

The Practice of Reporting Shariah Non-Compliant Income in the Annual Financial Report of Islamic Commercial Banks in Malaysia

Pelaporan Pendapatan Tidak Patuh Syariah dalam Laporan Kewangan Tahunan Bank Perdagangan Islam di Malaysia

NABILAH MAT NOR
MOHD FUAD MD SAWARI

ABSTRAK

Bank Negara Malaysia (BNM) telah memperkenalkan Polisi bagi Pelaporan Kewangan untuk Institusi Perbankan Islam yang berkuatkuasa pada 1 Januari 2018. Polisi ini bertujuan untuk memudahkan penilaian terhadap kedudukan kewangan, prestasi dan pematuhan Syariah bagi institusi kewangan Islam. Walau bagaimanapun, pelaporan daripada jawatankuasa Penasihat Syariah beberapa bank Islam mungkin tidak memenuhi piawaian yang ditetapkan oleh BNM dari segi melaporkan pendapatan tidak patuh Syariah dalam laporan kewangan tahunan mereka. Oleh itu kajian ini bertujuan untuk mengkaji sejauh mana bank-bank Islam mematuhi Polisi yang ditetapkan oleh BNM, khusus kepada pelaporan Bank Perdagangan Islam di Malaysia terhadap pendapatan tidak patuh Syariah dalam laporan kewangan tahunan mereka. Kaedah kualitatif digunakan sebagai metodologi penyelidikan utama kajian ini untuk mendapatkan maklumat daripada laporan kewangan tahunan bank, serta kajian yang berkaitan. Hasil kajian menunjukkan bahawa sembilan daripada enam belas bank Perdagangan Islam di Malaysia telah memenuhi piawaian yang disediakan oleh Bank Negara dalam melaporkan pendapatan tidak patuh Syariah dengan terperinci dan lengkap dalam laporan kewangan tahunan mereka. Walau bagaimanapun, bank Perdagangan Islam yang selebihnya tidak melaporkan pendapatan tidak patuh Syariah mereka dalam laporan tahunan. Penyelidikan ini akan menyumbang kepada para pengamal Bank Perdagangan Islam dari segi menyediakan maklumat yang telus mengenai urusan perniagaan dan kewangan.

Kata kunci: Ketidapatuhan Syariah; SNC; laporan kewangan tahunan; Bank Negara Malaysia

ABSTRACT

Bank Negara Malaysia (BNM) had introduced a policy document of Financial Reporting for Islamic Banking Institutions, which came into effect on 1st January 2018. This policy aimed to facilitate the assessment of Islamic financial institutions' financial positions, performance, and Shariah compliance. However, the disclosure of Shariah committee report of a few Islamic banks may not have fulfilled the standard specified by BNM in terms of reporting the Shariah non-compliance incomes in their annual financial reports. This study therefore aims to investigate the extent of the application of BNM policy document for Islamic banks, with special focus on the practice of Islamic commercial banks in reporting Shariah non-compliant incomes in their annual financial reports. The qualitative method is adopted as the main research methodology of this study in order to gain information from the banks' annual financial reports, as well as related research in the field. The findings show that nine out of sixteen Islamic commercial banks in Malaysia have fulfilled the standard provided by Bank Negara in reporting Shariah non-compliant incomes with complete detail in their annual financial reports. However, the remainder of the Islamic commercial banks did not properly disclose their Shariah non-compliant incomes in their report. This research would contribute to the practitioners of Islamic Commercial Banks in terms of providing transparent information with regards to business and financial dealings.

Keywords: Shariah non-compliant; SNC; annual financial report; Bank Negara Malaysia

INTRODUCTION

The key difference between an Islamic bank and its conventional counterpart is that the former's operation and management are compliant with

the principles of Islamic law (Shariah). Since the Islamic banking industry started in the mid-1970s, several legal frameworks related to Shariah governance in Islamic finance were formed in order to supervise the operation of Islamic financial

institutions – namely the Islamic Banking Act 1983, the Takaful Act 1984, Payment Systems Act 2003 and Exchange Control Act 1953. In 2013, all these legislations were repealed in favour of the Islamic Financial Services Act 2013, which is the first legal framework of Shariah governance in Islamic finance that was statutorily provided in Malaysia (Surianom Miskam, Muhammad Amrullah Nasrullah 2013).

