



Screening Process of Shariah-Compliant Companies: The Relevance of Financial Risk Management

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ABSTRACT

In complying with the issue of Shariah, it important to review on Shariah companies whether different levels of companies' uncertainties (risks) provides similar or contradict outputs on the level of compliance. This study examines the level of Islamic Shariah compliance for public listed companies in Malaysia based on their financial risk ratios and enterprise risk management (ERM). The final sample of this study consists of newly listed Shariah-compliant companies and Shariah-non compliant companies listed in Bursa Malaysia. The financial risk ratios and ERM measurements follow the guidelines set by the Dow Jones Islamic Market (DJIM) Index and COSO framework respectively. The results of this study suggest most companies were in compliance with the interest income requirement. However, many of the companies did not meet the liquidity and debt levels which have been suggested under the DJIM guideline. For Shariah companies, the level of ERM practices were significantly related to the liquidity and debt levels. This study proposes for more harmonized general criteria for an Islamic Capital Market (ICM) Index for Shariah screening process.

Key words: Equity capital, Shariah compliant companies, Islamic capital market, Financial risk ratios, Enterprise risk management

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Any remaining errors or omissions rest solely with the author(s) of this paper.

INTRODUCTION

During the midst of the 1990s, the business community had witnessed a drastic growth of Islamic funds all over the world. This was due to the awareness and demand from Muslims to participate in the capital market investment. Investors are not only concerned about what is profitable but also what makes their investments ethical (Ulrich and Marzban, 2008, Karim, 2001). In the case of Malaysia, ethical investments for Muslims are investments in financial products that are approved by the Islamic law (Shariah). Due to increasing awareness on Shariah-approved products, the Islamic Capital Market (ICM) hereafter, is established in Malaysia (Securities Commission, 2001). The ICM refers to the market where the activities are carried out in ways that do not conflict with the conscience of Muslims and the religion of Islam.

Today, various capital market products are available for Muslims who only seek to invest and transact in the ICM. Such products include the list of the Securities Commission's Shariah-compliant securities traded on Bursa Malaysia and is supervised by the Shariah Advisory Council (SAC) of the Securities Commission (SC) of Malaysia. Investors nowadays, particularly Muslim investors who are sensitive to Islamic investment guidelines, must examine whether the company undertakes its activities according to Shariah principles or not as shares represent an ownership right in the company. This updates is essential for helping Muslim investors to identify Shariah-compliant companies for making investment decisions. In order to give an updated list of Shariah-compliant companies, the SAC carried out investigations from various angles, including considering the views from within and outside the country before publishing the initial list of Shariah-compliant companies (Securities Commission, 2009).

Nevertheless, the criteria used by SAC of SC in classifying the Shariah-compliant companies are different and unique with the criteria used by other Islamic indices (Ulrich and Marzban, 2008). The only similar view that has been adopted by SAC of SC and other indices is their view of the core activities of a company that do not contravene the Shariah principles. The Dow Jones Islamic Market Index (DJIM) is the first Islamic Index that was established in December 1995, in order to facilitate and enable Islamic fund managers to transact business in the capital market. The move was then followed by other stock markets and financial institutions in developing their own Islamic Indices, such as the Financial Times Exchange (FTE), the Wellington Islamic Index, the Citi Bank Islamic Index, and the Global Alliance Islamic Index (Wilson, 2004). The criterion stipulated by DJIM for screening process of a permissible investment also has been used by other Islamic Indices (Nisar, 2007). The criterion used in the screening process done by

SAC of the SC is differing with what have been used by DJIM and other Islamic Indices (Syed Alwi, 2007a). This different screening process adopted in Malaysia could lead to disagreement and confusion among the international investors on the screening standards used by the SAC of the SC. This could negatively affect the reputation of the SAC (Abdul Rahman, Yahya, and Mohd Nasir, 2010).

Investments in financial services must not involved on *riba*, *gharar* (uncertainties), and manufacturing or the sale of non-halal goods (Securities Commission, 2009). This could create a doubtful situation from the stakeholders' view, whether the companies are really complying with the Shariah requirements or not. *Gharar* exist when there are any kind of gambling activities exist. For example, conventional insurance, conventional investments, and also buying and selling at the stock market exchange. This creates risk in the business. In business, risks are exists in the company and the management have to take an action to manage it (Collier, 2009). Risk is the uncertainty of plans and decision outcomes (McNamee and Selim, 1998).

