

Chapter Four - Murabaha and Other Deferred

Sales Murabaha and Murabaha to the Purchase Order are among the most common contracts among Islamic banks and financial institutions, and therefore an important component of their financial statements. Murabaha can be executed on a spot basis, but the most common form in Islamic finance is deferred (deferred payment) Murabaha. Rabaha Sale: This is one of the trust sales, and involves selling a commodity for the same price as its original price with a known profit.

Amanah sales are:

Tawliyah (sale of trust): A sale at cost, meaning no profit or loss. This is not suitable for Islamic banking operations.

Wadi'ah (sale of depreciation): A sale below cost, also known as ḥatiḥah (sale of reduction). This is not suitable for Islamic banking operations: the original price + ?% known profit.

Murabaha, in the terminology of Islamic jurists, is defined as a sale for the equivalent of the original capital plus a known profit. It is characterized by the seller stating to the buyer the price for which he purchased the item and stipulating a certain profit.

the concept of deferred sale: Any type of sale transaction in which payment is deferred for a specified credit period, whether in installments or in a single payment.

The concept of Murabaha: The sale of goods on the basis of adding an agreed-upon profit to their cost. This sale may be on a cash or deferred basis.

Commodity Murabaha: A Murabaha product based on commodity transactions in organized commodity markets, where the intent of both parties to the transaction is to take possession of the commodity.

The concept of Murabaha for the purchaser: A sale and purchase transaction whereby the prospective purchaser orders a specific commodity, confirming a promise to purchase it from the prospective purchaser according to the agreed-upon Murabaha terms.

Hamish Jiddiyyah/Arboun : The amount paid by the prospective purchaser as a guarantee, which will be converted into an advance payment as part of the sale price, pursuant to the promise to purchase. Under the contractual terms, the seller may retain the deposit if the purchaser fails to fulfill the promise to purchase.

Conditions for Murabaha sales:

- The initial price must be known.
- The commodity must be in the possession of the purchaser (the bank).
- The bank bears the risk of loss before delivery.
- The bank bears the risk of return due to a hidden defect.

The legitimacy of Murabaha sales to the buyer:

The legitimacy of Murabaha is established by the evidence cited to support the legitimacy of the sale, including the verse, "God has permitted trade." Some have cited as evidence the verse, "There is no blame upon you for seeking bounty from your Lord," considering profit to be the bounty. This type of sale—with its conditions—is valid in Islamic law, based on the general legitimacy of sales in the Qur'an, the Sunnah, and consensus

Murabaha Sales to the Buyer: The Islamic Ruling on the Murabaha Formula for the Buyer. This contract takes place in two forms:- The first form - Murabaha to the Buyer without being bound by the promise. The promise is not binding on either party. If the bank purchases the goods and they become its property, it informs the buyer of this and gives him the option to either buy or leave. This is what some Islamic banks apply. This type of sale is controversial. Some say it is permissible, which is the view of the Hanafi, Shafi'i, and Hanbali schools. The Maliki school holds that this sale is absolutely prohibited if the amount of profit is specified.

The second scenario: Murabaha for the purchaser, failure to fulfill the promise. The promise must be binding on the two parties. Sometimes, fulfillment of the promise involves the obligation to sell, and sometimes, it involves bearing the loss incurred by the bank due to the purchaser's refusal to fulfill the promise. When the bank sells its product to another customer and incurs a real loss, the bank sells it to another customer. This type of sale was prohibited by early jurists, such as the Hanafi, Maliki, Shafi'i, and Hanbali schools of thought. A group of contemporary scholars, including the Permanent Committee for Scholarly Research and Ifta in Saudi Arabia, favored the **prohibition**.

Inventory:

Inventory is recognized in the entity's books when it gains control of the inventory, when substantially all the risks and rewards incidental to the inventory have been transferred to it.

Inventory is initially recognized at cost, which includes all costs of purchase and other costs incurred in bringing the inventory to its present location and condition (paragraph 5).

**Dr/ Murabaha merchandise for the purchase orderer
(deferred sale merchandise)**

Cr/Payment method

The bank purchases merchandise

In the event that inventory is purchased in installments, each installment of inventory received is recognized upon fulfillment of the requirements set forth in paragraph (5).

- The discount granted on the cost of inventory, after completion of the sale, is deducted from the cost of sales.
- If the discount is allocated to the customer (accepted by Sharia standards), the same amount is recognized in the income statement as a deduction (reduction) from total revenues.

A- Before the bank sells the goods and after completing the purchase transaction

- **Dr /receivable account**

Cr/purchase orderer's Murabaha goods
(deferred sale goods)

- **B- Obtaining the discount after selling the goods to the purchase orderer:** The discount amount is added to the deferred profits and depreciated accordingly.

