

ISLAMIC FINANCIAL REPORTING: EVIDENCE FROM MALAYSIA

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Abstract

The purpose of this study is to examine whether Islamic financial institutions (IFIs) in Malaysia are presenting their financial statements according to AAOIFI requirements. Annual financial statements of seventeen Islamic financial institutions are selected and examined. The results of examination show that IFIs presentation of statement of financial position is 70.3% conform, statement of profit or loss is 45.6% conform, statement of changes in equity is 95% conform and statement of cash flow is 100% conform with the format suggested by AAOIFI requirements. However, statement of sources and uses of charity fund and statement for restricted investment are only disclosed in notes to the financial statement. The results added to existing literature in the area of Islamic financial reporting.

Keywords: Islamic financial reporting; IFI, AAOIFI, MFRS, Malaysia

PELAPORAN KEWANGAN ISLAM: BUKTI DARI MALAYSIA

Abstrak

Kajian ini bertujuan untuk membuat pemeriksaan sama ada institusi-institusi kewangan Islam (IFI) di Malaysia mempersembahkan penyata kewangan mereka mengikut kehendak format AAOIFI. Untuk tujuan tersebut, sebanyak 17 institusi kewangan Islam telah dipilih sebagai sampel dan penyata kewangan mereka telah diperiksa. Hasil pemeriksaan mendapati bahawa IFI telah mematuhi 70.3% kehendak format AAOIFI dalam pembentangan penyata kedudukan kewangan, 45.6% dalam pembentangan penyata untung atau rugi, 95% dalam pembentangan penyata perubahan dalam ekuiti dan 100% dalam pembentangan penyata aliran tunai. Walau bagaimanapun, penyata sumber dan penggunaan dana kebajikan dan penyata pelaburan terhad hanya dihebahkan di dalam nota-nota bagi penyata kewangan. Hasil penyelidikan ini telah menambah hasil kajian yang sedia ada dalam bidang pelaporan kewangan Islam.

Katakunci: Pelaporan kewangan Islam, IFI, AAOIFI, MFRS, Malaysia

INTRODUCTION

AAOIFI refers to the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI.Com, 2016; Ullah, 2013). According to AAOIFI.com (2016), AAOIFI accounting standards have been made part of mandatory regulatory requirement in a number of countries including Bahrain, Jordan, Oman, Qatar, Sudan, and Syria. AAOIFI accounting standards have also been adopted by Islamic Development Bank Group (IDB).

In addition, AAOIFI accounting standards have also been used as basis of national accounting standards in Indonesia and Pakistan. In other countries including Brunei, Dubai International Financial Centre, Egypt, France, Kuwait, Lebanon, Malaysia, Saudi Arabia, South Africa, United Arab Emirates and United Kingdom as well as in Africa and Central Asia, AAOIFI accounting standards have been used voluntarily as basis of internal guidelines by leading Islamic financial institutions.

Global Banking and Finance (2013) provided the list of IFI in Malaysia as at of 5 April 2013 follows: (1) Bank Islam Malaysia Berhad; (2) Alliance Islamic Bank; (3) Alkhair International Islamic Bank; (4) Dubai Islamic Bank; (5) Affin Islamic Bank Berhad; (6) Al-Rajhi Banking & Investment Corporation; (7)

Kuwait Finance House; (8) CIMB Islamic Bank; (9) Public Islamic Bank; (10) RHB Islamic Bank; (11) Bank Muamalat Malaysia Berhad; (12) Standard Chartered Saadiq Berhad; (13) AmIslamic Bank; (14) HSBC Amanah; (15) Hong Leong Islamic Bank. However (16) Maybank Islamic and; (17) Citybank Islamic are not listed in that website.

