

International Conference on Accounting Studies (ICAS) 2015
17-20 August 2015, Johor Bahru, Johor, Malaysia

The readiness of Malaysian companies in the compliance of shariah requirements: Implication from the revised screening methodology

Juliana Anis Ramli^a, Mohd Ismail Ramli^b

^a College of Business Management & Accounting, Universiti Tenaga Nasional, Malaysia

^b Faculty of Accountancy, Universiti Teknologi MARA, Puncak Alam, Malaysia.

Abstract

This study attempts to examine whether the board facets could influence the Shariah-approved companies (ShACs)' readiness in sustaining their Shariah status through the compliance of the Shariah requirements, following the Securities Commission (SC)'s revised screening methodology, and also to test whether there are significant differences in the Shariah compliance practices implication from the revised assessment. The data is gathered through a content analysis method which is taken from the corporate annual reports of the largest companies. On average, majority of the studied companies are competent to prevent themselves from being removed in the list of Shariah classification. Even though the minimum threshold of the SC's revised screening assessments have been satisfied, however the companies' Shariah compliance practices do not form any remarkable improvement especially after the revised takes place. The results seem to suggest that none the presence of majority Muslim directors, Muslim CEO and Muslim INEDs are able to exert significant influences on the readiness of ShACs in the compliance of Shariah through the quantitative assessments. However, the company size and industry type (control variables) have positive associations with the debt ratio benchmark. It is evident that different sector of industries has different inclination to adhere Shariah compliance through the SC's debt ratio assessment.

Keywords: Shariah, Compliance, Ratios, Revised Screening Methodology, Malaysia.

1. INTRODUCTION

Of late, the percentage of Islamic investment products and the Shariah-compliant funds have been upsurged about not less than 15-20 percent per year, following the increasing demand especially by the Muslim investors from the Middle-East countries. This growing factor can be attributed to the large number of Muslims population from all over the world which accounts for nearly a quarter of the total world's population (PWC, 2009) and also as a way to espouse the Islamic resurgence globally. Realising to the high demand for such Islamic investment funds and products, Malaysia as one of the Muslim countries that responsible to cater the Islamic portfolio investment needs. In fact, since Malaysia has been recognised as an International Islamic hub in recent years, the Malaysian Securities Commission (hereafter 'the SC') which is accountable to regulate the conventional as well as Islamic capital market, has taken proactive actions to strengthen the Islamic capital market (ICM) by way of introducing the stricter regulations in the Shariah screening process to the Shariah-compliant companies (hereafter 'ShACs') in order to bolster a better competitive atmosphere with other world's leading Shariah index providers.

* Corresponding author.
E-mail: juliana@uniten.edu.my

The ICM has been established by the SC as an ‘opening gate’ for Muslim investors specifically, in order to give them a freedom and confidence while investing the equities that are free from any suspicious involvement or prohibited elements that are against the Shariah principles such as riba’, gharar, gambling, producing alcoholic and pork-related products, etc. Those equities, either the existing ShACs or new applicant of ShAC, they must undergo for screening process which determine the classification of such companies, whether they are qualified to gain status as a ShACs or non-ShACs. This reviewing process is responsibly undertaken by the Shariah Advisory Council (SAC) and the list of ShACs is subject to be reviewed and updated twice a year (MIFC, 2014). Although it is a tedious process, yet it plays a crucial role in determining the credibility of the regulatory authority as well as the companies itself from the lens of Muslim investors and other stakeholders. To grant the Shariah status to the eligible companies, the SAC of the SC requires the companies to follow through this screening process in order to determine to which extent the companies which engage in mixed activities (permissible and non-permissible activities) are able to meet the minimum requirement or ‘threshold’ of Shariah teachings (based on Al-Quran, the Prophet’s sayings and as agreed by the Scholars). The minimum thresholds are introduced with different percentage based on the contributions of non-permissible activities from the core activities and its financial activities of companies (Refer to Table 1), with the understanding that to find companies that attain with perfectly unconnected with the non-permissible elements (i.e. paying interest or riba’) in this modern competitive market is impossible (Khatkhatay & Nisar, 2007). As such, a company in which its contributions of non-permissible activities fall below the minimum benchmark level will be successfully granted a Shariah status by the SC.

Table 1. Revised methodology of SAC of the SC

Quantitative assessment	Current Revised screening methodology	Previous screening methodology
Business activity benchmark ratios	5%	5%
	20%	10%
		20%
		25%
Financial benchmark ratios	33%	NA

Source: Website Malaysian Securities Commission (SC)

In line with the global competitive markets and to foster the robustness of screening procedures, the SC which has adopted a two-tier approach in the screening methodology (both the quantitative and qualitative assessments have been taken into the account to determine the Shariah status) has introduced the financial ratio benchmarks in addition to the existing business activity benchmarks. There are two ratios underpinning the financial ratio benchmarks; cash over company’s total assets and debt over company’s total assets with the threshold level of 33 percent (SC, 2014). Prior to these additional ratios, the existing quantitative assessment only relies on the computation of the contribution of Shariah non-compliant activities to the overall company’s turnover (revenue) and pre-tax earnings (SC, 2014).

