

***Shariah* and financial reporting practices**

The Islamic finance and capital market industries are growing. Therefore, how well organisations in these industries capture and report Islamic values in their business practices must be addressed. More publications are needed to critically examine the appropriate methods to capture and report *Shariah* issues that may arise from Islamic financial transactions. Existing accounting standards such as International Financial Reporting Standards (IFRSs) published by the International Accounting Standards Board and standards from the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) might not be sufficient to recognise, measure and disclose the unique Islamic financial transactions that arise from Islamic contracts and values; this may hinder faithful presentation in the financial statements. New research is needed to explore and debate how financial reporting practices (e.g. application of time value of money and fair value measurement) can actually be understood and applied by organisations in Islamic industry. Importantly, new arguments on the extent of *Shariah* disclosure are needed, as users of financial statements may need access to this important information for decision-making. The willingness of the International Conference on Islamic Perspective of Accounting, Finance, Economics and Management (IPAFEM) to encourage such debate and collaborate with the *Journal of Islamic Accounting and Business Research* to publish this special issue advances this debate.

Each article in this issue takes a different perspective on *Shariah* issues and financial reporting practices. The first article, by Mezbah Uddin Ahmed, Ruslan Sabirzyanov and Romzie Rosman, critically analyses the accounting for *Murabahah* contracts based on IFRS and AAOIFI standards. From an IFRS and AAOIFI standards perspective, the article compares both the recognition and measurement issues that may arise from *Murabahah* contracts. Two important financial reporting issues unique to *Murabahah* contracts are highlighted: application of the time value of money and the substance of the contract. A *Murabahah* contract, treated either as a financing or trading arrangement by Islamic financial institutions, is one of the most utilised Islamic exchange-based contracts that have been applied in the modern world. This article argues that for *Murabahah* contracts, the recognition of contracts must include trading elements of the assets, not only their financing aspects, to truly reflect their *Shariah* nature. *Murabahah* contracts differ in form and substance; nevertheless, *Shariah* law emphasises the recognition of the contract through its substance rather than its form. In addition, the article illustrates how application of the time value of money in a *Murabahah* contract differs under recognition and measurement techniques recommended by the IFRS and AAOIFI. Finally, the article compares both the recognition and measurement of *Murabahah* contracts under IFRS and AAOIFI and suggests harmonising the standards. Interestingly, the article argues that despite the extensiveness of the IFRS in formulating financial reporting rules, it still cannot capture the *Shariah* element in *Murabahah* contracts, particularly the recognition of discounts received by banks from credit purchases. The article also suggests that application of the new IFRS 15 Revenue from Contracts with Customers may affect the reporting of Islamic financial transactions, especially for *Murabahah* contracts.

Zurina Shafii and Abdul Rahim Abdul Rahman explore the conflicts between the fair value measurement introduced in IFRS 9 Financial Instruments and *Shariah* law for Islamic-based financial instruments. This article answers Baydoun and Willet's (2000) call for research to delve further into the textual and legal interpretations of *Quran* and *Hadith* to uncover significant knowledge on how *Shariah* law is relevant to corporate reporting. Drawing from textual analysis of Muslim scholars, Shafii and Abdul Rahman examine specific issues concerning the application of IFRS 9 Financial Instruments to Islamic financial instruments, particularly the impact of *Shariah* law on the recognition and measurement of fair value in measuring financial assets. The concept of the time value of money is discussed in detail where the concept can be recognised in Islam based on certain criteria; however, *Shariah* opinions differ on use of an interest rate as a benchmark for the discount rate in the discounting or valuation technique for financial asset measurement. The authors argue that fair value measurement, particularly for financial assets valued using Level 2 and 3 techniques, may be considered *gharar*, leading to non-*Shariah* compliance. *Gharar*, or uncertainty, may exist due to the possibility of excessive or inaccurate valuation of assets and liabilities, which results in one party to the contract or the users of the financial statements being deceived by the excessive and inaccurate valuation. Finally, the paper suggests that financial reporting requirements must be carefully analysed before being adopted for Islamic financial instruments.

