Accounting Treatment for Ijarah and Ijarah Muntahia Bittamleek in Sudanese Islamic Banks

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Abstract: Purpose – This paper aims to review and analyze the concept of Ijarah and Ijarah Muntahia Bittamleek (IMB) in Sudanese Islamic banks.

Design/methodology/approach – The researchers followed descriptive analytical methodology and Inductive method in conducting this study as well as the comparative method to compare FAS No.8 to IAS 17 concerning the accounting treatments. Also, the applied method was used for the practical side of the study based upon the financial reports in the Sudanese Islamic banks.

Findings – The study found that the main difference between two standards is that FAS No.8 focuses on the legal aspect of the financial transactions while IAS 17 focuses on the aspect of economy. The study also found that the Sudanese Islamic Banks were committed to apply FAS No.8 in regard to accounting measurement, but were not committed to apply FAS No.8 in regard to recognition, presentation and disclosure in the financial reports.

Practical implication – The paper contributes to the Sudanese Islamic Banks to apply the FAS No.8 with regard to recognition and accounting disclosure.

Originality/value – This research is the pioneer in analyzing the concept of Ijarah and Ijarah Muntahia Bittamleek (IMB) in Sudanese Islamic banks.

Keywords: Ijarah, accounting standards, Islamic finance, conventional lease, Ijarah Muntahia Bittamleek

1. Introduction

The main factor of creating competitive advantages among Islamic banks and finance is product innovation. Initially, the concentration was on developing financial infrastructure. However, a large portion of the attention has to be towards fulfilling the customer needs through the offering of various products and services. IBs are using various financial instruments through the incorporation of contracts with significant structural modification for Shariah compliance features. Ijarah is an innovation in Islamic finance, where it is the substitute for the traditional leasing product. Islamic finance has to adhere to Islamic principles where interests are prohibited. Businesses are adopting Ijarah broadly where it is a well-known choice for the financing of asset acquisition. Islam permits this form of transaction as evidenced by the Quran and Hadith. The conventional and Islamic contracts for leasing differ due to their fundamentals. Islamic leasing is a distinctive agreement where it involves the amalgamation of two forms of contracts, whereby leading to legal and Shariah concerns. Lease is recognized as the main financial tool in both conventional and Islamic FIs. This is because it is flexible and has a various economic benefits to owners. Thus, this paper intends to make a comparison between conventional and Islamic leasing practices through a review on FAS No.8 (Ijarah and Ijarah Muntahia Bittamleek) against IAS No.17 (leases). Analytical study is also conducted for the underlying concepts: accounting measurement, recognition and disclosure under each standard in the books of lesor and lease.

Ijarah is an important financial source to Islamic and other Institutions. Therefore, it is significant that the financial statements disclose sufficient data to their users. Based on the above, it is this study’s objective to review and analyze Ijarah and IMB from the accounting perspective. This research attempts to answer the following question: Is there any significant differences in accounting convention in operating Ijarah and Ijarah Muntahia Bittamleek under FAS No.8 and IAS No.17? The subsequent section presents literature review on the concepts of Ijarah and Ijarah Muntahia Bittamleek. This is followed by hypothesis development and explanation on the connection with past research. The next section explains the methodology of this research. The final section provides the results, and concludes.
2. Literature Review

Concept of Ijarah

Theoretically, Ijarah is an agreement where a party gains a benefit in exchange for another party’s services, and asset utilization. Academics of four Islamic schools (i.e. Maliki, Shafie, Hanafi and Hanbali) have each defined Ijarah. Briefly, all the definitions agreed that Ijarah refers to the contract where one utilizing the services or benefits and there are compensations as a return. Ijarah’s literal meaning is renting an object. From Islamic fiqh, Ijarah is applicable in two scenarios. The first is that Ijarah means the salaries paid in exchange of the work done. In this form of Ijarah, the worker is known as “ajir”, whilst “mustajir” is the employer. The second scenario from Islamic jurisprudence perspective; i.e. an asset’s usufruct is shifted to another party as an exchange of rentals.