This improvement in the screening methodology is a significant endeavour to reinforce the credibility enhancement of the ShACs and also to fortify the shareholders’ confidence. It is argued in the notion that the traditional westernize governance has caused a massive loss of the shareholders’ confidence resulting from the aftermath of giant corporate failures and selfish pursuits where the economic desire is isolated from the ethical dimensions (Brammer, Williams & Zinkin, 2007; Hunter, undated). It is important to note that the investors are ingenious in discerning their preferred investment equities as they are hoping that the ShACs are capable to protect their property (Dusuki & Abdullah, 2007). It is not surprising when there is an increasing awareness of investing communities towards the Islamic funds and equities that uphold the Islamic doctrine through the compliance of Shariah precepts with the understandings that the Islamic teachings place the highest emphasis on the ethical practices in all aspects of human life. Based on the concept of *Tawhid* (unity of God), Islam propagates mankind to engage in any activities that do not jeopardize other people’s life and surroundings. In business or muamalat activities specifically, Islam does not prohibit its followers to conduct trade since it is one of the good sources of income but Islam abhors the element of usury or riba’. Given the beautiful of Islam in advocating the concept of fairness and justice in human life, Mirza and Baydoun (2000), Haniffa and Hudaib (202), Talip and Phay (1998) and Nik Yusoff (2002) opine that the main motivation for the prohibition of riba’ is to avoid the calamity and harmful to humans but to encourage the spirit of solidarity and unity among the Muslims. As Allah commands:

“Allah has permitted trade and has forbidden interest. So whoever has received an admonition from his Lord and desists may have what is past, and his affair rests with Allah. But whoever returns to [dealing in interest or usury] - those are the companions of the Fire; they will abide eternally therein” (Al-Baqarah: 275)

Even though there have been a number of improvements and guidelines have been done by the regulatory bodies in order to foster commitment towards corporate best practices for investors' protection, however some companies may have less motivation to comply with such practices and perceive it as a troublesome (Klapper & Love, 2004). Such compliance of corporate practices is subject to a company's discretion and the company may have their own reason of such negligence of compliance. For instance, given the dropped list from being a ShAC resulted from the recent revised screening methodology, the SP Setia reported that they are aware and daunt of this impact (the possibility of being dropped list) will have on their share price to be slightly dwindled (Business Week, 2013). Other companies also reported that they find difficulties to shift from conventional to Islamic fund borrowings due to expensive costs incurred (Business Week, 2013). These scenarios provide the main motivation of this study to be undertaken in the sense that most of the prior studies have been done in ethical normative approach (Gambling & Karim, 1986, 1991; Adnan & Gaffikin, 1997; Baydoun & Willett, 1997, 2000; Lewis, 2001; Beekun & Badawi, 2005) and Shariah-related studies before the revised screening methodology takes place (Ousama & Fatima, 2010a, 2010b; Derigs & Marzban, 2008; Ho, Masood, Rehman & Belallah, 2012; Ahmad Haji & Mohd Ghazali, 2013).

The scarcity of this Shariah-related studies warrants this study to be conducted which aims to examine the readiness of ShACs in sustaining their Shariah status through the compliance of Shariah requirements following the revision of screening methodology by the SC and also to examine whether the board attributes play a significant role in influencing such compliance of Shariah practices. Since there are limited studies that examine the Shariah compliance practices specifically the ShACs, therefore this study is expected to be the first study that is intended to fill this loophole of the existing studies and provide a useful insight to the interested parties, especially investors and other potential stakeholders in evaluating the extent of compliance practices of Malaysian companies with Shariah principles. In addition, this study employs a sample of large companies which ranked by market capitalisation given that the larger firms are believed as financially strong, able to obtain more resources and expected to generate more revenues, so that they could be able to fulfil the social accountability as espoused by Shariah teachings (Ousama & Fatima, 2010; Mohamed Ibrahim, Fatima, Htay, 2006; Mohd Ghazali, 2010). Recognising the importance of investigating the extent of Shariah compliance involving the Malaysian larger companies, hence this study is expected to provide useful insights to the market regulators and investors by explaining whether the larger companies are consistently in compliance with Shariah practices (measured by quantitative assessments) especially after the revised screening methodology is introduced by the SC.

The remainder of the paper is organized as follows. Section 2 reviews the past literature with regards to the present study, while Section 3 outlines the research design and instrumentation, samples and sampling procedures. Section 4 presents the analysis of findings and the discussion of results. Ultimately, Section 5 concludes and sets out the limitations and provides directions for future research.

