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EVALUATING THE FINANCIAL REPORTING PRACTICES OF ISLAMIC FINANCIAL INSTRUMENTS FOR COMPLIANCE WITH *SHARIAH* REQUIREMENTS

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ABSTRACT

The introduction of value-based intermediation in Malaysian financial industries creates demands for applied studies to provide empirical evidence on the impact of value-based intermediation in achieving *maqasid al-Shariah*. This is to reduce the gap between *Shariah* compliance and achieving *maqasid al-Shariah* by the industry. For instance, the *ijarah* financing contract in the financial statement is under the leasing contract term and is no different from the conventional banks offering vehicle loans. Similar to *murabahah* financing, there is no reporting of underlying assets bought by Islamic banks as inventory before the assets are sold to the customers. Hence, the objectives of this research are: (1) to examine the substance in reporting financial instruments adopted by Islamic banks; and (2) to adopt the *maqasid al-Shariah* principles in validating the substance of the financial instruments adopted by Islamic banks. This research analysis was based on focus group discussions with the experts, and thematic analyses were conducted to assess the financial reporting practices that validate the economic substance and legal form of Islamic financial instruments in Islamic banks whether achieve the *maqasid al-Shariah* or merely compliance with *Shariah*. The study suggested a need for accounting standards that focus on Islamic financial instruments to ensure faithful representation of the financial statements. Moreover, the substance and legal form will align to reflect the financial statement based on policy documents that have been developed and to show the uniqueness of Islamic financial instruments in financial reporting.

KEYWORDS: MAQASID AL-SHARIAH, AAOIFI, IFRS, ISLAMIC FINANCIAL INSTRUMENTS, VALUE-BASED INTERMEDIATION

ABSTRAK

Pengenalan pengantaraan berasaskan nilai dalam industri kewangan Malaysia dengan mewujudkan tuntutan untuk kajian gunaan untuk menyediakan bukti empirikal tentang kesan VBI dalam mencapai *maqasid al-Shariah*. Ini bagi mengurangkan jurang antara pematuhan *Shariah* dan pencapaian *maqasid al-Shariah* oleh industri. Sebagai contoh, kontrak pembiayaan *ijarah* dalam penyata kewangan adalah di bawah tempoh kontrak pajakan dan tidak berbeza dengan bank

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konvensional yang menawarkan pinjaman kenderaan. Sama seperti pembiayaan *murabahah*, tiada laporan aset pendasar yang dibeli oleh bank Islam sebagai inventori sebelum aset tersebut dijual kepada pelanggan. Justeru, objektif penyelidikan ini adalah: (1) untuk mengkaji kandungan pelaporan instrumen kewangan yang diterima pakai oleh bank Islam; dan (2) mengguna pakai prinsip *maqasid al-Shariah* dalam mengesahkan kandungan instrumen kewangan yang diterima pakai oleh bank Islam. Analisis penyelidikan ini adalah berdasarkan perbincangan kumpulan fokus dengan pakar, dan analisis tematik telah dijalankan untuk menilai amalan pelaporan kewangan yang mengesahkan bahan ekonomi dan bentuk undang-undang instrumen kewangan Islam di bank Islam sama ada mencapai *maqasid al-Shariah* atau sekadar pematuhan *Shariah*. Kajian itu mencadangkan keperluan untuk piawaian perakaunan yang memfokuskan kepada instrumen kewangan Islam untuk memastikan perwakilan yang benar bagi penyata kewangan. Selain itu, kandungan dan bentuk undang-undang akan diselaraskan untuk mencerminkan penyata kewangan berdasarkan dokumen dasar yang telah dibangunkan dan untuk menunjukkan keunikan instrumen kewangan Islam dalam pelaporan kewangan.

KATA KUNCI: MAQASID AL-SHARIAH, AAOIFI, IFRS, INSTRUMEN KEWANGAN ISLAM, PENGANTARAAN BERASASKAN NILAI

1. INTRODUCTION

The contemporary Islamic banking and finance practice has not been without its critics (El-Gamal, 2006; Nomani, 2006). Khan (2010) investigates to what extent actual Islamic banking practices live up to the ideal and to what extent Islamic banking is different from conventional banking. El-Hawary *et al*. (2007) provided the four defining characteristics of Islamic banking and finance as (1) risk-sharing; (2) materiality; (3) no exploitation; and (4) no financing of sinful activities. Then, based on these four characteristics, Khan (2010) evaluated how well contemporary Islamic banking and finance practices are based on the four characteristics. The findings can be summarized as follows:

1. Islamic banking and finance cannot be said to be risk-sharing in any meaningful sense. The argument further stresses that Islamic banking and finance mimic conventional, collateralized debt contracts very closely; and are often being benchmarked by market interest rates;
2. Contemporary Islamic banking and finance often have no meaningful underlying transaction. The argument is that the sale and lease-back of existing physical assets, common in many Sukuk transactions, is fictional materiality in that either no new asset is being financed or that there is no actual title transfer;
3. Islamic banking and finance have failed in this aspect where the arguments include the higher fees associated with Islamic mortgages and investment funds for doing nothing more substantial than mimicking conventional banking and finance products are exploitative; and
4. Islamic banking and finance institutions are sometimes guilty of not being *Shariah* compliant. The arguments on the commodity placements usually rely on the simple word of the borrowing bank or firm that the funds will not be used for 'sinful' activities and rarely are *Shariah* audits performed to validate these *Shariah* non-compliance issues.

Despite the arguments on Islamic banking and finance mimicking conventional banking, instead of the ongoing debates on the issues in practice, the proposed research will examine the different approaches that can support the development of the *maqasid al-Shariah* framework to explain the substance of Islamic financial instruments adopted by Islamic banks in their operations. The identification of the substance and forms of Islamic financial transactions is important to justify whether the operation of Islamic banks fulfils the *maqasid al-Shariah* or merely complies with the legal form of the contracts. There are few studies (AOSSG, 2018; Ansari & Tabraze, 2018; MIA, 2020; MASB, n.d; BNM, 2022) from the accounting and reporting perspective of Islamic financial transactions. MIA (2020) explains the fundamentals of accounting of Islamic finance by illustrating and explaining the financial statements of Islamic banks and *takaful* operators on the reporting of their assets, liabilities, equities, income and expenses. Meanwhile, AOSSG (2018) illustrate the financial reporting issues relating to Islamic banking and finance on the applicability of IFRS 15 – Revenue from contracts with customers and IFRS 9 – Financial Instruments on the reporting of Islamic financial transactions, especially for Islamic sale-based contracts. This investigation is very critical to examine the findings from Khan (2010) on whether Islamic banks are mimicking conventional banking or not. Other accounting standards that can be examined include IFRS 16 – Leases.

