of the Securities Commission Malaysia (SCM) conducts the screening for Sharia-compliant companies twice per year based on their audited annual reports, and the list would normally be announced in May and November. To become a Sharia-compliant company, the SAC of the SCM screened companies through a two-tiered, quantitative approach.

The two-tiers of the approach were the business activity benchmark and the financial ratio benchmark. The former screened the contribution of non-Sharia-compliant activities to the companies’ revenue and profit, against a specific benchmark based on the main activity of the companies. A 5 per cent benchmark is applicable for conventional banking, conventional insurance, gambling, liquor and liquor-related activities, pork and pork-related activities, non-halal food and beverage, Sharia non-compliant entertainment, tobacco and tobacco-related activities and interest-income from conventional accounts and instruments. A 20 per cent benchmark is imposed for hotel and resort operations, share trading, stock-broking, rental received from Sharia non-compliant activities and other activities deemed non-compliant. The financial ratio benchmark screened for the amount of interest elements in the companies’ operations through the ratio of cash to total assets and debt over total assets; these ratios must not exceed 33 per cent. The liquidity and debt ratios are intended to measure interest and interest-based elements in the companies’ operations, and companies must score lower than 33 per cent on these ratios. Debt ratio is calculated on total debt, which consists of interest-bearing debt and excludes Islamic financing and sukuk, over total assets, while the liquidity ratio only includes total cash placed in conventional accounts and instruments (excluding cash placed in Islamic accounts and instruments) over total assets.
In relation to the screening approach, the SCM does not require any Sharia-related disclosures from companies in their annual report. The SAC reviews the Sharia-compliant status of companies bi-annually. At the end of May 2015, there were 674 companies listed on the Bursa Malaysia that were awarded the Sharia-compliant company status. This number represents nearly 75 per cent of the total companies listed in Bursa Malaysia (Securities Commission, 2015). Since its inception, the Malaysian Islamic capital market has provided greater opportunities for Sharia-compliant companies to obtain funding, either through the sale of their shares or through borrowings from the Islamic banking system.

The nature of Sharia-related information
Ullah et al. (2014) presented a comprehensive framework, for Islamic-based institutions, that not only consists of basic elements of Sharia but also those that are expected or desired by Sharia. Utilising a set of Islamic legal and moral rulings known as Ahkam, Ullah et al. (2014) segregated the actions and behaviours into different levels of importance according to Islam; they were categorised as required, desired and expected aspects. The required aspects include transactions that must be avoided by Islamic-based institutions. They are transactions that have elements of riba’ (interest) and ghurar (uncertainty), maysir (gambling), activities related to intoxicants, pornography and pork. Ullah et al. (2014) also identified the expected aspects as transactions that promote fair and equitable dealings with all stakeholders as stipulated by Sharia and avoidance of activities that are censured by Sharia, such as avoidance of businesses that deal in tobacco, any kind of child labour or that ill-treat their employees. The desired aspects are transactions that are considered to be socially responsible behaviour, including protection of the environment and its inhabitants. For the purpose of this study, we adopted Ullah et al.’s (2014) framework to embody the encompassing nature of Sharia disclosures.

The Sharia disclosures by Islamic financial institutions were examined by several studies, such as Maali et al. (2006) and Haniffa and Hudaib (2007). However, it is only recently that the literature also started to focus on the Sharia disclosures of Sharia-compliant companies (Ousama and Fatima, 2010; Al-Shammari, 2013). Sharia-compliant companies are unique because they offer insights into how Sharia disclosures could be applied in a conventional setting. As indicated earlier, Sharia-compliant companies were not established based on Sharia principles. For a Sharia-compliant company, the items listed by Ullah et al. (2014) in the required category are similar to the screening requirements, adopted by users of the Sharia screening method to determine the Sharia-compliant status of companies.