- **Dr/receivable account**

Cr/deferred investment profits

3-Accounts Receivable - When a bank sells inventory under a Murabaha or a forward sale contract, it is required to record the receivables and revenue in its financial statements (see treatment of deferred profits). Receivables are recorded at nominal value (invoice value/total amount)

.a- Inventory is considered sold under a Murabaha or forward sale contract at the time the Murabaha or forward sale contract is concluded. This means that when the contract becomes legally binding on all parties to the contract, and control of the inventory is transferred to the buyer who has expressed the intent to purchase.

Dr/ deferred sales receivables

Cr/Murabaha goods (or deferred sale)

Cr/Deferred investment profits

Investment profits for the party that financed the investment
(joint investment accounts)

When the purchase orderer (customer) pays the first installment, the bank records the following:

D/Deferred investment profits

D/Means of collection (current accounts)

C/Deferred sales receivables

C/Investment profits (realized)

Investment profits for the party that financed the investment (joint investment accounts)

In the event of actual or potential default, deferred profits are treated in accordance with the relevant standard (FAS 30). The bank records the transaction as follows:

D/Outstanding Deferred Sales Receivables

C/Outstanding Sales Receivables

The deferred profits are settled in accordance with FAS 30

D/Outstanding Profit

C/Outstanding Investment Profits

-Upon collection of the due installment, the bank records:

D/Means of collection

D/Accrued investment profits

C/Accrued deferred sales receivables

C/Accrued deferred profits

*The bank creates a provision for credit losses and impairment in accordance with FAS 30 in the event of default or potential default. The bank records the transaction as follows:

D/Investment profits

C/Provision for doubtful deferred sales receivables

A- **Early Settlement**: Pay the full amount, and the bank will then return a portion of the profits to the purchase orderer (client)

Dr/cash(current accounts)

Dr/Deferred investment profits account (in its balance on the day of settlement)

Cr/sales receivables

Cr/Investment profits

Dr/investment profits

Cr/current account

B- If the book amount cannot be recovered due to the customer's insolvency (the customer being exempted from payment due to certain circumstances or debt cancellation), the bank records the following:

Dr/investment profits

Cr/Outstanding sales receivables

Then the deferred profits account is credited

Dr/the deferred profits

Cr/the investment profits

Cr/Hamish Jiddiyyah/Arboun : A cash amount collected by the bank from the customer to verify the customer's seriousness in purchasing. The guarantee is recorded in the following accounting entry:

Dr/Cash	2000	
	Cr/Hamish Jiddiyyah/Arboun	2000

Example: Assuming that the bank purchases a commodity based on the customer's request for a value of 10,000 dinars, with a profit rate of 5% for a period of four years, and with a serious guarantee amount of 2,000 dinars.

When selling on a Murabaha or deferred basis with Hamish Jiddiyyah/Arboun

Dr/deferred sale receivables

Dr/Hamish Jiddiyyah/Arboun

Cr /Murabaha goods (deferred sale)

Cr/investment profits.. deferred

When selling for cash

Dr/ Cash(current accounts)

Dr/Hamish Jiddiyyah/Arboun

Cr /Murabaha goods (deferred sale)

Cr/investment profits.. deferred

-if the buyer defaults on the purchase order, the actual damages resulting from his promise are recovered if the goods are sold at a lower price.

Dr/cash(Current Accounts)

Dr/ hamish Jiddiyyah/Arboun

Cr/Murabaha Goods (Deferred Sale)

Bank Negligence:

Dr/Profit and Loss Account

Dr/ cash

Cr/Murabaha Goods (Forward Sale)

Upon completion of a Murabaha or deferred sale transaction:

- A- The margin of **hamish Jiddiyyah**/must continue to be presented as a liability to the seller as a preliminary guarantee, and must not be settled with the amounts due for collection.
- B- **The Arboun**, as an advance payment, must be settled with the amounts due for collection.

- **Charity Funds:**

Charity fund payments resulting from a customer's default are not recognized as income for the seller (bank). Rather, upon receipt, they are transferred directly to the charity account due.

Collecting a Fine from a Delinquent Debtor: The Shari'ah Standards Board has permitted collecting a fine from a delinquent debtor and depositing it in the charity fund. This is recorded as follow

Dr/ Cash

Cr/Charity Funds

- At the end of the fiscal year, if the goods are still with the bank before the sale stage, the goods are valued as follows:
 - **At cost if the promise is binding,**
 - **At realizable cash value** (selling price - expenses) if it is non-binding, and the bank creates a provision for decline in prices.

Dr/ Murabaha investment profits

Cr/Murabaha commodity price decline provision

The provision for Murabaha merchandise is deducted from the statement of financial position.