2. LITERATURE REVIEW

2.1 Business of the firm and the Screening Norms for Shariah Compliance

The existence of a company in the midst of society plays a significant role in discharging economic and social contributions. Based on theory of the firm, firms explicitly impose various types of contractual obligations through legal and financial contracts, and also implicit contractual relations with its internal and external constituents (Jensen & Meckling, 1976). Viewing the function of the firm as the nexus of a set of contracting relationship among its constituents and undergo for daily complex process, all the business operations as well as business dealings are carried out by the team of management. In the conventional agency theory, in the mutual relationship between the principal (shareholders) and agent (management), the authority of handling business matters are delegated to the management's hands with the expectation that the management is able to generate better investment returns for the principal (Aras & Crowth, 2008) or maximize their profit (Jensen & Meckling, 1976; Fama & Jensen, 1983), even though the prior studies which have sought to examine the relationship between corporate governance and firm performance (Bhagat & Black, 1999; Agrawal & Knoeber, 1996; Gompers, Ishii & Metrick, 2001; Klapper & Love, 2004; Haniffa & Hudaib, 2006; Mohd Ghazali, 2010; Haat, Abdul Rahman & Mahenthiran, 2008) have well documented with mixed results. Islam encourages business to be carried out in fair, honest and just manner and prohibits rigorously for any involvement of forbidden elements which could be harmful to other people's life. According to Chapra (2000) and Dusuki and Abdullah (2007), the Shariah can be defined as '*a system of ethics and values that comprising all aspects of mankind life including personal, social, political, intellectual and economics matters*'. The main motivation of this exhortation to comply with the Shariah principles is due to protect the mankind life from any distortion that could deviate him/her from the blessings of Allah, both in this worldly life and the Hereafter. In fact,

Khatkhatay and Nisar (2007) opined the doctrine of the Shariah principles to be imbued in the business activities and transactions in the sense that the management of the firm needs to have meticulous evaluation between Halal (allowed) or Haram (prohibited) decisions in which those decisions would have some implications not only to the interests of its shareholders, but also to the other stakeholders.

Given the business environment nowadays is dynamic and highly complex business process, it is implausible to eliminate all the impermissible activities of a company from its core activities and to find fully Shariah-compliant equities is extremely impossible. For instance, the ubiquitous nature of interest-based transactions in this modern economy is inevitably to prevent the companies to have transaction dealings with banks (Khatkhatay & Nisar, 2007). Therefore, the existence of Shariah screening process allows the companies to operate business activities within the boundary of Shariah principles. Nevertheless, the screening process also permits those companies with mixed permissible and impermissible activities as long as they meet the minimum acceptable threshold level of deviation from Shariah stipulations as agreed by the Shariah Scholars. In this case, in the previous practice (before November 2013), the quantitative screening norms of the Malaysian SC were only entailed for business activities benchmark with the different tolerance levels (refer to Figure 1 above) with no inclusion of additional financial ratios (debt ratio and cash ratio), while the qualitative assessment is only subject to the public perception or image (Maslahah). It sounds that the SC's Shariah screening norms imposed a great deal of flexibility and liberal treatment in evaluating the extent of the companies' conformance to the Shariah precepts relative to other world's leading Shariah index providers.

This viewpoint has been supported by Khatkhatay and Nisar (2007) who explored and critically assessed the various sets of screening norms of each three prominent institutions, namely Dow Jones (US), SEC (Malaysia) and Meezan (Pakistan) in which they found that the SC Malaysia appears to be the most liberal among the three studied institutions and expressed a disagreement on the SC's qualitative assessment. They suggested that such evaluation of screening criteria shall consider not only the nature of transaction itself but also the nature of the contracting (counter) parties, where the company's investments have been made with the respective parties. Since the accounting is a part of Tawhid and worship process, Khatkhatay and Nisar (2007) pointed out that the inclusion of financial structures of the business also shall be kept in mind while evaluating the Shariah compliance of the company, such as indebtedness of the firm, earnings from suspicious or impermissible (haram) activities as well as the extent of cash earned and paid by the firm. However, Business Week (2013) reported that there is an argument where some companies seemed were not ready to be in line with the SC' revised Shariah requirement especially on the debt ratio since they claimed that shifting from conventional financing to the Islamic financing would experience them a substantial amount of processing costs. Rice (1999) however argued that the adherence to the Shariah dictates among the companies is crucial by rendering the Islamic ethical system in the business practice in order to ascertain the equitable wealth distribution and uphold the Islamic resurgence. The Islamic scholars also advocated that limiting to the inevitably interest-bearing costs at a one-third proportion is too reasonable and well enough (Khatkhatay & Nisar, 2007). Similarly, Ho, et al. (2012) have exhaustively compiled and analysed the Shariah compliant screening methods by the fifteen users (including the Malaysian SC) with the different level of geographical area at micro and macro levels. They found that there were only two users (Dow Jones & Azzad) employed a more stringent assessment relative to other users including the SC when the companies with impermissible activities were deemed excluded from the list of Shariah status only be based on the qualitative assessment. Meanwhile, the remaining users including the Malaysian SC are perceived as lenient and more flexible in evaluating the companies with mixed activities by screening the extent of companies' deviation from the Shariah dictates using both the qualitative and quantitative assessment methods. From the aspect of quantitative screening methods, it is important to note that there is deemed necessary to have a universal set of standards of financial reporting and the measurement of financial ratios in screening the companies especially with mixed activities that are compatible to the compliance of Shariah principles must be taken into the account among the users since the SC is found as the only user that was inconsistent and deficient in providing such financial ratios in the screening methods.