The Islamic Financial Services Act 2013 (IFSA), which came into effect on 30th June 2013, was enacted to reinforce the Bank Negara Malaysia's mandate to safeguard financial stability as well as to statutorily monitor and enforce Shariah compliance (Yusuf 2013). The act was intended to provide a comprehensive legal framework for the regulation and supervision of Islamic Financial Institutions (IFI) (Surianom Miskam, Muhammad Amrullah Nasrullah 2013) that is in full compliance with the Shariah. Section 28 (1) of IFSA 2013 specifies that one of the obligations of IFI is to ensure all the operations of the institution are Shariah compliant. This section states that:

An institution shall at all times ensure that its aims and operations, business, affairs, and activities are in compliance with Shariah

(IFSA 2013)

Therefore, the IFI should comply in all its operations, businesses, affairs and activities with Shariah law by satisfying the rulings of the Shariah Advisory Council (SAC) of BNM and its Shariah standards, ensuring internal policies and procedures are in line with Shariah requirements, and by developing a Shariah audit function (Mohamad Akram Laldin, Hafas Furqani 2018).

Nevertheless, it cannot be denied that the IFI are always exposed to Shariah non-compliant events that have caused the failure to meet obligations or satisfy the Shariah standards as prescribed in the relevant jurisdiction's standards (Romzie Rosman, Anna Che Azmi, Siti Noraini Amin, 2017). Therefore, the Islamic banks must ensure that the management of these unavoidable risks are well organized, because the failure to comply with Shariah regulations may have an impact to the bank's sustainability and reputation. Section 28 (3) of IFSA 2013 regulates that when an institution becomes aware it is carrying on any of its business, affair or activity in a manner that is not in compliance with Shariah or the advice of its Shariah committee or the advice or ruling of the SAC, the institution shall:

1. Immediately notify the Bank and its Shariah committee of the fact;
2. Immediately cease from carrying on such business, affair or activity and from taking on any other similar business, affair or activity; and
3. Within 30 days of becoming aware of such non-compliance or such further period as may be specified by the bank, submit to the bank a plan on the rectification of the non-compliance (IFSA 2013).

In 2018, Bank Negara Malaysia has issued the Policy Document of Financial Reporting for Islamic Banking Institutions which specified the minimum disclosure requirements for Shariah non-compliant events. The policy requires the Islamic banks to disclose the Shariah Committee's Report in the Annual Report of the banks' state of compliance with Shariah principles, as well as actions taken to remedy such non-compliance (BNM 2018).

It must be noted that proper disclosure of Shariah compliance of an Islamic bank is significant to the users of financial information, including the investment account holders, shareholders, regulators and public at large. Furthermore, the reporting of any Shariah non-compliant activity enhances transparency of business and financial dealings of Islamic banks (Romzie Rosman, Anna Che Azmi, Siti Noraini Amin 2017).

However, the practice of reporting Shariah non-compliant (SNC) incomes for a few Islamic banks did not satisfy the standard as prescribed in the Bank Negara Policy Document. It was discovered that there was an absence of consistent and elaborate regulatory disclosure on SNC income. This is because relevant data either remains unreported or is reported in a manner that does not provide sufficient information on SNC income in the annual reports of certain banks.

Therefore, the main objective of this study is to investigate the extent of the application of BNM Policy Document for Islamic banks in reporting the SNC income in the annual financial report. The annual reports of 16 Islamic Commercial Banks for the year 2018 will be examined in this study. The researchers will review the Policy Document of Financial Reporting for Islamic Banking Institutions which was came into effect on 1st January 2018 in order to explore the requirements that need to be satisfied for the disclosure of Shariah Committee's Reports of the banks, with special focus on the SNC income reporting standards.

The outline of this paper is organized as follows. First, we present a brief introduction to Shariah non-compliant income which include discussions from jurists pertaining the matter. This is followed by the review of Policy Document from BNM. Next, the results are presented, followed by the concluding section.

SHARIAH NON-COMPLIANT (SNC) INCOME

Shariah Non-compliant income is income generated or received from events that are non-compliant to Shariah rules and principles; for example, income derived from Shariah non-compliant business and profit charges from transactions with invalid Shariah contracts (Standard Chartered, 2018). Invalid Shariah contracts are indicated by the jurists as *bāṭil* or *fāsid*. The majority of jurists did not differentiate between these two terms (al-Mahalli 2001). Literally, *bāṭil* means null and void. Technically, *bāṭil* or *fāsid* is a contract that fails to satisfy the essential requirements and conditions of the contract (al-Shawkani 2004). From a Shariah point of view, an invalid contract does not produce any legal effect (Wizarat al-Awqaf wa al-Shu'un al-Islamiyyah, 1404-1427). Hence, the contract should be re-executed if the parties wish to proceed it (Oz et al. 2016).

On the other hand, the Ḥanafī jurists distinguish the term *bāṭil* and *fāsid* in terms of the ruling and legal implications. The Ḥanafī's stand is premised upon the fact that a defect in a contract due either to fundamental element (*aṣl*) or an accessory attribute (*wasf*). A defect in a fundamental element of a particular contract renders the contract void and it cannot be rectified. However, a defect in an external factor will only make the contract irregular (*fāsid*), it does not render the contract void (al-Bukhari 1308).