On the other hand Ijarah as an alternative to English term “lease” can be defined as a contract between a lessee and lessor where within certain timeframe the lessee is entitled to utilize the lessor’s asset. In exchange, the lessor receives periodic rental payment from lessee. The second meaning of Ijarah under Islamic jurisprudence is similar to ‘leasing’, an English word. Here, “mujir” refers to the lessor whilst “mustajir” is the lessee; and “ujrah” is the rental payment. Nonetheless, Ijarah and lease are used as similar concepts in different jurisdictions. Followings are the classifications of Ijarah:

Operating Ijarah and IMB

Ijarah according to the AAOIFI (No. 8) benchmark can be categorized as IMB and operating Ijarah. The main condition of the categorization is whether the leased property’s title is promised to be transferred to the lessee once the lease expires. AAOIFI stipulates that if there is such promise, then it is IMB. However, if there are no promises made, then it is operating Ijarah. The promise of transferring the possession title may be done by: (a) gift (no consideration is given in title transfer), (b) the contract specifies certain amount of consideration, (c) transfer done before lease duration ended is subject to the amount equal to outstanding Ijarah periodic payments, or (d) progressive ownership transfer (sale) of leased property. Meanwhile, IAS.17 categorizes leasing into two types: (1) operating lease; and (2) finance lease, in accordance to the degree of rewards and risks involved in the ownership transfer between lessee and lessor. All other leases not fulfilling the condition are deemed to be operating lease. Meanwhile, IAS 17 stipulates that a lease is categorized as finance lease or operating lease depending on the contract’s substance instead of its legality. The substance over form concept can be explained as follow: In the form where a lessee may not eventually obtain the leased property’s legal ownership, but in reality, financially and economically the lessee stands to benefit and bear the accompanying risks for the use of asset, then in substance the transaction is a finance lease. Thus for finance lease, since the lessee will assume the risk and rewards the leased property is assumed to be the lessee’s fixed asset even though the lessee may or not eventually be the property’s registered owner. Meanwhile for operating lease, the lessee’s balance sheet could not reflect the leased property as the risks and rewards associated to ownership are not transferred to the lessee.

It must be noted that operating Ijarah is similar to operating lease, and the IMB seems similar to the finance lease, whereby the lessee will eventually hold the title legally. However, it is still different because IMB is considered as two agreements being combined; Ijarah runs over the leasing duration, and sale and purchase agreement once the leasing duration is over. Furthermore, the substance over form concept does not apply in Islamic lease. If the substance over form concept applies in Islamic lease, it will imply that the asset is in full control of the lessee. However, for Ijarah, the lessee only has the right to the benefits (usufruct) of using the asset but not the right of ownership to the leased asset. Thus, the substance over form concept is not consistent with the Shariah according to AAOIFI.

Types of Ijarah Muntahia Bittamleek

FAS No. 8 states that IMB has various categories. All the categories are aiming at passing the asset’s ownership to the lessee; if not it is called operating lease contract. The categories IMB agreements are: (i) IMB via gift (title is transferred without consideration). In this type of lease the lessee assumes the ownership without any consideration through a gift agreement entered upon the lease’s final payment, or a gift deed that is subject to Ijarah periodic payments being settled. The ownership transfer is automatic where no new agreement is to be entered and no additional payment is required except for the Ijarah periodic payment be settled. (ii) IMB is done by transferring the ownership (sale) once the lease has ended through a certain consideration. The contract encompasses:
(a) A feasible Ijarah agreement in which the rental payment and duration are established. When the Ijarah duration ends, the agreement is no longer valid.

(b) A pledge into entering a sale agreement is made upon the expiration of Ijarah contract should the lessee agrees, and to pay certain consideration. We must note that upon IMB expiration the ownership transfer is either done with no or minimal consideration by assuming that there will be higher rental earned by the lessor against comparable property where in both scenarios the lessor will regain the asset’s cost via Ijarah periodic payment.

(c) IMB via ownership transfer (sale) upon the final payment mentioned in the contract. The agreement incorporates Ijarah contract and the pledge of entering into a sale agreement. The sale agreement mentions the lessee’s purchase price (purchaser) upon the Ijarah expiration. Therefore, once the lessee paid the price, the property is sold and ownership is changed to the purchaser (lessee). He will then assume the right to benefit and dispose the property through any lawful means.

(d) IMB via ownership transfer (sale) before the ending of the lease at a price equal the Ijarah’s outstanding periodic payment. This includes the lessor’s pledge that ownership will be transferred to the lessee whenever the lessee requests during the Ijarah duration at an amount equal to the outstanding periodic payment.

(e) IMB via graduate ownership transfer (sale). The contract has a condition stating that the lessor agrees to progressively transfer the ownership until the lessee gained full ownership of the asset. The asset’s price will be ascertained by dividing the duration of the Ijarah agreement where the lessee will possess portion of the asset equal to the payment made. There has to be a sale agreement for every portion purchased by the lessee. Additionally, the rental payment must reduce in view that the lessee is now owning a larger portion of the leased property.