Interestingly, although all users of the Sharia screening method generally agree to these items in principle, differences exist on how these concepts are operationalised by different users. To illustrate this, we used a case that is related to the prohibition of riba’ (interest). Both interest paid for loans and received from the savings are not allowed from a Sharia perspective (Clarke, 2015). Sharia only allows an equity approach or risk and profit sharing, but not interest-bearing borrowings and repayments of riba (Abdul Rahman et al., 2010; Ho, 2015). There is no specific guideline in the Quran and Hadith on how to operationalise this concept. Thus, users of the Sharia screening method can differ slightly in the setting of their thresholds or limits for the amount of debt (with interest elements) and also in the method they use to calculate this debt ratio. For example, the SCM set the allowable limit for this ratio at 33 per cent, while the Gulf
Cooperation Council Islamic Index set it at 30 per cent. These two also differed in the
denominator of the debt ratio calculation. The former calculated the debt ratio by
dividing total interest-bearing debt with total assets, while the latter divided total
interest bearing debt with market capitalisation. Islam allows some degree of freedom
on how Islamic principles are interpreted and operationalised, and this flexibility is a
result of *ijtihad* [5] that allows qualified Islamic scholars to interpret them (Derigs and
Marzban, 2008; Ho et al., 2011). Generally, the use of *ijtihad* is a relaxation of the *Sharia*
rules, and is a tribute paid to both the complexity and the generally non-Islamic nature
of the current capital markets (Widiyanti, 2012).

While the existence of elements of *riba’* is widely discussed in the literature
(Mohammed, 2005; Derigs and Marzban, 2008; Abdul Rahman et al., 2010; Clarke, 2015;
Ho, 2015), less attention has been paid to other concepts, such as *gharar*. Many Islamic
scholars relate *gharar* to ambiguity, hidden knowledge, unknown facts and ignorance,
which could lead to undeliverable promises, fraud and treachery, or any other injustices
to the parties in the transaction (Kamali, 1998; Mohammed, 2005). Unlike *riba’* (interest),
there is no specific method of measurement of *gharar*. It is generally understood that the
main areas for business transactions that involve the elements of *gharar* significantly
are in the insurance industry and in investments in financial derivatives, such as
forwards, futures and options (Mohammed, 2005).

*Sharia*-related disclosures vary in their level of importance, as prescribed by Ullah
et al. (2014). The required aspects of *Sharia* are seen as the most important, and most of
these aspects are used by users of the *Sharia* screening method in their screening
methodology for *Sharia*-compliant status. Although there is general consensus on what
is relatively more important under *Sharia*, the operationalisation of these concepts
differs somewhat in a conventional setting, whereby some concepts have specific
methods of measurement, and the measurement of others is still vague. The degrees of
freedom in the operationalisation of *Sharia* in a conventional setting mean that
differences will always exist on how *Sharia* disclosures are understood and
implemented.

**Disclosures of *Sharia*-related information**

From the literature (Maali et al., 2006; Haniffa and Hudaib, 2007; Aribi and Gao, 2010;
Ousama and Fatima, 2010; Al-Shammari, 2013), it can be seen that researchers have
begun to observe the ethical or social reporting of Islamic banks and *Sharia*-compliant
companies. In their observation of these disclosures, apart from aspects of corporate
social responsibility (CSR), such as environmental concerns, other aspects that are
unique to *Sharia*-based institutions are also being investigated. The payment of *zakah*,
information of *Sharia* supervisory boards, the offering of *qard hasan* (benevolent loans)
and information on *riba’* and *gharar* activities are among the items that are included as
part of the ethical and social reporting of these organisations (Maali et al., 2006; Haniffa
and Hudaib, 2007; Aribi and Gao, 2010; Ousama and Fatima, 2010; Al-Shammari, 2013).