The approaches taken by IFRS for reporting financial transactions are principally based that required judgements. In terms of the conceptual framework of the reporting for Islamic banks, both AAOIFI (2018) and BNM (2022) have explained the accounting concepts among others such as the application of time value of money, and substance over form (Ansari & Tabraze, 2018). These fundamental concepts are important as the basis to support whether Islamic financial transactions are compliant and also meet the *maqasid al-Shariah*. The earlier studies and policy documents have explained the issues on the operation of Islamic banking and finance that can be argued to mimic conventional banking. However, the justification may not be convincing. Hence, this research is among the few that adopt an accounting perspective by explaining through the application of accounting concepts and standards to determine the substance of each main Islamic financial transaction, especially the asset-based transactions such as *tawarruq*, *murabahah* and *ijarah*. From the findings, the *maqasid al-Shariah* framework in validating the substance of Islamic financial instruments can be proposed. Hence, the validation technique may support whether or not the current Islamic banking operations achieve the *maqasid al-Shariah*.

According to Kamali (2020), Malaysia has been seen to focus on important *maqasid*-related initiatives in recent years in the areas, particularly in Islamic banking and finance and government policy formulation. For example, in February 2015, the government introduced the Malaysia *Shariah* index, and in July 2017, Bank Negara Malaysia introduced "Value-Based Intermediation" (VBI). However, the realization of the value-based intermediation concept especially for Islamic banks is still questionable when many reporting made by Islamic banks on their VBI activities focus on their corporate social responsibilities and the utilization of *zakat* funds. However, the expectation of VBI is more than that, especially in the realization of *maqasid al-Shariah*.

Hence, this research will examine the application of Islamic financial instruments by Islamic banks based on the *Shariah* contracts. The analysis includes explaining the financial reporting in the financial statements of Islamic banks. The accounting approach of reporting a particular transaction based on its economic substance rather than its legal form will support development of the *maqasid al-Shariah* framework that validates the substance and forms of financial reporting. Hence, it can be concluded whether the objectives of *Shariah* are met or not in the operation of Islamic banks as VBIs. The framework will support the policymakers and standards setters in validating the application of Islamic financial instruments. This is critical as the ongoing issues of Islamic banks mimicking conventional banks may increase both *Shariah* non-compliance risks and reputational risks of Islamic banks. Hence, immediate prevention measures and action by the policymakers and standards setters deem necessary.

2. LITERATURE REVIEW

Islamic Financial Institutions as Value-Based Intermediaries

Bank Negara Malaysia (BNM) has authoritatively announced VBI as a new initiative for Islamic banking institutions (IBIs) to be more revitalized. The intent of this initiative by the BNM is not only for economic growth but also to allow them to have more involvement in social needs as part of *maqasid al-Shariah* which is beyond *Shariah* compliance in the business activities of IBIs. Accordingly, the concept of VBI is defined by BNM as "an intermediation function that aims to deliver the intended outcomes of *Shariah* through practices, conduct, and offerings that generate positive and sustainable impact to the economy, community and environment, consistent with the shareholders' sustainable returns and long-term interests" (BNM, 2018a). VBI shares similarities with several established concepts such as Ethical Finance and Sustainable, Responsible, Impact Investing (SRI), Sustainable Development Goal (SDG), and Environmental, Social and Governance (ESG), especially on the objectives that are to promote proactive participation in societal well-being. It is not completely a new concept.

However, according to BNM, the aspect that makes VBI different from the other concepts is because of its *raison d'etre* (reason of existence). VBI depend on *Shariah* in determining its underlying priorities, values, and moral compass. The idea of VBI is devised by the industry to revitalize the declining growth rates in IBIs, from inception to the following years recently. In line with the establishment of VBI, the BNM has also developed an assessment tool to measure the adoption of VBI in IBIs. This assessment was publicly disclosed to allow the stakeholders to compare the performance of IBIs (BNM, 2018a). Accordingly, the IBIs also need to ensure their intent, strategy and performance are based on the underpinning thrusts of VBI as a basis for collective action as in Figure 1:

FIGURE 1: THE UNDERPINNING THRUSTS OF VBI
Source: Bank Negara Malaysia (2018a)

Four (4) underpinning principles must be manifested by IBIs:

1. Entrepreneurial mindset – Through IBI's holistic offers, which comprise funding and proactive assistance, i.e., advisory services, market infrastructure, and business networks, the goal of this principle is to encourage involvement in the promotion of entrepreneurial activities;
2. Community empowerment – Its goal is to empower communities by providing financial solutions that have a positive influence on them;
3. Good self-governance – this thrust instils organizational discipline (self-control) and guarantees meaningful engagement of all stakeholders in the governance framework; and
4. Best conduct – refers to the adoption of methods that help IBIs enhance their offers, procedures, and treatment of their stakeholders (such as customers and employees).

VBI is considered to be an attempt to promote a more holistic perspective of *Shariah* that goes beyond *Shariah* compliance in IBIs' commercial operations. One of the elements in *Maqasid al-Shariah* is the preservation of wealth, which forms the core of the financial transactions of IBIs. However, the approach of VBI on wealth preservation extends beyond its literal meaning by encouraging people to generate, accumulate, and distribute wealth in a just and equitable manner (BNM, 2018a). In other words, through VBI's ideas, IBIs have become a great place to contribute to social needs. It also fosters the creation of ethical values for IBIs within the framework of *Maqasid al-Shariah*. VBI tries to achieve the following aims in the context of general objectives, all of which are aimed at the public good as in Figure 2:

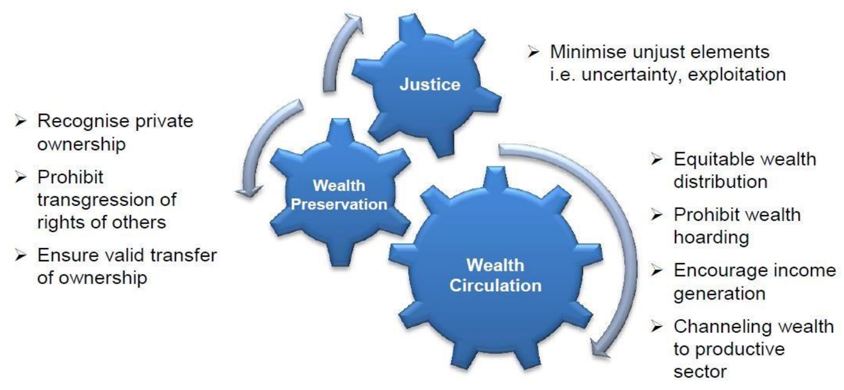

FIGURE 2: INTENDED OUTCOMES OF *SHARIAH*
Source: Bank Negara Malaysia (2018a)

A brief explanation of the intended outcomes of *Shariah* is as follows:

1. The pursuit of justice: In IBIs, there are two aspects to achieving justice i.e. macro and micro dimensions. The implementation of a just economic system can be achieved at the macro level through wealth distribution and circulation, resource efficiency, and societal progress (Laldin & Furqani, 2013). In this case, justice is reflected in the framework of VBI through underpinning thrusts such as "Best Conduct" and "Community Empowerment." The aim of "Best Conduct" in the micro-dimension emphasizes that stakeholder rights must be preserved through transparent and fair disclosure of all transactions and decisions made by IBIs;
2. Preservation of wealth through wealth circulation: There are at least two ways to circulate wealth i.e. doing business and facilitating a financial transaction (Lahsasna, 2013). It is envisaged that through implementing VBI, IBIs will be able to achieve their goal of wealth preservation through wealth circulation by engaging in *Shariah*-compliant entrepreneurship or company. Furthermore, providing comprehensive offers such as financial and proactive support, and enabling entrepreneurial activity as emphasized in VBI is one of the strategies for wealth circulation in IBIs; and
3. Preservation of wealth through wealth distribution: VBI's 'Community Empowerment' thrust emphasis on how the goal of wealth distribution can be achieved by development, finance, and providing solutions to difficulties that communities face, such as the integration of *waqf* and *sadaqah* into Islamic financial transactions. There are a few indicators that may be used to assess how well this drive is being implemented in IBIs. These indicators include the number of community-based services, goods, and projects, as well as the number of persons who benefited from the activities, as well as the social impact (BNM, 2018a).

Finally, VBI serves as a conduit for delivering *Shariah*'s desired objectives. These objectives will be achieved through a variety of tactics and practices. Firm and consistent regulation is essential in this regard. Beyond good practices, BNM must set higher requirements for sustainable finance in the country.

Maqasid al-Shariah Framework

Maqasid al-Shariah is developed to provide a framework for Islamic scholars and institutions including Islamic banks to address the *maslahah* of the Muslim community and human life. Fisol *et al*. (2017) and Saad and Fisol (2019) commented that *maslahah*, according to Muslim scholars (*Fuqaha*') including al-Ghazali referred to an effort to seek benefits or repelling of harm. The preservation of the objectives of the *Shariah* including the protection of religion, life, progeny, intellect and wealth constitutes the fundamental meaning of *maslahah*. Sharing the same understanding of *maqasid* and public interest from the point of view of Al Ghazali. Dusuki and

Bouheraoua, (2011) highlighted that al-Shāṭibī defines *maṣlaḥah* as addressing the subsistence of human life, the completion of man's livelihood and the acquisition of what his emotional and intellectual qualities required of him. Scholars of *Maqasid* for Islamic banking (Chapra, 2008; Bedoui, 2012) highlighted the main *maqasid* frameworks that can be considered for their applicability to Islamic banks developed by Al-Ghazali and Al-Najjar. With Al-Ghazali providing classical text for *maqasid al-Shariah*, Al-Najjar's framework considers the dynamics of Muslim contemporaries with the changing socio-economic spheres of Muslim communities (Ridwan & Santi, 2019; Ahmad, 2014). Al-Ghazali considers the Protection of Faith (*Deen*); Human self (*Nafs*); Intellect (*Aql*); Posterity (*Nasl*); and Wealth (*Mal*) at individual levels as integral elements of *maqasid*. Bedoui (2012) commented that Al-Najjar considers macro elements in his categorization of *maqasid al-Shariah* including safeguarding human rights, society, wealth and environmental ecology.

Drawing from the Islamic moral economy, Asutay (2008) advocated that the Islamic bank and finance industry should operate within the *maqasid al-Shariah* framework to achieve human well-being and social justice in financial and economic activities. Submitting to both *maqasid al-Shariah* and *Shariah* laws, Islamic banks demonstrate their moral and religious characteristics by avoiding involvement in *riba*, *gharar* and *maysir* (Tarique *et al*., 2021). Islamic banking provides an alternative to the conventional financial system and for Muslims to protect themselves from *riba* and *Shariah*-compliant financial transactions as a means of maintaining Islamic practices to be observed by Muslims. As economic and financial transactions take a big part of man's activities, the *maqasid* space is relevant to be considered in the development and sophistication of Islamic banks as Islamic institutions. Many studies in the literature consider this relevance. For instance, adopting the *maqasid* concept of Abu Zahrah, Hosen *et al*. (2019) highlight three dimensions of public interest (i.e. *maslahah*) applicable to Islamic banks' performance including profitability of the banks, redistribution of income and wealth, and investment in the real sector. Lateef *et al*. (2017) discussed the application of *maqasid* with its principles in Islamic banking products are to be clearly outlined and incorporated in the product contracts with the customers.