Stakeholders also want to make sure the companies in which they have an interest on are managed responsibly, with a balance of efficiency and resiliency (Kimmel and Anderson, 2010). Recently, risk management has also been given an increasing interest, specifically the term of Enterprise Risk Management (ERM) which defined as a process, affected by an entities board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives (COSO, 2004). Studies have shown that problems of trusts arise when risk management does not have seat at the management table, or even when risk management's warnings are ignored, or when risk management is performed unevenly (Stulz, 2009). The ERM has becoming the interest since many major corporate collapses was implied by the improper risk management (Metha, 2010). The ongoing financial crisis nowadays also has exposes the need for companies to effectively identify, asses and manage risk, as well as to take a sobering look at their approach to risk management (Shimpi, 2010).

This study compares the impact of Shariah status, Shariah compliant and Shariah non-compliant, on the level of debt, level of liquidity and level of interest income as applied in the Malaysian context. Following DJIM, this study examine whether level of debt, liquidity and level of interest income influence SAC's decision to classify the companies as Shariah compliant or Shariah-non compliant. Subsequently this study also includes the ERM practices among the Shariah companies as additional criteria that can be look into during the screening process.

A comparison analysis on the measurement of the level of debt, level of liquidity and also level of interest income for firms with high and low ERM are examined. Lastly, this study also discusses whether ERM practices would be additional criteria to look into upon the screening process of Shariah compliant companies by SC's Shariah Advisory Council.

The following section discusses the concept of shariah based on previous research and describes the shariah screening process and enterprise risk management that are relevant within the context of the study. This is followed by a discussion of the research method and sample construction. The last section discusses the research findings, conclusions and implications of the result.

LITERATURE REVIEW

Muslims have to comply with the proper ethical conducts, especially in dealing with business activity. Profit is not a sole objective for muslim in conducting business (Arham, 2010). Islam guides its followers to engage in commercial activities and to refrain from the practice of charging interest/usury (Cerimagic, 2010). As long as the process of the business is parallel with Islamic teaching on doing business, commerce is considered essential in Islam. The Qur'an prescribes mankind to engage in activities that are lawful and good and also prohibit those that can harm and dispute in the society (Baydoun and Willet, 1997). Prohibited goods, such as porks, also the entire value chain activities that have relation to the goods will be equally prohibited. All aspects of the production, storage, transportation, marketing and advertising of such products and activities will be included in determining the shariah compliance (Arham, 2010).

Profit should involve decisions on risk preferences and choices of acceptable finance, either for personal and business purposes as prescribed by the Shariah principles and rules (R.Wilson, 2008). As strongly recommended by Qur'an, trading must be fair and also honest in doing business. Wealth in Islam should not be exploited negatively and go against Shariah principles (Pryor, 1985). It is considered unlawful (haram) in Islam when buying the non-Shariah compliant stock according to Shariah Islam (Abdul Ghafar and Achmad, 2010). It can be considered as an act of worship (ibadat) when buying Shariah approved stocks (CIME, 2008).

The Shariah Advisory Council of the Securities Commission Malaysia

In effort to develop Islamic capital Market, Securites Commission established Islamic Capital Market Department (ICMD). Its employs full-time officers with Shariah education background (Securities Commision, 2011). The department carries out

research activities and functions as the secretariat to the Islamic Instrument Study Group (IISG). The SC viewed that it is important for IISG to expand its role and later it was upgraded into a body called Shariah Advisory Council (SAC) on 16th May 1996. Advising the SC on matters related to the comprehensive development of the ICM and to function as a reference centre (Securities Commission, 2006). SAC will receive input and support from the SC before classifying the companies and the SC will gathered information on the companies from various sources as stated in the SAC List Booklet (2007). The SC, through the SAC, continues to monitor the activities of all companies listed on Bursa Malaysia to determine their status from the Shariah perspective.

