

# Evaluating Murabaha in Islamic Banks

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## ABSTRACT

*After the collapse of the Islamic Caliphate in Istanbul and the loss of the First World War, Shari'a and Arabic as the law and language of the Muslim world were replaced with common laws and numerous European languages were introduced into the new Arab states. These events led to calls for reestablishing the shari'a for all aspects of life. Arab countries responded by constituting Islamic parties and institutions including Islamic banks. Islamic banks flourished quickly all over the world. Some consider this evidence of success. Most of the operations of Islamic banks (40%-80%) were in the area of Murabaha. Accounting and auditing standards were issued by the Organisation of Accounting and Auditing Standards for Islamic Financial Institutions in Bahrain (OAASIFI) in 1997 by translating the international standards so as to begin from where others reached. Many questions were raised about the lawfulness of Islamic banks operations, although there are shari'a control bodies in every bank, which make it necessary to investigate its activities. This is an analytical study of Islamic bank operations from a shari'a point view regarding Murabaha to the order of the purchaser concluding that it is far from shari'a's principles and provisions.*

**KEYWORDS:** Islamic Banks; Shari'a, Legitimacy; Murabaha

## 1. Introduction

In 1966, the Lebanese Intra Bank (a Christian Bank) sought to establish a branch in Italy (Deeb, 2014), European media commented that this is a new Arab invasion. Interestingly, today, Islamic banks and their branches are scattered all over the world, especially in Europe and face no objections. Both Islamic and conventional banks operate in Muslim and non-Muslim communities, and are recording rapid growth. Although Islamic banks insist they are operating based on the shari'a, such claims need to be verified. Evaluating a firm's performance is vital. Auditing of financial transactions and statements serve this aim. This research aims to evaluate the legitimacy of the activities of Islamic banks. Islamic banks often promote that their activities adhere to the shari'a, yet we are uncertain as to the degree this statement is correct, especially Murabaha which represents about 40%- 80% of its activities.

## 2. Research Methodology

This is an analytical study comparing Islamic bank operations with Islamic shari'a provisions for Murabaha. Islamic banks in Arab countries including Jordan are committed to complying with the legislations and regulations set by their central banks and the jurists serving (as consultants) to their boards, which can sometimes differ from the shari'a.

## 3. Literature Review and Theoretical Framework

Many Muslims were happy with the establishment of Islamic banks particularly its claimed commitment to the shari'a. Based on this assertion, Islamic banking has seen broad support leading to the establishment of branches and growth of capital, deposits, and investments. A lot of research has been done comparing the performance of conventional and Islamic banks. The study by the International Institute of Islamic Thought (1996) titled *Evaluation of Islamic Banks Performance* mentioned that 60% of Islamic banks practice *Zakat*, 65% of practice beneficent loans, but *Murabaha* was the overwhelming choice of investment contracts.

In Algeria, much research has been done evaluating the performance of Islamic banks. Kuraish (2000) found that between 1994-2000 Algerian banks considered performance evaluation critically important particularly in a world facing many corporate failures in America and Europe caused by misstatement of financial statements regarding their performance. Omar (2005) studied performance evaluation standards in Islamic banks and its importance as an objective response to the accusations of the illegitimacy of Islamic bank activities. They concluded that the first standard must be about its commitment to the shari'a. Alnasharty (2008) evaluated the efficiency of Egyptian Islamic banks, mentioning that when conditions of agency for depositors and *mudaribeen* are present, Islamic banks will behave as mediator in *Mudarabah*. Islamic banks choose low-risk investments with ordinary returns instead of investing in long-term investments which may yield extraordinary return, or may cause big losses. Bourqeh (2011) studied compliance of Islamic banks with the shari'a, while Alhabib & Almasri (2011) studied the impact of shari'a controls on the success of Islamic banks. Shehata (2005) concentrated on extracting the standards for the evaluation of Islamic banks' performance. He acknowledged that Islamic banks differ from traditional banks in many aspects, so when controlling and evaluating their performance, a method must be used that suits its nature and contain standards for religious performance of Islamic bank.

A lot of research had been done about Islamic banks performance, but few have studied compliance with Islamic shari'a as a whole. This study concentrates on *Murabaha* in Islamic banking operations.

Studies agree with the importance of studying performance evaluation of Islamic banks but have differed in the standards they have used and their focus, i.e. branches, capital, assets and profits. Some addressed evaluation standards, especially the religious side as commitment to the shari'a.