2.2 Hypotheses Development

The current study attempts to examine the readiness of the companies in respect their adherence to the Shariah compliance based on the SC's (revised) screening methodology and there are limited studies which examine the roles of the board of directors (BOD) to exert their significant influence towards upholding the compliance of Shariah principles. Based on the integration of conventional perspective of the agency theory and Islamic perspective of social accountability and full disclosure concepts, as a human being, the BOD are the trustees and the Khalifah (leader) to ummah (society) that hold a substantial amount of economic and social responsibilities and must be carried out the fiduciary duties with full of integrity, loyalty and justice manner if they wish to get blessings from Allah S.W.T. According to Bardai (2002), the BOD or 'Economic Man' are granted with special

facets by Allah in terms of their intelligence, wealth, wisdom, expertise and aptitude in order to be capable in managing the other people's wealth through their oversight functions. In fact, since Islamic religion is one of the influential factors to the preparation and reporting of financial disclosures (Ross, 1978; Naser & Pendlebury, 1997), it is expected that the BOD plays a major function to ensure whether the religious element is able to be embedded in the company's financial transactions and business dealings in order to be in line with the Shariah dictates (Baydoun & Willett, 1997). Since the emphasis is given on the SC's quantitative assessments being as part of evaluating the Shariah compliance by the companies, the conventional perspective of agency theory is also used in order to explain and predict the opportunistic motivation of managers in employing different methods and accounting policies. The different accounting choices by the managers will give a substantial implication to the computation of the quantitative assessment which is essentially used to determine the extent of Shariah compliance among the Malaysian listed companies. Hence, the presence of Muslim directors and CEO (proxies for board facets) are expected to provide an oversight function to the opportunistic behaviour of managers which will affect to the reported accounting numbers, since the SC's quantitative assessments heavily rely on the financial information.

Given the lacking studies which examine the BOD influence towards the Shariah compliance, taking the existing studies that similarly examine the BOD characteristics (including the religious factor) and corporate disclosure (Haniffa & Cooke, 2002) and performance of Shariah-compliant companies (Mohamed Ibrahim, et.al., 2006) from Malaysian context as an alternative way will be more appropriate. Haniffa and Cooke (2002) documented that the companies with higher proportions of Malay directors have significant impact towards the disclosure practices. However, Mohamed Ibrahim, et.al. (2006) failed to prove that the Shariah-compliant companies with majority Muslim directors on the board able to induce their significant influence towards the Shariah compliance indicators (proxied by percentage of prohibited income and prohibited expenses). However, the proponents advocate the presence of the majority of Muslim directors on the board as they have proven that the Muslim directors have significant congruence in the accounting values and practices (Haniffa & Cooke, 2002; Othman, Md Thani & K. Ghani, 2009). Besides, being the head of top management and directly involve in company's operational activities, CEOs play a vital role in steering the management strategy and activities in meeting the company's vision and goals. Since Islam encourages the leader to be absolute honesty in carrying out their fiduciary duties, the Muslim CEOs are expected to exert their significant power and influence towards the management of accounting number as well as the preparation of financial reports that are in compliance to Shariah principles. However, Haniffa and Cooke (2002) provided the contrary result when the Malay managing director or CEO failed to contribute a substantial effect towards the voluntary disclosure. This is similar to the findings of Ramli and Ramli (2015) which did not find any significant association between the Muslim CEO and the Shariah compliance disclosure of Malaysian top largest companies.

Meanwhile, there are number of studies that examine the influence of board composition (proxied by proportion of independent non-executive directors, or INEDs) and board size to the corporate business affairs (Haniffa & Hudaib, 2006; Hermalin & Weisbach, 2003; Weir & Lang, 1999; Mak & Yuanto, 2002; Abdul Latiff, Abdul Rahman & Abdul Rais, 2011; Ibrahim & Abdul Samad, 2011). Most of the studies are found have better corporate performance when the firms have smaller board in size, in which their findings are consistent with Jensen (1993) and Firstenberg and Malkiel (1994) who opined that smaller board size is in preference relative to larger board size due to more effectively functioning board, able to enhance the controlling function by the CEO and encourage greater focus and participation within the board. It is same goes to the board composition which many studies supported the smaller proportion of INEDs is associated with the corporate performance. However, to the researchers' knowledge, the study which examines the presence of Muslim INEDs and the corporate affairs is still unavailable to date. Thus, this study attempts to include this variable in the hypothesis testing in order to assess whether the higher proportion of Muslim directors among the INEDs could have a persuasive ambience in encouraging the Shariah compliance in business affairs through complying the SC's quantitative assessments. Therefore, the following hypothesis in an alternate form is provided:

- H1: There is a significant difference between quantitative assessments (both business activity and financial ratios) in year 2012 and 2014.
- H2: There is a significant association between majority Muslim directors and the SC's quantitative assessments;
- H3: There is a significant association between Muslim CEO and the SC's quantitative assessments;
- H4: There is a significant association between majority Muslim independent non-executive directors and the SC's quantitative assessments;
- H5: There is a significant association between board size and the SC's quantitative assessments.