It is the intention of the study by Saleem, S. and Mansor, F., (2020) to analyze the adherence of Malaysian Islamic banks to the AAOIFI standard No 9 in regard to Ijarah financing. The study had used the semi-structured interview where open-ended questions were adopted. For content analysis, the interviews were recorded and transcribed. It was found that the modern Ijarah financing is flawed. This signifies that there is a slight variance from the AAOIFI benchmark. This research assists the Malaysian IBs in reducing, if not eliminating the discrepancies between the guidelines issued by BNM (Bank Negara Malaysian) and AAOIFI benchmark for Ijarah financing. Additionally, this study is the first to examine the Ijarah financing practices among Malaysian IBs based on the AAOIFI benchmarks.

Study conducted by Yousef Rasheed & Hammoud iMaamar (2013) on (Ijarah Muntahia Bittamleek under Shariah Standard No.9 and Islamic Accounting Standard No.8) intends: to know the historical background of IMB as a financial product used as source of fund by Islamic banks, practical reality of the IMB through Shariah standard No.9 and Islamic Accounting Standard No.8, and compare the theoretical concepts between Ijarah and practical application in Islamic banks. The study depends on descriptive approach in reporting the historical background of IMB, and Inductive Method to know about the Shariah standard and accounting standard issued by AAOIFI. Moreover, applied method was also used to propose a model that shows the stages of Ijarah processing in Islamic banks.

A study was conducted by Abdullah, N.I. and Dusuki, A.W., (2004) on Accounting for Ijarah Muntahia Bittamleek from Islamic perspective in Islamic Banks. The study aims to know the legitimacy of IMB contracts, and their adaptation with the opinion of Islamic Jurists. The study also wants to know the accounting problems in Ijarah contracts and their treatments from Islamic perspective through an analytical study of International Accounting Standard and Islamic Standard. The researcher found that leased assets under IMB contracts must be capitalized in the lessee’s books and depreciation be recalculated.

**Sale and leaseback: operating Ijarah and IMB**

The type of Ijarah commonly used is in the scenario of a purchaser buys a property and leases it back to the seller. Juristic rule stipulates that the sale agreement should not be subject to lease agreement. This is not to breach the rule that a contract’s execution not to be dependent upon another contract’s execution. IAS-17 mentions that in determining whether a lease is a finance lease or operating lease, the substance over the form is examined. IAS-17 prescribes that if a lease satisfies one out of five situations, then a lease must be classified as finance lease. These five situations are as follows:

(a) At the conclusion of the lease duration, the lessee is to assume the asset’s ownership
(b) The lessee is given the choice of purchasing the property at a certain cost. The price is anticipated to not exceed the fair value on the date when the choice is executable.

(c) The lease duration of the asset is at least 75% of the asset’s economic life.

(d) During the lease’s establishment, the minimum payment’s present value is at least at the leased property’s fair value where it is equivalent to, or more than 90% of the property’s fair value.

(e) Leased properties with distinctive characteristics are to be used by the lessee where no significant changes being done.

Previous study on Islamic banking: Ijarah and Conventional Lease was the one conducted by Mohammed Haroon Ameer & Mohammed Saud Ansari (2014). It was the paper’s objective to study on the elimination of interest among FIs, and the Islamic banks’ definition of acceptable activities. In other words, the objective of the paper was on the analysis of interest-free transactions among businesses. The study revealed that there are correlations between IB and the determinants of conventional and Ijarah leases. The researchers utilized questionnaire as instruments in data collection, and the data were entered and analyzed by using software, i.e. SPSS and Excel.

Shariff and Rahman (2003) explored the nature of Ijarah accounting and made comparison between IAS.17 & FAS.8. It was discovered by the study that there are significant dissimilarities in the characteristics of Ijarah and conventional leasing. The study examined the level of acceptability of FAS.8in Malaysian FIs. Their surveys indicated that FAS.8 acceptance level was not high among Malaysian FIs.

Atmeh and Serdaneh (2012) examined the dissimilarities between IMB and conventional leasing through two dimensions, i.e. the contracts’ condition and structure, and accounting approach. The study argued that the AAOIFI’s accounting approach violates the matching principle and lacks honest presentation. The study also analyzed IMB (through gift) accounting framework of AAOIFI where the Ijarah duration is significantly shorter against the leased property’s useful life. Zafaar (2012) highlighted on the shortcoming of Ijarah for vehicle. The research employed a genuine case where a customer obtained a car financing through Ijarah contract from an Islamic FI. The customer had then abused this contract. The research urged for more studies to be done on Ijarah agreement in terms of vehicle leasing. Additionally, it stated that there should be consideration for down payment in addition to satisfying other conditions. It also mentioned that the deposit amount or down payment for the Ijarah vehicle contract not exceed the threshold of 40%. Abdullah (2013) made a comparison between Islamic and conventional leases using Islamic and conventional accounting standards as guidelines. The study also enlightened the financial report users and the public about the dissimilarities between Islamic and traditional leases. The study differs from other research as this paper included all the dimensions of Standard 8 in relation to IMB and Ijarah, and made a comparison against IAS17.

