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Financial Reporting and Disclosure Requirements for State Islamic Religious Councils (SIRCs)

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Abstract

The aim of this study is to gain insight the financial reporting and disclosure requirements for State Islamic Religious Councils (SIRCs) to discharge their religious, economic and social responsibilities towards the various stakeholders. From the point of respondents, this study suggests that the SIRCs should provide additional disclosures in the notes to account which are the Statement of Shariah Compliant and the Statement of SIRCs Responsibility towards Baitulmal, Zakat and Waqf. In addition, the SIRCs should embed three qualitative principles in the process of preparing and presenting financial and non-financial accounting information in order to enhance the quality of financial statements. The principles are full disclosure, social accountability and usefulness in decision making. Hopefully, this study may help regulatory bodies such as Accountant General's Department of Malaysia and National Audit Department in formulating new requirements of Islamic accounting and reporting standards for SIRCs.

Keywords: Islamic financial reporting, disclosure requirement, State Islamic Religious Council

1. INTRODUCTION

The main objective of Islamic financial reporting and disclosures in the financial statements is to provide accounting information for certain periodic reports about an entity financial position and performance and also to assist users in making decisions both with regards the financial aspects as well as the Shariah compliance considerations. In general, this information is presented on the face of financial statements and in the notes to the accounts. The requirement to disclose all information pertaining to the assets, liabilities, equities, revenue and expenses is as stated in Al-Quran (QS Al-Baqarah 2:282). This requirement has been discussed through the concepts of full disclosure and transparency.

In Malaysia, roles and responsibilities of State Islamic Religious Councils (SIRCs) among others are to manage and govern Muslim funds such as bailtumal, zakat and waqf funds. All these funds need to organise properly to increase the welfare of Muslim community. In order to discharge these responsibilities, the SIRCs have to report and disclose all financial and non-financial information in their annual financial reports and they need a proper guideline to prepare the report.

In order to enhance the quality of financial information that will be presented by the SIRCs, the regulatory body such as Accountant General's Department of Malaysia is highly recommended to provide a guideline on how the financial reporting and disclosures should be prepared and presented. This study tries to get some views from Shariah scholars on how this information should be presented. Thus, the objective of this study is to gain insight

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the financial reporting and disclosure requirements for SIRCs to discharge their religious, economic and social responsibilities towards the various stakeholders.

Hopefully, this study may help regulatory bodies such as Accountant General's Department of Malaysia, National Audit Department and state governments in producing new requirements of Islamic accounting and reporting standards for SIRCs. Moreover, this aim may provide a guideline to the SIRCs in the process of preparing annual financial reports for their entities.

The structure of this study is as follows. Section 2 highlights literature review related to objective of this paper. Section 3 explains the methodological aspect of this study and section 4 discusses the findings. The last part of this study states the conclusion and limitations of this study.

2. LITERATURE REVIEW

From Islamic perspective, there are three fundamental principles in discussing the financial and accounting reporting and disclosures, which are: full disclosure; social accountability; and transparency; (AAOIFI, 2019; Baydoun & Willet, 2000; Dahlifah, Triyuwono, Mulekal and Roekhudin (2018); Khoramin, 2012; Lewis, 2001; Haniffa & Hudaib, 2007). The objective of Islamic accounting information is to assist Muslim users in making economic and religious decisions (Haniffa & Hudaib, 2007; Muwazir, Muhamad & Noordin, 2006).

The first principal is full disclosure and according to Lewis (2001), the full disclosure requires an entity to disclose all relevant information correctly and fairly. This principal is been stated in the Qur'anic verses which Allah says:

> *"O ye who believe! stand out firmly for justice, as witnesses to Allah, even as against yourselves, or your parents, or your kin, and whether it be (against) rich or poor: for Allah can best protect both. Follow not the lusts (of your hearts) lest ye swerve and if ye distort (justice) or decline to do justice, verily Allah is well-acquainted with all that ye do".*
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> [QS An-Nisa' 4:135]

The purpose of full disclosure is to safeguard the public interest because the public or "ummah" has the right to know about the operations of an entity to meet the requirements of Shariah. The disclosure of true and relevant information is important to predict the future obligations and risks of investing in transactions involving the business partners in which the entity is involved.

The second principal is social accountability which explains on the accountability and responsibility of the financial statements preparers to account and present all financial and non-financial information fairly for the sake of ummah. Thus, from the Islamic perspective, the objectives of reporting and disclosing all information in the financial reports are to show the Shariah compliance has been taken care of and to demonstrate the responsibility, accountability and transparency of doing business towards Allah, the environment and society at large (Haniffa & Hudaib, 2007, Abu Bakar & Mohd Yusof, 2016).