The SAC of SC, in its written guidelines focuses only on two criteria, namely; firstly its core activity; and secondly the level of interest income received by company, which is being used to determine whether a particular company is permissible or not in its index. Companies will be classified as Shariah non-compliant companies if they are involved in the activities such as financial services based on *riba* (interest); gambling and gaming; manufacture or sale of non-halal products or related products; conventional insurance; entertainment activities that are non-permissible according to Shariah; manufacture or sale of tobacco-based product or related products; stock broking or share trading in Shariah non-compliant securities; and other activities deemed non-permissible according to Shariah (Commission, 2006). The SAC also takes into account the level of contribution of interest income received by the company from conventional fixed deposits or other interest bearing financial instruments. However, it is silent on the other two criteria, namely the debt level and the liquidity level as used by other Islamic Indices. This differing stance is due to non-standardization and non-mutual acceptance of Islamic rules across Muslim countries (Atan, 1999) which lead to debatable issues in Islamic investment.

The constituents of the FTSE Bursa Malaysia EMAS Index that are Shariah-compliant according to the SAC of SC's screening methodology also included in the Index. The FTSE Bursa Malaysia EMAS index incorporates the large and mid cap stocks of the FTSE Bursa Malaysia 100 Index, and the FTSE Bursa Malaysia Small Cap Index. The FTSE Bursa Malaysia EMAS Shariah Index replaced the KLSE Shariah Index in 2007 (Bursa Malaysia, 2011). SAC of SC will approve companies that are complied with Shariah requirement. The updated lists of Shariah-compliant companies will be made known to public by the SC. In the lists, there will be companies that are newly classified as Shariah compliant and also companies that are excluded in the Shariah approved companies (List of Shariah Compliant Securities by Shariah Advisory Council of the Securities Commission Malaysia 2009).

The level of interest income received from conventional fixed deposits or other interest bearing financial instruments also will be considered by SAC. Dividends received from investment in non-Shariah compliant securities will also be considered. SAC considers the following aspects for companies that have both permissible and non-permissible elements: The public perception or image of the company must be good; and The core activities of the company are important and considered *maslahah* (“benefit” in general) to the Muslim *ummah* (nation) and the country, and the non-permissible element is very small and involves matters such as ‘*umum balwa* (common plight and difficult to avoid), ‘*uruf* (custom) and the rights of the non-Muslim community which are accepted by Islam.

The DJIM Criteria of Shariah Screening Process

Main activity of the business that has been undertaken by the company is the core activity of the company. If the activities are unlawful thus the business also will be considered as unlawful too. Investors that interest in the company will be deemed to promote these activities (Securities Commission, 2006). This study uses the three financial features for examining the status of the newly classified as Shariah-compliant companies and Shariah-on compliant companies.

First, level of debt can be explained as the percentage level of assets that are provided through debts as according to the Wikipedia encyclopedia (2010). The higher the percentage, the higher the risk associated to the company. Nowadays it is common for a company to borrow money from conventional financial institutions to finance its capital. This can give rise to the issue of shareholder’s liability and *riba* (interest). This issue has been debated by the Shariah expert. It would be a grave sinful act borrowing on interest; however, it will not render the whole business as *haram* (impermissible). The responsibility of committing such deal rests with the person who will entirely indulged in a transaction of interest, but does not make the whole business as prohibited. The level of interest payments for debt is measured and limited by a threshold level. Here, Islamic and conventional analysis coincide and favour lower debt ratios, since in general a lower leverage level is interpreted as a positive investment signal (Derigs and Marzban, 2008).

Borrowing is a vital element of corporate development without which the growth of many business activities would stop. Many publicly companies are operating in jurisdictions where Islamic financing products are either not easily accessible or are not available at all given these considerations, scholars who advised in the formation of the Dow Jones Islamic Market (DJIM) index, the first global Islamic screening provider, permitted the equities of companies to be subscribed to by Islamic investors, even though these companies may have on loan using an

interest-based loan. This was held to be adequate so long as the proportion of the borrowing did not exceed a particular ratio when compared with the 12 month trailing average of market capitalisation of the company (Siddiqui, 2000).