Before deep deliberation on *bāṭil* contract and *fāsid* contract, it must be perceived that certain bank differentiates between impure incomes and SNC incomes. Impure income consists of interest income recognized as such in the company's accounts, income realized from Shariah non-compliant financial investments and income accrued on account of Shariah non-compliant business sources (products and subsidiaries) (AAOIFI 2015). While the SNC income is that derived from the SNC events only, which is the focus of this research.

BĀṬIL CONTRACT

Bāṭil contract is an invalid contract due to the presence of defects in any of its fundamental elements (al-Kasani 1986). There is no legal implication from any contract which are considered *bāṭil*. No transfer of ownership takes place, the purchaser does not legally own the asset and the seller cannot recognize any profit. Any income received from this kind of contract is illegitimate and it should be return to the original owner. This Ḥanafī school concept shares the same concept as presented by the majority jurists', which categorized as *ghayr ṣaḥīḥ* (invalid) (al-Baz 1998).

The following are some examples of *bāṭil* contracts; the subject matter involves impure or prohibited items, the subject matter has no value from the Shariah perspective, the asset is not fully owned by the seller, the acceptance is not in conformity with the offer, the seller or the purchaser (contracting parties) have not reached the age of maturity, the contract contains fraud, deceit, etc. (Dusuki et al. 2013).

FĀSID CONTRACT

A *fāsid* contract is a special class of contract recognized by Ḥanafī school, which is considered as intermediary class between *ṣaḥīḥ* and *bāṭil*. The Ḥanafī school defines a *fāsid* contract as a contract in which the essential element is valid, but it is tainted by a defect in its accessory attribute (Mahmud 2000). Compared to *bāṭil* contracts, a *fāsid* contract is not necessarily void; it is voidable and rectifiable. Once the defect is rectified, the contract becomes valid and effective. Ḥanafī jurists have highlighted a few factors leading to a *fāsid* contract. They are:

1. Insufficient information that may exist in four elements, which are the following:
 - a. The asset; for example, where the seller says, "I hereby sell you some of my cloth," and the parties disperse without determining which cloth is being sold by the seller.
 - b. The price; for example, the seller says to the buyer, "I sell this asset to you for RM100 spot payment or RM200 deferred payment," and both of them disperse without having the buyer state their choice of payment method (al-Imrani 2010).

- c. The time of delivery.
 - d. The guarantee or pledge; for example, a seller stipulates a guarantee or pledge without specifying what it is (al-Zuhayli 2011).
2. The existence of an invalid condition; for example, a condition that restricts the buyer from taking delivery of the asset purchased (al-Zuhayli 2011).
 3. The existence of coercion (*ikrāh*) element in a contract. According to Ḥanafī jurists, the absence of consent, such as the element of *ikrāh* exist, render the contract *fāsid*. Hence, it is voidable but rectifiable. This is because consent is not an essential element of a contract (Wizarat al-Awqaf wa al-Shu'un al-Islamiyyah, 1404-1427).
 4. The existence of *ribā* element. The majority of jurists agree that the existence of *ribā* element in a contract would make the contract invalid. However, Ḥanafī jurists hold that *ribā* does not make a contract void, rather it makes it irregular (*fāsid*) and, hence, rectifiable (Wizarat al-Awqaf wa al-Shu'un al-Islamiyyah, 1404-1427).

Since a *fāsid* contract is not considered void, according to Ḥanafī school, thus it can be rectified, and the contract does not need to be re-executed. There are two method of rectification (*taṣḥīh*) highlighted by jurists; the first one is to remove the defective condition that render the contract void in order to make it valid and effective. This corresponds with the Ḥanafī legal maxims, that is: "When the impediment disappears while the reason for the ruling is present, the (original) ruling returns." (Wizarat al-Awqaf wa al-Shu'un al-Islamiyyah, 1404-1427). For example, in a case whereby the existence of *ribā* which invalidates a particular contract, according to Ḥanafī school, this contract can be rectified by eliminating the *ribā* clause or by returning the *ribā* element to the original owner (Oz et al. 2016).

The second method of rectification is to convert a *fāsid* contract into another contract which will validate the contract, by looking into the substance in the contract. This method is substantiated by the legal maxims which reads: "In a contract the consideration is given to substance and meaning, not to the forms and structures." As an example, a custodian in a *wadī'ah* contract has stipulated the right in utilising the deposit of *wadī'ah*. In this case,

the contract become *fāsid* because a custodian of a *wadī'ah* contract is not allowed to use the deposit and is not liable to indemnify any loss or damage except in the case of negligence or misconduct. However, this contract can be rectified by shifting it into a *qard* or loan. As a result, the custodian is liable to guarantee the principal of deposit (Oz et al. 2016).