#### **4. Theoretical Framework**

Islamic banks were founded after the collapse of the seat of the Islamic Caliphate in Istanbul, the defeat of the Turks in World War One and the division to the Muslim world into nation states. Muslims were divided along national and political lines from which emerged religious and non-religious political parties. Education was ignored, especially shari'a education, leading many Muslims to neglect religion. In such an environment, conventional interest based banking spread throughout the Muslim world.

While Muslims accepted interest based banking, it is only reasonable that they would also accept Islamic banking particularly since it is in line with their religion. However, there remains criticism that Islamic banking is not Islamic as to be Islamic means complete compliance with the shari'a not partial compliance.

Although Islamic banks claim their operations to be Islamic, its operations have been criticised and some have advocated setting standards for their operations (Shehata, 2005; Omer, 2005) including standards for accounting and auditing of their financial statements side by side a body of fatwa for banks operations. These are detailed below:

**First: Body (form) of Shari'a Control**

Shari'a control in most Islamic banks has only control that helps and control management by a single shari'a consultation, which does not guarantee the shari'a commitment by Islamic banks as the base of their work (Omar, 2005). This body does not issue fatwas unless there is a request from the management, especially after the work (process), not before.

**Second: Accounting and Auditing Standards**

Islamic banks as new institutions face the challenge of serving their communities. They are urged to observe suitable accounting standards (Accounting and Auditing Standards for Financial Islamic Institutions (AASIFI): 17). They need to depart from the conventional interest based standards and include standards that better suit their Islamic nature. Although there is nothing preventing benefitting from existing standards, they need to ensure that their natures have been taken into account (AASIFI: 17-26).

These aforementioned quotes from AASIFI raise some questions:

1. Accounting standards in Islamic state and institutions must be derived from Quran and Sunnah since they are shari'a rules. Muslim states practised accounting and auditing standards for all firms in Muslims society for 15 centuries without any change. The Caliph, Abd AlMalik Bin Marwan was the first who introduced records and journals in accounting in 74 Hijra(H), 715 AD. Also the origin of modern accounting had grown in the Islamic community, since the first written accounting book in history was by Abdullah bin Mohammad bin Kaya AlMazindrani, titled: *Risala Falakia in Alsyaqat*, 1363 AD (Astronomical Letter in Alsyaqat). This had happened one thousand year ahead of the appearance of nation states (Zaid, 1995).
2. International accounting standards which developed since 1973 are now accused of being politicised for the benefit of firms of big nations.
3. Accounting standards in both Islamic and conventional banks are the same, since they are controlled by central banks and are processed by the same processes and procedures in accounting and auditing. A quick look on accounting systems in two banks explains this fact.
4. In the shari'a it is necessary to know lawful from unlawful, right from bad in order to fulfil Islamic obligations.
5. Allah, Sobhanah says: "To you be your religion, and to me my religion (Islamic Monotheism)" (Al-Kafiron:
6. The objectives of accounting in Islam is a shari'a duty and has different aims to those of modern accounting. This necessitates deriving accounting, auditing and ethical values and codes of conduct from the Quran and Sunna not from translating international standards.

*Third:* The two kinds of Murabaha are classic and modern. Murabaha in Islamic banking comprises between 40%-80% of its activities, which means it deserves to be studied. Classical and lawful Murabaha means to sell a commodity owned at the time of selling to a purchaser willing to buy it, and pay a price equals to its cost (capital of the commodity), plus determined net profit. This differs from a Murabaha to the order of the purchaser in Islamic banks, since Islamic banks have two aims:

A- Seeking an expert (i.e. the Islamic bank): to purchase a commodity, and a promise to buy depending on this expert.

B- Seeking financing: since he asks the bank to purchase the commodity, promising him to purchase it later and make profit for him knowing that the bank will sell it to him for complete or partial payment (AASIFI: 166-167). This commodity is not owned by the seller at the time of negotiation and the purchaser does not possess the sum required for its payment and seeks a loan from the bank.

To settle problems and judge amongst Muslims, Allah, Sobhanah said: “O you who believe! Obey Allah and obey the Messenger (Muhammad) and those of you (Muslims) who are in authority, (And) if you differ in anything amongst yourselves, refer it to Allah and His Messenger, if you believe in Allah and in the last day. That is better and more suitable for final determination” (An-Nisa’a: 59). Also Allah, Sobhanah says: “And whatsoever the Messenger (Muhammad) gives you, take it, and whatsoever he forbids you, abstain (from it)” (Al-Hasher: 7). And: “It is not for a believer, man or woman, when Allah and His Messenger have decreed a matter that they should have any opinion in their decision. And whoever disobeys Allah and His Messenger, he has indeed strayed into a plain error” (Al-Ahzab: 36). The Prophet said: “It is not permissible to lend on the condition of a sale, or to have two conditions in one transaction, or to sell what you do not have” (an-Nasa’i).

