

The Extent of the Obligation of the Jordanian Islamic Banks to Apply the Islamic Accounting Standard No. (11) Relating To the Provisions and Reserves

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Abstract

The study aimed at identifying the extent to which the performance of Islamic banks in Jordan conforms to the requirements of Islamic Accounting Standard No. (11) For the provisions and reserves by studying the annual financial reports and comparing them with the requirements of the standard. The study found that the Jordanian Islamic banks are consistent and committed in the majority of their procedures related to the provisions accounts with the requirements of the standard, And a significant difference in its investment risk reserve procedures with the requirements of Islamic Accounting Standard No. (11).

Introduction

The provisions and reserves have a massive importance in the banking, as they play an important role in addressing and managing credit risk. However, the mechanism for the composition and deduction of these provisions and reserves differ in Islamic banks from commercial banks, and this is because of the different nature of the contractual obligations of the Islamic Bank and the holders of the joint investment accounts, which are based mainly on the terms and conditions of Mudaraba from the nature of contracts that link and regulate the relationship between commercial banks and deposit holders.

The Importance of the Study

The importance of this study stems from its exposure to a very important subject in the accounting of Islamic banks and it sheds light on the reality of the application of Standard No. (11) in the Islamic banks of Jordan, especially that in the case of non-compliance by the Islamic banks to apply this standard means that they are in violation of legitimacy, which is very serious to any Islamic bank.

The Objective of the Study

The objective of the study is to identify the reality of the accounting of provisions and reserves in Jordanian Islamic banks and compare them with Islamic Accounting Standard No. (11) to identify any deviations in the application of this standard, and the reasons and effects of non-compliance with the application of the standard.

The Problem of the Study

Islamic banks are gaining their attractiveness and excellence through their commitment to applying the Sharia laws in their financial transactions. This advantage is the most important feature that makes most of Islamic bank customers to choose to deal with these banks rather than the commercial banks. Accordingly, in the case of breaching the Islamic banks the Islamic Sharia laws in financial transactions, these banks are considered hazardous and may question its credibility by their customers.

The problem of the study can be expressed by answering the following questions:

- 1- Are Jordanian Islamic banks committed to applying Islamic Accounting Standard No. (11) for Provisions and Reserves?
- 2- In the event that the Jordanian Islamic banks do not comply with the implementation of Standard No. (11), what procedures should be implemented by the Islamic banks and the supervisory bodies on the way the Jordanian Islamic banks work?

The Study Approach

To reach the results of the study, the researcher will follow the inductive method through the study of Islamic Accounting Standard No. (11) for provisions and reserves issued by the Accounting and Auditing Organization for Islamic Financial Institutions and the final financial statements of the Jordanian Islamic banks represented by Jordan Islamic Bank, Islamic International Arab Bank and Safwa Islamic Bank to identify the reality of accounting provisions and reserves in the Islamic banks of Jordan.

Previous Studies

1-Samhan (2016)" The extent to which the administrative and accounting aspects of the investment risk fund in Islamic banks complies with the Shari'ah requirements "(1).

The objective of this study was to identify the practical and accounting aspects of the investment risk fund in Islamic banks and the extent to which the reality conforms to the requirements of Islamic law. The most important results of the study were that the fund's funds were deducted from the profits of investment account holders, and that the correct adaptation of the jurisprudence of the Fund is the voluntary contribution or (Takaful donation).

2-Alsha'er (2010) "Calculation of profit in Mudaraba and Musharaka in the event of mixing Mudaraba and Musharaka funds"(2).The main objective of the study is to present the methods used to measure and distribute profits in the Islamic banks including the calculation of provisions and reserves. The most important results of the study that the methods used to measure and distribute profits in Islamic banks are not objective and there is a need for a special accounting input to the process of measurement and distribution of profits in Islamic banks.

3-Issa (2010)"Profits Dividend Policy in Islamic Financial Institutions"(3).

This study aims to explain the policies of calculating and distributing profits in Islamic banks in accordance with the terms and conditions of the Mudaraba contract, including the loading of provisions and reserves. The most important results of the study were the proposal of a new accounting model for the distribution of profits between the bank and the investment account holders be more fair.

According to the researcher knowledge, this study is the first of its kind study that deals with this issue in the Islamic banks in the Arab region as a whole. The researcher did not find any previous study on the subject of Allocations and Reserves separately and elaborately.

Islamic Accounting Standard No. (11) And its application requirements in the Islamic banks

First: The concept of Provisions and Reserves:

- 1- The Islamic Accounting Standards defined the Provision as an asset valuation account that is created by deducting an amount of income as an expense (4).
- 2- The Reserve is defined as: a portion of the equity holders 'equity and / or the investment account holders' rights is formed by the deduction of an amount of income.

Second: Scope of the Standard:

This Standard applies to the provisions made by the Islamic Bank for the valuation of assets, finance and investment, if the items of these assets are on or off the center's list, and this Standard does not include the provision for depreciation. This Standard applies to the profit rate reserve and the investment risk reserve. This standard does not include the reserves that are made up of the Bank's own profits and are part of equity and are created for general requirements or legal requirements such as statutory reserve.