According to the explanation above, it can be concluded that any SNC event that takes place in an Islamic Financial Institution may be rectified and not all SNC events are considered void, and the income is illegitimate. Once the SNC event is rectified, the contract become valid, and hence, the income is legitimate.

Adding onto that, the Ḥanafī approach on invalid contracts in financial transactions is also supported by Shāfi'ī and Mālikī schools. Al-Qarafi of Mālikī school highlighted that the Ḥanafī approach is sound (al-Qarafi 2010). Some Shāfi'ī jurists also differentiate between *bāṭil* and *fāsid* for certain contracts, such as for *wakālah* contracts and *ijārah* contracts. Some of them even follow the Ḥanafī approach completely in all contracts (al-Ramli 1994). The contemporary scholars also adopted the Ḥanafī approach in this manner. The Ḥanafī view is preferable in application for financial institutions, due to a number of reasons:

1. Not every defect in an invalid contract is serious enough to require re-execution. There are some defects that are considered minor and can be rectified to make the contract effective.
2. The process of re-execution of an invalid contract is a complex matter. This is because many contracts today are cross-border and include thousands of clients.
3. The Ḥanafī categorization of an invalid contract provides more choices for the market players to apply the Islamic law of contract in modern financial operations (Oz et al. 2016; Dusuki et al. 2013).

Indeed, invalid contracts or Shariah non-compliance may exist in any transaction in Islamic Financial Institutions, even though the institutions are expected to comply with Shariah principles in all their operations and activities. This is because invalid contracts are sometimes unavoidable. Examples of Shariah Non-compliant Incidents in Islamic Banks in Malaysia are presented in the table below:

TABLE 1. Examples of Shariah non-compliant incidents in Islamic Banks in Malaysia

Shariah Contract Involved	Description of Event
Bay' Bithaman Ajil (BBA)	Commitment fees have been charged to customers for the unutilized cash line-i facility. The contract does not observe the correct sequence – i.e. the time for sale aqad is prior to purchase aqad. The imposition of ta'wīd does not reflect actual cost.
Tawarruq	The asset is sold to the customer before the bank purchases the asset from the broker/platform. The facility is disbursed before the contract is executed. There is no wakālah arrangement involved in the commodity murābahah transaction. The price is disclosed incorrectly to the customer. The legal document involves a provision that restricts the customer, as the purchaser, from taking delivery of the commodity. The financing facility is used for Shariah non-compliant purposes. There is no evidence of commodity trading.
Bay' al- 'Īnah	The two contracts involve an inter-conditionality element to repurchase the asset. The underlying sale contract has not been executed. (The facility has been disbursed without any sale contract being executed). The sequence of contracts for the cashline facility were not properly observed. Financing is used for Shariah non-compliant purposes. Both the APA (Asset Purchase Agreement) and the ASA (Asset Sale Agreement) were executed without subject matter.
Istiṣnā'	In some legal documentation, it is found that the bank as the seller has required the customer to accept the constructed project/property under an istiṣnā' contract on an "as is, where is" basis.
AITAB (Al-Ijārah Thumma al-Bay')	There is an error in the imposition of compensation (ta'wīd) due to late payment which does not reflect the actual cost. Some Islamic banks still use conventional insurance as their panel

Source: Adopted from Oz et al. 2016

As a result, all the Shariah non-compliant incidents have led to Shariah non-compliant income being generated. In all cases of SNC events, the Shariah Committee of the bank is required to report the events and income derived from the incidents to Bank Negara Malaysia. This requirement was stated in the Policy Document which will be presented in the next part of this paper.

POLICY DOCUMENT OF BNM

Bank Negara Malaysia (BNM) has issued a policy document of Financial Reporting for Islamic Banking Institutions which comes into effect on 1st January 2018. This policy document sets out the minimum requirements on the application of Malaysian Financial Reporting Standards (MFRS) to an Islamic Financial Institution. The objective of this policy is to ensure adequate disclosures by an IFI in the financial statements to improve comparability for users of financial statements and better facilitate the assessment of an IFI's financial position, performance and Shariah compliance (BNM 2018).