Interestingly, Bedoui (2012) further enhanced the *maqasid* model for Islamic banking by providing different weights for different dimensions of *maqasid* for Islamic banks to focus on in developing and defining the banks' performance measurement system. He does recognize that Islamic banks are more relevant for specific contributions to the development of wealth, and equitable distribution of income in the economy. Specifically, the protection of wealth as part of *maqasid* should be given due consideration by Islamic banks in their governance and operations. Dusuki and Abozaid, (2007) highlighted that to realize the *maqasid al-Shariah*, Islamic banking and finance institutions must ensure that all of their transactions are *Shariah* compliant not only in their form and legal technicalities but more importantly, the economic substance which is premised on the objectives outlined by the *Shariah*. With the importance of financial and economic transactions, Mohd Naim (2016) explains the relevance of *maqasid al-Shariah* to Islamic economics and finance from the perspective of *al-Daruriyyah*, *al-Hajiyyah* and *al-Tahsiniyyah* as categories of *maqasid al-Shariah*. With *al-Daruriyyah* in upholding religious and worldly affairs, Islamic injunctions ensure fair distribution of economic resources, prohibition of riba and gambling, as well as the protection of properties as making its unlawful possessions a crime. With *al-Hajiyyat* demonstrating the *Muamalat* transactions through contract details, flexibility in trade is needed to complete the transactions to satisfy all parties in the contracts. *Maqasid* is also in support of *al-Tahsiniyyat* which recognises practising *mahasin al-'adat* (i.e. good customs) and keeping away from *al-Ahwal al-Mudannisat* (i.e. vile things). In line with this, in undertaking financial transactions, it is not advisable to pressure others and to charge excess profits at the disadvantage of others even if they are permissible by Islam.

Studies on the impact of *Maqasid* on Islamic banking operations tend to focus on Islamic banks achieving social dynamics of *Shariah* (Asutay & Harningtyas, 2015); however, fewer studies focus on other dimensions of *Maqasid* including income distribution and protection of wealth of the

Muslims. As highlighted by Lateef *et al*. (2017) the primary objective of *maqasid al-Shariah* is to establish justice and away from injustice in society; an Islamic economic system should be devoid of all forms of injustice or exploitation including protection of wealth in undertaking economic activities. This means the contracting parties should preserve justice and avoid injustice in business transactions including the exploitation and abuse in the acquisition of properties of others. Al-Najjar made five indicators to safeguard property which are: (1) by seeking and developing, (2) by safeguarding damage, (3) by safeguarding property by maintaining ownership rights, (4) by safeguarding property by safeguarding value, and (5) safeguarding property by distributing or investment (Ridwan & Santi, 2019). Closely related to the discussion of the study, Ismail, (2010) promoted that *Maqasid al-Shariah*'s protection of wealth is to ensure the community's wealth preservation and growth. With the emphasis on achieving *maqasid*, Islamic banks in both products and operations should be designed to contribute to greater wealth creation in line with the *Shariah* and to ensure its equitable distribution in the community. The concentration of wealth in the hands of a few individuals is not consistent with the spirit of *maqasid*.

Reporting of Islamic Financial Transactions

The reporting standard in Malaysia is based on the MRFS framework that complies with IFRS which enhances the quality, credibility, and transparency of the financial information in the companies and financial institutions in Malaysia. The financial reporting is based on policy documents by Bank Negara Malaysia for the financial institutions and companies to prepare and publish the financial statements that disclose information to the users on the financial performance and position. From a Malaysian perspective, Figure 3 shows the composition of financing by concepts or *Shariah* contracts amounting to RM488 billion as of January 2018 (MASB, nd). The composition of financing by concepts or *Shariah* contracts in this study is summarised in Figure 3:

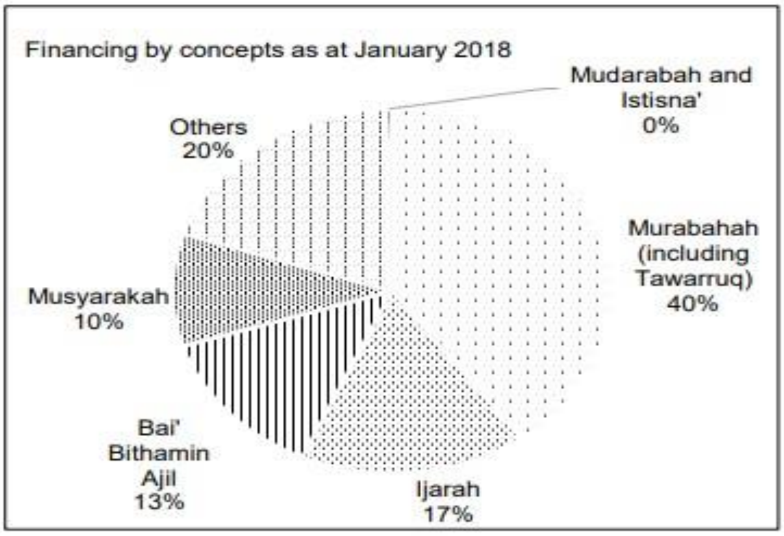

FIGURE 3: COMPOSITION OF FINANCING BY CONCEPTS OR *SHARIAH* CONTRACTS

Source: MASB (nd)

This shows that both *murabahah* (i.e. including *tawarruq*) and *ijarah* are the two most used contracts adopted by Islamic banks for their financing. Hence, it is important to examine the substance of both *murabahah* and *ijarah* financing adopted by Islamic banks and whether or not the instruments applied by Islamic banks achieve the *maqasid al-Shariah* or merely compliance with *Shariah*.

With the issues on the reporting of Islamic financial transactions, Asian Oceanian Standard-Setters Group (AOSSG, 2018) on the reporting of Islamic financial transactions under IFRS, highlighted the update on Financial Reporting Issues relating to Islamic finance. The working group on

AOSSG in 2010, had undertaken research to identify issues in applying IFRS to Islamic financial transactions and identified 15 issues including topics on recognition of financing effect, profit sharing contracts, *sukuk*, *takaful* and *ijarah* (AOSSG, 2018). For this research, the following are some summaries of the findings of the working group in Table 1 specifically on the recognition of the financing effect on the common contracts (i.e. asset-based financing and *ijarah*) that have been applied and being classified and recognised in the asset side of the Islamic financial institution's statement of financial positions in the perspective of accounting. Below is the summary of the findings on the selected issues from the working group committee of AOSSG in this study is summarised in Table 1:

TABLE 1: SUMMARY OF THE FINDINGS ON THE SELECTED ISSUES FROM THE WORKING GROUP COMMITTEE OF AOSSG, 2018

No.	Issues	Explanation
1.0	Recognising a financing effect	When a contract is within the scope of IFRS 15, and that contract contains a significant financing component, IFRS 15 requires an entity to adjust its transaction price for the effects of the time value of money and account for a receivable arising from the contract under IFRS 9. Consequently, if the seller's sale contract meets the definition and scope of a contract with a customer under IFRS 15, the seller will recognise two types of revenue. One is the revenue for transferring promised goods to the customer, and the other is for deferring the consideration. The seller would recognise a financial asset under IFRS 9 if such a contract is not a contract within IFRS 15. The applicability of IFRS 15 to an Islamic sale-based contract that is used to facilitate a financing transaction with a customer involves judgment. Among others, things that have been discussed is whether such a financing contract is "a contract with a customer" within the scope of IFRS 15.
2.0	*Ijarah*	It is noted that the accounting for *ijarah*-based contracts remains controversial between "Islamic accounting standards" and IFRS. This stems from the *Shariah* requirement that a "lessor" must own the *ijarah* asset throughout the *ijarah* period regardless of the circumstances accompanying the *ijarah* arrangement. It must be noted that "ownership" under *Shariah* does not necessarily result in an asset being recognised for accounting purposes. For example, a lessor in an *ijarah* contract who has the legal title of the asset would need to derecognise the asset if it is a finance lease under IFRS 16 Leases. In addition, paragraph B45 of IFRS 16 Leases states "…Obtaining legal title does not in itself determine how to account for the transaction." Despite the differences, additional disclosures may help to reduce the gap. For example, when an *ijarah* is reported as a finance lease under IFRS 16, from a lessor's perspective, the standard requires the lessor to derecognise the *ijarah* asset. This has led to the contentious point that such a treatment is not acceptable from *Shariah* precepts. In this case, additional disclosure could be included, for example in accounting policies or notes to the financial statements to cater to *Shariah*-conscious users about the "ownership" of the *ijarah* asset.

	Additional disclosure is in line with paragraph 17 of IAS 1 Presentation of Financial Statements which states that a fair presentation also requires an entity "…to provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and performance."

The issues in recognizing the financing effects are due to the asset-based contract especially the Murabaha contract is in the category of the sale contract. In this case, a trust sells contracts. Besides, this issue also has been addressed in the Review of Bank Negara Malaysia (BNM) *Shariah* Policy Documents from a Financial Reporting Perspective issued by MASB. Accordingly, in general, financial reporting considerations can be summarised as follows (MASB, nd):

a. Identification of the applicable MFRS. Amongst others, include the following considerations:
   i. Faithful representation of economic substance versus legal form; and
   ii. Elements of control and nature of returns associated with the contracts.

b. Measurement of the contracts. The review noted that an Islamic financial institution must assess the components of cash flows to determine the appropriate classification and measurement of the contracts.

Concerning this research, two types of asset-based financing are explained which are: (1) *Murabahah* financing; and (2) *Ijarah* financing, to examine the financial transactions concerning the substance over form concept. Based on MASB, (n.d), *murabahah*'s structure concerning the *murabahah* policy document can be explained in Figure 4. The structure clearly explains the *murabahah* financing adopted by Islamic banks. In particular, it shows both the flows of money and assets, hence, evidencing that the financing is not merely the provision of a loan (i.e. conventional bank), but the involvement of sale contracts. This can be seen as follows:

1. Transfer of ownership of the assets to the Islamic bank from the vendor;
2. Payment of purchase price on the spot by the Islamic bank to the vendor;
3. Transfer of ownership of the asset from the Islamic bank to the customer; and
4. Payment of deferred basis at a "cost plus markup" by the customer to the Islamic bank.

In terms of structure, it is clear that Islamic banks should buy the asset first before the asset is transferred (i.e. sell) to the customer. In particular, to the application of the *murabahah* contract by Islamic banks, for sale-based contracts, the Islamic bank needs to consider whether the contracts fall within the scope of MFRS 15. MFRS 15 applies to "a contract with a customer" whereby a customer is defined as a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities. However, since an Islamic bank is an Islamic financial intermediary that provides financing for their ordinary activities, currently, the contracts have been recorded as financial assets within the scope of MFRS 9 i.e., financial instruments. The illustration of *the murabahah* structure in this study is summarised in Figure 4:

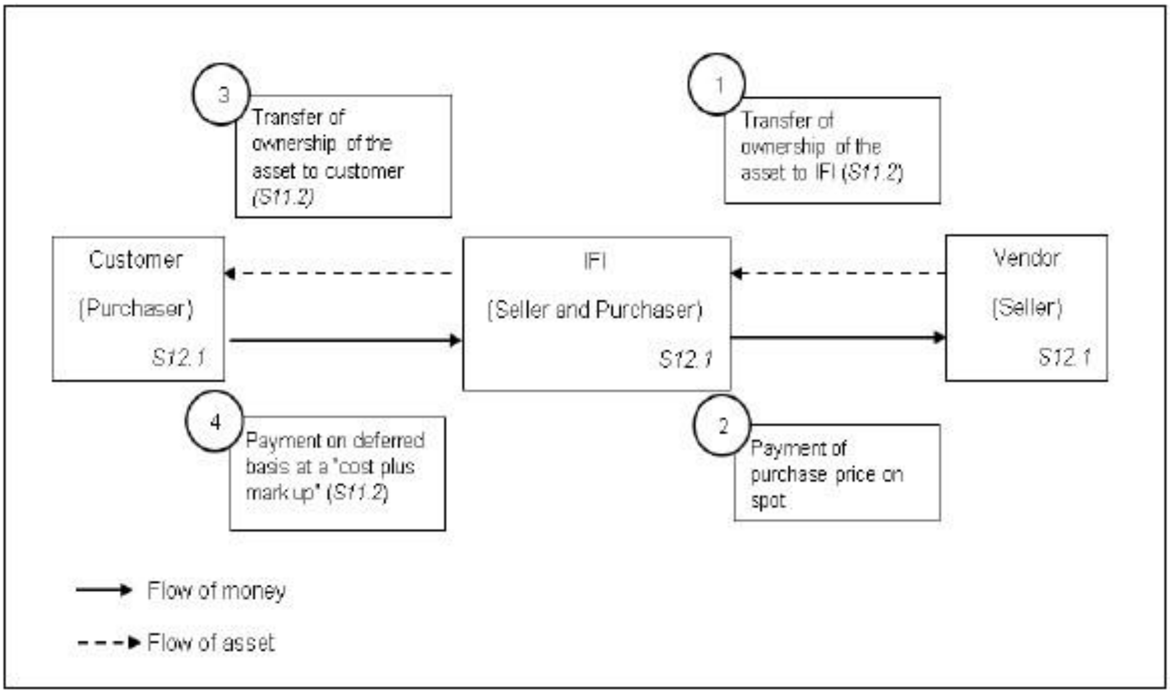

FIGURE 4: ILLUSTRATION OF *MURABAHAH* STRUCTURE
Source: MASB (n.d)