These studies found that this information has a low level of disclosure. They
examined the social reporting of *Sharia*-compliant companies and found that the
disclosure level of this information is below 25 per cent: Al-Shammari (2013) recorded
this type of disclosure at 13 per cent, Ousama and Fatima (2010) at 17 per cent and
Othman and Md Thani (2010) at 22 per cent. This disclosure level is also similar for
Islamic banks. Maali et al. (2006) found that Islamic banks do not disclose information
about haram (unlawful) transactions, their policy for dealing with insolvent clients. Some of these banks do not disclose that they charge interest for the late payment of a loan. Interestingly, these studies were conducted in countries with predominantly Muslim populations. Based on the findings in the literature, such as Maali et al. (2006) and Al-Shammari (2013), the main items that have low disclosure levels are similar to those that were categorised in the required category of Ullah et al.’s (2014) framework.

Certain aspects of the information related to the Sharia disclosures from the expected and desired categories, as presented in Ullah et al.’s (2014) framework, show a mixed level of disclosure. Maali et al. (2006, p. 286) indicates that Islamic banks prefer to disclose “their charitable activities and their involvement in society”. Al-Shammari (2013, p. 34) found that Sharia-compliant companies “disclose more corporate environment, financial and market information than employee, social responsibility, corporate governance, environment, and ownership structure”. Haniffa and Hudaib (2007, p. 111) found a low level of disclosure in information of commitments to society, their vision and mission, contribution and management of zakah, charity and benevolent loans, and information about top management.

Our review of the literature that examined Sharia disclosures showed that the required aspects of Sharia has low disclosures, while those related to the expected and desired aspects have mixed levels of disclosure. These studies were conducted using annual reports, a secondary source of data. These studies could only speculate on the results, and thus, clearly, a study is needed to examine the reasons behind this less-than-acceptable level of Sharia disclosure.

Methodology
Design and setting
To examine the Sharia disclosures of Sharia-compliant companies, a qualitative approach was found appropriate because it can successfully provide an understanding of how and why something occurs (Freeman and Cavusgil, 2007). We also chose qualitative research because it allows the selection of specific cases to address the research questions. Our study is exploratory. There is a lack of literature that examines the disclosure of Sharia-related information by Sharia-compliant companies. Our study used semi-structured, in-depth interviews with key participants as the data collection method. In-depth interviewing is a qualitative research technique that involves intensive individual interviews with a small number of respondents to explore their perspectives on a particular idea, programme or situation and is particularly useful when detailed information is required about a person’s thoughts and behaviours or to explore new issues in depth (Boyce and Neale, 2006).

The respondents selected for this research are involved in the Islamic capital market sector. The cases selected were taken from two groups: the Sharia-compliant companies and the professional users of these annual reports. The latter are from the Islamic asset management industry that seek, extract and analyse the information provided in annual reports to make investment decisions. Upon careful selection, we contacted the respondents through telephone calls and followed up with emails to secure an interview with them.

Table I presents the key information about our respondents. We manage to secure responses from 13 respondents, and this is within the range of cases recommended by Eisenhardt (1989) for this type of research, to ensure that there are sufficient data
without creating an overload during analysis. Most of our respondents were holding managerial positions. The job profiles of our respondents are presented in Table I. We chose our Sharia-compliant companies from the two groups. The companies in Group 1 were selected based on the following method. From the list of Sharia-compliant companies published on 29 November 2013 by SCM, we rated companies that pay zakah against the Ethical Identity Index (EII)[6]. We chose companies who paid zakah because Maali et al. (2006) found that organisations that pay zakah have better social disclosures. The companies with the highest EII score were selected for interviews. Group 1 has three companies, with two companies from the engineering and construction services industry, whereas one company belongs to the transportation and logistics industry. Only two companies declined our interview request but provided their answers to our questions via email instead. The companies from Group 2 were selected based on suggestions by our professional users. Both of these companies had experienced the task of working their way to classification as Sharia-compliant companies. Their brief exclusion from this Sharia-compliant list was due to the liquidity and debt ratio benchmarks introduced in the screening methodology by the SCM to qualify listed companies as Sharia-compliant. The details on the number of companies and their industry involved in the data collection are presented in Table II.