This policy document prescribes the information to be disclosed in the financial statements of IFI. Paragraph 11.4 of the policy regulates that an Islamic banking institution shall disclose the Shariah Committee's Report as part of the Annual Report, including the following information:

1. Opening or introductory paragraph;
 - a. Identification of the purpose of the Shariah Committee's engagement; and
 - b. A clear statement of management's responsibility in ensuring compliance with Shariah principles
2. Scope paragraph describing the nature of the work performed;
 - a. Confirmation that the Shariah Committee has performed appropriate tests, procedures and review work as appropriate; and
3. Paragraph expressing the Shariah Committee's opinion on the Islamic Banking Institution's compliance with Shariah in respect of;

- a. Contracts and related documentation used;
- b. Appropriateness of Shariah basis for the allocation of profit between shareholders and investment account holders; and where appropriate
- c. Disposal of any earnings from prohibited source/means to charitable causes;
- d. Zakat computation; and
- e. Any known non-compliance with Shariah and action taken to remedy such non-compliance as reported by the Islamic banking institution as specified in the Circular on Shariah Non-Compliance Reporting. (BNM, Financial Reporting for Islamic Banking Institutions 2018)

In order to present the Shariah Committee's Report, an Islamic banking institution may refer to the framework provided in the Shariah Governance Framework for Islamic Financial Institutions. In paragraph 2.9 of the framework states that "the Shariah Committee is expected to disclose sufficient information in the IFI's annual financial report on the state of the IFI, as per the requirements under the Guidelines on Financial Reporting for Licensed

Islamic Banks (GP8-i) and Guidelines on Financial Statements for Takaful Operators (GPT6)" (BNM 2010). The framework has provided a complete guideline as well as the example of minimum annual disclosure for the banks in presenting the Shariah Committee's Report.

Hence, the banks are supposed to present all the shariah non-compliant events and the income obtained from those events. Other than that, the banks must also present rectification plans to avoid the reoccurrence of the SNC events in the future.

THE PRACTICE OF REPORTING SHARIAH NON-COMPLIANT INCOME

A review has been done to the annual reports of sixteen Islamic Commercial Banks in Malaysia for year 2018 to investigate the existence of Shariah non-compliant incomes reported in the Shariah Committee's Report of the banks. The researchers found that out of sixteen Islamic commercial banks, nine provided the report of SNC income in the annual financial report for the year 2018. The details are given below in table 2:

TABLE 2. The Practice of Reporting SNC income in the Annual Report 2018

No.	Name of Banks	Existence of SNC Income Report in the Annual Report (2018)
1.	Affin Islamic Bank Berhad	Yes
2.	Al Rajhi Banking & Investment Corporation (Malaysia) Berhad	No
3.	Alliance Islamic Bank Berhad	Yes
4.	Ambank Islamic Bank Berhad	Yes
5.	Bank Islam Malaysia Berhad	Yes
6.	Bank Muamalat Malaysia Berhad	No
7.	CIMB Islamic Bank Berhad	No
8.	HSBC Amanah Malaysia Berhad	No
9.	Hong Leong Islamic Bank Berhad	Yes
10.	Kuwait Finance House (Malaysia) Berhad	No
11.	MBSB Bank Berhad	No
12.	Maybank Islamic Berhad	Yes
13.	OCBC Al-Amin Bank Berhad	Yes
14.	Public Islamic Bank Berhad	Yes
15.	RHB Islamic Bank Berhad	No
16.	Standard Chartered Saadiq Berhad	Yes

From the table presented, we can observe that nine Islamic Commercial Banks have satisfied the standard provided by BNM in reporting Shariah non-compliant income in the annual financial report. The details regarding the reports are as follows:

AFFIN ISLAMIC BANK BERHAD

The Shariah Committee of the bank reported that the contracts, transactions and dealings entered by the bank during the year ended 31 December

2018 that have been reviewed are compliant with Shariah principles. They stressed that the allocation of profit and incurrence of losses relating to investment accounts conform to the basis approved in accordance with Shariah principles. Hence, no earning and purification was recorded from sources or means prohibited by Shariah principles. The committee asserted that there were no Shariah non-compliant events discovered during the year (Affin Islamic, Annual Report, 2018).

ALLIANCE ISLAMIC BANK BERHAD

According to the Shariah Committee of the bank, two Shariah non-compliance events were confirmed which resulted in Shariah non-compliant income of RM2,797 in the year 2018. The first event recorded pertained to the rescheduling and restructuring of Cash Vantage Personal Financing-i, as it was executed without underlying assets. The second event was related to the delay in performing commodity trading for Commodity Murabahah Revolving Credit-i (Alliance Islamic 2018).

The report further explained that the SNC events were due to lack of communication and oversight by the officer in charge. Therefore, the bank guided by the Shariah Committee decisions had rectified the SNC by regularising the contract lapses and disposing the SNC income to the rightful owners. As a long-term measure to prevent the lapses, the bank has enhanced the current process flow, conducted trainings as well as enhanced the system controls to ensure compliance with Shariah requirements (Alliance Islamic 2018).

AMBANK ISLAMIC BANK BERHAD

For the financial year ended 31 March 2018, the Shariah Committee of the bank reported that there is one Shariah non-compliance incident recorded with a consequential SNC income totalling almost RM 4,000 (Ambank 2018). However, the committee did not describe the incident of non-compliance and the action to purify the income.