Second, liquid assets are current assets elements and may include cash and cash equivalents, short-term investments and accounts receivables (Derigs and Marzban, 2008)8. Companies should gain their returns from the illiquid assets only as assets of a Shariah compliant companies must in an illiquid form. The shares of the company are negotiable only if they have some non-liquid assets. If all the assets of a company are in the liquid form, thus that particular company is not allowed for investment (Abdul Rahman, *et al.*, 2010).

Third, level of contribution of interest income received by the company from conventional fixed deposit or other interest bearing financial instruments is called level of interest income. As dividend received from investment in Shariah non-compliant securities, SAC will be considering the dividend received in the screening process. Since the companies are cooperating with banks and this will produce interest, Islamic scholars' defined thresholds indicating to which amount interest is allowable. Interest is allowable in two ways, the amount of interest income generated or the amount of liquid assets that could generate interest income is limited (Usmani, 1999).

Enterprise Risk Management

In addition to that, ERM is considered in this study because it is one of extra element to be checked as it has been increasing of awareness of ERM in the SAC of SC. The Committee for Sponsoring Organizations of the Trade way Commission defined ERM as: "A process, affected by an entity's board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives." (COSO, 2004, p.2). Based on COSO ERM Framework, the framework has eight components and four objectives categories. It includes Risk Management architecture in terms of eight components to be considered under each of the four categories of objectives which including strategy, operations, reporting and compliance. Hence, each level of the organization applies the eight components of ERM to the following four categories of objective concerned.

Special investigation committee report a conclusion on Enron corporation's board "*failed to monitor...to safe guard Enron's shareholders*". The main cause of the 1997/1998 Asian financial crisis is the weak corporate governance as argued by many researches. Malaysian companies face a great pressure as the

amendment in the Bursa Malaysia's Listing Rules that requires the companies to disclose their report in on how the principles of corporate governance are applied in their organizations and the extend of its compliance to the code on corporate governance' best practices recommendations (Bursa Malaysia, 2001; Securities Commission, 2000).

ERM takes a range view of all risks facing the organization as a whole, and attempts to direct these through a methodical method using a general risk language. Then it will be characterized by efforts to recognize risks to the firm's objectives, assess risks and how to respond to the risks. Monitoring level will be at a high stage with systematic and consistent. Firms should encourage this process through mechanism such as performance metrics linked to risk management, strategic planning, risk policies, establishing an oversight committee and risk philosophy (Subramaniam, McManus, and Zhang, 2009).

RESEARCH METHODOLOGY

Data was collected from public listed companies listed in the Bursa Malaysia. In achieving the research objectives, the sample study had been focused on the companies that were newly listed (Shariah-compliant) and delisted (non-Shariah compliant) for three consecutive years, 2007, 2008 and 2009. After removing companies that have insufficient information, only 68 from 149 companies available. Table I shows the sample that have been selected in details for each year. This consists of 35 companies for 2007, 28 companies for 2008 and 5 companies for 2009.

Table 1 Sample of study: Shariah and non-Shariah compliant companies

Year of announcement made by the SAC of the SC	No. of companies newly classified as Shariah-compliant	No. of companies newly classified as non-Shariah-compliant	Total	No. of companies available
2007	35	21	56	35
2008	48	14	62	28
2009	26	5	31	5
Total	109	40	149	68

Data regarding the debt to equity ratio, liquidity ratio and level of interest income were extracted from *DataStream* databases. *The debt to equity ratio* is calculated by dividing total debt with total shareholders' equity. The debt refers to both long term and short term borrowing that is affected through interest-based borrowing. The measurement used in this study is based on the guidelines adopted

by DJIM (Siddiqui, 2000) and it is similar with the study done by Abdul Rahman, *et al.*, (2010). In the debt screen of the Shariah compliant companies, the portion of total debt from the total assets of a company may not exceed 30% (Derigs and Marzban, 2008)^o-. *The liquidity ratios* are derived by taking the sum of accounts receivables, cash and short-term investments divided by the total assets. This is adopted from the measurement used by the DJIM guidelines in the screening process of Shariah compliant companies (Siddiqui, 2000). A study done by Abdul Rahman, *et al.*, (2010) also used the same measurement adopted by the DJIM. A Shariah screen measuring the maximum permissible liquidity level of a company is the sum of accounts receivables, cash and short term investments, which may not represent more than 50 percent of the total assets of a company (Derigs and Marzban, 2008). *The level of interest income* is calculated by dividing the non-operating interest income with the total income, similar with the study done by (Ulrich and Marzban, 2008; Abdul Rahman, *et al.*, 2010). The level of acceptance of interest income level may not represent more than 5 percent of the total revenue of a company, as stated in the SAC of SC.