For the professional users group, an industry expert suggested that we interview people in the Islamic asset management industry. We interviewed people from both the selling and buying side of this industry. The people on the selling side are responsible for promoting, performing research, analysing and rating the Islamic securities, while those on the buying side are responsible for purchasing (and selling) these stocks for investment to gain profit for their clients. These are mostly institutional investors. From the selling side, we interviewed those who are responsible for the promotion of their investment research and analysis services to institutional clients, carry out research and provide an analysis of the stocks to be disseminated to fund managers. On the buying side, we interviewed those who are fund managers and are engaged in investment management services, and these managers analyse annual reports as part of own research efforts. In addition, we spoke to a Sharia legal advisor who is responsible for validating the Sharia-compliant status of the firm, based on specific standards prescribed by the fund managers. We also interviewed legal and compliance personnel;

<table>
<thead>
<tr>
<th>Job title</th>
<th>No. of interviews</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sharia-compliant companies</td>
<td></td>
</tr>
<tr>
<td>Executive</td>
<td>2</td>
</tr>
<tr>
<td>Senior management</td>
<td>4(^{a})</td>
</tr>
<tr>
<td>Professional users of annual reports</td>
<td></td>
</tr>
<tr>
<td>Analyst</td>
<td>2</td>
</tr>
<tr>
<td>Compliance officers</td>
<td>2</td>
</tr>
<tr>
<td>Institutional sales manager</td>
<td>1</td>
</tr>
<tr>
<td>Fund manager</td>
<td>1</td>
</tr>
<tr>
<td>Sharia advisor</td>
<td>1</td>
</tr>
<tr>
<td>Total</td>
<td>13</td>
</tr>
</tbody>
</table>

**Note:** \(^{a}\)Two of these interviews were conducted through email correspondences

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they monitor the investments of their Islamic fund managers to ensure that they adhere to the regulator's requirements.

Research process and analysis
As mentioned earlier, all respondents agreed to be interviewed face-to-face, except for two companies; these companies responded to our interview questions via email. All face-to-face interviews were conducted at the respondents’ offices and were recorded and transcribed. A meeting was scheduled at the firms’ locations, and the respondents were requested to allow for a 30-minute interview. The interviews started with a brief description of our study and its purpose, which was to observe how Sharia-related information is disclosed, and how it is examined in the annual reports of Sharia-compliant companies and the users, respectively. The respondents were assured of confidentiality and anonymity. General company information and the job description of these respondents were, to some extent, collected prior to the interviews. In most cases, the interviews lasted between 30 minutes and 1 hour. The average duration was 45 minutes. This is in line with a guide by Jacob and Furgerson (2012) which does not encourage lengthy interviews, so that respondents do not lose interest and stray from the questions being asked. Accordingly, interviewers encouraged further explanations from the respondents, but still followed the interview guide.

An interview guide had been developed prior to the interviews, inspired by discussions with an Islamic capital market scholar, as presented in Table III. All questions are open-ended and expansive, to assist and encourage the respondents to elaborate on the issues from their viewpoints and experiences in different directions but within the same context (Turner, 2010; Jacob and Furgerson, 2012). Our primary concern, during the interviews, was to probe interesting avenues for investigation regarding how Sharia-related information is disclosed or analysed in the annual report. Questions on similar themes, phrased differently, were prepared for Sharia-compliant companies and the professional users, to maintain the consistency of the responses.

One company did not allow recording of the interview, citing confidentiality as the reason, and thus, the two interviewers took notes during the session and collated their notes within 24 hours of the interview. The other interviews were recorded and transcribed, and the transcription was subsequently checked by the interviewers. The qualitative analysis was conducted manually, and the analysis and summary were then reviewed by two researchers independently. This was done for the purpose of identifying similar patterns and themes obtained from the respondents’ answers (Boyce and Neale, 2006). Thus, this study fulfilled the credibility and integrity criteria.