Gharbi and Halioui provide empirical evidence of the impact of fair value accounting on banking contagion between Islamic banks and conventional banks in the Gulf Cooperation Council (GCC) region. Twenty Islamic banks and 40 conventional banks operated in the GCC countries from 2003 to 2011. The authors examine whether fair value accounting contributes to systemic risk and whether fair value affects Islamic and conventional banks similarly. The paper reports a significant change in dynamic volatility in the GCC banking sector due to the financial crisis in 2008. However, no evidence suggests that fair value accounting is significantly associated with an increase in banking contagion for Islamic or conventional banks in GCC countries. Also, Gharbi and Halioui conclude that fair value accounting is unjustly blamed for exacerbating the severity of the crisis and suggest that fair value accounting can be blamed for the contagion effects; as far as Islamic banks are concerned, unlike Shafii and Abdul Rahman, a fair value-based regime satisfies Islam's concept of justice better than historical costs. However, one issue in fair value reporting is that it requires more extensive disclosure, particularly when measuring fair value based on unobservable inputs. Finally, the findings can be useful to accountants, policy makers and regulators in adopting a fair value-oriented accounting regime for Islamic banks and conventional banks in GCC countries; future research can be conducted for a qualitative analysis of the factors associated with accounting practices and banking contagion.

Anna Che Azmi, Norazlin Aziz, Normawati Non and Rusnah Muhammad adopt an exploratory study based on structured interviews to explain and understand the low level of *Shariah*-related disclosure, particularly from *Shariah*-compliant companies. They address the issues of *Shariah*-related disclosures by *Shariah*-compliant companies to understand the types of *Shariah*-related information that companies choose to disclose in their annual reports. They also explore user views of financial statements in their search for Islamic-related disclosures. Interestingly, the paper finds that most relevant *Shariah*-related information is understood as the information in the financial

statements and the notes to the accounts. Evidence suggests that companies see a separation in their understanding of the conventional disclosure practices for corporate social responsibility and the disclosure of *Shariah*-related information. This paper also discusses the nature of *Shariah*-related information through the categorisation developed by Ullah *et al.* (2014), which prioritises the disclosure elements of *Shariah* information. This article finds that respondents agree that *Shariah*-related information is commonly located in financial statements and their notes; the screening methodology adopted by Securities Commission Malaysia is seen as a strong influence on this perception. Moreover, they suggest that disclosing *Shariah*-related information in financial statements and their notes will require auditors to verify such information and, hence, auditors should equip themselves with knowledge of *Shariah*. Finally, they suggest that future research should incorporate a larger sample by including companies and professional users from different jurisdictions.

Each article in this issue adopts a different research orientation and explores different aspects of current financial reporting practices and Islamic business transactions. The first three articles focus on the impact of recognition and measurement issues for Islamic financial instruments. Ahmed, Sabirzyanov and Rosman examine the recognition and measurement issues associated with *Murabahah* contracts. Shafii and Abdul Rahman examine fair value measurement from the perspective of *Shariah* law for Islamic financial instruments. Gharbi and Halioui examine empirically whether fair value measurement affects banking contagion between Islamic banks and conventional banks. Meanwhile, in the final article, Che Azmi, Aziz, Non and Muhamad examine *Shariah*-related disclosures in financial reporting practices.

To understand the implications of these articles, we must understand the importance of both financial reporting regulations and *Shariah* law, as well as how they are applied within the current business environment. We need to look at how *Shariah* law views business transactions and seek a solution that can be applied effectively within the current financial reporting environment. These four articles explain the fundamental elements of the financial statements for the users of financial information in decision-making. Ensuring that the recognition and measurement of all financial transactions made in the Islamic business industry are *Shariah*-compliant is important. However, separating financial reporting rules for *Shariah* practices from conventional financial reporting practices should not be seen as the solution. A more effective and practical solution is to select the relevant financial reporting rules and change them to accommodate the concepts introduced by *Shariah* law. Through more articles published along the theme of this special issue, regulators will be able to identify the changes needed in financial reporting standards to accommodate a more faithful representation of financial transactions that are based on *Shariah* law.

In sum, this special issue seeks to promote discussion of how financial reporting practices can be addressed or developed to accommodate business practices in accordance with *Shariah* law. These articles encourage us to explore unique recognition, measurement and disclosure issues that may arise due to *Shariah* law. By developing a thorough understanding of how *Shariah* law can be applied in the current business environment and how Islamic investors search for Islamic information disclosures, we can better understand the multi-faceted nature of the issues between *Shariah* and financial reporting practices.

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