3. Hypotheses Development

To answer the questions previously mentioned in research's problem; the researchers assume the following hypotheses:

1- There are significance differences in accounting treatments (measurement and recognition) for operating Ijarah under FAS No. 8, as compared to IAS17.

2- There are significant differences in accounting treatments (presentation and disclosure) for operating Ijarah under FAS No. 8, as compared to IAS17.

3- There are significant differences in accounting treatments for IMB (financing lease) under FAS No. 8 compared to IAS 17.

4- The differences in accounting treatments has an impact on the financial statements.

5- Islamic banks in Sudan are applying the FAS No.8 issued by AAOIFI with regard to accounting recognition, measurement and disclosure for the Ijarah and IMB.

4. Methodology of the Study

The researcher adopted descriptive analytical methodology and Inductive method for this study. The comparative method was also used to compare FAS No.8 against IAS17 concerning the accounting treatments. Meanwhile, the applied method was used for the practical side of the study in Islamic banks in Sudan. Both primary data and secondary data were used. Primary data were obtained from the financial statements of the Sudanese Islamic banks. Secondary data obtained from books, previous research and studies, and the internet were used to build the theoretical framework of this study.

5. Results and discussions
The review on the annual reports of United Capital Bank (UCB) for the year 2015 shows the following: the bank disclosed in note 6 (investments in securities) the amount of SDG 64,548,000 as Ijarah Sukuk; which represents certificates of Ijarah Sukuk assets for Sudan Electricity Distribution Company (Shahamah Certificate). These were then leased back to the Ministry of Finance under operating Ijarah. The bank also disclosed in note 7 (Financing to customers) a total amount of SDG 101,180,752 for Ijarah. The amount of Ijarah comprised of the following:

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<th>SDG</th>
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<tr>
<td>Cost of leased property</td>
<td>74,794,780</td>
</tr>
<tr>
<td>Cost of leased Motor Vehicles</td>
<td>18,962,432</td>
</tr>
<tr>
<td>Deferred rental</td>
<td>7,423,540</td>
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<tr>
<td>Total</td>
<td>101,180,752</td>
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The UCB also disclosed notes to the following: (i) note 22 (Income from Investment in securities) the amount of SDG 3,538,232 as income from shasha certificates, (ii) note 23 (income from finance to customers) the amount of SDG 5,002,879 as income from Ijarah. (iii) Note 27 General & Administrative expenses) the amount of SDG 4,483,857 as Ijarah expenses.

There is an agreement between the two standards (FAS.8 and IAS17) in relation to accounting recognition and measurement for operating Ijarah; but with the exception to initial direct costs (under FAS.8, these costs must be recognized by the lessor and lessee, but under IAS.17 these costs must be recognized by the lessor only). There are differences between the two standards (FAS.8 and IAS17) in relation to accounting treatments for Ijarah Muntahia Bittamleek contracts. The main difference between two standards is that, the FAS No.8 focuses on the legal form of the accounting process, while the IAS 17 focuses on the economic substance rather than the legality. The accounting treatments for each standard have an impact on the financial statements and decisions of the users of the financial statements. This is because the capitalization policy of leased assets can affect the liquidity and profitability ratios. The Sudanese Islamic Banks are committed to applying FAS. No.8 in relation to measurement accounting, but were not committed in applying it in recognition and disclosure accounting.

**Limitations and recommendations of the study**

The study is limited by the followings: The study examines the practices confined to year 2017. The findings of study are limited to Islamic banks in Sudan and cannot generalized to other Islamic countries. Based on the results of this study, the main recommendations and implications are as follows: First, the requirements for presentation and disclosure in the financial statements must be expanded, whether for Ijarah Muntahia Bittamleek or operating Ijarah to fulfil the requirements of financial reports’ users. Second, some of the accounting treatments contained in standard No.17 must be adjusted to conform to Islamic standard No. 8. Third, Islamic banks and Islamic Institutions must apply the accounting treatments contained in Islamic accounting standard No.8. Fourth and finally, full compliance with standard and disclosure requirements will make the financial statements more relevant and useful.

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