<table>
<thead>
<tr>
<th>Industry</th>
<th>No. of companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Producers of annual reports</td>
<td></td>
</tr>
<tr>
<td>Oil, gas and consumable fuels</td>
<td>2</td>
</tr>
<tr>
<td>Transportation and logistics</td>
<td>1</td>
</tr>
<tr>
<td>Engineering and construction services</td>
<td>2</td>
</tr>
</tbody>
</table>

Table II.
Number of companies based on the respondents in this study

| Professional users of annual reports             |                  |
| Asset management                                | 3                |
| Sharia advisory                                 | 9                |
Findings and discussions

The findings and an analysis of the study are summarised in Table IV. Table IV arranges the Sharia disclosure prepared by companies and observed by professional users into the required, expected and desired categories, the main aspects of Socially Responsible Investment from an Islamic Perspective, developed by Ullah et al. (2014). Table IV also divides Sharia disclosure into accounting- and non-accounting-related disclosures. The following three subsections contain the analysis and findings from the data presented in Table IV.

Sharia-related disclosures and the required items

Ullah et al. (2014, p. 222) described transactions that fall into the required category as those that are not “interest-bearing transactions, gharar (excessively risky transactions), and investments in business sectors, such as alcohol and pornography”. These required aspects are similar to those used in the screening methodology employed by the SCM. The SCM uses a company’s revenue or profit before taxation, to screen for elements of haram activities in the companies’ business activity; there are different threshold for different industries. The financial ratio benchmark is used by the SCM to examine interest and interest elements of the companies’ operations, which must be less than 33 per cent.

Three of the Sharia-compliant companies interviewed associated information related to these required aspects with accounting-related disclosures. In this study, we define accounting-related disclosures as disclosures that will affect the way items in the financial statements are presented, such as a segregation of the profit/revenue of the company that is based on halal and haram activities. All of the professional users were only interested in the required aspects of Sharia-related information, which are mostly accounting-related disclosures, as depicted in Table IV. In the following sections, we provide a detailed account of the responses from companies and professional users on the required aspects of Sharia disclosures.

Companies

Two of the companies we interviewed were not aware of Sharia disclosures made by their companies, so we were unable to probe further on this issue. The three remaining
companies were selective about the types of required items that they disclose in their annual report. They share the view that their activities are halal activities, and they all believe that the industry that they operate in only allows them to be involved in halal activities. However, none of these companies stated such information in their annual report. This is evidenced in the following interview extracts:

Executive Company 1: We don’t have to disclose them in our annual report.

Manager Company 2: Businesses must be Sharia-compliant. If our ships carry alcoholic drinks then they would be carrying non halal things, which we do not do […] . From the business aspect, we only rent ships and handle petroleum products. We do not carry alcohol or any items that are haram. […] We do not disclose this non-involvement in non-halal activities in their annual report.

Regarding the information related to the interest elements (riba issues), two of the three companies specifically disclose conventional and Islamic loans separately in the notes to their financial statements. Both companies indicated that their notes on their borrowings present conventional and Islamic loans separately, for the specific purpose of informing readers about their involvement in Islamic financial practices. This is reflected in the following interview extract:

Manager Company 3: We differentiate conventional and Islamic, so, they [their readers] can see this.

Apart from separately disclosing the conventional debt from the Islamic debt, this company also took the initiative to disclose the ratio of total non-Islamic borrowings over total assets. This disclosure was intended to fulfil the SCM’s screening requirements. Manager Company 3 added that by disclosing this ratio in their annual report, the auditor would have to verify that this is true, thus adding credibility to the figure. Manager Company 2 also separately discloses its cash or investments in conventional and Islamic accounts. This is to separate those that receive interest and