Third: The most important elements of the standard:

1-With respect to provisions:

- A) Provisions (both private and public) are measured by charging the income statement at the end of the financial period by the amount required to reach the fund's target in the provision account for assets financed by the unrestricted investment account holders and / or equity holders. If the allocation balance exceeds the target level, the amount to be deducted is added to the related party as income.
- B) The special provision for receivables is deducted so that these assets appear in the statement of financial position at their at the expected value. The provision for individual financing and investment assets is deducted so that these assets are shown in the statement of financial position at the expected amount or cost, whichever is lower.
- C) The general provision is also made out of the total value of assets of receivables, finance and investment.
- D) The Bank should disclose in its financial statements the balance of provisions at the beginning of the financial period, additions, utilization and recoveries during the financial period and balance at the end of the financial period. It should also disclose the manner in which each type of provision is determined.

2-With regard to reserves:

Reserves within the scope of the Standard are two types:

A) Reserve profit rate

is the amount that the bank earns from the income of Mudaraba money before deducting the Mudarib share (the bank) in order to maintain a certain level of return on investment for the investment account holders and increase the rights of property owners.

to reach the target Reserve profit rate the required amount is treated as a dividend and before the Mudarib share is deducted, Where the share of the unrestricted investment account holders is presented in the Reserve profit rate under the unrestricted investment account holders' rights, and The Mudarib share in this reserve is presented as a reserve in the statement of financial position. The bank must also disclose the reserve balance at the beginning of the period, as well as the additional and uses which occurred during the financial period and the basis on which the amount or percentage of deduction and the end-of-period balance were determined.

B) Investment risk reserve:

Is the amount that the Bank earns from the profits of the investment account holders after deducting the share of the Mudarib (Bank) in order to protect against the future loss of the investment account holders, where the amount required to reach the balance of the target reserve shall be deducted as a distribution of income after deduction of Mudarib's share (the bank). If the amount of the reserve exceeds the balance estimated by the administration, the excess amount shall be returned to the income of the unrestricted investment account holders after deduction of the Mudarib share (the bank).

The reserve for investment risk is presented under the unrestricted investment account holders' equity in the statement of financial position. The balance of this reserve is disclosed at the beginning of the financial period, additions and uses occurring during the financial period and balance at the end of the financial period.

Analysis of the reality of accounting provisions and reserves

In Jordanian Islamic banks

Refer to the final financial statements of Jordan Islamic Bank⁽⁵⁾

Islamic International Arab Bank⁽⁶⁾ and Safwa Islamic Bank⁽⁷⁾ The following is illustrated :

First, with regard to provisions:

- 1- All these banks present the assets of the receivables, finance and investment net in the statement of financial position, which is in accordance with the requirements of the Islamic Accounting Standard No. (11).
- 2- All these banks present and disclose the balance of all provisions for assets at the beginning of the financial period and additions or uses made during the financial period to the end of the financial period, in accordance with the requirements of the Islamic Accounting Standard No. (11).
- 3- None of the banks disclosed the manner in which the value of each type of provision would be determined, which would violate the requirements of the Islamic Accounting Standard No (11).
- 4- The obligation of Islamic banks to treat the value of the provision as an expense recognized in the statement of income.

Second: Regarding Reserves:

1-None of the Jordanian Islamic banks has opened a profit rate reserve.

2-All Jordanian Islamic banks open an investment risk reserve. These banks deduct the net income from the joint investment operations, usually 10%, thus deducting the amounts allocated to the reserve for the shareholders and depositors (unrestricted investment accounts) This is contrary to the text of Standard No. (11), which provides for the deduction of the amounts of this reserve from the unrestricted investment account holders' share of the revenues, And this reserve is presented in the statement of financial position in the item "Future out of the unrestricted investment account holders' equity". This is because these banks consider that the balance of this reserve is not the property of the shareholders or the owners of the investment accounts which violates the standard core, where the Standard provides the presentation of the investment risk reserve balance under unrestricted investment account holders' rights. In addition, the Jordanian Islamic banks invest the funds of this reserve on the base of the "The one who gets the benefit of something must bear the damage". Thus, they alone shall reap the investment profits of this reserve without the depositors (unrestricted investment account holders) as the bank alone bears any losses incurred by the investment of these funds. It is clear that there is unfairness and injustice on the depositors (investment account holders) absolute as they bear part of the value of the deduction of the amounts allocated to this reserve, while the Bank alone accounts for the profits resulting from the investment of this reserve. The method used in the investment risk reserve also contradicts with the resolution No. (45) issued by the Jordanian Ifta'a Department on 25/4/2000, In which the investment risk reserve is stated below "this reserve shall not be disposed outside the objective for which it was established, Therefore, If an event occurs, the proceeds of the investment shall be for the same account".

Conclusions & Recommendations

Results:

- 1- The procedures of the Islamic banks in Jordan comply with the requirements of applying Islamic Accounting Standard No. 11 regarding the presentation of the assets of the receivables, financing and investments at the fair value and individually, in presenting the balance of provisions and additions or uses that have occurred on the balance. However, the Jordanian Islamic banks have not disclosed the manner in which they determined the value of these provisions.
- 2- There is no reserve profit rate in the Jordanian Islamic banks.
- 3- The method of deduction and composition of the investment risk reserve and its presentation in Jordanian Islamic banks is inconsistent radically with the requirements of the Islamic Accounting Standard No. (11).

Recommendations

- 1- Disclosures of Jordanian Islamic banks by forming and determining the value of the provisions related to the assets of the receivables, finance and investment.
- 2- The commitment of the Jordanian Islamic banks to the requirements of Islamic Accounting Standard No. 11 and to the decision of the Jordanian Ifta'a Department regarding the investment risk reserve.

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