The purpose of this study is to examine whether Islamic financial institutions (IFIs) in Malaysia present their financial statements according to AAOIFI requirements. The detail objective of the study are:

- To examine whether there is a statement about compliance or conformity to AAOIFI by IFIs.
- To examine the extent of compliance of AAOIFI in presentation of Statement of Financial Position (SOFP)
- To examine the extent of compliance of AAOIFI in presentation of Statement of Profit or Loss (SOPL)
- To examine the extent of compliance of AAOIFI in presentation of Statement of Changes in Equity (SOCIE)
- To examine the extent of compliance of AAOIFI in presentation of Statement of Cash Flow (SOCF)

REVIEW OF LITERATURE

Brief history of Islamic financial institution (IFI) in Malaysia:

According to Kadri (2015), Malaysian Government allows both conventional and Islamic financial system to be practiced side by side and they are licenced under two difference licences issued by Bank Negara Malaysia. Conventional financial system existed prior to independence whereas Islamic banking system only started in 1983 after the Government introduced Islamic Banking Act 1983. In the same year, the first Islamic banking, Bank Islam Malaysia Berhad was incorporated to provide alternative banking system that conceptually follow the teaching of Islam.

The system has developed, evidenced by the introduction of Islamic banking windows by conventional banks in Malaysia in 1990s. Later on in 2000s, the conventional banks either transformed their Islamic banking windows into subsidiary or transformed themselves into Islamic banks.

In terms of operations and reporting, all financial institutions in Malaysia are subject to legal provisions stated in Banking and Financial Institution Act, Companies Act 1965 and accounting standards issued by Malaysian Accounting Standards Board i.e MFRS. A part from that, Islamic banks and financial institutions are also subject to legal provisions enforced by Islamic Banking Act 1983 and Islamic Financial Services Act 2013.

Last but not least, Islamic banking and financial institution are required to form a Syariah Advisory Board to give advice and oversee the adherence to Islamic principle in Islamic banking and financial institution operations.

Accounting standards for IFI in Malaysia

The Malaysian Financial Reporting Act 1997 was enacted in 1997 to establish the Financial Reporting Foundation (MAREF) and Malaysian Accounting Standards Board (MASB). The Act empowers MASB to determine and issue financial reporting standards for public companies including financial institutions for the preparation and presentation of financial statements to be submitted to the respective authority such as Securities Commission of Malaysia, Companies Commission of Malaysia and Bank Negara Malaysia.

MASB requires 'an entity other than an private entity' to apply Malaysian Financial Reporting Standards (MFRS) for annual periods beginning on or after 1 January 2012, with the exception of entities that are permitted in the alternative to apply an earlier framework. Compliance with MFRS constitutes compliance with IFRS because Malaysia has converged with IFRS. Bank Negara Malaysia (BNM) circular, *Financial Reporting for Islamic Banking Institutions* issued on 5 February 2016, require a licensed person to comply with MFRS. As stated in paragraph 8.1 of the circular:

...a licensed person shall ensure that financial statements are prepared in accordance with the MFRS... and shall disclose a statement to that effect in the financial statements.

Islamic Banking Act 1983 only requires IFI to prepare and submit the copies of audited balance sheet (SOFP) and profit and loss account (SOPL) to Central Bank. However, Section 72 of the Islamic Financial Services Act 2013 states that financial statements has the same meaning as set out in the approved accounting standards issued or approved by the Malaysian Accounting standards Board under the Financial Reporting Act 1997 that include SOFP, SOPL, SOCIE, SOCF and notes to financial statement.

AAOIFI conformity all over the world:

There is a need for setting up a common standard for the accounting function in Islamic banks. And AAOIFI had taken charge to come out with standards for accounting as well as auditing of IFI. The standards set out by AAOIFI have been adopted by many countries while the others are using as guidelines in measurement and recognition of transaction and events as well as for preparation and presentation of financial statements.

As mentioned earlier in the introduction section, AAOIFI accounting standards have been made part of mandatory regulatory requirement in many countries such as Bahrain and Jordan and in other countries including Brunei and Malaysia, AAOIFI accounting standards have been used voluntarily as basis of internal guidelines.