<table>
<thead>
<tr>
<th>Dimensions</th>
<th>Type of disclosures</th>
<th>Sharia-compliant companies</th>
<th>Professional users</th>
</tr>
</thead>
<tbody>
<tr>
<td>Required</td>
<td>Accounting</td>
<td>Avoiding interest-bearing transactions, excluding haram elements, such as pork, gambling and liquor-related activities (not disclosed)</td>
<td>Avoiding interest-bearing transactions; avoiding excessive risks and uncertainty; excluding haram elements such as pork, gambling and liquor-related activities Sharia-compliant stock declaration</td>
</tr>
<tr>
<td></td>
<td>Non-accounting</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Expected</td>
<td>Accounting</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td></td>
<td>Non-accounting</td>
<td>Fair dealings with stakeholders</td>
<td>–</td>
</tr>
<tr>
<td>Desired</td>
<td>Accounting</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td></td>
<td>Non-accounting</td>
<td>Contribute to social-impact projects</td>
<td>–</td>
</tr>
</tbody>
</table>

Table IV.
Types of accounting and non-accounting disclosures, segregated into the required, expected and desired aspects, prepared by Sharia-compliant companies and observed by professional users.

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those that do not. We have summarised our findings on the Sharia-compliant companies in Table V.

**Analysts**
The professional users that we interviewed were only concerned with the required aspects and less with other aspects of Sharia information (i.e. the expected and desired aspects), as presented in Table IV. Most professional users were interested in accounting-related disclosures. Only one professional user was interested in non-accounting-related disclosures of Sharia-compliance. Compliance Officer 2 said that they “search the CEO statement, cover page or sometimes financial statements” to look for a declaration that this company is a Sharia-compliant company.

All our respondents agreed that they depend largely on the SCM list to determine the Sharia-compliant status of companies. This is evidenced in the following interview extracts.

*Sharia advisor:* As local *Sharia* advisors, we are more inclined towards Securities Commission methodology.

*Compliance officer 1:* We cannot do that [determine whether a company is Sharia compliant or not] because we, as fund managers, are not experts in *Sharia* […] We base our list [companies to invest in for Muslim funds] on this [Securities Commission] list.

As presented in Table IV, professional users are only interested in accounting-related disclosures. The accounting-related disclosures can be divided into two types: revenue segregation and ratios. This corresponds to the quantitative screening done by SCM, which focuses on the business activity benchmark, liquidity and debt ratio, respectively. This is explained in the following responses:

*Analyst 1:* The haram elements that a company is involved in can be found in the Annual Report or in the breakdown of revenue […]. Everything [items in the annual report is important], but mostly, the financial information […] actually the notes. I mean for me […] where is the revenue coming from, because they have to disclose it. So if it is odd, then we will be able to find out from the additional information part’.

*Sharia advisor:* We look at financial statements […] we focus on the types of income to determine the types of business activities, and where the income comes from […] we then look at the annual report for the percentage [allowable ratios as prescribed by SCM]. We allow some flexibility in the threshold, if the threshold is 33 per cent but the ratio [for the company] is a bit higher, 34 per cent, we allow […] the flexibility given is based on the opinion of *Sharia* scholars.

### Table V.
The practices of *Sharia*-compliant companies in disclosing required, expected and desired aspects in their annual reports, further divided into accounting- and non-accounting-related disclosures

<table>
<thead>
<tr>
<th>Required items</th>
<th>Expected and desired items</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounting</td>
<td>Accounting</td>
</tr>
<tr>
<td>Yes, disclosed</td>
<td>Non-accounting</td>
</tr>
<tr>
<td>Yes but not disclosed</td>
<td>Disclosed as part of CSR</td>
</tr>
</tbody>
</table>

Perspective of *Sharia*-compliant companies
Analyst 2: First of all we look at revenue, the nature of revenue whether it is Sharia-compliant or not, the breakdown of revenue we will oversee [...]. We can usually predict whether a company will continue to become Sharia-compliant [...] we would know by looking at the annual reports. Based on those [SCM's] policies, we can calculate and will know whether Securities Commission Malaysia will exclude them or include them in that coming month [...]. We are interested in Islamic debt or non-Islamic debt [...]. Revenue is another and the other one is cash, whether the cash they keep is in an Islamic account or non-Islamic account. [...] . On revenue, we need to know whether the income is actually Islamic in nature or not.