**The following are some notes on the purchase order based on Murabaha:**

1. Islamic banks practice Murabaha to the order of the purchaser which differs from the classical form of Murabaha practised by Muslims in the beginning of Islam.
2. Scholars in Islamic banking make it eligible (acceptable), lawful for more than one condition to be realised in the Murabaha to the order of the purchaser in so long as it does not affect the eligibility of the contract, especially if it is concluded or expected of it or for its benefit: (Fatawa Shariaa', part1:61). This contradicts what the Messenger (PBUH) states that it is unlawful to have two conditions in one contract”.
3. Islamic banks signs the contract while it does not yet own the commodity. This means that Islamic banks sell commodities not owned by them. The other issue is that the purchaser must agree with all the conditions set by the bank meaning that he has no right to criticise the bank (AASIFI :167).
4. Murabaha to order of the purchaser is a sale on account (AASIFI). When the bank buys and owns the commodity, he asks the customer to complete the sale asking him to pay one fourth of the price in cash, plus the insurance for the commodity and charges for changing the ownership and stamps duty which will be put on the promissory which equals the residual of the price plus the profit of Murabaha, so the sum

will be more than the original price of the commodity.

5. Murabaha is a way of cheating to commit interest. The Messenger (PBUH) says: Narrated Abdullah ibn Umar: I heard the Messenger of Allah, (Peace be upon him) say: When you enter into the Inah transaction, hold the tails of oxen, are pleased with agriculture, and give up conducting jihad (struggle in the way of Allah). Allah will make disgrace prevail over you, and will not withdraw it until you return to your original religion.

Sunan Abu Dawood Vol. 4, Book of Wages (Kitab Al-Ijarah, Hadith 3455).

6. Murabaha transactions concentrate on consumption commodities such as cars and does not invest in long term investments for the benefit of infrastructure operations, and to grow the income of the state and citizens. Allah says: "Allah burdens not a person beyond his scope. He gets reward for that (good) which he has earned, and he is punished for that (evil) which he has earned" (Al-Baqarah: 286).

7. The constitution of Islamic banks or real Islamic firms must be guarded and guaranteed by a powerful and real Islamic state, which is not attainable right now.

So, to establish new Islamic banks and branches in different countries under the protection of these states does not represent exactly Islam, or Islamic reality.

## **5. Results**

Islamic banks appeared after the collapse of the Islamic Empire in Istanbul in 1914. Islamic banks have been welcomed globally more than other Islamic belongings or phenomena. Islamic banks practice the same activities of conventional banks. This is evident in Murabaha to the order of the purchaser which represents 40%-80% of Islamic bank activities, concentrating on selling cars which is not a real investment in the national economy. It is an unlawful practise and it is surprising that it is endorsed by many shari'a committees. On the authority of Abu Sa'eed al-Khudree (may Allah be pleased with him) said: I heard the Messenger of Allah say, "Whosoever of you sees an evil, let him change it with his hand; and if he is not able to do so, then [let him change it] with his tongue; and if he is not able to do so, then with his heart — and that is the weakest of faith" (an-Nasa'i).

Also, it not acceptable to say that most Muslims agreed to support Islamic banks activities. So far, most Muslims agreed to support Reba banks activities, and more than for Islamic banks!!

In this condition, it is not easy to constitute a good thing as Islamic financial institution, because it must be planted in a good condition to grow as pure Islamic plant.(Moanis,1987) since Islamic banks had grown in non-Islamic conditions, as when hypocrites established a mosque, Allah Subhanah called it " who put up a mosque by way of Harm and disbelief and to disunite the believers and as an outpost for those who warred against Allah and His Messenger " ( At-Taubah:107), Allah Subhana ordered His Messenger to destroy it.

So, Moaamalat which represent 40-80% of Islamic bank operations is unlawful.

## **6. Conclusions**

Islamic bank operations must be verified and investigated to know its eligibility. This is a good opportunity to remind Muslims to Holding Fast to the Quran and Sunnah, and the Quranic Verse: “Read in the Name of your Lord Who created (all that exist)” (Surat Al-Alaq:1).

## **7. Recommendations**

It is essential for Islamic banks or any Islamic firm to be grown in an Islamic environment managed by the shari’a. Islamic banks must be founded because of the Muslim need for it and its services and activities, share in a real growth and development, commit itself to shari’a, derive its principles, and standards from Quran and Sunnah of His Messenger (PBUH). Additional research is recommended for other Islamic bank operations such as Mudarab, Musharaka, etc., to know its compliance with Islamic shari’a provisions and principles.

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