3. RESEARCH METHODOLOGY

3.1 Sample Selection and Data Collection

The top 100 largest companies which are based on the market capitalisation in 2012 have been selected as a sample of the current study. Among the reasons of restricting the sample determination to the largest companies are due to the capability of these firms of having more resources than counterparts, as well as their willingness to adhere with the Shariah compliance imposed by the capital market regulator, even though such compliance is said incurred inevitably expensive costs (Mohamed Ibrahim, et.al., 2006; Business Week, 2013). Since the revised screening methodology is started to be effective by November 2013, the present study undertakes a comparative study between the year 2012 (a year before revised screening implementation) and 2014 (a year after the revised screening implementation), therefore the list of companies in year 2014 is consistent with the list in the year 2012. The list of companies is subsequently compared with the list of ShACs in order to ensure its existence with the Shariah status in two years, 2012 and 2014. Consistent with the prior studies, the sample of the study represents the non-financial firms ShACs listed on the Main Market from various sector of industries, except for financial sector which is widely known of its nature of different rules and regulations (Mohamed Ibrahim, et.al. 2006; Ho, et.al., 2012; Ousama & Fatima, 2010a, 2010b; Haniffa & Cooke, 2002). This study employs a secondary data, in which the financial information that pertaining to the Shariah compliance measurement is mainly derived from the corporate annual reports. The final sample of available companies is 24, after considering the availability of the firms' existence with Shariah status as well as their corporate annual reports for both years.

Table 2. Measurement of the Variables

	Operationalisation of variables	Measurement
Independent Variables	Muslim directors	Percentage of Muslim directors on the board = No of Muslim directors on board / Total directors (Haniffa & Cooke, 2002; Mohamed Ibrahim, et.al., 2006).
	Muslim INED	Percentage of Muslim INEDs on the board = No of Muslim INEDs on board / Total directors (Ramli & Ramli, 2015).
	Muslim CEO	Dummy variable, 1- Muslim CEO; Non-Muslim CEO (Haniffa & Cooke, 2002; Ramli & Ramli, 2015)
Dependent Variables	Business activity ratios	1. Non-Shariah income/Group's Revenue 2. Non-Shariah income/Group's Profit before tax Benchmark: 5 percent/ 20 percent
	Financial ratios	1. Cash placed in conventional account/ Company's Total Assets (TA); 2. Interest-bearing debt/ Company's TA Benchmark for both ratios: 33 percent
Control variables	Company size	Total assets
	Industry type	1 = properties, 2 = industrial product, 3 = consumer, 4 = plantation, 5 = trading/service, 6 = technology/IPC, 7 = construction
	Auditor type	Dummy variable, 1- Big-Four auditor, 0- Non-Big-Four auditor

According to SC (2014), the 5 percent benchmark of business activities ratio would be applicable to the business activities that involving in conventional banking, conventional insurance, gambling, liquor and pork-related activities and other non-halal food and beverages, interest income from conventional accounts and instruments and other Shariah non-compliant activities. Meanwhile, the 20 percent benchmark applies for those activities including hotel and resort operations, share trading, rental received from Shariah non-compliant activities, stock broking and other activities that are deemed not in compliance to the Shariah principles. Since the Shariah-approved companies are subject to be evaluated based on two-tier assessments, the quantitative assessments play a crucial role in the determination of Shariah classification. Any computations of both business activity and financial ratios underpinning the quantitative assessments which exceed the following benchmark, therefore the companies' Shariah status will be revoked. Given the information on the non-shariah's sources of income are limited, majority of the companies basically disclosed their (typical) non-Shariah income in the form of interest income, which falls under category of 5 percent benchmark. The rental income also has been carefully perused to ensure if there are any non-Shariah elements, especially disclosed in the company's accounting policy in the section of financial statements. In addition, even though the financial ratios have been embarked on its application by late 2013, however the computation in 2012 has been accounted for in the effort to make comparative assessment between the year 2012 and 2014. It is important to note that the scope of quantitative assessments in respect to the Shariah compliance activities is limited to the evaluation of company's own activities, without taking into the account of its subsidiaries' business activities as well as financial matters. Hence, this can be regarded as one of the limitation of the study.