For the measurement of ERM, the measurement is based on the aggregate scores of ERM practices disclosed by each firm. The aggregate ERM scoring sheet to measure the relevant control and risk management practices based on prior work developed by Desender (2009). The scores are derived from the eight components of COSO-ERM framework, as shown in Figure 1. Using a content analysis technique, each firm had been assessed its ERM practices based on the list that composed of 87 items, scoring 1 or 0. Information was gathered from reviewing the secondary data (annual report) in the year before the company had been announced as newly classified Shariah-compliant and Shariah-non compliant Companies.

RESULTS

Descriptive Statistics

Table II below shows the distribution of level of interest income based on the five percent cut-off. It is depicted that majority companies (97%) were considered to have low level of interest with the interest income lower than the five-percent requirement. In other words, most of the companies were following the guideline on the interest income requirement disregard of shariah or non-shariah compliant status. Only two companies were considered to be high level of interest income. Based on the findings, Table II also shows 83.8 percent of companies have low level of liquidity, and the rest of the companies have high level of liquidity. Only 16.2 percent of companies did not meet the requirement of DJIM, in which their quick current assets were more than 50 percent of the total assets of a company. In

Internal environment	The first step of the risk management process encompasses the tone of an organization, and set the basis of how risk is view and addressed by management and employees. This include among other things, risk management philosophy, risk appetite, firm's integrity and ethical values, and the environment in which it operates.
Objective setting	Objectives must exist before management can identify potential events affecting their achievement. Management has in place a process to set objectives and the chosen objectives support and align with the entity's mission with its risk appetite along.
Event identification	During this process, management identifies internal and external events affecting achievement of firm's objectives which can impact the firm. Events that may have a negative impact represent risks. Events that may have a positive impact represent opportunities, which management channels back to strategy setting.
Risk assessment	The previously identified risks are being analyzed in order to get a basis for determining how they should be managed. Risks are assessed regarding their impact and likelihood on both an inherent and residual basis.
Risk response	Management evaluates possible risk response including avoiding, accepting/retaining, reducing or sharing/transferring risk while developing a set of actions to align risk with the entity's risk tolerance and risk appetite.
Control activities	The right control activities should be executed to ensure that these response strategies are effectively carried out. These can be done through establishment and implementation of policies and procedures.
Information and communication	Relevant information is identified, captured and communicated in a form and timeframe that enable people to carry out their responsibilities. Effective communication also occurs in a broader sense flowing down, across and up the entity.
Monitoring	The monitoring step in general controls and mitigates the deviation of established goals and objectives. This is where deficiencies can then be mitigated through modifications, where necessary. This may include ongoing management activities, separate evaluations or both.

(Sources: COSO, 2004)

Figure 1 COSO enterprise risk management components

terms of debt ratio, the result shows that 47 percent of companies were considered to have high level of debt. This indicates that many companies were violating the debt ratio as recommended under DJIM guideline to be lower than 33 percent.

Table 2 Descriptive statistics based on DJIM screening process

	Low frequency (%)	High frequency (%)
Interest level	66 (97.10)	2 (2.90)
Liquidity level	57 (83.80)	11 (16.20)
Debt ratio	36 (52.90)	32 (47.10)

The Chi-square test is used to explore the difference between two categorical variables. This test examines the liquidity and the debt level for newly classified as Shariah and non-Shariah companies. For the interest income, the comparison analysis was not done due to insufficient number of companies in one group. It has violated the assumptions of chi-square concerning the minimum expected cell frequency which should be 5 or greater.