The last principal is transparency which requires the entities or prepares to ensure that all accounting information in the financial statements are presented in faithful representation and understandability. The transparency is deemed to exist when there is adequate and appropriate disclosure. The adequate disclosure means that the financial statements should contain all material information necessary to make them useful to the users or decision makers. This information should be disclosed either on the face of financial statements, in the notes to the accounts or in the additional disclosures.

Muslim stakeholders expect SIRCs to conduct their duty in managing Muslim fund in the most prudence and efficient. To fulfil this aspiration, SIRCs should report and disclose all related information regarding the management of baitulmal, zakat and waqf fund. For instance, SIRCs should disclose how much the collection and distribution of zakat to increase the public confident towards the institution. In addition, Muslim decision-makers urge SIRCs to disclose additional information particularly regarding the waqf arrangement engagements to assist them make a prudent decision which is considered to be an economic and Islamic jurisprudence point of view. Hence, the SIRCs should disclose all information (financial and non-financial) whether the information is favorable or unfavorable (Quran 2:42) to the organization's image as long as it shows the compliance with *Shariah* law.

3. RESEARCH METHOD

This study is purely based on the interview data from three Shariah scholars who have vast experience and knowledge on Islamic business and fiqh mualamat. In addition, eleven SIRC's accountants in five states in Malaysia have been interviewed to gain insights the current practices of SIRCs in reporting and disclosing accounting information. The respondents are who directly involved in preparing the financial statements of SIRCs. This research utilized open-ended interview method for data collection method (Gubrium & Holstein, 2002). This method allows the researchers to gather, analyze and compare the data systematically within a short period of time (Gubrium & Holstein, 2002). The research data was collected in 2019. Three months were taken to complete the interview sessions and each session took 1 and half hours to two hours. In addition, the interview sessions were carried out on the agreed place, time and day.

Each audio-recorded conversation with the scholars was transcribed and transformed into a text. Due to small numbers of interviewees, the texts were analyzed manually and completed within one month. Then, the texts were analyzed according to the steps that have recommended by Miles and Huberman (1994) and Creswell (2007. The steps are: (1) developing as many as sub-themes; (2) classifying the sub-themes into main themes; (3) reallocating and relating the sub-themes to several other themes that have been emerged from data; (4) identifying patterns and explanations; and (5) establishing a story line formulated from sub-themes and main themes. After all, the findings were compared and verified with the respondents to ensure the accuracy of the data and validate the researchers' perceptions of the data.To gain significant themes and statements from the transcribed texts, the researchers had analyzed them carefully several times. The interviewees were also contacted several times in order to reduce personal bias and to validate the data.

4. RESEARCH FINDINGS AND DISCUSSIONS

Based on the interviews with Shariah scholars, this study suggests that the SIRCs may have to consider two additional disclosures in the notes to the accounts in the financial to enhance the transparency and quality of financial statements that have been prepared. The disclosures are the Statement of Shariah Compliant and the Statement of SIRCs Responsibility towards Baitulmal, Zakat and Waqf. Moreover, in preparing the financial statements the SIRCs should embed three qualitative principles of Islamic accounting and reporting information, namely full disclosure, social accountability and usefulness in decision making.

4.1 Statement of Shariah Compliant

The management of the SIRCs have to work closely with Shariah Advisory Council (if any) to ensure that their conducts and business transactions are in accordance with the Shariah rules and principles. Among the responsibilities of the management of SIRCs are as follows:

i. Refer all Shariah issues in the operation of the SIRCs to the Shariah Council / Advisor for decision;
ii. Practicing and taking necessary steps for the implementation of the decision of the Shariah Council / Advisor; and
iii. Ensure that the Shariah Council / Advisor is clear about the operation of the SIRCs.

In this context, the SIRCs should make a brief statement on this Shariah compliant. As suggested by Dahlifah et al. (2018), disclosure of Shariah compliance reports on Islamic accounting by Islamic banks in Indonesia should be made to indicate the level of transparency that emphasizes on full disclosure. Transparency meant here is one form of *da'wah* that has divine significance for an Islamic entity to the Muslim community (Dahlifah et al., 2018). In addition, the Statement of Shariah Compliant is a way to discharge the SIRCs responsibility in managing Islamic funds such as baitulmal, waqf and zakat in maintaining good human relations with Allah *(hablun min Allah)* and good relations with mankind *(hablun min an-nas).* Therefore, this study proposes an example of a statement of responsibility that has been disclosed by an Islamic financial institution.

> *"We, the members of the Shariah Advisory Council, hereby confirm that at our best, the operation of the State Islamic Religious Council XYZ for the year ending December 31, 2019 has been carried out in accordance with Shariah rules and principles".*

The priority of this statement is *Daruriyyah* (necessary) because it provides some assurances to stakeholders that all financial transactions and business operations are Shariah based on Shariah rules and regulations to preserve the religion.