4. DISCUSSION OF FINDINGS

This section discusses the findings analyses on the descriptive and inferential statistics, in which the normality test has been precedently tested as a prerequisite to inferential statistical analyses. Normality test has been employed, however due to the small sample of companies; the result shows the significant value (less than 0.005) of Kolmogorov and Smirnov tests. Therefore, this reaches to the assumption that the data is not normally distributed, and the use of non-parametric tests for subsequent analyses are known will be more appropriated (Pallant, 2010).

4.1 Descriptive Statistics

Table 3: Descriptive statistics

2014	Business activity ratios			Financial ratios	
	Non-Shariah/Rev @ 0.05 (max)	Non-Shariah/PBT @ 0.05	Cash/ Total Assets @ 0.33(max)	Interest-bearing Debt/Total Assets @ 0.33 (max)	
Mean	.006	.0373	.0759	.0410	
Std. dev.	.007	.0389	.1669	.0776	
Minimum	.000	.0000	.0000	.0000	
Maximum	.024	.1546	.7496	.2950	
2012					
Mean	.006	.0358	.0436	.0427	
Std. dev.	.006	.0406	.0607	.0745	
Minimum	.000	.0000	.0000	.0000	
Maximum	.0218	.1850	.2084	.2800	

Based on the Table 3 above, on average the computations of business activity ratios as well as financial ratios meet the requirements by the SC for both years. In other words, their assessments in respect to the Shariah compliance's requirements as stipulated by the SC have been fulfilled, and their computations fall below the given benchmarks of both business activities and financial ratios. However, based on the individual assessment especially on the maximum score of each quantitative assessment in year 2014, it depicts that both financial ratios benchmark as well as non-Shariah income over PBT fall more than the given benchmarks except for non-Shariah income over Group's revenues. These results indicate that there are possibilities that the companies are unable to comply with the stipulated SC's minimum requirements in an endeavour to sustain their Shariah status. In other words they seem are not financially ready to fulfil the Shariah requirements in reducing the prohibited or 'haram' sources of income as well as still adopting the conventional deposits and debts in large amounts. Even though debt over total assets is scored at 29.5 percent which is still below the minimum threshold at 33 percent, however it is important to note that the Shariah assessment in this study is only limited to the company's computation without taking the subsidiaries' financial figures into the account. There are three (3) companies which fail to sustain its Shariah status by meeting the minimum SC's requirements, which are YTL Power (interest-bearing debt at 29.5%, YTL Corporation (Non-Shariah/PBT at 10.95 percent) and Panasonic (non-Shariah/PBT at 15.46 percent and conventional cash deposit/total assets at 74.96 percent). Even though the maximum scores of all quantitative assessments except for non-Shariah/PBT (at 18.5 percent) fall below the minimum threshold, however such maximum score of 18.5 percent is still regarded as a Shariah-compliant company. Based on the careful evaluation, such score is gained by Panasonic Bhd in which the company is confirmed as holding the Shariah status company based on the list of Shariah -compliant companies in year 2012 (May and November) in the SC's website. This reason is due to the adoption of two-tier approach by the Shariah-compliant companies which came into effective by the revised screening methodology around November 2013.

4.2 Inferential Statistics

Table 4: Paired Sample T- Test

	Paired Difference		Std. error mean	95% Confidence level		t	Sig.
	Mean	Std. deviation		Lower	Upper		
Non- Shariah/rev2012: 2014	-.16846	.820	.167	-.5150	.1780	-1.006	.325
Non-Shariah revenue/PBT 2012:2014	-.00302	.0243	.004	-.0133	.00727	-.608	.549
Cash/ Total Assets 2014:2012	-.03231	.158	.032	-.0992	.03461	-.999	.328
Debt/Total Assets 2012:2014	.28924	1.42	.291	-.3137	.8921	.992	.331

Table 4 above depicts that none the business activity ratios as well as financial ratios between the two years have shown significant values, which means that the results fail to prove any significant differences of business activity and financial ratios benchmark between the year, before and after the introduction of the SC's revised

screening methodology. The results denote that there are less likely for the Shariah-compliant companies make some improvements in the year after the revised screening methodology takes place. The result is similar to study done by Ramli and Ramli (2015) that found there is no significant different between the extent of Shariah compliance disclosure in the year after and before SC's revised quantitative assessments.