BANK ISLAM MALAYSIA BERHAD

The Shariah Committee of Bank Islam Malaysia Berhad revealed the Shariah non-compliance events occurred throughout the financial year 2018. Eight incidences of SNC events were recorded:

1. Two occurrences of absence of *wakalah aqad* execution for Term Deposit Tawarruq-i (TDT-i) at branches;

2. Two occurrences of payment of late payment charges due to delay in rental payment;
3. Absence of *Mudarabah aqad* execution for Investment Account at branch;
4. Overcharged profit during abandoned period of house financing;
5. Income recognition of interchange fee received from Non-Halal Merchant Category Code (MCC); and
6. Absence of Tawarruq commodity trading for Islamic Credit Card.

Therefore, the bank has collected and purified SNC income amounting RM9,852.53 and disposed the amount to charitable causes. The bank has paid and refunded to the deserving counterparties amounting to RM11,568.13 based on the rectification plan approved by the Shariah Committee (Bank Islam 2018).

HONG LEONG ISLAMIC BANK BERHAD

The Shariah Committee of the bank reported that one SNC event was identified during the financial year 2018. The event occurred due to inadvertent breaches of procedure and process factor. The report disclosed that all earnings from sources or means prohibited by Shariah rules and principles, including all profits associated with the SNC events amounted to RM26,408.25, compared to the year before (2017), which was RM25,845.89. The earnings have been considered for disposal to charitable causes. During the year, the amount of RM52,514.33 had been channelled to the list of eligible beneficiaries as endorsed by the Shariah Committee (Hong Leong Islamic 2018).

MAYBANK ISLAMIC BERHAD

For the financial year ended 31 December 2018, there was one transaction deliberated at the Shariah Committee of Maybank Islamic for Shariah non-compliance, which was non-execution of Commodity Murabahah trading prior to financing disbursement amounting to RM28,000. Apart from the purification of income from the events, the bank has implemented several rectification measures relating to processes, legal documents and other control mechanism to minimise reoccurrence of SNC incidents. It is recorded that the amount of RM28,000 had been contributed to non-profit organizations during the year (Maybank 2018).

OCBC AL-AMIN BANK BERHAD

The Shariah Committee of OCBC Al-Amin Bank reported that there was one occurrence of SNC event for financial year 2018 due to non-adherence to Guidelines on Late Payment Charges for Islamic Financial Institution, which led to wrong computation of late payment charge for post judgement debt. The financial report of the bank reported that the SNC income of the year amounting to RM3,000 had been channelled to non-profit organizations (OCBC Al-Amin 2018).

PUBLIC ISLAMIC BANK BERHAD

For the financial year 2018, the earnings of Public Islamic Bank that have been realised from sources or means prohibited by the Shariah rules and principles, or any other non-recognisable earnings such as *Gharamah*, were recorded to amount to RM21,000. The Shariah Committee Report of the bank stated that the SNC income had been

considered for disposal to charitable organizations as a rectification plan to minimise reoccurrence of SNC events (Public Islamic 2018).

STANDARD CHARTERED SAADIQ BERHAD

It was reported that there was only one SNC event being detected by the Shariah Committee of Standard Chartered Saadiq Berhad (SCSB), with no SNC income in 2018. In addition to that, there was SNC income amounting to RM4,794 (2017: RM5,850) from an event classified as a SNC event in the year 2017 and approved as SNC income by SCSB's Shariah Committee in 2018. The bank has channelled an amount of RM10,644 (2017: nil) to charity (Standard Chartered, 2018).

The table below shows the conclusion of the reports explained previously, which pertaining to the amount of SNC income reported by the Shariah Committee of the banks and the amount channelled to charity as rectification plans:

TABLE 3. Amount of SNC Income and Charity Fund Reported in the Annual Report 2018 of Nine Islamic Commercial Banks

No	Name of banks	Amount of SNC Incomes (2018)	Amount of Charity Fund (2018)
1.	Affin Islamic Bank Berhad	No SNC income	No record
2.	Alliance Islamic Bank Berhad	RM2,797.00	No record
3.	Ambank Islamic Bank Berhad	RM4,000.00	No record
4.	Bank Islam Malaysia Berhad	RM9,852.53	RM11,568.13
5.	Hong Leong Islamic Bank Berhad	RM26,408.25	RM52,514.33
6.	Maybank Islamic Berhad	RM28,000.00	RM28,000.00
7.	OCBC Al-Amin Bank Berhad	RM3,000.00	RM3,000.00
8.	Public Islamic Bank Berhad	RM21,000.00	RM21,000.00
9.	Standard Chartered Saadiq Berhad	RM4,794.00	RM10,644.00