4.2 Statement of IRC Responsibility towards Baitulmal, Zakat and Waqf

The second disclosure that this study proposes is a brief statement of the SIRCs towards baitulmal, waqf and zakat. The disclosure of SIRC's responsibility for the management of baitulmal, waqf and zakat is in accordance with the provisions set out in the respective State Islamic Religious Administration Enactments. In zakat management for example, the SIRCs should state responsibility for the zakat management and their obligations in distributing the zakat. Examples of Zakat Obligations Statements are as follows:

> *"The council is exempted from zakat because based on the Islamic law, the entity is responsible to administer zakat in State X. But the subsidiaries of the entity are obligated to pay zakat once their business has complied with the legal requirements to pay zakat".*

In addition, the SIRCs are encouraged to provide a brief statement on the amount of zakat collection and distribution for the current year, the rates of zakat and information on the zakat collection center. The information is important for stakeholders of the SIRCs to evaluate the efficiency and effectiveness of the zakat management.

4.3 Qualitative Principles of Islamic Accounting and Reporting Information

In preparing and reporting the accounting information, the SIRCs should embed three qualitative principles to enhance the quality of financial statements. The principles are full disclosure, social accountability and usefulness in decision making.

4.3.1 Full disclosure

For the full disclosure, the SIRCs should disclose all important and useful information to stakeholders as part religious requirement to maintain the *habun min Allah* (Baydoun & Willett, 2000). For example, in the context of SIRCs, the full disclosure of financial information based on specific funds such as waqf, baitulmal and zakat is necessary to safeguard the public's interest as the public has the right to evaluate whether the operation of SIRCs is aligned with the Shariah laws and will enhance the well-being of Muslim society.

This concept also has been suggested by the "The Accounting and Auditing Organization for Islamic Financial Institutions" (AAOIFI) at the "Statement of Financial Accounting" 1 on Conceptual Framework for Financial Reporting by Islamic Financial Institutions "(SFA 1) (AAOIFI, 2019) on the requirement for adequate and appropriate disclosure. The adequate disclosure means that the financial statements must contain all of the essential information that necessary to the users. In general, this can be achieved if the information is included in the financial statements, the notes to the account and other additional disclosures (Abdul Rahim, 2010; Muhamad Sori, 2017).

4.3.2 Social Accountability

In general, the concept of accountability is to obey the commands of Allah S.W.T. All Muslims believe that all the resources in this world belong to Allah SWT and humans are the only trustees. This is supported in the Qur'anic verses which Allah says:

> *"O you who believe, do not betray the trust of Allah and the Messenger, and do not betray your mutual trusts, while you know".*
>
> [QS An-Anfal 8:27]

In the context of SIRCs, the management team should be morally responsible for their actions both internally and externally by providing proper financial accounting and reporting. This is contradict from concept of conventional accounting accountability that emphasizes personal accountability (for example, focusing on the relationship between management and capital providers) in order to meet legal requirements under the philosophy of the capitalist system (Abdul Rahim, 2010; Baydoun & Willet, 2000; Khoramin, 2012; Lewis, 2001).

4.3.3 Usefulness in Decision Making

The main purpose of financial reporting is to provide relevant and reliable information to the users to make decisions. The main users of financial information for the SIRCs are the state and federal government, regulatory bodies such as Accountant General's Department of Malaysia, zakat payers and recipients, and baitulmal donors.

In order to increase the usefulness of financial information disclosed by SIRCs in making decisions, this study suggests that such information should have certain features such as relevance, reliable, timeliness, comparability and prudence (AAOIFI, 2019).

5. CONCLUSION

Islamic financial reporting and disclosures issues are being discussed among the preparers of financial statements in the SIRCs for many years. It because they need a proper guideline to produce a quality annual financial statements that comply with the Shariah rules and regulation. Hence, the objective of this study is to gain insight the financial reporting and disclosure requirements for State Islamic Religious (SIRCs) to discharge their religious, economic and social responsibilities towards the various stakeholders. The findings of this study suggest that the SIRCs should provide additional disclosures in the notes to account which is the Statement of Shariah Compliant and the Statement of SIRCs Responsibility towards Baitulmal, Zakat and Waqf. In addition, the SIRCs should embed three qualitative principles in the process of presenting financial and non-financial accounting information in order to enhance the quality of financial statements which are full disclosure, social accountability and usefulness in decision making. Hopefully, in the next research project, the number of respondents from other states may need to be considered to enhance the findings.. This study may offer an insight to help regulatory bodies such as Accountant General's Department of Malaysia and National Audit Department in formulating a new requirement of Islamic accounting and reporting standards for SIRCs.

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