Concerning *ijarah*, The BNM *Ijarah* policy document distinguishes between primary *ijarah* and *ijarah* financing as indicated in Figures 5a and 5b. General application of primary *ijarah* is limited, and *ijarah* financing is broadly used for hire purchase financing. By examining the structure of *ijarah* financing, where this type of financing is accounted for following MFRS 16 if the *ijarah* meets the definition of a lease and the Islamic bank is exposed to not only credit risk but also residual asset risk. This may be true for the reporting of *ijarah* as in Figure 5a. However, it is found that the reporting of *ijarah* financing namely *al-Ijarah thumma al-bai* (AITAB) widely used for vehicle financing reported as financing (i.e. assets side of the balance sheet). Similarly, the Islamic bank as a financial intermediary is merely a financier, the contract is likely to be accounted for under MFRS 9 financial instruments. The illustration of the *ijarah* structure in this study is summarised in Figure 5a and Figure 5b below:

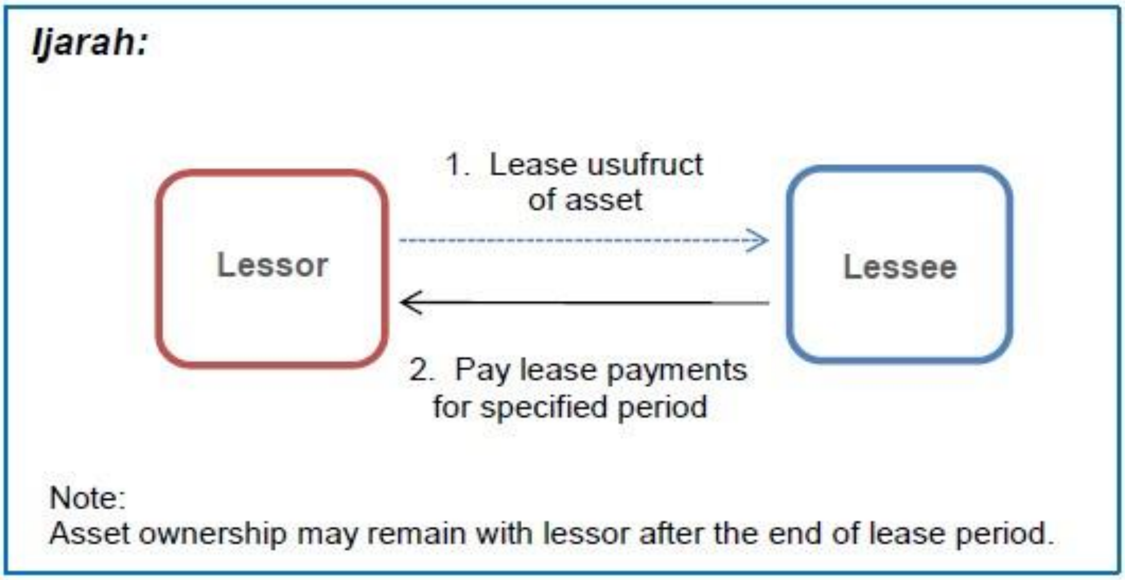

FIGURE 5A: ILLUSTRATION OF *IJARAH* STRUCTURE
Source: Bank Negara Malaysia (2018b)

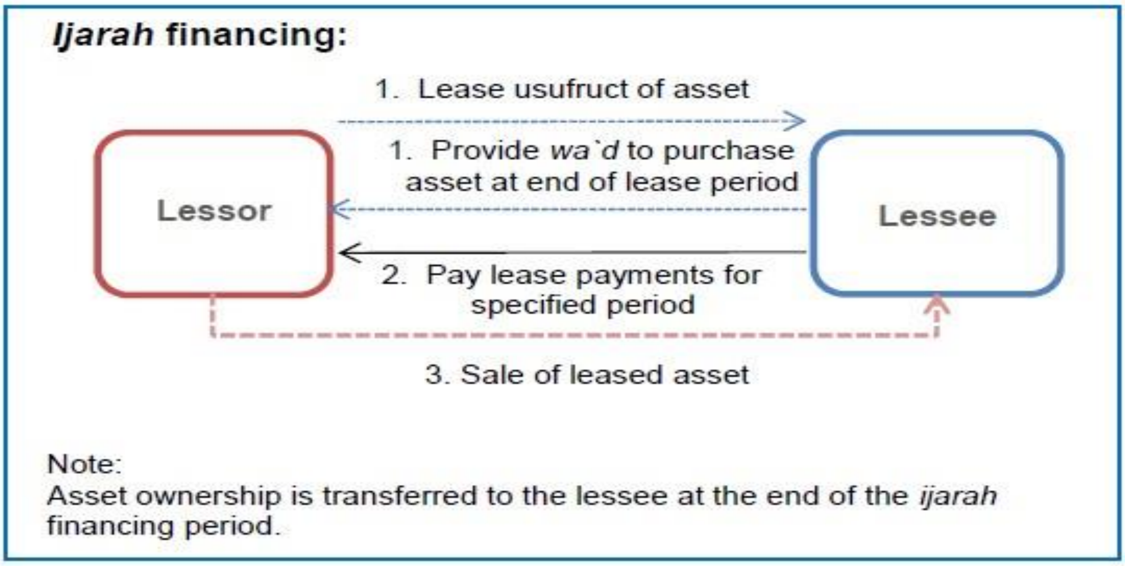

FIGURE 5B: ILLUSTRATION OF *IJARAH* FINANCING STRUCTURE
Source: Bank Negara Malaysia (2018b)

3. METHODOLOGY

The research adopts qualitative methods and techniques. The quantitative analysis summary findings on the issues of economic substance and legal form of the Islamic financial instruments are presented to the expert in accounting and Islamic banking in a focus group discussion as in Figure 6 which briefly explains the conceptual framework concerning the research. Four experts participate in the focus group discussion who are exposed to accounting and Islamic banking. The conceptual framework in this study is summarised in Figure 6:

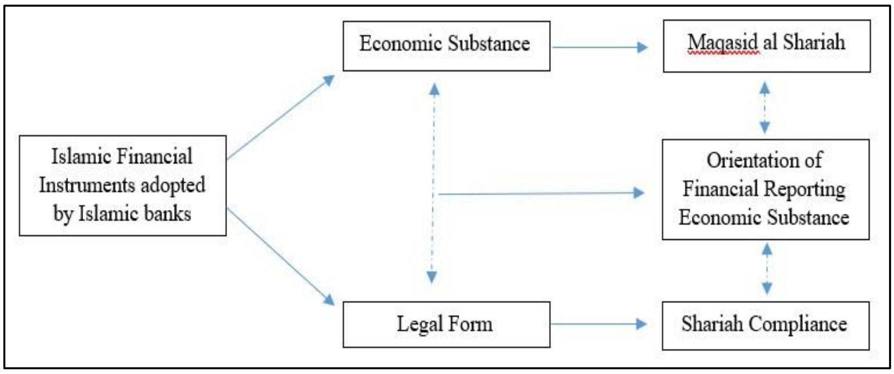

FIGURE 6: CONCEPTUAL FRAMEWORK

The focus group discussion was held for about two hours via the online platform and the questions were given before the discussion. During the focus group discussion, the reporting issues will be elicited from the views of the expert based on Islamic banks mimicking conventional banks, and whether the current practices achieve the *maqasid al-Shariah* will be debated and documented. The main questions for focus group discussion include the following:

1. Are Islamic banking activities expected to differ from the conventional bank in terms of their objectives and utilization (real economic benefits) of the assets as represented by the contractual relationships?
2. Should the financial products and instruments of Islamic banks comply with similar conventional bank regulatory and prudential requirements to safeguard and meet the needs of the Islamic finance community (such as financial reporting standards and requirements)?
3. Should the financial representation (reality) of Islamic bank activities be presented as similar or comparable to the conventional bank?
4. With only specific provisions on *Shariah* Compliance in IFSA (2013) do we expect the Islamic finance activities to be part (subset) of the single financial system?
5. To what extent do *Shariah* control functions in the BNM *Shariah* Governance Policy (2019) document distinguish the object and utilization of Islamic financial instruments to be consistent with *maqasid al-Shariah*?

The principles can then be applied to analyzing the reporting practices of Islamic bank's financing and investment activities as in the conceptual framework. The principles can be a basis to assess whether or not Islamic banking operations are consistent with *maqasid al-Shariah* and to explain to what extent its operations and reporting mimic conventional banking practices. The next section explains the main findings from the data analysis of the focus group discussion. The qualitative analysis addresses the issues found and groups them into several themes accordingly which identify the relevant *maqasid al-Shariah* principles for validating the substance of Islamic financial instruments. The principles can then be applied to analyzing the reporting practices of Islamic bank's financing and investment activities as in the conceptual framework. The principles can be a basis to assess whether or not the Islamic banking operations are consistent with *maqasid al-Shariah* and to explain to what extent its operations and reporting imitated conventional banking practices.

4. FINDINGS AND DISCUSSION

This section summarises the findings based on the questions that were asked and discussed during the focus group discussion. The findings have been categorised into the three (3) important themes as follows:

i. Definition of object and utilization of asset in Islamic banking activities;
ii. Interrelation among financial instruments and products of Islamic bank activities that comply with financial reporting requirements and financial representation; and
iii. Issue and concern in the implementation of *Shariah* compliance on Islamic finance activities.

Theme 1: Definition of object and utilization of asset in Islamic banking activities
In general, the idea was to ascertain the expert view on the object and utilization of assets in Islamic banking activities. Indeed, all respondents posited that Islamic banking activities differ from conventional banks in terms of the object and utilization (real economic benefits) of the asset by the contractual relationships. One of the respondents remarked the following:

"...about how important the contractual nature of Islamic banking products is. Because the contractual nature will make it different from conventional. To me, the contracts are very important. When looking into the issue of accounting, we need to take consideration of the nature of the legal contracts, as it will make a bigger difference between Islamic products and conventional products." (Respondent 4)

It is important to note that there are a few Islamic financial instruments in particular the *murabahah* financing and *ijarah* financing that by their legal form should be the transaction of trading of assets and leasing of assets respectively. These are the arguments on economic substance versus legal form. One of the respondents pointed out that:

"…object is referring to the financing that recorded as a financial instrument using MFRS 9 however it is not tally with policy document which in Islamic banking required trade and ownership on the asset before sell or rent using MFRS 15 on the revenue recognition." (Respondent 1)

However, the fact that the contractual relationship has shown the similarity between Islamic banking and conventional banking even though there is a development in a product characteristic to adapt to the object and utilization. One of the respondents remarked as follows:

"In the contractual itself, it is quite blurred to me with the recent development. Some of the arguments coming, they would like to have the Murabahah Hakiki again, but now the Islamic bank come out with a new contract which is similar to "Murabahah Hakiki" but the product itself is specific and designed to tell the customer that it is real and own by the bank. The bank buys a piece of land and sells it to customers…" (Respondent 3)

In summary, all respondents have attempted to shed light on the various concepts of object and utilization of Islamic banking activities. Islamic banking is supposed to differ from conventional banking to remain competitive in the market; however, contractual relationship needs to be aligned with policy documents and reporting requirements in the financial instruments.

Theme 2: Interrelation among financial instruments and products of Islamic bank activities that comply with financial reporting requirements and financial representation
In general, most respondents agree that Islamic banks should not have complied with conventional bank reporting. The adoption of the MFRS and IFRS was significant to the capital market and is applicable for companies to prepare financial statements. However, there are characteristics of IFRS that are not transparent under *Shariah* reporting. Besides, the Islamic banks should look towards the real economic benefits by actively addressing the social issue besides profit orientation. One of the respondents pointed out that:

"Regulators need to have additional guideline issue even though not a full solution, at least provide the customer to understand the uniqueness of Islamic banking and Shariah contract requirement." (Respondent 1)

Moreover, one of the respondents suggested that to comply with conventional banks' standards, as long as it reflects the economic reality of the transactions. The contracts need to be clear and legal in terms of *Shariah* requirements. One of the respondents remarked as follows:

"Not reject but its more beneficial, look into more flexibility in adoption of financial standard where need additional guideline and additional rules and regulation which more accurate on the activity in Islamic banking because of uniqueness compared to conventional banking." (Respondent 3)

