Notwithstanding the above, there is no Shariah objection on the adoption of the accrual method and this is consistent with the necessity (*hajah*) that arises from current practices. In addition, it is also in line with the following *fiqh* maxim:

المعاملة تجري على عادة أهل البلد و عرفه

“(Decrees of) transaction goes around based on custom of a particular state and ambience of a place.”

121. **Application of “Substance over Form” Principle in Islamic Finance**

“Substance over form” is an accounting principle that emphasises on the financial reality of a particular transaction rather than its legal form. It also refers to financial reporting that records the whole economic effects of a transaction, or a series of related transactions, instead of reporting it merely from disjunctive contracts or legal perspective.

For instance, in a sale and buy back contract, the financial reporting will record the overall effect of all contracts involved in the transaction, whereby the profit generated from the contracts will be recorded as the financing cost payable by the financee.

In this regard, the SAC was referred to on the issue as to whether the application of “substance over form” principle in Islamic financial reporting is permissible.

**Resolution**

The SAC, in its 57th meeting dated 30 March 2006 and 71st meeting dated 26 - 27 October 2007, has resolved that in principle, “substance” and “form” are equally important and highly taken into consideration by the Shariah. In this regard, the Shariah emphasises that “substance” and “form” must be consistent and shall not contradict one another. In the event of inconsistency between “substance” and “form” due to certain factors, the Shariah places greater importance on “substance” rather than “form”.

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Basis of the Ruling

In current Islamic finance contexts, most of the underlying contracts in financial products, especially financing products, are contemporary contracts (‘uqud mustajiddah). These new contracts contain collective elements derived from different traditional contracts (‘uqud musamma) and the elements are binding on one another in a certain manner. The absence of any of the elements would curtail the objective of the contract. Independent reporting of a series of transactions involved in this new contemporary contract would raise ambiguity in the overall transactions. Therefore, there is a need to record the series of transactions involved in the new contract as one transaction only. This is based on the application of “substance over form” principle.

The aforesaid consideration is also in line with the following fiqh maxim and the objective of the Shariah:

الأمور بمقاصدها

“In matters, effect is given to intention and meaning and neither words nor forms.”

122. Application of Probability Principle

The principle of probability refers to the practice of recording transaction although the contract has not yet been completely concluded. In this regard, assets will be recorded once there is a probability of economic resources inflow whilst liability will be recorded once there is a probability of economic resources outflow due to current obligation and its amount can be estimated with certainty. Instances of item recorded based on the principle of probability is wa’d (whether it is a binding promise or non-binding promise) and provision for impairment. Nevertheless, such practice is not meant to equalise promise and contract (aqad). Instead, it is aimed at notifying on the economic effect upon the execution of the arrangement.