On the other hand, the researchers found that the remainder (six banks) of Islamic Commercial Banks did not disclose the SNC income report for the year 2018 in their Annual Financial Report. Those banks only provided general statements on SNC income and did not disclose the nature of SNC events. Therefore, it can be summarized that those banks did not satisfied the standards regulated in the Policy Document of Bank Negara Malaysia. Those banks include Al Rajhi Banking & Investment Corporation (Malaysia) Berhad, Bank Muamalat Malaysia Berhad, CIMB Islamic Bank Berhad, HSBC Amanah Malaysia Berhad, Kuwait Finance House (Malaysia) Berhad, MBSB Bank Berhad and RHB Islamic Bank Berhad (Al-Rajhi Bank 2018; Bank Muamalat 2018; CIMB Islamic 2018; HSBC Amanah 2018; Kuwait Finance House 2018; MBSB 2018).

CONCLUSIONS AND RECOMMENDATIONS

Based on the previous discussion, a few points need to be highlighted. Firstly, Shariah non-compliant income is income received from invalid Shariah contracts which may have taken place in Islamic Financial Institutions, though the institutions are supposed to comply with Shariah rules in all their operations. Therefore, in order to enhance transparency in Shariah compliance of business and financial dealings of Islamic banks, Bank Negara Malaysia issued the Policy Document of Financial Reporting for Islamic Banking Institutions, which required that all Islamic Banks disclose SNC income in the annual report, including their rectification plans. The study of the annual reports of 16 Islamic

Commercial Banks found that nine of them are compliant with the BNM Policy Document in reporting the SNC income in the annual report 2018.

Hence, it is recommended that appropriate action must be taken by the authorities to improve the extent of transparency in Shariah compliance for all Islamic banking operations. Future studies could investigate the reasons behind the lack of SNC income disclosure and specific reasons of SNC incidents that occurred in Islamic Financial Institutions. It is also recommended that the future studies can be done with regards to the SNC income disclosure practices of all Islamic banks in Malaysia, as this paper has only focused on 16 Islamic Commercial Banks.