Table 3 Frequency analysis of Shariah and non-Shariah companies

	Shariah		Non-Shariah		Chi-square test
	Low N (%)	High N (%)	Low N (%)	High N (%)	
Liquidity Level ^a	35 (79)	9 (21)	22 (92)	2 (8)	0.195
Debt Ratio ^b	25 (57)	19 (43)	11 (46)	13 (54)	0.386

Note: ^aLiquidity level: Low = <50%, High = ≥ 50%; ^bDebt ratio: Low = <30%, High = ≥ 30%

^c No analysis was done for the interest income due to small number in the high level group.

Table III also presents the percentage of liquidity and debt level according to two categories, the Shariah-compliant and Shariah non-compliant companies. 79 percent of Shariah compliant companies were considered as low level of liquidity whereas 21 percent of Shariah compliant companies with a high level of liquidity. For Shariah-non compliant companies, 92 percent had a low level of liquidity while 8 percent had a high level of liquidity. In this table the Chi-square test is 0.195 (2-tail) or 0.098(1-tail). Therefore, there is a significant difference (<0.10) of debt level among companies which are being classified as newly Shariah-compliant and Shariah-non compliant companies.

From the table also, 57 percent of Shariah compliant companies had a low level of debt whereas 43 percent of Shariah compliant companies had a high level of debt. Likewise, for Shariah-non compliant companies, 46 percent had a low level of debt while 47 percent had a high level of debt. The Chi-square test is .386. Therefore, there are no significant difference of debt level among companies which being classified as newly Shariah-compliant and Shariah-non compliant companies.

Correlation

Correlation matrix provides the nature, direction and significance of the bivariate relationships of the variable used in the study. The method is useful because it explain how do variables related to each other. Table IV below shows the correlation statistics to be used in regressions analysis.

Table 4 Correlation statistics

	Interest	Debt	Liquidity
Debt	-.104		
Liquidity	.287	-.340*	
ERM	-.002	.116	-.249

**Correlation is significant at the 0.01 level (2-tailed).

*Correlation is significant at the 0.05 level (2-tailed).

Based on the statistics above, there are positive correlation between level of interest income and also level of liquidity with $r=0.287$ and p value more than 0.05. This shows there is insignificant positive relationship between the two variables. As for the level of debt and ERM practices, they are negatively correlated towards the level of interest income with the value of $r=-0.104$ and $r=-0.002$. These are the indicators of which the relationships between the variables are insignificantly negative. Debt is significantly related to the liquidity levels (significant at 0.05).

Comparison Analysis on ERM Practices and DJIM Screening Process Using Mann-Whitney U Test

This test is used to explore whether there are a significant difference in the ERM practices among the companies regardless they are newly listed Shariah-compliant and Shariah-non compliant companies.

Table 5 Comparison of ERM using Mann-Whitney U test

		N	Mean rank	Mann-Whitney U (sig.)
Liquidity level	Low	57	37.07	167 (0.015)
	High	11	21.18	
	Total	68		
Debt ratio	Low	36	39.04	412 (0.044)
	High	32	29.39	
	Total	68		

As shown in Table V, the result from the test shows a significant difference in the ERM practices in the perspective of liquidity level (a significance level of $p=.015 < .05$). This indicates that the companies with liquidity level more than 50 percent will practice less ERM as compare to the companies that have liquidity level less than 50 percent as they will employ more ERM. Companies with a low level of liquidity is practicing more ERM as compared with the company with a high level of liquidity.

The result also depicts the level of ERM practices for both group of companies, i.e. debt level of 30 percent and below and more than 30 percent. The result is significant since the z value is -2.0 with a significance level of $p=.044$ and plus, the probability value (p) is less than to .05. In other words, it shows the significant difference in the ERM practices between the groups of companies that have debt level below 30 percent and also companies that have debt level above 30 percent.

Further Analysis

This study also extend the analysis by testing whether there is significant difference of ERM practices level of companies newly classified as Shariah-compliant. In order to examine the difference, an Independent t- test is used to compare the mean score, on some continuous variable for two different groups for liquidity and debt levels.