Table 5: Spearman-Rho Correlation Test

	NonShariah/Rev20 14	NonShariahPBT 2014	Cash/TA2014	Interest- bearing Debt/TA2014
Majority Muslim directors on board	.928 (.02)	.923 (.021)	.166 (.292)	.478 (.152)
Muslim CEO	.582 (-.118)	.966 (-.009)	.798 (-.055)	.624 (.105)
Muslim INED	.607 (-.111)	.617 (-.108)	.290 (.225)	.376 (.189)
Board size	.312 (-.216)	.955 (-.012)	.635 (-.102)	.733 (.074)
Company size	.561 (-.125)	.953 (-.013)	.777 (.061)	.000 (.755)**
Industry type	.912 (.024)	.797 (.056)	.355 (.197)	.001 (.638)**
Auditor type	.851 (-.040)	.573 (-.121)	.596 (.114)	.072 (-.374)

Note: ** Correlation is significant at the .01 level (2-tailed)

* Correlation is significant at the .05 level (2-tailed)

Table 5 above shows that all the independent variables have no significant association with each quantitative assessment, given the significant p-value is more than 0.05. These results indicate that the presence of majority Muslim directors, Muslim CEO and Muslim INED on the board as well as the board size have less power to exert significant influence towards the management's incentive or readiness in complying the Shariah principles through the SC's stipulated quantitative assessments. Nonetheless, the company size and industry type (control variables) are found statistically associated with the interest-bearing debt over total assets ratio (underpinning the financial ratio benchmark). The higher the interest- bearing debt ratio indicates the closer the ratio to possibly dissatisfy the minimum threshold, and subsequently will have the higher chance of being dropped from the Shariah-compliant list. This also seems to point out the discouragement practice by the Islamic religion on riba' since it is characterized as unscrupulous and harmful practice to the humankind (Nik Yusoff, 2002). Given the positive associations between the variables denote a linear direction between the company size and industry type, and the interest-bearing debt ratio; hence the larger companies in size, the higher would be the interest-bearing (or conventional) debt concentration. In other words, the larger companies seem moderately are ready to comply with the Shariah compliance especially in conventional debt ratio; even though they meet closer to or at the borderline of the minimum benchmark ratio. Whilst, the significant association between the industry type and the interest-bearing ratio signifies that there is a variation in the Shariah compliance by certain sectors of industry. However, the larger and prestige auditing firms (i.e. Big-Four audit firms) is found not an influential factor in determining the Shariah compliance level of companies through all the quantitative assessments tested.

5. CONCLUSIONS

This paper presents the empirical evidence on the readiness of companies in compliance of Shariah precepts through the SC's quantitative assessments, which constitute a part of two-tier procedure in the process of granting Shariah status to the Malaysian listed companies. The additional requirement imposed by the SC in the form of financial ratios benchmark provides substantial challenges to the Shariah-approved companies especially in the effort to sustain their classification, given the expensive processing costs might be incurred resulting from the revised decision (Business Week, 2013). On average, majority of the studied companies are competent to prevent themselves from being removed in the list of Shariah classification. Even though the minimum threshold of the SC's revised screening assessments have been satisfied, however the companies' Shariah compliance practices do not form any remarkable improvement especially after the revised takes place. The findings reveal that the presence of majority Muslim directors on the board, Muslim chairman and majority Muslim independent non-executive directors (INEDs) are able to constitute as significant influential factors towards the Shariah compliance practices among the companies. The board size is also found not significant in its relationship with Shariah compliance practices. After controlling the firm-specific characteristics, only company size and industry type are associated with the companies' readiness of Shariah compliance practices. The findings cannot be generalised to the whole population since the sample is only taken based on the top 100 largest companies by market capitalisation. Perhaps, future studies can be undertaken by involving larger sample of companies whether to test the similar variables especially on cultural factors or other environmental factors which could shape the Shariah compliance practices among the Malaysian publicly companies. Future studies on the implications from the revised screening assessments are also warranted to have further examination.