Sarea and Hanefah (2013) found that Bahrain IFIs are 100% conform to accounting standards issued by AAOIFI. Ullah (2013) found that seven Islamic banks in Bangladesh are 44.68% comply with AAOIFI whereas Sakib (2015) found that six banks financial statements in Bangladesh are on average 53.79% conform to the AAOIFI standards. Shatnawi and Al-bataineh (2013) found that Jordan Islamic banks are committed with the disclosure requirement of AAOIFI. Asian Oceanian Standard Setters Group (2015) studied the adoption of AAOIFI accounting standards by IFIs in 31 countries all over the world and found 46% of IFIs asserted compliance with IFRS, 34% comply with local GAAPs, 18% comply with AAOIFI and 2% do not specify the compliance with any standards.

Current study examines whether Islamic financial institutions (IFIs) in Malaysia present their financial statements according to AAOIFI requirements.

RESEARCH METHODOLOGY

Sample:

The sample are selected from Islamic financial institutions established in Malaysia. This is following previous studies by Sarea and Hanefah (2013), Ullah (2013), Sakib (2015), Shatnawi and Al-bataineh (2013), Asian Oceanian Standard Setters Group (2015) and Kadri (2015) that select IFI of respective countries under study. The sample comprise of 17 IFIs.

Based on the objective of the study, the data are collected from the audited financial statement or annual reports of Malaysian IFIs. They are retrieved from the respective IFIs websites. The study uses the format of consolidated financial statement of AAOIFI as the basic document to make comparison. The IFI financial statements are then compared with the format of consolidated financial statement suggested by AAOIFI for IFIs. One conformity was allocated with one \surd . At the end the number of \surd for each IFI is translated into a meaningful percentage for conformity of AAOIFI Statement of Financial Position, Statement of Profit or Loss and other statements.

Table 1: LIST OF IFIs

#	Name	Annual Report
1	Bank Islam Malaysia Berhad	2015
2	Affin Islamic Bank Berhad	2015
3	Bank Muamalat Malaysia Berhad	2014
4	Cimb Islamic Bank Berhad	2015
5	Maybank Islamic Berhad	2015
6	RHB Islamic Bank Berhad	2015
7	AmIslamic Bank Berhad	2015
8	Public Islamic Bank	2014
9	Hong Leong Islamic Bank Berhad	2015
10	HSBC Amanah Berhad	2015
11	Citybank Islamic	2014
12	Standard Chartered Saadiq Berhad	2015
13	Alliance Islamic Bank Berhad	2015
15	Alkhair International Islamic Bank Berhad	2015
15	OCBC Islamic Bank Berhad	2014
16	Al Rajhi Banking & Investment Corporation	2015
17	Kuwait Finance House	2015

RESULTS

Results of the study are analysed based on the objectives of the study.

General statement of compliance with AAOIFI and MFRS:

First, the study examines whether there is a statement about compliance or conformity to AAOIFI by IFIs. Based on the examination of the 17 IFIs annual reports, there is no statement made by the management or stated in the notes to the financial statement about the compliance of AAOIFI standards by the respective IFIs. In contrast, all IFIs mention about the compliance with the Malaysian Financial Reporting Standards (MFRS) issued by MASB.

Table 2: ANALYSIS OF COMPLIANCE WITH AAOIFI AND MFRS

#	Name	AAOIFI	MFRS
1	Bank Islam Malaysia Berhad	X	√
2	Affin Islamic Bank Berhad	X	√
3	Bank Muamalat Malaysia Berhad	X	√
4	Cimb Islamic Bank Berhad	X	√
5	Maybank Islamic Berhad	X	√
6	RHB Islamic Bank Berhad	X	√
7	AmIslamic Bank Berhad	X	√
8	Public Islamic Bank	X	√
9	Hong Leong Islamic Bank Berhad	X	√
10	HSBC Amanah Berhad	X	√
11	Citybank Islamic	X	√
12	Standard Chartered Saadiq Berhad	X	√
13	Alliance Islamic Bank Berhad	X	√
15	Alkhair International Islamic Bank Berhad	X	√
15	OCBC Islamic Bank Berhad	X	√
16	Al Rajhi Banking & Investment Corporation	X	√
17	Kuwait Finance House	X	√

However, two of the IFIs (Citibank and Hong Leong) disclose the information that their Shariah Committee members are either expert or actively involve in activities conducted by AAOIFI.

