

**APPROPRIATENESS, TRANSPARENCY, AND TIMELINESS IN  
REPORTING OF RISK-RETURN IN ISLAMIC DEPOSITS: AN  
EXPLORATORY STUDY ON *MUDARABAH* DEPOSITS**



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## 6. ENHANCED EXECUTIVE SUMMARY

This report finds that given the voluntary nature of the BNM guidelines, these guidelines are not adopted by all the Islamic banks in Malaysia. Furthermore, these guidelines are not stringent because these do not attract any severe penalties for non-compliance in particular with reference to PSIA. We argue that it might be a sign of ineffective corporate governance in Islamic banks. BNM officials seem to take this position that given the growing nature of the Islamic banking sector in Malaysia, it is a very difficult to propose a comprehensive guideline. Even if such a guideline is developed, it will constitute “micro-management” which may not be liked by the Islamic banks and it ensue “tick-boxing” rather than actual compliance.

The report also contains a survey of full-fledged Islamic banks in Malaysia. This survey was carried out to determine whether the current disclosure of Islamic banks’ relating to investment management, risk and reward faced by *Mudarabah* (PSIAs) in their annual reports is similar to the new guidelines proposed by research team. The research team incorporated 3 themes: *appropriateness, transparency and timeliness* into these guidelines which were not addressed in BNM PSIA guidelines. These new guidelines constitute original contribution. The survey findings show that most of the disclosure items proposed in our guidelines were not disclosed in the annual reports of the sample banks. Some of the disclosure items were either being recorded for internal reporting purposes, while others were neither recorded nor reported because these Islamic banks did not feel the need to disclose such items now and in future.

## 7. REPORT

### 7.1 Introduction

Islamic banking is different from conventional banking because it replaces the interest-based bank deposit-cum-lending activities with risk-sharing and profit-sharing principles advocated by Islam. Savers can keep their money under custody and safekeeping of a bank (*Wakalah*) without any profit-sharing or make deposits under profit-sharing contract (*Mudarabah*). Under the *Wakalah* contract, Islamic bank acts as *wakeel* or agent for the savers. Bank receives a management fee for managing customer funds. On the other hand, deposits held under profit-sharing contract are known as *profit sharing investment accounts* (PSIA) and as such depositors are called the investment account holders (IAHs). These deposits differ from conventional deposits by virtue of the profit-sharing nature of the returns. The amount invested is not certain” i.e., depositors have to accept negative return or losses, if unfavorable circumstance occurs (Archer and Karim, 2009).

*Mudarabah* is a contract for profit-sharing and loss bearing on investment accounts. It is not specifically mentioned in the Holy Quran but its permissibility is derived from the Sunnah of the Prophet Muhammad (PBUH). The permissibility of *Mudarabah* transaction is due to fact that, there are some capital surplus investors, (*Rabbul mal*) who lack the business and investment expertise, and there are individuals who have business expertise but lack capital. Islamic bank acts as a *Mudarib*, and initiate a two-tier *Mudarabah*. In the first tier, Islamic bank takes *Rabbul mal* capital, while in second tier; it uses this capital for financing the projects selected by the entrepreneur. If the *Rabbul mal* has not specified a business in which to invest, in which case the *Mudarib* can select any type of *general Halal* business to invest funds. This is known as *al-Mudarabah al\_mualaqah* or *Unrestricted Mudarabah*. This type of investment by *Rabbul mal* is shown as unrestricted investment on Islamic bank’s balance sheet. In contrast, if the *Rabbul mal* indicate a *specific* business in which to invest, the *Mudarib* is restricted to invest in only that business. This is known as *al-Mudarabah al\_maqayyadah* or the *Restricted Mudarabah*. This type of investment account is shown under restricted