REFERENCES

- Abdul Rahman, A., Yahya, M.A., & Mohd Nasir, M.H. (2010), Islamic norms for stock screening: a comparison between Kuala Stock Exchange Islamic index and the Dow Jones Islamic Market index, *International Journal of Islamic and Middle Eastern Finance and Management*, 3(3), 228-240.
- Adam, N.L. & Bakar, N.A. (2014), Shariah screening process in Malaysia, *Procedia-Social and Behavioural Sciences* 121, 113-123.
- Ahmed Haji, A. & Mohd Ghazali, N.A. (2013), The quality and determinants of voluntary disclosures in annual reports of Shariah compliant companies in Malaysia, *Humanomics*, 29(1), 24-42.
- Baydoun, N. & Willett, R. (1997), Islam and accounting: ethical issues in the presentation of financial information, *Accounting, Commerce and Finance: The Islamic Perspective Journal*, 1(1), 1-25.
- Beekun, R.I. & Badawi, J.A. (2005), Balancing Ethical responsibility among multiple organizational stakeholders: The Islamic perspective, *Journal of Business Ethics* 60, 131-145.
- Brammer, S., Williams, G. & Zinkin, J. (2007), Religion and attitudes to corporate social responsibility in a large cross-country sample, *Journal of Business Ethics*, 71(3), 229-243.
- Business News (2013), Article “*It can be costly to get back on SC’s Syariah-compliant list*”, 4 December.
- Chapra, M.U. (2001), Islamic economic thought and the new global economy, *Journal Economic Studies*, 9 (1), 1-15.
- Che Haat, M.H., Abdul Rahman, R. & Mahenthiran, S. (2008), Corporate governance, transparency and performance of Malaysian companies, *Managerial Auditing Journal*, 23(8), 744-778.
- Derigs, U. & Marzban, S. (2008), Review and analysis of current Shariah compliant equity screening practices, *International Journal of Islamic and Middle Eastern Finance and Management*, 1(4), 285-303.
- Dusuki, A.W. & Abdullah, N.I. (2007), Maqasid Al-Shariah, Maslahah and Corporate Social Responsibility, *The American Journal of Islamic Social Sciences*, 24(1), 25-45.
- Haniffa, R.M. & Cooke, T.E. (2002), Culture, corporate governance, and disclosure in Malaysian corporations, *ABACUS*, 38(3), 317-349.
- Haniffa, R.M. & Hudaib, M. (2007), Exploring the ethical identity of Islamic banks via communication in annual reports, *Journal of Business Ethics*, 76, 97-16.
- Haniffa, R.M., Hudaib, M. & Mirza, A.M. (2002), Accounting policy choice within the Shariah Islami’iah framework, www.ex.ac.uk/sobe/research/discussionpaper.
- Harahap, S.S. (2002), The disclosure of Islamic values- annual report: the analysis of Bank Muamalat Indonesia’s annual reports, *IQTISAD Journal of Islamic Economics*, 3(1), 35-45.
- Ho, C.S.F. Masood, O., Abdul Rehman, A. & Bellalah, M. (2012), Syariah accounting and compliant screening practices, *Qualitative Research in Financial Markets*, 4(2/3), 240-254.
- Hossain, M., Tan, L.M., & Adams, M. (1994), Voluntary disclosure in an emerging capital market: some evidence from companies listed on the Kuala Lumpur Stock Exchange, *The International Journal of Accounting*, Vol.29, 334-351.
- Hunter, M. (undated), Integrating the philosophy of Tawhid- an Islamic approach to organization, Retrieved on 12 January 2015, at www.culturaldiplomacy.org
- Ibrahim, H. & Abdul Samad, F. (2011), Corporate governance mechanisms and performance of public-listed family- ownership in Malaysia, *International Journal of Economics and Finance*, 3(1), 105-115.
- Jensen, M.C. & Meckling, W.H 1976, ‘Theory of the firm: Managerial behaviour, agency costs and ownership structure’ *Journal of Financial Economics*, vol. 3, no. 40, pp.305-360.
- Naser, K. & Pendlebury, M. (1997), The Influence of Islam on bank financial reporting, *International Journal of Commerce and Management*, Vol. 7 Iss 2 pp. 56 -83.
- Khatkhatay, M.H. & Nisar, S. (2007), Shariah compliant equity investment: an assessment of current screening norms, *Islamic Economic Studies*, 15(1), 47-76.
- Maali, B., Casson, P., & Napier, C. (2006), Social reporting by Islamic banks, *ABACUS*, 42(2), 266-289.
- Mirza, A.M. & Baydoun, N. (2000), Accounting policy choice in a riba-free environment, *Accounting, Commerce & Finance: The Islamic Perspective Journal*, 4(1&2), 30-47.
- Mohamed Ibrahim, S.H., Fatima, A.H., & Htay, S.N.N. (2006), Corporate governance and Performance: A comparative study of Shariah- Approved and Non-Approved Companies on Bursa Malaysia, *Journal of Financial Reporting and Accounting*, 4(1), 1-23.
- Nazli A. Mohd Ghazali, (2008), Voluntary disclosure in Malaysian corporate annual reports: views of stakeholders, *Social Responsibility Journal*, Vol. 4 Iss 4 pp. 504 - 516.
- Nik Yusoff, N.M.A. (2002), Islam & Business, Pelenduk Publications.
- Othman, R., Md Thani, A. & K. Ghani, E. (2009), Determinants of Islamic Social Reporting among Top Shariah-Approved Companies in Bursa Malaysia, *Research Journal of International Studies*, Issue 12, 4-20.
- Ousama, A.A. & Fatima, A.H. (2010), Factors influencing voluntary disclosure: Empirical evidence from Shariah Approved companies, *Malaysian Accounting Review*, 9(1), 85-103.
- Ramli, J.A. & Ramli, M.I. (2015), Board Characteristics and Shariah Compliance disclosure of Malaysian Shariah-Approved companies: Implication from Revised Screening Methodology, *Proceedings of National Symposium on Business Management and Accounting*, 2 April.
- Rice, G. (1999), Islamic ethics and the implications for business, *Journal of Business Ethics*, 18 (4), 345-358.
- Securities Commission website www.sc.com.my, retrieved on 12 January 2014.
- Talib, A. A., & T. S. Phay. 1998. The Islamic economic system and riba: The foundation of Islamic banking. *Accounting, Commerce & Finance: The Islamic Perspective Journal*. 2, No. 3: 51-82.