Statement of Financial Position:

Second, the study examines the extent of compliance of AAOIFI in presentation of Statement of Financial Position. The examination of Statement of Financial Position of the IFIs found that on average the IFIs are 70.3% comply with the format of presentation of SOFP as suggested by AAOIFI. The lowest is Citibank with 35% and the highest is Bank Islam and Al-Rajhi with 75% compliance with SOFP format of AAOIFI respectively. Citibank Islamic is an Islamic operations of Citibank. It has not been incorporated as a full fledge bank yet.

Most of the IFIs reported assets, liabilities and equity as suggested by MFRS. However, other items such as Legal reserve, Risk reserve, Fair value reserves, Foreign currency translation reserve and Other reserves are not familiar and not required to be disclosed as items in the SOFP by MFRS. The reason for non compliance is different disclosure requirement between AAOIFI and MFRS. At the same time, there are many items required to be disclosed under MFRS format but not in AAOIFI format. They are Deferred tax, Derivatives financial liabilities, Bills and acceptance payables, Sukuk Murabahah, Zakat and tax

payable. And that leads to only 70.3% compliance with AAOIFI presentation format.

Statement of Profit or Loss:

Third objective is to examine the extent of compliance of AAOIFI in presentation of Statement of Profit or Loss. On average, the compliance with AAOIFI format of SOPL by IFIs is at 45.6% level. The highest is Bank Islam at 77.8% and the lowest is Citibank Islamic at 27.8%. An average of 45.6% conformity is low. This is due to different requirement by AAOIFI and MFRS in terms of items that should be reported in SOPL.

The first two items in the AAOIFI format and MFRS format of SOPL are already different. While AAOIFI requires the disclosure of net income from financing and investing activities, MFRS requires the disclosure of income derived from investment of depositors' fund and shareholders fund.

Table 3: ANALYSIS OF COMPLIANCE WITH AAOIFI

#	Name	SOFP	SOPL	SOCIE	SOCP
1	Bank Islam Malaysia Berhad	75	77.8	95	100
2	Affin Islamic Bank Berhad	70	55.6	95	100
3	Bank Muamalat Malaysia Berhad	70	38.9	95	100
4	Cimb Islamic Bank Berhad	70	55.6	95	100
5	Maybank Islamic Berhad	65	33.3	95	100
6	RHB Islamic Bank Berhad	70	44.4	95	100
7	AmIslamic Bank Berhad	70	44.4	95	100
8	Public Islamic Bank	70	50	95	100
9	Hong Leong Islamic Bank Berhad	65	44.4	95	100
10	HSBC Amanah Berhad	65	44.4	95	100
11	Citybank Islamic	35	27.8	95	100
12	Standard Chartered Saadiq Berhad	60	38.9	95	100
13	Alliance Islamic Bank Berhad	70	38.9	95	100
15	Alkhair International Islamic Bank Berhad	60	33.3	95	100
15	OCBC Islamic Bank Berhad	65	50	95	100
16	Al Rajhi Banking & Investment Corporation	75	38.9	95	100
17	Kuwait Finance House	70	66.7	95	100
	Average (%)	70.3	45.6	95	100

Fees and commission revenue and expenses need to be disclosed under AAOIFI but included in other operating income under MFRS and explained in notes to financial statements. There are many more items required to be disclosed under AAOIFI but only notes are disclosed under MFRS such as staff costs,

depreciation and amortisation, finance expense and other expenses. In addition, Direct expense, Income attributed to depositors, Income attributed to investment holders and Zakat that are always appear in MFRS's SOFP format are not required to be disclosed in AAOIFI's SOPL format.

Statement of Changes in Equity and Statement of Cash Flow:

The analysis of the fourth and fifth objectives: to examine the extent of compliance of AAOIFI in presentation of Statement of Changes in Equity and; to examine the extent of compliance of AAOIFI in presentation of Statement of Cash Flow can be combined. The examination of SOCIE results in 95% compliance of AAOIFI requirements as MFRS format is not significantly different from AAOIFI format. As for SOCF, the IFIs conform 100% to the format of AAOIFI as there is no difference between SOCF of MFRS and AAOIFI.