REFERENCES

- AAOIFI, Accounting And Auditing Organisation For Islamic Financial Institutions. 2015. Shariah Standard No. 21 3/4/1-5.
- Affin Islamic Bank Berhad. 2018. *Annual Report 2018*. Kuala Lumpur: Affin Islamic Bank Berhad.
- Al-Baz, 'A. 1998. *Ahkam al-Mal al-Haram wa Dhawabit al-Intifa' wa Tararruf bihi fi al-Fiqh al-Islami*. Jordan: Dar al-Nafais.
- Al-Bukhari, A. a.-A. 1308. *Kashf al-Asrar 'an Usul Fakh al-Islam al-Bazdawi*. Beirut: Dar al-Kitab al-Arabi.
- Al-Imrani, A. b. 2010. *Al-'Uqud al-Maliyyah al-Murakkabah, Dirasah Fiqhiyyah Ta'siliyyah wa Tatbiqiyyah*. Riyadh: Dar Kunuz Ishbiliya.
- Al-Islamiyyah, W. a.-A.-S. 1404-1427. *Al-Mawsu'ah al-Fiqhiyyah al-Kuwaitiyyah*. Kuwait: Dar al-Salasil.
- Al-Kasani, A. B. 1986. *Bada'i al-Sana'i fi Tartib al-Shara'i*. Beirut: Dar al-Kutub al-Ilmiyyah.
- Alliance Islamic Bank Berhad. 2018. *Report and Financial Statements for The Financial Year Ended 31 March 2018*. Kuala Lumpur: Alliance Islamic Bank Berhad.
- Al-Mahalli, I. 2001. *Sharh al-Waraqat fi Usul Fiqh*. Riyadh: Maktabah al-'Abikan.
- Al-Qarafi, A. b. 2010. *Al-Furuq al-Musamma bi Anwar al-Buruq fi Anwai' Al-Furuq*. Riyadh: Wizarat al-Awqaf al-Saudiyyah.
- Al-Rajhi Bank. 2018. *Annual Report 2018*. Riyadh: Al-Rajhi Bank.
- Al-Ramli, M. b. 1994. *Ghayat al-Bayan*. Beirut: Dar al-Kutub al-Ilmiyyah.
- Al-Shawkani, M. b. 2004. *Al-Sail al-Jarrar al-Mutadaffiq 'ala Hadaiq al-Azhar*. Beirut: Dar Ibn Hizm.
- Al-Zuhayli, W. 2011. *AL-Fiqh al-Islami wa Adillatuh*. Damascus: Dar al-Fikr.
- Ambank. 2018. *Annual Report 2018*. Kuala Lumpur: Ambank Group.
- Asyraf Wajdi Dusuki, M. Mahbubi Ali, Lokmanulhakim Hussain. 2013. Hanafi's Approach to Deal with Shari'ah Non-Compliance Transactions in Islamic Finance. *Australian Journal of Basic and Applied Sciences*, 589-595.
- Bank Islam Malaysia Berhad. 2018. *Financial Statements 2018*. Kuala Lumpur: Bank Islam Malaysia Berhad (BIMB).
- Bank Muamalat Malaysia Berhad. 2018. *Directors' Report and Audited Financial Statements - 31 March 2018*. Kuala Lumpur: Bank Muamalat Malaysia Berhad.
- BNM. 2010. *Shariah Governance Framework for Islamic Financial Institutions*. Kuala Lumpur: BNM.
- BNM. 2010. *The Shariah Governance Framework for the Islamic Financial Institutions*. Kuala Lumpur: BNM.
- BNM. 2018. *Financial Reporting for Islamic Banking Institutions*. Kuala Lumpur: BNM.
- CIMB Islamic Bank Berhad. 2018. *Financial Statements 2018*. Kuala Lumpur: CIMB Islamic Bank Berhad.
- Erdem Oz, Zahid ur Rehman Khokher, Mohammad Mahbubi Ali, Romzie Rosman. 2016. *Shariah Non-compliance Risk in The Banking Sector: Impact on Capital Adequacy Framework of Islamic Banks*. Kuala Lumpur: Islamic Financial Services Board (IFSB).
- Hong Leong Islamic Bank Berhad. 2018. *Annual Report 2018*. Kuala Lumpur: Hong Leong Islamic Bank.
- HSBC Amanah Malaysia Berhad. 2018. *Financial Statements - 31 December 2018*. Kuala Lumpur: HSBC Amanah Malaysia Berhad.
- Kuwait Finance House. 2018. *Annual Report Kuwait Finance House (K.S.C.P) and Subsidiaries 2018*. Kuwait: Kuwait Finance House .
- Laws of Malaysia. 2013. *Islamic Financial Services Act (IFSA) 2013*. Kuala Lumpur.
- Mahmud. 2000. *Al-Binayah Sharh al-Hidayah*. Beirut: Dar al-Kutub al-Ilmiyyah.
- Maybank. 2018. *Annual Report 2018*. Kuala Lumpur: Maybank.
- MBSB Bank Berhad. 2018. *Financial Statements for the Financial Year Ended 31 December 2018*. Kuala Lumpur: MBSB Bank Berhad.
- Mohamad Akram Laldin, Hafas Furqani. 2018. Islamic Financial Services Act (IFSA) 2013 and the Shari'ah-compliance requirement of the Islamic finance industry in Malaysia. *ISRA International Journal of Islamic Finance*, 94-101.
- OCBC Al-Amin Bank Berhad. 2018. *Reports and Financial Statements for The Financial Year Ended 31 December 2018*. Kuala Lumpur: OCBC Al-Amin Bank Berhad.
- Public Islamic Bank Berhad. 2018. *Financial Statements - 31 December 2018*. Kuala Lumpur: Public Islamic Bank.
- Romzie Rosman, Anna Che Azmi, Siti Noraini Amin. 2017. Disclosure of Shari'ah non-compliance income by Islamic banks in Malaysia and Bahrain. *International Journal of Business and Society*, 45-58.
- Standard Chartered Bank Malaysia Berhad. 2018. *Financial statements for the financial year ended 31 December 2018*. Kuala Lumpur: Standard Chartered Bank Malaysia Berhad.
- Surianom Miskam, M. A. 2013. Shariah Governance in Islamic Finance: The Effects of The Islamic Financial Services Act 2013. *World Conference on Integration of Knowledge*.
- Surianom Miskam, Muhammad Amrullah Nasrullah. 2013. Shariah Governance in Islamic Finance: The Effects of The Islamic Financial Services Act 2013. *Proceeding of the World Conference on Integration of Knowledge (WCIK)*, (pp. 455-463). Langkawi.
- Yusoff, S. A. 2013. The Islamic Financial Services Act 2013: Malaysia's Model Framework for Shariah-compliance and Stability. *Islam and Civilisational Renewal*, 391-406.

Nabilah Mat Nor
Department of Fiqh and Usul Fiqh,
Kulliyah of Islamic Revealed Knowledge and Human
Science,
International Islamic University Malaysia,
nabilahmatnor@gmail.com

Mohd Fuad Md Sawari
Assistant Professor,
Department of Fiqh and Usul Fiqh,
Kulliyah of Islamic Revealed Knowledge and Human
Science,
International Islamic University Malaysia,
sawari@iium.edu.my