The most important is the substance, the content that can show the difference between Islamic and conventional banks which apply the *Shariah* principle in the financial statement. The items under the financial statement are different as compared to conventional banks such as financing, finance income and so on. Islamic banks in Bahrain, for instance, that adopted the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) have more items to show the uniqueness of Islamic banking transactions in the financial statement and the presentation items in the financial statement should reflect the contract. Therefore, the *Shariah* contract use needs to be reflected and useful information to the users. Auditors and users can compare Islamic banks and conventional banks that comply with a financial standard because of their legal requirements. One of the respondents pointed out that:

"…Good to have a presentation on what Bahrain and AAOIFI have done in the financial statement…. The presentation is the key part of the financial statement that should be reflected in that financial statement. Of course, the note just be the detail to be referred to later. So, I would say that it shouldn't be an issue that will reflect the liability, asset and equity, only the auditors will not want to be reflected there, as my experience dealing with external auditors when coming on the presentation, where they want to follow exactly like a commercial bank..." (Respondent 1)

In summary, the financial products and instruments of Islamic banks can comply with conventional banks' regulations and requirements if there are flexibility and additional guidelines that are more suitable for Islamic banking activities that can solve the issues in Islamic banks such as *Zakat*, *Waqf* dan other Islamic banking products. Moreover, convergence can be applied besides the standardisation concept to comply with and meet the requirements for Islamic banks as well as conventional banks.

Theme 3: Issue and concern in the implementation of *Shariah* compliance in Islamic finance activities

In general, most of the respondents agree with the specific provision on *Shariah* compliance in IFSA 2013 because there is an act on Islamic banks and *Takaful* on the dual legislation in Islamic finance. According to one of the respondents, there is a difference in implementing *Shariah* compliance in a financial system based on the *Shariah* law and constitutions of the country. However, Islamic banking needs to be clear and independent based on *Shariah* principles to implement in the accounting standard. One of the respondents remarked that:

"Acheh has managed with qanun number 11-2013. Before the end of 2022, have optic of nearly 90 per cent of Islamic financial institutions from Acheh. It triggered the movement in other places as well, but again, they are very weak in terms of undang-undang (law) unlike Acheh the autonomy to regulate based on Shariah. So, if you would like to look at how Malaysian would be, look at Acheh, and to me is amazing. Bring peace and a clear understanding of the people of how Islamic banking looks like. Because everything is Islamic." (Respondent 2)

Moreover, the *Shariah* committees need to have evidence when conducting the task in Islamic finance activities based on policy documents by Bank Negara Malaysia which can be referred to as a guideline and ensure it is placed properly. Besides, one of the respondents recommended suggesting a unique and different reference from the existing references. *Shariah* committees need to ensure the control functions will be based on the *Shariah* committee report to look into the object and utilization to do the task. One of the respondents pointed out that:

"When comes to Shariah audit and Shariah review, the references can either from Shariah committee ruling, Shariah Advisory Council (SAC) ruling and all policy documents of Bank Negara Malaysia, all the policy documents and parameters issued by Bank Negara Malaysia, I think whatever will be there will be used by control financial to perform their specific rule in audit or review." (Respondent 1)

Furthermore, there is an issue of the limitation on accounting. One of the respondents suggested to development *of Shariah* accounting ruling independently and having more collaboration or discussion with another Islamic countries to effectively reflect the accounting standard on *Shariah* and be more appropriate for Islamic banking. One of the respondents pointed out that:

"When it's come to accounting, it does not full blood. For example, in Malaysia, we try to use the IFRS framework for both, so I don't have negative regards to the use of IFRS, but of course, we need to understand when we take one accounting framework to support side of institutions; conventional and Islamic banking, there were some limitations, how accurate for example like IFRS can represent the uniqueness of Islamic banking operation." (Respondent 3)

In summary, the *maqasid al-Shariah* framework in Islamic banks needs to be compliant with the *Shariah* control function based on the Bank Negara Malaysia policy documents. The adoption of reporting in financial instruments for Islamic banks needs further discussion to develop the *Shariah* accounting ruling that can reflect the accuracy and manage the issue in Islamic banking. There are a lot of issues pertaining development of Islamic products, especially on the nature of the products themselves. Not only that but there are also no specific policy documents for *Waqf* and *Zakat* for Islamic banks. Hence, despite the current issues on reporting the Islamic financial instruments by Islamic banks, further complications may arise when the Islamic banks report the Islamic social finance instruments (e.g. *Zakat* and *Waqf*) adopted by Islamic banks.

5. CONCLUSION

The validating of substance and forms on the reporting in *maqasid al-Shariah* framework for the financial instruments can be applied by Islamic banks to ensure compliance. There is a need for accounting standards that focus on Islamic financial instruments to ensure faithful representation of the financial statements. For instance, under the *ijarah* financing contract, the bank has to buy and own the asset (i.e. lessor), and then customers (i.e. lessee) will pay the rental to the bank. Finally, the bank will transfer the ownership to the user during the settlement period. However, in the financial statement, *ijarah* financing does not reflect the leasing contract term and is no different from the conventional banks providing vehicle loans. Similar to *murabahah* financing, there is no reporting of underlying assets bought by Islamic banks as inventory before the assets are sold to the customers. The substance and legal form should be aligned to reflect the financial statement based on policy documents that have been developed and to show the uniqueness of Islamic financial instruments in financial reporting. The debate is still ongoing due to the reporting of Islamic financial transactions in Malaysia is currently are based on MFRS. Hence, it is hoped that more research can address the issues.

6. LIMITATIONS AND FUTURE RESEARCH

The paper's limitations stem from several factors: first, a lack of empirical evidence or case studies to substantiate the effectiveness of the proposed framework; second, a narrow focus on Malaysian financial reporting standards (MFRS), which limits the generalizability of findings to other jurisdictions; and third, an emphasis on accounting standards, which may overlook broader regulatory or operational challenges faced by Islamic banks in complying with Shariah requirements. Future research should address these limitations by conducting empirical studies to validate the framework's effectiveness, exploring the impact of regulatory frameworks beyond accounting standards, investigating practical challenges and implementation issues faced by Islamic banks, comparing reporting practices across jurisdictions and investigating the role of auditing and assurance practices in ensuring *Shariah* compliance.

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