Statement of Restricted Investment and Statement of Sources and Uses of Charity Funds:

Lastly, there are two other statements that are required by AAOIFI to be disclosed as part of financial statement. They are statement of changes in restricted investment (SOCRI) and statement of sources and uses of charity fund (SSUCF).

Under MFRS, these two statements are not part of financial statement. However, they are disclosed as notes to the financial statement. The examination of 17 IFIs financial statements reveal only three banks disclose the movement of restricted investment account in notes to financial statement. They are Bank Islam Malaysia Berhad, CIMB Islamic Bank Berhad and RHB Islamic Bank Berhad. According to Bank Islam Malaysia Berhad Managing Director's Report 2015:

“One of the key milestones achieved for the industry was the launch of Al-Ansar on 2 April 2015, the first Restricted Investment Account (RIA), which was introduced with a strategic collaboration with Lembaga Tabung Haji (LTH). This is the first RIA that was structured off balance sheet in compliance with the Malaysian Financial Reporting Standards 10 (MFRS 10). For Al-Ansar, LTH specifies the mandate with regards to the purpose, asset class, economic sector and period of investment. As of 31 December 2015, we have disbursed 42% of the total fund or RM84 million which is in line with the target set. The investment is subject to the credit risk of the underlying financing asset, which is borne by the fund provider.”

Table 4: ANALYSIS OF COMPLIANCE WITH MFRS

#	Name	NOTE SOCRI	NOTE SSUCF
1	Bank Islam Malaysia Berhad	√	√
2	Affin Islamic Bank Berhad	X	√
3	Bank Muamalat Malaysia Berhad	X	X
4	Cimb Islamic Bank Berhad	√	√
5	Maybank Islamic Berhad	X	√
6	RHB Islamic Bank Berhad	√	X
7	AmIslamic Bank Berhad	X	X
8	Public Islamic Bank	X	√
9	Hong Leong Islamic Bank Berhad	X	X
10	HSBC Amanah Berhad	X	√
11	Citybank Islamic	X	X
12	Standard Chartered Saadiq Berhad	X	X
13	Alliance Islamic Bank Berhad	X	X
15	Alkhair International Islamic Bank Berhad	X	X
15	OCBC Islamic Bank Berhad	X	√
16	Al Rajhi Banking & Investment Corporation	X	X
17	Kuwait Finance House	X	√
	Total IFI	3	8

Special notes to the account that represents statement of sources and uses of charity fund are found in 8 out of 17 annual reports of Malaysian IFIs. They are Bank Islam, CIMB Islamic, AFFIN Islamic, HSBC Amanah, KFH, Maybank Islamic, OCBC Islamic and Public Islamic.

CONCLUSIONS AND RECOMMENDATIONS

Current study examines the conformity of Malaysian IFIs with regards to AAOIFI disclosure requirements. The overall results are SOFP 70.3% compliance, SOPL 45.6% compliance, SOCIE 95% compliance, SOCF 100% compliance. It can be concluded Malaysian IFIs are complying the requirements of AAOIFI even though they are only using AAOIFI standards as one of guidelines in preparation and presentation of their financial statements.

There are two recommendations to see the harmonisation between AAOIFI financial statements and MFRS financial statements. First, Malaysian Accounting Standards Board can consider to amend the disclosure requirement of (1) changes in restricted investment and (2) sources and uses of charity fund, from notes to the financial statement to a financial statement status like SOFP and SOPL. Alternatively, Malaysian Accounting Standards Board allows the

IFIs to voluntarily disclose changes in restricted investment and sources and uses of charity funds as financial statements.

Second, Malaysian representative in AAOIFI could suggest the inclusion of items currently disclosed in MFRS format but not required by AAOIFI format to be included in AAOIFI format.

Last but not least, future study should look at a more detailed requirements of AAOIFI and MFRS to find way for harmonisation of AAOIFI and MFRS in future.

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