Fund manager: We only look at annual report for analysis. I mean, for the second screening. For the first screening, we see Sharia or not and in the second screening, we want to see whether it meets our own criteria, because we have our own criteria on investing in the company that has nothing to do with Sharia.

Institutional sales manager: I look at assets of the companies.

Sharia-related disclosures and their expected and desired aspects
The expected aspects are the responsibility to engage in fair and equitable dealings with all stakeholders according to Sharia stipulations and to avoid activities that are censured by Sharia, avoiding businesses involved in tobacco and any kind of exploitation such as child labour, unfavourable treatment of employees, involvement in any illegal activities (Ullah et al., 2014, p. 223). The desired aspects are “optional socially responsible behaviour, including protection of the natural environment and animal welfare by avoiding doing business with companies involved in sectors that pose a threat them” (Ullah et al., 2014, p. 223). Environmental protection is a non-religious approach, but it is something desired by society and expected/required by governments and nongovernmental organisations. Based on this explanation of the expected and desired Sharia items, we can see a direct similarity between these items and those of CSRs (Guthrie et al., 2007; Cuganesan et al., 2010). Sharia-compliant companies have indicated that they do not consider Sharia disclosures as disclosures of CSRs. The CSRs disclosures are similar to those that are in the expected and desired aspects of Sharia information, and yet they are not recognised as such. This can be seen from the following responses from companies:

Executive in Company 1: We are Sharia it is more towards our CSR [...] if you observe our annual report, that is corporate social responsibility. It is not Sharia compliance. [...] It’s actually like this. Because we are a publicly listed company, so we have to follow the corporate governance by MCCG [Malaysian Code on Corporate Governance] and Bursa Malaysia’s listing requirement. We do CSR, because is one of the things that has been set out by corporate governance. Besides that, it shows a good and positive image about the company. It also shows that the company itself is not a company that is involved in illegal things. So, we are using public money and we are using it with good intention.

Manager Company 4: I am afraid that I would not be able to answer the questions as I am not familiar with Sharia disclosure. You can go into our website [...] and look through our previous year annual reports on the disclosure of the company’s Corporate Social Responsibility.

Manager Company 5: As far as I know, Company 5 never makes Sharia Disclosure in its annual report [...] under Company 5’s CR Policy, we support four quadrants of areas, i.e. Workplace, Marketplace, Community, and Environment.
Conclusions

This study extends the work of other research in this field (Maali et al., 2006; Haniffa and Hudaib, 2007; Aribi and Gao, 2010; Ousama and Fatima, 2010; Al-Shammari, 2013) by interviewing Sharia-compliant companies and also professional users of annual reports to understand the reason behind low levels of Sharia disclosures. Maali et al. (2006, p. 286) indicated that Islamic banks do not disclose information such as haram (unlawful) transactions about activities because this may attract criticism, but we have found that Sharia-compliant companies do not deliberately avoid stating this information. They simply feel that there is no need to do so. They consider that their compliance with the regulator, SCM, as a Sharia-compliant company, is sufficient to warrant non-disclosure of this information to their investors. Professional users also rely on the SCM’s list to ensure that their companies are abiding by Sharia.

Most Sharia-compliant companies and all professional users interviewed agreed that Sharia-related information is most commonly understood as that found in the financial statement and its notes (accounting-related disclosures). The screening methodology adopted by the SCM has strongly influenced this perception of not only Sharia-compliant companies but also of professional users of annual report of what Sharia disclosures should be. Some companies have prepared notes on their companies’ borrowings, distinguishing between Islamic and conventional borrowings to accommodate the Sharia-screening requirements of the SCM. Most of the professional users do not observe other items of Sharia disclosure, except those related to the screening methodologies, which are found in their accounting disclosures. Again, these screening requirements emphasise the required aspects, as mentioned by Ullah et al. (2014).