Table 6 T-test result of mean ERM practices of Shariah-compliant companies

		N	Mean	Std. deviation	t	Sig. (2-tailed)
Liquidity level	Low	35	.3720	.19742	-2.912	.006
	High	9	.1700	.12329		
Debt level	Low	25	.3752	.19620	-1.723	.092
	High	19	.2721	.19698		

Table VI shows t-test result of mean ERM practices for Shariah-compliant companies for low liquidity level (less 50 percent) and high liquidity level (more than 50 percent). There was significant difference in mean ERM practices for Shariah-compliant companies with low liquidity (mean=0.37, standard deviation = 0.197), and for Shariah-compliant companies with high liquidity (mean= .17, standard deviation=0.123). The t value is -2.912 ($p < .010$). The table also presents t-test result of mean ERM practices for Shariah-compliant companies for low debt level (less 30 percent) and high debt level (more than 30 percent). There was a significant difference in mean ERM practices for Shariah-compliant companies for low debt level (mean=0.37, standard deviation = 0.196), and for Shariah-compliant companies for high debt level (mean= .27, standard deviation=0.196). The t value is -1.723 ($p < .010$).

Both of the analysis demonstrates some evidences that companies were only following the recommended guideline by SC, which is on the interest income but not for liquidity and debt levels. Both of the ratios were suggested by DJIM only but not by SC. Likewise, the results of ERM were also consistent with both ratios in which high ERM for companies with low liquidity and debt levels. Companies with high levels of liquidity and debt were not managing their ERM better (i.e., low level of ERM).

CONCLUSIONS

This study compares the impact of Shariah status, Shariah compliant and Shariah non-compliant, on the level of debt, level of liquidity and level of interest income as applied in the Malaysian context. Following DJIM, this study examine whether level of debt, liquidity and level of interest income influence SAC's decision to classify the companies as Shariah compliant or Shariah-non compliant. Subsequently this study also includes the ERM practices among the Shariah companies as additional criteria that can be look into during the screening process. A comparison analysis on the measurement of the level of debt, level of liquidity and also level of interest income for firms with high and low ERM are examined. Lastly, this study also discusses whether ERM practices would be additional criteria to look into upon the screening process of Shariah compliant companies by SC's Shariah Advisory Council.

The results of this study reveals both companies, either newly classified as Shariah-compliant companies and Shariah-non compliant companies were in compliance with the interest income requirement which should be less than five percent of total income. However, this study found that many companies were not

meeting the suggested requirement of DJIM on level of liquidity and debt. In this regards, Malaysian companies were only following the minimum requirement as suggested by the SAC of SC to maintain minimum level of interest income but not on the liquidity and debt levels. Further analysis on the Shariah compliant companies revealed that the companies which have low level of liquidity and low level of debt practiced more ERM as compared with the company which have high level of liquidity and high level of debt. Many newly listed Shariah compliant companies were not only having high levels of liquidity and debt, but also managing low level of ERM. This indicates that, although the companies were in compliance with the SC requirements, some of them were having high risks from having high liquidity, high debt as well as low ERM. As discussed earlier in the paper, Shariah compliant companies should minimize its risk or uncertainties. The uncertainties can be considered as 'gharar' and hence, should be avoided under Islamic investment. The results also supported that the SAC of SC does not take into account the level of debt and liquidity as used by DJIM in screening for acceptable companies.

This study provides a number of implications. It is quite timely for the SC to adopt progressively the screening standards used by the DJIM for the benefits of the international investors especially Muslims investor which has growth rapidly all over the world (Abdul Rahman, Yahya, and Mohd Nasir, 2010; Yatim et.al., 2006). Although, the capital resources are very limited in Malaysia as compared to other countries, it would be beneficial for Muslim countries to harmonize the various rules in order to have general criteria for an ICM Index to operate. Other than that, the existing practice in determining the rules to be used by each index lies fully on the Shariah supervisory board of the respective indices. As a result, the indices differ from one country to another. However, the inconsistencies of the rules used among Islamic indices should not be used as revealing the weaknesses of the Muslim community in the eyes of the other communities.

There are several limitations regarding the study that have been done. The study selects only companies that their accounting data are available in DataStream to estimate the level of debt, liquidity and interest level income to be included in the sample. This study also covers only the Shariah compliant companies that newly announced as Shariah-compliant companies and Shariah-non compliant companies. Future research should consider larger sample of companies, so that the results can be generalized and the explanatory power of the results may be improved. Finally, this study also recommends for a comparison between industries which inherit certain business risks, e.g. construction or industrial sectors.

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