The responses from respondents on the Sharia disclosures related to the desired and required aspects indicate a disjoint between the conventional disclosure practices of CSR items and the Sharia-related information. The expected and desired aspects of Sharia-related information, as prescribed by Ullah et al. (2014) are similar to those of disclosure under the CSR. This disjoint is also found in other studies, such as Ousama and Fatima (2010) and Al-Shammari (2013), in which the disclosure index separates the conventional disclosure items from the Islamic ones, although Sharia considers both of these items as part of Sharia (Ullah et al., 2014). Future research can examine the reason for this disjoint between Islamic and conventional practices. One such avenue for future research in this area can explore the reasons why companies perceive CSRs as distinct from Sharia. This would offer additional insight into how companies could better project themselves in the SRI industry.

Our results have some theoretical implications. Maali et al. (2006, p. 286) indicate that:

[…]full disclosure and accountability of individuals and organizations to God and the Islamic community require Islamic banks to disclose all information deemed important from the Islamic perspective for people in the societies where they operate.

However, this idea is not shared by the companies, Sharia-compliant companies as preparers of reports, who do not yet provide such disclosures, but who still believe that their companies are operating in accordance with Sharia. Perhaps the idea of full disclosure needs to be further understood from the perspective of Sharia. This study provides insights into the types of Sharia-related information that are important for disclosure. Information on the screening requirements prescribed as
the required elements of Sharia disclosure by users of Islamic financing should also be considered to be items that warrant full disclosure.

Our findings from this study have further implications for Sharia disclosures. Users of the Sharia screening method, especially regulators, such as the SCM should encourage the disclosure of Sharia-required elements by companies because professional users are interested in this type of information. However, the location in which this information is disclosed in the annual report is important. Professional users rarely observe other parts of the annual report, other than the financial statements and their notes. If Sharia-related information is disclosed in the financial statements and their notes, this practice will inevitably require the auditors to verify such information. As a result, auditors will have to equip themselves with knowledge on Sharia to be able to perform this task.

The purpose of this study was to gain an understanding on the reasons behind the low levels of Sharia-related disclosures from the perspectives of Sharia-compliant companies and professional users of these annual reports. As Sharia disclosure is a comparatively new area of research, conducting interviews with these key informants was considered the most appropriate method (Miles and Huberman, 1994). As a consequence, our study cannot be generalised to a larger community and should be considered as an emergent study (Eisenhardt, 1989). Further research, examining a larger number of companies and interviewing more professional users from different jurisdictions is a worthwhile task to pursue.

Notes
1. This was confirmed through our interview with the Sharia division of the Islamic Capital Market, SCM. Any additional information that they require for the screening purposes, which are not available in the annual report are made through correspondences with the company in question.
2. Ahkam is the plural of Hukm, which means command. Ullah et al. (2014, p. 221) said: “Ahkam are … Islamic commandments derived from four main sources, namely The Quran, the prophetic traditions, Ijma, the consensus of Islamic scholars and Qiyas, that is solving emerging issues by finding their analogies in the first three sources”.
3. Qur’an is the Holy Book in Islam containing the words of God delivered.
4. Hadith is the recorded actions and sayings of Prophet Muhammad.
5. Ijtihad is the Islamic scholars’ efforts to derive and formulate Sharia from Qur’an and Hadith (Widiyanti, 2012; Derigs and Marzban, 2008). This ijtihad can either be in the form of ijma’ (consensus) or qiyas (analogy) rulings. However, diversity in the rulings exists, particularly marked by the four major Islamic schools of thought from scholars of Hanifah, Malik, Al-Shafie and Hanbali.
6. EII was developed by Haniffa and Hudaib (2007) to assess Islamic values being disclosed in the annual reports of Islamic banks and contains eight dimensions: Vision & Mission Statement; Board of Director & Top Management; Product; Zakah, Charity & Benevolent Loans; Employees; Debtors; Community; and Sharia Supervisory Board. We adapted this index for Sharia-compliant companies. Some of the items were omitted when applying this index to Sharia-compliant companies, including Dimension F (Debtors) and H (Sharia Supervisory Board), as they were not applicable to Malaysian Sharia-compliant companies.
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